



AS Tallinna Vesi

(incorporated with limited liability in the Republic of Estonia, commercial register number 10257326)

International Offering of 5,454,546 Ordinary Shares

(subject to an Over-allotment Option of up to an additional 545,454 Ordinary Shares)

5,454,546 ordinary A-shares of par value EEK10 each (the “Offer Shares”) of AS Tallinna Vesi (the “Company”), a public limited company organised under the laws of the Republic of Estonia (“Estonia”), are being offered by United Utilities (Tallinn) B.V., a limited liability company incorporated under the laws of the Netherlands, and the City of Tallinn (*Tallinna linn*) (together, the “Selling Shareholders”) in an international offering (the “Offering”). The Offering is comprised of an offering of (i) 4,254,546 Offer Shares to institutional investors outside the United States, including to institutional investors in Estonia (the “Institutional Offering”), and (ii) 1,200,000 Offer Shares to the public in Estonia by way of a public offering in Estonia only (the “Estonian Public Offering”), in each case in reliance on Regulation S (“Regulation S”) under the U.S. Securities Act of 1933 (the “Securities Act”). The number of Offer Shares being offered in the Institutional Offering may be increased pursuant to exercise of the Over-allotment Option referred to below.

The joint global co-ordinators and joint bookrunners of the Institutional Offering are CA IB Corporate Finance Beratungs Ges.m.b.H., AS Lõhmus, Haavel & Viisemann and AS Hansapank (together, the “Joint Global Co-ordinators” or the “Managers”). Carnegie Investment Bank AB is acting as co-lead manager of the Institutional Offering. AS Hansapank and AS Lõhmus, Haavel & Viisemann are the joint lead managers of the Estonian Public Offering.

Prior to the Offering, there has been no public market for the Company’s ordinary A-shares (the “Shares” or the “A-Shares”). Application has been made to list all of the 20,000,000 outstanding Shares on the Tallinn Stock Exchange under the symbol “TVE” and it is expected that such listing will become effective on or about 1 June 2005. The offering price per Offer Share (the “Offer Price”) in the Institutional Offering is €9.25. The Offer Price in the Estonian Public Offering is EEK144.73105.

See “Risk Factors” beginning on page 12 to read about factors that should be considered before buying the Offer Shares.

Offer Price: €9.25 or EEK144.73105 per Offer Share

The Selling Shareholders have granted to the Joint Global Co-ordinators an option (the “Over-allotment Option”), exercisable for 30 days from the Closing Date (as defined below), to purchase up to 545,454 additional Shares at the Offer Price, less commissions, to cover over-allotments, if any, in connection with the Institutional Offering.

Delivery of the Offer Shares in the Institutional Offering is expected to take place in book-entry form against payment therefor in immediately available funds on or about 31 May 2005 (the “Closing Date”). The Offer Shares have been registered with the Estonian Central Register of Securities (the “ECRS”) in accordance with Estonian law.

THE OFFER SHARES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OR THE SECURITIES LAWS OF ANY OTHER STATE OR JURISDICTION (SAVE FOR ESTONIA). SUBJECT TO CERTAIN EXCEPTIONS, THE OFFER SHARES MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES. THIS OFFERING CIRCULAR IS INTENDED FOR USE ONLY IN CONNECTION WITH OFFERS OUTSIDE THE UNITED STATES AND IS NOT TO BE SENT OR GIVEN TO ANY PERSON WITHIN THE UNITED STATES. SEE “SUBSCRIPTION AND SALE”.

Joint Global Co-ordinators and Joint Bookrunners



Co-Lead Manager



Each of the Company, United Utilities (Tallinn) B.V. (“UUTBV”) and the City of Tallinn hereby accepts responsibility for the accuracy and completeness of all the information contained in this Offering Circular. Each of the Company, UUTBV and the City of Tallinn also hereby confirms that it has taken all appropriate measures to check the accuracy and completeness of the information given in this Offering Circular, and that the information supplied contains no omissions likely to affect the content or meaning of this Offering Circular, and hereby also confirms that the Shares in respect of which this Offering Circular has been prepared, and the Company, each complies with the requirements of applicable Estonian legislation.

The Managers make no representation or warranty, expressed or implied, as to the accuracy or completeness of the information in this Offering Circular, and nothing in this Offering Circular is, or shall be relied upon as, a promise or representation by the Managers.

No person is or has been authorised to give any information or to make any representation in connection with the Institutional Offering or the sale of the Offer Shares, other than as contained in this Offering Circular, and, if given or made, any other information or representation must not be relied upon as having been authorised by the Company, the Selling Shareholders or the Managers. The delivery of this Offering Circular at any time after the date hereof shall not, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information set forth in this Offering Circular is correct as at any time since its date.

In connection with the Estonian Public Offering, a prospectus has been prepared in the Estonian language (the “Estonian Prospectus”). The Estonian Prospectus has been approved by the Tallinn Stock Exchange, in accordance with the provisions of the Estonian Securities Market Act (Väärtpaberituruseadus), legislation established on the basis thereof, and the Rules of the Tallinn Stock Exchange (the “TSE Rules”). Approval by the Tallinn Stock Exchange does not imply that the Tallinn Stock Exchange represents that the factual information provided in the Estonian Prospectus is correct or complete.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Company, the Selling Shareholders or the Managers to subscribe or purchase, any of the Offer Shares. The distribution of this Offering Circular and the offering of the Offer Shares in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Company, the Selling Shareholders and the Managers to inform themselves about and to observe any such restrictions. This Offering Circular may not be used for, or in connection with, and does not constitute, any offer to sell, or an invitation to purchase, any of the Offer Shares in any jurisdiction in which such offer or invitation would be unlawful. For a description of certain further restrictions on offers and sales of Offer Shares and distribution of this Offering Circular, see “Subscription and Sale” below.

This Offering Circular is for the intended recipients only and may not in any way be directed to the public in Estonia. Accordingly, each Manager has represented, warranted and agreed that it has not offered or sold and will not offer or sell any of the Offer Shares in the Institutional Offering in Estonia in a manner that would constitute a public offering and/or that would require the approval of a prospectus by the Tallinn Stock Exchange and/or registration of a prospectus with the Estonian Financial Supervision Authority (the “EFSA”).

This Offering Circular may not be distributed to, or in, any other country where such distribution (i) requires additional registration or measures other than those prescribed by Estonian law or (ii) conflicts with applicable legislation or regulation in such country.

The Listing and Surveillance Committee of the Tallinn Stock Exchange approved the Estonian Prospectus and granted its conditional decision for listing of the Shares on 13 May 2005. A description of the conditions which must be met for the listing decision to enter into effect is set out under “Subscription and Sale — The Offering — The Institutional Offering and the Estonian Public Offering”. This Offering Circular has been produced for the purpose of considering the purchase of the Offer Shares in the Institutional Offering. In making an investment decision regarding the Offer Shares, investors must rely on their own examination of the Company and the terms of the Offering, including, without limitation, the merits and risks involved. The Institutional Offering is being made solely on the basis of this Offering Circular.

In connection with the Institutional Offering, AS Hansapank or any agent of it may over-allot or effect transactions that stabilise or maintain the market price of the Shares at levels above those which might otherwise prevail in the open market. Such transactions may be effected on the Tallinn Stock Exchange, in the over-the-counter market or otherwise. There is no assurance that such stabilisation will be undertaken and, if it is, it may be discontinued at any time.

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PRESENTATION OF FINANCIAL AND OTHER INFORMATION

The term “Audited Financial Statements” as used in this Offering Circular means the Company’s audited consolidated financial statements as at and for the years ended 31 December 2002, 2003 and 2004 and the notes thereto. The term “Unaudited Financial Statements” as used in this Offering Circular means the Company’s unaudited financial statements as at and for the three months ended 31 March 2004 and 2005. The Audited Financial Statements and the Unaudited Financial Statements are collectively referred to herein as the “Financial Statements”. The Financial Statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”). The Audited Financial Statements have been audited by the Company’s independent auditors, AS Deloitte Audit Eesti (“Deloitte”). Deloitte has not audited any financial statements of the Company other than its Audited Financial Statements as included elsewhere in this Offering Circular and those of previous years.

In the opinion of the Company, the Unaudited Financial Statements have been prepared on a basis consistent with the Audited Financial Statements, and contain all necessary adjustments consisting only of normal recurring accruals, which are necessary for fair presentation of such financial data.

References to “Estonian kroons” and “EEK” are to the lawful currency of Estonia and references to “euro” or “€” are to the lawful currency of the countries of the European Monetary Union. References to the “Government” are to the Government of the Republic of Estonia and references to the “State” are to the Republic of Estonia.

Solely for convenience, this Offering Circular contains translations of certain Estonian kroon amounts into euro at the specified rate of EEK15.65=€1.00, the rate (rounded to two decimal places) at which the Estonian kroon is currently pegged to the euro and has been since December 1998. However, no representation is made that the amounts referred to herein as convenience translations have been, could have been or could be converted from Estonian kroons into euros at the rate indicated or at all.

Certain figures included in this Offering Circular have been subject to rounding adjustments. Accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

Unless otherwise indicated, all information contained in this Offering Circular assumes no exercise of the Over-allotment Option.

FORWARD-LOOKING STATEMENTS

This Offering Circular includes forward-looking statements, principally under the captions “Summary”, “Risk Factors”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business”. The Company has based these forward-looking statements largely on its current beliefs, expectations and projections about future events and financial trends affecting its business. Many important factors, in addition to those discussed elsewhere in this Offering Circular, could cause the Company’s actual results to differ substantially from those anticipated in its forward-looking statements, including, among other things:

- general economic, political and business conditions in Estonia and, more generally, Central and Eastern Europe;
- inflation and/or depreciation of the Estonian kroon, which is currently pegged to the euro;
- existing and future laws and governmental regulations applicable to the water industry;
- increases in wages or electricity costs;
- changes in market prices, including fluctuations in permitted tariff levels, customer demand and preferences and competitive conditions;
- adverse weather conditions;
- technical or mechanical problems with the Company’s facilities;
- the Company’s ability to implement successfully its growth strategy; and
- the risks factors discussed under “Risk Factors” beginning on page 12.

The words “believe”, “may”, “will”, “aim”, “estimate”, “continue”, “anticipate”, “intend”, “expect” and similar words are intended to identify forward-looking statements. Forward-looking statements include information concerning the Company’s possible or assumed future results of operations, business strategies, contractual relationships, fees for services, financing plans, competitive position, industry environment, potential growth opportunities, the effects of future regulation and the effects of competition. Forward-looking statements speak only as at the date they were made, and the Company undertakes no obligation to update publicly or to revise any forward-looking statements after the Company distributes this Offering Circular because of new information, future events or other factors. In light of the risks and uncertainties described above, the forward-looking events and circumstances discussed in this Offering Circular might not occur and are not guarantees of future performance.

AVAILABLE INFORMATION

In accordance with Estonian law and the TSE Rules, the Company’s annual reports for the financial years 2002, 2003 and 2004 and its Articles of Association are available at its head office located at Ädala 10, Tallinn 10614, Estonia and on the Company’s website (www.tallinnavesi.ee). Any interested party may obtain a copy of these items from the Company without charge. The Company intends to develop an investor relations programme for institutional as well as private investors. In addition, an electronic version of the Estonian Prospectus is expected to be available on the website of the Tallinn Stock Exchange (www.omxgroup.com/tallinn) for so long as the Company is listed on the Tallinn Stock Exchange.

SUMMARY

This summary should be read together with, and is qualified in its entirety by, the more detailed information and the Financial Statements and notes thereto appearing elsewhere in this Offering Circular. It should also be read together with the matters set forth under “Risk Factors”.

The Company

AS Tallinna Vesi is the exclusive supplier of drinking water and sewerage services in the main services area in Tallinn (the “Services Area”), an area of approximately 100 square kilometres covering approximately 63 per cent. of the City of Tallinn. The Company also provides drinking water and wastewater disposal services in a number of other smaller services areas in Tallinn and certain of Tallinn’s neighbouring municipalities. The Company operates a catchment area of approximately 2,000 square kilometres to collect raw water, and owns and operates a water treatment plant to produce potable water, a distribution network to supply treated water to the inhabitants of Tallinn, a sewerage network to collect wastewater, a wastewater treatment plant for treating wastewater and a stormwater network to collect stormwater.

In 2004, the Company distributed water to over 400,000 people, representing over 99 per cent. of the population of Tallinn, through 884 kilometres of water pipes and mains to 19,469 customer connections as at 31 December 2004. Over the same period, the Company provided sewerage services to approximately 97 per cent. of the population of Tallinn, through 1,045 kilometres of sewerage and stormwater pipes and mains from 14,736 customer connections as at 31 December 2004.

In 2004, the Company had net sales of EEK548.5 million and a net profit (after income tax on dividends) of EEK173.0 million. As at 31 December 2004, the Company had total assets of EEK2,224.7 million and total equity capital of EEK999.1 million. All of the Company’s sales are derived from, and all of its assets are located in, Estonia, save for certain limited non-recurring revenues relating to consultancy services provided by the Company in respect of a water company in Tajikistan. See “Business — Other Activities”.

The City of Tallinn has granted the Company the exclusive right to provide water supply services (including the operation and maintenance of raw water extraction facilities and water treatment and distribution) and wastewater collection, treatment and disposal services (including stormwater drainage on behalf of the City of Tallinn) and to undertake certain other related activities within the Services Area for a 15-year period from November 2000. This right was granted to the Company by the decision of the Tallinn City Council, dated 30 November 2000. The terms and conditions of the provision of services are specified in the Services Agreement executed by the City of Tallinn and the Company in January 2001. Under the terms of the Services Agreement, the Company is obliged to comply with 97 Levels of Service prescribed by the City of Tallinn. The Services Agreement and other project agreements concluded with the City of Tallinn set out the mechanisms for determining the water and sewerage tariffs which the Company is able to charge to its customers, as well as the amounts which the Company can recover directly from the City of Tallinn for certain services, such as making additional customer connections. See “Business — Key Operating Agreements” and “The Estonian Water Industry and Regulation”.

The Company is owned as a joint venture between the City of Tallinn (49.6 per cent.) and UUTBV (50.4 per cent.). UUTBV is owned by United Utilities B.V., an indirect, wholly-owned subsidiary of the international water company United Utilities PLC, and United Utilities Europe Holdings B.V., a joint venture between United Utilities B.V. and the European Bank for Reconstruction and Development (the “EBRD”). As a result, United Utilities B.V. holds a direct and indirect ownership interest of 75 per cent. and the EBRD holds an indirect ownership interest of 25 per cent. in UUTBV’s share capital. The joint venture between the City of Tallinn and UUTBV was formed in connection with the Company’s privatisation in January 2001. See “Business — History”. After giving effect to the Offering, and assuming exercise of the Over-allotment Option in full, the City of Tallinn will own 34.7 per cent. and UUTBV will own 35.3 per cent. of the Shares.

Competitive Strengths

The Company believes that its core strengths are:

- *Strong Shareholder Base.* The Company believes that it has a strong shareholder base that provides it with the technical expertise and funding that it requires to operate successfully. The United Utilities group is one of the largest international operators of water and sewerage systems. The

Company expects that it will continue to be able to benefit from the transfer of know-how and other water industry technology from United Utilities International Limited and other companies within the United Utilities group, which has been critical to the Company's success since privatisation. The EBRD, as well as being an indirect minority shareholder in the Company, is currently also the principal source of debt financing for the Company through the €80 million loan facility that it extended in November 2002. Finally, the City of Tallinn supports the Company through its continued professional working relationship with the Company under the framework of the Services Agreement and other related project agreements.

- *Effective and Professional Working Relationship with the City of Tallinn, the Supervisory Foundation and Other Regulatory Bodies.* The Company believes it has developed a successful public-private partnership and positive relationship with the City of Tallinn and the Supervisory Foundation, as well as other state and/or regulatory bodies with which the Company deals, such as the Ministry of the Environment, the Environmental Service of Harju County and the Health Protection Inspectorate. As a result of its relationship with the City of Tallinn, the Company has been successful in obtaining appropriate tariff rate adjustments, which are crucial to ensuring the sustainability of its operations and programme of capital investment. The Company believes that the strength of its relationship with the City of Tallinn is also demonstrated by the fact that it has, since privatisation, worked in partnership with each of the four main political parties (Union for the Republic - Res Publica, the Estonian Reform Party, the Estonian Centre Party and People's Union - Rahvaliid), representatives from which are likely to form part of the Tallinn City Government and the Tallinn City Council in the future. The Company expects that these relationships will help to ensure that regulatory and political risk will continue to be mitigated.
- *Management Capability and Track Record of Operating Efficiency.* The Company believes it has a proven track record of operating efficiency, having, since privatisation, delivered significant improvements in the quality of drinking water and treated wastewater and reduced system water losses while reducing operating costs. In addition, the Company's ability to deliver high quality water and sewerage services is evidenced by the fact that the Company has either met or exceeded each of the 97 Levels of Service under the Services Agreement since their implementation in January 2001 (save for a single unplanned interruption in water supply, as described in "Business — Key Operating Agreements — The Services Agreement"). The Company believes that its successful track record of operating efficiency since privatisation is largely due to the contribution of its experienced, flexible and responsive management team. The operating capabilities and the strength of its management systems are further evidenced by the Company's ISO 9001 accreditation, which the Company first achieved in July 2002, becoming the first water utility company in Estonia to have done so.
- *Environmentally-friendly Operating Practices and Track Record.* The Company achieved ISO 14001 certification for its environmental management systems in December 2003 and is currently in the process of being audited by Det Norske Veritas for the purposes of being verified as an Eco-Management and Audit Scheme ("EMAS") company, following completion of which it expects to be recommended to the Estonian Accreditation Centre during June 2005. The Company has also complied in all material respects with all environmental targets required by the Services Agreement since its privatisation. The Company believes that these achievements, together with its focus on environmentally-friendly practices in all parts of its operations as well as those of its suppliers, illustrate its commitment to the protection of the environment and to the community which it serves.
- *Diversified Customer Base.* The Company's customer base comprises a wide range of residential, commercial, industrial and governmental customers within the Services Area. The Company is not dependent on any single customer or group of related customers in either its water supply or wastewater operations. The Company believes that it has an efficient billing and collection process and has, since privatisation, experienced very high levels of collection of invoices and few delays in the collection process. The Company believes that the efficiency of its billing processes will be further enhanced by the implementation of its new customer information and billing system, which is expected to be completed by the end of 2005. The Company also believes that its exposure to uncreditworthy residential end-users is substantially mitigated by the fact that its customer for the majority of its residential end-users is the apartment association or other representative of residents of an apartment block, and not the end-user itself. The risk of non-collection from the residential end-user is therefore borne by the customer and not the Company.

- *Exclusive Services Area.* By virtue of its official appointment by the City of Tallinn and the terms of the Services Agreement, the Company has been granted the exclusive right to provide water supply services and sewerage services within the Services Area for a 15-year period from November 2000. The Company believes that the absence of any competitors within the Services Area provides it with a considerable competitive advantage and an opportunity to leverage its existing infrastructure and industry expertise to consolidate its existing market position and to expand its operations outside the Services Area in the future. Due to its ownership of substantially all of the fixed assets required to provide water production and supply services and wastewater collection, treatment and disposal services within the Services Area, the Company also believes that it will have a competitive advantage in re-applying for the exclusive right to provide its services when the current exclusivity period expires in 2015. See “The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act” for further details regarding the draft legislation on the appointment of an exclusive water company.
- *Expansion to Surrounding Areas.* The Company believes that it has the technical capability and capacity to provide its services to additional areas (representing up to an additional 40,000 people) not already served by the Company without significant cost and risk to the Company. Between January 2001 and the date of this Offering Circular, the Company has been appointed as the exclusive provider of water and sewerage services in three services areas in addition to the Services Area, and has concluded contracts for water supply and/or sewerage services within an additional 11 services areas. These contracts have been signed for periods of five to 10 years and account for approximately 45 per cent. of the potential customers in these additional areas. The Company expects to conclude agreements with four additional municipalities for the provision of its services during 2005. It is anticipated that this expansion will enable the Company to re-connect a proportion of those commercial customers which have relocated their operations to areas outside the Services Area.

Strategy

The Company’s strategy is based upon the following key elements:

- *Continue to Expand the Company’s Water Supply and Wastewater Services.* The Company’s principal strategic objective is to improve and expand its water supply and wastewater services both within its existing services areas (including the Services Area) and in other neighbouring areas. The Company believes that its ownership of substantially all of the fixed assets used in its operations will provide it with a significant competitive advantage to expand its operations in the future. Furthermore, the Company will seek to use the significant excess capacity at its Ülemiste water treatment plant and Paljassaare wastewater treatment plant to support the expansion of its water supply and wastewater services.
- *Continue to Improve Operating Efficiency and Cost Reduction.* A key strategic objective of the Company is to meet or exceed the Levels of Service prescribed in the Services Agreement. The Company has either met or exceeded each of the 97 Levels of Service since privatisation (save for the single unplanned interruption in water supply referred to above), and intends to focus on improvements in operating efficiency to ensure that it continues to do so. Water losses have been reduced over the last four years, and the Company will seek to restrict its water losses to current levels, or to levels which are lower but which remain economically sensible. Furthermore, the Company aims to reduce operating costs and increase productivity levels by using the latest technology. For example, in March 2005 the Company implemented a new asset management system, which it believes will enable more efficient use of its maintenance resources and better work planning. The Company expects to complete a programme of upgrading its customer information systems by the end of 2005, which will provide an enhanced customer service offering. The Company also expects to develop its website by the end of 2005, which will provide an improved and internet-based interface for its customers.
- *Leverage Organisational Competence and Flexibility.* The Company plans to leverage the skill set of its employees through structured initiatives to share knowledge within the Company and to focus on the personal development of individual employees, in particular by reference to a system of individually-tailored performance targets and a performance-related pay programme which the Company has developed. In addition, the Company is currently developing a recruitment programme for young graduates with engineering, finance and business management backgrounds which it expects will enable it to sustain the high quality of its management pool.

- *Continue Strategy of Partnership with Shareholders.* The Company has strong relationships with each of its direct and indirect shareholders, the City of Tallinn, the United Utilities group of companies and the EBRD. The Company seeks to continue and further develop these relationships, in particular with the United Utilities group of companies, which it believes will assist the Company in continuing to meet or exceed all Levels of Service included in the Services Agreement, as well as to provide the Company with the resources necessary to support the expansion of its services into areas not already served by the Company. Through the further development of its relationship with the City of Tallinn, the Company believes that it will be able to improve its operating efficiency during the remaining period covered by the Services Agreement, which it believes will help to ensure that the Company has a competitive advantage over other potential bidders for the renewal of the exclusive right to operate in the Services Area in November 2015.
- *Commitment to Sustainable Development.* The Company believes that it is well positioned to align its interests and those of its shareholders with the interests of the communities which the Company serves, creating considerable and sustainable benefits for all parties. The Company believes that its long-term growth will be influenced by its ability to manage the environmental impact of its business and improve the quality of its customers' lives through the provision of clean and safe water. The Company will maintain its involvement in environmental projects aimed at protecting watersheds and water sources, as well as applying environmentally-friendly systems for wastewater treatment and disposal. In addition to its ISO 14001 accreditation for its environmental management systems, the Company is currently in the process of being audited by Det Norske Veritas for the purposes of being verified as an EMAS company, following completion of which it expects to be recommended to the Estonian Accreditation Centre during June 2005 in recognition of its environmental performance and commitment to sustainable development.

By achieving its overall strategic objectives, the Company expects to be viewed as a “benchmark” organisation that has been able to demonstrate and capitalise on the benefits of privatisation, in particular the advantages obtained by working in partnership with the Company’s shareholders, the Supervisory Foundation and the other regulatory bodies with which the Company deals.

THE OFFERING

The Offering	Offer Shares are being offered pursuant to the Institutional Offering and the Estonian Public Offering. The Selling Shareholders are together offering 5,454,546 Offer Shares, subject to the Joint Global Co-ordinators' right to increase the total number of Shares offered by the Selling Shareholders in the Institutional Offering by up to an additional 545,454 Shares. See "Subscription and Sale — The Offering — The Institutional Offering and the Estonian Public Offering".
– Institutional Offering	4,254,546 Offer Shares are being offered by the Selling Shareholders to institutional investors outside the United States, including to institutional investors in Estonia, in compliance with Regulation S. The Offer Shares which are subject to the Over-allotment Option (if exercised) will be sold in the Institutional Offering. See "Subscription and Sale — The Offering — The Institutional Offering and the Estonian Public Offering".
– Estonian Public Offering	1,200,000 Offer Shares are being offered by the Selling Shareholders to the public in Estonia only pursuant to a separate prospectus in the Estonian language. See "Subscription and Sale — The Estonian Public Offering".
Selling Shareholders	United Utilities (Tallinn) B.V., a limited liability company incorporated under the laws of the Netherlands, and the City of Tallinn (<i>Tallinna linn</i>). See "Principal and Selling Shareholders".
Offer Price	The Offer Price in the Institutional Offering is €9.25 per Offer Share. The Offer Price in the Estonian Public Offering is EEK144.73105 per Offer Share. See "Subscription and Sale — The Offering — The Institutional Offering and the Estonian Public Offering".
Over-allotment Option	The Selling Shareholders have granted the Joint Global Coordinators an option, exercisable for 30 days from the Closing Date, to purchase up to an additional 545,454 Shares, solely to cover over-allotments, if any.
Use of proceeds	The aggregate net proceeds from the sale of Offer Shares in the Offering, after deduction of the Success Fee (as defined in "Subscription and Sale — The Offering — The Institutional Offering and the Estonian Public Offering") payable by the Selling Shareholders of €1,942,500 and assuming exercise of the Over-allotment Option in full, will be approximately €53,557,500 and will be payable to the Selling Shareholders (Estonian Kroon amounts having been converted for the purposes of the foregoing at EEK15.6466 = €1.00). The Company will not receive any of the proceeds from the sale of the Offer Shares. The Company has, however, agreed to pay certain expenses incurred in connection with the Offering, amounting in aggregate to an estimated €1.5 million (including any applicable taxes).
Voting Rights	The holders of Shares are entitled to one vote for each Share held. Shares may be voted by proxy. See "Description of Capital Stock and Corporate Governance — Shares and Share Capital — Class of Shares".

Lock-up Agreement	Each of the Company and the Selling Shareholders has agreed with the Managers that, subject to certain exceptions in the case of the Selling Shareholders, none of them will offer, sell, contract to sell, pledge or otherwise dispose of any Shares for a period of 360 days following the date of the Underwriting Agreement, without the prior written consent of the Managers. See “Subscription and Sale — The Offering — Lock Up Agreement”.
Risk Factors	See “Risk Factors” beginning on page 12 and the other information included in this Offering Circular for a discussion of factors that should be considered before a decision to invest in the Offer Shares is made.
Dividends	The Offer Shares will share proportionately on a per Share basis in all dividends and other distributions declared by the Company, if any. The Offer Shares will be eligible for dividends or other distributions, if any, declared in respect of the financial year ending 31 December 2005 and subsequent periods. There can be no assurance that in any given year a dividend or other distribution will be declared at all. See “Dividends and Dividend Policy”.
Listing	Application has been made for admission to listing of all of the Shares (except the single B-share owned by the City of Tallinn (the “B-Share”)) on the Tallinn Stock Exchange, which is expected to occur on or about 1 June 2005. Prior to the Offering, there has been no public market for the Shares.
Settlement and Clearance	The delivery of the Offer Shares in the Institutional Offering is expected to take place in book-entry form against payment therefor in immediately available funds on or about the Closing Date. The Offer Shares will initially be delivered through the facilities of the Estonian Central Registry of Securities administered by the Estonian Central Securities Depository.

RISK FACTORS

Prospective investors should consider carefully the risks described below and other information included in this Offering Circular, including the Financial Statements and related notes, prior to making any decision as to whether to invest in the Offer Shares. Additional risks and uncertainties not presently known to the Company or that currently are deemed immaterial may also adversely affect the Company's business, financial condition, liquidity or results of operations. The risks below are the risks that the Company currently believes may materially affect it and an investment in the Offer Shares. If any of the possible events described below occurs, the Company's business, financial condition, liquidity or results of operations could be materially and adversely affected. The trading price of the Shares could decline due to these risks and investors may lose part or all of their investment.

Risks Related to the Estonian Water Industry and Regulation

The Company's operations are subject to extensive laws and regulations.

The body of laws and regulations which applies to the Company's water supply and wastewater operations is extensive and complex. The Company is subject to European Union and Estonian legislation on matters such as raw water extraction, drinking water quality, pollution levels in wastewater and other environmental and health and safety matters. See "The Estonian Water Industry and Regulation" for further details on the regulatory regime within which the Company operates.

The Company has incurred, and will continue to incur, significant expenditure to comply with these laws and regulations. The future implementation of new laws and regulations, or the amendment of existing laws and regulations, could require changes in the Company's working practices or additions and/or modifications to the Company's assets to comply with these requirements, which could have a material adverse effect on the Company's results of operations.

Although pursuant to the terms of the Services Agreement the City of Tallinn has an obligation to adjust the tariffs that the Company charges for its water supply and wastewater operations to take into account the consequences of changes of laws affecting the Company's operations, there can be no assurance that the City of Tallinn will comply with its obligation to do so. There can therefore be no assurance that the Company will be able successfully to pass on in full all costs associated with future changes to the laws and regulations to which it is subject. There can therefore also be no assurance that any change of law will not materially affect the Company's business, its financial condition or results of operations, whether by reason of the delay in receiving revenues based on higher tariffs in the year following the change of law, a shortfall in the revenues expected to be recovered by the Company through future tariff increases or otherwise.

While the Company believes that it is in material compliance with all laws and regulations currently required for ownership and operation of its facilities, additional expenditure required for future compliance may, to the extent such costs cannot be passed on to customers through tariff increases, force the Company to reduce other planned investments. This could adversely affect its results of operations and could lead to the termination of the Services Agreement by the City of Tallinn.

The Company is subject to monitoring by the Supervisory Foundation and supervision by the City of Tallinn and other regulatory bodies.

Water extraction and environmental compliance relative to water and wastewater treatment and disposal are among the Company's activities subject to monitoring, regulation and supervision by the Supervisory Foundation and the City of Tallinn, as well as by other Estonian regulatory bodies such as the Ministry of the Environment, the Environmental Service of Harju County, the Environmental Supervisory Authority and the Health Protection Inspectorate. The Supervisory Foundation's main functions are to monitor the Company's compliance with the Levels of Service set out in the Services Agreement, to monitor tariffs and changes to them and to advise the City of Tallinn regarding the imposition of penalties if the Company fails to comply with any of its obligations under the Services Agreement. Pursuant to a decision of the Tallinn City Council passed in May 2005, the Supervisory Foundation shall expand its monitoring and evaluation activities to all agreements executed between the Company and the City of Tallinn.

While the Company believes that it dedicates sufficient resources to its compliance programme, and endeavours to respond to the requirements of the Supervisory Foundation in an appropriate way and takes corrective action when warranted, the Company faces the risk that a governmental or regulatory body (such as the City of Tallinn) could find that it has failed to comply with applicable regulations or has not successfully undertaken corrective action. In the cases provided for in the Services Agreement and

certain of the other project agreements, proceedings could be taken by the City of Tallinn against the Company for breach of the relevant agreement. See “Business — Key Operating Agreements — The Services Agreement”. In addition, other regulatory bodies having jurisdiction over the Company may impose sanctions or issue precepts against the Company if it fails to comply with its obligations. Any steps taken by the City of Tallinn, or any other authority having jurisdiction, against the Company could also result in adverse publicity to, or negative perceptions regarding, the Company and its operations, as well as diverting management’s attention from the day-to-day operation of the business. A significant regulatory action against the Company could therefore have a material adverse effect on its business, results of operations and/or financial condition.

The ability of the Company to operate its business successfully depends in part on it having a professional and co-operative relationship with the City of Tallinn and the Supervisory Foundation, as well as the Ministry of the Environment, the Environmental Service of Harju County, the Environmental Supervisory Authority, the Health Protection Inspectorate and other Estonian regulatory bodies. However, while the Company believes that it has maintained professional and co-operative relationships with these bodies since its privatisation, there can be no assurance that these relationships will be maintained in the future. If these relationships were to deteriorate for any reason, whether as a result of the actions of the Company or otherwise, and a different regulatory approach was to be applied by the relevant regulatory body, there can be no assurance that the Company’s business, its financial condition and results of operations would not be adversely affected.

Furthermore, there is currently no national state regulator of the water industry in Estonia. If a national regulator were to be appointed in the future, there can be no assurance that the Company’s operations would not be adversely affected.

The City of Tallinn may for political reasons seek to renegotiate the Services Agreement or other project agreements.

The Company’s exclusive right to provide water supply services and wastewater collection, treatment and disposal services within the Services Area until November 2015 has been granted by the City of Tallinn. Although the City of Tallinn is contractually bound by the Services Agreement and the other project agreements to which it is a party, the City of Tallinn may nevertheless, for political reasons, seek to renegotiate the Services Agreement or any of those other agreements to obtain more favourable terms from the Company. Furthermore, the City of Tallinn may seek to implement a new regulatory regime in Tallinn which would purport to override the current municipal regime. If this was to occur and the Company was in effect required by the City of Tallinn to agree to modifications to the Services Agreement or any of the other project agreements (whether as a result of changes in law, municipal regulations or otherwise), there can be no assurance that the Company’s business, financial condition and results of operations would not be adversely affected.

The City of Tallinn may seek to impose more onerous Levels of Service on the Company with effect from 2011.

The Levels of Service provided for in the Services Agreement are applicable during the period from 2001 to 2005 (inclusive). The Services Agreement also provides that the Levels of Service to be applicable during the period from 2006 to 2010 (inclusive) were to be determined by the City of Tallinn prior to the end of 2004, based on certain factors provided in the Services Agreement. Based on the provisions of the 2002 Amendment Agreement and the City of Tallinn’s Public Water Supply and Sewerage System Development Plan of Tallinn for 2004 - 2015, adopted by the Tallinn City Council on 13 May 2004, the Levels of Service set out in the Services Agreement as applicable from 2001 to 2005 (inclusive), and as amended in the 2002 Amendment Agreement and the 2005 Amendment Agreement, have been extended to be applicable also during the period from 2006 to 2010 (inclusive).

The Levels of Service will therefore need to be further extended by and/or renegotiated with the City of Tallinn in respect of the period from 2011 to the end of the exclusivity period covered by the Services Agreement. Although the Company believes that it has certain protections against the imposition by the City of Tallinn of more onerous Levels of Service in respect of this remaining period, there can be no assurance that the City of Tallinn will not seek to do so. If more onerous Levels of Service are imposed, there can be no assurance that the Company, its business or results of operations would not be adversely affected. See “Business — Key Operating Agreements — The Services Agreement” for further details.

Termination of the Services Agreement for material non-compliance with its terms may significantly affect the business of the Company and/or lead to a change in ownership of the Company.

The Company is obliged to operate its water supply and wastewater businesses under the terms and conditions of the Services Agreement and all applicable laws and regulations. Certain of the provisions of the laws and regulations with which the Company must comply in its operations are also incorporated within the Services Agreement, as prescribed “Levels of Service”. Although the Company has met or exceeded all Levels of Service since it was privatised (save for a single unplanned interruption in water supply, as described in “Business — Key Operating Agreements — The Services Agreement”), it cannot guarantee that it will in the future be in compliance at all times with all of the Levels of Service applicable to it. If the Company were to breach any applicable law or regulation, and thereafter fail in accordance with the terms of the Services Agreement to remedy the breach, the City of Tallinn could, among other things, seek to impose financial penalties or in certain prescribed circumstances exercise “step-in” rights or terminate the agreement. In addition to the above, certain statutory penalties could be imposed on the Company if it were to breach any applicable law or regulation (although if statutory penalties were imposed on the Company, any penalties payable under the Services Agreement for that breach would be reduced accordingly). As the provision of services under the Services Agreement constitutes the majority of the Company’s operations, the successful termination of the Services Agreement by the City of Tallinn may significantly affect the business of the Company. See “Business — Key Operating Agreements — The Services Agreement” for further details. In addition, in the same circumstances pursuant to which the City of Tallinn can terminate the Services Agreement, the City of Tallinn also has the right pursuant to the Services Agreement and the corresponding provisions of the Shareholders’ Agreement and the Option Agreement to exercise a call option in respect of all of the Shares owned by UUTBV. After giving effect to the Offering, and assuming exercise of the Over-allotment Option in full, the City of Tallinn will own 34.7 per cent. and UUTBV will own 35.3 per cent. of the Shares. Therefore, if the option described above was exercised by the City of Tallinn in the future, there would be an effective change of ownership of the Company and the City of Tallinn would gain control of more than one half of the votes determined by the Shares. In such circumstances, the City of Tallinn would be required under Estonian law to make an offer to purchase all remaining Shares outstanding. There can be no assurance that the obtaining of control by the City of Tallinn over the Company in the future would not be contrary to the interests of the Company’s remaining shareholders. See “Business — Key Operating Agreements — The Services Agreement” for further details regarding the Services Agreement and “Principal and Selling Shareholders — Shareholders’ Agreement” and “Description of Capital Stock and Corporate Governance” for further details regarding the Shareholders’ Agreement and the Option Agreement.

The Company’s business is dependent upon the Services Agreement, and there can be no assurance that it will be renewed when it expires in 2015.

The Company has been granted the exclusive right to provide water supply services and wastewater collection, treatment and disposal services and to undertake certain other related activities within its designated Services Area for a 15-year period from November 2000. When the exclusivity period expires in November 2015, the Services Agreement provides that its term may be extended by the City of Tallinn beyond that date. Under the current legal framework, the City of Tallinn must carry out a competitive tender process on expiry of the exclusivity period, and there can therefore be no assurance that the Company will be awarded the renewal of the contract at the time of its expiry. However, see “The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act” for further details regarding draft legislation regarding the appointment of an exclusive water company.

If the Company is not awarded the renewal of the contract at the time of its expiry, this would significantly affect the business of the Company. In addition, the Company may effectively be required by applicable competition legislation to conclude arrangements with the successful bidder for it to acquire and/or lease the assets currently owned by the Company and used by it in its water supply and wastewater activities. There can be no assurance that the Company will be able to conclude arrangements for the sale of its assets and/or the leasing of the same on terms favourable to the Company or at all. See “Business — Key Operating Agreements — The Services Agreement” for further details regarding the Services Agreement and a description of certain factors relevant to the renewal process upon expiry of the Services Agreement.

The City of Tallinn may not authorise in a timely manner or at all increases in customer tariffs under the Services Agreement.

The Company's results of operations and financial condition are highly dependent upon its ability to set and collect adequate tariffs for its water and sewerage services as agreed with the City of Tallinn and as set out in the relevant project agreements. Tariff adjustments during the exclusivity period under the Services Agreement are formula-driven, and the mechanics for seeking these adjustments are set out in the Services Agreement. Adjustments may be requested by the Company based on a coefficient as contractually agreed between the City of Tallinn and the Company, movements in the Estonian Consumer Price Index and certain extraordinary events, such as changes in law or *force majeure* events which require additional expenditure by the Company. Tariff adjustments may also be requested if the scope of the Services Agreement and of the services to be provided by the Company thereunder are to be amended as a result of variations proposed by either party.

However, there can be no assurance that the Company will be able successfully to pass on in full all costs associated with future events which require additional expenditure. For example, it is possible that the City of Tallinn could decide that the likely cost of the Company fulfilling additional obligations imposed as a result of a change in law would be less than the cost actually incurred by the Company in doing so. In such circumstances, the increase in tariffs permitted by the City of Tallinn may not lead to increased revenues sufficient to cover fully the actual costs incurred by the Company. Furthermore, the Company may be adversely affected by reason of the delay in receiving revenues based on higher tariffs in the year following the change of law or by a shortfall in the revenues expected to be recovered by the Company through future tariff increases.

In addition, although regulated in the Services Agreement, Estonian law requires that any tariff adjustment be approved by the City of Tallinn. Although the determinations of the City of Tallinn are subject to appeal, there can be no assurance that any tariff increase requested will automatically be granted or granted in the form or to the extent requested by the Company, despite the mechanism prescribed by the Services Agreement. Furthermore, the City of Tallinn may be constrained from granting tariff increases as a result of extraneous political factors.

For a further discussion of the tariff mechanism, see "Business — Tariffs". Any tariff adjustments that are not granted or that are not granted in full may have to be absorbed by the Company, which may have a material adverse effect on the Company's business, its financial condition and results of operations.

The Company may not be able to renew its water permits for water extraction and/or the discharge of wastewater, or the conditions attached to the renewal of its permits may be burdensome and could result in an increase in the Company's costs and higher capital expenditure requirements.

The Company is only able to extract water from its surface catchment area and from groundwater wells in and around the City of Tallinn, and discharge its wastewater, in accordance with water permits granted by the Ministry of the Environment (the Environmental Service of Harju County), which are valid for periods up to five years only. The Company's current principal water permit expires on 31 March 2008. However, the City of Tallinn has granted the Company the exclusive right to provide water supply services and wastewater collection, treatment and disposal services within the Services Area until November 2015. It will therefore require the renewal of its water permit every five years, as well as the renewal of its other permits (such as waste disposal and air pollution permits) as necessary.

The failure of the Company to obtain renewal of its permits would mean that the Company would not be legally allowed to operate from the date of expiry of the existing permits. Although under the Services Agreement the City of Tallinn is under an obligation to use its reasonable endeavours to ensure that any permits required by the Company for the performance of the services under the Services Agreement are granted to the Company, and although the Company believes that the relevant authority would not be able to decline an application for renewal of a permit if the Company has been in compliance with the conditions applicable thereto prior to its renewal, there can be no assurance that the Company will be successful in its application to renew all its permits in the future. The Company's permits may be revoked or modified by the relevant authorities in the event of any significant or recurring breach by the Company of the conditions of its permits and/or of any applicable laws and regulations. See "The Estonian Water Industry and Regulation" for further details regarding the granting and renewal of permits required by the Company in its operations.

In addition, if the Company is unable to renegotiate any burdensome condition imposed by the authority which has granted the renewal of the relevant permit, the Company (although protected to a certain

extent by the change of law provisions of the Services Agreement) may be exposed to increased costs and capital expenditure, which may negatively affect its business, financial condition and results of operations.

Risks Related to the Company

The financial condition of the Company may be adversely affected as a result of the environmental consequences of its operations.

The Company is exposed to environmental risks given the nature of its water supply and wastewater operations. Any environmental liability arising from its water supply or wastewater operations could breach the relevant Levels of Service in the Services Agreement and/or obligations under applicable laws and regulations and could adversely affect the Company's business, its financial condition and results of operations.

The Company provides treated drinking water to a large proportion of the population in the City of Tallinn and surrounding areas. Water supplies may be exposed to pollution, including pollution from the development of naturally occurring compounds and contamination resulting from man-made or other sources. If the Company's water supply were to become polluted or contaminated, and it is unable to substitute a water supply from an uncontaminated water source, or to treat adequately and cost-effectively the contaminated water source, it may breach the relevant Levels of Service in the Services Agreement and/or obligations under applicable laws and regulations. If drinking water supplied to consumers is severely contaminated, the Company could also be held liable for human exposure to dangerous substances in its water supplies, as well as other environmental damage.

In addition, the Company provides sewerage services to a large proportion of the population in the City of Tallinn and its surrounding areas. Wastewater is treated and discharged into the Baltic Sea. A failure of the Company's treatment processes to operate or to operate properly may lead to the discharge of effluent containing pollution into the Baltic Sea which could cause environmental damage for which the Company would be liable. The discharge of polluting effluent may also breach the relevant Levels of Service in the Services Agreement and/or obligations under applicable laws and regulations and lead to liability by the Company.

While the Company maintains insurance policies in relation to potential environmental liabilities arising as a result of its operations, there can be no assurance that all of its environmental liabilities would be covered in full or at all, or that coverage will continue to be available in the future. In addition, although the Company has taken steps to mitigate the effect of the potential environmental damage caused by its operations, the Company's liability insurance is subject to monetary limits. There can therefore be no assurance that its insurance coverage will meet all liability incurred in connection with the occurrence of such events and therefore there can also be no assurance that its business, financial condition and/or results of operations will not be adversely affected. Moreover, insurance cover for these events may not be available at a commercially acceptable premium in respect of gradual contamination.

The Company is vulnerable to extreme weather conditions, natural disasters and other disruptive events.

The Company's water supply and wastewater facilities may incur significant loss, damage or other impairment as a result of the occurrence of extreme weather conditions, natural disasters or other disruptive events, including the following:

- natural disasters, such as, but not limited to, earthquakes, floods, prolonged droughts and severe gales;
- prolonged periods of climate change;
- human errors in operating the Company's water supply and wastewater facilities, including the treatment facilities and the distribution and collection networks, or other accidents involving the same;
- water leakages and other water losses;
- sewer bursts;
- failures of plant or equipment (including computer hardware or software, such as that relating to the Company's billing systems);
- the interruption of the Company's power supply; and
- acts of terrorism.

In particular, the Company is at risk from the effects of flooding in Tallinn caused by extreme rainfall, as occurred on two separate occasions in Tallinn in the summer of 2004 and in January 2005 when unprecedented levels of rain fell on Tallinn and its surrounding areas. In addition, the effects of the high levels of precipitation in January 2005 were exacerbated by the unseasonably high temperatures experienced in Tallinn, which led to the rapid melting of snow. Although the Company was able to implement successfully its crisis management plans on these occasions, it is not possible to assess accurately the impact that the future occurrence of extreme weather conditions, natural disasters or other disruptive events may have on the Company and its operations, nor whether the Company would be able to implement successfully its crisis management plans in time or at all to deal with the consequences of those events. Although the Company is not liable for the consequences of flooding caused solely by reason of the volumes of stormwater exceeding the capacity for which the stormwater network has been designed, the Company is responsible for the operation and maintenance of the stormwater network and would therefore be liable for flooding caused as a result of its failure to comply with those obligations.

The Company would also be at risk from the effects of drought if prolonged periods of climate change were to occur.

The occurrence of any of these events could result in personal injury, loss of life, pollution or environmental damage, severe damage to or destruction of the Company's operational assets or claims for compensation or remediation, and therefore could have a material adverse effect on the Company's business, financial condition and results of operations. Although the Company maintains insurance against some but not all of the events specified above and has taken steps to mitigate the effect of the occurrence of any of these events where practicable, the Company's insurance policies are subject to monetary limits and deductibles, and there can therefore be no assurance that the Company's insurance will be adequate to cover any direct or indirect losses or liabilities it may suffer. Furthermore, there can be no assurance that insurance cover will be available for some or all of these risks in the future at commercially reasonable rates or at all.

The Company benefits from the transfer of know-how and other water industry technology from United Utilities International Limited and other companies within the United Utilities group.

The Company has entered into a Technical Services Agreement with United Utilities International Limited in connection with its operations. United Utilities International Limited provides technical services to the Company such as the transfer of know-how and other water industry technology from the United Utilities group of companies, as well as the provision of certain management personnel, which currently includes the Company's chief executive officer, chief operating officer and chief financial officer.

The Company benefits from the technical support provided by United Utilities International Limited and other companies within the United Utilities group pursuant to the Technical Services Agreement in the conduct of its operations. Although the Company believes that United Utilities International Limited currently intends to continue providing services under the Technical Services Agreement for at least as long as the United Utilities group of companies continues to have a major shareholding in the Company, there can be no assurance that any termination of the Technical Services Agreement by United Utilities International Limited, if it were to occur, would not have a material adverse effect on the Company's business, financial condition and results of operations. See "Principal and Selling Shareholders — Related Party Transactions — The Technical Services Agreement" for further details.

If the City of Tallinn seeks to accelerate the programme of network extensions, the Company's business, financial condition and results of operations may be adversely affected.

The Services Agreement (as originally executed) provides that the programme of network extensions should be completed by the end of 2005. Due to budgetary constraints of the City of Tallinn, this programme has been extended to the end of 2010, and agreement to this effect has been recorded in the 2002 Amendment Agreement and the 2005 Amendment Agreement. However, although the City of Tallinn is contractually bound by these provisions, it may nevertheless for political reasons seek to renegotiate the timetable for completion of the Company's programme of network extensions. If this was to occur and the Company was effectively required by the City of Tallinn to complete the programme of network extensions by a date earlier than 2010, there can be no assurance that the Company's financial condition, and in particular the amount of working capital available to it for its remaining operations, would not be adversely affected.

The Company may need to undertake a more significant capital works programme than first anticipated, which may be costly.

The Company depends upon a network of pipes beneath the City of Tallinn and its neighbouring areas, as well as its Ülemiste water treatment plant and its Paljassaare wastewater treatment plant and catchment areas, to provide its water supply and wastewater services. The Company is required to undertake a schedule of capital works in relation to its treatment plants, its water supply distribution network and its wastewater collection network under the terms of the Services Agreement, including the periodic replacement of pipes and upgrading of certain specified plant and machinery. Any accelerated ageing of the pipes or deterioration in the Company's other plant and machinery, or any other extraordinary events, may require the Company to undertake a significantly increased programme of capital works. This would likely be undertaken at a greater expense to the Company, which could have a material adverse effect on its business, financial condition or results of operations.

The Company depends on different sources of ground water, a single source of surface water, a single water treatment plant consisting of two parallel treatment lines located on the same site and a single wastewater treatment plant. Any interruption in its operations as a result of this dependence may have a material adverse effect on the Company.

The Company relies on Lake Ülemiste as its principal source of surface water, and Ülemiste water treatment plants as its only surface water treatment facility. Any significant contamination of the surface water stored in Lake Ülemiste, or any event causing both treatment lines of Ülemiste water treatment plant to be unable to function, would result in difficulties for the Company in supplying the same amount of treated water to its network. In that case, the Company would be able to use the ground water wells or other sources (e.g. Lake Raku, a small lake adjoining Lake Ülemiste) that are located in or around the Services Area as an alternative resource for only a proportion of its customers.

Lake Ülemiste and the Ülemiste water treatment plant are located in close proximity to the Tallinn International Airport. Hazardous materials, such as airline fuel, lubricants and de-icing fluids, are stored at the airport. In addition, aircraft take off and land over Lake Ülemiste on occasion. Therefore, there can be no assurance that direct contamination of the water in Lake Ülemiste will not occur as a result of an incident involving aircraft landing, or jettisoning fuel, in Lake Ülemiste itself. The operations at the Ülemiste water treatment plant would also be interrupted if an aircraft were to crash into the water treatment plant itself. The Company expects that these events would be classified as *force majeure* events under the Services Agreement, entitling the Company to recover any increased costs through an increase in the tariffs charged by it for its services. In addition, the Company maintains insurance against certain of these risks. However, there can be no assurance that, if any of these events was to occur, the Company would in fact be able to recover all of its costs through the tariff mechanism or under its insurance coverage.

The Company also relies on the Paljassaare wastewater treatment plant as its only wastewater treatment facility. If any event were to occur that caused the Paljassaare wastewater treatment plant to be unable to function to any extent, the Company would continue to provide its customers with sewerage services but would have to discharge partially treated or untreated sewage into the Baltic Sea until the wastewater treatment plant was brought back online.

The Company could face reputational damage, considerable costs providing its customers with an alternative source of drinking water and/or significant environmental liability in discharging effluent with high pollution levels into the Baltic Sea. Depending upon the cause of the event, the City of Tallinn could also seek to take action against the Company for breach of its obligations under the Services Agreement, and, depending on the nature of the breach, other regulatory authorities with jurisdiction over the Company may also impose sanctions on the Company. There can therefore be no assurance that the occurrence of any of the events or other interruptions described above will not have a material adverse effect on the Company's business, its financial condition and/or its results of operations.

If the Paljassaare wastewater treatment plant fails to meet the required reduced nitrogen output levels in effluent, the Company may be liable for additional pollution charge payments.

The Company has been exempted from paying pollution charges to the State in relation to the levels of nitrogen in effluent discharged by it into the Baltic Sea from its wastewater treatment plant at Paljassaare, in return for the Company's investment and upgrade of the plant to reduce nitrogen levels in the future. The Company's agreement with the State represented by the Ministry of the Environment provides for the repayment by the Company of all previously exempted pollution charges if the concentration of

nitrogen discharged into the Baltic Sea in the 12-month period ending in June 2006 exceeds pre-determined levels.

Although the plant's designers forecast that the future nitrogen concentration of its effluent would be lower than the required levels, the Company is unable to provide any assurances that the concentration of nitrogen discharged into the Baltic Sea in the 12-month period ending in June 2006 will, in fact, be below the required levels. If the specified nitrogen levels are not met, the Company will be required to repay all previously exempted pollution charges, amounting to approximately EEK13 million (the amount provisioned as at 31 March 2005 was EEK8.3 million). Furthermore, after this period the Company would have to pay a higher level of pollution charges on nitrogen emissions. In addition, if the Company fails to meet the required levels of emissions of nitrogen in its effluent, it will need to make further investment in its wastewater treatment facility to enhance the treatment process so that the necessary compliance is achieved. There can be no assurance that any additional investment which may be required to achieve compliance would not be significant. See "Business — Wastewater Services — Pollution and Quality Control" for further details regarding the denitrification project and the pollution charges.

The Company may not have title to its network which has been constructed since April 1999.

Estonian law provides that the Company's network and other technical infrastructure facilities built on municipal or state owned land (where that land has not been registered at the Land Register) since 1 April 1999 must be built on the basis of a written agreement with the landowner; otherwise title to the assets vests in the landowner. In addition, where, since 1 April 1999, these facilities have been built on land owned by private parties (and the land has been registered at the Land Register), the construction is required by Estonian law to have been carried out on the basis of a real servitude or personal right of use.

A substantial proportion of the Company's network which has been constructed after 1 April 1999 is located on municipal or state owned land. However, the Company has not effected express written agreements with the relevant state or municipal landowner for the construction. Similarly, the Company has not acquired real servitudes or personal rights of use in respect of a substantial proportion of its network which has been constructed after 1 April 1999 on land owned by private parties.

The Company believes that the proportion of its total network which falls within the above categories is small (in particular because a substantial majority of its network was constructed prior to 1 April 1999). In addition, the Company is in the process of implementing written arrangements with the City of Tallinn in respect of those areas of the network which have been built on municipal or state owned land where the required arrangements are not yet in place. Nevertheless, there can be no assurance that a proportion of the Company's network constructed after 1 April 1999 will not be deemed to have been unlawfully constructed. If this is the case, the relevant parts of the network would become the property of the landowner in accordance with Estonian law. See "Business — Property, Plant and Equipment — Title to Network Constructed since April 1999" for further details.

The Estonian Supreme Court's ruling relating to 'servitudes' required for the Company's network located on land owned by third parties may entail significant payments by the Company to affected parties.

In April 2004, the Estonian Supreme Court concluded that utility companies in Estonia should be required to pay a compensatory charge for the use of land owned by third parties where the utility company's technical infrastructure passes over/under the land. The implementation of this charge is subject to final determination by the Government, which is currently expected during 2005.

The Company is unable to predict the amount of any charge which might be payable by it to third parties as a result of the imposition of this charge, and there can be no assurance that the amount of the charge will not be substantial, in particular in view of the extent of the Company's water supply distribution network and wastewater collection network throughout the City of Tallinn and its neighbouring areas. In particular, the Company expects that the charge will apply retrospectively, with effect from 1 November 2004. As the Company believes that the imposition of the charge would constitute a change of law under the terms of the Services Agreement, the Company would expect to be able to recover additional costs incurred by increasing future tariff levels. There can be no assurance, however, that the pass-through of any charge to customers via a tariff increase would be approved by the City of Tallinn.

The Company may have difficulty accomplishing its growth strategy within and outside its current operating areas.

Even though the Company has an exclusive Services Agreement for its present operating area in the City of Tallinn, its ability to expand its operating area is subject to the co-operation of the local governments

in each of the surrounding areas of Tallinn. Part of the Company's long-term strategy is to expand its water supply and wastewater operations to other locations outside the areas in which it currently operates, to utilise more fully the capacity of the water treatment plant at Lake Ülemiste and the wastewater treatment plant at Paljassaare. The Company's expansion into new locations depends on its ability to win new operating contracts in these areas and/or agree on a bulk supply contract with the said areas.

The Company's proposed growth strategy within and outside its current operating areas may not be successful in offsetting the effects of lower residential per capita water consumption and a decline in the population in the Services Area.

The Company has experienced decreasing water consumption on a per capita basis. Residential water supply volumes have decreased from an average of approximately 108 litres per person per day in 2001 to approximately 101 litres per person per day in 2004. The Company's residential water and wastewater volumes reflect the fact that a proportion of its customers leave the Services Area for weekends and for extended periods during holidays, in particular over the summer months. In addition, volumes may be negatively affected by the movement of residential and commercial customers from the Services Area to other areas outside Tallinn. See "Business — Customers" for further details.

The Company is proposing to use the significant excess capacity at its Ülemiste water treatment plant and Paljassaare wastewater treatment plant to support the expansion of its water supply and wastewater services. However, if the additional areas into which the Company expands its operations do not lead to increased revenues for the Company, whether due to their limited size or otherwise, or if the Company is unable to expand into additional areas at all, the Company will not be able to meet its growth target.

The Company is unable to guarantee that there will be no potential pollution liability from the previous waste disposal site below Paljassaare.

The land upon which the Paljassaare wastewater treatment plant is built was used as a waste disposal site in the period from the 1960s until the late 1970s. After this period, the Paljassaare wastewater treatment plant, together with a number of additional buildings, were built on the land. Prior to the Company's acquisition of ownership of the land at Paljassaare as part of the Government's privatisation process, the Company commissioned two independent studies which it believes show that the residual pollution contained in the land, despite being in excess of certain prescribed limits, does not constitute a significant environmental threat and does not present any radiological risk to the area surrounding the wastewater treatment plant.

Notwithstanding the results of the studies commissioned by the Company, it is unable to determine with any certainty whether the pollution levels at the Paljassaare wastewater treatment plant are significant or whether the Company, as owner of the land, would be required to remedy the effects of any pollution or other environmental liability associated with its ownership of polluted land and/or pay damages for any environmental liability in the future. If it is determined in the future that the Company is liable for pollution levels at the site of its wastewater treatment plant and that it is required to remedy the effects of the pollution, there can be no assurance that the costs of undertaking the required remedial steps and/or the amounts of compensation payable would not be significant. Furthermore, although the Company believes that under Estonian law it is able to argue against any alleged liability of it and/or to seek redress against the party which owned or operated the landfill site prior to its transfer to the Company, and notwithstanding the fact that it is currently in the process of selling part of the surplus land at Paljassaare to mitigate further any potential liability, there can be no assurance that the Company would be successful in these arguments and/or in any action to recover any of the costs from, or transfer any of its potential liability to, that party. See "Business — Wastewater Services — Pollution and Quality Control" for further details.

Interruptions in the supply of electricity, or significant increases in the price of electricity, may adversely affect the Company's business.

The Company's operations require it to consume significant amounts of electricity and, as a result, the Company is one of the largest users of electricity in Tallinn. Although the Company uses back-up electricity generators in some parts of its operations, there can be no assurance that a continued interruption in its electricity supply will not have a material adverse effect on its ability to continue operating. Furthermore, in 2004, power constituted 13.4 per cent. of the Company's cost of goods sold – main operating activities. Increases in power costs will increase the Company's operating expenses, and, although the Company believes that it would be able to absorb relatively significant electricity price

increases, there can be no assurance that the effect of very significant price increases on the Company's business, financial condition and results of operations will not be material. Although these costs cannot be directly passed through to the Company's tariffs, the effect of electricity increases generally will be included as a part of the Consumer Price Index component of the annual tariff calculation. However, there can be no assurance that the Consumer Price Index adjustment to future tariff levels will protect the Company fully from a rise in its power costs. See "Business — Electricity Consumption".

The Company has relied and will likely continue to rely significantly on the services of key members of its management, and the departure of any of these persons could cause its operating results to suffer.

The Company must recruit and retain highly skilled employees with particular expertise for it to be able to develop, support and maintain its business. The implementation of the Company's business plan could be undermined by a failure to recruit or retain key personnel, the unexpected loss of key senior employees, failures in the Company's succession planning, or a failure to invest in the development of key skills. Additionally, unless skills are supported by a sufficient infrastructure to enable knowledge and skills to be passed on, the Company risks losing accumulated knowledge if key employees leave the Company.

In particular, there is a shortage of appropriately skilled personnel resident in Estonia. If the Company is unable to recruit a sufficient number of skilled employees for its water supply and wastewater operations from Estonia, it may be required to source its personnel from other countries. There can be no assurance that the costs involved in sourcing additional members of the Company's workforce from other countries will not be significant.

Additionally, the Company does not maintain any key-man life insurance policies for any of its top management personnel. The loss of the services of any member of the Company's senior management or the inability to hire and retain experienced management personnel could have a material adverse effect on the Company's business, financial condition and results of operations.

Possible conflicts of interest may arise between the Company and its controlling shareholders.

There is a risk that the respective interests of the City of Tallinn and UUTBV may differ from each other and may differ from the interests of the Company itself. While the Company believes that the relationship between itself and its shareholders, and between the shareholders, is good, were this to change in the future, there can be no assurance that the Company's business, its financial condition and results of operations would not be adversely affected.

In particular, although the Company has, since it was privatised in January 2001, worked successfully with each of the four main political parties (Union for the Republic – Res Publica, the Estonian Reform Party, the Estonian Centre Party and People's Union – Rahvaliid), representatives from which are likely to form part of the Tallinn City Government and/or the Tallinn City Council in the future, there can be no assurance that the Company will be able to maintain its successful relationship with the City of Tallinn in the future, or that its relationship with the City of Tallinn will not be adversely affected by any governmental instability in the future.

The Company has not effected notarial agreements for the transfer of pipes and facilities constructed by third parties.

The Company has entered into a number of agreements with private parties, such as real estate developers, for network extensions, which provide for the transfer of the constructed pipeline facilities to the Company free of charge or for nominal consideration upon completion. In accordance with Estonian law, agreements and preliminary agreements for transfer or encumbrance of buildings as movables (including technical infrastructure) are required to be in notarial form. The Company has not effected notarial agreements for the transfer of the pipes and facilities constructed by these developers, although the Company believes that the proportion of its total network falling within this category is small. The transaction costs for such transfers (in particular the applicable fees levied by the relevant notary and the state) are calculated on the basis of the value of the asset transferred (and not on the basis of the agreed transfer price). Therefore, the Company may not have an enforceable claim against the real estate developers for the transfer of network extensions free of charge or for the relevant nominal consideration. Furthermore, although on certain previous occasions the relevant notaries have agreed that their fees should be calculated on the basis of the agreed transfer price, there can be no assurance that the Company will not incur substantial costs in connection with the pipeline transfer transactions, in

particular if the fees described above are calculated on the basis of the value of the asset transferred, which may be significant.

The planned amendments to the Public Water Supply and Sewerage Act regarding the determination of the charge for connection to the public water supply and sewerage system and tariffs for water and wastewater services may have an adverse effect on the Company's financial position.

The Estonian Public Water Supply and Sewerage Act (*Ühisveevärgi ja – kanalisatsiooni seadus*, the “PWSSA”) regulates the supply of water from the public water supply and the collection and treatment of wastewater via the public sewerage system. It also provides for the corresponding rights and obligations of the State, local governments, water companies (such as the Company) and customers. However, draft legislation (referred to in this Offering Circular as the “draft PWSSA Amendment Act” (*Ühisveevärgi ja - kanalisatsiooni seaduse muutmise seaduse eelnõu*)), which is expected to come into effect by the end of 2005, proposes certain amendments to the determination of the connection charge and tariffs for water and wastewater services. Pursuant to the draft PWSSA Amendment Act, the connection charge to be applied in certain “older” residential areas (i.e., areas where more than 50 per cent. of the houses to be connected have been issued building permits before 22 March 1999) may no longer incorporate the development costs of the public water supply and sewerage system in the relevant areas. The draft PWSSA Amendment Act provides that the costs of development of the public water supply and sewerage system in these “older” residential areas should instead be recovered by their inclusion in the tariffs for water supply and wastewater services.

Furthermore, the draft PWSSA Amendment Act no longer provides for the right of the Company to include a justified profitability margin in the connection charge. Under the current regulation, the connection charge applied by the Company must guarantee the Company an element of justified profitability with regard to connection of customers to the public water supply and sewerage system.

Under the Service Agreement the Company is entitled to recover the costs of any changes of law through increases in tariffs. Despite these provisions, if the draft PWSSA Amendment Act is adopted and comes into effect, there can be no assurance that all the costs borne by the Company in connection with the development of the public water supply and sewerage system and connection of customers thereto will be met or that the Company is able to receive a justified profit therefrom. Therefore, the coming into effect of the draft PWSSA Amendment Act may have an adverse effect on the financial position of the Company. See “The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act” for further details.

Ownership of a plot of land at Mõigu Polder is being disputed and may be determined adversely for the Company.

An Estonian individual is claiming ownership of a plot of land at Mõigu Polder, which is currently owned by the State and is used by the Company as an integral part of its stormwater collection and drainage operations. If the claim is successful the Company would likely need to acquire a replacement plot of land to fulfil its stormwater collection and drainage obligations under the Services Agreement and Storm Water Agreement. The Company is unable to predict the likelihood of success of the claim or, if determined adversely for the Company, the impact of the claim on the Company, its financial condition or results of operations, which could be material. Although the Storm Water Agreement provides that the construction of the stormwater system is the obligation of the City of Tallinn and, therefore, the City of Tallinn is required to meet the costs of any investments required to be made to develop an alternative solution, should the claim be successful, there can be no assurance that the City of Tallinn will in fact do so. See “Business — Legal Proceedings” for further details.

Risks Related to the Shares

The City of Tallinn and UUTBV will control the majority of the Shares after completion of the Offering, and will be able to exercise control over the Company's business.

After giving effect to the Offering, and assuming exercise of the Over-allotment Option in full, the City of Tallinn will own 34.7 per cent. and UUTBV will own 35.3 per cent. of the Shares. The City of Tallinn and UUTBV will therefore remain the controlling shareholders of the Company after completion of the Offering. The Shareholders' Agreement provides that UUTBV shall have operational control over the Company, by requiring the City of Tallinn to vote in favour of nominees for membership of the Management Board which have been put forward by UUTBV. In addition, pursuant to the Shareholders' Agreement, the City of Tallinn has the right to have three members, and UUTBV has the right to have

four members, in the Supervisory Council. In addition, the City of Tallinn holds the B-Share in the Company, which gives it the right to veto certain significant corporate actions proposed by the Company. See “Principal and Selling Shareholders — Shareholders’ Agreement” and “Description of Capital Stock and Corporate Governance – Shares and Share Capital – Classes of Shares”.

After completion of the Offering, the City of Tallinn and UUTBV will therefore continue to exert significant influence over the policies and management and affairs of the Company and will be able to control the outcome of almost all corporate actions. The respective interests of the City of Tallinn and UUTBV may differ from those of the Company’s other shareholders, and they could vote their Shares in a manner that may be contrary to the interests of other shareholders.

No active public market has existed for the Shares prior to the Offering, and there can be no assurance that an active market will develop for the Shares.

The Shares have not previously been publicly traded. Application has been made to the Tallinn Stock Exchange for the Shares to be admitted to trading on the Tallinn Stock Exchange’s market for listed securities. However, the Company cannot provide any assurance that an active trading market for the Shares will emerge, develop or be sustained after completion of the Offering.

The Tallinn Stock Exchange’s aggregate market capitalisation was approximately EEK98.0 billion (€6.3 billion) as at 20 May 2005. The Tallinn Stock Exchange had an average daily trading turnover amounting to approximately EEK43.1 million (€2.8 million) for the period from 1 January 2004 to 31 December 2004. The average daily trading turnover on the Tallinn Stock Exchange from 1 January 2005 to 20 May 2005 was EEK278.8 million (€17.8 million). A total of 13 companies were listed on the Tallinn Stock Exchange as at 20 May 2005. The two largest companies in terms of market capitalisation (being AS Hansapank and AS Eesti Telekom) represented, as at 20 May 2005, approximately 89.0 per cent. of the Tallinn Stock Exchange’s aggregate market capitalisation as at that date, of which AS Hansapank alone constituted 71.0 per cent. of the total. Consequently, the Estonian securities market in general, and the Tallinn Stock Exchange in particular, is substantially less liquid and more volatile than established markets such as those in other countries with highly developed securities markets. The relatively small market capitalisation and low liquidity of the Tallinn Stock Exchange may impair the ability of shareholders to sell the Shares on the Tallinn Stock Exchange, which could increase the volatility of the price of the Shares. In addition, in connection with its recent acquisition by ForeningsSparbanken AB (“Swedbank”), AS Hansapank has announced that it will seek to delist from the Tallinn Stock Exchange. Such a delisting (or the delisting of any of the other large companies listed on the Tallinn Stock Exchange) would be likely to have a negative effect on the market capitalisation and liquidity of the Tallinn Stock Exchange.

Actual or anticipated sales of a substantial number of Shares could decrease the market price of the Shares.

Sales of a substantial number of Shares, or the perception that such sales may occur, could decrease the trading price of the Shares. After giving effect to the Offering, and assuming exercise of the Over-allotment Option in full, the City of Tallinn will own 34.7 per cent. and UUTBV will own 35.3 per cent. of the Shares. Although UUTBV and the City of Tallinn have agreed to certain restrictions regarding the sales of Shares, these restrictions are subject to certain exceptions and may be removed or otherwise amended by agreement of the parties. See “Description of Capital Stock and Corporate Governance — Restrictions on Transfer of Shares” for further details. As a consequence of sales by the City of Tallinn or UUTBV, or perceptions that sales of Shares by any of those significant shareholders may occur, the market price of the Shares may decrease significantly. As a result, the liquidity of the Shares may be adversely affected and a holder of Shares may not be able to sell its Shares at or above the price paid for them.

USE OF PROCEEDS

The aggregate net proceeds from the sale of Offer Shares in the Offering, after deduction of the Success Fee payable by the Selling Shareholders of €1,942,500 (representing 3.50 per cent. of the total gross proceeds from the sale of the Offer Shares) and assuming exercise of the Over-allotment Option in full, will be approximately €53,557,500 and will be payable to the Selling Shareholders (Estonian Kroon amounts having been converted for the purposes of the foregoing at EEK15.6466 = €1.00). The Company will not receive any of the proceeds from the sale of the Offer Shares by the Selling Shareholders. The Company has, however, agreed to pay certain expenses incurred in connection with the Offering, amounting in aggregate to an estimated €1.5 million (including applicable taxes).

DIVIDENDS AND DIVIDEND POLICY

The Company's general meeting of shareholders has the power to determine whether the Company will pay a dividend on its Shares on the terms and conditions set out in the profit distribution proposal presented to the Company's general meeting of shareholders by the Management Board. The Supervisory Council has the right to make changes to the Management Board's profit distribution proposal before its presentation to the Company's general meeting of shareholders.

Dividends may only be paid out of retained earnings that have not been appropriated to statutory reserves (which must be equal to 10 per cent. of the Company's nominal share capital), provided that the net assets of the Company, determined as disclosed by the Company's annual report approved at the end of the previous financial year, amount at least to the total of share capital and reserves. Dividends are paid in cash or, with the consent of the shareholder, in other property. The amount and procedure for payment of dividends is decided by the shareholders once a year on the basis of the annual report, as set out in the Articles of Association. Although the general meeting of shareholders may decide on the payment of a dividend in several parts, payouts in past years have been in the form of a single annual payment, except that the dividend for 2004 was paid in two parts (in March and April 2005).

The table below sets forth certain information regarding the dividends declared in respect of the A-Shares for each of the years indicated. The dividends for each of the years below were paid in the immediately following year.

Year ended 31 December	Dividends per Share		Total dividends paid on Shares	
	<i>(EEK)</i>	<i>(€)⁽¹⁾</i>	<i>(EEK millions)</i>	<i>(€ millions)⁽¹⁾</i>
2002 ⁽²⁾	2.25	0.14	45.0	2.9
2003.....	3.75	0.24	75.0	4.8
2004.....	5.60	0.36	112.0	7.2

Notes:

- (1) The financial data for each year has been translated for convenience only at the rate of EEK15.65 = €1.00.
- (2) Dividends per Share is calculated by dividing the dividends paid by the number of A-Shares outstanding at the end of the year. If the weighted average number of A-Shares outstanding throughout the year were to be used as the basis for the calculation of dividends per Share for that year, dividends per Share for 2003 and 2004 would be unchanged, whereas dividends per Share for 2002 would instead be EEK0.54 (€0.03), reflecting the reduction in the Company's share capital in September 2002 from 115,000,000 to 20,000,000 Shares.

The Company's policy regarding its dividend distributions has been to pay to its shareholders all cash available to be so distributed, after analysing its budgetary requirements for the forthcoming financial year and after ensuring that it maintains a cash float at a level which it determines is prudent for its activities during the forthcoming year (the Company has to date maintained a free cash float of not less than EEK20 million). In making dividend distributions, the Company is also required to ensure continued compliance with the relevant provisions of the EBRD Loan Agreement, which permits the payment of dividends and other distributions of the Company's share capital only if no event of default or potential event of default has occurred and the Company is in compliance with the financial covenants set out in the EBRD Loan Agreement. The Company has met or exceeded these financial covenants, and has otherwise been in material compliance with, the EBRD Loan Agreement since its execution. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Debt Financing" for further details.

Dividends paid by the Company in respect of 2002, 2003 and 2004 represented 26.5 per cent., 62.6 per cent. and 56.2 per cent., respectively, of the Company's profit before taxes. The Company currently expects that its dividend policy to be applied in the future will be substantially consistent with the policy described above, and subject to the same conditions.

The Offer Shares will be eligible for dividends or other distributions, if any, declared in respect of the financial year ending 31 December 2005 and subsequent periods. In relation to listed companies, dividends are paid to those shareholders who have been entered on the list of shareholders as finalised in accordance with the TSE Rules. The TSE Rules provide that a listed company is required to disclose details about finalising the list of shareholders at least nine trading days before the date of finalising the list. If a Company's general meeting of shareholders adopts a resolution that relates to rights attached to

the shares (for example, the declaration of payment of dividends), the list of shareholders may not be finalised at an earlier date than 10 trading days after the date of the relevant general meeting of shareholders. The Estonian Income Tax Act (*Tulumaksuseadus*) provides that the accrued profit of a legal entity resident in Estonia, such as the Company, is not subject to tax, but that an equivalent tax is charged only on dividend distributions. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Factors Affecting the Company’s Results of Operations — Estonian corporate tax regime” and Note 26 to the Audited Financial Statements included elsewhere in this Offering Circular for further details.

See “Estonian Taxation” for a summary of certain Estonian tax consequences of any future dividend distributions to holders of the Shares.

SELECTED FINANCIAL AND OPERATING DATA

The selected financial information set forth below should be read in conjunction with, and is qualified in its entirety by reference to, the Financial Statements (including the notes thereto which provide further breakdowns in respect of certain of the information set forth below) which appear elsewhere in this Offering Circular. The Audited Financial Statements have been audited by Deloitte. The Unaudited Financial Statements are unaudited. In the Company's opinion, the Unaudited Financial Statements include all adjustments, consisting only of normal recurring adjustments, which it considers necessary for a fair presentation of its financial position and the results of its operations for such periods. The Company's results for the three months ended 31 March 2005 are not necessarily indicative of the results for the financial year ending 31 December 2005 or for any other period.

	For the year ended 31 December				For the three months ended 31 March		
	2002	2003	2004	2004 ⁽¹⁾	2004	2005	2005 ⁽¹⁾
		<i>(EEK)</i>		<i>(€)</i>	<i>(EEK)</i>		<i>(€)</i>
	<i>(thousands, except earnings per Share data)</i>						
	(Audited)				(Unaudited)		
Income Statement Data							
Sales from main operating activities.....	432,947	434,794	478,814	30,595	119,674	139,350	8,904
Revenues from other operating activities	79,577	69,223	69,715	4,455	30,122	17,277	1,104
Net sales	<u>512,524</u>	<u>504,017</u>	<u>548,529</u>	<u>35,050</u>	<u>149,796</u>	<u>156,627</u>	<u>10,008</u>
Cost of goods sold – main operating activities	(202,219)	(193,157)	(195,486)	(12,491)	(49,081)	(49,250)	(3,147)
Cost of goods sold – other operating activities.....	(69,963)	(61,608)	(64,410)	(4,116)	(26,700)	(15,449)	(987)
Gross profit	<u>240,342</u>	<u>249,252</u>	<u>288,633</u>	<u>18,443</u>	<u>74,015</u>	<u>91,928</u>	<u>5,874</u>
Marketing expenses	(6,602)	(6,342)	(6,134)	(392)	(1,631)	(1,666)	(107)
General administration expenses.....	(42,143)	(56,440)	(40,739)	(2,603)	(10,640)	(11,335)	(724)
Other income/(expenses)	(16,701)	(16,635)	13,158	841	10,430	12,184	779
Operating profit	<u>174,896</u>	<u>169,835</u>	<u>254,918</u>	<u>16,289</u>	<u>72,174</u>	<u>91,111</u>	<u>5,822</u>
Financial income/(expenses)...	(5,344)	(50,013)	(55,680)	(3,558)	(13,589)	(12,985)	(830)
Profit before tax	<u>169,552</u>	<u>119,822</u>	<u>199,238</u>	<u>12,731</u>	<u>58,585</u>	<u>78,126</u>	<u>4,992</u>
Income tax on dividends	(23,359)	(15,281)	(26,277)	(1,679)	0	(35,368)	2,260
Net profit	<u><u>146,193</u></u>	<u><u>104,541</u></u>	<u><u>172,961</u></u>	<u><u>11,052</u></u>	<u><u>58,585</u></u>	<u><u>42,758</u></u>	<u><u>2,732</u></u>
Earnings per Share in Estonian kroons ⁽²⁾	7.31	5.23	8.65	0.55	2.93	2.14	0.14

Notes:

- (1) The financial data for 2004 and the three months ended 31 March 2005 has been translated for convenience only at the rate of EEK15.65 = €1.00.
- (2) Earnings per Share is calculated as net profit (less the preference dividend payable in respect of the B-Share) divided by the number of A-Shares outstanding at the end of the year. If the weighted average number of A-Shares outstanding throughout the year were to be used as the basis for the calculation of earnings per Share for that year, earnings per Share for 2003 and 2004 would be unchanged, whereas earnings per Share for 2002 would instead be EEK1.75, reflecting the reduction in the Company's share capital in September 2002 from 115,000,000 to 20,000,000 Shares.

	As at 31 December				As at 31 March		
	2002	2003	2004	2004 ⁽¹⁾	2004	2005	2005 ⁽¹⁾
	(EEK)		(€)		(EEK)		(€)
	(Audited)				(Unaudited)		
Balance Sheet Data							
Current assets	295,477	153,045	161,483	10,318	187,674	238,486	15,239
Non-current assets	1,972,325	2,011,188	2,063,182	131,833	1,986,950	2,078,407	132,805
Total assets.....	2,267,802	2,164,233	2,224,665	142,151	2,174,624	2,316,893	148,044
Current liabilities	296,771	164,558	184,598	11,795	117,952	346,059	22,112
Non-current liabilities.....	1,129,443	1,098,546	1,040,977	66,516	1,096,958	1,040,986	66,517
Total liabilities	1,426,214	1,263,104	1,225,575	78,311	1,214,910	1,387,045	88,629
Total equity capital	841,588	901,129	999,090	63,840	959,714	929,848	59,415
Total liabilities and equity capital	2,267,802	2,164,233	2,224,665	142,151	2,174,624	2,316,893	148,044

Note:

- (1) The financial data as at 31 December 2004 and 31 March 2005 has been translated for convenience only at the rate of EEK15.65 = €1.00.

	As at and for the year ended 31 December				As at and for the three months ended 31 March		
	2002	2003	2004	2004 ⁽¹⁾	2004	2005	2005 ⁽¹⁾
	(EEK)		(€)		(EEK)		(€)
	(Audited)				(Unaudited)		
Cash Flow							
Total cash flow from operating activities.....	177,345	105,639	167,829	10,724	68,674	65,157	4,163
Total cash flow from investing activities.....	(112,996)	41,695	(59,365)	(3,793)	(7,864)	10,292	658
Total cash flow from financing activities.....	(204,226)	(251,392)	(91,617)	(5,854)	(19,833)	(28,253)	(1,805)
EBITDA ⁽²⁾	244,281	243,293	332,655	21,256	91,720	110,631	7,069
Capital expenditure ⁽³⁾	107,508	114,066	104,254	6,662	16,828	43,247	2,763

Notes:

- (1) The financial data as at and for the year ended 31 December 2004 and as at and for the three months ended 31 March 2005 has been translated for convenience only at the rate of EEK15.65 = €1.00.
- (2) EBITDA (earnings before interest, taxes, depreciation and amortisation) is included in this Offering Circular because such data is used by certain investors to measure a company's financial performance, ability to service debt and fund capital expenditure. It is included herein for convenience only. The Company calculates EBITDA by adding depreciation and amortisation to its operating profit, in each case determined in accordance with IFRS. EBITDA is not a measure of financial performance under IFRS and should not be considered in isolation or as a substitute for net income as a measure of operating performance, or as an alternative to cash flows as a measure of liquidity. Additionally, the Company's calculation of EBITDA may be different than the calculation used by other companies, and therefore any comparability may be affected.
- (3) Reflects total capital expenditure during the year, less expenditure incurred by the Company on its network extensions programme on behalf of the City of Tallinn, individual connectees and developers. See Note 11 to the Audited Financial Statements included elsewhere in this Offering Circular.

As at and for the year ended 31 December

	2002	2003	2004
	(Audited)		
Other Operating Data			
Operating margin ⁽¹⁾	34.1	33.7	46.5
Net profit margin ⁽²⁾	28.5	20.7	31.5
Return on equity ⁽³⁾	11.2	12.0	18.2
Return on assets ⁽⁴⁾	6.3	4.7	7.9
Debt to equity ratio ⁽⁵⁾	1.7	1.4	1.2
Current ratio ⁽⁶⁾	1.0	0.9	0.9
Number of employees ⁽⁷⁾	370	348	351

Notes:

- (1) Operating profit as a percentage of net sales.
- (2) Net profit as a percentage of net sales.
- (3) Net profit as a percentage of average total equity capital.
- (4) Net profit as a percentage of average total assets.
- (5) Total liabilities divided by total equity capital.
- (6) Total current assets divided by total current liabilities.
- (7) At year end.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read together with the Financial Statements included elsewhere in this Offering Circular. Certain statements in this section are "forward-looking" statements and should be read together with the information contained in the section headed "Forward-Looking Statements". The Company prepares its Financial Statements in accordance with IFRS.

Overview

The Company is the exclusive supplier of drinking water and sewerage services in the main Services Area in Tallinn. It also provides drinking water and sewerage services in a number of other smaller services areas in Tallinn and certain of its neighbouring municipalities.

In 2004, the Company distributed water to over 400,000 people, representing over 99 per cent. of the population of Tallinn, through 884 kilometres of water pipes and mains to 19,469 customer connections as at 31 December 2004. Over the same period, the Company provided sewerage services to approximately 97 per cent. of the population of Tallinn, through 1,045 kilometres of sewerage and stormwater pipes and mains from 14,736 customer connections as at 31 December 2004.

The City of Tallinn has granted the Company the exclusive right to provide water supply services (including the operation and maintenance of raw water extraction facilities and water treatment and distribution) and wastewater collection, treatment and disposal services (including stormwater drainage on behalf of the City of Tallinn) and to undertake certain other related activities within the Services Area for a 15-year period from November 2000. This right was granted to the Company by the decision of the Tallinn City Council, dated 30 November 2000. The terms and conditions of the provision of services are specified in the Services Agreement executed by the City of Tallinn and the Company in January 2001. See "Business — Key Operating Agreements — The Services Agreement" for further details.

In 2004, the Company had net sales of EEK548.5 million, approximately 40.2 per cent. of which was generated by its water supply services and approximately 37.3 per cent. of which was generated by its wastewater collection and disposal services. The remainder of the Company's net sales in 2004 was generated primarily by the Company's water, sewerage and stormwater connections construction services and its stormwater treatment and disposal services undertaken on behalf of the City of Tallinn.

All of the Company's sales are derived from, and all of its assets are located in, Estonia, save for certain limited non-recurring revenues relating to consultancy services provided by the Company in respect of a water company in Tajikistan. Upon completion of these consultancy services, the Company expects that its sales will continue to be derived solely from Estonia for the foreseeable future.

Factors Affecting the Company's Results of Operations

Effects of changes in tariffs

The Company's results of operations are highly dependent upon its ability to charge appropriate tariffs for its water supply and wastewater services, and upon its ability to adjust the levels of its tariffs in certain circumstances specified in the Services Agreement. The Company's charges levied on its customers are based solely on volumes of water supplied to and sewage collected from the customer's premises. A standing, fixed charge may, under applicable laws and the terms of the Services Agreement, be levied on customers, although the Company does not currently do so.

Tariffs are applicable for a calendar year and are generally adjusted annually. Separate tariffs are payable by the Company's customers for each of its water and sewerage services. The Company's commercial customers are charged higher tariffs for the Company's water and sewerage services than are payable by its residential customers.

The following table sets out details of the Company's tariffs applicable to its residential and commercial customers located in the Services Area for each of the years ended 31 December 2002, 2003 and 2004, as well as the tariffs currently applicable during 2005:

	Year ended/ending 31 December			
	2002	2003	2004	2005
	<i>(EEK per cubic metre, including VAT)</i>			
TARIFFS				
Residential tariff				
Water.....	8.85	8.85	10.08	11.67
Sewerage.....	7.15	7.15	8.15	9.44
Total	16.00	16.00	18.23	21.11
Commercial tariff				
Water.....	21.48	21.48	24.44	28.28
Sewerage ⁽¹⁾	15.93	15.93	18.12	20.98
Total	37.41	37.41	42.56	49.26

Note:

(1) Commercial tariffs for sewerage reflect the common minimum applicable rate, rate SG2. Other commercial tariffs apply for sewerage which are dependent on levels of pollution in the wastewater.

The following table sets out information regarding volumes of water and sewerage services invoiced by the Company, by type of customer, for the years ended 31 December 2002, 2003 and 2004 and for the three months ended 31 March 2004 and 2005:

	Year ended 31 December			Three months ended 31 March	
	2002	2003	2004	2004	2005
	<i>(cubic metres, millions)</i>			<i>(cubic metres, millions)</i>	
VOLUMES					
Water supply					
Residential.....	15.5	15.5	14.7	3.6	3.6
Commercial.....	4.8	4.7	4.7	1.2	1.2
Total	20.3	20.2	19.4	4.8	4.8
Wastewater					
Residential.....	14.9	15.0	14.5	3.6	3.5
Commercial.....	6.5	6.5	6.7	1.6	1.6
Total	21.4	21.5	21.2	5.2	5.1

The Services Agreement provides that the Company's tariffs may be adjusted in the following circumstances:

- to reflect changes in the Consumer Price Index as published by the Statistical Office of Estonia;
- by reference to a variable (the "K coefficient") agreed between the Company and the City of Tallinn for each year. The K coefficient reflects changes in necessary expenses to be made by the Company to achieve its Levels of Service;
- to take into account the consequences of certain events that qualify as a change of law affecting the Company's operations and its ability to comply with its obligations under the Services Agreement;
- where changes to the Services Agreement are required following the occurrence of one or more *force majeure* events;
- to take into account an increase or decrease in the cost of raw water abstraction; and
- to take into account any amendments to the contractual arrangements set out in the Services Agreement which have been proposed by either the City of Tallinn or the Company itself. See "Business — Key Operating Agreements — The Services Agreement".

Since its privatisation in January 2001, the Company has received tariff rate adjustments under the terms of the Services Agreement (as originally executed and as amended in the 2002 Amendment Agreement). However, the actual tariffs levied by the Company in 2003 did not change from the tariffs applicable in

2002. The Company agreed to maintain its 2003 tariffs at 2002 levels in return for the City of Tallinn's agreement in advance of the amount of the K coefficient for each of the years from 2004 to 2010 (inclusive). The K coefficient agreed for the period of 2005 – 2010 is as follows: +10 per cent. in 2005, +6.5 per cent. in each of 2006, 2007 and 2008 and +2.0 per cent. in each of 2009 and 2010.

The Company believes that the circumstances in which its tariffs may be adjusted pursuant to the Services Agreement cover all material prospective events which may increase its costs of operations in the future, such as changes in applicable law or regulation. However, there can be no assurance that this will be the case. See “Risk Factors — Risks Related to the Estonian Water Industry and Regulation — The City of Tallinn may not authorise in a timely manner or at all increases in customer tariffs under the Services Agreement”.

Revenues from network extensions

The Company is required by the Services Agreement to undertake a capital works programme that includes extending the water, sewer and stormwater networks to districts of Tallinn not already connected to the network. Completion of the network extension programme depends on the amount of investment allocated by the City of Tallinn to the extension of the network. The 2002 Amendment Agreement provided that the extent of network extensions to be carried out by the Company in each year, pursuant to the Services Agreement and any additional programmes agreed with the City of Tallinn and the Tallinn public water supply and sewerage system development plan, was to be dependent on the availability of funds to the City of Tallinn from its annual budget. The City of Tallinn was required annually to approve the scope of network extensions by the Company. The parties were required jointly to monitor the network extensions made by the Company during the year and the City of Tallinn was required to ensure that relevant allocations were made in its budget for each subsequent year for the reimbursement of the Company for the network extension costs to be incurred by it in the next financial year.

As a result of the arrangements described above, the Company has since 2002 only undertaken the relevant construction activities necessary to extend the network to the extent that the City of Tallinn has allocated in its annual budget sufficient funds to meet the Company's connection charges (comprising its full construction cost including overheads, financing costs and applicable VAT). The costs of construction on behalf of the City of Tallinn are included in the Company's balance sheet as “Unfinished pipelines – new connections” until the relevant construction project has been completed in full and the City of Tallinn has confirmed its agreement as to the level of compensation payable (based on a schedule of works completed and related payments prepared by the Company on a periodic basis). Upon completion of construction and confirmation of compensation as described above, the costs of construction are expensed to the Company's income statement under “cost of goods sold — other operating activities”.

As a result of the construction and compensation schedules, income received by the Company in any year may relate to construction activities carried out by it in preceding years. In addition, although the Company's net sales during the periods under review reflect the gross amounts received from the City of Tallinn in respect of these activities, the Company's gross profit during the periods under review reflects only the margin made by the Company in respect of these activities in each particular year. See “Business — Expansion of Networks”.

In the 2005 Amendment Agreement, the City of Tallinn, the Company and UUTBV agreed a new network extension programme, based on the principles agreed in the 2002 Amendment Agreement. In the 2005 Amendment Agreement, the parties also agreed upon new principles of reimbursement by the City of Tallinn for the network extension costs incurred by the Company. According to the new principles agreed between the parties, where the Company's network extension charges are eligible for compensation by the City of Tallinn (as described in “The Estonian Water Industry and Regulation — Economic Regulation — Connection Charge — Compensation for Connection Charges”), the compensation is to be paid in the following manner, whereby the amount of the connection charge paid by the City of Tallinn depends on the date by which connection to the network occurs:

- if a customer connects to the relevant network extension within 12 months after the date on which the permit for use was issued in respect of the extension or a part thereof, the City of Tallinn is required to pay 100 per cent. of the relevant connection charge to the Company on behalf of the connecting customer; and
- after 12 months from the date on which the permit for use was issued in respect of the extension or a part thereof, the City of Tallinn is required to pay the Company an amount equal to 80 per cent. of

the amount of the connection charges relating to the properties the owners of which have been given the opportunity to connect to the network, but have not yet done so.

If a customer connects to the relevant network extension after 12 months after the date on which the permit for use was issued in respect of the extension or a part thereof, the relevant customer must itself pay the remaining 20 per cent. of the connection charge to the Company directly. The compensation levels agreed between the Company and the City of Tallinn for the years 2005-2011 average approximately EEK55 million per year (the exact amount per year being subject to the City of Tallinn's allocation in its annual budget for the relevant years of sufficient funds therefor).

For those properties constructed which are not eligible for compensation from the City of Tallinn (i.e., all residential buildings constructed on the basis of building permits issued after 16 June 1995 and all commercial buildings), the connecting customers pay 100 per cent. of their connection charges directly to the Company.

Stormwater extensions are reimbursed by the City of Tallinn in the year after the completion of the agreed construction works has been proved and documented. This process is carried out once a year in the manner prescribed by the 2005 Amendment Agreement.

The Company and the City of Tallinn have, pursuant to the EU Funds Agreement, agreed that it is in the common interest of both parties to benefit, where possible, from the involvement of EU funds in the development of the public water and sewerage system located in the Services Area. One area of activity which has already been identified as potentially being able to benefit is the network extension programme. If the City of Tallinn is able to benefit from the availability of funds from the European Union to conduct all or part of the network extension programme, the Company would to that extent no longer be required to finance the network extensions on behalf of the City of Tallinn. In this case, the Company's revenues from other operating activities and costs of goods sold – other operating activities would decrease accordingly. In addition, as the value of the unfinished network which is currently under construction on behalf of the City of Tallinn is included in the balance sheet as "Unfinished pipelines — new connections", in the future the Company's total non-current assets would also be reduced accordingly if funding for the network extensions programme was to be made available by the European Union. However, the Company believes that if this was to be the case, any such change in funding structure would have an overall beneficial effect on the Company by reducing its working capital requirements.

In addition to the construction activities which the Company undertakes on behalf of the City of Tallinn as described above, the Company also provides construction and technical advisory services to individual customers and developers wishing to connect to the Company's water distribution network and sewage collection network. Individual connectees pay the full construction cost (including costs of supervision and overheads), as compared to developers who only pay an agreed fee to the Company for the provision of technical expertise and administration costs (the developer pays the contractor directly for all construction costs). As the Company is not required to undertake the project management or financing of these connections in the same manner as it does so on behalf of the City of Tallinn or individual connectees, revenues from developers are generally recognised when construction is complete and the asset is transferred to the Company for nominal consideration.

Estonian corporate tax regime

The Company's results of operations are affected by the tax regime applicable in Estonia, and in particular by the corporate income tax regime applicable to Estonian companies. The Estonian Income Tax Act (*tulumaksuseadus*) provides that the accrued profit of a legal entity resident in Estonia, such as the Company, is not subject to tax, but that an equivalent tax, payable by the Company, is charged on dividend distributions or other profit distributions and other payments considered as not related to the business of the legal entity by law.

In particular, pursuant to the Income Tax Act, corporate income tax is charged on:

- dividends;
- expenses and payments not related to the business of the Company;
- fringe benefits granted to employees;
- advances to natural persons related to the Company, exceeding 50 per cent. of the expenses of the Company which are subject to Estonian social tax;

- costs of entertaining, catering, accommodation and transportation of guests of the Company, which exceed two per cent. of the expenses of the Company which are subject to Estonian social tax; and
- gifts and donations.

The rate of income tax is 24 per cent., although the taxable amount for these purposes is deemed to be the amount of the dividend or profit distribution or other applicable payment made, grossed-up at 24 per cent. (i.e. divided by 0.76), meaning that the effective rate is in fact 24/76 (i.e., approximately 31.6 per cent.). The relevant amount of income tax due is required to be paid by the tenth day of the month following the month in which the payment was made. Estonian taxation regulations provide that this currently applicable rate of income tax will be reduced to 22 per cent. (22/78) on 1 January 2006 and to 20 per cent. (20/80) on 1 January 2007.

The statements relating to the Estonian corporate tax regime set out above are based upon the laws and regulations in effect as at the date of this Offering Circular. There can be no assurance that there will be no changes to the applicable regime in the future, which changes may have retroactive effect. In particular, the new coalition Government has granted its approval to a draft act amending the Income Tax Act that proposes that the applicable rate of income tax will instead be 23 per cent. (23/77) with effect from 1 January 2006, 22 per cent. (22/78) with effect from 1 January 2007, 21 per cent. (21/79) with effect from 1 January 2008 and 20 per cent. (20/80) with effect from 1 January 2009.

The potential tax liability that the Company might incur if it were to pay out as dividends all distributable retained earnings is not required to be provided for in the Company's financial statements as a liability for deferred tax (income tax liability on dividends is recognised on the date of declaration of the relevant dividend distribution). To the extent that the Company were to pay an amount of dividends equal to the full amount of its distributable retained earnings, the Company may, subsequent to making this payment, have limited available funds and may therefore be unable to meet its liability to income tax in respect of that payment.

See Note 26 to the Audited Financial Statements included elsewhere in this Offering Circular for further details.

Changes in pollution taxes

The Company's results of operations during the periods under review have been, and can be expected to continue to be, affected by changes in environmental taxes. The rate of pollution tax has risen by 20 per cent. per annum during the periods under review and the Company believes that this upward trend will continue. Other environmental tax rates have also been increasing in recent years. In particular, the fee for the special use of water relating to ground water has increased by approximately 10 per cent. per annum over the last three years and the fee for the special use of water relating to surface water increased by 3 per cent. in 2005. The Company believes that further increases in these and other tax rates will continue.

Results of Operations for the Three Months ended 31 March 2004 and 2005

Net sales

The substantial majority of the Company's net sales is attributable to sales from its main operating activities. Sales from the Company's main operating activities comprise primarily recurring revenues from the Company's (i) water treatment and supply service, (ii) wastewater collection, treatment and disposal service and (iii) stormwater collection, treatment and disposal service on behalf of the City of Tallinn. The remainder of the Company's net sales are attributable to its revenues from other operating activities, which comprise its water, sewerage and stormwater connections construction income on behalf of the City of Tallinn and other customers such as individual connectees (residential and commercial) and developers (residential and commercial) wishing to connect to the network. See "— Factors Affecting the Company's Results of Operations — Revenues from network extensions" for further details regarding the Company's connections construction income.

All net sales data set out below excludes applicable VAT (tariff rates included elsewhere in this Offering Circular are stated inclusive of VAT).

The following table provides information regarding the Company's net sales by operating activity, as well as the contribution of these activities as a percentage of net sales, for each of the three month periods ended 31 March 2004 and 2005:

	Three months ended 31 March			
	2004		2005	
	<i>(EEK millions)</i>	<i>(per cent.)</i>	<i>(EEK millions)</i>	<i>(per cent.)</i>
NET SALES				
Sales from main operating activities				
Water supply service.....	56.0	37.4	68.5	43.8
Wastewater disposal service	50.7	33.8	57.6	36.8
Stormwater treatment and disposal service	11.2	7.5	11.6	7.4
Fire hydrants service.....	0.5	0.3	0.5	0.3
Other work and services	1.3	0.9	1.1	0.7
Total sales from main operating activities	119.7	79.9	139.3	89.0
Revenues from other operating activities				
Water, sewerage and stormwater connections construction income	30.1	20.1	17.3	11.0
Total net sales.....	149.8	100.0	156.6	100.0

Sales from main operating activities

Sales from the Company's main operating activities increased by EEK19.7 million, or 16.4 per cent., from EEK119.7 million for the three months ended 31 March 2004 to EEK139.4 million for the three months ended 31 March 2005. This increase was almost entirely attributable to (i) an increase of EEK12.5 million in water supply service, from EEK56.0 million for the three months ended 31 March 2004 to EEK68.5 million for the three months ended 31 March 2005 and (ii) an increase of EEK6.9 million in wastewater disposal service, from EEK50.7 million for the three months ended 31 March 2004 to EEK57.6 million for the three months ended 31 March 2005.

The increase in sales attributable to the Company's water supply service was due primarily to increases in water tariffs for both the Company's residential and commercial customers. Residential water tariffs rose during the period from EEK10.08 per cubic metre to EEK11.67 per cubic metre and commercial water tariffs also rose, from EEK24.44 per cubic metre to EEK28.28 per cubic metre. Sales attributable to the Company's water supply service during the three months ended 31 March 2005 also increased as a result of the billing of a commercial customer for un-invoiced water from prior periods (amounting in aggregate to EEK0.9 million) and a slight increase in volumes when compared to the corresponding period in 2004. In addition, although actual volumes invoiced in the periods under review were broadly flat, as a result of the normal operation of the Company's billing cycle, a substantial number of the Company's customers were not invoiced during the three months ended 31 March 2005 for volumes consumed during that period. Net sales attributable to the Company's water supply service are therefore based on actual volumes invoiced for the period, of approximately 4.8 million cubic meters, and the Company's estimation of the volumes consumed but not invoiced during the period (the latter amounting to approximately 0.14 million cubic meters). In respect of these additional estimated volumes, an accrual for receivables and additional net sales of EEK 1.4 million was recorded as at 31 March 2005. An equivalent determination of volumes which had been consumed but not invoiced was not deemed necessary for the three months ended 31 March 2004 as a result of the different operation of the Company's billing cycle during that period.

The increase in sales attributable to the Company's wastewater disposal service was entirely attributable to increases in sewerage tariffs for both the Company's residential and commercial customers. Residential sewerage tariffs rose during the period from EEK8.15 per cubic metre to EEK9.44 per cubic metre and commercial sewerage tariffs also rose during the period, with rate SG2, the common minimum applicable rate, increasing from EEK18.12 per cubic metre to EEK20.98 per cubic metre.

Revenues from other operating activities

Revenues from other operating activities decreased by EEK12.8 million, or 42.6 per cent., from EEK30.1 million for the three months ended 31 March 2004 to EEK17.3 million for the three months ended 31 March 2005. This decline was due entirely to a reduction in confirmed payments from the City of Tallinn for connections from network extensions and a reduction in connections income from new customers. Revenues from the City of Tallinn are only recognised in the income statement when a project

is completed and compensation is confirmed, whereas revenues from individual connectees and developers are generally recognised when construction is complete. See “— Factors Affecting the Company’s Results of Operations — Revenues from network extensions” for further details.

Costs of goods sold

The substantial majority of the Company’s costs of goods sold is attributable to costs of goods sold from its main operating activities. Costs of goods sold from the Company’s main operating activities comprise primarily recurring costs relating to the Company’s water supply service, wastewater collection, treatment and disposal service and stormwater collection, treatment and disposal service on behalf of the City of Tallinn. The principal recurring costs are depreciation and amortisation, staff costs (salaries, wages and other employee benefits) and charges for electricity used in the Company’s operations, chemical costs, tax on special use of water and pollution tax. Other costs of goods sold relates to the direct production costs of the business and mainly comprises transport and asset maintenance costs.

The remainder of the Company’s costs of goods sold is attributable to its costs of goods sold – other operating activities, which comprise its water, sewerage and stormwater connections construction costs on behalf of the City of Tallinn and other customers such as individuals and developers wishing to connect to the network. See “— Factors Affecting the Company’s Results of Operations — Revenues from network extensions” for further details regarding the Company’s connections construction costs.

The following table provides information regarding the Company’s costs of goods sold by category, as well as their respective percentages of the Company’s total costs of goods sold, for each of the three month periods ended 31 March 2004 and 2005:

	Three months ended 31 March			
	2004		2005	
	<i>(EEK millions)</i>	<i>(per cent.)</i>	<i>(EEK millions)</i>	<i>(per cent.)</i>
COSTS OF GOODS SOLD				
Costs of goods sold – main operating activities				
Depreciation and amortisation.....	18.4	24.2	18.3	28.3
Staff costs.....	11.9	15.7	10.5	16.2
Electricity	6.3	8.3	7.1	11.0
Chemicals.....	2.3	3.0	2.6	4.0
Tax on special use of water.....	2.4	3.2	2.4	3.6
Pollution tax.....	1.9	2.5	2.1	3.2
Other costs of goods sold.....	5.8	7.7	6.3	9.8
Total costs of goods sold – main operating activities	49.1	64.8	49.3	76.1
Costs of goods sold – other operating activities				
Water, sewerage and stormwater connections construction costs	26.7	35.2	15.4	23.9
Total costs of goods sold.....	75.8	100.0	64.7	100.0

Costs of goods sold – main operating activities

Costs of goods sold – main operating activities increased marginally by EEK0.2 million, or 0.3 per cent., from EEK49.1 million for the three months ended 31 March 2004 to EEK49.3 million for the three months ended 31 March 2005. The reduction in staff costs of EEK1.4 million between the two periods was offset by small increases in most other cost categories.

The reduction in staff costs resulted from lower bonus payments expensed to the income statement for the three months ended 31 March 2005 when compared to the prior period. The small increases across the other cost categories were primarily due to the impact of the extreme weather conditions on the Company’s operations in January 2005. See “Risk Factors — Risks Related to the Company — The Company is vulnerable to extreme weather conditions, natural disasters and other disruptive events” for further details.

Costs of goods sold – other operating activities

Costs of goods sold – other operating activities decreased by EEK11.3 million, or 42.1 per cent., from EEK26.7 million to EEK15.4 million for the three months ended 31 March 2004 and 2005 respectively. This decrease was due entirely to a reduction in confirmed payments from the City of Tallinn and a reduction in connections income from new customers. Costs incurred in relation to the Company's connections activities are only recognised in the income statement when a project is completed and compensation is confirmed as described above. See “— Factors Affecting the Company's Results of Operations — Revenues from network extensions” for further details.

Gross profit

As a result of the factors discussed above, the Company's gross profit for the three months ended 31 March 2005 was EEK91.9 million, which represented an increase of EEK17.9 million, or 24.2 per cent., compared to gross profit of EEK74.0 million for the three months ended 31 March 2004.

The Company's gross profit margin was 58.7 per cent. for the three months ended 31 March 2005, compared to 49.4 per cent. for the three months ended 31 March 2004. This reflected the Company's ability to grow its sales at a faster rate than its operating costs during the period. In 2005, this was primarily as a result of the tariff increase on 1 January 2005.

General administration expenses

General administration expenses comprises staff costs, related depreciation and amortisation thereof and other general administration expenses for all staff in the Company's corporate services and commercial divisions, as well as costs incurred by the Company under the Technical Services Agreement.

General administration expenses increased by EEK0.7 million, or 6.5 per cent., from EEK10.6 million for the three months ended 31 March 2004 to EEK11.3 million for the three months ended 31 March 2005. Staff costs were EEK0.9 million below levels for the three months ended 31 March 2004, as a result of the over-accrual of 2004 staff bonus costs that were paid out in March 2005. Other general administration expenses for the three months ended 31 March 2005 were EEK1.6 million higher than levels for the three months ended 31 March 2004, mainly due to lower capitalisation of costs incurred in connection with the undertaking by the Company of its activities between the respective periods.

Other income/expenses

Other income/expenses consists mainly of profits/losses from fixed asset sales, movements on provisions such as bad debts or the ageing of stock, plus any non-business related expenses.

Other income, net was EEK12.2 million for the three months ended 31 March 2005, representing an increase of EEK1.8 million compared to other income, net of EEK10.4 million for the three months ended 31 March 2004. The principal component of the other income for the three months ended 31 March 2005 was the sale of excess land at Lake Ülemiste, whereas the principal component of the other income for the three months ended 31 March 2004 was the release of certain provisions for doubtful debts.

Operating profit

As a result, the Company's operating profit for the three months ended 31 March 2005 was EEK91.1 million, which represented an increase of EEK18.9 million, or 26.2 per cent., over the operating profit of EEK72.2 million for the three months ended 31 March 2004.

Financial income/expenses

Financial income/expenses comprises primarily the interest income received, and interest expense paid, by the Company during the relevant period, as well as certain other items of financial income and expenses.

Net financial expenses decreased by EEK0.6 million, or 4.4 per cent., from EEK13.6 million for the three months ended 31 March 2004 to EEK13.0 million for the three months ended 31 March 2005. This decrease was primarily attributable to improved cash management for the three months ended 31 March 2005.

Income tax on dividends

Income tax on dividends is recorded once the dividend payment for the year has been declared. See “— Factors Affecting the Company’s Results of Operations — Estonian corporate tax regime” above for further details. A dividend of EEK112.0 million was declared on 22 March 2005 in respect of the 2004 financial year, giving rise to a tax charge of EEK35.4 million. However, the dividend in respect of the 2003 financial year was only declared on 20 April 2004, meaning that the related tax charge in 2004 did not fall within the first three months of the year under review.

Net profit

As a result of the factors discussed above, net profit for the three months ended 31 March 2005 decreased by EEK15.8 million, or 27.0 per cent., to EEK42.8 million, compared to net profit of EEK58.6 million for the three months ended 31 March 2004.

Results of Operations for the Years ended 31 December 2002, 2003 and 2004

Net sales

The following table provides information regarding the Company’s net sales by operating activity, as well as the contribution of these activities as a percentage of net sales, for each of the years ended 31 December 2002, 2003 and 2004:

	Year ended 31 December					
	2002		2003		2004	
	<i>(EEK millions)</i>	<i>(per cent.)</i>	<i>(EEK millions)</i>	<i>(per cent.)</i>	<i>(EEK millions)</i>	<i>(per cent.)</i>
NET SALES						
Sales from main operating activities						
Water supply service.....	201.2	39.3	200.9	39.9	220.7	40.2
Wastewater disposal service	178.0	34.7	180.8	35.9	204.5	37.3
Stormwater treatment and disposal service.....	42.7	8.3	44.3	8.8	44.7	8.1
Fire hydrants service.....	1.9	0.4	1.9	0.4	2.0	0.4
Other work and services	9.1	1.8	6.9	1.4	6.9	1.3
Total sales from main operating activities	432.9	84.5	434.8	86.3	478.8	87.3
Revenues from other operating activities						
Water, sewerage and stormwater connections construction income	79.6	15.5	69.2	13.7	69.7	12.7
Total net sales.....	512.5	100.0	504.0	100.0	548.5	100.0

Sales from main operating activities

Sales from main operating activities increased by EEK44.0 million, or 10.1 per cent., from EEK434.8 million in the year ended 31 December 2003 to EEK478.8 million in 2004. This increase was almost entirely attributable to (i) an increase of EEK23.8 million in wastewater disposal service, from EEK180.8 million in 2003 to EEK204.5 million in 2004 and (ii) an increase of EEK19.8 million in water service, from EEK200.9 million in 2003 to EEK220.7 million in 2004.

The increase in sales attributable to the Company’s wastewater disposal service was caused primarily by increases in sewerage tariffs for both the Company’s residential and commercial customers. Residential sewerage tariffs rose from EEK7.15 per cubic metre to EEK8.15 per cubic metre, although the effect of this increase was partially offset by a decline in residential wastewater volumes during the period, from 15.0 million cubic metres in 2003 to 14.5 million cubic metres in 2004. The decline in residential volumes was attributable to a decrease in the consumption of customers in apartment blocks that was partially offset by a strong increase in the consumption of customers in individual houses, reflecting the trend of the residential population in Tallinn towards living in individual houses as opposed to apartment blocks. Commercial sewerage tariffs also rose during the period, with rate SG2 increasing from EEK15.93 per cubic metre, to EEK18.12 per cubic metre while commercial wastewater volumes rose from 6.5 million

cubic metres in 2003 to 6.7 million cubic metres in 2004, due to the increases in tourist arrivals during the period and the expansion of the area serviced.

The increase in sales attributable to the Company's water supply service was also due to increases in water tariffs for both the Company's residential and commercial customers. Residential water tariffs rose from EEK8.85 per cubic metre to EEK10.08 per cubic metre and commercial water tariffs also rose, from EEK21.48 per cubic metre to EEK24.44 per cubic metre. However, the effect of the increases in water tariffs was partially offset by a decline in residential water volumes, from 15.5 million cubic metres in 2003 to 14.7 million cubic metres in 2004. The decline in residential volumes was attributable to a decrease in the consumption of customers in apartment blocks that was partially offset by a strong increase in the consumption of customers in individual houses, reflecting the trend of the residential population in Tallinn towards living in individual houses as opposed to apartment blocks. Commercial water volumes were flat during the period.

In 2003, sales from main operating activities experienced a slight increase of EEK1.8 million, or 0.4 per cent., to EEK434.8 million from EEK432.9 million in the year ended 31 December 2002. This increase was primarily attributable to marginal increases in sales attributable to the Company's wastewater disposal service and stormwater treatment and disposal service, of EEK2.7 million and EEK1.6 million, respectively, which were in turn partially offset by a decrease of EEK2.2 million in other work and services. Due to the maintenance of tariffs in 2003 at 2002 levels and relatively constant overall volumes of water supplied and wastewater collected, sales attributable to the Company's water supply and wastewater disposal service were relatively stable between 2002 and 2003, although a marginal increase in residential wastewater volumes from 14.9 million cubic metres in 2002 to 15.0 million cubic metres in 2003 contributed to the slight increase in sales attributable to wastewater disposal service overall. Sales attributable to the Company's stormwater treatment and disposal service and fire hydrants service rose over the period due to higher revenues received as a result of upward adjustments to the Company's charges made to reflect increases in the Consumer Price Index. In contrast, other work and services fell, primarily as a result of loss of income from the sale of buildings that had previously been used as rental properties.

Revenues from other operating activities

As a result of the relatively constant amount of payments confirmed or otherwise received by the Company between 2003 and 2004, revenues from other operating activities increased marginally by 0.7 per cent. from EEK69.2 million in the year ended 31 December 2003 to EEK69.7 million in 2004. Although costs of goods sold – other operating activities increased during the period (see below for details), as a result of the greater proportion of connections income during the period which was attributable to parties other than the City of Tallinn, and in respect of which the Company is only able to levy lower charges, revenues from other operating activities did not increase on the same basis during the period. In contrast, a reduction in the network extensions programme authorised by the City of Tallinn for 2003 as a result of budgetary constraints, and lower payments received and confirmed during the year, caused revenues from other operating activities to fall by 13.0 per cent., or EEK10.4 million, from EEK79.6 million in the year ended 31 December 2002 to EEK69.2 million in 2003.

Costs of goods sold

The following table provides information regarding the Company's costs of goods sold by category, as well as their respective percentages of the Company's total costs of goods sold, for each of the years ended 31 December 2002, 2003 and 2004:

	Year ended 31 December					
	2002		2003		2004	
	(EEK millions)	(per cent.)	(EEK millions)	(per cent.)	(EEK millions)	(per cent.)
COSTS OF GOODS SOLD						
Costs of goods sold – main operating activities						
Depreciation and amortisation.....	66.5	24.4	69.6	27.3	73.1	28.1
Staff costs.....	55.4	20.4	44.7	17.4	44.6	17.2
Electricity	26.1	9.6	26.5	10.4	26.1	10.1
Chemicals.....	12.2	4.5	10.1	4.0	9.4	3.6
Tax on special use of water.....	10.1	3.7	9.9	3.9	9.3	3.6
Pollution tax.....	2.5	0.9	7.6	3.0	8.4	3.2
Research and development.....	0.1	0.0	0.2	0.1	0.1	0.0
Other costs of goods sold.....	29.4	10.8	24.6	9.7	24.5	9.4
Total costs of goods sold – main operating activities	202.2	74.3	193.2	75.8	195.5	75.2
Costs of goods sold – other operating activities						
Water, sewerage and stormwater connections construction costs.....	70.0	25.7	61.6	24.2	64.4	24.8
Total costs of goods sold.....	272.2	100.0	254.8	100.0	259.9	100.0

Costs of goods sold – main operating activities

Costs of goods sold – main operating activities increased slightly by EEK2.3 million, or 1.2 per cent., from EEK193.2 million in 2003 to EEK195.5 million in 2004. This change was mainly due to increases in depreciation and amortisation and pollution tax of EEK3.5 million and EEK0.8 million, respectively, which were partially offset by slight decreases of EEK0.7 million in each of the chemicals used in the Company's operations and tax on special use of water.

The increase in depreciation and amortisation was due to the replacement of old and fully depreciated assets by new investments between 2003 and 2004. The reduction of volumes of chemicals used in the Company's water and wastewater treatment processes, as well as the introduction of the more efficient coagulant PAX 18 in the Company's water treatment process and marginally lower costs of other chemicals used in both the Company's water and wastewater treatment processes, all of which contributed to the decrease in chemical costs. The decrease in tax on special use of water was due to decreases in the volumes of raw water abstracted by the Company during 2004, as a direct result of the success of the Company's initiatives to reduce its water losses.

The Company's total costs of goods sold – main operating activities fell by EEK9.1 million, or 4.5 per cent., from EEK202.2 million in 2002 to EEK193.2 million in 2003. This decrease was primarily attributable to reductions during 2003 in staff costs and other costs of goods sold, in particular transportation services, repair and maintenance of assets and the use of consultants. Staff costs decreased by EEK10.7 million and other costs of goods sold decreased by EEK4.8 million, although these decreases were partially offset by increases of EEK5.0 million and EEK3.1 million, respectively, in pollution tax and depreciation and amortisation.

The reduction in staff costs was due to a decrease in the average number of the Company's employees, from 480 in 2002 to 351 in 2003, as part of the Company's strategy to rationalise its workforce and reduce its cost base following its privatisation in the previous year. In particular, redundancy costs totalling EEK10.0 million were paid throughout 2002. The redundancies made in 2002 saved a proportion of the salary costs that would have been incurred in 2002, as well as the corresponding full year costs in subsequent years. The decrease in other costs of goods sold was due primarily to improved operating processes and procedures that were put in place towards the end of 2002. The increase in depreciation and amortisation was due to the replacement of old and fully depreciated assets by new investments in 2003, whereas the increase in pollution tax between 2002 and 2003 reflected changes in the coefficients used in the calculation of pollution tax payable, combined with a 20 per cent. increase in the pollution tax rate itself.

Costs of goods sold – other operating activities

The Company's costs of goods sold – other operating activities increased slightly, by EEK2.8 million, or 4.5 per cent., from EEK61.6 million in the year ended 31 December 2003 to EEK64.4 million in 2004. This increase was due to higher levels of completed construction projects during 2004.

The Company's costs of goods sold – other operating activities experienced a decline of EEK8.4 million, or 11.9 per cent., from EEK70.0 million in the year ended 31 December 2002 to EEK61.6 million in 2003. This decline was due to a decrease in water, sewerage and stormwater connections construction costs caused almost entirely by lower levels of completed construction projects, and therefore reduced amounts of compensation received, during the year.

Gross profit

As a result of the factors discussed above, the Company's gross profit in the year ended 31 December 2004 was EEK288.6 million, which represented an increase of EEK39.4 million, or 15.8 per cent., compared to gross profit of EEK249.3 million in 2003. The Company's gross profit in 2003 represented an increase of EEK8.9 million, or 3.7 per cent., compared to gross profit of EEK240.3 million in 2002.

The Company's gross profit margin was 52.6 per cent. in the year ended 31 December 2004, compared to 49.5 per cent. in 2003 and 46.9 per cent. in 2002. This reflected the Company's ability to grow its sales at a faster rate than its operating costs during the period. In 2004, this was primarily as a result of the tariff increase on 1 January 2004 and the cost savings described above. In comparison, the Company's gross profit margin improved between 2002 and 2003 largely as a result of the EEK9.1 million reduction in costs of goods sold – main operating activities described above.

General administration expenses

General administration expenses decreased by EEK15.7 million, or 27.8 per cent., from EEK56.4 million in the year ended 31 December 2003 to EEK40.7 million in 2004. This decrease was almost entirely attributable to a decrease of EEK15.4 million in other general administration expenses, from EEK35.8 million in 2003 to EEK20.4 million in 2004. Other general administration expenses were higher in 2003 due primarily to the additional invoicing in 2003 by United Utilities International Limited for services provided to the Company under the Technical Services Agreement in 2001 and 2002.

In contrast, 2003 saw an increase of 33.9 per cent., or EEK14.3 million, in general administration expenses to EEK56.4 million, as compared to EEK42.1 million in the year ended 31 December 2002. This increase was attributable to an increase of EEK14.2 million in other general administration expenses, from EEK21.6 million in 2002 to EEK35.8 million in 2003, reflecting the absence in 2002 of the additional invoicing described above.

Other income/expenses

Other income, net was EEK13.2 million in 2004, reflecting an improvement of EEK29.8 million compared to other expenses, net of EEK16.6 million in 2003. Other expenses, net were EEK16.7 million in 2002.

The income in 2004 was attributable to three main areas. First, the profit realised from the sale of fixed assets during the period contributed approximately EEK6 million. Second, the Company was able to reverse EEK10.0 million of a bad debt provision and related costs as a result of the finalisation of a notarised payment plan with a major customer. Finally, the reversal of other provisions during 2004 amounting to EEK3.8 million. These transactions were offset by the normal movement on provisions and other unrelated expenses during the period.

In 2002 and 2003, the Company did not receive the benefit of the above non-recurring items. In addition, as a result of debts owing by a major client, the Company increased its provisions for doubtful debts during those years, resulting in charges of EEK5.0 million and EEK1.3 million to the income statement in 2002 and 2003, respectively, and other expected costs of EEK7.7 million for the same client in 2003.

Operating profit

As a result, the Company's operating profit in 2004 was EEK254.9 million, which represented an increase of EEK85.1 million, or 50.1 per cent., over operating profit of EEK169.8 million in 2003. This contrasted with the decrease of EEK5.1 million, or 2.9 per cent., experienced in 2003 from operating profit in 2002 of EEK174.9 million.

Financial income/expenses

Financial expenses, net increased by EEK5.7 million, or 11.3 per cent., from EEK50.0 million in the year ended 31 December 2003 to EEK55.7 million in 2004. This increase was primarily attributable to other financial expenses in 2004 of EEK3.6 million, compared to other financial income in 2003 of EEK2.2 million. This change reflected the non-recurring gain realised by the Company in 2003 of EEK5.0 million in connection with its sale during that year of Estonian privatisation vouchers (being vouchers which the Company had purchased in prior years from the market with a view to being able to use the vouchers to privatise the land on which its operations were situated, but which could not legally be used for this purpose by the Company when it became a foreign-owned enterprise in connection with its own privatisation in January 2001). The increase in financial expenses, net also reflected a EEK1.5 million decrease in the Company's interest income during the period due to lower cash balances held throughout (as opposed to at the end of) the year.

Financial expenses, net increased significantly by EEK44.7 million to EEK50.0 million in 2003 from EEK5.3 million in 2002. This increase was almost entirely the result of a EEK42.4 million increase in interest expense from EEK13.2 million in 2002 to EEK55.6 million in 2003, as well as a decrease of EEK4.6 million in interest income, from EEK8.9 million in 2002 to EEK4.3 million in 2003. The increase in interest expense was attributable to the Company's increased interest costs under the €80 million EBRD Loan Agreement (as defined below) following the initial drawdown of €71 million at the end of 2002 under the facility. See “— Liquidity and Capital Resources — Debt financing”. The decline in interest income was attributable to lower cash balances held throughout the year. The increase in financial expenses in 2003 was partially offset by other financial income in 2003 of EEK2.2 million, compared to another financial expense in 2002 of EEK1.4 million. This was attributable to the EEK5.0 million gain realised on the sale of Estonian privatisation vouchers, as described above.

Income tax on dividends

Due to an increase of EEK30.0 million in dividends distributed and paid during 2004, from EEK45.0 million in 2003 to EEK75.0 million in 2004, income tax on dividends rose by EEK11.0 million, or 72.0 per cent., from EEK15.3 million in 2003 to EEK26.3 million in 2004. The increased dividend payment was attributable to the higher level of dividends which the Company believed it could distribute in respect of that year when taking into consideration the requirements of its dividend policy. See “Dividends and Dividend Policy” for further details.

Income tax on dividends decreased by EEK8.1 million, or 34.6 per cent., from EEK23.4 million in the year ended 31 December 2002 to EEK15.3 million in 2003. This decrease was attributable to a corresponding decrease of EEK86.8 million in dividends distributed and paid during the year, from EEK131.8 million in 2002 to EEK45.0 million in 2003, and was also attributable to the change of law that required income tax to be paid on dividend distributions to legal entities with Estonian residency from 2003 onwards. In 2002, the Company paid income tax only on dividends distributed to non-residents. The reduced dividend distribution reflected the lower level of dividends that the Company determined could be distributed in respect of that year in the exercise of its dividend policy.

Net profit

As a result of the factors discussed above, net profit in 2004 rose by EEK68.4 million, or 65.4 per cent., to EEK173.0 million, compared to net profit of EEK104.5 million in 2003. Net profit in 2003 fell by EEK41.7 million, or 28.5 per cent., compared to net profit of EEK146.2 million in 2002.

Liquidity and Capital Resources

In the opinion of the Company, taking account of the Company's existing facilities, the working capital available to the Company is sufficient for its business activities for at least the next 12 months following the date of this Offering Circular.

In order to satisfy its liquidity and capital requirements, the Company has primarily relied on cash provided by its sales from main operating activities and its revenues from other operating activities, as well as from financing provided by the EBRD. As at 31 December 2004, the Company had EEK101.0 million of cash and equivalents.

Cash flows from operating activities

Cash flows from operating activities have been, and the Company expects that it will continue to be, the single largest source of its liquidity and capital resources. Cash flows from operating activities in 2004

were EEK167.8, an increase of EEK62.2 million, or 58.9 per cent., from EEK105.6 million in 2003. Cash flows from operating activities in 2003, however, represented a decline of EEK71.7 million, or 40.4 per cent., as compared to EEK177.3 million in 2002. The increase between 2003 and 2004 reflected the increased profitability between the relevant years offset by a payment of EEK46.1 million to long-term deposit to comply with the EBRD debt service coverage ratio included in the EBRD Loan Agreement and described under “— Debt Financing” below. The decline between 2002 and 2003 reflected the Company’s reduced profitability between the relevant years and the movement of EEK31.4 million of cash to long-term deposit to comply with the debt service coverage ratio referred to above.

The Company capitalised EEK37.6 million, EEK60.1 million and EEK39.0 million of operating expenses in 2002, 2003 and 2004, respectively, representing salaries and associated costs of management, other employees and external consultants where there has been direct participation in capital expenditure projects. The Company anticipates that the amount of operating expenses capitalised will decrease in the future, as a result of its reduced headcount and improved operating efficiencies.

Cash flows from/used in investing activities

In 2004, cash outflows used in investing activities were EEK59.4 million, compared to cash inflows from investing activities of EEK41.7 million in 2003. Cash outflows used in investing activities in 2002 were EEK113.0 million.

Cash flows from investing activities have been affected principally by the acquisition of fixed assets during the periods under review, as well as the differences between payment by the Company for pipelines financed by construction income and proceeds received by the Company for pipelines financed by construction income.

In 2004, the cash outflow used in investing activities of EEK59.4 million reflected the cash outflow of EEK73.0 million used in the construction of fixed assets, plus net cash outflows of EEK1.4 million from the network extensions programme and other new connections, which were offset by cash inflows of EEK15.0 million from the sale of shares, other assets and interest income received from cash on deposit.

In 2003, the main contributing factors to the cash inflow of EEK41.7 million from investing activities were the following: the receipt of EEK58.6 million of cash in excess of the cash paid out by the Company in respect of the network extension programme completed during the year, due almost entirely to the City of Tallinn’s payment of its outstanding balances in respect of the network extension programme completed during prior years and other new connections; further cash inflows from the sale of assets and Estonian privatisation vouchers that yielded in aggregate EEK39.8 million; and interest received of EEK4.2 million.

These positive movements in cash inflows were offset by cash outflows of EEK62.6 million resulting from the Company’s acquisition of fixed assets for its own account, and not for the account of the City of Tallinn.

In 2002, the Company had a cash outflow of EEK113.0 million as a result of cash expenditures on fixed assets of EEK112.1 million, plus expenditures of EEK64.4 million to finance the network extension programme, which were offset by EEK51.4 million of cash from the City of Tallinn and customers for new connections, as well as by EEK11.8 million of interest received from cash on deposit.

Cash flows from/used in financing activities

Cash flows used in financing activities in 2002, 2003 and 2004 were EEK204.2 million, EEK251.4 million and EEK91.6 million, respectively.

Cash flows used in financing activities have been affected during the periods under review by the capital restructuring undertaken in 2002, and by drawdowns made by the Company under long-term loans and repayments thereunder. In particular, the Company’s capital restructuring of EEK950.0 million in 2002 led to cash outflows from payments to shareholders of EEK837.9 million in 2002 and EEK112.1 million in 2003. EEK1,110.9 million was drawn down under the EBRD Loan Agreement in 2002, and an additional EEK31.3 million was drawn down in 2004. In contrast, repayment of long-term loans in 2004 was EEK19.0 million, a significant decline as compared to EEK76.0 million and EEK318.4 million in 2003 and 2002, respectively.

Debt financing

In 2002, the Company executed a loan agreement with the EBRD, pursuant to which the EBRD extended to the Company a loan facility in the amount of €80 million (EEK1,251.7 million) (the “EBRD Loan Agreement”). A total of €73 million (EEK1,142.2 million) was drawn down under the loan facility between November 2002 and November 2004, and the remaining balance of €7 million (EEK109.5 million) was drawn down in April 2005. The Company must repay the loan in semi-annual instalments commencing on 28 May 2005 and ending on 28 May 2015.

The interest rate applicable to the loan facility is the sum of a margin of 1.80 per cent. per annum (or 1.50 per cent. per annum if the Company is entitled to a reduced margin in accordance with the provisions of the EBRD Loan Agreement) and the relevant interbank rate (six month EURIBOR) for the relevant period. The Company has also reached an agreement with the EBRD for the payment of a fixed interest rate of 4.19 per cent. per annum (plus the margin of 1.50 or 1.80 per cent. per annum as described above) in respect of the majority of the loan. Approximately €48.8 million (EEK763.7 million) of the outstanding amount drawn down under the loan as at 31 December 2004 was subject to the fixed interest rate. The Company has been eligible for the reduced margin since 2003.

The Company has entered into an interest rate swap transaction with Nordea Bank in respect of €22.2 million (EEK347.1 million) of the loan which remains payable at the floating rate described above. The swap, which expires in May 2009, provides that Nordea Bank will pay to the Company a floating amount equivalent to the prevailing six month EURIBOR rate and the Company will pay to Nordea Bank a rate which depends on the prevailing six month EURIBOR rate. The maximum rate payable by the Company under the swap agreement is the aggregate of 6 per cent. per annum, and the minimum payable is 2.1 per cent. per annum, in each case together with the applicable margin of 1.50 or 1.80 per cent. per annum in accordance with the EBRD Loan Agreement described above.

The €2.0 million (EEK31.3 million) drawn down under the EBRD Loan Agreement during 2004, and the €7.0 million (EEK109.6 million) drawn down in April 2005, are not subject to the fixed rate or the swap agreement, and therefore remains payable by the Company under the EBRD Loan Agreement at the prevailing six month EURIBOR rate plus the applicable margin.

The EBRD Loan Agreement provides that the financing granted by the EBRD must be used exclusively for the following activities:

- the expansion, development, maintenance and management of the existing water supply and wastewater systems of the Company located in or around the City of Tallinn;
- the reduction of the Company’s share capital (see “Description of Capital Stock and Corporate Governance — Shares and Share Capital — History of the Share Capital”); and
- repayment of certain of the Company’s existing financial debt as detailed in the EBRD Loan Agreement.

The EBRD Loan Agreement also establishes an extensive list of requirements that must be complied with by the Company in connection with the receipt of each loan disbursement, such as requirements for the specific use of the loan proceeds and a requirement for the continuing validity of the Company’s principal operating agreements. In addition, the EBRD Loan Agreement includes a number of positive and negative covenants applicable to the Company on a continuing basis. Furthermore, the EBRD Loan Agreement provides that, in the event of certain breaches by the Company, the EBRD may declare all or any portion of the loan (principal and any accrued interest) due and payable and to enforce the security under the related financing agreements (including to require the sale of shares owned by UUTBV). In the event that the EBRD enforces the security, the City of Tallinn is required to consult with the EBRD to identify an appropriate transferee for the security, including the relevant Shares.

The Company has executed a number of related financing and security agreements to secure the repayment of the loan, including, in particular, a commercial pledge, a buildings pledge, an insurance pledge, a share pledge, a local bank account pledge and a debt service reserve account charge and assignment deed whereby the Company must maintain on deposit a balance equal to not less than the sum of all payments of principal and interest which will be due and payable on the loan at the next interest payment date. See “Principal and Selling Shareholders — Related Party Transactions — The EBRD Loan Agreement” for further details.

In May 2005, the Company agreed with the EBRD a new calculation of the amount that the Company is required to hold in its Debt Service Reserve Account. Prior to this date, the Company has been required

to hold on deposit an amount equal to not less than the sum of all payments of principal and interest on the loan which would be due and payable on the next interest payment date. However, the renegotiated covenant provides that, if the Company complies with the applicable debt service coverage ratios, the amount to be held on deposit can be reduced as follows:

- if the Company has maintained a debt service coverage ratio for the most recent 12 month period of not less than 1.75:1 and the Company's projected debt service coverage ratio (based on the Company's budgets and forecasts) for the immediately following 12 month period is also not less than 1.75:1 then the Company shall maintain a balance in the Debt Service Reserve Account equal to not less than 50 per cent. of the sum of all payments of principal of and interest on the loan which will be due and payable at the next interest payment date; and
- if the Company has maintained a debt service coverage ratio for the most recent 12 month period of not less than 2.0:1 and the Company's projected debt service coverage ratio (based on the Company's budgets and forecasts) for the immediately following 12 month period is also not less than 2.0:1, then the Company may reduce the amount in the Debt Service Reserve Account to zero.

The long-term portion of the Company's total long-term debt obligations as at 31 December 2004 was EEK1,040.9 million, comprising EEK1,039.2 million outstanding under the EBRD Loan Agreement and EEK1.7 million outstanding under the Company's finance leases. The short-term portion of the Company's long-term debt obligations as at 31 December 2004 was EEK88.9 million, comprising EEK87.1 outstanding under the EBRD Loan Agreement and EEK1.8 million outstanding under the Company's finance leases.

The following table provides further information regarding the Company's repayment schedule under its loan from the EBRD (including amounts drawn down in April 2005) and its finance leases as at 31 March 2005, excluding the capitalisation of the costs associated with the EBRD Loan Agreement:

	<u>Less than one year</u>	<u>One to five years</u>	<u>Over five years</u>	<u>Total</u>
	<i>(EEK millions)</i>			
EBRD loan	88.6	530.9	632.2	1,251.7
Finance leases	1.6	1.3	–	2.9
Total	<u>90.2</u>	<u>532.2</u>	<u>632.2</u>	<u>1,254.6</u>

Capital expenditure

The Company's gross capital expenditure includes the capital expenditure on all fixed assets, including construction activities undertaken on behalf of the City of Tallinn, and certain developers and individual connectees. The Company's net capital expenditure reflects the deduction of all amounts of capital expenditure incurred by the Company on network extensions where these have been connected to the network and the related costs thereof that are compensated by the City of Tallinn in accordance with the 2005 Amendment Agreement, as well as the deduction of connection costs compensated by developers and individual connectees.

The Company's net capital expenditure, totalling EEK107.5 million, EEK114.1 million and EEK104.3 million in 2002, 2003 and 2004, respectively, has principally been related to its water supply and wastewater networks, as well as capital expenditure on the Ülemiste water treatment plant to build a technically advanced chlorine storage facility, capital expenditures on the wastewater treatment plant at Paljassaare and on processes designed to reduce the amounts of nitrogen in treated effluent. The Company anticipates that its net capital expenditure for 2005 to 2007 will be approximately EEK390 million in aggregate.

In the period from 2005 to the end of the exclusivity period under the Services Agreement in 2015, the Company expects that it will incur approximately EEK1.6 billion (gross) on capital expenditure for new projects and maintenance works. Of this amount, approximately EEK800 million (gross) is anticipated to be spent on new projects, principally water, sewerage and storm water network extensions and the upgrade of the sludge process. Approximately EEK800 million is expected to be incurred in relation to maintenance works, principally on the water and sewerage network and pumping stations and the operating condition of the water and wastewater treatment plants.

The Company expects to fund its projected capital expenditure programme through its cashflows from operating activities and the final draw down under the EBRD Loan Agreement.

Outlook

The Company believes that its performance (financial situation and market position) will not change significantly during the remainder of 2005, save to the extent that circumstances referred to elsewhere in this Offering Circular, including, but not limited to, the section headed “Risk Factors”, occur.

BUSINESS

Overview

AS Tallinna Vesi is the exclusive supplier of drinking water and sewerage services in the Services Area, an area of approximately 100 square kilometres covering approximately 63 per cent. of the City of Tallinn. The Company also provides drinking water and sewerage services in a number of other smaller services areas in Tallinn and certain of Tallinn's neighbouring municipalities. The Company operates a catchment area of approximately 2,000 square kilometres to collect raw water, and owns and operates a water treatment plant to produce potable water, a distribution network to supply treated water to the inhabitants of Tallinn, a sewerage network to collect wastewater, a wastewater treatment plant for treating wastewater and a stormwater network to collect stormwater.

In 2004, the Company distributed water to over 400,000 people, representing over 99 per cent. of the population of Tallinn, through 884 kilometres of water pipes and mains to 19,469 customer connections as at 31 December 2004. Over the same period, the Company provided sewerage services to approximately 97 per cent. of the population of Tallinn, through 1,045 kilometres of sewerage and stormwater pipes and mains from 14,736 customer connections as at 31 December 2004.

In 2004, the Company had net sales of EEK548.5 million and a net profit (after income tax on dividends) of EEK173.0 million. As at 31 December 2004, the Company had total assets of EEK2,224.7 million and total equity capital of EEK999.1 million. All of the Company's sales are derived from, and all of its assets are located in, Estonia, save for certain limited non-recurring revenues relating to consultancy services provided by the Company in respect of a water company in Tajikistan. See "— Other Activities".

The City of Tallinn has granted the Company the exclusive right to provide water supply services (including the operation and maintenance of raw water extraction facilities and water treatment and distribution) and wastewater collection, treatment and disposal services (including stormwater drainage on behalf of the City of Tallinn) and to undertake certain other related activities within the Services Area for a 15-year period from November 2000. This right was granted to the Company by the decision of the Tallinn City Council, dated 30 November 2000. The terms and conditions of the provision of services are specified in the Services Agreement executed by the City of Tallinn and the Company in January 2001. Under the terms of the Services Agreement, the Company is obliged to comply with 97 Levels of Service prescribed by the City of Tallinn. The Services Agreement and other project agreements concluded with the City of Tallinn set out the mechanisms for determining the water and sewerage tariffs which the Company is able to charge its customers, as well as the amounts which the Company can recover directly from the City of Tallinn for certain services, such as making additional customer connections. See "— Key Operating Agreements" and "The Estonian Water Industry and Regulation".

The Company is owned as a joint venture between the City of Tallinn (49.6 per cent.) and UUTBV (50.4 per cent.). UUTBV is owned by United Utilities B.V. an indirect, wholly-owned subsidiary of the international water company United Utilities PLC, and United Utilities Europe Holdings B.V., a joint venture between United Utilities B.V. and the EBRD. As a result, United Utilities B.V. holds a direct and indirect ownership interest of 75 per cent. and the EBRD holds an indirect ownership interest of 25 per cent. in UUTBV's share capital. The joint venture between the City of Tallinn and UUTBV was formed in connection with the Company's privatisation in January 2001. See "— History". After giving effect to the Offering, and assuming exercise of the Over-allotment Option in full, the City of Tallinn will own 34.7 per cent. and UUTBV will own 35.3 per cent. of the Shares.

Competitive Strengths

The Company believes that its core strengths are:

- *Strong Shareholder Base.* The Company believes that it has a strong shareholder base that provides it with the technical expertise and funding that it requires to operate successfully. The United Utilities group is one of the largest international operators of water and sewerage systems. The Company expects that it will continue to be able to benefit from the transfer of know-how and other water industry technology from United Utilities International Limited and other companies within the United Utilities group, which has been critical to the Company's success since privatisation. The EBRD, as well as being an indirect minority shareholder in the Company, is currently also the principal source of debt financing for the Company through the €80 million loan facility that it extended in November 2002. Finally, the City of Tallinn supports the Company through its

continued professional working relationship with the Company under the framework of the Services Agreement and other related project agreements.

- *Effective and Professional Working Relationship with the City of Tallinn, the Supervisory Foundation and Other Regulatory Bodies.* The Company believes it has developed a successful public-private partnership and positive relationship with the City of Tallinn and the Supervisory Foundation, as well as other state and/or regulatory bodies with which the Company deals, such as the Ministry of the Environment, the Environmental Service of Harju County and the Health Protection Inspectorate. As a result of its relationship with the City of Tallinn, the Company has been successful in obtaining appropriate tariff rate adjustments, which are crucial to ensuring the sustainability of its operations and programme of capital investment. The Company believes that the strength of its relationship with the City of Tallinn is also demonstrated by the fact that it has, since privatisation, worked in partnership with each of the four main political parties (Union for the Republic – Res Publica, the Estonian Reform Party, the Estonian Centre Party and People’s Union – Rahvaliid), representatives from which are likely to form part of the Tallinn City Government and the Tallinn City Council in the future. The Company expects that these relationships will help to ensure that regulatory and political risk will continue to be mitigated.
- *Management Capability and Track Record of Operating Efficiency.* The Company believes it has a proven track record of operating efficiency, having, since privatisation, delivered significant improvements in the quality of drinking water and treated wastewater and reduced system water losses while reducing operating costs. In addition, the Company’s ability to deliver high quality water and sewerage services is evidenced by the fact that the Company has either met or exceeded each of the 97 Levels of Service under the Services Agreement since their implementation in January 2001 (save for a single unplanned interruption in water supply, as described in “— Key Operating Agreements — The Services Agreement”). The Company believes that its successful track record of operating efficiency since privatisation is largely due to the contribution of its experienced, flexible and responsive management team. The operating capabilities and the strength of its management systems are further evidenced by the Company’s ISO 9001 accreditation, which the Company first achieved in July 2002, becoming the first water utility company in Estonia to have done so.
- *Environmentally-friendly Operating Practices and Track Record.* The Company achieved ISO 14001 certification for its environmental management systems in December 2003 and is currently in the process of being audited by Det Norske Veritas for the purposes of being verified as an EMAS company, following completion of which it expects to be recommended to the Estonian Accreditation Centre during June 2005. The Company has also complied in all material respects with all environmental targets required by the Services Agreement since its privatisation. The Company believes that these achievements, together with its focus on environmentally-friendly practices in all parts of its operations as well as those of its suppliers, illustrate its commitment to the protection of the environment and to the community which it serves.
- *Diversified Customer Base.* The Company’s customer base comprises a wide range of residential, commercial, industrial and governmental customers within the Services Area. The Company is not dependent on any single customer or group of related customers in either its water supply or wastewater operations. The Company believes that it has an efficient billing and collection process and has, since privatisation, experienced very high levels of collection of invoices and few delays in the collection process. The Company believes that the efficiency of its billing processes will be further enhanced by the implementation of its new customer information and billing system, which is expected to be completed by the end of 2005. The Company also believes that its exposure to uncreditworthy residential end-users is substantially mitigated by the fact that its customer for the majority of its residential end-users is the apartment association or other representative of residents of an apartment block, and not the end-user itself. The risk of non-collection from the residential end-user is therefore borne by the customer and not the Company.
- *Exclusive Services Area.* By virtue of its official appointment by the City of Tallinn and the terms of the Services Agreement, the Company has been granted the exclusive right to provide water supply services and sewerage services within the Services Area for a 15-year period from November 2000. The Company believes that the absence of any competitors within the Services Area provides it with a considerable competitive advantage and an opportunity to leverage its existing infrastructure and industry expertise to consolidate its existing market position and to expand its operations outside the Services Area in the future. Due to its ownership of substantially all of the fixed assets

required to provide water production and supply services and wastewater collection, treatment and disposal services within the Services Area, the Company also believes that it will have a competitive advantage in re-applying for the exclusive right to provide its services when the current exclusivity period expires in 2015. See “The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act” for further details regarding the draft legislation on the appointment of an exclusive water company.

- *Expansion to Surrounding Areas.* The Company believes that it has the technical capability and capacity to provide its services to additional areas (representing up to an additional 40,000 people) not already served by the Company without significant cost and risk to the Company. Between January 2001 and the date of this Offering Circular, the Company has been appointed as the exclusive provider of water and sewerage services in three services areas in addition to the Services Area, and has concluded contracts for water supply and/or sewerage services within an additional 11 services areas. These contracts have been signed for periods of five to 10 years and account for approximately 45 per cent. of the potential customers in these additional areas. The Company expects to conclude agreements with four additional municipalities for the provision of its services during 2005. It is anticipated that this expansion will enable the Company to re-connect a proportion of those commercial customers which have relocated their operations to areas outside the Services Area.

Strategy

The Company’s strategy is based upon the following key elements:

- *Continue to Expand the Company’s Water and Sewerage Services.* The Company’s principal strategic objective is to improve and expand its water supply and wastewater services both within its existing services areas (including the Services Area) and in other neighbouring areas. The Company believes that its ownership of substantially all of the fixed assets used in its operations will provide it with a significant competitive advantage to expand its operations in the future. Furthermore, the Company will seek to use the significant excess capacity at its Ülemiste water treatment plant and Paljassaare wastewater treatment plant to support the expansion of its water supply and wastewater services.
- *Continue to Improve Operating Efficiency and Cost Reduction.* A key strategic objective of the Company is to meet or exceed the Levels of Service prescribed in the Services Agreement. The Company has either met or exceeded each of the 97 Levels of Service since privatisation (save for the single unplanned interruption in water supply referred to above), and intends to focus on improvements in operating efficiency to ensure that it continues to do so. Water losses have been reduced over the last four years, and the Company will seek to restrict its water losses to current levels, or to levels which are lower but which remain economically sensible. Furthermore, the Company aims to reduce operating costs and increase productivity levels by using the latest technology. For example, in March 2005 the Company implemented a new asset management system, which it believes will enable more efficient use of its maintenance resources and better work planning. The Company expects to complete a programme of upgrading its customer information systems by the end of 2005, which will provide an enhanced customer service offering. The Company also expects to develop its website by the end of 2005, which will provide an improved and internet-based interface for its customers.
- *Leverage Organisational Competence and Flexibility.* The Company plans to leverage the skill set of its employees through structured initiatives to share knowledge within the Company and to focus on the personal development of individual employees, in particular by reference to a system of individually-tailored performance targets and a performance-related pay programme which the Company has developed. In addition, the Company is currently developing a recruitment programme for young graduates with engineering, finance and business management backgrounds which it expects will enable it to sustain the high quality of its management pool.
- *Continue Strategy of Partnership with Shareholders.* The Company has strong relationships with each of its direct and indirect shareholders, the City of Tallinn, the United Utilities group of companies and the EBRD. The Company seeks to continue and further develop these relationships, in particular with the United Utilities group of companies, which it believes will assist the Company in continuing to meet or exceed all Levels of Service included in the Services Agreement, as well as to provide the Company with the resources necessary to support the expansion of its services into areas not already served by the Company. Through the further development of its relationship with the City of Tallinn, the Company believes that it will be able to improve its operating efficiency

during the remaining period covered by the Services Agreement, which it believes will help to ensure that the Company has a competitive advantage over other potential bidders for the renewal of the exclusive right to operate in the Services Area in November 2015.

- *Commitment to Sustainable Development.* The Company believes that it is well positioned to align its interests and those of its shareholders with the interests of the communities which the Company serves, creating considerable and sustainable benefits for all parties. The Company believes that its long-term growth will be influenced by its ability to manage the environmental impact of its business and improve the quality of its customers' lives through the provision of clean and safe water. The Company will maintain its involvement in environmental projects aimed at protecting watersheds and water sources, as well as applying environmentally-friendly systems for wastewater treatment and disposal. In addition to its ISO 14001 accreditation for its environmental management systems, the Company is currently in the process of being audited by Det Norske Veritas for the purposes of being verified as an EMAS company, following completion of which it expects to be recommended to the Estonian Accreditation Centre during June 2005 in recognition of its environmental performance and commitment to sustainable development.

By achieving its overall strategic objectives, the Company expects to be viewed as a “benchmark” organisation that has been able to demonstrate and build on the benefits of privatisation, in particular the advantages obtained by working in partnership with the Company's shareholders, the Supervisory Foundation and the other regulatory bodies with which the Company deals.

History

The Company's predecessor was established in 1967 under the name *Tallinna Veevarustuse ja Kanalisatsiooni Valitsus* (Tallinn Water Works and Sewerage Management) and was operated as a structural unit of the Government. In October 1991, the Government transferred *Tallinna Veevarustuse ja Kanalisatsiooni Valitsus* to the ownership of the City of Tallinn. The City of Tallinn operated the Company under various corporate structures, culminating in its establishment as a public limited company, AS Tallinna Vesi, wholly-owned by the City of Tallinn, and the contribution to the Company of its principal assets, comprising the distribution and collection networks and pumping stations, the water treatment plant and the wastewater treatment plant.

The City of Tallinn resolved on 15 June 2000 to sell a majority stake in the Company, and the privatisation process (involving the sale of existing Shares and the issue of new Shares) was completed in 2001 with the acquisition of a 50.4 per cent. stake in the Company by International Water UU (Tallinn) B.V. (“IWUU”). IWUU (a 50:50 joint venture between International Water Holdings B.V., acting directly and through its subsidiary International Water (Estonia) B.V., and United Utilities International Limited) was awarded the contract as a result of a competitive tender process conducted by the City of Tallinn. The main objective of the privatisation process was to find an international strategic investor with the requisite industry experience and technical know-how to develop the Company's operations and ensure its compliance with the quality requirements of forthcoming European Union water quality legislation.

On 30 November 2000, the City of Tallinn appointed the Company as the exclusive water company in the Services Area for a 15-year period. Completion of the purchase by IWUU from the City of Tallinn of Shares in the Company occurred on 24 January 2001. Completion of the subscription by IWUU of new Shares in the Company occurred on 10 April 2001, after which the privatisation of the Company was completed.

In connection with the privatisation, and to attain the objectives referred to above, the Services Agreement between the City of Tallinn and the Company was signed on 12 January 2001. The Services Agreement laid down detailed Levels of Service for the provision of drinking water, the collection, treatment and disposal of wastewater (including stormwater), firefighting water services, surface water collection, customer service and other key operational matters. The Services Agreement also provided for the creation by the City of Tallinn of an independent body, the Mandate Monitoring Unit (the role of which was subsequently undertaken by the current Supervisory Foundation), to monitor the Company's performance of its obligations under the Services Agreement. See “— Key Operating Agreements” for further details regarding the Services Agreement and “The Estonian Water Industry and Regulation — Supervision — Supervisory Foundation” for further details regarding the Supervisory Foundation.

The City of Tallinn and the Company concluded two further project agreements on 22 June 2001 to clarify and regulate in more detail certain issues related to (i) the conduct of rain water, drainage water

and other soil and surface water from public roads, streets and squares to the public sewerage system and treatment thereof and the construction of stormwater facilities, and (ii) the extraction of firefighting water from fire hydrants in the public water supply system and the extraction of water from public water extraction points, which the parties considered had not been dealt with adequately in the Services Agreement (the “Storm Water Agreement” and the “Fire Hydrants Agreement”, respectively). See “— Key Operating Agreements” for further details.

The Services Agreement and certain other related agreements were subsequently amended in September 2002 pursuant to an amendment agreement (the “2002 Amendment Agreement”) between the Company, the City of Tallinn and IWUU. The 2002 Amendment Agreement clarified the relationship between the parties on certain matters, including the transfer of ownership to the Company of certain public water supply and sewerage pipes located in the Services Area. The 2002 Amendment Agreement also recorded the parties’ agreement that the Supervisory Foundation, rather than the Mandate Monitoring Unit, should undertake the monitoring of the Company as contemplated by the Services Agreement. The 2002 Amendment Agreement also set the tariffs for water supply and sewerage services until 2010 and recorded the parties’ agreement regarding the City of Tallinn’s reimbursement of connection costs incurred by the Company as part of the extension of its network.

On 22 March 2005, the City of Tallinn, the Company and UUTBV concluded a further amendment agreement (the “2005 Amendment Agreement”) which sets out new principles of payment to the Company for stormwater services and services related to fire hydrants and public water extraction points. It includes a new network extension programme and (i) describes the new principles of reimbursement by the City of Tallinn of network extension costs incurred by the Company, (ii) extends until 1 January 2008 the deadline for the establishment of personal rights of use for “ownerless” pipes (see “— Property, Plant and Equipment — “Ownerless” Pipes”), and for the transfer of ownership of these pipes to the Company, and (iii) amends the Level of Service included in the Services Agreement relating to the permitted occurrence of unplanned interruptions to the water supply. See “— Key Operating Agreements” for a more detailed description of the Services Agreement, the Storm Water Agreement, the Fire Hydrant Agreement, the 2002 Amendment Agreement and the 2005 Amendment Agreement.

The Company signed an €80 million loan agreement with the EBRD in November 2002. A total of €73 million was drawn down under the EBRD loan facility between November 2002 and November 2004, and the final drawdown of €7 million took place in April 2005. The loan has been used primarily to fund the capital works requirements set out in the Services Agreement, in particular the rehabilitation of the Company’s water supply distribution network and its wastewater collection network. The City of Tallinn also gave a Support Letter to the EBRD in respect of the loan facility, pursuant to which, among other things, the City of Tallinn undertook to the EBRD to comply with its obligations under the Services Agreement, the Storm Water Agreement, the Fire Hydrants Agreement and certain other related agreements. The City of Tallinn has given a further undertaking to the EBRD to the effect that it will fulfil its obligations under the Support Letter only in a manner consistent with the rules of the Tallinn Stock Exchange and legal requirements regulating the securities markets and its statutory duties as a local municipality.

On 16 December 2003, the 50 per cent. interest held by International Water Holdings B.V. and International Water Estonia B.V. in IWUU was purchased by United Utilities Europe Holdings B.V., a joint venture between United Utilities (Europe) Limited and the EBRD, thereby giving the United Utilities group of companies an aggregate 37.8 per cent. interest and the EBRD a 12.6 per cent. interest in the outstanding Shares. As a result of an intra-group restructuring within the United Utilities group, United Utilities Europe Holdings B.V. is currently owned by United Utilities B.V. and the EBRD. IWUU changed its name to United Utilities (Tallinn) B.V. on 5 January 2004.

In December 2001, the laboratories at the Ülemiste water treatment plant and the Paljassaare wastewater treatment plant received ISO 17025 certification. In June 2002, the Company’s management systems received ISO 9001 certification, with the Company thereby becoming the first water utility company in Estonia to be so certified. In December 2003, the Company received ISO 14001 certification for its environmental management systems.

Key Operating Agreements

Summary of Contractual Framework

The Company is subject to the provisions of a number of operating and other contracts relevant to its activities, including the following:

- A Services Agreement, pursuant to which the Company provides services within the Services Area, including, among other things, (i) the production and supply of water, (ii) the collection, treatment and disposal of wastewater, (iii) the provision of stormwater drainage services and (iv) the provision of fire hydrant water supply services;
- A Storm Water Agreement, pursuant to which the Company collects and disposes of stormwater and constructs stormwater drains in the Services Area on behalf of the City of Tallinn;
- A Fire Hydrants Agreement, pursuant to which the Company supplies water for fire hydrants, public drinking water extraction points and public fountains and carries out maintenance of fire hydrants;
- A Shareholders' Agreement, setting out, among other things, the principles of the election, nomination and removal of the members of the Supervisory Council and the principles of voting at the Company's shareholders' general meetings and Supervisory Council meetings;
- The 2002 Amendment Agreement, which amends the Services Agreement and the Shareholders' Agreement;
- The 2005 Amendment Agreement (comprising two separate agreements entered into in March 2005), which further amends the Services Agreement and the Shareholders' Agreement and amends the Storm Water Agreement, the Fire Hydrants Agreement and the 2002 Amendment Agreement; and
- EU Funds Agreement, which sets out the principles agreed between the Company and the City of Tallinn to ensure the eligibility of the City of Tallinn to receive funding from the European Union for the development of the public water supply and sewerage system located in the Services Area.

References in this Offering Circular to the Services Agreement, the Shareholders' Agreement, the Storm Water Agreement and the Fire Hydrants Agreement are to the relevant agreement as amended by the 2002 Amendment Agreement and/or the 2005 Amendment Agreement (as appropriate), unless the context requires otherwise.

The Services Agreement

The Services Agreement was entered into between the City of Tallinn and the Company on 12 January 2001 in connection with the Company's privatisation, and became effective on 24 January 2001.

Pursuant to the decision of the Tallinn City Council, dated 30 November 2000, and the Services Agreement, the Company was granted the exclusive right to, and agreed to, provide the following services within the Services Area for a 15-year period from November 2000:

- water services, including the operation and maintenance of raw water extraction facilities and systems, water treatment plants and water distribution;
- sewerage services, covering wastewater collection, treatment and disposal services, including the operation and maintenance of the sewer network and wastewater treatment plants;
- the provision to the City of Tallinn of stormwater drainage services;
- the provision to the City of Tallinn of fire hydrant and firefighting water supply services, and other services related to the extraction of water from public points; and
- certain additional services related to the services set out above, such as modelling, the provision of customer services and complaint-handling, financial reporting and ISO accreditation.

The Company has also agreed in the Services Agreement to provide water production and supply services, wastewater collection, treatment and disposal services (including stormwater drainage) and fire hydrant services in certain additional areas outside the Services Area but which are connected to the public water supply or sewerage system within the Services Area.

The Services Agreement provides that the Company is entitled to charge its customers for its water supply and wastewater services, and sets out the basis for the determination of applicable tariffs and their adjustment in certain specified circumstances. In addition, in September 2002 the City of Tallinn, the Company and IWUU (now UUTBV) agreed the components of the tariffs for each year up to and including 2010, which are recorded in the 2002 Amendment Agreement. See “— Tariffs” and “— Billing Procedures” below.

The Company is also entitled to charge for other services which it provides under the Services Agreement, such as extending the water supply and sewer networks inside the Services Area. The City of Tallinn is obliged pursuant to the Services Agreement to pay certain amounts towards the Company's costs in creating new customer connections for domestic properties in respect of which building permits were issued prior to 16 June 1995, and to make payments to the Company for the provision, testing and maintenance of fire hydrants, the City of Tallinn's use of the Company's water for firefighting purposes and for public fountains and for the provision of stormwater services (including construction of stormwater facilities). The specific rights and obligations of the City of Tallinn and the Company relating to the Company's fire hydrant and stormwater services and related network extensions and facilities were set out in the Fire Hydrants Agreement and the Storm Water Agreement, respectively, in June 2001.

The Company is obliged to comply with 97 Levels of Service under the Services Agreement, which comprise a collection of minimum performance standards covering the Company's obligations under the Services Agreement. The Company has met or exceeded all of these Levels of Service since it was privatised (save for a single unplanned interruption in water supply, as described below). Although the Company is obliged pursuant to the Services Agreement to make the investments necessary to comply with the contractual Levels of Service, the Services Agreement does not stipulate the amounts which the Company must invest for these purposes. However, the 2005 Amendment Agreement includes the revised network extension programme which details the amounts of reimbursement payable by the City of Tallinn to the Company for network extension costs. The Services Agreement itself recognises that compliance with the Levels of Service requires a combination of improved operational efficiency of the Company's business activities after privatisation, as well as the fulfilment of a programme of capital investment, such as improvements required at the treatment plants and a programme of selective rehabilitation or replacement of sections of the networks. The Levels of Service themselves either replicate or refer to the relevant legislative requirements applicable to the Company's activities.

Although the Company believes that compliance with the Levels of Service is essential to deliver high quality drinking water and sewerage services, it has identified the following Levels of Service which are particularly important to its operations:

- *Water quality at Ülemiste water treatment plant and from boreholes:* the Company is required to achieve compliance with European Council Directive 98/83/EC of at least 99.5 per cent. of all samples (measured as an average failure rate of one in every 200 tests), and 100 per cent. of all microbiological samples, of surface water following treatment at the Ülemiste water treatment plant and of raw groundwater extracted from boreholes. The Company has been compliant with this Level of Service since 2001;
- *Water quality at the consumer's premises:* the Company is required to achieve compliance with European Council Directive 98/83/EC of at least 95 per cent. of all samples, and 97 per cent. of all bacteriological samples, of water intended for human consumption measured at the consumer's tap, save that in accordance with the provisions of the 2002 Amendment Agreement, the Company is only required to comply with required levels of iron in drinking water by 1 January 2007. The Company is only responsible for meeting these standards for water up to customer connections. The Company has been compliant with this Level of Service since 2001;
- *Drinking water quality monitoring and reporting:* the Services Agreement provides that drinking water quality measurement procedures shall correspond fully with the corresponding requirements of European Council Directive 98/83/EC, which include random testing of water quality at the consumer's tap. Reporting, including detailing of reasons for any failures in water quality compliance and remedial measures undertaken by the Company, is required annually. The Company has been compliant with this Level of Service since 2001;
- *Unplanned interruptions in water supply:* the Company is required to ensure that no single unplanned interruption of water supply to customers exceeds 12 hours. If the Company's water supply is interrupted for more than five hours, the Company is required to provide its customers with an alternative source of water supply. The Company has been compliant with this Level of Service since 2001, save for a single unplanned interruption to its water supply in February 2005, described below;
- *Planned interruptions in water supply:* the Company is required to give at least five days' written notice to its customers of any planned interruptions in water supply and their expected duration, which should be kept to the minimum possible. If the Company's water supply is interrupted for

more than five hours, the Company is required to provide its customers with an alternative source of water supply. The Company has been compliant with this Level of Service since 2001;

- *Effluent quality at the Paljassaare wastewater treatment plant:* the Company is required to comply fully with the existing and planned future standards regarding the discharge of effluent in accordance with Decree No. 269 of the Government dated 31 July 2001 (“Decree No. 269”) (which is based on European Council Directive 91/271/EEC) and detailed in the water permit. Decree No. 269 replaced Decree No. 11 of the Government dated 20 January 1998, which is directly referred to in the Services Agreement. The Company is also required to conduct sampling and testing of effluent in accordance with Decree No. 269 as detailed in the water permit and to report its results to the Environmental Service of Harju County. The pollution concentrations and total loads are used as the basis for determining the amount of “pollution charge” to be paid by the Company in respect of the effluent discharged by it into the Baltic Sea. See “— Wastewater Services — Pollution and Quality Control” for a description of the pollution charge. The Company has been compliant with this Level of Service since 2001;
- *Water losses:* the Company was required by the Services Agreement to reduce its water losses by at least 25 per cent. by 2005, as compared to 1999 levels. This reduction was achieved in 2004. Thereafter, the Company is required to maintain an “economic” level of water leakage, to be achieved through active control of water losses. See “— Water Services — Water Losses”;
- *Customer service:* the Company established a new Customer Services Department at the end of 2001, as required by the Services Agreement. The Services Agreement requires this department to monitor all customer contacts and complaints and to record the speed of the Company’s responses thereto. All complaints are to be addressed within 10 working days of correspondence being received and registered, except for complaints regarding flooding of sewers for which maintenance staff are required to be mobilised within four hours of notification of the relevant incident. The Company has been compliant with this Level of Service since 2001;
- *Environmental disposal of treated sludge:* the annual volume of sludge disposed to landfills after the treatment of wastewater at the Company’s wastewater treatment plant at Paljassaare was required by the Services Agreement to be reduced to 25 per cent. of all sludge generated with effect from 2005. The Company first met this Level of Service in 2003. In 2004, the Company disposed of no sludge to landfills, instead mixing the majority of its sludge with peat and selling the resulting compost as organic fertiliser. The Company anticipates that it will no longer need to dispose of any sludge to landfills in the future, and will continue to use the sludge for composting or other sustainable alternatives such as forestry re-cultivation, in accordance with the Services Agreement. See “— Wastewater Services — Wastewater Treatment and Disposal”;
- *Sewerage network coverage:* the Services Agreement required 189.6 kilometres of new sewerage pipes to be constructed between 2001 and 2006, for the purpose of ensuring full coverage of the Company’s sewerage network in certain specified districts of Tallinn. However, this obligation was subsequently superseded by the entry by the City of Tallinn and the Company into the 2002 Amendment Agreement and the 2005 Amendment Agreement, which provided a new framework for these activities. As at 31 December 2004, the Company had been in compliance with these Levels of Service, with approximately 59 kilometres of new sewerage pipes having been constructed since the Company’s privatisation in January 2001. This has also necessitated the construction of 15 additional local pumping stations. See “— Expansion of Networks — Network Extensions within Existing Areas”.

The Company experienced a single extended unplanned interruption to its water supply in February 2005. This occurred when a water main burst in a residential area in the Services Area, leading to two additional smaller bursts in neighbouring areas which resulted in approximately 40 individual houses suffering an interruption to supply. As described above, the relevant “Unplanned interruptions in water supply” Level of Service requires that no single unplanned interruption of water supply should exceed 12 hours. The interruption to the Company’s water supply in February 2005 in this residential area exceeded this period, lasting in total approximately 19 hours. This event will be reported to the Supervisory Foundation in the first quarter of 2006 when the Company is required to submit its record of performance for 2005. Due to the cumulative nature of these water bursts, the Company believes that it was not possible to comply with the maximum time period prescribed by the Level of Service and will therefore submit in its report to the Supervisory Foundation that the interruption not be treated as a breach of the relevant Level of Service.

In addition to the contractual Levels of Service with which the Company must comply, the Company also imposes its own objectives to measure its operational performance. The two most significant operational measures are growth in billed volumes, whereby the Company measures the volumes of water and wastewater billed to its customers, and collection performance/debtor days, whereby the Company measures the percentage of invoices collected and the average length of time its customers take to pay for the services received. Furthermore, the Company also measures the success of its operational performance by reference to satisfaction levels of its customers and its employees. See “— Customers” and “— Employees” for further details of the Company’s customer and employee satisfaction initiatives.

The Services Agreement provides that the Levels of Service described above, together with all remaining Levels of Service provided for in the Services Agreement, are applicable during the period from 2001 to 2005 (inclusive). The Services Agreement also provides that the Levels of Service to be applicable during the period from 2006 to 2010 (inclusive) were to be determined by the City of Tallinn prior to the end of 2004, based on certain factors provided in the Services Agreement, including the City of Tallinn’s water quality requirements for that future period and a series of indicative Levels of Service set out in the Services Agreement itself.

Based on the provisions of the 2002 Amendment Agreement and the City of Tallinn’s Public Water Supply and Sewerage System Development Plan of Tallinn for 2004 – 2015, adopted by the Tallinn City Council on 13 May 2004, the Levels of Service set out in the Services Agreement as applicable from 2001 to 2005 (inclusive), and as amended in the 2002 Amendment Agreement and the 2005 Amendment Agreement, have been extended to be applicable also during the period from 2006 to 2010 (inclusive).

The Levels of Service will therefore need to be further extended by and/or renegotiated with the City of Tallinn in respect of the period from 2011 to the end of the exclusivity period covered by the Services Agreement. The Company believes that it will be protected against the imposition of more onerous Levels of Service in respect of this future period by virtue of the fact that the City of Tallinn announced in its Public Water Supply and Sewerage System Development Plan of Tallinn (which binds the City of Tallinn) that it would not seek to impose more onerous Levels of Service on the Company during the period covered by the plan. Furthermore, the Public Water Supply and Sewerage System Development Plan of Tallinn provides that the Levels of Service set out in the Services Agreement, and which were amended by the 2002 Amendment Agreement, should remain unchanged, irrespective of the investments prescribed by the Public Water Supply and Sewerage System Development Plan of Tallinn. In addition, even if the City of Tallinn were to seek to impose more onerous Levels of Service on the Company during this period, the Company believes that the effect of these more onerous obligations would be mitigated by the fact that the City of Tallinn is obliged to cover any costs associated therewith (as recorded in the Public Water Supply and Sewerage System Development Plan of Tallinn) . See “ — Tariffs” and “Risk Factors — Risks Related to the Estonian Water Industry and Regulation — The City of Tallinn may seek to impose more onerous Levels of Service on the Company with effect from 2011” for further details.

As a consequence of the Levels of Service requirements referred to above, the Company has been required by the Services Agreement to undertake a capital works programme which includes extending the water supply, wastewater and stormwater networks to districts of Tallinn not already connected to the network, replacing outdated fire hydrants, ensuring that all customers are fitted with separate water meters and that outdated water meters are replaced, constructing additional raw water control and flow measurement stations, ensuring compliance with health and safety legislation at the Ülemiste water treatment plant and in sewers, and installing equipment for the measurement of groundwater levels. All the capital works requirements of the Services Agreement have been completed or will be completed by the end of 2005, save for the network extension programme, completion of which depends on the amount of investment allocated by the City of Tallinn to the extension of the network. One of the most significant capital works requirements prescribed by the Services Agreement was for the Company to build a new facility for the storage of chlorine which complied with applicable health and safety regulations. The new storage facility was completed in October 2003 at a cost of EEK14 million and provides a high degree of environmental protection in the event of a leakage of chlorine gas.

The Services Agreement sets out the consequences of non-compliance by the Company of its obligations thereunder, including the City of Tallinn’s right of termination in certain prescribed circumstances. The Services Agreement also provides that any disputes arising are to be resolved by arbitration. The Services Agreement also provides a framework of financial penalties for non-compliance with the applicable Levels of Service. These penalties are adjusted annually in accordance with changes to the Consumer Price Index as published by the Statistical Office of Estonia, but are subject to a maximum of €6 million in

any one operating year or €10 million in any two consecutive operating years. The Services Agreement provides that if the Company is subject to a pollution charge or other statutory penalties due to the Company's non-compliance with any applicable laws or regulations and is also liable to pay a penalty under the Services Agreement in respect of the same matter, the penalty under the Services Agreement will be reduced by the amount of the pollution charge or other statutory penalty actually paid.

In addition, if the Company is in material default of its obligations under the Services Agreement and has failed to remedy the relevant default within a reasonable period after receiving notice from the City of Tallinn, the City of Tallinn may arrange for the default to be remedied and to recover the costs of the work from the Company. Furthermore, the Services Agreement incorporates "step-in" rights, whereby the City of Tallinn may take over the operation of all or part of the water supply and sewerage systems operated by the Company if the Company is not properly discharging its obligations under the Services Agreement. Finally, the City of Tallinn may terminate the Services Agreement and/or require UUTBV to sell its Shares to the City of Tallinn upon the expiry of a prescribed notice period ranging from 30 days to six months following the occurrence of a number of specified events, such as a material breach by the Company of its obligations under the Services Agreement. However, the City of Tallinn is not entitled to terminate the Services Agreement if certain of the relevant events have been remedied by the Company prior to the expiry of the notice period or within any further period agreed by the City of Tallinn. In addition, the breach of certain other specified obligations under the Services Agreement does not allow the exercise of any remedy in respect of the relevant breach.

The Services Agreement also provides the Company with a degree of protection if certain events occur which impose unanticipated obligations or costs on the Company, by allowing an adjustment to the Company's tariffs in the following year. For example, tariffs may be adjusted to take into account the consequences of certain events that qualify as a change of law affecting the Company's operations and/or its ability to comply with its obligations under the Services Agreement. Tariffs may also be adjusted in circumstances where changes to the Services Agreement are required following the occurrence of one or more *force majeure* events or upon the increase or decrease in the cost of raw water abstraction. Furthermore, tariffs are also adjusted if either the Company or the City of Tallinn proposes a variation of the terms of the Services Agreement, to take account of any necessary additional costs resulting from the amendments proposed by either of the parties. Any necessary additional costs associated with any of the foregoing events are therefore not the responsibility of the Company and can be recovered from customers through tariff adjustments in the following year (based on expected revenue levels). See "— Tariffs" for further details.

Although the exclusivity period under the Services Agreement expires in November 2015, the Services Agreement provides that its term may be extended by the City of Tallinn beyond that date. However, the City of Tallinn must carry out a competitive tender process on expiry of the exclusivity period, and there can, therefore, be no assurance that the Company will be awarded the renewal of the contract at the time of its expiry, whether by virtue of the imposition of any legislative changes prohibiting the Company from doing so or as a result of another water services company submitting a more attractive tender. Moreover, the new tender would be for five years only, unless a further specific exception is granted by the Government on the occasion of the renewal. However, the Company believes that its position is strengthened by the fact that the City of Tallinn is obliged by the terms of the Services Agreement to ensure that the tender process takes into account the competence of bidders to provide the relevant services, and that competence shall be determined by taking into account whether or not the bidder has ownership or control of the assets required to provide the relevant services. The Company believes that its position will be further strengthened by the draft PWSSA Amendment Act, which is expected to come into force during 2005. The draft PWSSA Amendment Act provides that if a private company owns the public water supply and sewerage network, it may make a proposal regarding the appointment of a water company and the proposal shall be confirmed by the local municipality, with the result that the exclusive right to provide the relevant services would be able to be granted without the need for the municipality to carry out a public tender. See "The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act". See "— Property, Plant and Equipment" for a description of the extent of the Company's current ownership of the assets used by it to provide its water supply and wastewater services under the Services Agreement.

The Storm Water Agreement

The Storm Water Agreement provides that the Company shall, in the Services Area, (i) collect stormwater flowing through the drains in the streets, roads and squares owned by the City of Tallinn and/or in public use, (ii) transport the stormwater either through the combined sewerage network or the

separate stormwater network and (iii) dispose of the stormwater by safe and environmentally acceptable means. The Company is also required to plan, design and build additions to the stormwater network in the Services Area at the cost of the City of Tallinn pursuant to the Services Agreement, additional programmes agreed with the City of Tallinn from time to time, and the Tallinn public water supply and sewerage system development plan which is established by the City of Tallinn and reviewed from time to time.

The 2005 Amendment Agreement provides that, with effect from 2006 until 2015, the agreed fee to be paid by the City of Tallinn to the Company for its stormwater services will be based on a formula which takes account of the volumes of stormwater collected by the Company both in its separate stormwater network and its combined sewer network, as well as the actual costs of treatment of the stormwater (as part of the Company's wastewater generally) at the Paljassaare wastewater treatment plant. The fee for 2006 has already been set at EEK35.5 million. The fee will be reviewed annually to take account of the actual volumes treated and the actual costs incurred by the Company in providing its stormwater services during the preceding year.

The City of Tallinn is required to pay to the Company the planning, design and construction costs incurred by the Company for the new works relating to the stormwater network. Such costs are to be agreed between the parties prior to commencement of the works.

The Storm Water Agreement is deemed to be effective for as long as the Company is a water company within the meaning provided by the PWSSA and the Services Agreement remains in force.

The Fire Hydrants Agreement

The Fire Hydrants Agreement provides that the Company shall, in the Services Area, supply water for fire hydrants and drinking water for the public water extraction points and the fountains located in the public places specified in the agreement. The Company is also required to monitor, maintain and repair the fire hydrants and public water extraction points in the Services Area to ensure a constant supply of water, and replace the fire hydrants in existence at the time of entering into the Fire Hydrants Agreement at its own cost.

The Company is also required to install new fire hydrants in new locations at the request of and at the cost of the City of Tallinn. In new developments, the connection charge paid by the developers shall include the costs of building and installing new fire hydrants and all necessary equipment. The Company is also required to install new public water extraction points at the request of and at the cost of the City of Tallinn.

Pursuant to the 2005 Amendment Agreement, the City of Tallinn is required to pay to the Company for 2006 the gross sum of approximately EEK3.4 million. For each subsequent year, the City of Tallinn is required to pay to the Company a charge for the Company's services related to fire hydrants and extraction points calculated on the basis of an agreed formula, which is applicable until 30 November 2015. The formula takes into account the Company's actual costs incurred in the immediately preceding year for maintenance and annual pressure checks, the depreciation costs of fire hydrants and the cost of water used for firefighting and extracted from public water extraction points.

The City of Tallinn is required to pay to the Company the installation and construction costs incurred by the Company for the new works relating to fire hydrants and public water extraction points. These costs are to be agreed between the parties prior to commencement of the works.

The Fire Hydrants Agreement is deemed to be effective for as long as the Company is a water company within the meaning provided by the PWSSA and the Services Agreement remains in force.

Water Services

The Company's supply of water to its customers generally involves abstraction of water from available sources and its subsequent treatment and distribution to its customers. In 2004, the Company produced approximately 25.8 million cubic metres of water (2003: 30.0 million cubic metres) and had a total of 18,585 metered customer connections as at 31 December 2004, compared to 18,332 metered connections as at the end of 2003. In 2003 and 2004, the Company's revenues from its water supply operations were EEK200.9 million and EEK220.7 million, respectively, which represented 39.9 per cent. and 40.2 per cent., respectively, of the Company's total net sales for the relevant year. References in this section and in the remainder of this Offering Circular to water "produced" by the Company are to the amounts of water abstracted by the Company from available sources and which have been treated at the Ülemiste water treatment plant and to the water abstracted from the Company's bore wells which is not treated at the

plant. The volumes of water “supplied” by the Company are lower than the Company’s production volumes, reflecting the volumes used for operational purposes (such as network cleaning) and the level of the Company’s water losses. See “— Water Losses” and “— Customers” below for further details.

The following table sets out the volumes of raw water produced by the Company for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	Year ended 31 December			
	2001	2002	2003	2004
	<i>(cubic metres, millions)</i>			
Surface water	27.8	27.4	26.8	22.9
Groundwater	3.4	3.2	3.2	2.9
Total	31.2	30.6	30.0	25.8

Water production volumes are affected by various factors, in particular the volume of the Company’s water losses, population trends and per capita water consumption levels. Water production volumes are not, however, generally affected by seasonality considerations. As can be seen from the table above, the volumes of water produced by the Company have been falling over the past four years. The principal reason for the continued decline in volumes produced is the success of the Company’s initiatives to reduce its levels of water losses, meaning that smaller amounts of water are required to be produced to meet the same levels of customer demand. See “— Water Losses” below for a description of the Company’s initiatives to reduce its levels of water losses and “— Customers” below for a description of the volumes of water actually supplied to the Company’s customers.

Water Resources

As illustrated by the table above, approximately 89 per cent. of water produced by the Company in 2004 was surface water abstracted from rivers and reservoirs located in the area surrounding Tallinn, with the remaining 11 per cent. sourced from groundwater obtained from bore wells. Water is abstracted by the Company pursuant to water permits issued by the Environmental Service of Harju County, which are valid for up to five years. The Company’s current principal water abstraction permit expires on 31 March 2008, and the Company expects that its permit will be renewed for a further five years with effect from that date. Regular fees for the special use of water are payable by the Company to the Environmental Service of Harju County based on the volumes of water extracted. See “The Estonian Water Industry and Regulation — Provision of Water and Sewerage Services — Requirement for Water Permit” for further details.

Surface Water

The annual volume of water available from the Company’s catchment area is estimated to be approximately 62 million cubic metres. The Company’s surface water system comprises six surface reservoirs with an aggregate total usable capacity of approximately 23 million cubic metres, originating from two different principal lines of supply, the flow of which can be regulated by the Company in accordance with the limits prescribed by its water permit. Surface water is conducted via a network of man-made channels and natural rivers, with a total length of more than 100 kilometres, to Lake Ülemiste, a large shallow natural lake located next to Tallinn International Airport, with a usable capacity of 16.7 million cubic metres. Surface water is also available from Lake Raku, a small lake adjoining Lake Ülemiste. Lake Ülemiste serves as the storage reservoir for raw water prior to its treatment at the neighbouring Ülemiste water treatment plant. The total area of the Company’s raw surface water resources is approximately 2,000 square kilometres.

Approximately 22.9 million cubic metres of surface water was produced by the Company in 2004 (2003: 26.8 million cubic metres). Average production of surface water in 2004 was therefore approximately 62,400 cubic metres per day. This is significantly less than the capacity of the Ülemiste water treatment plant, which is approximately 123,000 cubic metres per day, illustrating the ability of the Company to expand significantly the scope of its water supply services in Tallinn and the neighbouring areas.

The Company must deal with adverse weather conditions in its operations, which were seen most recently in July and August 2004 and in January 2005, when the highest rainfall ever recorded fell on Tallinn and its surrounding areas. The Company experienced very high levels of water in Lake Ülemiste which necessitated the implementation of the Company’s crisis management plans dealing with critical

situations such as these, which were undertaken by the Company in co-ordination with the City of Tallinn, the Rescue Board and the Environmental Service. The Company's crisis management steps undertaken included the operation of the Ülemiste water treatment plant at full capacity for a limited period, notwithstanding that there was not an increased demand in the Services Area for drinking water during the period, and the opening of a valve at Lake Ülemiste which enabled surface water to be discharged directly into the Baltic Sea. The Company's crisis management procedures also included the opening of valves enabling the discharge of only partially treated wastewater, which had been diluted with stormwater, directly into the Baltic Sea. This was necessary as the capacity of the sewer network and the Paljassaare wastewater treatment plant had been exceeded.

Currently, the Company extracts water from the reservoirs within its catchment area pursuant to water permits issued by the Environmental Service of Harju County. The Company has filed applications to privatise, with the right of pre-emption, the land beneath and servicing the reservoirs, dams and channels within its catchment area. These privatisation applications are processed by the relevant local municipalities on whose territories the Company's buildings and other structures are located. The size of each parcel of land allotted to the Company for privatisation is determined by the local government authorities in accordance with the Land Reform Act (*Maareformi seadus*).

Groundwater

Approximately 11 per cent. of the residents of the City of Tallinn obtain their drinking water from groundwater wells. Groundwater is extracted from the Company's network of 85 groundwater wells by 56 pumping stations. Groundwater is extracted from three aquifers at depths of up to approximately 200 metres. The cost of production of groundwater is comparable to that of surface water.

Three districts in Tallinn use only groundwater, of which the Nõmme district accounted for 63.7 per cent. of all groundwater produced in 2004. In addition, the City of Saue is also provided with groundwater by the Company.

Approximately 2.9 million cubic metres of groundwater were produced by the Company in 2004 (2003: 3.2 million cubic metres). Average production of groundwater in 2004 was therefore 8,080 cubic metres per day. The levels of available groundwater reserves mean that the Company can increase average production of groundwater to approximately 60,000 cubic metres per day. This corresponds to the maximum theoretical limit allowed by the water permit, although the Company has not had reason to test this limit to date.

Water Treatment

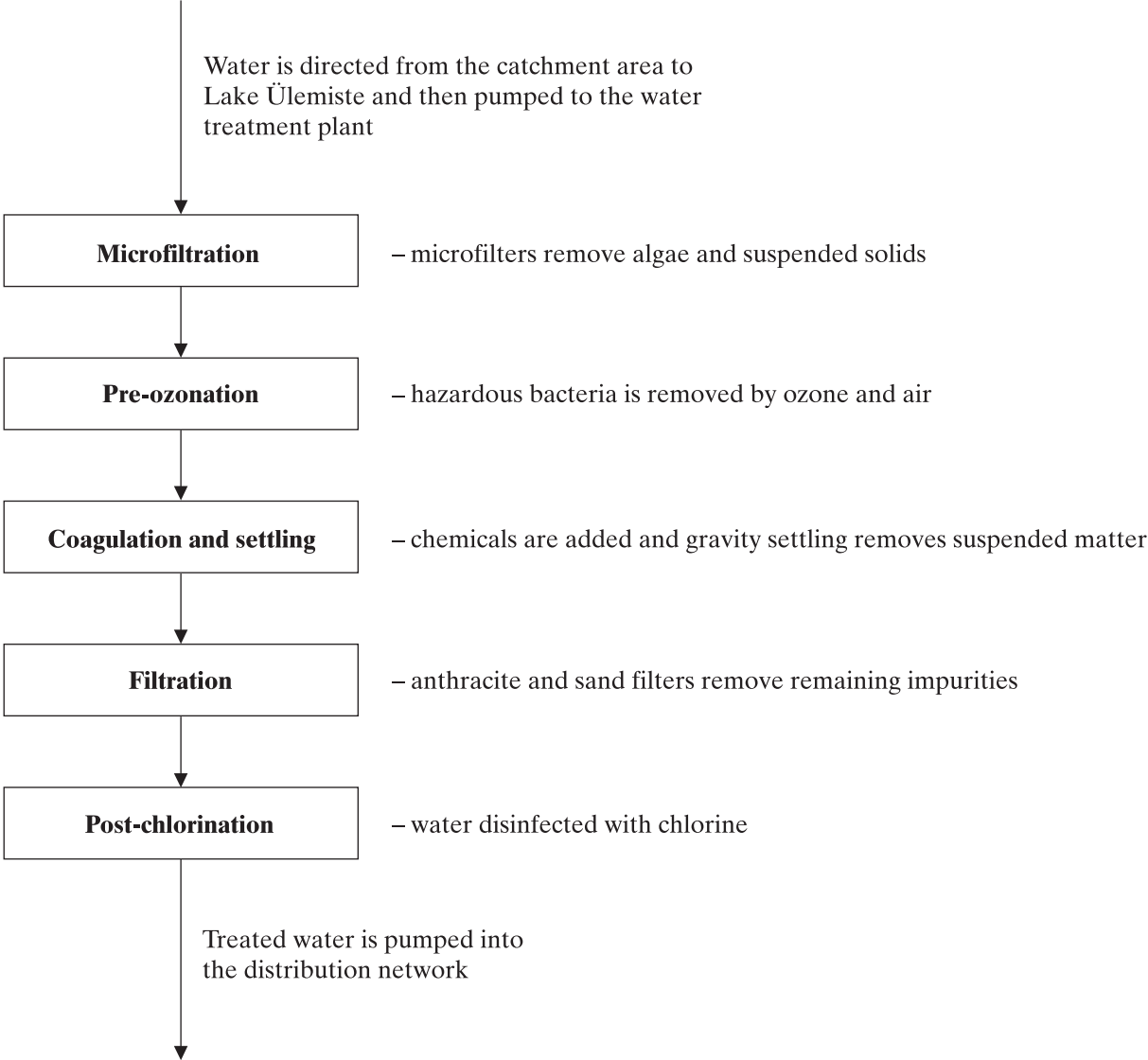
All surface water supplied by the Company is treated at the Ülemiste water treatment plant prior to its delivery to customers via the Company's distribution network. The current capacity of the water treatment plant is approximately 123,000 cubic metres per day, which is significantly in excess of current production levels. This reflects decreasing water supply to the Services Area, which can be explained by a significant reduction in water consumption since Estonian independence in 1991 due to the collapse of heavy industries and a reduction in domestic consumption following the introduction of metering/billing, as well as a significant reduction in water losses. The Company considers the condition and age of the plant and machinery located at its Ülemiste water treatment plant to be generally good.

The water purification process at the Ülemiste water treatment plant comprises the following stages:

- first, microfiltration, where raw water passes through microfilters which remove algae and suspended solids;
- second, pre-ozonation, where the water is directed into basins in which hazardous bacteria, organic matter and other pollutants such as oil are removed by a mix of ozone and air;
- third, coagulation and settling, whereby poly-aluminium-chloride (PAX 18) and other chemicals are added to clarify the water and a sedimentation phase removes suspended solids, chemical floc and precipitate from suspension through gravity settling;
- fourth, filtration, whereby the water passes through anthracite and sand filters to remove any remaining impurities and improve the taste of the water; and
- fifth, post-chlorination, whereby, before the water is pumped into the Company's distribution network, it is disinfected with chlorine.

Matter removed from the water during the treatment process, in particular during the third and fourth stages above, is transported via the sewerage network to the Company’s wastewater treatment plant at Paljassaare for treatment. See “ — Wastewater Services — Wastewater Treatment and Disposal” for further details.

The following sets out the water treatment process in diagrammatic form:



The water purification process employed has been enhanced over the past two years by the use of the chemical PAX 18, which was first introduced by the Company to its water treatment process in May 2003. PAX 18 increases the alkalinity of drinking water (when compared with the past treatment using different chemicals) and adjusts its chemical balance. As PAX 18 does not contain any sulphates, this leads in turn to a reduction in corrosion of the distribution pipes. As a result, tests have shown a reduction in the iron content of drinking water delivered to the Company’s customers, and thus lower levels of turbidity and colour.

In October 2003, the Company’s technically advanced chlorine storage facility was commissioned at a total cost of EEK14 million. This facility was constructed to comply with European Union requirements for the storage of chlorine. The importance which the Company attaches to environmental protection and safety can also be seen from the new residual ozone destructor which was installed at the Ülemiste water treatment plant in January 2003, which eliminates all emissions of ozone used in the purification process.

To improve the quality of the raw water being stored in Lake Ülemiste, the Company has undertaken a number of initiatives since its privatisation. First, the Company has sought to improve the quality of raw water being transported into Lake Ülemiste by introducing in June 2002 a natural filtration process for one of the rivers leading to the lake, pursuant to which the Company created an artificial wetland through

which water from that river must flow before reaching the lake. The wetland removes a large proportion of the nitrogen, phosphorus, heavy metals and solid particles from the raw water through the combined processes of sedimentation, absorption and microbiological decomposition. Second, the Company has introduced a programme of bio-manipulation in the lake itself by introducing into the lake certain species of fish and removing others. This ensures an appropriate biological balance of the lake and restores the natural order of the food chain, which in turn leads to a consequent reduction in the build-up of algae. Furthermore, the entirety of the lake is fenced and access is restricted to Company personnel only. The current sanitary zone (being an area surrounding a body of water from which drinking water is extracted, and in which activities are restricted by the Water Act (*Veeseadus*) to prevent the deterioration of water quality) extends 90 metres around the entire shoreline of Lake Ülemiste. The Company has submitted an application to extend the sanitary zone, which is currently being processed by the City of Tallinn.

The quality of raw surface water is generally lower in the summer months of July and August due to higher temperatures and their effect on the organic components of raw water, meaning that the Company is required to make certain technical adjustments to the treatment process and the management of the distribution network to ensure continued water quality at the customer connection.

Groundwater is not generally treated. The quality of the Company’s untreated groundwater is generally good, except in some cases where the level of iron and/or manganese is above the prescribed limits. Although the iron and manganese is not harmful to human health, in order to comply fully with Estonian regulations, the Company has already installed iron/manganese removal equipment on certain of its pumping stations where necessary, and expects to complete the installation process on all remaining pumping stations which require the relevant equipment by December 2006. Seven pumping stations have been equipped with pressure filters to ensure the required water quality. None of the ground water pumping stations is equipped with chlorination facilities. Groundwater from all wells is tested regularly before being released into the Company’s distribution network.

The Company does not add fluoride to its surface water or groundwater as part of the treatment process.

Water Network

After treatment, water is distributed to customers through the water pipes and mains of the Tallinn public water supply network, which range in size from 1.0 metre to 15 centimetres in diameter. As at 31 December 2004, the water distribution network for both treated surface water and groundwater included 884 kilometres of water pipes and mains, 19,469 water connections, one principal pumping station at Lake Ülemiste and 14 local booster pumping stations. Since it was privatised in 2001, the Company has laid approximately 55 kilometres of pipeline, either through replacement of existing pipeline or expansion of the network into areas which had not previously been serviced by the Company, and has added approximately 150 additional customer connections. Substantially all of the water distribution network is owned by the Company, which is responsible for its operation and maintenance pursuant to the provisions of the Services Agreement. In addition, a very small proportion of the network is owned either by the City of Tallinn or by private parties (such as developers) who have agreed to transfer their ownership to the Company at an agreed date in the future. See “— Property, Plant and Equipment — “Ownerless” Pipes” below for further details. The Company has connected these parts of the network to its network and is currently providing services to its customers through these parts of the network.

Although there is some limited interconnection between the distribution network for surface water with that for groundwater, in general the networks are separate, as the distribution network for groundwater usually serves only the locality around the relevant groundwater well.

The following table sets out details of the length of the distribution network and the total number of customer connections for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	As at 31 December			
	2001	2002	2003	2004
Total length of water distribution pipes and mains (km).....	818	851	869	884
Number of customer connections (thousands).....	18,759	18,923	19,205	19,469

The Company considers the condition of the water pipes and mains in its water distribution network generally to be adequate for its purposes. The Company considers the age of the water pipes and mains generally to be good. The following table sets out the age of the Company's water pipes and mains as at 31 December 2004:

As at 31 December 2004		
	Length	Percentage of total
	<i>(km)</i>	<i>(per cent.)</i>
10 years or less	170	19.2
11 to 20 years.....	69	7.8
21 to 30 years.....	140	15.8
31 to 40 years.....	149	16.9
41 to 50 years.....	111	12.6
51 to 60 years.....	87	9.8
Over 60 years.....	158	17.9
Total	884	100.0

The water pipes and water mains in the Company's distribution network are principally made of cast iron, steel and plastic. Newer water pipes are generally made of plastic (primarily polyethylene). Distribution pipes at customer connections are typically made of plastic (primarily polyethylene). The following table sets out the materials used in the Company's water pipes and mains, together with their respective lengths, as at 31 December 2004:

As at 31 December 2004		
	Length	Percentage of total
	<i>(km)</i>	<i>(per cent.)</i>
Cast iron	556	62.9
Steel.....	174	19.7
Polyethylene.....	110	12.4
Other plastic materials	35	4.0
Other ⁽¹⁾	9	1.0
Total	884	100.0

Note:

(1) Principally lead.

A large proportion of the Company's water pipes were designed to accommodate water supply volumes greater than those currently needing to be met by the Company. The Company is, therefore, carrying out a programme of replacement or decommissioning some of the pipes with large diameters which are unsuitable for current water supply volumes. The Company believes that this initiative will reduce the time that water remains in the distribution network and, as a result, lead to improved quality levels.

The condition of the pipes in the water supply network is good. The relatively lower quality of the steel used in the production of certain pipes has led to a level of corrosion in those pipes which the Company is currently remediating. In particular, the Company has decreased the corrosiveness of the water it supplies by introducing a new chemical (PAX 18) in the treatment process, and has also enhanced its network management procedures.

The Company maintains its water distribution network by regular cleaning as well as other maintenance activities, thereby ensuring continued high water quality as it is delivered from the Ülemiste water treatment plant via the Company's distribution network to the customer. The Company flushes its distribution network with water to remove accumulated sediments from the pipes. In addition, the Company undertakes a regular air-scouring programme which involves injecting pressurised air into the network and flushing with high-pressure water to remove sediment as well as accumulated particles of the distribution pipe which have corroded. All of the water distribution network is flushed at least once per

year, with some parts of the network being flushed on several occasions per year. Approximately 200 kilometres per year of the water distribution network is air-scoured. Finally, the Company expects to implement by the end of 2005 a new cleaning process, known as “pigging”, pursuant to which pipes with large diameters are cleaned by inserting a cleaning brush into the pipe and forcing the brush along the pipe using water pressure, thereby more effectively removing accumulated sediment and corrosion particles. The Company is typically notified of breaks in the water distribution network, such as burst pipes or open fire hydrants, by the public through a 24-hour telephone hotline operated by the Company. The Company is also itself able to monitor the network for breakage via a system of pressure probes located at various points on the network that are part of the Company’s remote surveillance system at its head office.

Treated water is delivered to customers through a pressurised distribution system. Pumping stations regulate the volume of water flowing through the network to maintain adequate pressure and continuous water supply. All of the surface water supplied by the Company is pumped to ensure appropriate supply and pressure levels to customers in areas of high elevation and/or in sites located on the edges of the distribution network.

The Company operates 14 pumping stations located throughout Tallinn. In addition, the Company operates 56 groundwater pumping stations. All pumping stations are fully automated, the majority of which are managed by a remote surveillance system based in the head office.

More than 99 per cent. of the population in the Services Area is connected to the Company’s water network. The Company believes that it will be able to connect the majority of the remaining part, and conclude the development of the sewerage system, by 2011. The extension of the water and sewer network in areas that are not covered is regulated by the Services Agreement between the Company and the City of Tallinn.

Fire Hydrant and Firefighting Water Supply

The Company also maintains and tests over 4,000 fire hydrants within the City of Tallinn, replacing them as necessary. It installed 410 new fire hydrants (including replacements for obsolete fire hydrants) in 2004, in accordance with its obligations under the Services Agreement. In total, over 1,600 fire hydrants have been replaced by the Company since it was privatised in January 2001. The Company’s customer for the purposes of these services is the City of Tallinn itself. See “— Key Operating Agreements — The Fire Hydrants Agreement” for further details regarding the Fire Hydrants Agreement which regulates these and other related activities of the Company.

Water Losses

The difference between the amount of water produced by the Company and the amount of water sold by it generally represents water losses. For the purposes of the Company’s obligations under the Services Agreement, water losses (referred to in the Services Agreement as unaccounted for water) are calculated by the Company as the amount of water produced by it less its sales of water, deducting from the resulting figure the water used for firefighting use (as estimated by the Harju Rescue Service), water lost to illegal uses (as estimated by the Company) and water discharged for the purposes of cleaning mains and sewers (as estimated by the Company). In addition, the resulting figure for water losses is required to reflect the Company’s estimate of errors (positive or negative) in the volumes measured by its water meters.

The Company’s water loss percentage (i.e. water losses, calculated as described above, expressed as a percentage of measured total works output) in 2004 was 21.4 per cent. The following table sets out details of the Company’s water losses for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	Year ended 31 December			
	2001	2002	2003	2004
Water loss percentage (per cent.).....	32.4	31.7	29.6	21.4
Average losses (actual) ⁽¹⁾	34.0	30.9	28.1	17.0

Note:

(1) Actual losses, measured in cubic metres of water per kilometre of distribution network per day.

The Company was required by the Services Agreement to reduce its water losses by at least 25 per cent. by 2005, as compared to 1999 levels. In 1999, the level of the Company’s water losses was 34.9 per cent. and the target to be achieved by the end of 2005 is 26.2 per cent. This reduction was achieved and

exceeded in 2004. Thereafter, the Company has been required to maintain an “economic” level of water leakage, to be achieved through active control of water losses. The Company therefore plans to restrict its water loss percentage to an economic level of water leakage in the future. This would comply with the parameters of the Services Agreement and would reflect a level that the Company believes is acceptable for its operations and below which it would not be economically sensible for the Company to reduce water losses.

The Company’s initiatives to reduce physical water losses include reducing response times to repair broken pipes and mains and better monitoring of non-visible mains fractures. In particular, the Company has recently installed special zoning sensors on certain significant network points to monitor more effectively flow rates and pressure levels throughout the distribution network. This allows it to localise leakages more quickly after they occur, consequently reducing water losses. The Company currently repairs approximately 125 broken pipes and mains per month. Measures adopted by the Company to reduce non-physical water losses (which relates to water produced by the Company and supplied to the network but which has not been invoiced) include on-site customer and connection surveys, preventive maintenance of water meters with regular testing of their accuracy, and the replacement of existing meters with more accurate meters.

Water Quality

The Company supplies high quality drinking water that complies with currently applicable national legislative requirements, European Union requirements and the requirements prescribed by the Services Agreement. Drinking water supplied by the Company has met or exceeded the requirements set out in the Services Agreement in each year since the Company was privatised in January 2001. These requirements were originally based upon the relevant standards for drinking water set out in Estonian national legislation. However, due to Estonia’s accession to membership of the European Union in May 2004 and the eventual harmonisation of Estonian legislation with the European Union’s body of applicable water legislation, the requirements of the Services Agreement are now based upon the corresponding provisions of the relevant European Union directives, in particular European Council Directive 98/83/EC on the quality of water intended for human consumption. See “The Estonian Water Industry and Regulation — Water and Wastewater Quality and Levels of Service — Requirements for Drinking Water”.

The Company’s laboratory at the Ülemiste water treatment plant takes water samples at all stages of the water production process. See “— Laboratories, Technical Services and Research and Development Activities” for further details. In 2004, 100 per cent. of all drinking water quality samples taken from the water network met the applicable microbiological requirements and 99.04 per cent. met the applicable chemical requirements, as compared to 2003 where the corresponding compliance levels were 99.97 per cent. and 99.06 per cent. (giving an overall compliance of 99.04 per cent. in 2004 and 99.02 per cent. in 2003).

Water quality has improved steadily since privatisation, and the Company believes that the actions which have been and which will continue to be implemented (for example new chemicals being used at the Ülemiste water treatment plant, enhanced network management procedures and water network rehabilitation) will enable it to continue to comply with applicable water quality standards. The following table summarises the microbiological and chemical contractual compliance of water produced by the Company for each of the years ended 31 December 2001, 2002, 2003 and 2004, measured after treatment at the Ülemiste water treatment plant and at the relevant sampling points in the network which have been agreed between the Company and the Health Protection Inspectorate:

	Year ended 31 December			
	2001	2002	2003	2004
	<i>(per cent.)</i>			
Quality after treatment				
Microbiological compliance	100.00	100.00	100.00	100.00
Chemical compliance	100.00	100.00	99.85	100.00
Total compliance	100.00	100.00	99.85	100.00
Quality in the network				
Microbiological compliance	97.72	99.88	99.97	100.00
Chemical compliance	97.39	98.30	99.06	99.04
Total compliance	95.10	98.20	99.02	99.04

As used in the table above, microbiological compliance means compliance of the water supplied with microbiological standards for drinking water as set out in the Estonian Drinking Water Standard EVS 663: 1995 (“EVS 95”). Chemical compliance means compliance of the water supplied with the chemical standards for drinking water as set out in EVS 95. Total compliance means compliance of the water supplied with both the minimum microbiological standards and the minimum chemical standards for drinking water as set out in EVS 95. The Company has complied fully with the levels of compliance required by the Services Agreement since privatisation. The Company is also required to comply with the parameters of Decree No. 82 of the Minister of Social Affairs, dated 31 July 2001, except for certain parameters which will only be effective from January 2007 and in respect of which temporary non-compliance is permitted (see “The Estonian Water Industry and Regulation — Water and Wastewater Quality and Levels of Service — Requirements for Drinking Water” for further details). The Company’s current level of compliance with Decree No. 82 is 92.4 per cent.

The Company’s laboratories first received ISO 17025 certification in 2001. This certification has been confirmed each year since then, demonstrating the Company’s expertise in the technical processes of analysing drinking water.

In addition to the treatment processes applied to raw water at the Ülemiste water treatment plant and the Company’s initiatives to maintain water quality at all stages of distribution after the treated water has left the water treatment plant, the Company has also adopted certain measures to improve the quality of raw water before its treatment at the Ülemiste water treatment plant. See “— Water Treatment” for further details.

Sewerage Services

The Company is responsible for the collection, treatment and disposal of wastewater and stormwater (together referred to in this Offering Circular as “sewage”) within the Services Area. The Company estimates that it was responsible for the collection of approximately 97 per cent. of the wastewater produced in the Services Area in 2004. In 2003 and 2004, the Company’s revenues from its wastewater collection, treatment and disposal operations were EEK180.7 million and EEK204.5 million, respectively, which represented 35.9 per cent. and 37.3 per cent., respectively, of the Company’s total net sales for the relevant year. Furthermore, in 2003 and 2004, the Company’s revenues from its stormwater collection, treatment and disposal operations amounted to EEK44.3 million and EEK44.7 million, respectively, which represented 8.8 per cent. and 8.2 per cent., respectively, of the Company’s total net sales for the relevant year.

The following table sets out the volumes of sewage collected by the Company for each of the years ended 31 December 2001, 2002, 2003 and 2004, broken down into volumes collected by the combined network and the separate network and specifying the respective proportions thereof which were disposed of either treated (which includes instances of partial treatment by the first stage of the wastewater treatment plant) or untreated during the relevant years:

	Year ended 31 December			
	2001	2002	2003	2004
	<i>(cubic metres, millions)</i>			
Combined sewage and stormwater volumes				
Treated.....	51.1	46.6	45.5	51.3
Untreated.....	0.0	0.1	0.1	2.0
Stormwater volumes				
Untreated ⁽¹⁾	2.9	3.9	3.9	6.3
Total	<u>54.0</u>	<u>50.6</u>	<u>49.6</u>	<u>59.6</u>

Note:

(1) All stormwater conducted to the Company's separate stormwater network is discharged directly to the environment.

Sewage volumes are directly affected by the levels of water supplied by the Company in its water supply operations. In addition, wastewater volumes are also directly affected by adverse weather conditions, such as heavy rainfall and unseasonably warm conditions leading to the rapid melting of snow.

Sewer Network

The function of the Company's sewer network is to collect and transport wastewater and stormwater. As at 31 December 2004, the Company's sewer network comprised 728 kilometres of wastewater and combined sewer lines, 317 kilometres of stormwater drains, 65 pumping stations and 14,736 customer connections. The network had a geographic coverage of approximately 97 per cent. of the Services Area in 2004, with the remaining areas generally served by third parties using septic tanks for wastewater disposal. Wastewater and stormwater is collected by the Company both in a "combined" network, which carries wastewater and stormwater in the same pipes, and in a "separate" network of wastewater lines and stormwater drains which carry only wastewater or stormwater, respectively. The Company's sewer lines and stormwater drains have diameters ranging from 10 centimetres to 2.9 metres. The Company has laid approximately 79 kilometres of sewer lines, either through replacement of existing sewer lines or expansion of the network into areas which had not previously been serviced by the Company, since it was privatised in January 2001. The Company also built approximately 13.5 kilometres of new stormwater network during the same period. During this period the Company also added almost 2,500 additional customer connections to its sewerage network. Substantially all of the wastewater collection network is owned by the Company, which is responsible for its operation and maintenance pursuant to the provisions of the Services Agreement. In addition, a very small proportion of the network is of uncertain ownership or owned either by the City of Tallinn or by private parties (such as developers) who have agreed to transfer their ownership to the Company at an agreed date in the future. See "— Property, Plant and Equipment — "Ownerless" Pipes" below for further details. The Company has connected these parts of the network to its network and is currently providing services to its customers through these parts of the network.

Wastewater and stormwater from all areas in the City of Tallinn and the City of Saue is conveyed along the Company's collection network to its wastewater treatment plant at Paljassaare, except for stormwater collected in the Company's separate stormwater network which is discharged directly to the environment. The collection network also conveys sewage and stormwater from neighbouring municipalities where, or for whom, the Company also provides sewerage services. See "— Wastewater Treatment and Disposal" below. The collection network is generally designed to operate by gravitational flow, although a network of 65 sewage pumping stations located in Tallinn and the surrounding areas is also employed by the Company to ensure continuous flow of sewage to the main pumping station and thereafter to the Paljassaare wastewater treatment plant. Most of the sewer pumping stations are automated, and potential problems are monitored by a remote surveillance system based in the Company's head office.

The following table sets out details of the length of the wastewater network and the total number of customer connections for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	As at 31 December			
	2001	2002	2003	2004
Wastewater and combined sewer lines (<i>km</i>)	643	679	714	728
Stormwater drains (<i>km</i>)	283	302	310	317
Number of customer connections	12,274	12,983	14,123	14,736

The Company considers the condition and age of its sewer network generally to be adequate for its purposes, and that the replacement and/or rehabilitation requirements of the wastewater network are considered generally to be good. An average of five kilometres of wastewater or combined sewer network has been replaced or refurbished each year since 2001. The following table sets out the age of the Company's sewerage and stormwater networks as at 31 December 2004:

	Wastewater and combined sewer network As at 31 December 2004		Stormwater network As at 31 December 2004	
	Length	Percentage of total	Length	Percentage of total
	(<i>km</i>)	(<i>per cent.</i>)	(<i>km</i>)	(<i>per cent.</i>)
10 years or less	221	30.4	66	20.8
11 to 20 years	104	14.3	60	18.9
21 to 30 years	163	22.4	107	33.8
31 to 40 years	96	13.2	63	19.9
41 to 50 years	59	8.1	13	4.1
51 to 60 years	17	2.3	–	–
Over 60 years	68	9.3	8	2.5
Total	728	100.0	317	100.0

The wastewater, combined sewer and stormwater lines in the Company's sewer network are made primarily of concrete, asbestos cement, cast iron and plastic. Older sewer lines are generally made of brick. The following table sets out the materials used in the Company's wastewater, combined sewer and stormwater networks, together with their respective lengths, as at 31 December 2004:

	Wastewater and combined sewer network As at 31 December 2004		Stormwater network As at 31 December 2004	
	Length	Percentage of total	Length	Percentage of total
	(<i>km</i>)	(<i>per cent.</i>)	(<i>km</i>)	(<i>per cent.</i>)
Concrete	240	33.0	147	46.4
Plastic	254	34.9	87	27.4
Asbestos cement	136	18.7	72	22.7
Ceramics	48	6.6	9	2.8
Cast iron	35	4.8	1	0.3
Brick	3	0.4	1	0.3
Other	13	1.8	–	–
Total	728	100.0	317	100.0

The Company has reduced the number of blockages occurring in its sewer collection network since privatisation, in accordance with the requirements of the Services Agreement. 1,356 blockages were recorded in 2004, as compared to 1,654 blockages recorded in 2003 and 2,444 in 1999. The majority of blockages occurring in the sewer network are caused by wastewater including matter such as oil products and large solids being discharged into the network, as well as by deterioration or failure of the pipes. In addition, sediments accumulate in the network as a result of reduced water consumption generally, which leads in turn to reduced speeds of flow in the sewer network. The accumulation of sediments also leads to

a deterioration of the quality of the sewer network due to the fermentation of organic matter contained in the sediment, which leads in turn to corrosion of the sewer pipes themselves.

The following table sets out the total number of blockages that occurred in the Company's sewer collection network in each of the years ended 31 December 2001, 2002, 2003 and 2004, as compared to the length of the network as at the end of each period:

Year ended 31 December	Network length at year end	Number of blockages <i>(km)</i>	Blockages per kilometre
2001.....	643	2,080	3.2
2002.....	679	1,638	2.4
2003.....	714	1,654	2.3
2004.....	728	1,356	1.9

To counteract the effects of deterioration and thereby reduce blockages, the Company performs preventive pressure washing on its sewer collection network. High-pressure water flows are used to flush sand and other sediments which have accumulated in the network into a manhole, from which they are extracted and transported to the wastewater treatment plant to be processed. A similar washing process is employed to prevent overflows from the stormwater network and reduce flooding in the streets of the City of Tallinn. Approximately 79 kilometres of the network were flushed in 2004, as compared to approximately 71 kilometres in 2003.

Wastewater Treatment and Disposal

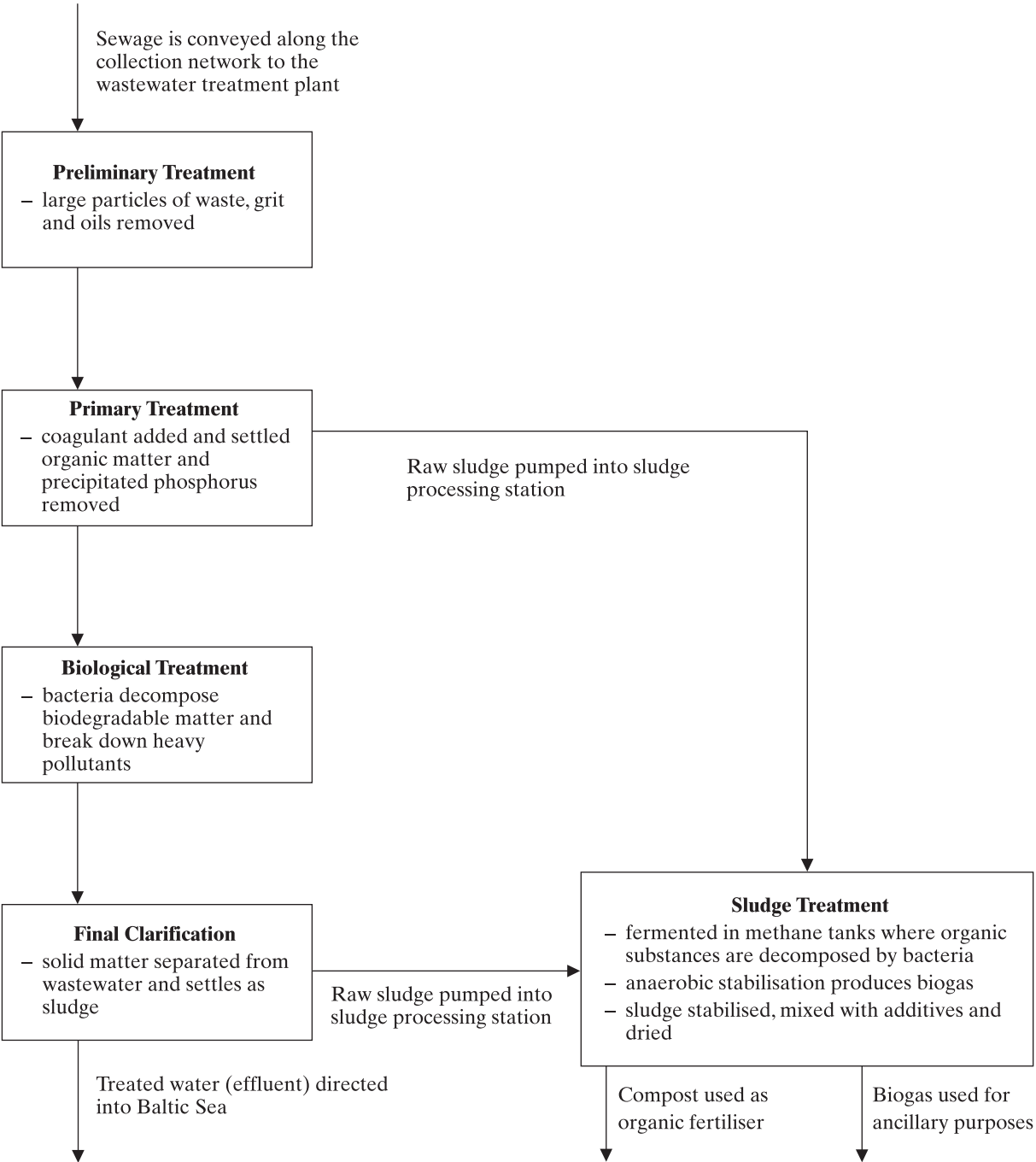
The Company is required to treat wastewater and stormwater in accordance with applicable legislation and the corresponding provisions of the Services Agreement to reduce the polluting impact of wastewater before it is discharged into the environment. The Company also treats wastewater or sewage on behalf of third parties, and levies charges based on wastewater or sewage volumes and pollution content when it is discharged by the relevant party into the Company's sewer collection network at one of five designated discharging points located at different points in Tallinn.

Sewage is conveyed along the collection network described above to the Company's wastewater treatment plant located at Paljassaare, on the shore of the Baltic Sea, approximately six kilometres from the centre of the City of Tallinn. After treatment, effluent is discharged into the Baltic Sea via a deep sea outflow located approximately three kilometres offshore. The quantities of sewage being treated by the Company are highly dependent on the amount of rain coming into the network. The Company treated on average approximately 140,000 cubic metres of sewage per day during 2004 at the Paljassaare wastewater treatment plant. This amount is significantly less than the capacity of the treatment plant of approximately 350,000 cubic meters per day, and illustrates the ability of the Company to expand significantly the scope of its wastewater services in Tallinn and the neighbouring areas. The Company considers the condition and age of the plant and machinery located at its Paljassaare wastewater treatment plant generally to be good. By way of illustration, the Company replaced the entire air production facility (air/oxygen being one of the main constituent parts of the wastewater treatment process) at the treatment plant during 2003 and 2004.

The treatment of wastewater relies on physical separation processes and on natural biological processes to break down organic matter and to reduce the amount of harmful organisms and chemicals in the wastewater prior to its discharge, in particular to reduce the amount of the wastewater's carbon and nitrogen content. Large particles of waste are first removed from the wastewater by screening and grit and oils are removed. Grit chambers are used to separate grit from the water. Thereafter coagulant is added and the wastewater is treated in a first settlement tank to remove settled organic matter and precipitated phosphorus. The wastewater is then passed into aeration tanks where bacteria decompose biodegradable matter and break down heavy pollutants. Air is injected and methanol is added into the wastewater to enable the growth of the bacteria. After the aeration tank, the wastewater is passed into a second settlement tank where solid matter is separated from the wastewater and settles as sludge. From the settlement tank, the treated water (effluent) is directed into the Baltic Sea through outflows approximately three kilometres off the Estonian coast. The remaining raw sludge is removed from the settlement tank, with a portion of the raw sludge being injected back into the aeration tank to aid the biological process, with the remainder being pumped into the Company's separate sludge processing station at Paljassaare.

Sludge pumped into the Company’s separate sludge processing station is first passed through a thickening centrifuge and thereafter into methane tanks where it remains for approximately 30 days. During this period, it is fermented and organic matter is transformed into minerals by bacteria. Anaerobic stabilisation of sludge produces biogas which contains methane. This biogas is used as energy in the production of air required for the biological treatment process. The Company also recycles this biogas by burning it for use in heating the treatment plant and for powering certain of the treatment processes undertaken at the plant. Once the sludge has been stabilised in the digesters (methane tanks), it is treated with additives and is dried. The majority of the sludge treated by the Company is mixed with peat and composted to be sold as organic fertiliser. In addition, sludge which has been treated but which has not been composted is also used in certain reforestation activities which the Company supports.

The following describes the wastewater treatment process in diagrammatic form:



In 2004, all the sludge produced by the Company was composted or used for other sustainable alternatives such as forestry re-cultivation, as described above. However, in previous years, a proportion of the sludge was disposed to landfill sites. The following table sets out the total volumes of sludge

produced, and the respective proportions of sludge composted (or used in other sustainable alternatives) and disposed to landfill, for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	Year ended 31 December							
	2001		2002		2003		2004	
	<i>Volume (tonnes)</i>	<i>(per cent.)</i>	<i>Volume (tonnes)</i>	<i>(per cent.)</i>	<i>Volume (tonnes)</i>	<i>(per cent.)</i>	<i>Volume (tonnes)</i>	<i>(per cent.)</i>
Compost ⁽¹⁾	9,113	28.3	20,643	63.6	22,684	80.9	35,770	100.0
Landfill	23,080	71.7	11,837	36.4	5,362	19.1	–	–
Total	32,193	100.0	32,480	100.0	28,044	100.0	35,770	100.0

Note:

(1) Including other sustainable alternatives such as forestry re-cultivation.

The Company currently has approximately 5.4 hectares of composting fields and expects that this will increase to a total of 10.7 hectares by the end of July 2005. The Company believes that the creation of additional composting fields is a further step towards not having to dispose of any sludge in landfills in the future. Composting is also attractive to the Company as it not only avoids environmental concerns resulting from disposal of sludge in landfills, but is also financially advantageous to the Company. In particular, the Company estimates that, based on 2004 volumes, it saved approximately EEK17.9 million of costs which would have otherwise been incurred in the disposal of sludge to landfills during that year. In addition, the Company generated net sales of approximately EEK1.3 million in 2004 from the sale of compost. The Company has obtained the relevant waste permits from the Environmental Service of Harju County. See “The Estonian Water Industry and Regulation — Environmental Matters and Regulation — Waste”.

Partially treated or untreated sewage is on very infrequent occasions discharged directly into the Baltic Sea, although only in connection with extremely heavy rainfall when the capacity of the wastewater network is exceeded. This is only effected, with the co-operation of the relevant environmental authorities, to preserve the wastewater treatment capacity at Paljassaare, as its loss would result in a greater detrimental affect on the environment. See “— Stormwater Services” below.

Since privatisation, an extensive capital programme has been implemented by the Company. The air production equipment and the aeration tanks equipment (where the biological process is conducted) have been upgraded and/or replaced to allow the plant to treat nitrogen, and a project to enhance the sludge process is ongoing. After the first step, which was to extend the composting fields (5.3 hectares being built in 2005), the sludge processing facilities will be upgraded in 2005 and 2006. Further projects include the upgrade of screening at the main pumping station and the upgrade of pre-treatment facilities.

Pollution and Quality Control

The Company believes that the wastewater that it treats complies with currently applicable regulatory requirements and the requirements prescribed by the Services Agreement. Wastewater treated by the Company has met or exceeded the requirements set out in the Services Agreement in each year since the Company was privatised in January 2001. See “The Estonian Water Industry and Regulation”.

The Company’s wastewater laboratory at the Paljassaare wastewater treatment plant takes samples at all stages of the wastewater process. See “— Laboratories, Technical Services and Research and Development Activities” for further details. In 2004, the Company met or exceeded all Levels of Service applicable to treated effluent.

The following table sets out certain statistical data regarding compliance of the treated wastewater with the applicable requirements of the Services Agreement for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	Year ended 31 December			
	2001	2002	2003	2004
<i>(per cent.)</i>				
Wastewater Treatment Efficiency Percentage⁽¹⁾				
BOD ⁽²⁾	97.6	97.8	98.2	97.6
COD ⁽³⁾	91.9	90.6	94.4	91.8
Total phosphorus.....	82.5	83.9	85.3	84.8
Total nitrogen	55.2	57.1	56.9	58.5
Suspended solids.....	97.1	97.1	97.3	97.2
Oil products.....	77.4	72.6	78.6	78.1

	Year ended 31 December				Estonian Regulation Threshold
	2001	2002	2003	2004	
<i>(mg/litre)</i>					
Pollution concentration in the effluent					
BOD ⁽²⁾	4.1	3.9	3.7	3.9	15.0
COD ⁽³⁾	30.0	30.0	26.0	33.0	125.0
Total phosphorus.....	0.96	0.97	0.98	0.87	1.0
Total nitrogen	14.8	15.5	17.2	13.8	20.0
Suspended solids.....	7.0	8.0	8.0	8.0	15.0
Oil products.....	0.5	0.6	0.6	0.7	1.0

Notes:

- (1) Reduction of pollutant concentration after treatment.
- (2) Biological Oxygen Demand, which refers to the quantity of oxygen utilised by a mixed population of micro-organisms in an aerobic oxidation of the organic matter in a sample of wastewater at a temperature of 20°C +/- 1°C.
- (3) Chemical Oxygen Demand, which refers to the quantity of oxygen required for chemical oxidation of organic matter to carbon dioxide and water in a sample of wastewater.

Although the wastewater treated by the Company has met or exceeded the applicable Levels of Service in each of the years set out in the above table, the table reflects a slight overall deterioration in the effluent quality between 2003 and 2004. This deterioration is attributable to the extensive upgrading works currently being undertaken at the Paljassaare wastewater treatment plant (discussed below), which were also underway during 2003 and 2004, and which led to a consequent reduction in the plant's treatment capacity during those years.

The original design of the Paljassaare wastewater treatment plant did not include the capability to treat nitrogen levels in effluent. Therefore, the Company commenced a biological treatment upgrade project in 2003, with the objective of reducing the amount of nitrogen discharged into the Baltic Sea by spring 2006. The denitrification project will remove nitrogen more efficiently from the effluent and will convert the nitrates and nitrites in the wastewater into gaseous nitrogen and oxygen that will be released into the atmosphere. In July 2003, in connection with the implementation of the project, the Company agreed with the Ministry of the Environment that the Company would, during the period of construction of the denitrification facility, be granted a specific exemption for the levels of nitrogen in its effluent, and would also be exempt from the pollution charge which would otherwise be levied on nitrogen discharged into the Baltic Sea. However, these exemptions were granted on the condition that an amount at least equal to the expected basic amount of pollution charge should be invested in the project. The project is expected to be completed by April 2006 at a total cost of approximately EEK26.5 million.

The pollution charge is levied by the State on all parties which discharge effluent into the Baltic Sea or any other body of water in Estonia. If the effluent complies with the prescribed minimum standards for effluent, then the basic amount of the pollution charge is levied. If, however, the effluent does not comply with the prescribed minimum standards, then a penalty equal to 10 times the basic amount of the

pollution charge is levied. See “The Estonian Water Industry and Regulation — Environmental Matters and Regulation — Fee for the Special Use of Water and Pollution Charge” for further details.

The Company’s agreement with the Ministry of the Environment also provides for the repayment by the Company of all previously waived pollution charges relating to the discharge of nitrogen if the amount of nitrogen discharged into the Baltic Sea in the 12 months from July 2005 to June 2006 exceeds pre-determined levels. As at the date of this Offering Circular, the Company expects to achieve compliance with the required nitrogen levels in its effluent with effect from April 2006. However, as the Company is unable to determine with any certainty whether future compliance will be successful, it has provided in full for the maximum amount of pollution charge (excluding applicable fines for delays in compliance) to which it may be subject in the event of non-compliance. See “The Estonian Water Industry and Regulation — Environmental Matters and Regulation — Fee for the Special Use of Water and Pollution Charge” and Note 14 to the Company’s audited financial statements included elsewhere in this Offering Circular for further details regarding the pollution charge.

In 1992 (i.e., prior to commencement of the construction of the biological treatment process at the Paljassaare wastewater treatment plant), Tallinn was included on the list of environmental “hotspots” by the Helsinki Commission (“HELCOM”), due to the relatively higher pollution levels in effluent being discharged by the Paljassaare wastewater treatment plant at that time. HELCOM is the governing body of the Convention on the Protection of the Marine Environment of the Baltic Sea Area, a convention governing pollution levels of the Baltic Sea and in respect of which all of the Baltic Sea countries are signatories and have agreed to take steps to control and minimise land-based pollution of the marine environment of the Baltic Sea area. Although the Company anticipates that following completion of the denitrification project at Paljassaare it will be discharging reduced amounts of nitrogen into the Baltic Sea, there can be no assurance that HELCOM will remove Tallinn from its list of environmental “hotspots” after completion of the project. If Tallinn is not removed from HELCOM’s list of “hotspots”, there can be no assurance that the Company would not suffer adverse publicity and/or negative public perception regarding the Company and its operations.

The land upon which the Paljassaare wastewater treatment plant is built was used as a waste disposal site in the period from the 1960s until the late 1970s. After this period, the Paljassaare wastewater treatment plant, together with a number of additional buildings, were built on the land. In 2003, in connection with the proposed privatisation of the land at Paljassaare, the Company employed an independent expert to undertake an environmental study of the Paljassaare area. The results of this study showed that the residual pollution contained in the land, despite being in excess of certain prescribed limits, did not constitute a significant environmental threat. A further independent study was also commissioned, the results of which indicated that radiation levels at the wastewater treatment plant were normal and that there was no radiological risk to the area surrounding the wastewater treatment plant. The Company has subsequently obtained ownership of the land at Paljassaare as part of the privatisation process. See “— Property, Plant and Equipment — Privatisation of Land” for details of the privatisation regime.

Notwithstanding the results of the studies commissioned by the Company, it is unable to determine with any certainty whether the pollution levels at the Paljassaare wastewater treatment plant are significant or whether the Company, as owner of the land, would be required to remedy the effects of any pollution or other environmental liability associated with its ownership of polluted land and/or pay damages for any environmental liability in the future. If it is determined in the future that the Company is liable for pollution levels at the site of its wastewater treatment plant and that it is required to remedy the effects of the pollution, there can be no assurance that the costs of undertaking the required remedial steps and/or the amounts of compensation payable would not be significant. Furthermore, although the Company believes that under Estonian law it is able to argue against any alleged liability of it and/or to seek redress against the party which owned or operated the landfill site prior to its transfer to the Company, there can be no assurance that the Company would be successful in these arguments and/or in any action to recover any of the costs from, or transfer any of its potential liability to, that party. In addition, the Company believes that any potential exposure by it to liability is further mitigated by the fact that it is currently in the process of completing the sale of approximately half of the total area of land at the Paljassaare site which it considers to be surplus to its requirements. Furthermore, the buyer of the land has agreed to assume any environmental liability in respect of the land being purchased by it. See “Risk Factors — Risks Related to the Company — The Company is unable to guarantee that there will be no potential pollution liability from the previous waste disposal site below Paljassaare” and “The Estonian Water Industry and Regulation — Environmental Matters and Regulation — Liability for Contaminated Land” for further details.

Stormwater Services

As referred to above, the Company's sewerage activities include the collection, treatment and disposal of stormwater within the Services Area on behalf of the City of Tallinn. Stormwater (which refers to all forms of precipitation falling within the collection area) is collected by the Company both in a "combined" network, which carries wastewater and stormwater, and in a "separate" network of stormwater drains, which carry only stormwater. After collection, the stormwater is conveyed by the combined network to the Company's wastewater treatment plant at Paljassaare, is treated at the plant and is discharged into the Baltic Sea in the same manner as the wastewater collected by the Company. The stormwater collected in the Company's separate stormwater system is discharged directly to the Baltic Sea via 16 outlets. See "— Wastewater Network" and "— Wastewater Treatment and Disposal" above.

However, in the case of extreme rainfall levels such as the unprecedented rainfalls which were experienced in Tallinn in mid-2004 and in January 2005, the amounts of rainfall are likely to exceed the levels for which the combined sewage collection network was designed. In these circumstances, the excess stormwater which cannot be conveyed by the normal sewage collection network and treated at the wastewater treatment plant is instead diverted to alternative stormwater drains and discharged untreated directly into the Baltic Sea via outflow pipes located on the shores of the Bay of Tallinn. In these circumstances, although a certain amount of untreated sewage is discharged into the Baltic Sea together with the excess stormwater, the environmental impact of discharging untreated effluent into the Baltic Sea is substantially mitigated by the dilution of pollutants in the effluent due to the significantly higher volumes of stormwater being discharged.

The Company is contractually obliged in the Storm Water Agreement to extend the stormwater network in the Services Area. The Company determines the extent of the extension programme to be undertaken in any year with the City of Tallinn prior to the start of the year and is reimbursed in full by the City of Tallinn in the year after the relevant extension programme has been undertaken.

See "— Key Operating Agreements — The Storm Water Agreement" for a description of the amounts payable by the City of Tallinn for these operations and for a description of the construction obligations of the Company.

Expansion of Networks

Network Extensions within Existing Areas

The Services Agreement required 189.6 kilometres of new sewer pipes to be constructed between 2001 and 2006, for the purpose of ensuring full coverage of the Company's sewer network in certain specified districts of Tallinn. In addition, the Services Agreement required an additional 45.3 kilometres of stormwater network and an additional 35.1 kilometres of water supply network to be constructed during the same period. However, these obligations were superseded by the 2002 Amendment Agreement and the 2005 Amendment Agreement which provided a new framework for the extension of the sewer network and extended the timetable for completion of the programme to the end of 2010.

The 2002 Amendment Agreement provided that the extent of network extensions to be carried out by the Company in each year (pursuant to the Services Agreement, additional programmes agreed with the City of Tallinn, and the Tallinn public water supply and sewerage system development plan) was to be dependent on the availability of funds to the City of Tallinn from its annual budget. The City of Tallinn was required annually to approve the scope of network extensions by the Company. The parties were required jointly to monitor the network extensions made by the Company during the year and the City of Tallinn was required to ensure that relevant allocations were made in its budget for each subsequent year for the reimbursement of the Company of the network extension costs incurred by it. The 2002 Amendment Agreement also provided that if the scope of network extensions set out in the Services Agreement was not achieved, due to the application of the above provisions or to the fact that the amounts allocated were not paid in time for reasons attributable to the City of Tallinn, the penalties set out in the Services Agreement or other remedies for failure to comply with the requirements set forth therein were not to be applied.

In the 2005 Amendment Agreement, the City of Tallinn, the Company and UUTBV agreed a new network extension programme, based on the principles agreed in the 2002 Amendment Agreement. In the 2005 Amendment Agreement, the parties also agreed upon new principles of reimbursement by the City of Tallinn for the network extension costs incurred by the Company. According to the new principles agreed between the parties, where the Company's network extension charges are eligible for

compensation by the City of Tallinn (as described in “The Estonian Water Industry and Regulation — Economic Regulation — Connection Charge — Compensation for Connection Charges”), the compensation is to be paid in the following manner, whereby the amount of the connection charge paid by the City of Tallinn depends on the date by which connection to the network occurs:

- if a customer connects to the relevant network extension within 12 months after the date on which the permit for use was issued in respect of the extension or a part thereof, the City of Tallinn is required to pay 100 per cent. of the relevant connection charge to the Company on behalf of the connecting customer; and
- after 12 months from the date on which the permit for use was issued in respect of the extension or a part thereof, the City of Tallinn is required to pay the Company an amount equal to 80 per cent. of the amount of the connection charges relating to the properties the owners of which have been given the opportunity to connect to the network but have not done so.

If a customer connects to the relevant network extension after 12 months after the date on which the permit for use was issued in respect of the extension or a part thereof, the relevant customer must itself pay the remaining 20 per cent. of the connection charge to the Company directly.

The compensation levels agreed between the Company and the City of Tallinn for the years 2005-2011 average approximately EEK55 million per year (the exact amount per year being subject to the City of Tallinn’s allocation in its annual budget for the relevant years of sufficient funds therefor).

For those properties constructed which are not eligible for compensation from the City of Tallinn (i.e., all residential buildings constructed on the basis of building permits issued after 16 June 1995 and all commercial buildings), the connecting customers pay 100 per cent. of their connection charges directly to the Company.

As at 31 December 2004, approximately 59.0 kilometres of new sewer pipes, 13.5 kilometres of new stormwater pipes and 13.7 kilometres of new water supply pipes had been constructed since the Company’s privatisation in January 2001, which has also necessitated the construction of 15 additional local pumping stations.

In addition to the construction activities which the Company undertakes on behalf of the City of Tallinn as described above, the Company also provides technical advisory services to individual customers and housing developers wishing to connect to the Company’s water distribution network and sewer network. The Company levies lower charges on these customers as its services are generally confined to the provision of technical expertise, and the Company is not required to undertake the project management or financing of these connections in the same manner as it does so on behalf of the City of Tallinn. Revenues from these private customers are generally recognised when payment is received.

Expansion into New Areas

In addition to its programme of network extensions within existing areas, the Company is currently undertaking a programme of expansion of its water supply and sewerage services into additional areas not already served by it. The Company believes that it has the technical capability and capacity to do so without significant cost or risk to the Company.

Contracts may be entered into by the Company on a bulk supply basis, where the Company supplies treated water to, and collects sewage from, the boundary of the relevant area. In addition, the Company may participate from time to time in public bid processes to be awarded the contract to operate the water supply and sewerage services within the relevant area itself. Depending on the circumstances, the contract may be for both water supply and sewerage services or only one of these services.

Although the expected volumes for its water supply and sewerage services in these additional areas are currently small in comparison to its existing volumes within the Services Area, the Company believes that the areas neighbouring Tallinn offer greater growth potential than the Services Area, in particular because of population trends in Tallinn and the movement of a number of commercial enterprises from the Services Area to other areas neighbouring Tallinn. See “— Customers” below for further details.

As a result of this expansion programme, between January 2001 and the date of this Offering Circular, the Company has been appointed as the exclusive provider of water and sewerage services in three services areas in addition to the Services Area, and has concluded contracts (for periods of five to 10 years) for water supply and/or sewerage services within an additional 11 services areas. The Company

expects to conclude agreements with four additional municipalities for the provision of its services during 2005.

Customers

The following table sets out information regarding volumes of water and sewerage services invoiced by the Company, by type of customer, for each of the years ended 31 December 2001, 2002, 2003 and 2004:

	Year ended 31 December							
	2001		2002		2003		2004	
	<i>Volume⁽¹⁾</i>	<i>(per cent.)</i>	<i>Volume⁽¹⁾</i>	<i>(per cent.)</i>	<i>Volume⁽¹⁾</i>	<i>(per cent.)</i>	<i>Volume⁽¹⁾</i>	<i>(per cent.)</i>
Water supply								
Residential.....	16.0	76.4	15.5	76.4	15.5	76.5	14.7	75.8
Commercial.....	4.9	23.6	4.8	23.6	4.7	23.5	4.7	24.2
Total	<u>20.9</u>	<u>100.0</u>	<u>20.3</u>	<u>100.0</u>	<u>20.2</u>	<u>100.0</u>	<u>19.4</u>	<u>100.0</u>
Sewerage								
Residential.....	15.4	70.0	14.9	69.8	15.0	69.8	14.5	68.2
Commercial.....	6.6	30.0	6.5	30.2	6.5	30.2	6.7	31.8
Total	<u>22.0</u>	<u>100.0</u>	<u>21.4</u>	<u>100.0</u>	<u>21.5</u>	<u>100.0</u>	<u>21.2</u>	<u>100.0</u>

Note:

(1) In millions of cubic metres.

Information on volumes during the three months ended 31 March 2005 is included in “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Factors Affecting the Company’s Results of Operations — Effects of changes in tariffs”.

The Company’s customer base comprises a wide range of residential, commercial, industrial and governmental customers within the Services Area. The Company’s residential customers accounted for approximately 59 per cent. and 55 per cent., respectively, of the Company’s water supply and sewerage revenues during 2004. In comparison, the Company’s commercial customers accounted for approximately 41 per cent. and 45 per cent., respectively, of the Company’s water supply and sewerage revenues during the year. During 2004, no single customer accounted for more than two per cent. of the Company’s total net sales from its main operating activities.

The Company’s total number of customers as at 31 December 2004 for its water supply services was 18,860, comprising 16,684 residential customers and 2,176 commercial customers. The Company’s total number of customers as at 31 December 2004 for its sewerage services was 13,949, comprising 11,911 residential customers and 2,038 commercial customers. However, the Company estimates that it provided water and sewerage services to over 400,000 people located in the Services Area during 2004. The total number of customers as at 31 December 2004 for each of the Company’s water and sewerage operations was lower than the respective numbers of customer connections as at that date due to the fact that certain customers (in particular the Company’s larger commercial customers) have more than one connection per customer, for example factories with multiple production units requiring separate connections for each production unit. The difference between the number of customer connections and the number of people served is accounted for by the fact that customer connections are either at the household level, with households often including more than one person, or at an apartment block level where one single customer connection can account for multiple apartments and therefore up to several hundred consumers in some instances.

The Company’s customer profile has been affected over the last 10 years by population trends in Tallinn and the movement of some of its commercial customers from the Services Area to other areas neighbouring Tallinn. Over recent years the urban population has tended to migrate to new housing areas further from the city centre, some of which are outside the Services Area. The Company’s water and wastewater volumes are also affected by a proportion of its customers leaving the Services Area for weekends and for extended periods during holidays, in particular over the summer months, although this decline is partially offset by an increase in tourist numbers in the Services Area during this period. Finally, water supply volumes have also been affected by rainfall levels over recent years. In particular, as illustrated by the table above, residential water supply volumes fell in 2004 primarily due to the heavy rainfall in Tallinn over the summer months of that year, meaning that less water was required by the Company’s customers for watering purposes.

The Company established its dedicated customer service department in 2001 following its privatisation at the start of that year. As at 31 December 2004, 28 employees were employed in the department. In addition to its operational activities designed to improve water quality and reduce water losses, the Company has undertaken a number of initiatives to improve its customer service generally, such as the implementation of a contact centre to answer any customer query (written or by telephone), a 24-hour telephone number for customers to provide their meter readings, new offices that will be opened in June 2005 and a new customer information/billing system which will be operational by the end of 2005.

The Company has also undertaken public awareness campaigns relating to its efforts to deliver high quality drinking water at a low cost to its consumers, and the circulation of the customer newsletter "Veeleht" twice a year to approximately 130,000 households in Tallinn. The Company has commissioned independent customer services analyses of its operations, pursuant to which both customers and end-users are questioned about the Company's services, and believes that the results of these studies are positive and demonstrate the success of the Company's initiatives by reporting improved customer satisfaction levels. In the most recent survey in November 2004, the overall number of customers who were "satisfied" and/or "very satisfied" with the Company's service was 77 per cent. and the overall number of customers who were satisfied with the quality of the Company's drinking water had risen by approximately 22 per cent. as compared to the previous year. The Company also expects to deliver improved levels of customer service following the introduction of more functionality on its customer website, in connection with an upgrade of the Company's information technology systems expected to be concluded by the end of 2005.

Tariffs

The Services Agreement provides that the Company is entitled to charge its customers for its water and sewerage services, and sets out the basis for the determination of applicable tariffs and their adjustment in certain specified circumstances. Tariffs are applicable for a calendar year and are generally adjusted annually. Separate tariffs are payable by the Company's customers for each of its water supply and sewerage services. The Company's commercial customers are charged higher tariffs for the Company's water and sewerage services than are payable by its residential customers.

The following table sets out details of the Company's tariffs applicable to its residential and commercial customers located in the Services Area for each of the years ended 31 December 2001, 2002, 2003 and 2004, as well as the tariffs currently applicable during 2005:

	Year ended 31 December				
	2001	2002	2003	2004	2005
	<i>(EEK per cubic metre, including VAT)</i>				
Residential tariff					
Water.....	8.30	8.85	8.85	10.08	11.67
Sewerage.....	6.70	7.15	7.15	8.15	9.44
Total.....	15.00	16.00	16.00	18.23	21.11
Commercial tariff					
Water.....	20.10	21.48	21.48	24.44	28.28
Sewerage ⁽¹⁾	14.90	15.93	15.93	18.12	20.98
Total.....	35.00	37.41	37.41	42.56	49.26

Note:

- (1) Commercial tariffs for sewerage reflect the common minimum applicable rate, rate SG2. Other commercial tariff rates apply for sewerage which are dependent on levels of pollution in the wastewater.

As illustrated by the table above, the actual tariffs levied by the Company in 2003 did not change from the tariffs applicable in 2002. The Company agreed to maintain its 2003 tariffs at 2002 levels in return for the City of Tallinn's agreement in advance of the size of the K coefficient (described below) for each of the years from 2004 to 2010 (inclusive). This agreement has been recorded in the 2002 Amendment Agreement which the Company believes has provided it with a stable platform for conducting its operations until the end of 2010. Different tariffs may be applicable to the Company's water supply and wastewater services in areas served by it which are located outside the Services Area depending on the type of service provided.

The Company believes that, in respect of its residential customers, the proportion of average earnings in Estonia represented by a customer's average water and sewage costs remains low in comparison to other countries in the Baltic region and other countries in western Europe, notwithstanding the recent rises in tariffs illustrated in the table above.

The Company's charges levied on its customers are based solely on volumes of water supplied to and sewage collected from the customer's premises. A standing, fixed charge may, under applicable laws and the terms of the Services Agreement, be levied on customers, but is not currently used by the Company. The tariff for each year is based on the tariff for the immediately preceding year, as adjusted in line with changes in the Consumer Price Index as published by the Statistical Office of Estonia and as adjusted by reference to a further variable (the "K coefficient") agreed between the Company and the City of Tallinn for each year. The K coefficient reflects changes in necessary expenses to be made by the Company to achieve its Levels of Service. In September 2002, the City of Tallinn, the Company and IWUU (now UUTBV) agreed the level of the K coefficient for each of the years 2003 to 2010, inclusive, which are recorded in the 2002 Amendment Agreement. The K coefficient agreed for the period of 2005 – 2010 is as follows: +10 per cent. in 2005, +6.5 per cent. in each of 2006, 2007 and 2008 and + 2.0 per cent. in each of 2009 and 2010.

Tariffs may also be adjusted to take into account the consequences of certain events that qualify as a change of law affecting the Company's operations and its ability to comply with its obligations under the Services Agreement, as well as in circumstances where changes to the Services Agreement are required following the occurrence of one or more *force majeure* events, or to take account of an increase or decrease in the cost of raw water abstraction. Any additional costs associated with any change of law or *force majeure* event are not the responsibility of the Company and can be recovered from customers through tariff adjustments in the following year. The tariffs are also adjusted to take into account any amendments to the contractual arrangements proposed by either the City of Tallinn or the Company itself. See "Risk Factors — Risks Related to the Estonian Water Industry and Regulation — The City of Tallinn may not authorise in a timely manner or at all increases in customer tariffs under the Services Agreement".

Billing Procedures

The procedure for billing and payment of the Company's water and sewerage services is similar for each customer category. Water and sewerage bills are based upon water usage determined by water meter readings, which are given by the customers themselves (and checked at least annually by the Company) or, in the case of larger accounts, which are taken by Company personnel to ensure accuracy. Water meter readings are taken monthly or quarterly, depending on the type of customer. Sewerage billing is included as part of the water bill and is generally based on the water meter reading or, in limited circumstances, readings taken from separate wastewater meters. The actual amount payable by the customer is determined by applying the applicable tariff to the volumes used.

Substantially all of the Company's customers are connected to the water distribution network by meters, which are replaced regularly to ensure continued accuracy of meter readings and to reduce non-physical water losses. Meters are generally physically checked once per month in the case of commercial customers and once per year in the case of residential customers. Meter readings are given to the Company by customers by telephone, via a 24-hour telephone service, or by electronic mail.

Water and sewerage bills can be paid at all banks and offices of Eesti Post, the Estonian post office, in Tallinn. If payments are made at the post office the Company meets the transaction fees levied by the post office for effecting payments. Payments can also be made at the Company's offices in Tallinn. The Company is preparing to offer direct debit payment services by the end of 2005.

Customers must pay their water and sewerage bills by the due date for payment if they wish to avoid paying interest on late bill payments. The Company also sends reminders in respect of unpaid invoices to customers, and in extreme cases has the power to disconnect the customer's water supply, provided that it has notified the local city government where necessary. The Company believes that it has an efficient billing process and has, since privatisation, experienced very high levels of collection of invoices and few delays in the collection process. It has also improved the number of debtor days since privatisation by implementing enhanced collection policies. Since 2001, the Company has reduced the average number of days receivable from 48 to 38. The Company believes that its exposure to uncreditworthy residential end-users is substantially mitigated by the fact that its customer for the purposes of approximately 88 per cent. of its residential end-users is the apartment association or other representative of residents of an

apartment block, and not the end-user itself. The risk of non-collection from the end-user in circumstances like these is therefore borne by the customer and not the Company.

Laboratories, Technical Services and Research and Development Activities

The Company operates two laboratories, one at the Ülemiste water treatment plant and one at the Paljassaare wastewater treatment plant. The laboratories analyse and test the Company's water and wastewater to ensure the production of high quality water and/or the emission of effluent that is compliant with all applicable requirements. The Services Agreement requires the laboratories to have both up-to-date laboratory equipment and the latest staff training in accordance with applicable European Union directives. In December 2001, the laboratories at each treatment plant received ISO 17025 certification, which has been reaffirmed each year since that date.

The laboratory at the Ülemiste water treatment plant takes water samples at all stages of the water production process, including from Lake Ülemiste and its catchment area and inflow channels, each stage of the treatment process at the plant and at 130 points in the distribution network. In addition, groundwater from bore wells operated by the Company is also tested. The laboratory at the Paljassaare wastewater treatment plant also takes samples at all stages of the wastewater treatment process. Approximately 20 technicians, biologists, engineers and chemists in aggregate are employed at the Company's laboratories and perform on average an aggregate of approximately 12,500 analyses per month.

The Company has entered into a Technical Services Agreement with United Utilities International Limited in connection with its operations. United Utilities International Limited provides technical services to the Company such as the transfer of know-how and other water industry technology from the United Utilities group of companies. See "Principal and Selling Shareholders — Related Party Transactions — The Technical Services Agreement" and "Risk Factors — Risks Related to the Company — The Company benefits from the transfer of know-how and other water industry technology from United Utilities International Limited and other companies within the United Utilities group" for further details.

In addition, the Company has undertaken a number of research and development-related initiatives over recent years to improve the quality of drinking water and to minimise the environmental impact of the discharge of wastewater into the Baltic Sea. These initiatives have included the implementation of the chemical PAX 18 in the water treatment process, the biomanipulation of Lake Ülemiste, the use of sludge for composting and the use of untreated sludge for reforestation. The Company's initiatives to improve its treatment processes are undertaken on a continuous basis by specialists employed by the Company with the assistance of its laboratories. The Company has also worked with the Tallinn Technical University to develop hydraulic models for the operation of its water and sewer networks, and has concluded an agreement with the Tallinn Technical University to upgrade and develop these models further.

The Company's total expenditure incurred solely in relation to its research and development activities during 2004 was EEK85,000, as compared to approximately EEK211,000 during 2003.

Industrial and Intellectual Property

The Company does not own any patents, utility models or trademarks.

Pursuant to the Technical Services Agreement, the Company receives technical and asset management services from United Utilities International Limited and other companies within the United Utilities group, including know-how and technology, for which the Company is granted a royalty-free perpetual licence to use any intellectual property rights, which survives the expiry or termination of the Technical Services Agreement (see "Principal and Selling Shareholders — Related Party Transactions — The Technical Services Agreement" for further details).

Electricity Consumption

The Company's operations require the use of a significant amount of electricity. As a result, the Company is one of the largest users of electricity in Tallinn. The Company obtains all of its electricity from a single supplier, the state-owned national electricity company AS Eesti Energia. This electricity is acquired at the market rates charged to industrial customers. In 2004, power constituted 13.4 per cent. of the Company's cost of goods sold – main operating activities.

The Company uses various initiatives in order to reduce its total electricity consumption. For example, the Company recycles biogas (which contains methane) produced at the Paljassaare wastewater

treatment plant and burns it for use in heating the plant and powering certain of the treatment processes undertaken at the plant.

To date, the Company has not experienced any major disruptions in its electricity supply. Any significant disruption of electricity to the Company could, however, have a material adverse effect on the Company's business, financial condition, results of operations or prospects. The risk of interruption is, however, mitigated by the multiple electricity connections to the power grid at both the Ülemiste water treatment plant and the Paljassaare wastewater treatment plant. In addition, the Ülemiste water treatment plant has standby electricity generators for use during disruptions of electricity to the Lake Ülemiste facility. See "Risk Factors — Risks Related to the Company — Interruptions in the supply of electricity, and significant increases in the price of electricity, may adversely affect the Company's business" for further details.

Property, Plant and Equipment

The Company's principal properties consist of reservoirs, a raw water treatment facility at Lake Ülemiste, a water distribution network consisting of water pipes, water mains, water connections and water meters, pumping stations, a wastewater treatment facility at Paljassaare and a wastewater collection network consisting of sewer lines, sewer connections and stormwater drains. As at 31 December 2004, the Company substantially owned 884 kilometres of water pipes and mains and 1,045 kilometres of wastewater, combined sewer and stormwater lines, as well as two water quality laboratories. The Company also owns its headquarters building.

Substantially all of the Company's movable assets and certain of its immovable assets have been pledged or are subject to other security interests in favour of the EBRD as security for its €80 million loan facility made available to the Company in 2002. See "Principal and Selling Shareholders — Related Party Transactions — The EBRD Loan Agreement" for further details. "Immovables" (*kinnisasi*) are delineated parcels of land. All other objects, which are not immovables by definition, are "movables" (*vallasasi*).

On 31 December 2004, the total net book value of the Company's property, plant and equipment was EEK1,966 million.

Privatisation of Land

Pursuant to Estonian land reform legislation, owners of buildings categorised as "movables" under Estonian law have the right to acquire the land beneath and servicing their buildings. Alternatively, the owners of these buildings can instead acquire a building title right enabling them, for a period up to 50 years (or for a period of up to 99 years where permission therefor is granted by the Government), to own and freely dispose of the buildings which they have erected on real property belonging to third parties. Currently, the majority of the buildings and operating facilities owned by the Company are categorised as "movables".

In 1997, the Company filed applications for privatisation of the land underneath and servicing the Company's key buildings and facilities in Tallinn and within its water catchment area outside Tallinn, including the land underneath and servicing the pumping stations and dams, channels, reservoirs and other facilities. Privatisation of the land involves a time-consuming public administrative procedure, involving a survey of the land, the execution and notarisation of the purchase deed executed with the State, and a court decision in respect of the registration of the Company as the owner of the privatised land on the Estonian Land Register. The costs of the privatisation process must be borne by the person privatising the land. The privatisation of land involves the payment by the purchaser of the privatisation land price, which is generally the lower of the 1993 or 1996 land tax prices of the particular privatised parcel of land, rather than the current market price (land tax prices are land values determined by the relevant municipality which are used for calculating the land tax payable for the relevant parcel of land).

The Company has successfully completed the privatisation process in respect of all of the land beneath and servicing its core operating facilities, including the Company's headquarters, the water treatment plant site at Ülemiste and the wastewater treatment plant site at Paljassaare by means of purchasing the land beneath and servicing these sites. In the case of the Company's remaining operational sites (including all remaining dams, channels and reservoirs), the Company will continue with the privatisation process on a case-by-case basis, although it expects that it will seek to acquire building title rights in the case of the majority of the remaining sites and will only seek to privatise or purchase the land in exceptional cases, depending on the Company's operational priorities, the particulars of each site and cost

efficiency considerations. The Company's objective is to settle the ownership in respect of all the buildings, structures and land at its operational sites within five years.

The Shareholders' Agreement requires the City of Tallinn to assist the Company to gain valid title to the land under the buildings, structures and pipelines which were transferred to the Company upon its reorganisation or which the Company uses but which were not formally transferred to the Company.

“Ownerless” Pipes

The Company currently uses in its operations certain pipes forming part of the public water supply and sewerage network of the City of Tallinn, but for which ownership is not clear (referred to in this Offering Circular as “ownerless” pipes). The Company uses and maintains these pipes at its own cost.

The City of Tallinn is in the process of acquiring ownership of these pipes by means of occupation procedures available to the State and local government under Estonian law. The 2002 Amendment Agreement and 2005 Amendment Agreement require the City of Tallinn to create servitudes (personal rights of use) in respect of these pipes in favour of the Company and to transfer them by 1 January 2008 to the Company without any cost to the Company. The Company estimates that approximately 150 kilometres of ownerless pipes which the Company uses in its operations will be transferred to the Company pursuant to this process.

Prospective Transfer of Pipes to the City of Tallinn

The Company and the City of Tallinn have agreed in principle that the Company may transfer certain of its pipes, on a case-by-case basis, to the City of Tallinn to the extent required to ensure the eligibility of the City of Tallinn to receive funding from the European Union for renovation projects supported by the European Union. To the extent that any transfers are made, the City of Tallinn is required to return the relevant assets to the Company for nominal consideration after the expiry of the relevant holding period as is required by the funding conditions imposed by the European Union. See “Management's Discussions and Analysis of Financial Condition and Results of Operations — Factors Affecting the Company's Results of Operations — Revenues from network extensions” for further details.

Title to Network Constructed since April 1999

Estonian law provides that the Company's network and other technical infrastructure facilities built on municipal or state owned land (where that land has not been registered at the Land Register) since 1 April 1999 must be built on the basis of a written agreement with the landowner; otherwise title to the assets vests in the landowner. In addition, where, since 1 April 1999, these facilities have been built on land owned by private parties (and the land has been registered at the Land Register), the construction is required by Estonian law to have been carried out on the basis of a real servitude or personal right of use.

A substantial proportion of the Company's network which has been constructed after 1 April 1999 is located on municipal or state owned land. However, the Company has not effected express written agreements with the relevant state or municipal landowner for the construction. Similarly, the Company has not acquired real servitudes or personal rights of use in respect of a substantial proportion of its network which has been constructed after 1 April 1999 on land owned by private parties.

The Company believes that the proportion of its total network which falls within the above categories is small (because a substantial majority of its network was constructed prior to 1 April 1999). In addition, the Company is in the process of implementing written arrangements with the City of Tallinn in respect of those areas of the network which have been built on municipal or state owned land where the required arrangements are not yet in place. Nevertheless, there can be no assurance that a proportion of the Company's network constructed after 1 April 1999 will not be deemed to have been unlawfully constructed. If this is the case, the relevant parts of the network will become the property of the landowner in accordance with Estonian law. See “Risk Factors — Risks Related to the Company — The Company may not have title to its network which has been constructed since April 1999” for further details.

Outsourcing

In common with the practice of the majority of water industry participants, the Company outsources all construction work, which primarily relates to network extensions, network replacement, rehabilitation, refurbishment, upgrading of its main treatment plants and the construction of additional pumping stations required to ensure adequate water and sewage flows to and from the extended parts of the network. A limited proportion of maintenance and repair work is also outsourced depending on internal resources

and the terms offered by third party providers. The Company has also outsourced its transport operations and the operation of its 24-hour meter reading telephone service. The Company does not currently believe that the outsourcing of any of its other core activities would be in the interests of the Company.

Competition

The Company does not currently face competition in its water and sewerage disposal operations within the Services Area due to the exclusive nature of its appointment as the water company for the Services Area. The Company has been granted the exclusive right to provide water supply services and wastewater collection, treatment and disposal services and to undertake certain other related activities within the Services Area for a 15-year period from November 2000. Furthermore, in November 2015, when the current contract period is expected to expire, the Company believes that it will have a substantial competitive advantage over other potential bidders for the renewal of its exclusive appointment as the water company to the Services Area due to the fact that the Company already owns the substantial majority of the fixed assets required by any water operator for its operations, such as the networks and the treatment plants. The Company believes that its position will be further strengthened by the draft PWSSA Amendment Act, which is expected to come into force during 2005. The draft legislation provides that if a private company owns the public water supply and sewer network, it may make a proposal regarding the appointment of a water company and the proposal shall be confirmed by the local municipality, with the result that the exclusive right to provide the relevant services would be able to be granted without the need for the municipality to carry out a public tender. See “The Estonian Water Industry and Regulation — The Draft PWSSA Amendment Act”.

Insurance

Pursuant to the Services Agreement, the Company is obliged to maintain insurance for physical loss and damage, property damage, business interruption, third party liability and any other matters against which a prudent company undertaking business operations and activities similar to those of the Company would insure. The Company believes that it maintains insurance in a manner which is in compliance with the Services Agreement and in accordance with customary industry practices.

All the Company’s monetary claims exceeding €10,000 (except claims for the compensation of damage to injured third parties arising from civil liability insurance contracts, which are not subject to any minimum amount), against an insurer arising from all existing or future contracts concluded by the Company whereby its loss, damage or civil liability have been or will be insured, have been pledged in favour of the EBRD as security for its €80 million loan facility made available to the Company in 2002. See “Principal and Selling Shareholders — Related Party Transactions — The EBRD Loan Agreement” for further details.

Legal Proceedings

The Company is party to a number of legal proceedings which arise in the ordinary course of its business. In addition, the Company is aware of the following matters which, if determined adversely, could have a material impact on the Company, its financial condition or results of operations.

An Estonian individual has sought restitution of a plot of land at Mõigu Polder, comprising approximately 195,000 square metres located adjacent to Lake Ülemiste and Tallinn International Airport, based on a claim of prior ownership. The land is currently owned by the State and is used by the Company as an integral part of its stormwater collection and drainage operations, and if the claim is successful the Company would likely need to acquire a replacement plot of land to fulfil its stormwater collection and drainage obligations under the Services Agreement and Storm Water Agreement. The claim is currently being considered by the City of Tallinn. The Company is unable to predict the likelihood of success of the claim, the expected date of pronouncement by the City of Tallinn regarding its resolution of the matter or, if determined adversely for the Company, the impact of the claim on the Company, its financial condition or results of operations. The Storm Water Agreement provides that the construction of the stormwater system is the obligation of the City of Tallinn and, therefore, the City of Tallinn will be required to meet the costs of any investments required to be made to develop an alternative solution, should the claim be successful. See “Risk Factors — Risks Related to the Company — Ownership of a plot of land at Mõigu Polder is being disputed and may be determined adversely for the Company” for further details.

In April 2004, the Estonian Supreme Court concluded that utility companies in Estonia should be required to pay a charge for the use of land owned by public or private entities where the infrastructure

used by the utility passes over the land. The implementation of this charge is subject to final determination by the Government, which is currently expected during 2005. The Company is unable to predict the amount of any charge which might be payable by it to public or private entities as a result of the imposition of this service charge, and there can be no assurance that the amount of the service charge will not be substantial, in particular in view of the extent of the Company's water and sewer networks throughout the City of Tallinn and its neighbouring areas. The Company expects that the charge will apply retrospectively, with effect from 1 November 2004. Although the provisions of the Services Agreement ensure a degree of protection for the Company in the case of the occurrence of changes in law affecting its operations, by allowing the Company to recover additional costs incurred by increasing future tariff levels and by providing that the Company is not liable for the additional costs itself, there can be no assurance that the imposition of any service charge as described above will not have an adverse effect on the Company, its financial condition or results of operations. See "Risk Factors — Risks Related to the Company — The Estonian Supreme Court's ruling relating to "servitudes" required for the Company's network located on land owned by third parties may entail significant payments by the Company to affected parties" for further details.

Save as described above, the Company is not aware of any legal proceedings, either individually or in the aggregate, which are expected to have a material adverse effect on the Company, its financial condition or results of operations.

Employees

As at 31 December 2004, the Company had 351 employees. Approximately 89 per cent. were non-management employees and approximately 11 per cent. held management positions. All three members of the Company's Management Board were seconded from the Company's indirect shareholder, United Utilities PLC, and its subsidiaries.

The following table sets out the total number of Company employees for each of the years ended 31 December 2001, 2002, 2003 and 2004, broken down into management and other employees, and also sets out the average number of employees for each year:

	Year ended 31 December			
	2001	2002	2003	2004
Management.....	35	44	38	38
Other employees	483	326	310	313
Total	518	370	348	351
Average	589	480	351	346

As can be seen from the table above, there was a reduction of 148 employees at the end of 2002. This reduction in headcount, in connection with which all employee departures were voluntary, was attributable to the Company's initiative following its privatisation to streamline its operations and maximise its operating efficiency. The Company has undertaken further steps since its restructuring in 2002 to motivate its workforce and to make training and development programmes available to its employees. In particular, in 2003 the Company commenced its "Tulemuste Võti" (Key to Results) culture change programme in which all employees, including management, participated and which the Company believes has had a significant impact on the development of its workforce and the relationship both within the Company and between the Company's management and the rest of its employees. In addition, in 2003 the Company also introduced performance-related pay as a component of the remuneration package of all members of its workforce. The Company believes this has had a positive impact on the motivation of its employees and their own development, as the performance-related pay is based on the performance both of the individual concerned (as to 60 per cent. of the performance-related pay) and of the Company as a whole (as to 40 per cent.). Finally, the Company has also sought to empower its employees by delegating decision-making to an operational level and seeking to ensure that cost reductions and other operational efficiencies are implemented on a decentralised basis.

As at 31 December 2004, 62 employees, representing 17.7 per cent. of the Company's workforce, belonged to the Trade Union of Water Supply and Sewerage Workers (*Veevarustuse ja Kanalisatsiooni Töötajate Ametiühing*). In 2003, the Company and the union signed a Collective Agreement, the first since 1993. The Collective Agreement is planned to be reviewed in 2005. The Collective Agreement

covers all employees of the Company. The Collective Agreement provides for, among other things, childcare benefits, long service awards and compensation in the case of the death of an employee or family member. It also provides for certain occupational health and safety issues. The Company believes that its management maintains a strong relationship with union officials and its members. The Company has not suffered any strikes or threats to strike by its workforce since its privatisation.

The Company's internal structure comprises three principal departments: (i) the Corporate Services Division, (ii) the Operations and Customer Services Division, and (iii) the Finance Division. Significant changes were made in the Company's internal structure in 2003 to centralise certain activities of the Company (e.g. the internal structure of five divisions was streamlined into three divisions). One of the principal changes concerned the formation of an additional division, which comprises both operational and development departments that previously were separate divisions.

Other Activities

The Company has been engaged by the EBRD to undertake a consultancy project on behalf of a water company operating in Tajikistan. The value to the Company of the project, which commenced in mid-2004 and is expected to be completed by the end of 2005, is approximately €280,000. The work has been undertaken by the Company on arm's length commercial terms. The Company does not expect to undertake work of this nature on a regular basis.

THE ESTONIAN WATER INDUSTRY AND REGULATION

Regulation of the Water and Sewerage Industry in Estonia

Regulatory Framework

The current regulation of the water and sewerage industry in Estonia dates back to 1999, when the Estonian Public Water Supply and Sewerage Act was enacted. The PWSSA regulates the supply of water from the public water supply and the collection and treatment of wastewater via the public sewerage system. It also provides for the corresponding rights and obligations of the State, local governments, water companies (such as the Company) and customers. Most of the matters regulated by the PWSSA are further implemented by regulations of local governments.

The activities of the Company as a provider of water and sewerage services are also subject to the Estonian Water Act, effective as of 16 June 1994, which regulates the use and protection of water and relations between landowners and water users, and provides for the issuance of permits for the special use of water.

Provision of Water and Sewerage Services

Legal Basis for Provision of Services

Exclusive Right for Provision of Services

In Estonia, water companies operate on the basis of an exclusive right granted by a local government. The PWSSA provides that a water company is appointed (i.e. in practice the exclusive right is granted) by a decision of the local government council on the basis of the Estonian Competition Act (*Konkurentsiseadus*) pursuant to the procedure established by the Government as described below.

The procedure for organising a public tender for granting special or exclusive rights was established by Decree No. 303 of the Government, dated 25 September 2001. The Competition Act provides that special or exclusive rights are rights granted to a company by the state or a local government, which enable the company either to have a competitive advantage over other undertakings or to be the only undertaking in the market.

An open tender procedure is generally used to determine the entity to be granted a special or exclusive right. The organiser of the public tender reviews and evaluates all bids on the basis of the terms and conditions of the tender documentation.

Water companies are appointed separately for each services area (licensed territory), determined by a decision of the local government council. In the administrative territory of the City of Tallinn, there are currently 12 services areas. Between January 2001 and the date of this Offering Circular, the Company has been appointed as the exclusive provider of water and sewerage services in three services areas in addition to the Services Area, and has concluded contracts (for periods of five to 10 years) for water supply and/or sewerage services in an additional 11 services areas. The Company expects to conclude agreements with four additional municipalities for the provision of its services during 2005.

In Tallinn a public tender for the appointment of a water company to operate in the main services area No. 1 (the Services Area) was announced on 2 September 2000. As a result of the public tender, the Tallinn City Council appointed the Company as the water company in the Services Area on 30 November 2000.

The Company provides its services in the Services Area on the basis of the Services Agreement entered into with the City of Tallinn on 12 January 2001, as subsequently amended.

Term of the Exclusive Right

Special and exclusive rights are generally granted on the basis of a public tender for a period of five years. However, the Government may allow rights with a longer duration on the basis of a proposal from a minister or the relevant local government.

On the basis of Order No. 641-k of the Government, dated 1 August 2000, the City of Tallinn was authorised to grant water companies the exclusive right to operate in any of the services areas of Tallinn for up to 15 years. It was on this basis that the exclusive right in the Services Area was granted to the Company for a period of 15 years.

In the services areas of Raku-Raudalu and Mõigu, the Company has been appointed as the water company for a period of five years, with effect from 19 August 2004. In the Apametsa services area of

Harku parish, the Company has been appointed as the water company for a period of five years, with effect from 28 August 2003.

After the expiry of the term of the exclusive right, a new public tender for the appointment of a water company must be announced in accordance with applicable requirements. Although the exclusivity period under the Services Agreement expires in November 2015, the Services Agreement provides that its term may be extended by the City of Tallinn beyond that date. However, the City of Tallinn must carry out a competitive tender process on expiry of the exclusivity period, and there can therefore be no assurance that the Company will be awarded the renewal of the contract at the time of its expiry, whether by virtue of the imposition of any legislative changes prohibiting the Company from doing so, or as a result of another water services company submitting a more attractive tender. Moreover, the new tender would be for five years only, unless a further specific exception is granted by the Government on the occasion of the renewal. However, the Company believes that its position is strengthened by the fact that the City of Tallinn is obliged by the terms of the Services Agreement to ensure that the tender process takes into account the competence of bidders to provide the relevant services, and in determining that competence the City of Tallinn shall take into account whether or not the bidder has ownership or control of the assets required to provide the relevant services. The Company believes that its position will be further strengthened by the draft PWSSA Amendment Act, which is expected to come into force during 2005 and which provides that if a private company owns the public water supply and sewerage network, it may make a proposal regarding the appointment of a water company and the proposal shall be confirmed by the local municipality, with the result that the exclusive right to provide the relevant services would be able to be granted without the need for the municipality to carry out a public tender. See “— The Draft PWSSA Amendment Act” below.

Provision of Public Water Supply and Sewerage Services

Construction and Development of the Public Water Supply and Sewerage System

A public water supply and sewerage system is constructed on the basis of, and following approval by the relevant local government council of, a public water supply and sewerage system development plan. The development plan must be prepared for a period of at least 12 years.

The basis for the construction and development of the public water supply and sewerage system in Tallinn is the Public Water Supply and Sewerage System Development Plan of Tallinn for 2004 – 2015, adopted by the Tallinn City Council on 13 May 2004. The Development Plan provides for, among other things, the following:

- delineation of the area serviced by the public water supply and sewerage system;
- an estimate of the cost of constructing the public water supply and sewerage system;
- water extraction points used in the public interest and for extracting firefighting water; and
- connections between the public sewerage system and collection of rain water, drainage water and other soil and surface water.

The owner or possessor of a public water supply and sewerage system is obliged to develop the system in the area serviced by it in a manner which ensures that all the immovables in the area are supplied with water from the public water supply and that wastewater is led off from the immovables to the public sewerage system. Furthermore, in its services area, a water company must ensure the functioning and maintenance of the public water supply and sewerage system pursuant to the rules on use of the public water supply and sewerage system and a contract entered into between the local government and the water company, being the Services Agreement in the case of the Company.

Connection to the Public Water Supply and Sewerage System

In accordance with the PWSSA, the connection of a customer to the public water supply and sewerage system is regulated on the basis of a connection contract entered into between the customer and the water company (the “Connection Contract”). The Connection Contract must comply with regulations adopted by the local government, as well as being compatible with the contract between the local government and the water company.

The boundary between a public water supply and sewerage system and the water supply and sewerage facilities of an immovable is determined by the connection point. A connection point is the connection point between a public water supply and sewerage system and the water supply and sewerage facilities of

an immovable. A connection point may be situated up to two metres outside the boundary of an immovable, unless otherwise agreed by the water company and the owner or possessor of the immovable.

The water company must permit connection of the water supply and sewerage facilities of immovables to the public water supply and of the sewerage facilities of immovables to the public sewerage system under the conditions provided by the PWSSA and legislation established on the basis thereof.

Specific rules for connection to the public water supply and sewerage systems are enacted by local governments. In Tallinn, the Rules on Connection to the Public Water Supply and Sewerage System of Tallinn were established by Decree No. 24 of the Tallinn City Council, dated 15 June 2000. The decree provides for, among other things, the following:

- the conditions for the connection of the water supply and sewerage facilities of immovables to the public water supply and sewerage system;
- the procedure for reviewing applications for connection;
- the bases for calculation of connection charges; and
- the procedure for payment of connection charges.

An application for connection will be denied if (i) the applicant's need for water cannot be satisfied from the public water supply without impairing the proper functioning thereof, (ii) the applicant wants to discharge wastewater into the public sewerage system, but the content of the hazardous substances in wastewater does not comply with applicable requirements or (iii) the amount of wastewater of the applicant cannot be collected by the public sewerage system without damaging the system.

Use of the Public Water Supply and Sewerage System by Customers

Customers have the right to receive water from the public water supply and to discharge wastewater into the public sewerage system in an area covered by a public water supply and sewerage system.

In order to extract water from a public water supply system and conduct wastewater to a public sewerage system, a customer and a water company are required to enter into an agreement regulating the use of the public water supply and sewerage system. In the case of a building consisting of multiple apartments and where an apartment association has been established, the contract is entered into between the apartment association and the water company.

Specific rules on use of the public water supply and sewerage systems are established by local government councils. In Tallinn, the Rules on Use of the Public Water Supply and Sewerage System of Tallinn were established by Decree No. 25 of the Tallinn City Council, dated 26 August 1999. The decree provides for, among other things, the following:

- the requirements and conditions for supplying customers with water and for the collection of wastewater;
- the procedure for metering water used and wastewater collected and, in the absence of a water meter, the procedure for calculating thereof;
- the procedure for payment for supplying water and collecting wastewater; and
- the procedure for restriction or suspension of supplying water and collecting wastewater in the case of damage to or an accident in the public water supply and sewerage system.

Use of the Public Water Supply and Sewerage System in the Public Interest

Use of the public water supply and sewerage system in the public interest comprises the following:

- the extraction of firefighting water from fire hydrants and the extraction of water from other public water extraction points; and
- the conducting of rain water, drainage water and other soil and surface water from public roads, streets and squares to the public sewerage system and the treatment thereof.

The Company has entered into two agreements with the City of Tallinn regulating the use by the City of Tallinn of the public water supply and sewerage system in the public interest:

- the agreement on the Conduct of Rain Water, Drainage Water and Other Soil and Surface Water from Public Roads, Streets and Squares to the Public Sewerage System and Treatment thereof and

the Construction of Storm Water Facilities, dated 22 June 2001 (referred to in this Offering Circular as the “Storm Water Agreement”); and

- the agreement on the Extraction of Fire Fighting Water from Fire Hydrants in the Public Water Supply System and Extraction of Water from Public Water Extraction Points, also dated 22 June 2001 (referred to in this Offering Circular as the “Fire Hydrants Agreement”). See “Business — Key Operating Agreements”.

Requirement for Water Permit

General

In order to provide public water supply and sewerage services, water companies are subject to the Water Act. One of the main requirements applicable to the use of water is the obligation to obtain permits for the special use of water (*vee erikasutushuba*, the “water permit”) in cases prescribed by the Water Act.

The special use of water is the use of water with technical equipment, constructions or substances which could affect the condition of a body of water or aquifer. A water permit is deemed to be an administrative act giving the right for the special use of water according to its conditions. Although the water permit gives the right to use water, the permits usually stipulate several conditions related to the use of water.

Generally, the environmental services of the relevant counties (*maakondade keskkonnateenistused*) within Estonia are the competent authorities for the issue of water permits.

A water permit is necessary, if, among other things:

- water is abstracted from a surface water body at a rate in excess of 30 cubic metres per day;
- groundwater is abstracted at a rate in excess of five cubic metres per day;
- effluent or other water pollutants are discharged to a body of water or to the ground;
- a body of water is barred or dammed or the level thereof is lowered; or
- the physical or chemical characteristics of water or the biological characteristics of a body of water change upon its use.

If any person who purports to carry out any of the activities referred to above fails to obtain a water permit for its activities or breaches the conditions of an existing water permit, administrative or criminal sanctions may be imposed. The polluter may also be subject to clean-up responsibilities and/or associated costs.

Holders of water permits are generally obliged to pay regular fees for the special use of water and the Company regularly pays such fees.

The principal supervisory body is the Estonian Environmental Supervisory Authority (*Keskkonnainspeksioon*), an institution separate from the issuer of the water permits. The Environmental Supervisory Authority has inspected the facilities of the Company, and has not found any material breaches nor imposed any sanctions since the Company’s privatisation in 2001.

Water permits are generally granted with terms of up to five years. A person intending to continue such activities after the expiry of its water permit must apply for and receive a new water permit for the relevant activities.

The water user must hold, in the case of using the land of another, the additional consent of the landowner. However, a local municipality which owns or possesses certain drinking water intakes need not obtain the consent of the owner of the water body. Under the Water Act, the relevant right of usufruct (*kasutusvaldus*) for the abstraction of drinking water and the maintenance of a body of water is established for the benefit of the respective local municipality. A person appointed by the local municipality may have the right of usufruct. The use of water without the relevant consent may be stopped or made subject to a fine of up to EEK30,000.

The Company does not currently own the plots of land under its water reservoirs and dams, nor does it hold the relevant consents and/or the right of use and as a result, the relevant land belongs to the State. Therefore, the issue of the landowners’ consents under the Water Act is related to the land reform and privatisation of land by the Company. See “Business — Property, Plant and Equipment”. The Company believes that the issue will cease to be of relevance or its relevance will be significantly reduced after the Company has acquired the remaining land necessary to conduct its operations.

Water Permits held by the Company

The Environmental Service of Harju County, the county in which the Company's operations are located, has issued the following water permits to the Company:

Permit number	Permitted activities	Term
L.VV.HA-13579	<ul style="list-style-type: none">● Abstraction of surface water and water from bore wells (aquifers Cm-V, Q and O-Cm)● Discharge of rain water and drainage water to water bodies● Discharge of biologically purified wastewater to water bodies	From 1 January 2003 to 31 March 2008
L.VA.HA-17798 (temporary water permit)	<ul style="list-style-type: none">● Discharge of nitrogen to water bodies	From 25 June 2003 to 31 March 2006
L.VV.HA-19537	<ul style="list-style-type: none">● Abstraction of water from bore wells at the City of Saue (aquifers Cm-V and O-Cm)	From 1 November 2003 to 31 October 2008

The Company believes that these water permits are the only water permits required to conduct its water supply and sewerage activities.

The Company also operates dams and regulates the water level in its water bodies. As described above, a water permit is necessary if a water body is barred or dammed or the level thereof is lowered. The water permits referred to above do not clearly and explicitly stipulate that the Company is entitled to dam water bodies and/or regulate water levels. However, water permit No. L.VV.HA-13579 requires the maintenance of minimum water flows to achieve sanitary conditions and of water levels in the particular water bodies. Therefore, the Company believes that it has the necessary rights to operate dams and regulate water levels.

Modification and Revocation of Water Permits

The terms and conditions of a water permit may be modified or revoked in accordance with the procedures laid down in the Estonian Administrative Procedure Act (*Haldusmenetluse seadus*), the Water Act and in implementing legislation enacted pursuant to the Water Act.

The Water Act stipulates that a water permit must be modified, if:

- the personal or contact details of a special user of water have changed;
- the legislation which constituted the basis for the requirements set by the water permit have been amended, and the public interest that the water permit be amended outweighs the person's certainty that the permit remains valid in its current form;
- a significant environmental impact arising from an activity determined by the water permit creates adverse changes in the environment due to which the requirements established by the permit must be changed;
- to prevent accidents, techniques different from those determined by the water permit are required to be applied; or
- the holder of the water permit has submitted a reasoned request that the permit be modified.

Pursuant to the Administrative Procedure Act, the relevant authority must give to the holder of permit or other parties in the procedure (if present) an opportunity to make representations and objections, which the authority must take into consideration.

A water permit must be revoked if, among other factors, the holder of the permit fails to comply with its conditions, if it becomes evident that the supply of water is not sufficient for the relevant purpose or if the special use of water directly endangers human health or the environment.

A water permit can generally only be revoked or modified if the public interest outweighs the reliance of the water company on the validity of the water permit up to its expiry date.

Water and Wastewater Quality and Levels of Service

Requirements for Drinking Water

The Water Act provides that the quality of drinking water must comply with the requirements established by the Minister of Social Affairs. Detailed requirements for drinking water, as well as control requirements and analysis methods for drinking water, have therefore been established by Decree No. 82 of the Minister of Social Affairs, dated 31 July 2001.

Drinking water is deemed to be safe for human health if its microbiological and chemical quality indicators do not exceed the limits provided for in the Decree. It is the obligation of the water company to guarantee the carrying out of regular water inspections at prescribed depths in its water supply system to ensure compliance.

Decree No. 82 provides for transitional periods with respect to certain requirements. Specific quality indicators applicable to iron, manganese, hydrogen ions, colour, smell, turbidity, conductivity, chloride and sulphate are applicable only with effect from 1 January 2007. However, pursuant to Decree No. 82 and the Water Act, the production, provision, processing and delivery of such water, i.e. water not in compliance with the specified limit values subject to the transitional period, must occur pursuant to the permit for selling drinking water (the "Sales Permit"). This permits the non-compliance of water with the quality requirements, but confirms that it is safe to drink. The Sales Permit is issued by the local health protection offices of the Health Protection Inspectorate for a period of up to three years. The Sales Permit is not required if the water that is not in compliance with the specified limit values can be brought into compliance within 30 days. The Health Protection Inspectorate has confirmed to the Company that instances of non-compliance of the water supplied by the Company have not exceeded 30 days and the Company has therefore not been required to obtain a Sales Permit.

Requirements for Wastewater

The Water Act provides a general requirement that water companies implement technological, land improvement, agrotechnical, hydrotechnical and sanitary measures to protect water against pollution and depletion or a water body against littering. The discharge of wastewater into a water body or into soil may be carried out only pursuant to the procedure established by the Government. Required measures shall be implemented at the expense of the water company.

Requirements relating to the discharge of wastewater have been established by Decree No. 269 of the Government, dated 31 July 2001. The Decree provides for upper limits on the amounts of dangerous substances in wastewater which may be discharged into a water body or soil, purification levels of effluent as well as methods for checking compliance with the requirements of the Decree.

Transitional periods have also been established with respect to certain upper limit values.

Levels of Service

In addition to the requirements applicable to drinking water and wastewater described above, more detailed "Levels of Service" (comprising minimum standards for potable water, the collection, treatment and disposal of wastewater, fire hydrant services and other services) have been prescribed by the City of Tallinn in the Services Agreement and with which the Company must comply.

Economic Regulation

General

The PWSSA provides that a water company is entitled to charge fees for connections to the public water supply and sewerage system, for the provision of water supply and sewerage services generally and for other services related to water supply and sewerage. The underlying principle of the economic regulation of a water company's activities is price control by local governments.

Connection Charge

Basis for Calculation and Payment

The PWSSA provides that the owner or possessor of a public water supply and sewerage system has the right to collect justified connection charges pursuant to the procedure and under the conditions established by the local government council from those parties which it has connected to the public water supply and sewerage system.

The charge for connection to the public water supply and sewerage system in Tallinn is calculated according to formulae set out in Decree No. 24 of the Tallinn City Council, Rules on Connection to the Public Water Supply and Sewerage System of Tallinn, dated 15 June 2000.

The amount of the connection charge in Tallinn generally depends on whether or not the water and sewerage system existed in the relevant area before 16 June 1995.

The amount of the connection charge in areas where the system existed before 16 June 1995 is based upon the cost of the construction of connection pipes and connection points for the immovable and of the construction and reconstruction of the public water supply and sewerage system required for providing services to the immovable.

In areas where no public water supply and/or public sewerage network existed before 16 June 1995, the connection charge is based upon the following:

- the area of the immovable (plot) and the maximum gross surface area of the buildings authorised by planning permission to be built on the plot (or if no planning permission exists, the actual gross surface area); and
- the connection charge rates per area unit as calculated from the costs of purchase of installations and the costs of construction and reconstruction of the public water supply and sewerage system to be performed for the requirements of the area in accordance with planning documents and the public water supply and sewerage system development plan.

The customer is required to pay the connection charge in accordance with a schedule based upon the stage of completion of the construction works to be completed under the Connection Contract.

Compensation for Connection Charges

Pursuant to Decree No. 25 of the Tallinn City Council, dated 15 June 2000, the City of Tallinn is required to compensate the person connecting to the public water supply and sewerage system (by direct payment to the Company) for all fees incurred for connection to the public water supply and sewerage system in whole or in part (according to the procedure provided for in Decree No. 25) if all of the following criteria are met:

- the applicant is the owner of a building constructed on the basis of a building permit issued before 16 June 1995;
- the building is located in an area where there is no public water supply and/or sewerage network;
- the address of the owner of the building registered in the Population Register (*Rahvastikuregister*) is an address in Tallinn; and
- the building(s) are located on a plot of land registered for residential use.

The application for compensation is reviewed and evaluated by the Municipal Engineering Services Department of the City of Tallinn (*Tallinna Kommunaalamet*).

The rights and obligations of the City of Tallinn and the Company with respect to reimbursement of the connection charges in the Services Area have been specified in the 2005 Amendment Agreement. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Factors Affecting the Company’s Results of Operations — Revenues from network extensions” and “Business — Expansion of Networks — Network Extensions within Existing Areas” for further details regarding the City of Tallinn’s agreement with the Company regarding the reimbursement of connection charges.

Tariffs

The PWSSA provides that in addition to connection charges, a water company is entitled to charge its customers for water supply and sewerage services. The charge for supplying water and collecting wastewater comprises the following:

- a basic charge;
- a charge per cubic metre of water supplied; and
- a charge per cubic metre of wastewater collected.

The charges for the service must be such that the water company is able to (i) cover operation costs, (ii) comply with applicable quality and safety requirements, (iii) comply with applicable environmental

protection requirements and (iv) operate with justified profitability. The charges may not be discriminatory with regard to different clients or groups of clients, although this does not prevent the water company from charging higher tariff levels to its commercial customers (legal persons and sole proprietors) than to its residential customers (natural persons).

The procedure for regulating prices for the supply of water and the collection of wastewater is approved by the local government council. The exact price for a specific period is established by the local government (on the basis of an application submitted by the water company) and made public at least three months prior to making changes thereto.

The current charges for the service of supplying water and collecting wastewater in the Services Area have been established by Decree No. 79 of the Tallinn City Government, dated 22 September 2004, effective from 1 January 2005. The decree does not impose on the Company's customers a basic charge (that is, the basic charge is currently levied at a zero rate), but provides for different charges with regard to natural persons and legal persons.

The fee charged by the Company for its supply of water is therefore based solely on volumes supplied, multiplied by the applicable tariff. The fee charged by the Company for its collection of wastewater is also based solely on volumes collected, multiplied by the applicable tariff.

Water consumption of all of the Company's customers is measured with water meters. Wastewater volumes are either deemed equal to the volumes of water supplied (and which have been measured by the water meter) or are measured separately by wastewater meters.

Fees for Other Services

In addition to the fees for water supply and sewerage services, a water company is entitled to collect fees for extraction of firefighting water from fire hydrants in the public water supply system, for the extraction of water from public water extraction points, for the conduct of rain water, drainage water and other soil and surface water from public roads, streets and squares to the public sewerage system and for the treatment thereof, provided that agreements relating to these activities have been entered into with the local government. The provision of these services in the Services Area and the ability of the Company to charge fees are currently regulated by the Storm Water Agreement and the Fire Hydrants Agreement.

Furthermore, pursuant to the Services Agreement, the Company is entitled to charge fees for any additional services provided by the Company related to water supply and sewerage.

Environmental Matters and Regulation

Introduction

Water and sewerage companies in Estonia are subject to a number of regulatory requirements concerning the protection of the environment.

In connection with Estonia's accession to the European Union in May 2004, Estonian environmental legislation has been substantially revised to harmonise Estonian requirements with those of the European Union.

Principal Environmental Authorities

The main environmental licensing authority for the Company is the Environmental Service of Harju County (*Harjumaa Keskkonnateenistus*), (the "Environmental Service"). The Environmental Service has granted the Company's water permits for the abstraction of water and the discharge of wastewater, as well as waste permits and ambient air pollution permits. The Environmental Service also handles the calculation of the pollution charges described below.

The Environmental Service is a department of the Ministry of the Environment, which has an important role in all environmental regulatory and licensing matters relating to the Company. The Ministry of the Environment also assists the Environmental Service in the administration of more complex environmental matters. Planning (zoning) matters are mainly handled by the relevant departments of the City of Tallinn.

The principal environmental supervisory authority is the Environmental Supervisory Authority, which operates in all areas of environmental protection. The Environmental Supervisory Authority implements measures to ensure, among other things, environmental protection and to prevent illegal activities. It also suspends unlawful activities which are damaging or dangerous to the environment, as well as lawful

activities relating to the use of natural resources where those activities may endanger the life, health or property of persons.

The Company believes that it has developed professional and successful working relationships with all environmental authorities with which it liaises in the conduct of its operations.

Water and sewerage

The Ministry of the Environment manages the preparation of water management programmes (*veemajanduskavad*) for several river basins. The programmes should include, among other things, an action plan for keeping the water status as pure as possible and an overview of the areas where water use must be restricted or further water use prevented. The programmes are mainly prepared to achieve the objectives of the European Union Water Framework Directive (2000/60/EC). The programmes must be considered in the compilation, review or revision of the public water supply and sewerage system development plan and/or the different levels of land planning. The Ministry of the Environment has announced that it intends to publish the draft water management programme for the river basin in the Harju area (from which the Company receives its water) by spring 2006. While the water management programmes may have a significant effect on the public water supply and sewerage system development plan and/or the Environmental Service may stipulate additional restrictions in relation to the water permits, given the purpose and content of the programmes finally adopted, the Company believes that the programmes, once adopted, will not have a material impact on the Company's operations.

In 2003 the Company started significant reconstruction works on the biological treatment plant at the Paljassaare wastewater treatment plant to make reduction of nitrogen more efficient. The Company intends to complete the reconstruction during 2005. During the reconstruction phase, total nitrogen levels in the wastewater discharged by the Company are not in compliance with the relevant Decree No. 269 of the Government, dated 31 July 2001. However, the Company has obtained a temporary water permit No. L.VA.HA-17798 which alleviates the upper limit for total nitrogen stipulated in water permit No. L.VV.HA-13579 for the period of the reconstruction of the Paljassaare wastewater treatment plant. The Company believes that it is feasible to complete the reconstruction in such a way that the Company complies with the relevant requirements for nitrogen levels in its wastewater when the temporary water permit expires on 31 March 2006.

According to Decree No. 269 of the Government dated 31 July 2001, polluted stormwater must be purified before it is discharged. Water permit No. L.VV.HA-13579 also initially required construction of mechanical treatment systems for purification of stormwater to certain outlets by 31 December 2003, and the term was subsequently extended to 31 December 2004 in relation to all but one outlet. For that outlet, the term was extended to 31 December 2005. However, the Company has not been able to set up the treatment systems to date because of the delays in the privatisation of the necessary land from the state, and in land planning activities. In 2004, the fixed deadline was deleted from the water permit and was replaced with the requirement to construct the systems within 18 months from receipt of the design criteria (*projekteerimistingimused*) from the City of Tallinn. The Company has not yet received the design criteria.

According to the Water Act, the sanitary protection zone of a water intake is an area of land and water surrounding a body of water from which drinking water is abstracted. The Water Act restricts activities and movement in the sanitary protection zone to prevent the deterioration of water quality and to protect the water intake. Within the borders of the sanitary protection zones, all economic activities (with certain exceptions) are prohibited. The owner of a water intake is responsible for ensuring compliance with the restrictions in the sanitary protection zone. The Company's water permit No. L.VV.HA-13579 also requires that sanitary protection zones must be implemented around the relevant bodies of water and the Company's bore wells. However, the Company is currently unable to ensure fulfilment of the regime of protection zones around certain of its reserve bore wells, in particular because the City of Tallinn has historically permitted construction to occur within the sanitary protection zones of certain of the Company's reserve bore wells, and in some cases compliance is impossible.

The Company has been formalising its emergency plan in respect of its water resources. This plan will set out the wells which the Company has determined should be kept as reserve wells in case capacity at the Ülemiste water treatment plant is reduced for any reason. The plan, which was submitted to the City of Tallinn for approval on 13 May 2005, will be integrated into the overall emergency plan to be adopted by the City of Tallinn.

As described above, Decree No. 269 of the Government, dated 31 July 2001, sets out the minimum standards for effluent which is discharged to a body of water or to the soil. The water permits held by the Company also provide certain conditions for the extraction and discharge of effluent by the Company. However, during adverse weather conditions, such as those which were seen most recently in July and August 2004 and in January 2005, when the highest rainfall ever recorded fell on Tallinn and its surrounding areas, the Company must implement its crisis management plans. Implementation of these plans may involve the undertaking of certain steps which are not expressly provided for in the Company's water permits. In co-operation with the relevant environmental authorities, the Company is currently preparing a proposal to amend its water permit, in order to include within the scope of the water permit the crisis management steps which it may be required to take if similar adverse weather conditions were to occur in the future. The Company's policy in the event of a crisis is always to apply its crisis management measures in consultation with the City of Tallinn, the Rescue Board and the Environmental Service. To date, the Company has not been notified of any breaches of applicable water protection requirements in either its water permits or in Decree No. 269.

In 1992 (i.e. prior to the commencement of the construction of the biological treatment process at the Paljassaare wastewater treatment plant), Tallinn was included on the list of environmental "hotspots" by HELCOM, due to the relatively higher pollution levels in effluent being discharged by the Paljassaare wastewater treatment plant at that time. HELCOM is the governing body of the Convention on the Protection of the Marine Environment of the Baltic Sea Area, a convention governing pollution levels of the Baltic Sea and in respect of which all of the Baltic Sea countries are signatories and have agreed to take steps to control and minimise land-based pollution of the marine environment of the Baltic Sea area. See "Business — Wastewater Operations — Pollution and Quality Control" for further details.

Waste

The Waste Act, which became effective on 1 May 2004, provides for, among other things, the prevention of health and environmental hazards arising from waste generation and for the organisation of waste management with the objective of reducing the harmfulness and quantity of waste. It also imposes penalties for violation of its requirements. In addition to the Waste Act itself, several implementation acts enacted on the basis of the Waste Act provide specific requirements for waste handling.

Under the Waste Act, a waste permit (*jäätmeluba*) is required for, among other things, the disposal of waste and the recovery of waste. In certain prescribed operations, a waste permit is also required for waste generation.

The main category of waste generated by the Company is the residual sludge from the wastewater treatment process. Although in previous years a proportion of the sludge produced by the Company was disposed to landfill sites, in 2004 all of the sludge produced by the Company was composted or used for other sustainable alternatives such as forestry re-cultivation. See "Business — Wastewater Services — Wastewater Treatment and Disposal". Therefore, as the Company anticipates that it will no longer need to dispose of any sludge to landfills in the future, the Company currently holds only the following waste permits:

Permit number	Waste handling sites	Permit is given for	Term
L.JÄ.HA-31326	Composting field at Paljassaare põik 14, Tallinn	Recovery of non-hazardous waste listed in the permit	From 9 September 2004 to 8 September 2009
L.JÄ.HA-34941	Composting field at Liikva village, Harku parish	Recovery of non-hazardous waste listed in the permit	From 31 December 2004 to 31 December 2009

Ambient Air Pollution

Activities that involve the emission of pollutants into the ambient air, damage to the ozone layer and factors which cause climate change are regulated by the Ambient Air Protection Act (*Välisõhu kaitse seadus*, the "AAPA"), which became effective on 30 September 2004. In addition to the AAPA, additional legislation enacted pursuant to the AAPA also provides requirements for air pollution related matters.

Under the AAPA, an ambient air pollution permit (*välisõhu saasteluba*, the “pollution permit”) and a special pollution permit are required for the Company to be able to emit pollutants into the ambient air from a stationary source of pollution.

The Company currently holds the following pollution permits:

Permit number	Sources of emission	Permit is given for	Term
696	Chimneys and exhaust pipes at Paljassaare põik 14, Tallinn	Emission of substances listed in the permit (NO ₂ , CO, CO ₂ , VOC)	From 1 January 2001 to 31 December 2005
L.ÕV.HA-21334	Chimney and exhaust pipe at Järvevana tee 3, Tallinn	Emission of substances listed in the permit (NO ₂ , CO, SO ₂ , suspended solids, VOC, CO ₂)	From 1 January 2004 to 31 December 2010
L.ÕV.HA-21490 (special pollution permit)	Ventilation system at Järvevana tee 3, Tallinn	Emission of ozone	From 1 January 2004 to 31 December 2010

Integrated Pollution Prevention and Control

The Integrated Pollution Prevention and Control Act (*Saastuse kompleksse vältimise ja kontrollimise seadus*), which became effective on 1 May 2002 (the “IPPCA”), provides for the prevention and control of pollution arising from environmentally hazardous activities to prevent or reduce the harmful effect of human activity on the environment. The IPPCA was drafted and implemented on the basis of the IPPC Directive (the Council Directive 96/61/EC of 24 September 1996 concerning integrated pollution prevention and control).

According to the IPPCA and Decree No. 150 of the Government, dated 7 May 2002, an integrated environmental permit (*keskkonnakompleksluba*), (the “IPPC permit”) is required for several activities. An operator must not operate in a category of activity for which the IPPC is required, without holding such permit. The IPPC permit, once issued, replaces the waste permit, water permit and air pollution permit, which will therefore not be necessary for the operation of the relevant installations.

Water companies, such as the Company, which operate certain waste-related activities, must submit their applications for IPPC permits by 1 January 2006. If the Company fails to do so, the operation of the relevant installation may be suspended pursuant to the Environmental Supervision Act (*Keskkonnajärelevalve seadus*). The Company, in consultation with a number of independent experts, is currently assessing its activities to ascertain whether the Company needs to apply for an IPPC permit.

Fee for the Special Use of Water and Pollution Charge

Under the Water Act, a fee for the special use of water (*vee erikasutuse tasu*) must be paid for the extraction of water from an aquifer or other body of water. The Company is subject to such fee.

Under the Pollution Charge Act (*Saastetasu seadus*), which became effective on 21 March 1999, a pollution charge (*saastetasu*) is levied on the release of certain substances into ambient air, water bodies, underground water or the soil. The pollution charge must be paid irrespective of any other charges or fees imposed on the release of these substances. Pursuant to the Pollution Charge Act, the rates of pollution charges have increased approximately 20 per cent. each year since its implementation.

The pollution charge for the release of pollutants or waste into the environment in larger quantities than permitted or for the release of pollutants or waste into the environment without a permit (if a permit is required) is calculated according to an increased rate. For example, the pollution charge rate for the release of pollutants into a body of water, aquifer or the ground in larger quantities than permitted is equal to a multiple of 10 times the basic level of the pollution charge rate.

In certain limited cases, the pollution charge may be substituted by the financing of environmental protection measures (investments) that ensure the reduction of pollutants or waste. In 2003, the Company signed an agreement with the State relating to the substitution of the pollution charge. By March 2006, the Company must make investments to achieve a reduction of 25 per cent. in the concentration of nitrogen in the wastewater discharged into the Baltic Sea (in comparison with 2002 levels). According to

the agreement, the total cost of the project is approximately EEK26.5 million. If the Company fails to achieve the targeted reduction, the State will have the right to withdraw from the agreement. In this case, the substitution will be deemed to be invalid and the Company will be required to pay the relevant pollution charges (based upon its actual levels of nitrogen discharged) for all three years in retrospect together with fines for delay (if such fines are required by the State). Based on the calculation of the relevant experts, the Company believes that it is feasible to achieve the required reduction in the nitrogen concentration.

The Ministry of the Environment has prepared a draft Environmental Charges Act (*Keskkonnatasude seaduse eelnõu*). The draft Act also provides for the gradual increase of the pollution charge each year. However, the Government has not yet submitted the draft Act to the Estonian Parliament (*Riigikogu*) and the draft may be substantially amended during the procedures in the parliament. The impact of the draft Act will depend on the amounts of the charges finally adopted. However, this may be classified as a change of law event under the Services Agreement.

Natura 2000 Network

Under the Nature Protection Act (*Looduskaitse seadus*) and the Habitats Directive (92/43) and the Birds Directive (79/409), Estonia has designated several new areas as areas of habitats to be protected, and the Company is required to comply with these directives and the corresponding Estonian implementing legislation where they relate to areas in which or near which the Company operates its business. These areas will belong to the network of areas called “Natura 2000”. Several of these areas are within the temporary protection of Decree No. 24 of the Ministry of the Environment dated 22 April 2004. The Ministry of the Environment prepares the draft legislative acts for taking these areas under protection. It is likely that the areas will be taken under protection in the near future.

A contemplated bird habitat area is located adjacent to the Paljassaare wastewater treatment plant. The area has been designated for protection of the habitats of swans, ducks and several other birds. If the Company’s activities at Paljassaare wastewater treatment plant adversely affect the area, the Company may be subject to additional restrictions. In order to comply with possible additional restrictions, the Company may be exposed to increased costs and capital expenditure. A representative of the Environmental Service has orally expressed the opinion that including the area under protection should not materially restrict the Company (based on its current operations at Paljassaare).

Liability for Contaminated Land

Part of the land underneath and servicing the Paljassaare wastewater treatment plant was previously used as a waste disposal site (in the 1960s and 1970s). The Company has commissioned two independent studies which it believes show that the residual pollution contained in the land, despite being in excess of certain prescribed limits, does not constitute a significant environmental threat and does not present any radiological risk to the area surrounding the wastewater treatment plant. The Company has also informed the relevant authorities of the findings. See “Risk Factors — Risks Related to the Company — The Company is unable to guarantee that there will be no potential pollution liability from the previous waste disposal site below Paljassaare” and “Business — Wastewater Services — Pollution and Quality Control” for further details.

Estonian law regulating liability for residual pollution on a plot of land is unclear. The “original polluter” may be liable to remedy the effects of contamination of a plot of land. However, the owner of a plot of land may also be liable to remedy the effects of contamination, or to pay compensation for damage caused by the contamination particularly if the original polluter cannot be found.

Estonia must implement the European Union Directive on environmental liability (2004/35/EC) by 30 April 2007. This Directive is based on the “polluter pays” principle and applies also to environmental damage caused by certain occupational activities, including waste management operations, such as the disposal of waste and disposal sites. Although liability under the Directive will not be retrospective, the Estonian authorities may seek to amend legislation related to the contaminated sites (residual pollution) which falls outside the scope of the Directive. However, it is not currently possible to evaluate the effect of such amendments on the Company.

Principal EU Legislation

The principal European Union directive regulating water companies is the Water Framework Directive (2000/60/EC) adopted in 2000. It is intended to rationalise existing European Union water legislation to provide a framework for the prevention of further deterioration and protection of inland and coastal

waters and to promote sustainable water use. In Estonia, the Directive is transposed into Estonian law mainly by the provisions of the Water Act. To comply with the Directive, Estonia has to achieve a “good” status for surface water and ground water by 2015, though this deadline may be extended in limited cases. The Ministry of the Environment co-ordinates preparation of water management programmes for the individual river basin districts. According to the Ministry, the draft water management programme for Harju river basin is intended to be published by spring 2006. According to the Water Act, preparation of the programmes must be ready by 1 April 2008.

The Urban Wastewater Treatment Directive (91/271/EEC) is aimed at reducing pollution from urban wastewater. The Directive sets forth minimum requirements, including limit values, for the treatment of urban wastewater, i.e. domestic wastewater or the mixture of domestic wastewater with industrial wastewater and/or run-off rain water. In Estonia, the main requirements of the Directive have been transposed into Estonian law by Decree No. 269 of the Government, dated 31 July 2001.

The Directive on the Quality of Water intended for Human Consumption (98/83/EC) aims to protect human health from the adverse effects of any contamination of water intended for human consumption by ensuring that it complies with certain prescribed minimum standards. The Directive sets forth minimum requirements and quality standards for water intended for human consumption, as well as standards for quality control. In Estonia, the requirements set forth in the Directive have been established by virtue of Decree No. 82 of the Minister of Social Affairs, dated 31 July 2001.

The Directive concerning the Quality Required of Surface Water Intended for the Abstraction of Drinking Water (75/440/EEC) prescribes certain quality requirements with which surface fresh water used or intended for use in the abstraction of drinking water must comply after appropriate treatment. The Directive concerning Methods of Measurement and Frequencies of Sampling and Analysis of Surface Water intended for the Abstraction of Drinking Water (79/869/EEC) deals with reference methods of measurement and frequencies of sampling and analysis for the parameters listed in Annex II to Directive 75/440/EEC. In Estonia, the requirements under the above-referred directives have been incorporated in Decree No. 1 of the Minister of Social Affairs, dated 2 January 2003.

The Directive on the Quality of Bathing Water (76/160/EEC) concerns the quality of bathing water, with the exception of water intended for therapeutic purposes and water used in swimming pools. In Estonia, the requirements of the Directive have been transposed into Estonian law by Decree No. 247 of the Government, dated 25 July 2000. However, the Directive on the Quality of Bathing Water reflects the state of knowledge and experience of the early 1970s, both technically and socially. Since 1976, epidemiological knowledge has progressed and managerial methods have improved. The EU Commission therefore produced a proposal for the revision of the Bathing Water Directive on 24 October 2002. In December 2004, the Environmental Council agreed on a common position and sent the revised Directive to the European Parliament. The draft directive is currently being considered by the European Parliament.

The Directive on Environmental Liability (2004/35/EC) aims both to prevent and remedy environmental damage including water damage, damage to protected species and habitats and land contamination which causes serious harm to human health. Under the Directive, operators operating or controlling certain prescribed activities causing environmental damage will, subject to certain defences, be held strictly liable for remedying the damage or will be made to pay for the remedial works. All other operators who cause damage to protected species or natural habitats by fault or negligence will be under an obligation to remedy the damage. The operators will also be under an obligation to take preventive actions in certain circumstances. The Directive must be transposed into Estonian law by 30 April 2007. Although liability under the Directive will not be retrospective, the Directive may well have a significant impact on the water and sewerage companies whose activities cause damage to the environment and protected species and habitats.

Supervision

Supervisory Foundation

The Foundation for Supervision over Water Companies in Tallinn (*Tallinna Vee-ettevõtjate Järelevalve Sihtasutus*, the “Supervisory Foundation”) is a mandatory unit specifically designated to monitor water companies in Tallinn. The Supervisory Foundation was established by the Tallinn City Council on 21 March 2002 and commenced its activities on 9 September 2002. The purpose of the Supervisory Foundation, as prescribed by its Articles of Association, is to exercise independent supervision over water companies in Tallinn, including the Company.

The Supervisory Foundation performs the following tasks:

- check the performance of the obligations of the Company;
- check the quality of services provided by the Company;
- monitor the carrying out of construction works and investments by the Company;
- issue opinions and recommendations to the City of Tallinn regarding implementation of contractual penalties with respect to the Company;
- issue opinions and recommendations to the City of Tallinn regarding changing the tariffs for water supply and collection of wastewater;
- monitor the compliance of the Company with the activity plan adopted on the basis of the public water supply and sewerage system development plan approved by the Tallinn City Council;
- verify the economic validity of the charge for connection to the public water supply and sewerage system and compensation thereof pursuant to applicable legislation;
- check and analyse the information (including reports) submitted by the Company to the Supervisory Foundation and the City of Tallinn;
- protect the interests of consumers of the services rendered by the Company; and
- perform other tasks on the basis of agreements with the City of Tallinn or the Company.

Pursuant to a decision of the Tallinn City Council passed in May 2005, the Supervisory Foundation shall expand its monitoring and evaluation activities to all agreements executed between the Company and the City of Tallinn. In practice, however, the principal activities of the Supervisory Foundation are the monitoring of compliance by the Company with the Levels of Service under the Services Agreement.

The Supervisory Foundation is managed by its supervisory council and its management board. The supervisory council comprises three to five members. Currently there are five members on the supervisory council, one of whom has been appointed at the proposal of the Company and the remainder of whom have been nominated by the City of Tallinn. The duration of the appointment of members of the supervisory council is five years.

The Supervisory Foundation is managed and represented by the management board. The management board comprises one to three independent members. There are currently two members on the management board. Pursuant to the 2002 Amendment Agreement, members of the Supervisory Council are to use reasonable endeavours to appoint members of the management board by unanimous vote.

The Company believes that it has developed an effective professional working relationship with the Supervisory Foundation and the members of its management board and supervisory council.

Other Supervisory Bodies

In addition to the Supervisory Foundation, certain governmental agencies exercise supervision over specific aspects of the activities of the Company.

The Health Protection Inspectorate (*Tervisekaitseinspeksioon*) monitors the quality of drinking water and the handling of drinking water. The Health Protection Inspectorate is a government agency administered by the Ministry of Social Affairs exercising supervision over compliance with the requirements applicable to drinking water and groundwater and surface water used or intended to be used for drinking, and over the safety of drinking water.

Supervision in the areas of environmental protection is conducted by the Environmental Supervisory Authority, and competition law-related supervision is conducted by the Competition Board (*Konkurentsiamet*).

Furthermore, the activities of the Company are also subject to the supervision of the City of Tallinn. The City of Tallinn's Municipal Engineering Services Department monitors the compliance of the Company with applicable requirements to guarantee effective engineering of the public water supply and sewerage system in Tallinn. The Municipal Engineering Services Department is also responsible for the public water supply and sewerage system development plan of Tallinn. In addition, the City's Environment Department exercises supervision over the environmental implications of the Company's activities.

See “— Environmental Matters and Regulation — Principal Environmental Authorities” for details regarding the environmental supervisory authorities relevant to the Company’s operations.

Competition in the Water Industry

General

Under the PWSSA, only one company may be appointed as the water company in each services area. As described elsewhere in this section, the water company is appointed on the basis of a public tender conducted according to the rules set forth under the Competition Act for granting of special or exclusive rights. The public tender should provide all potential entrants equal access to the market.

Therefore, although there is competition between companies in the tender process for a specific services area, after it has been appointed, the selected water company effectively has a geographical monopoly to provide water supply and sewerage services in the given services area for the duration of its appointment as the water company.

The Competition Act

The Competition Act became effective on 1 October 2001 and is largely modelled on EC competition rules. The Supreme Court of Estonia has also held that since the Competition Act was adopted on the basis of the relevant EC legislation and practice, in the case of ambiguity the EC legislation and practice should be used to interpret the provisions of the Competition Act.

The Competition Act prohibits agreements between undertakings, concerted practices and decisions by associations of undertakings which have as their object or effect the restriction of competition. The Act also provides that any direct or indirect abuse by an undertaking or several undertakings of the dominant position in the market is prohibited. Mergers and acquisitions of a certain size are also subject to control under the Competition Act.

Regime Applicable to Dominant Position

An undertaking is considered to hold a dominant position if its position enables it to operate in the market to an appreciable extent independently of competitors, suppliers and buyers. Under the Competition Act, undertakings with a special or exclusive right or in control of an essential facility are also, by definition, undertakings holding a dominant position. An undertaking is deemed to control essential facilities or to have a natural monopoly if it owns, possesses or operates a network, infrastructure or any other essential facility which other persons cannot duplicate, or for whom it is not commercially viable to duplicate, but without access to which, or the existence of which, it is impossible to operate in the market.

Therefore, a company that is appointed as a water undertaking in a given services area is automatically considered to be in a dominant position. However, the same may be true even after the end of the duration of such exclusive right (e.g. if a new water company is appointed) if the company owns the network or any other material assets necessary for operating as a water company in the services area.

In addition to the general prohibition against abuse of a dominant position, the Competition Act imposes specific obligations on undertakings with a special or exclusive right or in control of an essential facility, according to which such undertakings must:

- permit other undertakings to gain access to the network, infrastructure or other essential facility under reasonable and non-discriminatory conditions for the purposes of the supply or sale of products or services; and
- keep separate account of income and expenses related to each product or service, based on objectively justified and consistently applied accounting principles that must be clearly determined in the internal rules of the undertaking. The accounting of income and expenses must facilitate the assessment of whether the price of the product or service set by the undertaking is in reasonable proportion to the value of the relevant product or service.

However, according to the Competition Act, an undertaking with special or exclusive rights or in control of an essential facility may refuse to grant other undertakings access to the network, infrastructure or other essential facility if the refusal is based on objective reasons, such as safety, security or efficiency grounds, technical non-conformity problems or risk of insufficient data protection.

The Company is of the opinion that, due to the exclusive nature of the appointment of a water company to a given services area, the Competition Act does not allow competitors of the Company to request

access to the Company's network for provision of public water supply and sewerage services in a services area where the Company is appointed as the water undertaking. However, such rules may be relevant if the exclusive right granted to the Company is not extended and another company is appointed as the water company in the relevant services area.

In addition, there can be no assurance that measures will not be introduced in the future which increase competition in the context of provision of public water supply and sewerage services, which could mean that the Company becomes obliged to provide other companies with access to its network for provision of such services.

The Draft PWSSA Amendment Act

The Ministry of the Environment has prepared a draft PWSSA Amendment Act, aimed at specifying certain aspects of the current regulation. The draft legislation is expected to come into effect before the end of 2005.

The main changes proposed by the draft legislation specify issues pertaining to the discretion of the local governments upon adoption of rules for connection to the public water supply and sewerage system and rules on use of the public water supply and sewerage system. Further, the draft PWSSA Amendment Act also specifies the formation of the charge for connection to the public water supply and sewerage system and the prices of the water and wastewater services. As regards the regulations applicable to appointment of water companies by a local government, the draft PWSSA Amendment Act provides that if a private company owns the public water supply and sewerage network, it may make a proposal regarding the appointment of a water company and the proposal shall be confirmed by the local municipality, with the result that the exclusive right to provide the relevant services would be able to be granted without the need for the municipality to carry out a public tender.

Protection of Customers' Interests

The Consumer Protection Board (*Tarbijakaitseamet*) is the main institution engaged to protect the rights of consumers and to represent their interests and develop and implement consumer policy in accordance with the provisions of the Consumer Protection Act (*Tarbijakaitseadus*) and European Union consumer policy. The Consumer Protection Board also follows in its activities certain consumer protection principles set out in the guidelines issued by the United Nations. The Supervisory Foundation, as well as certain other Estonian regulatory bodies, also oversee the protection of consumer interests in Estonia.

MANAGEMENT

Supervisory Council

Under Estonian company law and the Company's Articles of Association, the Supervisory Council has ultimate responsibility for the organisation of the work of the Company, plans the activities of the Company and supervises the activities of the Management Board. See "Description of Capital Stock and Corporate Governance — Corporate Governance — Supervisory Council" for further details regarding the role of the Supervisory Council.

Certain information concerning the members of the Supervisory Council as at the date of this Offering Circular is set out below:

Name	Age	Position/Nominated by	Appointed	Term Expires
Michael James Southworth	50	Chairman/United Utilities group	September 2003	September 2005
David John Kilgour	44	Member/United Utilities group	September 2004	September 2006
Karl Olof Joakim Forsberg	32	Member/EBRD	November 2004	November 2006
Marion Elaine Price	56	Member/EBRD	March 2005	March 2007
Jüri Ratas.....	26	Member/City of Tallinn	April 2005	April 2007
Siim Roode	38	Member/City of Tallinn	November 2004	November 2006
Toivo Tootsen.....	61	Member/City of Tallinn	April 2005	April 2007

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

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

Karl Olof Joakim Forsberg, Swedish, Member of the Supervisory Council, nominated by the EBRD, since 19 November 2004. He has a Master of Science degree in civil engineering and another degree in finance. He has been active in infrastructure and utility financing for more than seven years. Between 1997 and 2000, Mr Forsberg worked for the major international construction company Skanska. Since 2000, he has been working for the EBRD in London, where he is currently responsible for managing municipal and environmental projects in certain Baltic countries.

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

Jüri Ratas, Estonian, Member of the Supervisory Council, candidate of the City of Tallinn appointed by the shareholders' general meeting, since 27 April 2005. He has a Masters degree in economics and is currently studying law at Tartu University. Mr. Ratas is the Deputy Mayor of the City of Tallinn,

responsible for the utilities and infrastructure area, a post he has held for one and a half years. Prior to this, he served as an Economic Counsellor in the Tallinn City Office. Before entering public service his work experience included the position of Chairman of the Management Board in a private company as well as other posts in the area of sales and marketing.

Siim Roode, Estonian, Member of the Supervisory Council nominated by the City of Tallinn since 17 November 2004. He has BA in law and is a Partner of the Estonian law firm Markus, Meidra, Missik & Co, attorney at law. He specialises in public and administrative law, including environmental law, public building and planning law, public commercial law, revenue and contribution law and municipal law, as well as public procurement.

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

The TSE Rules require that if more than 30 per cent. of the share capital of a company listed on the Tallinn Stock Exchange is held by a single shareholder, then at least two members of the supervisory council of the relevant company must be independent (i.e. unconnected with the shareholder). However, the Listing and Surveillance Committee of the Tallinn Stock Exchange has the right to grant an extended deadline to the relevant company for compliance with such requirement. In connection therewith, the Company has been granted a deadline of 31 December 2005 for the election of two independent members of its Supervisory Council.

The business address of each of the members of the Supervisory Council is the registered office of the Company.

Management Board

Under Estonian company law and the Company's Articles of Association, the Management Board represents the Company in its relations with third parties and manages the Company's daily activities and organises its accounting. The Management Board reports to and is instructed by the Supervisory Council. See "Description of Capital Stock and Corporate Governance — Corporate Governance — Management Board" for further details regarding the role of the Management Board.

Certain information concerning the members of the Management Board as at the date of this Offering Circular is set out below:

Name	Age	Position	Director Since	Term Expires
Robert John Gallienne	57	Chief Executive Officer/ Chairman	April 2002	March 2008
Roch Jean Guy Antoine Chéroux	38	Chief Operating Officer	April 2002	March 2008
Ian John Alexander Plenderleith	41	Chief Financial Officer	September 2004	September 2007

Robert John Gallienne, British, has served as the Chief Executive Officer and Chairman of the Management Board of the Company since 1 April 2002. Prior to that date, Mr. Gallienne held the positions of Managing Director of Sofyiska Voda and Group Customer Services Director of Manila Water in the Philippines. He has over 25 years' experience in senior management positions in the water industry both in the United Kingdom and overseas. He is a Chartered Public Accountant. Mr. Gallienne also serves as a Director of UUTBV, United Utilities (Poland) B.V., United Utilities (Pacific Holdings) B.V., United Utilities B.V., United Utilities Australian Holdings B.V. and United Utilities Europe Holdings B.V.

Roch Jean Guy Antoine Chéroux, French, Chief Operating Officer and Member of the Management Board of the Company since 1 April 2002, graduated from École Nationale Supérieure d'Arts et Métiers in engineering and management. He has more than 13 years' experience in the water and wastewater sector. Mr. Chéroux started in a major French water company where he held successive management positions, first in the design and construction of water and wastewater facilities in the north-west of France, following which he held a management position in the south-west of France and finally held the position of Managing Director for the north of France.

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

The business address of each of the members of the Management Board is the registered office of the Company.

Executive Team

The Management Board is assisted in its day-to-day management of the Company by the Executive Team, which comprises a group of senior managers of the Company which meets weekly. The Executive Team currently comprises eight members, being the three members of the Management Board itself, together with the Company's Customer Service General Manager, Chief Controller, Human Resources Manager, Networks Manager and Head of Legal Services.

Certain information concerning the members of the Executive Team as at the date of this Offering Circular is set out below:

Name	Age	Position
Robert John Gallienne.....	57	Chief Executive Officer/Chairman
Roch Jean Guy Antoine Chéroux.....	38	Chief Operating Officer
Ian John Alexander Plenderleith.....	41	Chief Financial Officer
Merle Lindma	37	Customer Service General Manager
Siiri Lahe	34	Chief Controller
Ilona Lott	43	Human Resources Manager
Leho Võrk.....	38	Networks Manager
Triin Frosch.....	26	Head of Legal Services

Robert John Gallienne, see “— Management Board” above.

Roch Jean Guy Antoine Chéroux, see “— Management Board” above.

Ian John Alexander Plenderleith, see “— Management Board” above.

Merle Lindma, Estonian, Customer Service General Manager of the Company since January 2004, having joined the Company on 7 January 2002. Prior to joining the Company, she held various positions in Glaxo SmithKline Beecham in Estonia and in the United Kingdom. She has also served as Logistics Manager in the Logistics Department, Transport Manager and other positions in the Purchasing Department of AS MicroLink in Tallinn from 1993 to 1995. She is a graduate from Tallinn Pedagogical University with a BA in physics and mathematics and has an Executive MBA from the Estonian Business School.

Siiri Lahe, Estonian, Chief Controller of the Company since November 2001. She has been working for the Company since November 1994 when she started as a Chief Reporting and Procurement Specialist in the Company's EBRD Project Implementation Unit. In 1997, she was appointed to the position of Head of Management Accounting. She is an economics graduate from Tallinn Technical University and has a Master's degree in Public Administration from the same university.

Ilona Lott, Estonian, Human Resources Manager of the Company since 2001. Prior to joining the Company, she worked for six years for the insurance company Sampo Eesti Varakindlustus, where between 1999 and 2001 she held several positions in the Personnel and Sales Departments. Prior to 1999, she worked in retail and consulting joint ventures with four Estonian companies. She is a graduate from Tartu University, majoring in English language and literature, has an MBA from the Estonian Business School and has been an accredited Facilitator by Senn-Delaney since June 2003.

Leho Võrk, Estonian, Networks Manager of the Company since December 2002. His earlier positions included foreman in sewerage, foreman in the water network departments, followed by Deputy to the Managers of Central and Eastern Districts and the Manager of the Western District of Tallinn. Prior to his current position, Mr Võrk has also served as Networks Senior Specialist and Head of the Emergency Department. He joined the Company in August 1992, having graduated from the Estonian Agricultural University as a qualified soil-reclamation engineer.

Triin Frosch, Estonian, Head of Legal Services of the Company since January 2004. Previously she had been working as an attorney-at-law at Raidla & Partners law office for three years. Ms Frosch graduated from the Faculty of Law of the University of Tartu. During her studies she spent one month as a trainee at the Estonian National Court (the Supreme Court). In addition to studying law, Ms Frosch studied English Philology at the University of Tartu.

Remuneration

The following table sets out the aggregate salaries and premiums paid by the Company to the members of its Supervisory Council, Management Board and Executive Team during 2004 (excluding those appointed during 2005):

	Year ended 31 December 2004
	Salaries and Premiums
	<i>(EEK)</i>
Supervisory Council	18,000
Management Board	2,058,702
Executive Team ⁽¹⁾	2,065,073

Note:

(1) Excludes members of the Management Board.

The following table sets out the aggregate salaries expected to be paid by the Company to the members of its Supervisory Council, Management Board and Executive Team during 2005:

	Year ended 31 December 2005
	Salaries and Premiums
	<i>(EEK)</i>
Supervisory Council	1,500 ⁽¹⁾
Management Board	2,121,086
Executive Team ⁽²⁾	2,898,855

Notes:

(1) Per member per meeting.

(2) Excludes members of the Management Board.

The members of the Management Board also receive additional remuneration and other related benefits from the United Utilities group of companies. These additional amounts are payable by the Company to United Utilities International Limited as part of the payments due by the Company pursuant to the Technical Services Agreement. See “Principal and Selling Shareholders — Related Party Transactions — The Technical Services Agreement” for further details.

Connected Transactions

The Company has not entered into any transactions (other than transactions related to their employment or position within the Company and contracts relating to water supply and sewerage services to their residential premises) with members of the Supervisory Council, the Management Board or the Executive Team or with any commercial undertakings in which any of these persons have a significant holding.

PRINCIPAL AND SELLING SHAREHOLDERS

Principal and Selling Shareholders

UUTBV, a limited liability company incorporated under the laws of the Netherlands, and the City of Tallinn are the Selling Shareholders and the only shareholders of the Company immediately prior to the Offering.

UUTBV was formed by United Utilities International Limited and International Water Holdings B.V. with the purpose of acquiring a shareholding in the Company. UUTBV is currently owned by United Utilities B.V. and United Utilities Europe Holdings B.V., a joint venture between United Utilities B.V. and the EBRD. See “Business — History” for further details. The EBRD is an international organisation formed by treaty, owned by 60 countries and two intergovernmental institutions, that invests to foster the transition of former command economies to market economies. United Utilities B.V. is an indirect wholly-owned subsidiary of United Utilities PLC, one of the largest international water supply and wastewater management companies. United Utilities B.V. holds a direct and indirect interest in UUTBV of 75 per cent. and the EBRD holds an indirect interest in UUTBV of 25 per cent.

The City of Tallinn (*Tallinna linn*) is a local municipality existing pursuant to the laws of Estonia. The City of Tallinn was the sole shareholder of the Company prior to its privatisation. See “Business — History” for further details.

The following table sets out certain information regarding the beneficial ownership of the Shares as at the date of this Offering Circular, both prior to the Offering and assuming completion of the Offering, both with and without the exercise of the Over-allotment Option in full.

	Shares beneficially owned prior to the Offering		Shares beneficially owned after the Offering		Shares beneficially owned after the Offering assuming exercise of the Over- allotment Option ⁽¹⁾	
	(Shares)	(per cent.)	(Shares)	(per cent.)	(Shares)	(per cent.)
United Utilities (Tallinn) B.V.	10,086,957	50.4	7,335,968	36.7	7,060,870	35.3
City of Tallinn ⁽²⁾	9,913,043	49.6	7,209,486	36.0	6,939,130	34.7
Public float ⁽³⁾	—	—	5,454,546	27.3	6,000,000	30.0
Total	20,000,000	100.0	20,000,000	100.0	20,000,000	100.0

Notes:

- (1) Assumes that the maximum number of Offer Shares will be taken up in the Offering, comprising 6,000,000 Offer Shares, of which the Over-allotment Option comprises 545,454 Offer Shares.
- (2) Share ownership information for the City of Tallinn excludes the B-Share owned by the City of Tallinn that will not be subject to the Offering. See “Description of Capital Stock and Corporate Governance”.
- (3) Comprising the aggregate number of Offer Shares which may be taken up in the Institutional Offering and the Estonian Public Offering.

Shareholders’ Agreement

On 12 January 2001, the Company, UUTBV and the City of Tallinn entered into the Shareholders’ Agreement, as subsequently amended by the 2002 Amendment Agreement and the 2005 Amendment Agreement (referred to herein as the “Shareholders’ Agreement”).

The Shareholders’ Agreement contains the following material provisions:

- the principles of the election, nomination and removal of the members of the Supervisory Council and the Management Board (see “Description of Capital Stock and Corporate Governance — Corporate Governance” for further details);
- the principles of voting at the Company’s shareholders’ general meetings and the Supervisory Council meetings, as well as the requirements for the consent of the City of Tallinn for certain resolutions of the shareholders’ general meeting (see “Description of Capital Stock and Corporate Governance — Corporate Governance” for further details);
- the restrictions on transfer of Shares (see “Description of Capital Stock and Corporate Governance — Restrictions on Transfer of Shares” for further details);

- the restrictions on the acquisition of additional Shares. The City of Tallinn and UUTBV (and any person that controls UUTBV or that is controlled, directly or indirectly, by the City of Tallinn or UUTBV) undertake not to purchase any Shares to increase their respective shareholdings in the Company without the prior written agreement of the other party, except in circumstances where the City of Tallinn is entitled or required to exercise its call option in respect of Shares held by UUTBV (see “Description of Capital Stock and Corporate Governance — Third Party Rights on Shares — Options” for further details);
- the City of Tallinn’s call options and UUTBV’s put option in respect of Shares held by UUTBV (see “Description of Capital Stock and Corporate Governance — Third Party Rights on Shares — Options” for further details); and
- certain additional provisions relating to confidentiality and disclosure.

Related Party Transactions

The Technical Services Agreement

The arrangements concluded in connection with the privatisation of the Company in 2001 provided that, in return for certain fees, IWUU would provide the Company with certain technical and asset management services and would make certain of its personnel available to the Company in connection with its operation and management.

A Technical Services Agreement (the “Technical Services Agreement”) was therefore concluded between the Company and IWUU on 29 March 2001. The Technical Services Agreement was assigned from IWUU to United Utilities International Limited (a member of the United Utilities group of companies) on 16 December 2003.

According to the Technical Services Agreement, United Utilities International Limited has been appointed by the Company to provide it with the following principal technical and asset management services:

- identifying senior staff for the Company;
- providing seconded staff to fill executive and managerial roles within the Company;
- providing consulting services concerning the financing and re-financing of the Company’s operations;
- defining the commercial strategy for contract regulation, negotiation and extension;
- providing an advisory and consulting role in master planning and investment projections, in respect of billing and collection systems and associated information technology, for human resources issues and in relation to the Company’s corporate identity;
- providing up-to-date know-how and detailed recommendations in respect of the techniques and processes used in the Company;
- advising on the latest methods and techniques to improve water quality and the quality of effluent;
- advising and assisting the Company in the appraisal, selection and procurement of relevant computer systems and software applications; and
- communicating and explaining the latest improvements and innovations in asset planning and maintenance systems and techniques suitable for the Company.

Under the Technical Services Agreement, United Utilities International Limited is required to provide all professional, supervisory, managerial, administrative and other personnel as are necessary for it to perform the above services. The working hours, rates of compensation, manner of performance, and all other matters relating to the employment of these individuals are to be determined solely by United Utilities International Limited.

For the services provided to it, the Company is required to pay to United Utilities International Limited a base fee of €550,000 per contract year, increased in line with inflation. In addition, the Company shall reimburse United Utilities International Limited for all its costs arising from the provision of its services under the Technical Services Agreement. These costs include the costs of personnel, except where the salaries and other employment costs have been paid directly by the Company, in which case the amounts paid by the Company are deducted from the fees payable by it to United Utilities International Limited.

The contractual payments made by the Company pursuant to these arrangements amounted to EEK15.7 million in 2002, EEK54.3 million in 2003 (part of which also related to payments due in respect of 2001 and 2002) and EEK22.1 million in 2004.

The Technical Services Agreement has been concluded for an initial term of 15 years with effect from 12 January 2001, and may be extended by agreement. Either party may terminate the Technical Services Agreement at any time, and for any reason, having given at least 180 days' prior written notice to the other party. In addition, where a *force majeure* event has rendered financially or practically impossible the performance of the Technical Services Agreement for a period of time so as to have a fundamental effect on the rights or obligations of either of the parties or has prevented the performance of a material part of their obligations for at least 60 days, either party may, following an attempt to reach a negotiated solution, by notice to the other party terminate the Technical Services Agreement.

See "Risk Factors — Risks Related to the Company The Company benefits from the transfer of know-how and other water industry technology from United Utilities International Limited and other companies within the United Utilities group" for further details.

The EBRD Loan Agreement

In 2002, the Company executed a loan agreement with the EBRD, pursuant to which the EBRD extended to the Company a loan facility in the amount of €80 million (the "EBRD Loan Agreement"). See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Debt Financing" for further details regarding the terms of the EBRD Loan Agreement.

As required by the EBRD Loan Agreement, the Company has executed a number of related financing and security agreements to secure the repayment of the loan. These consist primarily of the following:

- ***Share Retention and Debt Subordination.*** This agreement, executed among UUTBV, United Utilities Europe Holdings B.V., United Utilities B.V. and the EBRD, establishes the following principal requirements which are applicable for so long as any sums remain outstanding under the EBRD Loan Agreement and/or any of the related security or financing agreements:
 - UUTBV may not transfer any of its Shares or create any lien over its shareholding in the Company (except for the Share pledge in favour of the City of Tallinn described in "Description of Capital Stock and Corporate Governance — Third Party Rights on Shares — Share Pledge"). However, the parties have agreed to amend this agreement to allow UUTBV to transfer the Offer Shares owned by it pursuant to the Offering; the relevant amendment agreement was executed on 27 May 2005;
 - United Utilities Europe Holdings B.V. and United Utilities B.V. may not generally transfer their shares in UUTBV or create any lien over their respective shareholdings in UUTBV, and United Utilities B.V. may not transfer its shares in United Utilities Europe Holdings B.V. or create any lien over its shareholding in that company; and
 - any indebtedness owed by the Company to UUTBV or any of UUTBV's affiliates is, in general, required to be subordinated to the payment in full of the indebtedness owed by the Company to the EBRD (except for certain payments permitted under the agreement);
- ***Share Pledge.*** UUTBV has pledged in favour of the EBRD all of the issued and outstanding Shares held by UUTBV, other than those already pledged to the City of Tallinn (see "Description of Capital Stock and Corporate Governance — Third Party Rights on Shares — Share Pledge"). On 5 May 2005, the EBRD and UUTBV entered into an agreement pursuant to which 3,026,087 Shares owned by UUTBV were released from the pledge. This release was registered with the ECRS on 13 May 2005;
- ***Buildings Pledge.*** The Company has pledged in favour of the EBRD all buildings stipulated in the buildings pledge agreement that are located at its Ülemiste water treatment plant;
- ***Commercial Pledge.*** The Company has pledged the majority of its movable assets in favour of the EBRD in the amount of EEK1,877,592,000 (€120 million);
- ***Insurance Pledge.*** The Company has pledged in favour of the EBRD the Company's monetary claims exceeding €10,000 (except claims for compensation of damage to injured third parties arising from civil liability insurance contracts) against an insurer that arise from all existing or future insurance contracts concluded by the Company; and

- *Bank Account Pledge.* The Company has pledged in favour of the EBRD the Company's debt service reserve account, as well as certain additional bank accounts held with Estonian banks.

Tajikistan Consultancy Services

The Company has been engaged by the EBRD to undertake a consultancy project on behalf of a water company operating in Tajikistan. The work has been undertaken by the Company on arm's length commercial terms. See "Business — Other Activities" for further details.

DESCRIPTION OF CAPITAL STOCK AND CORPORATE GOVERNANCE

Set out below is a summary of certain information concerning the Shares and the preferred share (B-Share) and certain provisions of the Company's Articles of Association on corporate governance. This summary does not purport to be complete and is qualified in its entirety by reference to the Company's Articles of Association, information available from the public registries, the Shareholders' Agreement and the Option Agreement.

General

The Company is a public limited company incorporated under the laws of Estonia, with its registered office in Tallinn, Estonia. The Company's predecessor was established in 1967 under the name *Tallinna Veevarustuse ja Kanalisatsiooni Valitsus* (Tallinn Water Works and Sewerage Management), and was operated as a structural unit of the Government. In October 1991, the Government transferred *Tallinna Veevarustuse ja Kanalisatsiooni Valitsus* to the ownership of the City of Tallinn, following which it was operated as a structural unit of the City of Tallinn. On 9 January 1993, the structural unit was reorganised into the municipal enterprise *Tallinna Veevarustus ja Kanalisatsioon* and on 7 October 1993 it was registered under a new name – *Tallinna Veevarustuse ja Kanalisatsiooni Munitsipaaltevõte* (Tallinn Water Works and Sewerage Municipal Enterprise). Pursuant to the Tallinn City Council Resolution No. 68, dated 29 May 1997, the Company was reorganised into a public limited company *AS Tallinna Vesi*.

The Commercial Code (*Äriseadustik*) required all companies to be registered with the new Commercial Register by 1 September 1997 or to submit the relevant registration application by such date. The Company was duly re-registered with the Commercial Register on 28 August 1997. The Company's corporate registration number is 10257326.

The Shares have been registered with the ECRS. The International Securities Identification Number (ISIN) for the Shares is EE3100026436 and for the B-Share is EE3100026442.

The Company's Articles of Association were adopted at the shareholders' general meeting held on 27 April 2005, and were registered with the Commercial Register on 6 May 2005.

Shares and Share Capital

Classes of Shares

Pursuant to the Company's Articles of Association, the Company has two classes of shares: (i) the A-Shares (referred to in this Offering Circular as the "Shares"), with a nominal value of EEK10 each and (ii) a single preferred share (B-Share), with a nominal value of EEK1,000.

Each Share provides its holder with one vote at the Company's shareholders' general meetings, the right to participate at the shareholders' general meetings, the right to participate in the division of profits and in the division of remaining assets upon liquidation of the Company.

The B-Share provides its holder with the right to participate at the Company's shareholders' general meeting, the right to participate in the division of profits and in the division of remaining assets upon liquidation of the Company.

Additionally, the B-Share provides its holder with the following rights:

- the right to receive an annual preferred dividend in the amount of EEK10,000;
- the right of veto at the Company's shareholders' general meeting if any of the following issues are to be voted upon:
 - amendment of the Company's Articles of Association;
 - increase and decrease of the Company's share capital;
 - issuance of convertible bonds;
 - acquisition of treasury shares by the Company;
 - merger, division, reorganisation and/or liquidation of the Company; and
 - deciding other issues regarding the Company that are not in the exclusive competence of the Company's shareholders' general meeting upon request by the Supervisory Council or the Management Board; and
- the right to nominate and remove two members of the Supervisory Council of the Company.

Authorised Share Capital

Under the Company's Articles of Association, the Company's financial year is the calendar year. The Company's share capital must be between EEK200,000,000 and EEK800,000,000.

The Company's issued share capital amounts to EEK200,001,000, represented by 20,000,000 A-Shares and 1 B-Share.

History of the Share Capital

The table below sets out the changes in the Company's share capital since the registration of the Company with the Commercial Register in 1997 until the date hereof:

Year	Transaction	Subscription price (EEK)	Change in number of shares	Change in share capital (EEK)	Total number of shares	Total share capital (EEK)	Nominal value per share (EEK)
1997	In-kind contribution ⁽¹⁾	—	—	—	85,000,000 A-Shares	850,000,000	10 per A-Share
2000	New issue of B-Share	1,000	1 B-Share	1,000	85,000,000 A-Shares 1 B-Share	850,001,000	10 per A-Share 1,000 per B-Share
2001	New issue of A-Shares ⁽²⁾	22.90	30,000,000 A-Shares	300,000,000	115,000,000 A-Shares 1 B-Share	1,150,001,000	10 per A-Share 1,000 per B-Share
2002	Share capital reduction ⁽³⁾	—	95,000,000 A-Shares	950,000,000	20,000,000 A-Shares 1 B-Share	200,001,000	10 per A-Share 1,000 per B-Share

Notes:

- (1) Upon the conversion of the municipal enterprise into a public limited company and registration of the Company with the Commercial Register, the Company's share capital was formed by an in-kind contribution made by the City of Tallinn transferring the net assets shown on the balance sheet of the municipal enterprise.
- (2) On the basis of Resolution No. 210 of the Tallinn City Council, dated 15 June 2000, the City of Tallinn announced on 26 June 2000 a tender offer for sale of 28,000,000 Shares and for the subscription of 30,000,000 Shares of the Company. IWUU was announced as the winner of the tender offer and the relevant Share Sale and Subscription Agreement was executed on 12 January 2001. Pursuant to the terms of the Share Sale and Subscription Agreement, IWUU subscribed for 30,000,000 new Shares, each at EEK10 par value plus a premium of EEK12.90, the aggregate subscription price therefore being EEK687,000,000.
- (3) Pursuant to the resolution of the Company's extraordinary shareholders' general meeting, dated 1 November 2001, it was resolved to reduce the Company's share capital to restructure the Company's balance sheet. One of the purposes of the capital reduction was to ensure continued compliance with the requirement of Estonian law pursuant to which the level of net assets of an Estonian company must be at least half of the relevant company's share capital.

Restrictions on Transfer of Shares

The Company's Articles of Association do not provide for a pre-emptive right on the part of a shareholder upon transfer of any existing Shares to a third person. In accordance with the Company's Articles of Association, the Shares are freely transferable.

However, the Shareholders' Agreement establishes the following contractual restrictions in connection with the transfer of the Shares:

- UUTBV may not transfer or grant any interest in any of its Shares remaining after the sale of the Offer Shares in the Offering until 1 January 2010. After that date, UUTBV may transfer or grant any interest in some or all of its Shares only in accordance with the terms of the Shareholders' Agreement and the Articles of Association (i.e. with the prior written consent of the City of Tallinn). UUTBV may, however, with the prior written consent of the City of Tallinn, transfer its Shares to a wholly-owned subsidiary of it, or a subsidiary of a shareholder holding at least one-third of its shares. In addition, the Shareholders' Agreement establishes certain additional grounds pursuant to which UUTBV may sell its Shares that are not pledged in favour of the City of Tallinn without the prior written consent of the City of Tallinn, such as (i) in the event that the exclusive right of the Company to act as a water undertaking in the Services Area is terminated or terminates without renewal due to a violation of the Company's obligations under the Services Agreement, or (ii) the exclusive right of the Company is not terminated but the City of Tallinn exercises its call option to purchase from UUTBV 11,500 A-Shares or the number of Shares corresponding to one per cent. of the Company's total share capital at the relevant time (whichever is greater);

- notwithstanding the above, UUTBV may pledge its Shares to any person without the prior consent of the City of Tallinn;
- UUTBV may only sell or transfer its Shares in whole and not in part;
- the City of Tallinn may not transfer any of its Shares to any indirect competitor of UUTBV or any of its affiliates, or to any person or organisation that, to the knowledge of the City of Tallinn, is related to such a competitor through any other substantial interest, without first offering the Shares to UUTBV on exactly the same terms and conditions;
- UUTBV has a right of first refusal with respect to any of the Shares and the B-Share, if the shareholding of the City of Tallinn in the Company's total share capital decreases at any time to 35 per cent. or less. This right of first refusal does not apply to any public offerings of the Company's Shares. In addition, UUTBV has a right of first refusal with respect to any transfer of the B-Share by the City of Tallinn;
- the City of Tallinn has a right of first refusal with respect to any Shares sold by UUTBV under the Shareholders' Agreement (i.e., if the exclusive right to act as a water company in the Services Area is terminated or terminates without renewal because of a violation of the Company's obligations under the Services Agreement, or the City of Tallinn exercises its call option to purchase from UUTBV 11,500 Shares or the number of Shares corresponding to one per cent. of the Company's total share capital. See “— Third Party Rights on Shares — Options” for further details);
- UUTBV and the City of Tallinn have agreed that it shall be a precondition to any transfer of Shares that the transferee will unconditionally assume all the rights and obligations of the transferring shareholder under the Shareholders' Agreement, by signing a trilateral agreement between the City of Tallinn, UUTBV and that third person. This obligation does not apply to any public offerings for the sale of the Shares by the City of Tallinn; and
- notwithstanding any restrictions on the transfer of the Shares as provided above, the City of Tallinn and UUTBV may sell up to 30 per cent. of their respective shareholdings in the Company through the Offering.

In addition, prior to 5 May 2005, UUTBV was not entitled to transfer any of its Shares or create any lien over its shareholding in the Company pursuant to the Share Retention and Debt Subordination Agreement and the Share Pledge Agreement, each executed with the EBRD. see “Principal and Selling Shareholders — Related Party Transactions — The EBRD Loan Agreement”. However, on 5 May 2005, the EBRD and UUTBV executed an amendment agreement to the Share Pledge Agreement according to which 3,026,087 Shares owned by UUTBV were released from the pledge. This release was registered with the ECRS on 13 May 2005. The EBRD and the United Utilities group have also agreed to amend the Amended and Restated Share Retention and Subordination Agreement to reflect the amendments required to effect the Offering. The relevant amendment agreement was executed on 27 May 2005.

Third Party Rights on Shares

Options

The Shareholders' Agreement and the related Option Agreement of 12 January 2001 (the “Option Agreement”) set out the following option rights regarding the Shares as between the City of Tallinn and UUTBV:

- the City of Tallinn has been granted a call option to purchase from UUTBV, at a price equal to EEK22.90 per Share, 11,500 Shares or the number of Shares corresponding to one per cent. of the Company's total share capital at the relevant time (whichever is greater) if the City of Tallinn serves a notice under the Services Agreement requiring UUTBV to sell its Shares in the Company (which notice may be served in the same circumstances in which the City of Tallinn can terminate the Services Agreement);
- the City of Tallinn has been granted a call option to purchase from UUTBV the remaining balance of the Shares held by UUTBV, at a price equal to the market value of the Shares (as determined on the date when notice of exercise of the option is given) or, if trading on the Tallinn Stock Exchange has been suspended and no market value can be determined, at a price for each Share equal to the relevant proportion of the net asset value of the Company, if the City of Tallinn serves a notice requiring UUTBV to sell its Shares in the Company as described above; and

- UUTBV has a put option to sell all of its Shares to the City of Tallinn if the City of Tallinn fails to pay to the Company within 14 months any amount in excess of €10,000,000 (subject to adjustment in accordance with the Services Agreement) which it is obliged to pay to the Company under a decision, award or judgment rendered pursuant to the disputes resolution procedure under the Services Agreement. The price per Share is the relevant proportion of the net asset value of the Company at the time of the exercising of the put option, as adjusted for dividends that have been paid to the City of Tallinn in the five immediately preceding operating years of the Company.

Share Pledge

Pursuant to Estonian law, rights to securities registered with the ECRS are deemed to be enforceable with regard to third parties only if such rights are registered with the ECRS. Pursuant to the excerpt from the share register of the Company, issued by the ECRS on 13 May 2005, certain Shares have been pledged as follows:

- 200,000 Shares belonging to UUTBV have been pledged for the benefit of the City of Tallinn (to secure UUTBV's obligations under the call option held by the City of Tallinn, described above); and
- 6,860,870 Shares belonging to UUTBV are currently pledged for the benefit of the EBRD (9,886,957 Shares belonging to UUTBV had previously been pledged for the benefit of the EBRD, but on 5 May 2005 in connection with the Offering, the EBRD and UUTBV executed an amendment agreement to the Share Pledge Agreement according to which 3,026,087 Shares owned by UUTBV were released from the pledge; this release was registered with the ECRS on 13 May 2005).

Convertible Bonds

The Company has not issued any convertible bonds and/or executed any agreements and/or documents obliging the Company to issue convertible bonds for the benefit of any third person.

Corporate Governance

Activities of the Company

According to the Company's Articles of Association, the Company's activities are the following:

- supplying customers with drinking and industrial water meeting the applicable quality standards and collecting and treating customers' wastewater and rainwater;
- designing and building the supply network and sewerage facilities, carrying out required repairs and maintenance and remedying the effects of accidents;
- providing consultation and training in the field of water supply and sewerage;
- analysing wastewater and the quality of drinking water;
- developing and issuing technical conditions for water supply and sewerage systems;
- maintaining and repairing the energetics equipment for the water supply and sewerage systems;
- utilising sludge created by the purification and treatment of drinking water and wastewater and producing and selling greenhouse soil;
- generating heat on the basis of purified wastewater;
- developing, producing, mediating and selling technical and technological solutions, equipment, machinery, measuring devices and operating systems for water supply and sewerage systems; and
- providing transportation services.

Shareholders' General Meeting

The Articles of Association, as currently in effect, provide that the Company's shareholders' general meeting shall be held in Estonia at a time and place as determined by the Management Board.

Pursuant to the Articles of Association, the Company's shareholders' general meeting is competent to:

- amend the Articles of Association;
- increase and reduce the Company's share capital;

- issue convertible bonds;
- elect an auditor;
- designate a special audit;
- approve the annual report and distribute profit;
- decide on the dissolution, merger, division and transformation of the Company;
- appoint and remove members of the Supervisory Council, which shall be appointed by the shareholders' general meeting in accordance with the Articles of Association;
- decide on the assertion of a claim against a member of the Management Board or Supervisory Council, or a shareholder, and to appoint a representative of the Company in such claim;
- decide on the conclusion of a transaction between the Company and a member of the Supervisory Council and to appoint a representative of the Company in that transaction;
- acquire treasury shares;
- decide on other issues related to the activities of the Company, at the request of the Management Board or the Supervisory Council; and
- decide on other issues placed in the competence of the shareholders' general meeting by virtue of law.

The quorum of the Company's shareholders' general meeting is more than one half of the votes determined by the Shares.

A resolution of the Company's shareholders' general meeting is adopted if more than one half of the votes represented at the shareholders' general meeting are cast for the resolution. However, there are certain exceptions to this rule as set forth by the Articles of Association and by the Commercial Code:

- The B-Share must be voted in favour of the following resolutions for them to be effective:
 - amending the Articles of Association;
 - increasing and reducing the Company's share capital;
 - issuing convertible bonds;
 - acquisition of treasury shares;
 - deciding on the dissolution, merger, division and transformation of the Company; and
 - deciding on other issues related to the activities of the Company, which are not in the sole competence of Company's shareholders' general meeting, at the request of the Management Board or the Supervisory Council.
- At least two-thirds of the votes represented at the shareholders' general meeting must be voted in favour of the following resolutions for them to be effective:
 - amending the Articles of Association;
 - removing members of the Supervisory Council before the end of their term (applicable only in respect of the Supervisory Council members elected by the Company's shareholders' general meeting);
 - increasing and reducing the Company's share capital;
 - issuing convertible bonds; and
 - deciding on the dissolution, merger, division and transformation of the Company.
- Pursuant to the Commercial Code, exclusion of the pre-emptive right of the Company's shareholders to subscribe for new Shares requires at least three-quarters of the votes represented at the shareholders' general meeting to be voted in favour of the resolution for it to be effective.
- Any decision to amend the rights attaching to a class of shares needs a majority of at least four-fifths of the votes cast for it to be effective, provided also that nine-tenths of the shareholders whose shares belong to the class of which the rights are amended vote in favour.

In addition to the relevant provisions of the Articles of Association, pursuant to the Shareholders' Agreement the following resolutions require the prior written consent of the City of Tallinn at the Company's shareholders' general meeting:

- issuance by the Company of any securities entitling their holder to vote and/or to acquire Shares and/or other securities in the future, including any increase of the Company's share capital or the issuance of any convertible bonds; and
- any transaction of a substantially similar nature or having a substantially similar effect to any of the above or any agreement or proposal to do any of the above.

Management Board

Pursuant to the Articles of Association, the Management Board consists of two to five members who are elected by the Supervisory Council for a term of three years. If there are more than two members of the Management Board, they must themselves elect one of their members as Chairman. The Chairman of the Management Board organises the activities of the Management Board.

Pursuant to the Shareholders' Agreement, the City of Tallinn is required to procure that the members of the Supervisory Council nominated by it and the members elected from among its candidates will vote together with the members of the Supervisory Council representing UUTBV on the appointment of the Management Board members. The objective of this provision is to ensure that the candidates nominated by UUTBV are elected, except when the relevant candidates are not duly qualified or do not have sufficient experience to serve as members of the Management Board.

The Management Board is responsible for the day-to-day management of the Company. Pursuant to the Articles of Association, the consent of the Supervisory Council is required by the Management Board for transactions and activities in all areas and issues that bear relevance to the activities of the Company which, according to law and the Articles of Association, are not in the sole competence of the Company's shareholders' general meeting and the Supervisory Council, and which are beyond the scope of everyday economic activities of the Company, including the following:

- making investments exceeding EEK10 million per investment or per series of related investments;
- assumption of loans and debt obligations or taking on external funds exceeding EEK10 million per loan or debt obligation or per series of related loans or debt obligations;
- granting of loans or guaranteeing of debt obligations exceeding EEK10 million;
- transfer, acquisition, pledging or otherwise encumbering of assets (including immovables and registered movables) the value of which exceeds EEK10 million or the conclusion of transactions which, in the future, incur obligations to transfer or acquire the above assets;
- conclusion of agreements which impose obligations on the Company exceeding EEK10 million per transaction or per series of related transactions;
- changing of the areas of activity of the Company, launching of new, or termination of current, areas of activity, or sub-contracting for services in the main areas of activity;
- acquisition or termination of holdings in other companies;
- acquisition or transfer of an enterprise or termination of its activities;
- conclusion of transactions with affiliate companies;
- specification of the authority of the representatives of the Company with its subsidiaries or other undertakings in which the Company has a holding; and
- foundation and closure of foreign branches.

Supervisory Council

Pursuant to the Articles of Association, the Supervisory Council consists of nine members the term of whose authority is two years (the Listing and Surveillance Committee of the Tallinn Stock Exchange has granted the Company a deadline of 31 December 2005 for the election of the two independent members of its Supervisory Council required to be appointed pursuant to the TSE Rules; see "Management — Supervisory Council" for further details). Five members of the Supervisory Council shall be elected and removed by the shareholders' general meeting of the Company. A member of the Supervisory Council who is elected by the shareholders' general meeting may be removed before the end of his/her term,

provided that at least two-thirds of the votes represented by the shares at the shareholders' general meeting vote in favour of the removal. Each shareholder who is the holder of the B-Share, or whose Shares represent at least 34 per cent. of the votes granted by the Shares, is entitled to appoint and remove two members of the Supervisory Council, provided however that no single shareholder may appoint or remove more than two members of the Supervisory Council.

Under the Shareholders' Agreement, UUTBV and the City of Tallinn have agreed that the division of the seats in the Supervisory Council shall be such that UUTBV shall have four seats, the City of Tallinn shall have three seats and two seats shall be for independent members of the Supervisory Council as required by the TSE Rules. The Shareholders' Agreement provides that this division of seats is subject to change if the City of Tallinn acquires additional Shares from UUTBV.

Pursuant to the Articles of Association, the Supervisory Council is competent to:

- plan the activities of the Company and approve the development plan and strategy of the Company;
- approve and change the business plan and annual budget;
- give instructions to the Management Board on organising the management of the Company, and supervise the activities of the Management Board;
- elect and remove members of the Management Board;
- determine the duties of the members of the Management Board and establish the principles of their remuneration;
- appoint and remove the procurator (being the representative of the Company who under applicable law is empowered to represent the Company in all legal acts related to the Company's economic activities, other than a right to transfer or encumber the Company's real estate if such right has not been expressly granted to him/her);
- approve the annual report prepared by the Management Board and make changes to the profit distribution proposal;
- determine the agenda of a shareholders' general meeting;
- grant consent to the Management Board for transactions and activities described above; and
- decide on other issues placed in the competence of the Supervisory Council by law or the Articles of Association.

Voting on a Related Proposal, Arrangement or Contract

Pursuant to the Commercial Code, a member of the Supervisory Council may not participate in voting if approval of the conclusion of a transaction between such member and the Company is being decided, or if approval of the conclusion of a transaction between a third person and the Company is being decided, if the interests of the member of the Supervisory Council arising from such transaction are in conflict with the interests of the Company.

Pursuant to the Articles of Association, a member of the Management Board may not participate in voting by the Management Board on the conclusion of a transaction between the member and the Company, or on the conclusion of a transaction between the Company and a legal person in which such member of the Management Board or person connected with him or her (in the meaning of the TSE Rules) has a qualifying holding (in the meaning of the TSE Rules).

Pursuant to the Articles of Association, it is in the competence of the shareholders' general meeting to decide on conclusion of a transaction with a member of the Supervisory Council, and on the appointment of a representative of the Company in such transaction.

Pursuant to the Commercial Code, the Supervisory Council shall decide on the conclusion and terms and conditions of transactions with the members of the Management Board and on the appointment of a representative of the Company in such transactions.

DESCRIPTION OF ESTONIAN COMPANY LAW

The following describes certain of the provisions of Estonian legislation regulating the legal status and management of public limited companies. The following description does not constitute an exhaustive overview of the subject matter and may be subject to changes as a result of any future amendments to Estonian legislation.

Introduction

Under Estonian law, limited liability companies are divided into two categories – private limited companies (*osajühing*, abbreviated as *OÜ*) and public limited companies (*aktsiaselts*, abbreviated as *AS*). Public limited companies are characterised by greater capital requirements and the ability to issue more numerous classes of shares than private limited companies, and are required to register with the Estonian Central Registry of Securities (“ECRS”). The ECRS holds shares and other securities stipulated in the Estonian Central Registry of Securities Act, records transactions executed with such securities (including pledges), maintains ownership registration records, and processes and clears securities transactions. Any person has access to certain information, and has the right to obtain extracts and transcripts of documents from the ECRS, concerning the issuer (its name, seat and registry code) and the securities (the type, nominal value and amount of securities) registered with the ECRS. If shares are quoted on the stock exchange, the information concerning the shareholders is also accessible to the public. The Estonian Central Registry of Securities Act (*Eesti väärtpaberite keskregistri seadus*) stipulates further circumstances when additional information registered with the ECRS is accessible to third parties. See “The Tallinn Stock Exchange and the Estonian Securities Market” for further details regarding the activities of the ECRS.

Pursuant to Estonian law, the legal capacity of a company is effective upon its entry in the Commercial Register (*Äriregister*). Therefore, a public limited company organised under Estonian law must be registered with the Commercial Register. The Commercial Register is a record maintained by the registration departments of the various courts of first instance.

Shares and Share Capital

Minimum Share Capital

Public limited companies must have a minimum share capital of EEK400,000 (approximately €25,600). A public limited company’s share capital must be fully paid-up as a condition of registration in the Commercial Register.

Classes of Shares

The shares of a public limited company may be divided into different classes, each of which may be granted different rights. The Commercial Code provides examples of two possible classes of shares: ordinary shares and preferred shares. Ordinary shares typically entitle the shareholder to participate in general meetings, to share in the distribution of profits and, upon dissolution, to receive a portion of the company’s remaining assets. The second class of shares – preferred shares – typically consists of non-voting shares that grant shareholders a preferential right to receive dividends and to participate in the distribution of the company’s remaining assets upon dissolution. However, the articles of association may prescribe that a preferred share grants the right to vote for certain resolutions (i.e. a restricted voting right).

The rights attached to a class of shares may only be amended if at least four-fifths of the votes represented by all shares of the company are cast for such resolution. Additionally, at least 90 per cent. of the shareholders holding the shares of the class to be amended must vote in favour of the resolution for it to be effective. A resolution for cancellation or amendment of the preferred rights shall require approval of all holders of the preferred shares.

The dividends payable to a holder of a preferred share must be paid prior to the dividend payment to other shareholders. The actual dividend payable to a holder of a preferred share may be higher than the amount provided in the articles of association of a company. If a company has no profits to distribute from its current year and from retained earnings, the payment of dividends may be postponed to the subsequent year. If a dividend has not been fully paid to the holder of a preferred share for two financial years, the holder of the preferred share shall obtain voting rights in proportion to the nominal value of its share. Such voting rights shall be lost on the last day of the financial year when the relevant dividend is fully paid. If the company has more than one class of shares, upon issuance of new shares in a certain

class, the holders of shares of the relevant class have the pre-emptive right to subscribe the newly issued shares.

Nominal Value

The shares of public limited companies must have a nominal value of EEK10 each or a full multiple thereof. Shares are freely transferable, but the company's articles of association may confer a pre-emptive right on other shareholders. Dividends must be distributed to shareholders *pro rata*, based upon the nominal value of the shares held by each shareholder. Where a public limited company has different classes of shares, owners may enjoy different rights, such as, for example, the right of preferred shareholders to receive dividends in a pre-determined amount.

Pre-emptive Rights to Subscribe for Ordinary Shares

Under Estonian law, existing shareholders have pre-emptive rights in proportion to their shareholdings with respect to the issuance of new shares for cash. A resolution to the effect that the pre-emptive rights of existing shareholders are to be disapplied requires at least three-quarters of the votes represented at the shareholders' general meeting to be in favour for it to be effective. If the company has several classes of shares and new shares of one or more classes are issued, the holders of the relevant classes of shares have a pre-emptive right in the subscription of such shares before other shareholders.

Dividends

Pursuant to the Commercial Code, only the shareholders' general meeting may authorise the payment of dividends. Payment of dividends may be decided only once a year on the basis of the approved annual report (the decision may, however, stipulate that the dividends are paid out in several instalments). Under Estonian law, no interim dividends may be paid in respect of a financial period for which the annual report (together with the audited financial statements) has not yet been approved by the shareholders' general meeting.

Dividends may only be paid out from net profit or undistributed profit from previous financial years and from which unrecovered losses from previous years have been deducted. Dividends may not be paid if the net assets of the company, as recorded in the annual report approved at the end of the previous financial year, are less than or would be less than the total of share capital and reserves which pursuant to applicable law or the relevant company's articles of association shall not be paid out to shareholders.

A holder of a preferred share must be paid a dividend prior to the payment of dividends to other shareholders.

Corporate Governance

Governance Structure

The shareholders' general meeting is the highest decision-making forum of a public limited company. A public limited company incorporated in Estonia must also have a two-tier management structure, comprising a management board and a supervisory council.

Shareholders' General Meeting

In accordance with the Commercial Code, the annual shareholders' general meeting must be held within six months of the end of the financial year. An extraordinary shareholders' general meeting may be held whenever the management board deems it appropriate (including circumstances when an extraordinary shareholders' general meeting is required by the Commercial Code), or when the supervisory council, shareholders representing at least one-tenth of the share capital of the company or the auditor of the company so request to the management board. If the management board does not convene the general meeting within one month after receipt of such a request, the shareholders, the supervisory council or the auditor are entitled to convene the general meeting themselves.

Notices of annual shareholders' general meetings must be given at least three weeks prior to the meeting, and notices of extraordinary shareholders' general meetings must be given at least one week in advance. A shareholder may attend and vote at the meeting in person or may vote by proxy. Notices to convene the shareholders' general meetings must be sent to the shareholders by registered mail to their registered addresses (being the address of the shareholder entered in the share register of the company as maintained by the ECRS). However, if the company has more than one hundred shareholders, notices need not be sent by registered mail, but may be published in at least one national daily newspaper in Estonia.

The supervisory council of the company usually determines the agenda of the shareholders' general meeting. If, however, the shareholders or the auditor convene a general meeting, they must also determine the agenda of that meeting. The management board or one or more shareholders holding at least one-tenth of the share capital of the company may require that other items be included on the agenda of a forthcoming general meeting.

If, upon convening a general meeting, the requirements of law or the articles of association have been breached, the meeting is not entitled to adopt any decision unless all the votes represented by the company's shares are represented at the meeting. Resolutions may be adopted at either annual or extraordinary shareholders' general meetings.

Management Board

The management board is an executive body charged with the day-to-day management of the relevant company, as well as with representing the company in its relations with third parties, for example, by entering into contracts on behalf of the company. The management board must adhere to the lawful orders of the supervisory council. The management board may enter into transactions which are beyond the scope of the company's everyday economic activities only with the consent of the supervisory council.

At least half of the management board members of a public limited company must be residents of Estonia, member states of the European Economic Area or Switzerland. The members of the management board may not simultaneously serve on the supervisory council.

Supervisory Council

The supervisory council engages in oversight and longer-term management activities, such as supervising the management board and devising business plans. The consent of the supervisory council is necessary for a company to conclude transactions which are beyond the scope of its ordinary activities.

No residency requirements apply to the members of the supervisory council. The supervisory council reports to the shareholders' general meeting.

General Obligations of Members of Governing Bodies

Management board and supervisory council members have certain obligations to the company under the Estonian General Part of the Civil Code Act (*Tsiviilseadustiku üldosa seadus*) and the Law of Obligations Act (*Võlaõigusseadus*). Pursuant to this, members of a company's governing body must fulfil various general duties to the company, including upholding a fiduciary duty of loyalty, acting with due diligence, performing their duties with sufficient skill and in a manner commensurate with their knowledge and abilities, and acting to maximise benefits to the company and to prevent any losses.

Members of governing bodies must also keep the company informed of all material facts related to the performance of their obligations, such as any conflicts of interest which may arise. A strict confidentiality requirement also applies where members of governing bodies learn of facts that the company has a legitimate interest in keeping confidential. For example, the company is presumed to have a legitimate interest in maintaining the confidentiality of its production and business secrets. The confidentiality obligation continues after the board or council member's term of service expires, to the extent necessary to protect the company's interests. Exceptions to the confidentiality obligation arise where the company authorises disclosure, or where the law requires disclosure. Unauthorised disclosure of business secrets may result in criminal punishment.

Miscellaneous

Pursuant to the Commercial Code, a public limited company is required to engage an auditor who must be appointed by the shareholders' general meeting. The shareholders' general meeting shall also determine the principles of remuneration of the company's auditors. The auditors may be appointed for a specified term or for a single audit.

The Commercial Code provides that a shareholder whose shares, together with the shares of its parent undertaking and its subsidiaries, represent at least 90 per cent. of the share capital of a public limited company, is entitled to acquire the remaining outstanding shares of the company for fair monetary compensation. A resolution on the acquisition of these shares shall be adopted, and shall bind all shareholders, if at least 95 per cent. of the shareholders vote in favour.

A public limited company is entitled to acquire its own shares only if the following conditions are met: (i) the acquisition occurs within one year after the adoption of a resolution of the general meeting which

specifies the conditions and term for the acquisition and the price to be paid for the shares; (ii) the sum of the nominal value of the shares held by the company does not exceed one-tenth of its share capital; and (iii) the shares are paid for from assets excluding the share capital, reserve capital and premium. However, a public limited company may acquire its shares by a resolution of the supervisory council without requiring a resolution of the general meeting if the acquisition of the shares is necessary to prevent significant damage to the company. The shareholders must be informed of the circumstances of the acquisition of the company's own shares at the next shareholders' general meeting. In any case, a public limited company which has acquired its own shares must transfer those shares within one year from the date on which they were acquired.

There are no limitations imposed by Estonian law on the rights of non-residents or foreign persons to hold or vote for the shares of an Estonian company, other than those limitations that apply to all shareholders.

Various additional restrictions and limitations on the activities of the Company and its managing bodies are imposed by the TSE Rules, which to a large extent have been applicable to the Company with effect from the submission by the Company of its application for listing of the Shares on the Tallinn Stock Exchange.

THE TALLINN STOCK EXCHANGE AND THE ESTONIAN SECURITIES MARKET

Set out below is a summary of certain information concerning the Estonian regulated securities market and certain provisions of Estonian law and Estonian securities market regulations in effect on the date of this Offering Circular. The summary is based on Estonian laws and securities market regulations and publicly available information on OMX AB group, the principal shareholder of the company operating the Tallinn Stock Exchange, and on NOREX.

The Tallinn Stock Exchange

The Tallinn Stock Exchange is the only stock exchange operating in Estonia. It is operated by AS Tallinna Börs, a public limited company whose principal shareholder is the Swedish company OMX AB, through its Finnish subsidiary. OMX AB group companies also operate the Copenhagen Stock Exchange, the Stockholm Stock Exchange, the Helsinki Stock Exchange, the Riga Stock Exchange and the Vilnius Stock Exchange.

The Tallinn Stock Exchange is also a member of NOREX, an alliance of Nordic and Baltic stock exchanges. NOREX currently consists of the Iceland Stock Exchange, Oslo Börs and the following OMX exchanges: the Copenhagen Stock Exchange, the Stockholm Stock Exchange, the Helsinki Stock Exchange, the Riga Stock Exchange and the Tallinn Stock Exchange.

The activities of, and trading on, the Tallinn Stock Exchange are subject to two tiers of regulation. Laws and government regulations comprise the basic regulatory framework, which is supplemented by the TSE Rules.

The principal laws governing the activities of, and trading on, the Tallinn Stock Exchange are the Securities Market Act, the Estonian Central Registry of Securities Act and the Financial Supervision Authority Act (*Finantsinspektsiooni seadus*).

The TSE Rules are established by the operator of the Tallinn Stock Exchange (AS Tallinna Börs) to ensure the regular and lawful operation of the stock exchange. The operator may unilaterally amend the TSE Rules, though the Estonian Financial Supervision Authority (“EFSA”) must approve such amendments. The TSE Rules are binding on the members of the Tallinn Stock Exchange and the issuers whose securities are listed on the Tallinn Stock Exchange or admitted to trading on the separate Free Market regulated by the Tallinn Stock Exchange.

The Estonian Central Registry of Securities and Registration of Shares

The ECRS is a public register established, among other things, for the registration of shares and share transactions.

The ECRS is administered by the Estonian Central Securities Depository (*Eesti Väärtpaberikeskus*, the “ECSD”). The ECSD is organised as a public limited company, and its shares are fully owned by AS Tallinna Börs. The ECSD’s primary functions include clearing and settling securities transactions, maintaining records of share ownership and pledges, and providing securities-related services to issuers and investors.

All shares listed and traded on the Tallinn Stock Exchange must be registered in the ECRS by professional participants in the Estonian securities market, which also maintains share registers of Estonian public limited companies. No share certificates are issued with respect to shares registered in the ECRS. Shares are registered in the ECRS in book-entry form and are held in dematerialised form in the respective shareholders’ securities accounts opened in the ECRS. Consequently, all transactions involving shares listed on the Tallinn Stock Exchange must be recorded on the ECRS’ electronic database by account operators and are cleared and settled through the ECSD. The rights attached to the shares belong to the persons who are registered as the shareholders in the share register of the issuer maintained by the ECSD.

A securities account can be opened in the ECRS by any Estonian or foreign person. The opening of the account takes place through an account operator. Account operators are institutions that qualify under Estonian law as professional participants in the securities market, such as investment firms, credit institutions and other persons specified by law. In certain cases, foreign persons may act as account operators.

Under certain conditions a nominee account can be opened in the ECRS, in which case a notation is made in the ECRS indicating the nominee status of the relevant account. Shares held in the nominee

account are deemed to be the client's shares, and not the shares of the account owner. The person who is entitled to exercise the rights arising from shares held in the nominee account is the account owner. In the exercise of voting rights and other rights arising from a share, the owner of a nominee account must follow the instructions of the client. At the request of the client, the owner of a nominee account must grant authorisation in the required format to the client for the client to represent the owner in the exercise of rights arising from the shares.

Listing on the Tallinn Stock Exchange

There are two different lists available for trading of shares on the Tallinn Stock Exchange: (i) the main list and (ii) the investor list. In addition to securities listed on the Tallinn Stock Exchange, securities admitted to the Free Market of the Tallinn Stock Exchange can be traded through the exchange's trading system.

The principal differences between admission to the main list and the investor list are the minimum required length of operating history of an issuer (three and two years, respectively) and the minimum required market value of the issuer's shares (€4 million and €1 million, respectively). Currently the shares of 13 companies are listed for trading on the Tallinn Stock Exchange, of which seven companies are listed on the main list. Application has been made to list the Shares on the main list.

In order to list shares on the main list of the Tallinn Stock Exchange, among other requirements, a sufficient number of such shares must be held by the public. As a general rule, this condition is fulfilled if at least 25 per cent. of the share capital to be listed is held by the public, or such level of distribution is expected to be achieved shortly after listing. The TSE Rules set out certain specific requirements when the shares are not deemed to be held by the public.

Trading on the Tallinn Stock Exchange

The trading system of the Tallinn Stock Exchange is open for trading to its members. Stock exchange membership is open to investment firms and credit institutions. Foreign investment firms and branches of foreign credit institutions are also eligible for membership, provided that they have fulfilled the necessary legal requirements for operating in Estonia. Membership by NOREX exchange members is subject to certain limited documentary requirements of the TSE Rules.

Trading on the Tallinn Stock Exchange takes place on each business day from 10:00 a.m. to 2:00 p.m. (Tallinn time). The Tallinn Stock Exchange uses the Nordic-Baltic trading system SAXESS, which in addition to Estonia is used by exchanges in Sweden, Finland, Denmark, Norway, Iceland and Latvia. The official trading currency of the Tallinn Stock Exchange trading system is the euro.

Transactions can be concluded on the Tallinn Stock Exchange either through automatic matching or through negotiated deals. In the case of automatic matching, the buy and sell orders are matched by the trading system automatically according to price and time priorities. Automatically matched transactions are settled on the third day after the transaction (T+3), unless agreed otherwise. Negotiated deals can be concluded during the Tallinn Stock Exchange trading period at a price between the best bid and offer prices quoted at the time of concluding the transaction. Negotiated deals concluded after the Tallinn Stock Exchange's trading period must be concluded at a price at or between the best bid and offer prices quoted during trading on that day. Negotiated deals are negotiated between stock exchange members outside the system and brokers must enter the deal in the trading system as soon as possible, and in any event not later than five minutes, after its conclusion. Negotiated deals may have a settlement day between T+1 (inclusive) and T+6 (inclusive) if agreed between the relevant stock exchange members.

The operator of the Tallinn Stock Exchange is required to ensure constant access on its website to information on the securities traded on the market, including the acquisition and transfer prices of the securities, recent prices, price changes, the highest and lowest prices and the volume and number of transactions. The Tallinn Stock Exchange operates an electronic trading system that provides real-time stock quotes, distributes issuer announcements and displays information regarding executed transactions, statistics and other such data.

The operator of the Tallinn Stock Exchange must record at least the following regarding transactions concluded on the exchange: (i) the time at which the transaction is concluded; (ii) information regarding the market participant who concluded the transaction; (iii) the securities which served as the object of the transaction; and (iv) their number, nominal value and price. In accordance with the TSE Rules, the operator of the Tallinn Stock Exchange has the right to request additional information regarding a transaction for the purposes of recording the transaction.

The Listing and Supervisory Committee of the Tallinn Stock Exchange has the right, for the purpose of ensuring sufficient liquidity of a security, to demand from the issuer applying for listing the conclusion of a market-making agreement with a member of the Tallinn Stock Exchange in respect of the securities to be listed. The Company and AS Hansapank intend to enter into a market-making agreement in connection with the listing of the Shares on the Tallinn Stock Exchange.

Supervision over the Tallinn Stock Exchange and Trading on the Tallinn Stock Exchange

Activities of the Tallinn Stock Exchange are supervised by the EFSA. Compliance with the TSE Rules by its members is monitored by the Listing and Surveillance Committee of the Tallinn Stock Exchange.

The operator of the Tallinn Stock Exchange exercises supervision over the exchange with respect to the prices of securities traded on the exchange and the conducting and execution of transactions for the purpose of detecting and reducing transactions conducted on the basis of inside information, market manipulation and other violations of law. The operator is under an obligation to notify the EFSA immediately of any violation of law. The EFSA also has specific supervisory obligations for monitoring transactions concluded on the exchange.

Disclosure of Transactions and Ownership

A person who has acquired in an issuer, either directly or indirectly, individually or together with persons operating in concert, a qualifying holding and in connection therewith or thereafter acquired or increased the number of votes owned by such person over 10 per cent., 20 per cent., one-third, 50 per cent. or two-thirds of all votes represented by the shares of the issuer, must immediately, and in any event by no later than four business days thereafter, notify the issuer and the EFSA of the number of votes owned by such person.

The same notification requirements also apply in case the holding falls below the prescribed levels. The EFSA has the right to make exemptions from such notification requirements in certain circumstances.

In the case of a company whose shares are listed on the Tallinn Stock Exchange, the disclosure obligations described above also apply in the case of the acquisition or reduction of a holding by 5 per cent. or more.

The issuer is also required to ensure that shareholders holding more than 5 per cent. of the shares of the issuer disclose, through the issuer, all the significant provisions of all the agreements made with other shareholders or third parties which are aimed at restricting the free transferability of the shares or which may have a significant effect on the price of the shares.

In order to ensure that disclosure obligations established by law are also fulfilled in respect of shareholdings held by nominee accounts, the operator of a nominee account is required to enter into written agreements with the clients on whose behalf the operator holds securities. These agreements must, among other requirements, require the client to notify the issuer and/or the competent supervisory body (the exact person to whom the notification must be submitted may vary depending on a particular transaction) if a holding in a company exceeds the threshold established by law or to obtain the permission of the competent supervisory body for the holding to exceed the threshold established by law (such permission is required, for example, in the case of the acquisition of a holding above a certain level in financial institutions, or in the case of an acquisition subject to concentration control by competition authorities).

The TSE Rules also regulate the disclosure of the issuer's dealings in its own shares.

Market Abuse

Estonian law prohibits market abuse, which (within the meaning of the Securities Market Act) is misuse of inside information and market manipulation. Restrictions established for the misuse of inside information also apply to financial instruments that are not admitted to trading in Estonia or in an EEA member state but the value of which depends on a financial instrument that is admitted to trading in Estonia or in an EEA member state.

Inside information is information of a precise nature which has not been made public, relating, directly or indirectly, to the financial instrument or its issuer and which, if it were made public, would be likely to have a significant effect on the price of the financial instrument or on the price of related derivative financial instruments. The law establishes additional conditions under which information may qualify as inside information.

An insider is a person who possesses inside information by virtue of being a partner in the issuer, or by virtue of his membership of the management or supervisory bodies of the issuer, or by virtue of his shareholding in the issuer, or by virtue of having access to the information through the exercise of his employment, profession or duties, or by virtue of his criminal activities. Third parties who possess inside information are also treated as insiders if they knew or should have known that the information is inside information. The TSE Rules stipulate that, among other persons, persons who hold or control at least 10 per cent. of shares in an issuer and certain officials of such shareholders and persons associated with them are deemed to be insiders for the purpose of the TSE Rules.

Misuse of inside information comprises, among other things, the trading on the basis of inside information, unauthorised disclosure of inside information, and the making of recommendations on the basis of inside information for the acquisition or disposal of financial instruments to which that information relates.

Misuse of inside information is a criminal offence, and may result in fines or imprisonment. Issuers of publicly-traded securities and other individuals or entities that have regular access to inside information are required to establish internal rules and procedures to prevent the disclosure of such information.

The Securities Market Act contains a non-exhaustive list of actions that are deemed to constitute market manipulation. Under the Securities Market Act, market manipulation may be punishable by a fine.

In order to monitor compliance with the prohibition on insider trading, the operator of the Tallinn Stock Exchange has the right to receive from the ECSD information on transactions involving an issuer's securities. In addition, the EFSA is obliged to monitor transactions involving an issuer's shares.

The TSE Rules also restrict transactions involving an issuer's securities by certain officials of the issuer and by persons connected with such officials, to avoid profiting from short-term price fluctuations of the issuer's securities and during restricted periods (in particular, after the end of a financial period but when the financial results of the issuer have not yet been made public). The Listing and Supervisory Committee of the Tallinn Stock Exchange has the right to make exemptions from the requirement to abstain from trading during a restricted period if the Committee is of the opinion that the transaction will not be executed on the basis of confidential information.

Mandatory Take-over Bid

A person who has gained, either directly or together with other persons acting in concert, a dominant influence over a company whose shares (of all or some classes) are listed on the Tallinn Stock Exchange, is required to make within 20 days a takeover bid for all the outstanding shares of such issuer. Exemptions from the obligation to make the mandatory take-over bid may be granted by the EFSA in case of certain specific circumstances provided by law. For these purposes, a "dominant influence" is a situation where a person: (i) owns the majority of votes represented by the issuer's shares; or (ii) being a shareholder of the company, has the right to appoint or remove a majority of the members of the supervisory council or management board of the company; or (iii) being a shareholder of the company, controls a simple majority of the votes represented by the company's shares on the basis of an agreement entered into with other shareholders.

ESTONIAN TAXATION

The taxation discussion set out below is intended only as a descriptive summary and does not purport to be a complete analysis or listing of all potential tax effects relevant to the acquisition, ownership or disposal of Shares. The statements of Estonian tax laws set forth below are based upon the laws and regulations in effect as at the date of this Offering Circular, and are subject to any changes in Estonian law occurring after that date, which changes may have retroactive effect. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Factors Affecting the Company’s Results of Operations — Estonian corporate tax regime” for details of the Estonian corporate tax regime as it relates to the Company itself.

Withholding Tax on Dividends

No Estonian dividend withholding tax is imposed on dividends paid to Estonian residents (whether legal persons or individuals) or to non-resident individuals.

However, an Estonian dividend withholding tax of 24 per cent. is currently imposed on dividends paid by the Company to non-resident legal persons. A limited exemption from this dividend withholding tax applies where the non-resident legal person owns at least 20 per cent. of the share capital or votes of the Company. However, the exemption does not apply where the relevant non-resident legal person is located in a “low tax rate territory” for the purposes of Estonian taxation regulations. Additional exemptions or more favourable tax rates available to non-resident legal persons may be enjoyed under international treaties in effect between Estonia and certain other states, including EU Member States.

Estonian taxation regulations provide that the currently applicable rate of dividend withholding tax of 24 per cent. referred to above will be reduced to 22 per cent. on 1 January 2006 and to 20 per cent. on 1 January 2007.

Taxation of Capital Gains

Income tax is not charged on gains realised by non-residents (whether legal persons or individuals) from the sale or exchange of shares of Estonian companies, except in the case of a sale or exchange of more than 10 per cent. of the shares of an Estonian “real estate company”. A real estate company is a company with more than 75 per cent. of its property comprising immovables or structures as movables located in Estonia (calculated by reference to the company’s balance sheet on the last day of the financial year preceding the relevant sale or exchange). Based on the financial information set out in its balance sheet as at 31 December 2004, the Company believes that its Shares would be deemed to be those of a real estate company. See the Audited Financial Statements included elsewhere in this Offering Circular for further details.

In addition, as the current income tax system applicable in Estonia provides that the profits of Estonian legal persons are not taxed upon their generation but are only taxed upon their distribution to shareholders, income tax is not charged on capital gains realised by Estonian legal persons from the sale or exchange of Shares.

Income tax is, however, charged on gains realised by Estonian individuals from the sale or exchange of Shares.

If income tax is due to be paid as described in the previous paragraphs, it is charged on the gains realised from the sale or exchange of a shareholding, with the gains being deemed to be equal to the difference between the acquisition costs and the sale/exchange price of the relevant shareholding. Capital gains realised are currently subject to income tax of 24 per cent., and are required to be declared annually by the relevant person by 31 March in each year.

Payments made by the Company as a result of any redemption of its Shares or any repurchase of its Shares through offers directed to its shareholders, being Estonian individuals or non-residents (whether legal persons or individuals) only, as well as the proceeds of any liquidation of the Company which are paid to those shareholders, are also treated as capital gains which are chargeable as described above.

Estonian taxation regulations provide that the currently applicable income tax rate of 24 per cent. chargeable on capital gains and referred to above will be reduced to 22 per cent. on 1 January 2006 and to 20 per cent. on 1 January 2007.

Stamp Duty and Other Transfer Taxes

There are currently no stamp duties or other transfer taxes payable on the transfer of Shares. However, fees and charges are generally levied by the operators of securities accounts in the ECRS on transactions in the Shares which are cleared and settled through the ECSD.

SUBSCRIPTION AND SALE

The Offering

The Institutional Offering and the Estonian Public Offering

The Institutional Offering comprises an offering of 4,254,546 Offer Shares by the Selling Shareholders to institutional investors outside the United States. In addition, 1,200,000 Offer Shares are being offered by the Selling Shareholders to the public in Estonia in the Estonian Public Offering. The Offer Shares which are subject to the Over-allotment Option (if exercised) will be sold in the Institutional Offering.

CA IB Corporate Finance Beratungs Ges.m.b.H., AS Hansapank and AS Lõhmus, Haavel & Viisemann are the Joint Global Co-ordinators and joint bookrunners, and Carnegie Investment Bank AB is co-lead manager, of the Institutional Offering. AS Hansapank and AS Lõhmus, Haavel & Viisemann are the joint lead managers of the Estonian Public Offering. See “— The Estonian Public Offering” for further details.

Subject to the terms and conditions set out in the underwriting agreement dated 27 May 2005 (the “Underwriting Agreement”) among the Company, the Selling Shareholders and the Managers, the Selling Shareholders have severally agreed to sell, and the Managers have severally agreed to procure purchasers for, or, failing which, to purchase themselves from the Selling Shareholders, such number of Offer Shares to be sold in the Offering as is set out opposite its name in the table below.

Manager	Number of Shares
CA IB Corporate Finance Beratungs Ges.m.b.H.	3,272,728
AS Hansapank	1,090,909
AS Lõhmus, Haavel & Viisemann ⁽¹⁾	1,090,909
Total	<u>5,454,546</u>

Note:

- (1) Carnegie Investment Bank AB has agreed with AS Lõhmus, Haavel & Viisemann to sub-underwrite half of the Offer Shares to be underwritten by AS Lõhmus, Haavel & Viiseman.

The Offer Price in the Institutional Offering is €9.25 per Offer Share, and the Offer Price in the Estonian Public Offering is EEK144.73105 per Offer Share. Prior to the Offering, there has been no public market for the Shares.

As compensation to the Managers, the Selling Shareholders will pay *pro rata* in accordance with the number of Offer Shares sold by the Selling Shareholders to the Joint Global Co-ordinators a combined management commission, underwriting commission and selling concession (the “Success Fee”) of 3.50 per cent. of the total gross proceeds from the sale of the Offer Shares and any additional Shares sold pursuant to the Over-allotment Option.

The Selling Shareholders have granted to the Joint Global Co-ordinators the Over-allotment Option, which can be exercised by the Joint Global Co-ordinators, in whole or in part on one occasion at any time up to and including the date falling 30 days after the Closing Date, to purchase up to a further 545,454 Shares at the Offer Price.

The Joint Global Co-ordinators have the right to terminate the Offering in certain circumstances in accordance with the terms of the Underwriting Agreement prior to payment for the Offer Shares being made to the Selling Shareholders.

The Company and the Selling Shareholders have agreed to indemnify the Managers against certain liabilities in connection with the offer and sale of the Offer Shares. In addition, the Company has agreed to reimburse the Joint Global Co-ordinators for certain of their expenses incurred in connection with the offer and sale of the Offer Shares.

In connection with the Offering, AS Hansapank or any agent of it may over-allot or effect transactions with a view to supporting the market price of the Shares at a level higher than that which might otherwise prevail. However, there is no obligation on AS Hansapank or any agent of it to do this. Such stabilisation, if commenced, may be discontinued at any time, and will in any event be discontinued 30 days after the Closing Date.

The Listing and Surveillance Committee of the Tallinn Stock Exchange approved the Estonian Prospectus and granted its conditional decision for listing of the Shares on 13 May 2005. According to the decision, the following conditions must be met for the listing decision to enter into effect:

- the Estonian Public Offering has taken place in accordance with the terms and conditions set out in the Estonian Prospectus, the results thereof have been announced to the public in Estonia and the Offer Shares actually sold have been transferred to the securities accounts of investors in the ECRS;
- as a result of the Offering, at least 25 per cent. of the Shares are held by the public; and
- a market-making agreement has been entered into in compliance with the requirements of the Tallinn Stock Exchange.

Lock-Up Agreement

The Company has agreed in the Underwriting Agreement that it will not, for a period of 360 days following the date of the Underwriting Agreement, without the prior written consent of the Managers (which consent shall not be unreasonably withheld or delayed), directly or indirectly, offer, sell, contract to sell, pledge, otherwise dispose of, enter into any transaction that is designed to, or might reasonably be expected to, result in the disposition (whether by actual disposition or effective economic disposition due to cash settlement or otherwise) by the Company or any Affiliate (as defined in the Underwriting Agreement) of the Company of any Shares or any securities convertible into, or exercisable or exchangeable therefor, or publicly announce an intention to effect any such transaction.

In addition, each Selling Shareholder has agreed in the Underwriting Agreement that it will not, for a period of 360 days following the date of the Underwriting Agreement, without the prior written consent of the Managers, directly or indirectly, offer, sell, contract to sell, pledge or otherwise dispose of, enter into any transaction which is designed to, or might reasonably be expected to, result in the disposition (whether by actual disposition or effective economic disposition due to cash settlement or otherwise) by such Selling Shareholder or any of its Affiliates of, any Shares or any securities convertible into, or exercisable or exchangeable therefor, or publicly announce an intention to effect any such transaction; provided that this restriction shall not apply to the transactions contemplated in the Underwriting Agreement in respect of the Offer Shares.

Selling Restrictions

Republic of Estonia

Each Manager has represented, warranted and agreed that it has not offered or sold and will not offer or sell any of the Offer Shares in the Institutional Offering in Estonia in a manner that would constitute a public offering and/or that would require the approval of a prospectus by the Tallinn Stock Exchange and/or registration of a prospectus with the EFSA.

United States

The Shares have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States.

The Offer Shares are being offered and sold outside the United States in reliance on Regulation S.

In addition, until 40 days after the commencement of the Offering, any offer or sale of the Shares that is made within the United States by any dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented, warranted and agreed that (i) it has not offered or sold and, prior to the expiry of a period of six months from the Closing Date of the Offer Shares, will not offer or sell any Offer Shares to persons in the United Kingdom, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as a principal or agent) for the purposes of their business or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "FSMA")) received by it in connection with the issue or sale of any Offer Shares in circumstances in which section 21(1) of the FSMA does not apply to the Company; and (iii) it has complied and will comply with all applicable provisions of the

FSMA with respect to anything done by it in relation to the Offer Shares in, from or otherwise involving the United Kingdom.

The Netherlands

UUTBV confirms that the Offer Shares will only be offered (a) in the Netherlands to persons who trade or invest in securities in the conduct of their profession or business, and (b) outside the Netherlands in compliance with the laws and regulations of each jurisdiction in which the Offer Shares are or will be offered.

To that extent, each of the Managers, the Company and the Selling Shareholders has represented and agreed in the Underwriting Agreement that it will only offer the Offer Shares (i) in the Netherlands to persons who trade or invest in securities in the conduct of their profession or business (which includes banks, securities firms, investment institutions, insurance companies, pension funds, other institutional investors, finance companies and large enterprises who as an ancillary activity regularly invest in securities); and (ii) outside the Netherlands in compliance with the laws and regulations of each jurisdiction in which the Offer Shares are or will be offered (except that the Managers accept no responsibility for the acts or omissions of the Company or the Selling Shareholders, and the Company and the Selling Shareholders accept no responsibility for the acts or omissions of the Managers).

The Estonian Public Offering

The Estonian Public Offering is being carried out as a solicitation of offers to purchase Offer Shares.

The Estonian Public Offering is being made pursuant to a separate prospectus in the Estonian language. The Estonian Prospectus has been approved by the Tallinn Stock Exchange, in accordance with the provisions of the Estonian Securities Market Act, legislation established on the basis thereof and the TSE Rules. The Estonian Prospectus is available as described under “Available Information” on page 5 in this Offering Circular.

The settlement date for the Offer Shares is expected to be on or about 31 May 2005. Registration in the Estonian Central Registry of Securities (the Estonian book-entry securities system) of transfer of the Offer Shares to investors to whom the Offer Shares have been allocated is therefore expected to be completed on or about 31 May 2005. See “The Tallinn Stock Exchange and the Estonian Securities Market — The Estonian Central Registry of Securities and Registration of Shares”.

The Managers and their respective affiliates have engaged in, and may in the future engage in, investment banking and other commercial dealings in the ordinary course of business with the Company and the Selling Shareholders and any of their respective affiliates, such as United Utilities PLC and its subsidiaries. They have received customary fees and commissions for these transactions and services.

GENERAL INFORMATION

- (1) The Audited Financial Statements covering each of the financial years ended 31 December 2002, 2003 and 2004 appearing elsewhere in this Offering Circular have been audited without qualification by Deloitte, independent auditors, as set out in their report appearing elsewhere in this Offering Circular. The auditor at Deloitte responsible for the audit of the Company's financial statements for each of the last three financial years is Sander Kallasmaa, Certified Auditor (Certified Auditor no. 247). Deloitte's registered number is 10687819 and its registered office is set out on the last page of this Offering Circular.
- (2) In the opinion of the Company, taking account of the Company's existing facilities, the working capital available to the Company is sufficient for its business activities for at least the next 12 months following the date of this Offering Circular.
- (3) The Company has made an application for its Shares, including the Offer Shares, to be listed on the Tallinn Stock Exchange, representing 99.9995 per cent. of the share capital of the Company. No application has been made for the listing of the B-Share, which is currently held only by the City of Tallinn. Trading of the Shares on the main list of the Tallinn Stock Exchange is expected to commence on or about 1 June 2005.

All investors, including institutional investors outside Estonia, will be required to have a current account and a securities account with an Estonian custodian bank, either directly or indirectly through their own custodian banks outside Estonia.

- (4) No significant changes have occurred to the financial situation or the market position of the Company since 31 December 2004.
- (5) Raidla & Partners, Attorneys at Law, whose principal office is at Roosikrantsi 2, Tallinn 10119, Republic of Estonia, and Law Office Ots & Co., whose principal office is at Parnu mnt 15, Tallinn 10141, Republic of Estonia, are the principal legal advisers to the Company in relation to its operations.
- (6) AS Hansapank, whose principal office is at Liivalaia 8, Tallinn 15040, Republic of Estonia, is the principal bank of the Company in relation to its operations.
- (7) The Company does not have any off-balance sheet liabilities (guarantees and sureties).
- (8) The following table provides details of the land owned by the Company as at 31 March 2005 based on excerpts from the Electronic Land Register:

<u>Location</u>	<u>Size</u>	<u>Balance sheet value</u>
	<i>(square metres)</i>	<i>(EEK thousands)</i>
J. Sütiste tee 41A, Tallinn.....	52	7.4
Kesktee 58, Tallinn	1,529	479.1
Kirsi tn 15A, Tallinn	37	40.7
Kolde pst 100A, Tallinn	241	68.8
Kopli tn 87C, Tallinn.....	547	61.8
Lennujaama tee 1, Tallinn	72	13.5
Liivamäe tn 5A, Tallinn	65	61.8
Piiri tn 8, Tallinn	533	186.2
Vana-Pärnu mnt 4A, Tallinn.....	190	41.2
Vanemuise tn 42A, Tallinn	70	34.7
Võidu tn 58A, Tallinn	30	2.4
Ädala tn 10, Tallinn	18,221	7,106.5
Kaabli tn 3a, Peetri village, Rae parish.....	302	24.0
Laabi village, Harku parish	300	7.3
Laabi village, Harku parish	295	7.8
Liikva village, Harku parish	208,200	522.4
Liikva village, Harku parish	1,562	31.2
Liikva village, Harku parish	30,004	456.1
Segu tn 11, Vanamõisa village, Saue parish.....	3,284	69.1
Tabasalu hamlet, Harku parish.....	439	12.3
Ankru tn 1C, Tallinn	118	16.1
Erika tn 1B, Tallinn	159	36.2
Nõmme-Kase tee 12A, Tallinn	250	34.7

Location	Size	Balance sheet value
	<i>(square metres)</i>	<i>(EEK thousands)</i>
Roolahe tn 1A, Tallinn	30	0.6
Rummu tee 3A, Tallinn	4,355	362.4

On 2 May 2005, the plot of land underneath and servicing the Ülemiste water treatment plant (size 178,545 square metres) was also registered with the Land Register as an immovable. The acquisition cost of the land underneath and servicing the Ülemiste water treatment plant was EEK15.1 million.

On 13 May 2005, the plot of land underneath and servicing the Paljassaare wastewater treatment plant (size 1,077,753 square metres) was also registered with the Land Register as an immovable. The acquisition cost of the land underneath and servicing the Paljassaare wastewater treatment plant was EEK16.6 million.

As at 31 March 2005, the Company was also the registered owner of the plot of land at Järvevana tee 3a (size 4,978 square metres). However, the land was sold on 31 March 2005. The sale process was completed by registration of the change of ownership with the Land Register on 14 April 2005.

- (9) The following table provides details of the buildings owned by the Company as movables and immovables as at 31 March 2005:

Location	Building	Balance sheet value	Percentage of total balance sheet value
		<i>(EEK thousands)</i>	<i>(per cent.)</i>
Paljassaare põik 14, Tallinn	Wastewater treatment plant complex	85,538.0	34.5
Järvevana tee 3, Tallinn	Water treatment plant complex	64,106.8	25.8
Ädala tn 10, Tallinn	Headquarters	39,339.5	15.9
Various	Pumping stations ⁽¹⁾	52,530.4	21.2
Various	Other buildings	6,661.6	2.7
		<u>248,176.3</u>	<u>100.0</u>

Note:

- (1) Comprising 71 buildings in aggregate representing buildings at water, wastewater and stormwater pumping stations (excluding technical facilities).

- (10) During the three years prior to the date of this Offering Circular, the Company had significant shareholdings in two companies:
- Vesimer Investeeringute Aktsiaselts (“Vesimer”); and
 - Aktsiaselts Kemivesi (“Kemivesi”).

Vesimer was a 100 per cent. subsidiary of the Company, whose main area of activity was the development and maintenance of real estate and water supply and sewerage projects. On 26 April 2004, a merger agreement was executed between the Company and Vesimer, whereby Vesimer was merged with the Company. The merger has been duly completed and registered with the Commercial Register.

The Company also owned 33.3 per cent. of the share capital of Kemivesi. Kemivesi operated in the field of the production and sale of chemicals (including water treatment chemicals) and provided related services to third parties. Pursuant to a share purchase agreement executed between the Company and Kemira Oyj on 25 October 2004, the Company sold its shareholding in Kemivesi to Kemira Oyj for €400,000.

The following table reflects the balance sheet value of Vesimer and Kemivesi as at 31 December 2002, 2003 and 2004:

	As at 31 December		
	2002	2003	2004
	<i>(EEK, thousands)</i>		
Vesimer	4,996	6,169	0
Kemivesi	8,504	6,126	0

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of AS Tallinna Vesi:

We have audited the annual accounts of AS Tallinna Vesi ("the Company") for the years ended 31 December 2004, 2003 and 2002. These annual accounts are the responsibility of the Company's Management Board. Our responsibility is to express an opinion on these annual accounts based on our audit.

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

In our opinion, the annual accounts present fairly, in all material respects, the financial position of the Company as of 31 December 2004, 2003 and 2002, the results of its operations and its cash flows for the years then ended, in accordance with Estonian Accounting Law and International Financial Reporting Standards.

Sander Kallasmaa
Certified Auditor
11 February 2005

AS Deloitte & Touche Audit

AS TALLINNA VESI
BALANCE SHEET
At 31 December 2004, 2003 and 2002

(thousand EEK)

ASSETS

	Note	2004	2003	2002
Cash at bank and in hand.....	2	101,000	84,153	188,211
Customer receivables.....	3	51,644	53,837	86,701
Other receivables	4	66	2,551	332
Accrued income and prepaid expenses	5	3,886	4,171	3,049
Inventories.....	6	3,266	5,544	11,625
Assets for sale.....	7	1,621	2,789	5,559
TOTAL CURRENT ASSETS.....		161,483	153,045	295,477
NON-CURRENT ASSETS				
Shares of associated companies	8	0	6,126	8,504
Long-term deposit.....	9	77,538	31,448	0
Other long-term investment assets	10	1,330	2,576	4,320
Tangible assets.....	11	1,779,897	1,785,139	1,778,319
Intangible assets	11	18,460	21,361	11,826
Construction in progress	11	102,634	62,797	51,168
Unfinished pipelines – new connections.....	11	79,675	93,176	99,254
Prepayments for fixed assets	11	3,648	8,565	18,934
TOTAL NON-CURRENT ASSETS.....		2,063,182	2,011,188	1,972,325
TOTAL ASSETS		2,224,665	2,164,233	2,267,802
LIABILITIES				
CURRENT LIABILITIES				
Current portion of long-term finance lease.....	12	1,777	2,632	3,007
Current portion of long-term bank loans.....	12	87,086	17,477	74,486
Trade and other payables	13	55,707	78,459	172,979
Taxes payable	14	20,534	15,827	18,471
Short-term provisions	15	912	13,668	1,708
Deferred income.....	16	18,582	36,495	26,120
TOTAL CURRENT LIABILITIES.....		184,598	164,558	296,771
NON-CURRENT LIABILITIES				
Finance lease.....	12	1,685	3,462	5,587
Bank loans.....	12	1,039,192	1,094,984	1,112,601
Other payables.....	13	100	100	11,255
TOTAL NON-CURRENT LIABILITIES.....		1,040,977	1,098,546	1,129,443
TOTAL LIABILITIES		1,225,575	1,263,104	1,426,214
EQUITY CAPITAL				
Share capital	17	200,001	200,001	200,001
Share premium		387,000	387,000	387,000
Statutory legal reserve.....	17	93,394	93,394	93,394
Accumulated profit		145,734	116,193	15,000
Net profit for the financial year		172,961	104,541	146,193
TOTAL EQUITY CAPITAL		999,090	901,129	841,588
TOTAL LIABILITIES AND EQUITY CAPITAL.....		2,224,665	2,164,233	2,267,802

AS TALLINNA VESI
INCOME STATEMENT
For the years 2004, 2003 and 2002

(thousand EEK)

	Note	2004	2003	2002
Sales from main operating activities	18	478,814	434,794	432,947
Revenues from other operating activities	18	69,715	69,223	79,577
Net sales	18	548,529	504,017	512,524
Cost of goods sold main operating activities	19, 20	-195,486	-193,157	-202,219
Cost of goods sold other operating activities	19, 20	-64,410	-61,608	-69,963
GROSS PROFIT		288,633	249,252	240,342
Marketing expenses	19, 20	-6,134	-6,342	-6,602
General administration expenses.....	19, 20	-40,739	-56,440	-42,143
Other income/ expenses (-)	19	13,158	-16,635	-16,701
OPERATING PROFIT		254,918	169,835	174,896
Financial income / expenses (-)	21	-55,680	-50,013	-5,344
PROFIT BEFORE TAXES		199,238	119,822	169,552
Income tax on dividends	22	-26,277	-15,281	-23,359
NET PROFIT FOR THE FINANCIAL YEAR		172,961	104,541	146,193
Attributable to:				
Equity holders of A-shares.....		172,951	104,531	146,183
B-share holder		10	10	10
Earnings per share in kroons	23	8.65	5.23	1.75

AS TALLINNA VESI
CASH FLOW STATEMENT
For the years 2004, 2003 and 2002

(thousand EEK)

CASH FLOWS FROM OPERATING ACTIVITIES

	Note	2004	2003	2002
Profit before taxes.....		199,238	119,822	169,552
Adjustment for depreciation		77,736	73,458	69,385
Adjustment for income and expenses from constructions.....	24A	-5,306	-7,616	-9,311
Adjustment for shares and finance income and expenses		51,845	38,265	3,684
Profit/loss(+) from privatisation vouchers (EVP)		0	-5,066	7
Profit from sale of fixed assets		-2,844	-1,595	-21
Write off of fixed assets		2,470	683	4,712
Write off of financial assets	10	1,200	0	0
Capitalisation of operating expenses.....		-38,974	-60,144	-37,615
Change in current assets involved in operating activities	24B	-48,978	-17,245	-1,132
Change in liabilities involved in operating activities	24B	-11,045	21,731	-1,605
Interest paid		-57,513	-56,654	-20,311
Total cash flow from operating activities		167,829	105,639	177,345

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from sale of shares of associated company.....	8	6,259	0	0
Sale of EVP.....		0	18,930	0
Acquisition of fixed assets	24C	-72,957	-62,583	-112,080
Payment of pipelines financed by construction income	24A	-60,750	-50,568	-64,380
Proceeds from pipelines financed by construction income	24A	59,371	109,172	51,441
Repayments of loans to third parties.....		2	25	52
Proceeds from sale of fixed assets		3,799	11,332	167
Proceeds from sale of inventories/goods for sale.		2,250	9,500	0
Received dividends		0	1,717	0
Interest received.....		2,661	4,170	11,804
Total cash flow from investing activities		-59,365	41,695	-112,996

CASH FLOWS FROM FINANCING ACTIVITIES

Decrease in share capital		0	-112,083	-837,917
Received long-term loans	12	31,293	0	1,110,864
Repayment of long-term loans.....	12	-19,001	-76,004	-318,412
Finance lease payments.....	12	-2,632	-3,024	-3,574
Dividends paid.....	22	-75,000	-45,000	-131,828
Income tax on dividends	22	-26,277	-15,281	-23,359
Total cash flow from financing activities		-91,617	-251,392	-204,226

Change in cash and bank accounts

CASH AND EQUIVALENTS AT THE BEGINNING OF THE YEAR.....

CASH AND EQUIVALENTS AT THE END OF THE YEAR.....

		16,847	-104,058	-139,877
		84,153	188,211	328,088
	2	101,000	84,153	188,211

AS TALLINNA VESI
STATEMENT OF CHANGES IN EQUITY
For the years 2004, 2003 and 2002

(thousand EEK)

	Share capital	Share premium	Statutory legal reserve*	Accumulated profit*	Net profit	Total equity
31 December 2001.....	1,150,001	387,000	85,000	-12,660	167,882	1,777,223
Transfer of financial year profit to the accumulated profit	0	0	0	167,882	-167,882	0
Increase of reserves.....	0	0	8,394	-8,394	0	0
Declared dividends.....	0	0	0	-131,828	0	-131,828
Reduction of shares	-950,000	0	0	0	0	-950,000
Net profit of the financial year	0	0	0	0	146,193	146,193
31 December 2002.....	200,001	387,000	93,394	15,000	146,193	841,588
Transfer of financial year profit to the accumulated profit	0	0	0	146,193	-146,193	0
Dividends.....	0	0	0	-45,000	0	-45,000
Net profit of the financial year	0	0	0	0	104,541	104,541
31 December 2003.....	200,001	387,000	93,394	116,193	104,541	901,129
Transfer of financial year profit to the accumulated profit	0	0	0	104,541	-104,541	0
Dividends.....	0	0	0	-75,000	0	-75,000
Net profit of the financial year	0	0	0	0	172,961	172,961
31 December 2004.....	200,001	387,000	93,394	145,734	172,961	999,090

*As a subsequent event 73,394 kroons were transferred from the Statutory legal reserve to the Accumulated profit on 3 February 2005 (see note 17).

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 1. ACCOUNTING PRINCIPLES

The financial statements for the financial year 2004 have been prepared according to International Financial Reporting Standards (IFRS) for the first time. All IFRS standards valid and effective from 1 January 2005, and applicable to the company have been adopted before their effective date. The implementation of IFRS did not cause any material changes to the existing accounting principles and had no influence on the profit of the company. As a consequence of the reporting of IFRS, the presentation of the information has changed slightly with the additional information published in the notes to the accounts. The disclosures required by IFRS 1 concerning the transition from Estonian GAAP to IFRS are presented in note 29.

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

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

Foreign currency transactions

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

Financial assets and liabilities

Financial assets are cash, customer receivables, accrued income, other current and long-term receivables. Financial liabilities are accounts payable, accrued expenses, other current and long-term liabilities.

Financial assets and liabilities are recognised at acquisition cost, which is assumed to be a fair value paid for or gained from that asset or liability.

Financial assets and liabilities are recorded in the Balance Sheet when the company acquires the ownership according to financial asset or liability contract conditions.

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

Cash and cash equivalents

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

Receivables

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

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

Until 2004 the likelihood of receipt of all receivables was evaluated individually. In 2004 the principle was revised to simplify the procedure and to be in accordance with the parent company's accounting principles. Individual debts are now grouped by age and the following percentages are applied in the doubtful debt calculation:

61 to 90 days 10%;

91 to 180 days 30%;

181 to 360 days 70%;

over 360 days 100%.

The change in principle did not cause any material difference to the 2004 accounts and caused no need to revise the 2003 and 2002 accounts.

Accounting for inventories

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

Inventories are recorded on the Balance Sheet at the lower of acquisition cost and net realisable value with any impairment recorded in the Income Statement to "Other expenses". The acquisition cost of inventories is accounted for by using weighted average acquisition cost method. Any inventories received at nil cost are recorded at zero value.

Long-term financial investments

Shares of associates, subsidiaries and other securities and financial assets acquired for periods of more than one year are recorded as long-term financial investments.

In 2002 and 2003 the Company had one fully owned subsidiary which was accounted for using the equity method in the accounts. During 2004 the subsidiary was merged into the Company and the accounts of the subsidiary were merged row by row into the accounts of the Company. The assets, liabilities, revenues and expenses arising from the transactions between the subsidiary and the parent have been eliminated. The accounts for 2002 and 2003 have been consolidated retrospectively. The effects of consolidation are shown in note 29.

Until 2003 investments in an associated company were accounted using the equity method, whereby the investment balance was adjusted each year by the share of the associated company's profit or loss less any dividends received. In 2004 the share of the associated company was sold. The earlier share and result of the sale are indicated in note 8.

As at 31 December 2004 the company does not own any subsidiary or own any shares in an associated company.

Tangible and intangible fixed assets

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

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

Unfinished pipelines – new connections include the costs of acquiring water or sewerage pipelines. After completion of construction and the concluding of the connection contracts with customers the costs related to the acquisition of these pipelines are recorded within costs of goods sold to ensure the correct matching of revenues and expenses in the same accounting period. Remaining expenses relating to the

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

construction, that are not directly compensated to the company, are recorded within the Balance Sheet as “Facilities” within fixed assets.

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

- buildings 1.25-2.0% per annum;
- facilities 1.0-8.33% per annum;
- machinery and equipment 3.33-50% per annum;
- instruments, facilities etc. 10-20% per annum;
- intangible assets 20-33% per annum.

Land is not depreciated.

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

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

Improvements to fixed assets are capitalised if the properties of that asset are improved substantially or, as a result of the improvement, the useful life of the asset will be extended, or it is foreseen that additional future revenues will result. Maintenance and repair works are expensed in the period incurred.

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

Impairment of tangible and intangible assets

At each balance sheet date, the Company reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Individual assets with no realisation value are removed from operations and the net balance sheet value is recorded in the Income Statement to “Other expenses”.

Investment property and Assets for sale

The property held by the company to earn rentals is classified as investment property. The revenues and costs related to the property are disclosed in note 10.

The land and buildings held for sale in the ordinary course of business are classified as inventory as management has decided to sell and will endeavour to make every effort to do so during the next accounting year.

Investment property and assets for sale are measured at cost. The investment property is continuously depreciated using the same principles as applied to tangible fixed assets. For assets for sale the depreciation is stopped after the decision is taken to move the assets to the inventory. Management has evaluated the fair value of all items listed within both investment property and inventory and is confident that the fair value is at least equal to the net balance sheet value.

Liabilities

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

No long-term employee benefit schemes are applicable to the company. The company has made an internal decision to pay bonuses to the employees based on the accounting year results of the company

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

and other individual performance criteria. The expected cost is recorded on the Income Statement as an expense and on the Balance Sheet as a short-term liability.

As profits are not taxable in Estonia no deferred tax liabilities are applicable. Taxation is described more thoroughly in notes 26 and 14.

Provisions

Legal or contractual liabilities which have arisen during the financial year or previous periods, which are reasonably expected to result in abandoning the asset and in costs that can be reliably measured at any point in the future, but whose final cost or term of payment is not firmly fixed, are accounted for as provisions.

Financial statements include short-term provisions from ongoing court cases, potential insolvencies of high risk customers, contractual obligations other than accruals and the expected loss from the liquidation of financial assets existing independently of the company's future actions. Provisions for losses are recorded using the best evaluation of the management of AS Tallinna Vesi. The final costs of such transactions may differ from these estimates.

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

Reserves

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

Accounting for leases

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

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

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

Revenues

Sales revenue is recorded on an accruals basis based upon the revenue principle if the sales revenue and the costs related to transaction are reliably defined. Net sales comprise the income received from goods and services sold after the deduction of sales discounts and all applicable taxes. Sales income from services is recorded in the period when the service has been provided.

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

Subsequent events

During the preparation of the annual accounts management considers the materiality of all subsequent events that occurred between the balance sheet date and the preparation date of the report. Subsequent events, which could in the opinion of the management have a material impact on the disclosure of the assets, liability and equity capital, are disclosed in the notes if they do exist.

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 2. CASH AND CASH EQUIVALENTS

(thousand EEK)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Cash and bank accounts.....	85,253	77,053	25,494
Short-term deposits.....	15,747	7,100	162,717
Total cash and cash equivalents.....	101,000	84,153	188,211

NOTE 3. CUSTOMER RECEIVABLES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Accounts receivable.....	59,383	65,849	101,484
Allowance for doubtful debts.....	-7,739	-12,012	-14,783
Total customer receivables.....	51,644	53,837	86,701

Change in customer receivables includes the following movements:

Write off of uncollectible receivables.....	-1,723	-1,100	-100
Change in allowance for doubtful debts.....	4,273	2,770	-8,298

NOTE 4. OTHER RECEIVABLES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Receivables from parent company.....	0	23	0
Other receivables.....	66	2,528	332
Total other receivables.....	66	2,551	332

NOTE 5. ACCRUED INCOME AND PREPAID EXPENSES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Accrued interest.....	274	156	0
Other accrued income.....	26	27	107
Prepaid taxes.....	3	180	10
Other prepaid expenses.....	3,583	3,808	2,932
Total accrued income and prepaid expenses.....	3,886	4,171	3,049

NOTE 6. INVENTORIES

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

Old raw materials with a nature and value only specific to the Company are considered obsolete, subject to the assumption that management has made all reasonable efforts to sell the unnecessary assets during the year. The most likely outcome for the majority of these assets is treatment as scrap with no material revenue to the Company. These items have been fully provided in the accounts, 1,508 thousand kroons and 4,631 thousand kroons as of 31 December 2004 and 2003 respectively. Any subsequent revenues received on the sale of these assets have been immaterial in value and have been offset against the value written off. In 2002 no provisions were recorded for aged stock.

NOTE 7. ASSETS FOR SALE

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Assets for sale.....	693	1,919	4,631
Prepayments for land in assets for sale.....	928	870	928
Total assets for sale.....	1,621	2,789	5,559

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 8. INVESTMENT IN ASSOCIATED COMPANY

The Company had the long-term investment in AS Kemivesi with the following participation:

Number of shares at 31 December 2002	6,900
Number of shares at 31 December 2003	6,900
Number of shares at 31 December 2004	0

Book value of shares at 31 December 2001	7,837
Income calculated using equity method	667

Book value of shares at 31 December 2002	8,504
Income calculated using equity method	-661
Decrease in investment value by dividends announced.....	-1,717

Book value of shares at 31 December 2003	6,126
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Share ownership % 31 December 2003	33.25%
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In 2004 the company sold the participation in AS Kemivesi with the following result to the accounts:

Revenue from sale of shares	6,259
Carrying value of the investment	-6,126

Profit from the transaction	133
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AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 9. LONG-TERM DEPOSITS

The Company has opened a Debt Service Reserve (hereinafter the DSR) deposit in accordance with the EBRD loan agreement (see note 12). The company is required to maintain the DSR to an amount equal to not less than the sum of the payments of principal and interest on the loan that become due and payable at the next interest payment date throughout the whole loan agreement period. The withdrawal of amounts from the DSR is restricted to payments of the loan obligations, and can only be used for any other purpose with the prior written consent of the bank. The approximate amount of the obligation is to maintain 80,000 thousand kroons in DSR account until 2015.

NOTE 10. OTHER LONG-TERM INVESTMENT ASSETS

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Long term loans	0	1	2
Other Shares*	0	1,200	1,200
Investment Property (acquisition value)**	1786	1,786	3,596
Accumulated depreciation of investment property (-).....	-456	-411	-478
Total other long-term investment assets	1,330	2,576	4,320

*Other Shares

In 2001 AS Tallinna Vesi acquired 8 B-shares of AS Rocca al Mare Suurhall with a nominal value of 100 kroons and in a total amount of 1,200,000 kroons, based on a contract signed between AS Tallinna Vesi and AS Rocca al Mare Suurhall during the financial year ended 31 December 2000. As the financial situation of AS Rocca al Mare Suurhall is weak and there is a plan to cancel all ordinary shares, the value of the shares is written off and recorded in Income Statement within financial expenses in 2004.

**Real Estate Investment

The real estate investment includes one property at the address Järvevana Street 3, Tallinn.

No movements other than depreciation have happened to the balance sheet value of the property during the reporting year.

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Rental revenue from the investment, excluding VAT.....	1,064	1,257	1,254
Direct operating expenses that generated rental income	456	624	612
The occupation rate of the property (average of the reporting year)	93%	99%	99%

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS
For the year ended 31 December 2004

(thousand EEK)

NOTE 11. TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS

	Tangible assets in usage				Assets in progress			Intangible assets			Total tangible and intangible non-current assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Unfinished pipelines - new connections	Prepayment for fixed assets	Development costs	Acquired licenses and software		
Acquisition cost at											
31/12/2002.....	314,452	1,819,172	441,806	14,539	51,168	99,254	18,934	8,201	12,195	2,779,721	
Acquisition.....	0	0	1,601	540	106,065	59,502	4,761	0	1,099	173,568	
Sale of fixed assets.....	-12,518	-846	-2,334	-334	-63	0	-489	0	0	-16,584	
Write-off of fixed assets.....	-285	-5,704	-1,908	-365	0	0	0	0	0	-8,262	
Reclassification within balance sheet.....	0	0	-463	0	597	0	-13,835	0	0	-13,701	
Reclassification to expenses.....	0	0	0	0	-221	0	0	0	0	-221	
Expensed pipelines.....	0	0	0	0	0	-61,608	0	0	0	-61,608	
Reclassification from assets in progress.....	2,153	51,063	33,485	525	-94,749	-3,972	-806	174	12,127	0	
31/12/2003.....	303,802	1,863,685	472,187	14,905	62,797	93,176	8,565	8,375	25,421	2,852,913	
Acquisition.....	0	0	0	0	104,254	54,125	0	0	0	158,379	
Sale of fixed assets.....	-1,462	0	-2,204	-6	0	0	0	0	0	-3,672	
Write-off of fixed assets.....	-205	-2,885	-4,504	-412	0	0	0	0	0	-8,006	
Reclassification within balance sheet.....	331	0	0	0	173	0	-81	0	0	423	
Reclassification to expenses.....	0	0	0	0	-495	-1	0	0	0	-496	
Expensed pipelines.....	0	0	0	0	0	-64,410	0	0	0	-64,410	
Reclassification from assets in progress.....	9,004	38,719	19,416	1,848	-64,095	-3,215	-4,836	1,223	1,936	0	
31/12/2004.....	311,470	1,899,519	484,895	16,335	102,634	79,675	3,648	9,598	27,357	2,935,131	
Accumulated depreciation											
31/12/2002.....	47,189	540,618	214,604	9,239	0	0	0	5,255	3,315	820,220	
Depreciation.....	4,160	26,219	38,050	1,064	0	0	0	916	2,984	73,393	
Depreciation of fixed assets sold and written-off (-).....	-1,659	-6,147	-3,298	-634	0	0	0	0	0	-11,738	
Reclassification.....	-224	1,034	-775	0	0	0	0	-35	0	0	
31/12/2003.....	49,466	561,724	248,581	9,669	0	0	0	6,136	6,299	881,875	
Depreciation.....	4,061	27,624	38,874	1,073	0	0	0	905	5,155	77,692	
Depreciation of fixed assets sold and written-off (-).....	-638	-2,598	-5,129	-385	0	0	0	0	0	-8,750	
Reclassification.....	0	-3	5	0	0	0	0	0	0	0	
31/12/2004.....	52,889	586,747	282,329	10,357	0	0	0	7,041	11,454	950,817	
Net book value											
30/12/2002.....	267,263	1,278,554	227,202	5,300	51,168	99,254	18,934	2,946	8,880	1,959,501	
31/12/2003.....	254,336	1,301,961	223,606	5,236	62,797	93,176	8,565	2,239	19,122	1,971,038	
31/12/2004.....	258,581	1,312,772	202,566	5,978	102,634	79,675	3,648	2,557	15,903	1,984,314	

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

Net balance sheet value of finance leases was 9,434 thousand kroons, 11,197 thousand kroons and 14,236 thousand kroons in 2004, 2003 and 2002 respectively.

Interest capitalised to fixed assets was 2,689 thousand kroons, 3,815 thousand kroons and 8,750 thousand kroons in 2004, 2003 and 2002 respectively.

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 12. SHORT-TERM AND LONG-TERM DEBT OBLIGATIONS

(thousand EEK)

The Company's long-term obligations are as follows:

Bank loans	Loan date	Loan received	Residual amount 31.12.2002	Residual amount 31.12.2003	Residual amount 31.12.2004	Short-term portion 31.12.2004	Long-term portion 31.12.2004	Interest rate %	Maturity date
DePfa bank ...	04/1999	304,013	95,005	19,001	0	0	0	3 months Euribor +3	04.2004
EBRD	12/2002	1,251,731	1,110,864	1,110,864	1,142,157	88,610	1,053,547		05.2015
incl. A loan....		860,565	763,719	763,719	785,233	60,920	724,313	5.69	
incl. B loan		391,166	347,145	347,145	356,924	27,690	329,234	Euribor + 1,5	
Loan costs.....	12/2002	-18,782	-18,782	-17,404	-15,879	-1,524	-14,355		05.2015
Total bank loans		1,536,962	1,187,087	1,112,461	1,126,278	87,086	1,039,192		
Finance lease.		15,332	8,594	6,094	3,462	1,777	1,685	3,56-9,28	06.2007
Total long-term debt obligations .		1,552,294	1,195,681	1,118,555	1,129,740	88,863	1,040,877		

The amount not drawn from the EBRD loan as of 31 December 2004 is 109,574 thousand kroons, all of which is intended to be drawdown by May 2005.

The short-term portion of the finance lease in the amount of 1,777 thousand kroons is recorded on the Balance Sheet line "Current portion of long-term finance lease".

The long-term portion of the finance lease in the amount of 1,685 thousand kroons is recorded on the Balance Sheet line "Finance lease".

The underwriting of the loan from EBRD is indicated in Note 27.

Name Repayments period

EBRD Loan repayments start in 2005. The repayments will be made twice a year in May and November in accordance with the repayment factors agreed in the loan agreement.

Finance lease Repayments on a monthly or quarterly basis in accordance with the contracts.

The repayments, including the amount of EBRD loan to be drawdown in 2005, are as follows:

	Less than 1 year	1-5 years	Over 5 years	Total	Repayment period
EBRD	88,610	530,874	632,247	1,251,731	9 years
Finance leases	1,777	1,685	0	3,462	2 years
Total	90,387	532,559	632,247	1,255,193	

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 13. TRADE AND OTHER PAYABLES

(thousand EEK)

Short-term payables	2004	2003	2002	Maturity date
Accounts payable – operating expenditures	15,025	15,270	13,840	
Accounts payable – capital expenditures	20,855	36,871	28,696	
Factoring	282	1,255	4,354	
Payables to parent company	1,523	5,734	42,683	
Payables to associated company	0	957	412	
Payables to Tallinn City for shares	0	0	71,738	
Payables to employees	12,865	13,154	8,782	
Interest payable	5,120	5,185	2,429	
Other accrued expenses	37	33	45	
Total short-term trade and other payables	55,707	78,459	172,979	
Long-term payables				
Accounts payable – capital expenditures	0	0	10,000	06.2004
Factoring	0	0	1,255	04.2004
Long-term guarantee deposit*	100	100	0	04.2102
Total long-term trade and other payables	100	100	11,255	

*Long-term deposit is in acquisition value.

NOTE 14. TAXES PAYABLE

	2004	2003	2002
Income tax	1,593	1,581	1,888
VAT	4,147	4,396	10,287
Water usage tax	2,289	2,369	2,653
Pollution taxes*	9,274	4,497	564
Social security tax	2,815	2,708	2,929
Other	416	276	150
Total	20,534	15,827	18,471

*Within pollution taxes is an accrual for 7.5 mln kroons. This accrual is to cover the full value of the taxes that the Company has been exempted from up to 31 December 2004 relating to tax on Nitrogen waived by the Ministry of the Environment in return for the upgrade of the Waste Water Treatment Works the Company has undertaken. At this moment in time the Company is unable to predict with any degree of certainty the results of measurements to be taken at the end of the first quarter 2006 that will determine if these taxes have to be re-paid, therefore a liability has been recorded.

AS TALLINNA VESI**NOTES TO THE ANNUAL ACCOUNTS****For the year ended 31 December 2004****NOTE 15. PROVISIONS***(thousand EEK)*

Provisions include expected losses from the following:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Contractual obligations	912	8,028	0
Ongoing Court Cases.....	0	5,640	1,708
Total provisions	912	13,668	1,708

NOTE 16. DEFERRED INCOME

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Water and sewerage services revenues.....	4,027	2,852	269
Connection revenues.....	14,555	33,643	25,851
Total deferred income	18,582	36,495	26,120

NOTE 17. SHARE CAPITAL AND STATUTORY LEGAL RESERVE

At 31 December 2004 the nominal value of the share capital was 200,001,000 (two hundred million one thousand) kroons, composed of 20,000,000 shares with nominal value of 10 kroons per share (A-share) and one preferred share (B-share) with a nominal value of 1,000 kroons.

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

At 31 December of the years ending 2002, 2003 and 2004 International Water UU (Tallinn) B.V. owned 10,086,957 AS Tallinna Vesi A-shares and Tallinn City 9,913,043 A-shares and 1 B-share.

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

NOTE 18. NET SALES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Sales from main operating activities			
Water supply service.....	220,688	200,889	201,245
Waste water disposal service	204,494	180,739	178,026
Stormwater treatment and disposal service	44,731	44,311	42,682
Fire hydrants service.....	1,959	1,941	1,869
Other work and services	6,942	6,914	9,125
Total sales from main operating activities	478,814	434,794	432,947
Revenues from other operating activities			
Water, sewerage and storm water connections construction income	69,715	69,223	79,577
TOTAL NET SALES	548,529	504,017	512,524

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

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 19. COSTS AND EXPENSES

(thousand EEK)

Cost of goods sold main operating activities

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Tax on special use of water	-9,272	-9,929	-10,124
Chemicals.....	-9,387	-10,113	-12,173
Electricity	-26,151	-26,484	-26,094
Pollution tax.....	-8,380	-7,557	-2,516
Staff costs.....	-44,643	-44,657	-55,350
Research & development.....	-85	-211	-70
Depreciation and amortisation.....	-73,104	-69,642	-66,540
Other costs of goods sold.....	-24,464	-24,564	-29,352
Total cost of goods sold main operating activities.....	-195,486	-193,157	-202,219

Cost of goods sold other operating activities

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Water, sewerage and storm water connections construction cost	-64,410	-61,608	-69,963

Marketing Expenses

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Staff costs.....	-4,240	-4,280	-4,540
Depreciation and amortisation.....	-113	-114	-71
Other marketing expenses	-1,781	-1,948	-1,991
Total cost of marketing expenses	-6,134	-6,342	-6,602

General Administration Expenses

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Staff costs.....	-15,813	-16,913	-17,744
Depreciation and amortisation.....	-4,520	-3,702	-2,774
Other general administration expenses	-20,406	-35,825	-21,625
Total cost of general administration expenses	-40,739	-56,440	-42,143

Other income/expenses includes the profits recognised on the sale of fixed assets during the year, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial year.

NOTE 20. STAFF INFORMATION

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Salaries and wages	-48,461	-49,326	-58,153
Social security taxation.....	-16,235	-16,524	-19,481
Staff costs total	-64,696	-65,850	-77,634
No of employees at end of reporting period	351	348	370

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 21. FINANCIAL INCOME AND EXPENSES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Financial income/expenses (-) from associated company	133	-661	667
Interest income	2,780	4,326	8,889
Interest expense	-54,757	-55,595	-13,241
Other financial income/expenses (-)	-3,637	2,224	-1,421
Foreign exchange loss	-199	-307	-238
Total financial income/expenses	-55,680	-50,013	-5,344

NOTE 22. DIVIDENDS

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Dividend distributed and paid during the year	75,000	45,000	131,828
Income tax on dividends distributed and paid (26/74)	-26,351	-15,811	-23,359
The income tax paid on dividends received	74	530	0
The income tax accounted	-26,277	-15,281	-23,359

The income tax accounting principles are explained in Note 26.

NOTE 23. EARNINGS PER SHARE

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Earnings per share from continuing operations:			
Earnings for the purposes of basic earnings per share (net profit for the year minus B-share preference rights)	172,951	104,531	146,183
Weighted average number of ordinary shares for the purposes of basic earnings per share	20,000,000	20,000,000	83,333,333
Earnings per share in kroons	8.65	5.23	1.75

NOTE 24. NOTES TO THE CASH FLOW STATEMENT

NOTE 24A. PIPELINES FINANCED BY CONNECTION FEES

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Revenue			
Connection fees from pipelines taken into use	69,715	69,223	79,273
Increase in prepayments for pipelines	-19,088	7,792	790
Decrease in accounts receivable from pipelines	8,744	34,268	-28,104
Offset with liabilities	0	-2,111	-518
Connection fees received	59,371	109,172	51,441
Expenses			
Acquisition cost of pipelines taken into use	-64,410	-61,607	-69,963
Decrease in pipelines not in use	13,502	6,078	27,129
Increase in payables to suppliers for pipelines	-9,842	4,961	-21,546
Payment for pipelines	-60,750	-50,568	-64,380

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 24B. CHANGE IN CURRENT ASSETS AND LIABILITIES

Addition to changes in balance sheet, current assets and liabilities are changed as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Current assets			
Change in balance sheet	-8,438	142,432	108,473
<i>Adjustments:</i>			
Change in money and equivalents.....	16,847	-104,058	-139,877
Changes between fixed assets and current assets.....	-423	11,998	5,094
Assets sold from inventory	-2,250	-2,053	0
Change in securities, deferred interests and loans.....	119	151	-2,927
Change in construction income debt.....	-8,743	-34,267	28,105
Cash to long-term deposit.....	-46,090	-31,448	0
Total change in current assets.....	-48,978	-17,245	-1,132
Liabilities			
Change in balance sheet	20,040	-132,213	51,231
<i>Adjustments:</i>			
Change in finance lease and loan costs	-67,163	166,712	32,300
Liability due to share capital reduction.....	0	0	-112,083
Change in debt for connection constructions	9,842	-4,961	21,546
Change in payables for capital investments.....	7,148	-115	5,673
Change in construction income prepayments.....	19,088	-7,792	-790
Change in deposit.....	0	100	0
Offset related to operating expenditures.....	0	0	518
Total change in liabilities.....	-11,045	21,731	-1,605

NOTE 24C. PAYMENTS FOR FIXED ASSETS

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Acquisition of fixed assets	-158,379	-173,568	-182,614
<i>Adjustments:</i>			
Acquisition cost of connection pipelines taken into use.....	64,410	61,607	69,963
Decrease in connection pipelines not taken into use.....	-13,502	-6,078	-27,129
Additional finance lease	0	525	4,221
Additional factoring.....	282	0	467
Payment for factoring.....	-1,255	-4,353	-5,286
Payments for facilities	-10,000	-13,091	-13,113
Increase in other accounts payable related to investments....	3,824	6,305	-4,954
Interest capitalisation.....	2,689	3,815	8,750
Capitalisation of operating expenses.....	38,974	60,144	37,615
Offsetting of payments for investments.....	0	2,111	0
Total payments for fixed assets.....	-72,957	-62,583	-112,080

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 25. COMMITMENTS

(thousand EEK)

Leased assets

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Total operating lease expense for computers and vehicles.....	4,077	5,532	6,075
<i>Minimum operating lease payments are as follows:</i>			
Less than 1 year	4,230		
1-5 years.....	7,091		
Total minimum lease payments	11,321		

As of 31 December 2004 the Company had taken commitments for capital investments, i.e. concluded contracts and requested works with purchase requisitions in the amount of 49,610 thousand kroons.

NOTE 26. INCOME TAX ON DIVIDENDS

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act Section 50, effective since 1 January 2003, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The tax rate applicable is 24/76 on the amount of the dividends paid in 2005; in 2002, 2003 and 2004 the rate was 26/74. In 2002 the dividends paid to resident corporate bodies were not taxable.

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

The Company's distributable retained earnings as at 31 December 2004 amounted to 318,695 thousand kroons. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 100,641 thousand kroons.

Tax due on dividend distribution is reduced by up to 26/74 of the total dividends received from subsidiaries and associated companies.

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 27. COLLATERAL OF LOANS AND PLEDGED ASSETS

In connection with the loan agreement concluded between the European Bank for Reconstruction and Development (hereafter EBRD) and AS Tallinna Vesi on 8 November 2002, the following guarantee contracts were concluded, which concern the assets of the Company and/or the assets of shareholders of the Company:

- (a) Account Pledge Agreement, which was concluded between EBRD, the Company and AS Hansapank on 11 November 2002. All the open accounts and accounts to be opened in Hansapank have been pledged as security in favour of EBRD within the contract;
- (b) Account Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. All the open accounts and accounts to be opened in Nordea Bank have been pledged as security in favour of EBRD within the contract;
- (c) Commercial Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002 in favour of EBRD in the amount of 1,877,592 thousand kroons;
- (d) Buildings Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. All buildings and facilities at address Järvevana tee 3, which are in possession of the Company, have been pledged in favour of EBRD within the contract in net balance value 165,618 thousand kroons;
- (e) Insurance Pledge Agreement, which was concluded between EBRD and the Company on 11 November 2002. According to the contract, EBRD has been established as the beneficiary in the Company's asset contracts, business interruption contracts, and liability insurance contracts.

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 28. RELATED PARTIES

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

Those companies that were related to the Company as of 31 December 2004 had recorded transactions in 2002, 2003 and 2004 and balances as of 31 December as follows:

	Tallinn City Government and related boards	United Utilities (Tallinn) B.V.* and United Utilities International Ltd**
2002		
Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet		
Accounts receivable – customer and other receivables	38,005	0
Payables to shareholders for shares	71,737	40,346
Accounts payable – short term trade and other payables	10,000	2,337
Accounts payable – long term trade and other payables	10,000	0
Transactions recorded to AS Tallinna Vesi Income Statement		
Net sales.....	104,976	0
General administration cost	0	3,557
Financial cost	0	1,297
Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet		
Tangible non-current assets including unfinished constructions and new connections	0	12,189
Deferred income – connection revenue.....	3,285	0
2003		
Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet		
Accounts receivable – customer and other receivables	4,348	23
Accounts payable – short term trade and other payables.....	10,000	5,734
Transactions recorded to AS Tallinna Vesi Income Statement		
Net sales.....	97,370	0
General administration cost	0	19,462
Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet		
Tangible non-current assets including unfinished constructions and new connections.....	0	34,831
Other deferred income	727	0

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

(thousand EEK)

NOTE 28. RELATED PARTIES (continued)

	Tallinn City Government and related boards	United Utilities (Tallinn) B.V.* and United Utilites International Ltd**
2004		
Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet		
Accounts receivable – customer and other receivables	1,551	0
Accounts payable – short term trade and other payables.....	0	1,523
Transactions recorded to AS Tallinna Vesi Income Statement		
Net sales.....	99,216	40
General administration cost	0	7,663
Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet		
Tangible non-current assets including unfinished constructions and new connections.....	0	14,306

The agreed market prices were implemented in transactions with related parties.

*International Water UU (Tallinn) B.V. was transformed to United Utilities (Tallinn) B.V. on 5 January 2004.

**United Utilities (Tallinn) B.V. holds 50.4% of the Company. The ultimate controlling parties of United Utilities (Tallinn) B.V. are EBRD and United Utilities Plc. United Utilities International Ltd is owned by United Utilities Plc.

	2004	2003	2002
The fees paid to management board members excluding social tax	2,059	2,470	507
The fees paid to supervisory board members excluding social tax	18	41	39

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 29. CONSOLIDATION AND RECLASSIFICATION

(thousand EEK)

In 2003 and 2002 accounts the following rows of the Balance Sheet were changed as result of consolidation of the 100% owned subsidiary, AS Vesimer's results, and the reclassifications made follow the format of IFRS reports.

Line of balance	2003				2002			
	Opening balance	Consolidation adjustment	Reclassification adjustment	Revised Balance	Opening balance	Consolidation adjustment	Reclassification adjustment	Revised Balance
Cash at bank and in hand.....	82,358	1,795	0	84,153	185,305	2,906	0	188,211
Customer receivables.....	53,837	0	0	53,837	86,474	227	0	86,701
Other receivables.....	2,251	300	0	2,551	4,083	-3,751	0	332
Accrued income and prepaid expenses.....	21,563	12	-17,404	4,171	21,823	8	-18,782	3,049
Inventories.....	1,264	0	4,280	5,544	7,272	1,312	3,041	11,625
Assets for sale.....	0	2,789	0	2,789	4,689	870	0	5,559
Shares of subsidiaries and associated companies.....	12,295	-6,169	0	6,126	13,501	-4,996	0	8,505
Other long-term investment assets	1,201	1,375	0	2,576	1,202	3,117	0	4,319
Tangible assets.....	1,789,419	0	-4,280	1,785,139	1,780,924	436	-3,041	1,778,319
Current portion of long-term bank loans.....	19,001	0	-1,524	17,477	76,004	0	-1,518	74,486
Trade and other payables.....	78,385	74	0	78,459	172,933	46	0	172,979
Taxes payable.....	15,799	28	0	15,827	18,388	83	0	18,471
Bank loans.....	1,110,864	0	-15,880	1,094,984	1,129,865	0	-17,264	1,112,601

In 2003 and 2002 accounts the following rows of Income Statement were changed as result of consolidation of AS Vesimer results to AS Tallinna Vesi accounts and due to reclassification of currency exchange losses between lines of Income Statement.

Line of income statement	2003				2002			
	Opening Results	Consolidation adjustment	Reclassification adjustment	Revised Results	Opening Results	Consolidation adjustment	Reclassification adjustment	Revised Results
Net sales.....	502,972	1,045	0	504,017	509,913	2,611	0	512,524
Cost of goods sold.....	-254,966	201	0	-254,765	-272,182	0	0	-272,182
General administration expenses.....	-54,789	-1,651	0	-56,440	-39,710	-2,433	0	-42,143
Other income/ expenses (-).....	-18,537	1,839	63	-16,635	-16,799	-5	0	-16,804
Financial income / expenses (-).....	-48,590	-1,360	-63	-50,013	-5,069	-172	0	-5,241
Income tax on dividends.....	-15,207	-74	0	-15,281	-23,359	0	0	-23,359

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 29. CONSOLIDATION AND RECLASSIFICATION (continued)

(thousand EEK)

In 2003 and 2002 accounts the following rows of Cash Flow Statement were changed as result of consolidation of Vesimer Investeeringute AS to AS Tallinna Vesi accounts.

	2003			2002		
	Opening balance	Consolidation adjustment	Revised balance	Opening balance	Consolidation adjustment	Revised balance
CASH FLOWS FROM OPERATING ACTIVITIES						
Profit before taxes.....	119,748	74	119,822	169,552	0	169,552
Adjustment for depreciation	73,393	65	73,458	69,316	69	69,385
Adjustment for shares and finance income and expenses ..	36,887	1,378	38,265	3,458	226	3,684
Profit from sale of privatisation vouchers (EVP)	-5,039	-27	-5,066	0	7	7
Income from sale of fixed assets.....	228	-1,823	-1,595	-21	0	-21
Change in current assets involved in operating activities...	-13,026	-4,219	-17,245	-2,911	1,779	-1,132
Change in liabilities involved in operating activities.....	21,756	-25	21,731	-1,989	384	-1,605
CASH FLOWS FROM INVESTING ACTIVITIES						
Sale of EVP	18,703	227	18,930	0	0	0
Acquisition of fixed assets	-62,583	0	-62,583	-112,044	-36	-112,080
Repayments of loans to third parties.....	6	19	25	19	33	52
Proceeds from sale of inventories/goods for sale	6,000	3,500	9,500	0	0	0
Received dividends	1,928	-211	1,717	0	0	0
Interest received.....	4,165	5	4,170	11,798	6	11,804
CASH FLOWS FROM FINANCING ACTIVITIES						
Income tax on dividends	-15,207	-74	-15,281	-23,359	0	-23,359
Change in cash and bank accounts.....	-102,947	-1,111	-104,058	-142,345	2,468	-139,877
CASH AND EQUIVALENTS AT THE BEGINNING OF THE YEAR.....	185,305	2,906	188,211	327,649	439	328,088
CASH AND EQUIVALENTS AT THE END OF THE YEAR.....	82,358	1,795	84,153	185,304	2,907	188,211

AS TALLINNA VESI

NOTES TO THE ANNUAL ACCOUNTS

For the year ended 31 December 2004

NOTE 30. FINANCIAL RISK MANAGEMENT

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

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

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

The Company has no significant concentrations of credit risk. The Company has procedures in place to ensure that sales of products and services and purchases are only made in accordance with the Company's policies.

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

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

AS TALLINNA VESI
CONDENSED BALANCE SHEET
At 31 March 2005 and 31 December 2004

(thousand EEK)

	31 March		31 December
	Note	2005	2004
ASSETS			
CURRENT ASSETS			
Cash at bank and in hand.....		148,196	125,130
Customer receivables.....		70,446	50,550
Other receivables.....		4,525	909
Accrued income and prepaid expenses.....		10,105	3,422
Inventories.....		3,594	5,620
Assets for sale.....		1,620	2,043
TOTAL CURRENT ASSETS.....		238,486	187,674
NON-CURRENT ASSETS			
Shares of associated companies.....		0	6,126
Long-term deposit.....		77,796	31,595
Other long-term investment assets.....		0	2,564
Tangible assets.....	2	1,774,234	1,777,915
Intangible assets.....	2	21,196	20,623
Construction in progress.....	2	110,061	72,483
Unfinished pipelines – new connections.....	2	71,668	71,755
Prepayments for fixed assets.....	2	23,452	3,889
TOTAL NON-CURRENT ASSETS.....		2,078,407	1,986,950
TOTAL ASSETS.....		2,316,893	2,174,624
LIABILITIES			
CURRENT LIABILITIES			
Current portion of long-term finance lease.....		1,655	2,246
Current portion of long-term bank loans.....		87,086	0
Trade and other payables, incl. dividends.....		136,577	68,864
Taxes payable.....		60,256	19,962
Short-term provisions.....		130	6,008
Deferred income.....		60,355	20,872
TOTAL CURRENT LIABILITIES.....		346,059	117,952
NON-CURRENT LIABILITIES			
Finance lease.....		1,313	3,016
Bank loans.....		1,039,573	1,093,842
Other payables.....		100	100
TOTAL NON-CURRENT LIABILITIES.....		1,040,986	1,096,958
TOTAL LIABILITIES.....		1,387,045	1,225,575
EQUITY CAPITAL			
Share capital.....		200,001	200,001
Share premium.....		387,000	387,000
Statutory legal reserve.....		20,000	93,394
Accumulated profit.....		280,089	220,734
Net profit for the period.....		42,758	58,585
TOTAL EQUITY CAPITAL.....		929,848	999,090
TOTAL LIABILITIES AND EQUITY CAPITAL.....		2,316,893	2,174,624

AS TALLINNA VESI
CONDENSED INCOME STATEMENT
For the quarters ended 31 March 2005 and 2004

(thousand EEK)

	Note	1st quarter ended		Year ended
		2005	2004	31 December
				2004
Sales from main operating activities	3	139,350	119,674	478,814
Revenues from other operating activities		17,277	30,122	69,715
Net sales	3	156,627	149,796	548,529
Cost of goods sold main operating activities	4	-49,250	-49,081	-195,486
Cost of goods sold other operating activities	4	-15,449	-26,700	-64,410
GROSS PROFIT		91,928	74,015	288,633
Marketing expenses	4	-1,666	-1,631	-6,134
General administration expenses.....	4	-11,335	-10,640	-40,739
Other income/expenses (-).....		12,184	10,430	13,158
OPERATING PROFIT		91,111	72,174	254,918
Financial income/expenses (-)		-12,985	-13,589	-55,680
PROFIT BEFORE TAXES		78,126	58,585	199,238
Income tax on dividends	5	-35,368	0	-26,277
NET PROFIT FOR THE PERIOD		42,758	58,585	172,961
Attributable to:				
Equity holders of A-shares.....		42,748	58,575	172,951
B-share holder		10	10	10
Earnings per share in kroons	6	2.14	2.93	8.65

AS TALLINNA VESI
CONDENSED CASH FLOW STATEMENT
For the quarters ended 31 March 2005 and 2004

(thousand EEK)

	1st quarter ended		Year ended
	2005	2004	31 December 2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit.....	91,111	72,174	254,918
Adjustment for depreciation	19,520	19,547	77,736
Adjustment for income and expenses from constructions..	-1,829	-3,423	-5,306
Other finance income and expenses.....	-577	-511	-3,835
Profit from sale of fixed assets	-1,496	0	-2,844
Expensed non-current assets	1,428	15	3,670
Capitalisation of operating expenses.....	-6,433	-10,107	-38,974
Movement in current assets involved in operating activities .	-30,034	-1,556	-48,978
Movement in liabilities involved in operating activities	-6,609	-7,305	-11,045
Interest paid	76	-160	-57,513
Total cash flow from operating activities	65,157	68,674	167,829
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sale of shares of associated company	0	0	6,259
Acquisition of fixed assets	-44,899	-19,588	-72,957
Payment of pipelines financed by construction income	-7,441	-13,731	-60,750
Proceeds from pipelines financed by construction income	16,431	22,545	59,371
Repayments of loans to third parties.....	0	0	2
Proceeds from sale of fixed assets	45,300	0	3,799
Proceeds from sale of inventories/goods for sale.....	0	2,250	2,250
Interest received	901	660	2,661
Total cash flow from investing activities	10,292	-7,864	-59,365
CASH FLOWS FROM FINANCING ACTIVITIES			
Received long-term loans	0	0	31,293
Repayment of long-term loans.....	0	-19,001	-19,001
Finance lease payments.....	-494	-832	-2,632
Dividends paid.....	-27,759	0	-75,000
Income tax on dividends	0	0	-26,277
Total cash flow from financing activities	-28,253	-19,833	-91,617
Change in cash and bank accounts.....	47,196	40,977	16,847
CASH AND EQUIVALENTS AT THE BEGINNING OF THE PERIOD.....	101,000	84,153	84,153
CASH AND EQUIVALENTS AT THE END OF THE PERIOD.....	148,196	125,130	101,000

AS TALLINNA VESI
CONDENSED STATEMENT OF CHANGES IN EQUITY

For the quarters ended 31 March 2005 and 2004

(thousand EEK)

	<u>Share capital</u>	<u>Share premium</u>	<u>Statutory legal reserve</u>	<u>Accumulated profit</u>	<u>Net profit</u>	<u>Total equity</u>
31 December 2003	200,001	387,000	93,394	116,193	104,541	901,129
Transfer of financial year profit to the accumulated profit....	0	0	0	104,541	-104,541	0
Dividend	0	0	0	-75,000	0	-75,000
Net profit of the financial year.	0	0	0	0	172,961	172,961
31 December 2004	200,001	387,000	93,394	145,734	172,961	999,090
31 December 2003	200,001	387,000	93,394	116,193	104,541	901,129
Transfer of financial year profit to the accumulated profit....	0	0	0	104,541	-104,541	0
Net profit of the financial period.....	0	0	0	0	58,585	58,585
31 March 2004	200,001	387,000	93,394	220,734	58,585	959,714
31 December 2004	200,001	387,000	93,394	145,734	172,961	999,090
Transfer of financial year profit to the accumulated profit....	0	0	0	172,961	-172,961	0
Transfer of statutory legal reserve to the accumulated profit.....	0	0	-73,394	73,394	0	0
Dividend	0	0	0	-112,000	0	-112,000
Net profit of the financial period.....	0	0	0	0	42,758	42,758
31 March 2005	200,001	387,000	20,000	280,089	42,758	929,848

AS TALLINNA VESI

NOTES TO THE INTERIM ACCOUNTS For the Quarters ended 31 March 2005 and 2004

NOTE 1. ACCOUNTING PRINCIPLES

The interim accounts have been prepared according to International Financial Reporting Standards, and give a true and fair view of the financial position, results of operations and cash flows of AS Tallinna Vesi. The same accounting policies are followed in the interim financial statements as in the most recent annual financial statements. The interim report is prepared in accordance with IAS 34 Interim Financial Reporting.

NOTES TO THE INTERIM ACCOUNTS

For the Quarters ended 31 March 2005 and the year ended 31 December 2004

Acquisition cost at	(thousand EEK)										
	Tangible assets in usage					Assets in progress					Intangible assets
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Unfinished pipelines – new connections	Prepayment for fixed assets	Development costs	Acquired licenses and software	Total tangible and intangible non-current assets	
31/12/2003	303,802	1,863,685	472,187	14,905	62,797	93,176	8,565	8,375	25,421	2,852,913	
Acquisition	0	0	0	0	104,254	54,125	0	0	0	158,379	
Sale of fixed assets	-1,462	0	-2,204	-6	0	0	0	0	0	-3,672	
Write-off of fixed assets	-205	-2,885	-4,504	-412	0	0	0	0	0	-8,006	
Reclassification within balance sheet	331	0	0	0	173	0	-81	0	0	423	
Reclassification to expenses	0	0	0	0	-495	-1	0	0	0	-496	
Expensed pipelines	0	0	0	0	0	-64,410	0	0	0	-64,410	
Reclassification from assets in progress	9,004	38,719	19,416	1,848	-64,095	-3,215	-4,836	1,223	1,936	0	
31/12/2004	311,470	1,899,519	484,895	16,335	102,634	79,675	3,648	9,598	27,357	2,935,131	
Acquisition	0	0	0	0	23,443	8,119	19,804	0	0	51,366	
Sale of fixed assets	-83	-127	-1	0	0	0	0	0	0	-211	
Write-off of fixed assets	0	-143	-951	-9	0	0	0	0	0	-1,103	
Reclassification to expenses	0	0	0	0	-50	-3	0	0	0	-53	
Expensed pipelines	0	0	0	0	0	-15,448	0	0	0	-15,448	
Reclassification from assets in progress	120	10,014	1,533	488	-15,966	-675	0	3,712	774	0	
31/03/2005	311,507	1,909,263	485,476	16,814	110,061	71,668	23,452	13,310	28,131	2,969,682	
Accumulated depreciation											
31/12/2003	49,466	561,724	248,581	9,669	0	0	0	6,136	6,299	881,875	
Depreciation	4,061	27,624	38,874	1,073	0	0	0	905	5,155	77,692	
Depreciation of fixed assets sold and written-off (-)	-638	-2,598	-5,129	-385	0	0	0	0	0	-8,750	
Reclassification	0	-3	3	0	0	0	0	0	0	0	
31/12/2004	52,889	586,747	282,329	10,357	0	0	0	7,041	11,454	950,817	
Depreciation	988	7,279	9,110	386	0	0	0	419	1,331	19,513	
Depreciation of fixed assets sold and written-off (-)	-83	-233	-935	-8	0	0	0	0	0	-1,259	
Reclassification	0	0	0	0	0	0	0	0	0	0	
31/03/2005	53,794	593,793	290,504	10,735	0	0	0	7,460	12,785	969,071	
Net book value											
31/12/2003	254,336	1,301,961	223,606	5,236	62,797	93,176	8,565	2,239	19,122	1,971,038	
31/12/2004	258,581	1,312,772	202,566	5,978	102,634	79,675	3,648	2,557	15,903	1,984,314	
31/03/2005	257,713	1,315,470	194,972	6,079	110,061	71,668	23,452	5,850	15,346	2,000,611	

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

Net balance sheet value of finance leases was 5,433 thousand and 9,434 thousand kroons in 2005 I quarter and 2004 respectively.

Interest capitalised to fixed assets was 817 thousand kroons and 2,689 thousand kroons in 2005 I quarter and 2004 respectively.

AS TALLINNA VESI

NOTES TO THE INTERIM ACCOUNTS
For the quarters ended 31 March 2005 and 2004

(thousand EEK)

NOTE 3. NET SALES

	1st quarter ended		Year ended
	2005	2004	31 December
			2004
Sales from main operating activities			
Water supply service.....	68,488	55,981	220,688
Waste water disposal service.....	57,579	50,688	204,494
Stormwater treatment and disposal service.....	11,643	11,183	44,731
Fire hydrants service.....	510	490	1,959
Other work and services.....	1,130	1,332	6,942
Total sales from main operating activities.....	139,350	119,674	478,814
Revenues from other operating activities			
Water, sewerage and storm water connections construction income.....	17,277	30,122	69,715
TOTAL NET SALES.....	156,627	149,796	548,529

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

AS TALLINNA VESI

NOTES TO THE INTERIM ACCOUNTS
For the Quarters ended 31 March 2005 and 2004

(thousand EEK)

NOTE 4. COSTS AND EXPENSES

Cost of goods sold main operating activities	1st quarter ended		Year ended
	2005	2004	31 December
			2004
Tax on special use of water	-2,337	-2,429	-9,272
Chemicals.....	-2,597	-2,303	-9,387
Electricity	-7,098	-6,322	-26,151
Pollution tax.....	-2,062	-1,908	-8,380
Staff costs.....	-10,504	-11,899	-44,643
Research & development.....	-23	-29	-85
Depreciation and amortisation.....	-18,315	-18,365	-73,104
Other costs of goods sold.....	-6,314	-5,826	-24,464
Total cost of goods sold main operating activities.....	-49,250	-49,081	-195,486

Cost of goods sold other operating activities	1st quarter ended		Year ended
	2005	2004	31 December
			2004
Water, sewerage and storm water connections construction cost	-15,449	-26,700	-64,410

Marketing Expenses	1st quarter ended		Year ended
	2005	2004	31 December
			2004
Staff costs.....	-1,167	-1,092	-4,240
Depreciation and amortisation.....	-24	-31	-113
Other marketing expenses	-475	-508	-1,781
Total cost of marketing expenses	-1,666	-1,631	-6,134

General Administration Expenses	1st quarter ended		Year ended
	2005	2004	31 December
			2004
Staff costs.....	-3,707	-4,621	-15,813
Depreciation and amortisation.....	-1,181	-1,150	-4,520
Other general administration expenses	-6,447	-4,869	-20,406
Total cost of general administration expenses	-11,335	-10,640	-40,739

Other income/expenses includes the profits recognised on the sale of fixed assets during the period, the movement of the bad debt provision during the year and provisions recognised and released throughout the financial period.

AS TALLINNA VESI

**NOTES TO THE INTERIM ACCOUNTS
For the Quarters ended 31 March 2005 and 2004**

(thousand EEK)

NOTE 5. DIVIDENDS

	1st quarter ended		Year ended
	2005	2004	31 December 2004
Dividend declared during the period.....	112,000	0	75,000
Dividend paid during the period	27,759	0	75,000
Income tax on dividends declared.....	-35,368	0	-26,351
The income tax paid on dividends received	0	0	74
The income tax accounted.....	-35,368	0	-26,277

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

NOTE 6. EARNINGS AND DIVIDENDS PER SHARE

	1st quarter ended		Year ended
	2005	2004	31 December 2004
Earnings per share from continuing operations:			
Earnings for the purposes of basic earnings per share (net profit for the period minus B-share preference rights).....	42,758	58,585	172,951
Weighted average number of ordinary shares for the purposes of basic earnings per share.....	20,000,000	20,000,000	20,000,000
Earnings per share in kroons	2.14	2.93	8.65
Dividends per A-share in kroons	5.60	0.00	3.75
Dividends per B-share in kroons.....	10,000.00	0.00	10,000.00

NOTE 7. REDUCTION IN STATUTORY LEGAL RESERVE

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

AS TALLINNA VESI

NOTES TO THE INTERIM ACCOUNTS For the Quarters ended 31 March 2005 and 2004

(thousand EEK)

NOTE 8. RELATED PARTIES

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

The transactions with related parties in 2004 and 2005 and respective balances as of 31 March 2004 and 31 March 2005 are recorded as follows:

	<u>Tallinn City Government and related boards</u>	<u>United Utilities (Tallinn) B.V. and United Utilities International*</u>
2004 1st quarter		
Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet		
Accounts receivable – customer and other receivables	276	0
Accounts payable – short-term trade and other payables	0	762
Transactions recorded to AS Tallinna Vesi Income Statement		
Net sales.....	34,784	0
General administration expenses.....	0	4,070
Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet		
Tangible non-current assets incl. unfinished constructions and new connections	0	3,730
2005 1st quarter		
Transactions recorded to AS Tallinna Vesi Working Capital of Balance Sheet		
Accrued income and prepaid expenses	0	7,212
Accounts payable – short-term trade and other payables, incl. dividends	27,759	58,376
Transactions recorded to AS Tallinna Vesi Income Statement		
Net sales.....	13,559	0
General administration expenses.....	0	2,984
Transactions recorded to the other accounts of AS Tallinna Vesi Balance Sheet		
Tangible non-current assets incl. unfinished constructions and new connections	0	2,832

The agreed market prices were implemented in transactions with related parties.

* United Utilities (Tallinn) B.V. holds 50.4% of the Company. The ultimate controlling parties of United Utilities (Tallinn) B.V. are EBRD and United Utilities Plc. United Utilities International Ltd. is owned by United Utilities Plc.

	<u>1st quarter ended</u>		<u>Year ended 31 December</u>
	<u>2005</u>	<u>2004</u>	<u>2004</u>
The fees paid to management board members excluding social tax	530	530	2,059
The fees paid to supervisory board members excluding social tax	6	4	18

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