

AS TALLINNA VESI

*Annual report
for the financial year ended
31 December 2010
(Translation of the Estonian original)*

AS TALLINNA VESI

ANNUAL REPORT

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2010

(thousand EUR)

Beginning of the financial year	1 January 2010
End of the financial year	31 December 2010
Name of the Company	AS TALLINNA VESI
Legal form of the Company	Public limited company
Commercial register number	10257326
Address	Ädala St.10, Tallinn, Estonia
Chairman of the Board	Ian John Alexander Plenderleith
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Web-page	www.tallinnavesi.ee
Field of activity	Production, treatment and distribution of water; storm and wastewater disposal and treatment
Auditors	AS PricewaterhouseCoopers
Documents attached to the Annual Report	Independent auditor's report

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MANAGEMENT REPORT

CHAIRMAN'S STATEMENT

2010 has been an extremely challenging year for AS Tallinna Vesi. Our company, our performance, our financial results and our business model have all been criticised by various politicians, political groups and state institutions. All of these criticisms have been made without any prior discussion with our company, or without making any attempt to understand our services agreement or our financial model. In addition we have been faced with some of the most extreme weather conditions, in both winter and summer, seen in Estonia in decades, which has contributed to the most difficult operating conditions we have faced.

Therefore it gives me great pleasure to say that our operating performance across most business areas has continued to improve. This improvement is a testimony to the attitude and commitment of our staff who have worked tirelessly to provide a better service for our clients in spite of the adverse weather conditions and the difficult political environment. For this, on behalf of the Board and owners of the company, I would like to say thank you.

It is also very pleasing to see that our efforts have been recognised externally. At the NASDAQ OMX Baltic Stock Exchange awards for 2010 we once again won the award for the company with the best Investor Relations in Estonia. In addition the Ministry of Environment presented the Company with the "Environmental Player of the Year Award" for our operational performance and our customer awareness campaigns during the year. These awards are clear demonstrations of the company's commitment to improving environmental awareness and of course transparent reporting and high quality corporate governance, both of which are pre-requisites for any responsible utility company.

Operations & Customer Service – best ever water quality at western European levels

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

We invested almost 18 mln euros in 2010, in our networks, treatment plants and catchment area to help deliver an improved service for the people of Tallinn. In 2010, the highlight of our operational performance was the quality of tap water with drinking water quality compliance at the customer's tap improving to almost 99.6%, which is well above the EU standard and close to the highest standards in Western Europe.

Network access for everyone

In November 2007 we agreed a partnership with the City of Tallinn to finance and deliver over 3,500 new sewerage connections by the end of 2010 and to finalise the construction program fully by end of 2012. We are pleased to report that all the connections promised by the end of 2010 were delivered and this important environmental programme was completed on time. As a result of the efforts of our teams and our contract partners we have constructed 170 km of water, wastewater and storm water networks and 3,779 connection points in the past three years. These constructions bring

significant environmental benefits and cost savings to all the households that have been given the opportunity to connect. Furthermore, fulfilling this programme on time enables the City of Tallinn to fulfil its EU obligation regarding network accessibility. We are rightly proud of our contribution in this extremely important project.

Customers recognise our quality

I was delighted to see that our customer satisfaction rating improved in 2010. After a disappointing fall in 2009 our performance rating in 2010 for domestic customers increased to 78 points on the TRIM Index, an increase of 11% year on year and brings our customer satisfaction back to 2007 levels. It is extremely positive that, in spite of the negative media comment about the company our customers recognise the quality of our products and services. We fully understand the responsibility we have before our customers and are determined to provide an even better service.

Our People and teams

In 2010 the commitment of our workers was exemplary. The severest of winters and the dries of summers placed additional stresses on our teams and our resources. However it comes as no surprise for me to say that our people rose to these challenges and once again delivered an excellent service that is without comparison across the Baltic's. During the year we made some structural changes in our customer facing departments in order to make our working processes and internal communications even more customer focussed. We expect our customers to see the full benefits of these changes in 2011.

In AS Tallinna Vesi we strive to develop our talented members of staff. In 2010 we saw a number of our talented young people rise into management positions. This is something I very much welcome and hope that giving opportunities for personal and professional development will make the company an attractive employer for the brightest and the best.

Stable Revenues, returns in accordance with other privatised utilities

Our financial performance continues to be robust. Our turnover from our main business activity, sales of water and wastewater decreased by 0.1% to 45.2 mln euros and our operating profit from these activities increased by 10.1% to 24.2 mln euros. The real return (net of inflation) on invested capital in our main business was 5.5% in 2010 and 6.3% over the five year period from 2006 to 2010, which is in accordance with the rates of return made by other privatised water utilities.

Uncertain growth potential

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

Change of law and new regulator

It is impossible to review 2010 performance without commenting on the potential impact on the company of the changes in the way the water sector will be regulated from 2011 onwards.

In August 2010 the Act on Establishing Price Limits on Monopolies was passed by Parliament, which gave the power to set tariffs to the Estonian Competition Authority. On 10 November the Competition Authority also published their recommended methodology which they will use as the basis to regulate prices in the water industry.

This act and methodology fundamentally changed the contract that we have with the City of Tallinn. In previous years our tariffs were approved by the City of Tallinn in accordance with the tariff mechanism agreed on privatisation, and the 'K' factors agreed when the contract was amended in 2007. This was a simple and effective tariff mechanism that gave little room for dispute and, as 'K' factors were agreed until 2020, gave excellent transparency to all stakeholders.

From 1 November 2011 we have had to apply to the Competition Authority for our tariff increase due from 1 January 2011. In order to ensure our application was as professional as possible we worked with Oxera, the UK economic consulting group, to analyse our current contract and ensure that the returns made by the company were in accordance with those made by other privatised utilities. This analysis proved that this was correct and that our real rates of return were not excessive. Therefore, as per the terms and conditions of our contract, on 9 November 2010 we applied to the Competition Authority for a 3.5% tariff increase from 1 January 2011. To date however the Competition Authority has not processed our tariff application or taken the opportunity to engage in meaningful discussion on the merits of the application. Therefore, at present our tariffs remain frozen at 2010 levels.

Uncertain outlook and a request to respect the contract

The change in regulatory environment leaves the company in a very uncertain position. At present we have no clarity of revenues, do not know the policies and levels of risk we may have to take when purchasing supplies which are absolutely necessary but where the prices are extremely difficult to predict, such as energy and chemicals, and are unsure of the quality standards we must achieve on behalf of our customers, nor the investments we need to make to protect our services and the environment. In summary we are currently unable to fully manage our business and will be unable to do so until the authorities engage in meaningful discussion about our current contract. However I would like all our stakeholders to know that we are doing everything in our power to ensure this contract is fully respected as we believe it has brought and will continue to bring significant benefits to the citizens of Tallinn. In this uncertain interim period we are 100% committed to bringing the same high level of service to all our direct customers and service users.

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

RESULTS OF OPERATIONS - FOR THE YEAR 2010**Main economic indicators**

million euros	2010	2009	2008	2007	2006
Sales	49,7	49,4	46,0	41,4	37,7
Gross profit	29,0	31,2	28,6	27,6	23,6
Gross profit margin %	58,4	63,2	62,1	66,6	62,6
Operating profit	27,5	29,5	25,9	24,1	21,6
Operating profit - main business	24,2	26,9	24,1	23,2	21,2
Operating profit margin %	55,3	59,8	56,3	58,2	48,7
Profit before taxes	24,9	25,6	23,1	21,3	18,9
Profit before taxes margin %	50,1	51,9	50,3	51,4	42,5
Net profit	16,4	21,7	18,9	17,8	15,9
Net profit margin %	33,0	44,0	41,1	42,9	42,1
ROA %	8,9	12,3	11,6	10,9	10,0
Debt to total capital employed	60,1	49,7	49,9	51,8	53,4
ROE%	22,4	24,4	23,1	22,5	21,5
Current ratio	2,1	4,2	1,8	1,9	2,2
Number of employees	319	336	327	312	318
Share capital	12,8	12,8	12,8	12,8	12,8

Gross profit margin – Gross profit / Net sales

Operating profit margin – Operating profit / Net sales

Profit before taxes margin – Profit before taxes / Net sales

Net profit margin – Net profit / Net sales

ROA – Net profit / Total assets

Debt to Total capital employed – Total liabilities / Total capital employed

ROE – Net profit / Shareholders' equity

Current ratio – Current assets / Current liabilities

Profit and loss statement**Sales**

In 2010 the Group's total sales increased, year on year, by 0.6% to 49.7 mln EUR. Included within this is a contribution of 1.6 mln EUR from Maardu, a contract which commenced only in the 3rd quarter of 2009. Sales in the main operating activity principally comprise of sales of water and treatment of wastewater to domestic and commercial customers within and outside of the service area, and fees received from the City of Tallinn for operating and maintaining the storm water system. There is no considerable seasonality in the Group's operation.

Sales of water and wastewater services were 45.2 mln EUR, a 0.1% decrease compared to 2009, resulting from the 0.9% decrease in tariffs from 1st January 2010 for the Group's residential and commercial customers combined with the factors described below.

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Within the service area, sales to residential customers decreased by 1.8% to 23.8 mln EUR. Sales to commercial customers decreased by 2.1% to 17.1 mln EUR. Sales to customers outside of the service area increased by 33.6% to 3.4 mln EUR, which includes the Maardu operating contract that commenced from 1st July 2009. Over pollution fees received were 0.85 mln EUR, a 10.1% decrease compared to 2009.

In 2010, the volumes sold to residential customers dropped 0.9%, year on year. Still the decrease in volumes sold has lowered during the course of the year.

The volumes sold to commercial customers inside the service area decreased by 1.2% compared to the respective period in 2009. Total sales volumes to the industrial sector decreased due to leave of one key customer from the Group's service area. Despite the fall in respective consumption some increase can be noticed in the industrial sector as a whole. Better economic conditions are contributing also to leisure sector volumes starting to pick up.

Excluding Maardu volumes, then outside service area volumes were 9.8% higher than in 2009, compared to 21.5% increase with Maardu volumes. The main factor in this increase was higher storm water volumes during the first two quarters of 2010 compared to 2009.

Compared to last year, sales from operation and maintenance of storm water and fire-hydrant system increased by 8.8% to 3.5 mln EUR in 2010. This increase is driven by the terms and conditions of the contract whereby the storm water and fire hydrant costs are invoiced based on actual costs and volumes treated.

Cost of goods sold and gross margin

The cost of goods sold for the main operating activity was 20.7 mln EUR in 2010, an increase of 2.5 mln EUR or 13.9% from the equivalent period in 2009, of which Maardu added 1.2 mln EUR compared to 0.70 mln EUR in 2009.

In 2010 the Group achieved the beneficial 0.5 coefficient for pollution tax only in 1st quarter whereby in 2009 the Group had received the beneficial 0.5 coefficient in quarters 1, 3 and 4. Due to the combination of high nitrogen concentration, low wastewater volumes and low temperature during the second half of 2010 the amount of pollution tax payable was 2.3 mln EUR compared to 1.1 mln EUR in 2009. In addition to the coefficient used compared to 2009, the higher pollution tax payable in 2010 is generated by the increase in tax rates year on year by 19%. The results of the nitrogen treatment are highly dependant on temperature, concentration and volume of incoming sewage. To mitigate the nitrogen treatment and tax risk the Group has started with the investment into an additional stage of waste water treatment and according to the construction schedule the works should be completed in the beginning of the 3rd quarter of 2011.

Chemical costs were 1.4 mln EUR, representing an 11.7% increase compared to 2009. Although lower volumes were treated the main contributor to higher chemical costs was dosed methanol and other chemicals quantities related to the need to treat the increased pollution concentration in incoming sewerage. Also the increase in prices added some unfavorable impact to the cost of chemicals.

Electricity costs increased by 0.57 mln EUR or 26.6% in 2010 compared to 2009 due to higher electricity prices as a result of three sites buying electricity from the open market having an extra 0.05 mln EUR adverse impact from the extra half-year implementation of the Maardu's contract.

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FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2010

(thousand EUR)

Salary expenses within costs of goods sold decreased in 2010, year on year, by 0.46 mln EUR or 10.3% mainly due to the reduced operating headcount.

Transport costs increased by 0.10 mln EUR, or 8.5% year on year, having adverse impact from the increase in fuel prices and usage of rented machinery in the beginning of the year to deal with the consequences of the severe weather. The costs were balanced by decrease in usage of staff cars.

Other cost of goods sold in the main operating activity increased 0.93 mln EUR, or 43.7% year on year, mainly due to the additional costs of repair services resulting from new City's act related to asphaltting costs and also due to the rental costs paid to Maardu Vesi.

The increase in uncontrollable costs is a real challenge for the management of the Group. The Group is continuously seeking for efficiencies to hit the inflatory increases of fixed costs. In 2010 the Group proved its success via reduction in payroll costs. In 2011 the Group is looking actively on further efficiencies to keep the cost increases under control.

As a result of all of the above the Group's gross profit for 2010 was 29.0 mln EUR, which is a decrease of 2.2 mln EUR, or 7.1%, compared to the gross profit of 31.2 mln EUR for 2009.

Operating costs and operating margin

Marketing expenses increased by 0.07 mln EUR to 0.79 mln EUR during 2010 compared to the 2009. This is mainly the result of a slight increase in expenses due to OÜ Watercom start-up costs in the second half year of 2010.

In 2010 the General administration expenses increased by 0.23 mln EUR to 3.6 mln EUR year on year, mainly due to the need for the consultancies related to the implication of the Law of Establishing Price Limits for Monopolies and attempts to improve the image of the Group insisting on the quality aspects.

Other income/expenses

The majority of the net income in Other income/expenses relates to constructions and government grants. The driver for this income stream is the connections activity in Tallinn. Income and expenses from constructions and government grants totaled a net income of 3.3 mln EUR in 2010 compared to a net income of 2.6 mln EUR in 2009. This line's value varies throughout the year depending on construction volumes and estimates to the profit margins on projects completed.

The rest of the other income/expenses totaled an expense of 0.40 mln EUR in 2010 compared to an expense of 0.20 mln EUR in 2009. This line was mainly impacted by the change in accounting principles as described in the financial accounts and Note 2 to the accounts. In addition it should be noted that collection rate from the main business is above 99%.

As a result the Group's underlying operating profit from sales of water and wastewater for 2010 totaled 24.2 mln EUR compared to 26.9 mln EUR in 2009. In total the Group's operating profit for all activities for 2010 was 27.5 mln EUR, a decrease of 2.1 mln EUR compared to an operating profit of 29.5 mln EUR achieved in 2009. Year on year the operating profit for 2010 has decreased by 7.0%.

Financial expenses

Net Financial expenses were 2.6 mln EUR in 2010, which is a decrease of 1.3 mln EUR or 34.1% compared to the net expenses in 2009. The higher level of net financial costs in 2009 was mainly related to unwinding costs of EBRD loan.

The Group has mitigated considerable part of the long term floating interest risk with 5 interest swap agreements, each with a principal value of 15 mln EUR. The fair value of swap agreements changed considerably throughout the year, firstly decreased by 2.2 mln EUR during the first 6 months, but then the fair values turned up again, having a 1.0 mln EUR positive impact in the second half-year of 2010. At this point in time the estimated fair value of these swap contracts is still negative, totaling 2.3 mln EUR.

Profit before taxes

The Group's profit before taxes for 2010 was 24.9 mln EUR, which is 0.73 mln EUR lower than the profit before taxes of 25.6 mln EUR for 2009.

The Group's net profit for 2010 was 16.4 mln EUR, which is 5.3 mln EUR lower than the net profit of 21.7 mln EUR in the equivalent period in 2009 mainly due to the higher dividend payment and related income tax paid on dividends in 2010.

Balance sheet

During the twelve months of 2010 the Group invested 17.5 mln EUR into fixed assets. Non-current assets were 150.2 mln EUR at 31st December 2010. Current assets increased by 2.5 mln EUR to 33.7 mln EUR in the twelve months of the year, with customer receivables increasing by 7.9 mln EUR and cash at bank decreasing by 5.5 mln EUR.

Current liabilities increased by 8.5 mln EUR to 15.9 mln EUR in the twelve months of the year. This was mainly due to a 1.1 mln EUR increase in Trade payables and also due to 7.5 mln EUR increase in Current portion of long-term borrowings.

The Group has a leverage level as expected of 60.1% with the future target range within 60%. Long-term liabilities stood at 94.6 mln EUR at the end of December 2010, consisting almost entirely of the outstanding balance of three long-term bank loans. During 2nd quarter of 2010 the Group drew down an additional 20 mln EUR, and at the end of 2010 the total loan balance was 95 mln EUR, which is currently the total available loan facility. The weighted average interest margin for the total loan facility is 0.67%.

Cash flow

During the twelve months of 2010, the Group generated 24.8 mln EUR of cash flows from operating activities, a decrease of 2.5 mln EUR compared to 2009. 2010 operating cash flows were below 2009 cash flows mainly due to the decrease in operating profits. Underlying operating profit still continues to be the main contributor to operating cash flows.

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In the twelve months of 2010 net cash outflows from investing activities were 9.8 mln EUR, which is 5.1 mln EUR more than in 2009. This is mainly due to reduced inflow due to timing of compensations received for construction of pipelines. At the end of 2010 the cash outflows in relation to fixed asset investments were 17.1 mln EUR.

The cash outflows from financing activities were 20.5 mln EUR during the twelve months of 2010 compared to a cash outflow of 18.6 mln EUR during the same twelve months of 2009. These sums represent the payouts of the dividends and income tax on dividends and received loans following the loan drawdown.

As a result of all of the above factors, the total cash outflow in the twelve months of 2010 was 5.5 mln EUR compared to a cash inflow of 4.0 mln EUR in the twelve months of 2009. Cash and cash equivalents stood at 13.2 mln EUR as at 31st December 2010, which is 5.5 mln EUR lower than at the corresponding period of 2009.

Employees

At the end of 2010, the total number of employees was 319 compared to 336 at the end of 2009. The full time equivalent (FTE) was respectively 305 in 2010 compared to the 322 in 2009. The decrease in FTE is primarily due to reorganization in various departments at the end of 2009. The total salary cost was 5.8 mln EUR, including 0.24 mln EUR paid to the Management and Supervisory Council members. The off balance sheet potential salary liability would be up to 0.04 mln EUR if the Council would want to replace the Management Board member.

Corporate structure

At the end of the year, 31st December 2010, the Group consisted of 2 companies. The subsidiary OÜ Watercom is wholly owned by AS Tallinna Vesi and consolidated to the results of the Group.

Dividends and share performance

Based on the results of the 2009 financial year, the Group paid 31,956,463 EUR of dividends. Of this 639 EUR was paid to the owner of the B-share and 31,955,824 EUR, i.e. 1.60 EUR per share, to the owners of the A-shares. The dividends were paid out on 11th June 2010, based on the list of shareholders, which was fixed on 1st June 2010.

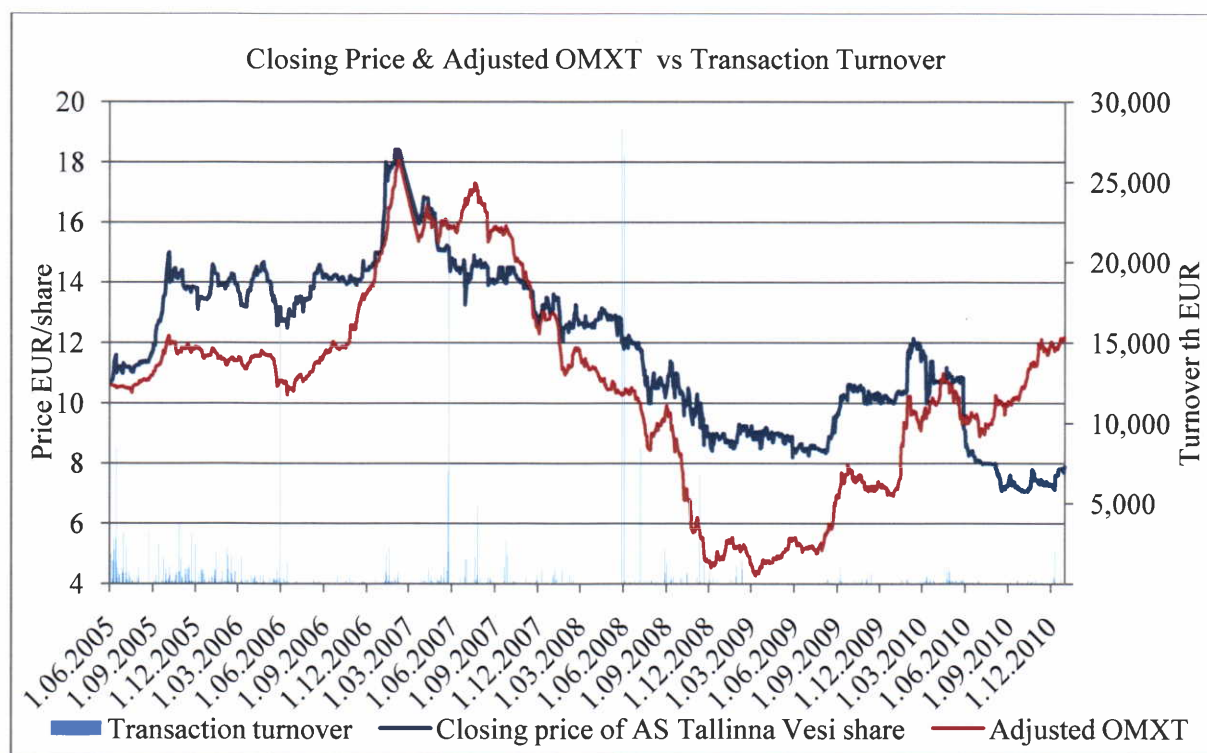
AS Tallinna Vesi is listed on OMX Main Baltic Market with trading code TVEAT and ISIN EE3100026436.

As of 31st December 2010 AS Tallinna Vesi shareholders, with a direct holding over 5%, were:

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

AS Tallinna Vesi has seen the next two biggest shareholders, Parvus AM and AKO Capital, reducing their holdings in the Group in the second half-year of 2010. Parvus AM has declared that their shareholding in the clients' accounts fell below 10% of the share capital and AKO Capital has declared selling their entire holding in AS Tallinna Vesi.

At the end of the year, 31st December 2010, the closing price of the share of AS Tallinna Vesi was 7.89 EUR, which is a 21.10% decrease compared to the closing price of 10.00 EUR at the beginning of the year. During the same period the OMX Tallinn index increased by 72.62%.



Share price statistics

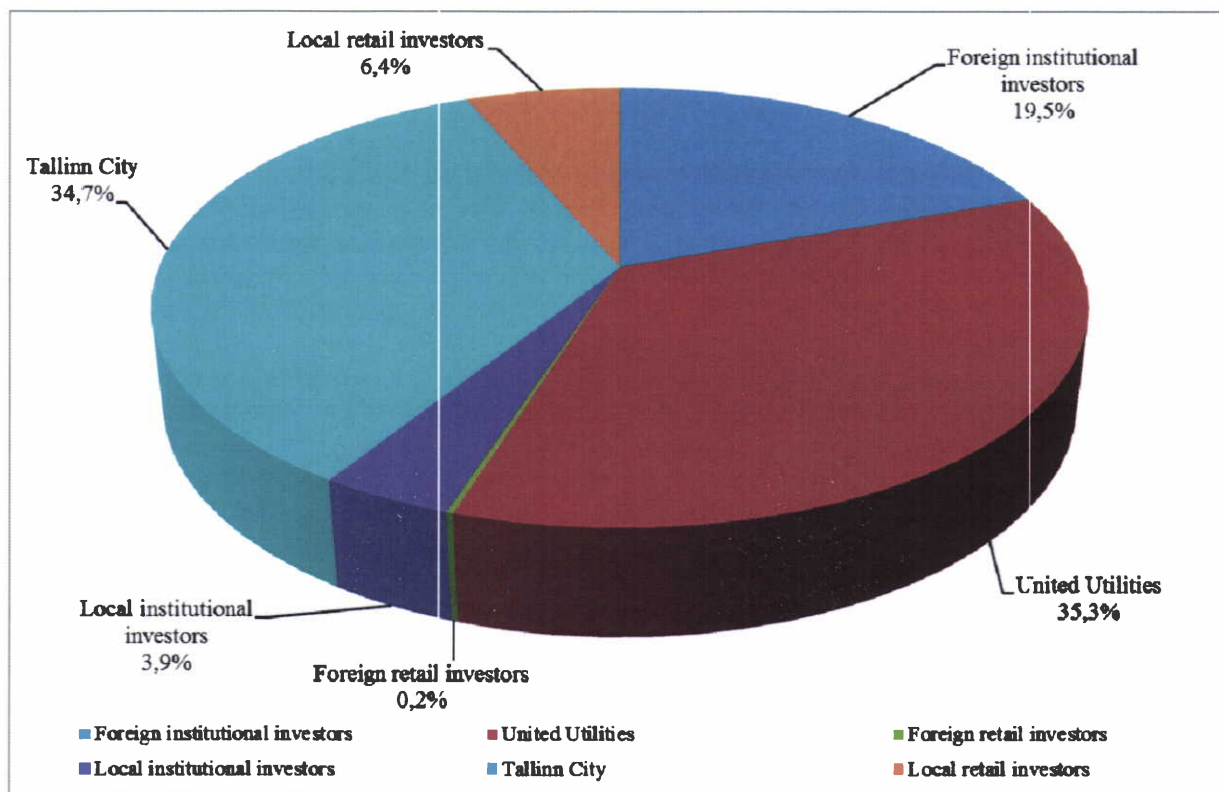
EUR	2010	2009	2008	2007	2006
Share price, open	10,18	9,00	13,25	15,00	13,50
Share price, at the end of the year	7,89	10,00	8,99	12,96	15,01
Share price, low	7,00	8,20	8,41	12,50	12,47
Share price, high	12,25	10,69	13,60	18,59	15,01
Share price, average	8,95	9,28	11,38	14,84	13,90
Traded volume	2 879 132	1 547 108	7 958 820	5 462 916	4 274 094
Turnover, million	25,6	14,5	92,9	82,8	58,4
Capitalisation, million	157,8	200,0	179,8	259,2	300,2
Earnings per share	0,82	1,09	0,95	0,89	0,79
Dividend per share	n/a	1,60	0,73	0,80	0,63
Dividend / net profit	n/a	147%	78%	90%	79%
P/E	9,62	9,20	9,50	14,60	18,94
P/BV	2,2	2,2	2,2	3,3	4,1

P/E = share price at the end of the year / earnings per share

P/BV = share price at the end of the year / book value per share

In 2005 the listing price was 144.70 EEK, equal to 9.25 EUR

Shareholders by type as of 31.12.2010



Distribution of share capital by size of share ownership as of 31.12.2010

	Shareholders	Shareholders %	No. of shares	% of share capital
1 - 100	779	27,2%	42 223	0,2%
101 - 200	604	21,1%	93 657	0,5%
201 - 300	336	11,7%	89 897	0,4%
301 - 500	342	11,9%	143 777	0,7%
501 - 1 000	363	12,7%	279 698	1,4%
1 001 - 5 000	352	12,3%	768 351	3,8%
5 001 - 10 000	40	1,4%	273 821	1,4%
10 001 - 50 000	30	1,0%	612 113	3,1%
50 000 +	19	0,7%	17 696 463	88,5%
TOTAL	2865	100,0%	20 000 000	100,0%

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

**CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE
RECOMMENDATIONS REPORT**

Overview

Corporate governance constitutes a system of principles for the management of a company. Generally those principles are regulated by law, the Articles of Association and the internal rules of a company. Since 01.01.2006, the companies listed on the Tallinn Stock Exchange are recommended to follow the "Corporate Governance Recommendations" issued by the Financial Supervision Authority. Throughout 2010 the management of AS Tallinna Vesi has followed those regulations and principles.

AS Tallinna Vesi is committed to high standards of corporate governance for which the Management Board and Supervisory Board are accountable to the shareholders. The Group endeavours to be transparent in its ways of operating, corporate disclosures and relations with its shareholders. AS Tallinna Vesi has been recognized several times for this – in 2008 and 2009 the IR Magazine ranked AS Tallinna Vesi to be the best in investor relations in Estonia. In 2009, the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Annual Report in NASDAQ OMX Baltic and for the Best Investor Relations in NASDAQ OMX Tallinn. In 2010 the NASDAQ OMX Baltic awarded AS Tallinna Vesi for the Best Investor Relations in NASDAQ OMX Tallinn and the Baltic Corporate Governance Institute awarded AS Tallinna Vesi for the Best Corporate Governance in Estonia.

Investor Relations and Disclosure of Information

At the beginning of each calendar year, AS Tallinna Vesi discloses the financial calendar, including the disclosure dates of the quarterly and annual financial information and the date of the Annual General Meeting (AGM) of the Shareholders via the Tallinn Stock Exchange. All information disclosed via the Tallinn Stock Exchange is also subsequently disclosed on the AS Tallinna Vesi's website. In addition, AS Tallinna Vesi discloses the following information on its website: useful background information prior to the AGM, questions and answers regarding the topics discussed at the AGM, information about corporate governance and information about the Management and Supervisory Board members.

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

The General Meeting of Shareholders

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

On 18th May, 2010, AS Tallinna Vesi held an Annual General Meeting (AGM) of its Shareholders to approve the 2009 annual report, distribution of dividends, appointment of auditors and recalling as well as electing of Supervisory Board members. On 14th December, 2010 AS Tallinna Vesi held an

Extraordinary General Meeting (EGM) to elect a Supervisory Board member after one member tendered in his resignation.

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

The agendas of AGMs and EGMs of AS Tallinna Vesi are pre-approved by the Supervisory Board, who also puts forward proposals for the attention and voting at the General Meeting. The General Meeting agenda items, the Supervisory Board's proposals, with relevant commentaries about the agenda items, procedural instructions for participating at a General Meeting and how and when to propose additional items to the agenda are disclosed within the General Meeting notice. In addition, AS Tallinna Vesi discloses the following information on its website prior to General Meetings: background information about the agenda and any candidates standing for election, any new agenda items and draft resolutions proposed, and questions about existing agenda items. In 2010 the shareholders did not submit any questions in advance of the General Meetings. All respective documents are also available at the headquarters of the Group until the day before the date of the General Meeting. Resolutions of the General Meetings are published on the AS Tallinna Vesi's webpage within 7 (seven) days following the date of the General Meeting.

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

The chairman of any AGMs and EGMs is an independent person. In 2010, both the AGM and the EGM were chaired by Mr. Raino Paron, who introduced the procedure for conducting the General Meeting, including the procedure for inquiring about the company's activities from the Management Board.

All members of the Management Board, the Chairman of the Supervisory Board and the auditor participated at the AGM in 2010. When Supervisory Board members stood for election, the candidates for these positions also participated at the respective AGM or EGM.

AS Tallinna Vesi did not enable the shareholders to participate at the AGM or the EGM via electronic communication tools in 2010, as it would be too complicated and expensive to establish reliable solutions to identify the shareholders most of whom are overseas' residents.

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

As per the Articles of Association of AS Tallinna Vesi, the company has issued one registered preferred share with the nominal value of 1,000 (one thousand) kroons (63.9 euros) (B-share). The B-share grants the holder the right to participate at General Meetings as well as in the distribution of profits and of the assets remaining upon dissolution of the company, also other rights provided by law and the Articles of Association of the company. The B-share grants the holder the preferential right to receive a dividend in an agreed sum of 10,000 (ten thousand) kroons (639 euros). The B-share grants the shareholder 1 (one) vote at the General Meeting (restricted right to vote) when deciding on

amending the Articles of Association of the company; increasing and reducing the share capital of the company; issuing convertible bonds; acquisition of treasury shares by the company; deciding on the merger, division, transformation and/or dissolution of the company and deciding on issues related to the activities of the company that have not been placed in the sole competence of the General Meeting by law.

The Supervisory Board, Audit and Board Committees

The Supervisory Board plans the activities of the Group, organises its management and supervises the activities of the Management Board. Pursuant to the Articles of Association of AS Tallinna Vesi, the Supervisory Board consists of nine members with the term of two years. In 2010, five regular and two extraordinary Supervisory Board meetings were held. The Supervisory Board pre-approved the 2010 annual report presented to the Annual General Meeting for approval, and the Group's 2011 budget.

At the time of compilation of this report, AS Tallinna Vesi's Supervisory Board consisted of the following members: Messrs Robert John Gallienne (Chairman of the Supervisory Board), Leslie Anthony Bell, Andrew James Prescott, Simon Gardiner, Mart Mägi, Valdur Laid, Ardo Ojasalu, Rein Ratas and Deniss Boroditš.

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

The main tasks of the Audit Committee are:

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

The appointed external auditor and any member of the external audit team cannot provide any service outside the scope of annual audits without prior approval from the Audit Committee. In 2010, the external auditor did not provide any services to the Group outside the scope of the annual audit.

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

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such evaluation in the AGM notice. The external auditor is present at the AGM and participates where necessary.

In addition, the Supervisory Board has formed a Remuneration Committee to advise the Supervisory Board on management remuneration issues. Mr. Valdur Laid is the Chairman of the Remuneration Committee and Mr. Robert John Gallienne is the second member of the Remuneration Committee.

The Management Board

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

Both, the Management Board and Supervisory Board members are deemed to be insiders, have signed respective insider agreements, are aware of AS Tallinna Vesi's insider rules and together with their related persons are listed in the Group's insider list.

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

The duties of the member of the Management Board, Mr. Robert Thomas Yuille, were, amongst others, to fulfil the everyday obligations of the Chief Operating Officer (COO) of AS Tallinna Vesi by managing and being responsible for the operating activities of the company.

Until 22nd October 2010, the duties of the member of the Management Board, Mr. Stephen Benjamin Howard, were, amongst others, to fulfil the everyday obligations of the Chief Financial Officer (CFO) of AS Tallinna Vesi by managing and being responsible for the accounting and financial activities of the company. As of 22nd October 2010, Ms. Siiri Lahe took over the role of the CFO and Mr. Stephen Benjamin Howard was recalled from this position as well as from the position of the member of the Management Board. From 30th November 2009 until 22nd October 2010, Ms. Siiri Lahe was a member of the Management Board without being directly responsible for any operational areas during her maternity leave period.

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

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

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

Conformity to Tallinn Stock Exchange Corporate Governance Recommendations

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

Declaration of Conformity by AS Tallinna Vesi

In 2010, AS Tallinna Vesi has complied with the vast majority of the Corporate Governance principles. However, AS Tallinna Vesi did not comply with certain principles, which are listed below together with the reasons for such non-compliance:

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

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

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

AS Tallinna Vesi does disclose the overall Management Board remuneration in the report, appendix 26, but considers that individual remuneration is sensitive and private information and the disclosure thereof would bring no benefit to the shareholders.

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

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

Information Disclosure

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

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

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

The Supervisory Board approves the remuneration principles of the Management Board. In 2010, there were no other transactions between the Group and any member of the Management Board.

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

According to the decision of the General Meeting the remuneration of Supervisory Board members is set at 6 391 euros per year per person. The fee is paid to six members out of nine. The fee is subject to deduction and payment of applicable taxes and is payable monthly. The Supervisory Board members were not paid any additional benefits in 2010.

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

In 2010, seven Supervisory Board meetings were held (28th January 2010, 25th March 2010, 21st April 2010, 22nd July 2010, 1st September 2010, 21st October 2010 and 1st November 2010).

The Chairman of the Supervisory Board (Mr. Robert John Gallienne) and most of the members of the Supervisory Board (Messrs Matti Hyrynen, Leslie Anthony Bell, Mart Mägi, Andrew James Prescott, Rein Ratas, Deniss Borodits and Valdur Laid) have attended more than 50% of the meetings during the time they were in office. Mr. Matti Hyrynen resigned from the Supervisory Board on 01.12.2010.

As the members of the Supervisory Board have changed during the year, the following Supervisory Board members have attended less than half of the meetings held during the year.

- Mr. Elmar Sepp attended two Supervisory Board meetings, until being recalled from the Supervisory Board on 01.05.2010. He attended on 25.03.2010 and 21.04.2010, respectively.

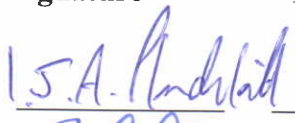


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- Mr. Ardo Ojasalu attended two Supervisory Board meetings since his nomination on 01.05.2010. He attended on 01.09.2010 and 21.10.2010, respectively.
- Mr. Simon Gardiner did not attend any of the Supervisory Board meetings as no Supervisory Board meetings were held after his election on 14.12.2010.

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

All Supervisory Board members are aware of this requirement and at minimum once per annum AS Tallinna Vesi requires all Supervisory Board members to update the record of their business interests. No business transactions took place between the Group and either any Supervisory Board member or any persons or companies related to them in 2010.

The previous sections, Chairman's statement, Results of operations – for the year 2010, Corporate Governance and Corporate Governance Recommendations Report from the Management Report are an integral part of the annual report of AS Tallinna Vesi for the financial year ended 31 December 2010. The Management Report gives a true and fair view of the trends and results of operations, main risks and doubts of the Group.

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25/2/11
Robert Thomas Yuille	Member of the Management Board		25/2/11
Siiri Lahe	Member of the Management Board		25.02.11

CONSOLIDATED FINANCIAL STATEMENTS**MANAGEMENT CONFIRMATION**

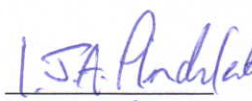


The Management Board hereby declares its responsibility for the preparation of the financial statements of AS Tallinna Vesi (Parent Company) and its subsidiary (Group) for the financial year ended 31 December 2010 on pages 20 to 58.

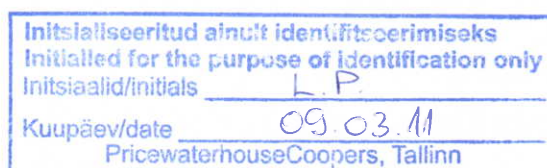
The financial statements have been prepared according to International Financial Reporting Standards as adopted by the EU, and give a true and fair view of the financial position, results of operations and cash flows of the Group.

The preparation of the financial statements according to International Financial Reporting Standards involves estimates made by the Management Board of the Group's assets and liabilities as of 31 December 2010, and of income and expenses during the financial year. These estimates are based on current information about the Group and consider all plans and risks as of 31 December 2010. The actual results of these business transactions recorded may differ from such estimates.

Any subsequent events that materially affect the valuation of assets and liabilities and have occurred up to the completion of the financial statements on 25 February 2011 have been considered in preparing the financial statements.

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

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		<u>25/2/11</u>
Robert Thomas Yuille	Member of the Management Board		<u>25/2/11</u>
Siiri Lahe	Member of the Management Board		<u>25.02.11</u>



CONSOLIDATED STATEMENT OF FINANCIAL POSITION

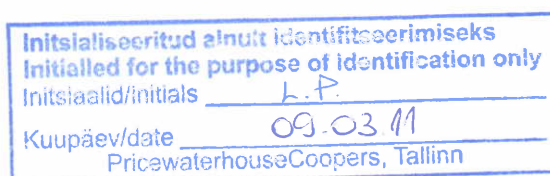
ASSETS	Note	2010	as of 31 December	
			2009	2008
CURRENT ASSETS			adjusted	adjusted
Cash and cash equivalents	6	13 235	18 692	14 691
Trade receivables, accrued income and prepaid expenses	7, 8	20 088	12 227	7 199
Inventories		306	244	240
Non-current assets held for sale		76	77	73
TOTAL CURRENT ASSETS		33 705	31 241	22 203
NON-CURRENT ASSETS				
Property, plant and equipment	9, 2	148 179	142 964	141 800
Intangible assets	9	1 972	2 577	2 776
TOTAL NON-CURRENT ASSETS		150 151	145 541	144 575
TOTAL ASSETS		183 856	176 782	166 778
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Current portion of long-term borrowings	10	7 624	124	5 295
Trade and other payables	11, 12	6 369	5 225	5 578
Derivatives	11	963	1 030	0
Short-term provisions		117	228	159
Prepayments	15	810	747	1 265
TOTAL CURRENT LIABILITIES		15 881	7 354	12 296
NON-CURRENT LIABILITIES				
Deferred income from connection fees	2, 15	5 765	5 365	3 225
Borrowings	10	87 428	75 034	69 321
Derivatives	11	1 304	0	0
Other payables	11	115	115	47
TOTAL NON-CURRENT LIABILITIES		94 612	80 514	72 593
TOTAL LIABILITIES		110 494	87 868	84 890
EQUITY				
Share capital	16	12 782	12 782	12 782
Share premium		24 734	24 734	24 734
Statutory legal reserve		1 278	1 278	1 278
Retained earnings		34 568	50 120	43 094
TOTAL EQUITY		73 363	88 914	81 889
TOTAL LIABILITIES AND EQUITY		183 856	176 782	166 778

Notes to the financial statements on pages 24 to 58 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

		for the year ended 31 December	
	Note	2010	2009
Revenue	17	49 680	49 368
Costs of goods sold	19	-20 684	-18 155
GROSS PROFIT		28 996	31 213
Marketing expenses	19	-787	-717
General administration expenses	19	-3 651	-3 419
Other income/ expenses (-)	20	2 906	2 446
OPERATING PROFIT		27 464	29 523
Financial income	21	1 059	1 615
Financial expenses	21	-3 624	-5 505
PROFIT BEFORE TAXES		24 900	25 633
Income tax on dividends	22	-8 495	-3 908
NET PROFIT		16 405	21 726
TOTAL COMPREHENSIVE INCOME		16 405	21 726
Attributable to:			
Equity holders of A-shares		16 404	21 725
B-share holder		0,64	0,64
Earnings per A share (in kroons)	23	0,82	1,09
Earnings per B share (in kroons)	23	639	639

Notes to the financial statements on pages 24 to 58 form an integral part of the financial statements.



CONSOLIDATED STATEMENT OF CASH FLOW

		for the year ended 31 December	
	Note	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating profit		27 464	29 523
Adjustment for depreciation/amortisation	9, 19	5 620	5 698
Adjustment for profit from government grants and connection fees	20, 24A	-3 312	-3 037
Other finance expenses	21	-14	-1 866
Profit from sale of property, plant and equipment, and intangible assets		-3	-10
Write down of property, plant and equipment		70	0
Change in current assets involved in operating activities	24B	-8 895	-938
Change in liabilities involved in operating activities	24B	6 297	394
Interest paid		-2 443	-2 479
Total cash flow from operating activities		24 784	27 285
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of property, plant and equipment, and intangible assets	24C	-17 055	-15 588
Compensations received for construction of pipelines	24A	6 139	9 956
Proceeds from sale of property, plant and equipment, and intangible assets		16	15
Interest received		1 109	964
Total cash flow used in investing activities		-9 790	-4 654
CASH FLOWS FROM FINANCING ACTIVITIES			
Received loans	10	20 000	44 800
Repayment of loans	10	0	-44 821
Dividends paid	22	-31 956	-14 700
Income tax on dividends	22	-8 495	-3 908
Total cash flow used in financing activities		-20 451	-18 629
Change in cash and cash equivalents		-5 458	4 002
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		18 692	14 691
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	6	13 235	18 692

Notes to the financial statements on pages 24 to 58 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
31 December 2008	12 782	24 734	1 278	43 094	81 889
Dividends (Note 22)	0	0	0	-14 700	-14 700
Net profit of the financial year (Note 23)	0	0	0	21 726	21 726
31 December 2009	12 782	24 734	1 278	50 120	88 914
Dividends (Note 22)	0	0	0	-31 956	-31 956
Net profit of the financial year (Note 23)	0	0	0	16 405	16 405
31 December 2010	12 782	24 734	1 278	34 568	73 363

Information about share capital is disclosed in note 16.

Notes to the financial statements on pages 24 to 58 form an integral part of the financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

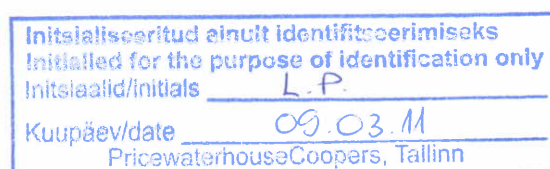
NOTE 1. GENERAL INFORMATION

AS Tallinna Vesi is the largest water utility in Estonia providing drinking water and wastewater disposal services to over 400 000 people in Tallinn and in several neighbouring municipalities of Tallinn. AS Tallinna Vesi has the exclusive right to provide water and sewerage services in Tallinn's main service area until the year 2020.

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

Contacts of AS Tallinna Vesi:

Commercial register number 10257326
VAT identification number EE100060979
Address Ädala 10, 10614 Tallinn
Telephone 62 62 200
Fax 62 62 300
E-mail tvesi@tvesi.ee



NOTE 2. ACCOUNTING POLICIES

The significant accounting policies applied when preparing the financial statements (hereinafter referred to as 'financial statements') of the Group have been set out below. The accounts have been prepared on the basis of the principle of sustainability and comparability; the nature of changes in methodology and their impact have been described in respective notes. In case the presentation of the entries of the accounts or the method of classification has been amended, then the comparable figures of the previous period have also been adjusted. Accounting policies have been applied consistently for all the periods presented in the accounts.

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

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

Operating segments are reported in a manner consistent with the internal reporting provided to the Management Board, being the chief operating decision-maker. The Management Board, who is responsible for allocating resources and assessing performance of the operating segments, reports to the Supervisory Board which has been identified as the steering committee that makes strategic decisions. The Management Board has determined that the activities of the Group form a single operating segment.

The Management Board of AS Tallinna Vesi authorised these consolidated financial statements for issue at 25 February 2011. Pursuant to the Commercial Code of the Republic of Estonia, the financial statements are subject to approval by the Supervisory Board of AS Tallinna Vesi and the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and approved by the Management Board, and request preparation of a new annual report.

The preparation of the accounts in compliance with IFRS requires the use of certain critical accounting estimates. Also the Management Board must make decisions in the process of implementing the accounting principles of the Group. The Group provides estimates and makes assumptions regarding the future. Accounting estimates do not often match with the subsequent actual events. Estimates and decisions are constantly reviewed and based on previous experiences and other factors, including expectations regarding future events that are considered justified while taking into consideration the known circumstances.

Adoption of New or Revised Standards and Interpretations

Certain new or revised standards and interpretations became effective for the Group from 1 January 2010

IFRIC 18, Transfers of Assets from Customers - The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers.

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The Group has changed its accounting policy for recognizing revenues and related property, plant and equipment, arising from connection fees received from the customers in relation to single connections and development area connections. In case an ongoing service is identified as part of the agreement, the revenue from the connection fees is recognized over the term of the agreement with the customer, or if the agreement does not specify a period, the revenue is recognized over a period of no longer than the useful life of the related asset used to provide the ongoing service. The respective revenue is presented within "other income/expenses", as "income from connection fees". The Group also recognizes the item of property, plant and equipment at its cost if the constructed item meets the definition of an asset.

The change in the accounting policy was applied to transfers of assets received on or after 1.1.2008, as the Group had information needed to apply the interpretation about past transfers until that date.

The change in the accounting policy did not have a material effect on the comprehensive income of 2009 and retained earnings as of 1.1.2009 and 31.12.2009. The comparative information was amended as follows:

	31.12.2009		
Consolidated statement of financial position	Balance in 2009 financial statements	Impact of change in accounting policy	Adjusted Balance
Property, plant and equipment	137 599	5 365	142 964
Deferred income from connection fees	0	5 365	5 365

	31.12.2008		1.01.2009
Consolidated statement of financial position	Balance in 2009 financial statements	Impact of change in accounting policy	Adjusted Balance
Property, plant and equipment	138 575	3 225	141 800
Deferred income from connection fees	0	3 225	3 225

Certain new or revised standards and interpretations became effective for the Group from 1 January 2010, but are not relevant to the Group:

IFRIC 12, Service Concession Arrangements as adopted by the EU is effective for annual periods beginning on or after 30 March 2009.

IFRIC 15, Agreements for the Construction of Real Estate effective for annual periods beginning on or after 1 January 2009; IFRIC 15 as adopted by the EU is effective for annual periods beginning after 31 December 2009.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009 effective for annual periods ending on or after 30 June 2009; amendments to IFRIC 9 and IAS 39 as adopted by the EU are effective for annual periods beginning after 31 December 2009.

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IFRIC 16, Hedges of a Net Investment in a Foreign Operation effective for annual periods beginning on or after 1 October 2008; IFRIC 16 as adopted by the EU is effective for annual periods beginning after 30 June 2009.

IFRIC 17, Distributions of Non-Cash Assets to Owners effective for annual periods beginning on or after 1 July 2009; IFRIC 17 as adopted by the EU is effective for annual periods beginning after 31 October 2009.

IAS 27, Consolidated and Separate Financial Statements, revised in January 2008 effective for annual periods beginning on or after 1 July 2009.

IFRS 3, Business Combinations, revised in January 2008 effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.

Amendment to IFRS 5, Non-current Assets Held for Sale and Discontinued Operations (and consequential amendments to IFRS 1) effective for annual periods beginning on or after 1 July 2009.

Eligible Hedged Items—Amendment to IAS 39 is effective with retrospective application for annual periods beginning on or after 1 July 2009.

IFRS 1, First-time Adoption of International Financial Reporting Standards, revised in December 2008 effective for the first IFRS financial statements for a period beginning on or after 1 July 2009; restructured IFRS 1 as adopted by the EU is effective for annual periods beginning after 31 December 2009, early adoption permitted.

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2 effective for annual periods beginning on or after 1 January 2010.

Additional Exemptions for First-time Adopters - Amendments to IFRS 1 is effective for annual periods beginning on or after 1 January 2010.

Improvements to International Financial Reporting Standards, issued in April 2009 amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010.

New or Revised Standards and Interpretations Not Yet Adopted by the Group

Certain new or revised standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2011 or later periods and which the Group has not early adopted

IFRS 9, Financial Instruments Part 1: Classification and Measurement, issued in November 2009 effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU. IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost.

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The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

New or revised standards and interpretations that are not yet effective and not early adopted by the Group, and not expected to have a significant effect on the Group's financial statements.

Amendment to IAS 24, Related Party Disclosures, issued in November 2009 effective for annual periods beginning on or after 1 January 2011.

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments effective for annual periods beginning on or after 1 July 2010.

Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14 effective for annual periods beginning on or after 1 January 2011.

Limited exemption from comparative IFRS 7 disclosures for first-time adopters - Amendment to IFRS 1 effective for annual periods beginning on or after 1 July 2010.

Improvements to International Financial Reporting Standards, issued in May 2010 effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011; the improvements have not yet been adopted by the EU.

Disclosures—Transfers of Financial Assets – Amendments to IFRS 7 effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU.

Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12 effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU.

Severe hyperinflation and removal of fixed dates for first-time adopters – Amendment to IFRS 1 effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU.

Classification of Rights Issues - Amendment to IAS 32, issued in October 2009 - effective for annual periods beginning on or after 1 February 2010.

Principles of consolidation, accounting for business combinations and subsidiaries

A subsidiary is an entity in which the Group, directly or indirectly, has interest of more than one half of the voting rights or otherwise has power to govern the operating and financial policies so as to obtain economic benefits. All subsidiaries have been consolidated in the Group's financial statements. An associate is an entity, in which the Group owns between 20% and 50% of shares with voting rights and over which the Group has significant influence. As at the balance sheet date, the Group had no associates.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognizes any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

In the consolidated financial statements, the financial statements of the subsidiaries under the control of the Parent company (except for the subsidiaries acquired for resale) are combined on a line-by-line basis. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Group and all of its subsidiaries use uniform accounting policies consistent with the Group's policies. Where necessary, the accounting policies of the subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Investments into subsidiaries are reported at cost (less any impairment losses) in the separate primary financial statements of the Parent company.

Functional currency

The functional currency of the Group is Estonian kroon. Estonian kroon is pegged to the Euro at the fixed exchange rate of 15.6466 kroons per 1 Euro.

Presentation currency

For the convenience of the users, these financial statements have been presented in euros, rounded to the nearest thousand, unless stated otherwise.

Foreign currency transactions

Foreign currency transactions are translated into Estonian kroons using the official exchange rates of the Bank of Estonia at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies have been converted into Estonian kroons based on foreign currency exchange rates valid at the balance sheet date. Gains and losses from exchange rate changes are aggregated and shown in the income statement as "other income (-expense)" on net basis.

Current and non-current distinction of assets and liabilities

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

Cash and cash equivalents

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

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

Financial assets

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

Financial assets are recorded in balance sheet at value date (i.e. are recognised when the Group becomes the owner of the financial assets and are derecognised when the Group has transferred substantially all risk and rewards incidental to ownership).

According to the purpose of acquisition and management intentions the financial assets are divided into the following groups:

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

As of 31 December 2010 and 2009 the Group did not have any investments held-to-maturity and financial assets available-for-sale.

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

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value at each balance sheet date.

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Derivatives comprise interest rate swaps used by the Group to manage the Group's interest rate profile. Derivatives are classified as a current asset or liability if expected to be settled within 12 months; otherwise, they are classified as non-current.

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

Receivables

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

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

Inventories

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

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

Non-current assets held for sale

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

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

Property, plant and equipment, and intangible assets

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

Intangible assets are recognised in the balance sheet only if the following conditions are met:

- the asset is controlled by the Group;

-
- it is probable that the future economic benefits that are attributable to the asset will flow to the Group;
 - the cost of the asset can be measured reliably.

Development costs

Development costs are costs that are incurred for at the application of research findings for developing, forming or testing new specific products, services, processes or systems. Development costs are capitalized in case there are technical and financial possibilities and positive intention for the implementation of the project, the Group is able to use or sell the assets and the amount of the development costs and the economic benefit emerging from intangible assets in the future can be measured reliably.

Software

Acquired computer software that is not an integral part of the related hardware is recognised as an intangible asset. Development costs of computer software are recognised as intangible assets if these are directly related to the development of such software objects that are identifiable, controllable by the Group and that are expected to generate economic benefits beyond one year. Capitalizable development costs of computer software include staff costs and other expenses directly related to the development. Costs related to the day-to-day maintenance of computer software are recognised as expenses in the income statement. Costs of computer software shall be depreciated over the estimated useful lifetime, the duration of which is up to 5 years.

Other intangible assets

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

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

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

In respect of borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2010, the Group capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

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

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

Applicable depreciation/amortization rates:

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

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

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

Impairment of assets

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

Assets are written down to their recoverable amount in case the latter is lower than the carrying amount. The recoverable amount of the assets is the higher of the:

- fair value less costs to sell and
- value in use.

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

The impairment of assets may be assessed either for an individual asset or a group of assets (cash-generating unit). For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment loss is immediately recognised in the income statement. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

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

Financial liabilities

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

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

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

Corporate income tax

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

Income tax on dividends in Estonia

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to tax, as tax is charged only on dividend distributions. Pursuant to the Income Tax Act, resident legal entities are liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The rate is 21/79 on the amount of the dividends payable (2009: 21/79).

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

Employee benefits**Employee short-term benefits**

Employee short-term benefits include wages and salaries as well as social security taxes, benefits related to the temporary halting of the employment contract (holiday pay or other similar pay) when it is assumed that the temporary halting of the employment contract will occur during 12 months after the end of the period in which the employee worked, and other benefits payable within 12 months after the end of the period during which the employee worked.

Termination benefits

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

Provisions and contingent liabilities

Provisions for environmental restoration, restructuring costs and legal claims are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognized for future operating losses.

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

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

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

Share capital

Shares are recorded within the equity capital. Pursuant to the Group's Articles of Association, the Group has two classes of shares: the A-Shares, with a nominal value of 10 kroons each and a single preference share B-Share, with a nominal value of 1 000 kroons.

Statutory reserve capital

Pursuant to the requirements of the Commercial Code the statutory reserve capital is set up comprising of the allocations from net profits. The annual allocation must be at least 5% of the net profit of the accounting year until the reserve capital is equal to 10% of paid-up share capital. As the Group's reserve capital has reached the required level, the reserve capital is no longer increased from net profit. At the decision of the General Meeting of the Shareholders the reserve capital can be used for the covering of loss in case it is not possible to cover it from the Group's available shareholders' equity, also for increasing the Group's share capital. The reserve capital cannot be distributed to the shareholders.

Leases

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

The Group as the lessee

Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of minimum lease payments. Each lease payment is apportioned between the finance charge and the reduction of the outstanding liability. Finance charges are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining

balance of the liability. The finance lease liability is reduced by principal payments. The finance charge is recognised as an interest expense in the income statement. The finance lease liability is recognised either within short or long-term borrowing in the balance sheet.

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

Government grants

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

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

Revenue

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

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

Revenues received from the sale of assets shall be recognised when all the significant risks and rewards related to the ownership of assets have been transferred to the purchaser, it is probable that economic benefits associated with the transaction will flow to the entity and the cost related to the transaction can be reliably determined.

Connection fees received from customers are recognized as income during the period of the duration of useful life of related assets. Such income is recorded as "other income/expenses".

Interest income is recognised in case the receipt of income is likely and the amount of income can be determined reliably. Interest income is recognised using the effective interest rate, except when the receipt of interests is uncertain. In this case interest income is recognised on cash basis.

Earnings per share

Earnings per share are calculated by dividing the net profit of the accounting year with the weighted average number of issued shares of the period. When calculating diluted earnings per share, the earnings and the average number of shares are adjusted with potential shares that have a diluting effect on the earnings per share.

NOTE 3. FINANCIAL RISK MANAGEMENT

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

Financial assets	as of 31 December	
	2010	2009
Loans and receivables (incl cash and cash equivalents)	33 173	30 737
Total	33 173	30 737

Financial liabilities	as of 31 December	
	2010	2009
Financial liabilities at amortised cost	101 536	80 498
Financial liabilities at fair value through profit and loss	2 267	1 030
Total	103 803	81 528

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

Market risk*Currency risk*

Currency risk is the potential loss due to unfavourable movements in currency exchange rates against Estonian kroon. Amounts that have been received, paid or denominated in euros are considered currency risk free because euro's exchange rate to Estonian kroon is fixed.

The Group's currency risk is mainly related to international purchases and amounts owed in foreign currencies (excluding euro). Most of the Group's purchases are made in kroons and euros. The proportion of purchases in other currencies in 2010 was less than 0.5% (2009: less than 0.1%). Because of the small proportion of transactions in other currencies the Group has not taken any special activities to reduce this risk.

On 31 December 2010 the Group's bank accounts balances (including deposits) totalled 13 235 thousand euros (2009: 18 692 thousand euros) from which less than 0.06 thousand euros (2009: 0.06 thousand euros) were in other currencies than Estonian kroons or euros. There were no other significant exposures to foreign currencies arising from other financial assets or financial liabilities.

Due to the above the Group considers its currency risk level to be low and conversion from Estonian kroon to euro will impact it only positively.

Price risk

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

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Price risk related to the tariffs of the main services of AS Tallinna Vesi is covered in greater detail in Note 5.

Cash flow and fair value interest rate risk

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

In essence the Group's operating incomes and expenses are independent from interest rate changes on the market. Interest risk related to financial income arises only from depositing finances to overnight or fixed term deposits and is considered, due to requirements to counterparties, to be low.

The Group's interest rate risk related to financial expenses is related to long term borrowings of which all as of 31 December 2010 had floating interest rates (2009: also all).

To mitigate the interest risk of cash flows and to fix its interest payments future cash flows the Group has concluded five interest rate SWAP contracts. The interest rate SWAP contracts expose the Group to fair value interest rate risk and are accounted at fair value.

	as of 31 December	
SWAP contracts	2010	2009
Contracts start date	2009.11 - 2011.05	2009.11 - 2010.05
Contracts maturity date	2013.11 - 2015.11	2015.05
Contracts notional amount	75 000	45 000
Contracts fair value	-2 267	-1 030

Group's average interest rate for loans in 2010 was 1.58% (2009: 3.01%). More detailed information about the Group's loans can be seen in Note 10.

If the interest rates of the Group's loans with floating interest rates had been 50 basis points higher or smaller and all other variables were held constant, then the Group's profit before tax for the year ended 31 December 2010 would have decreased or increased by 447 thousand euros (2009: 306 thousand euros).

Credit risk

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

According to the Group's risk management policies the Group's short term available resources can be deposited only in accounts and fixed term deposits opened in credit institutions. For depositing counterparties with at least an A rating are used. As of 31.12.2010 100% of Group's cash and deposits were deposited with counterparty with higher rating than A3 by Moody's (2009: 100% higher than A3).

The Group has procedures for co-operation with customers, to ensure that selling of products and services is always in compliance with the Group's internal principles. To reduce the credit risk related to accounts receivable the customer's payment discipline is consistently observed. In case of overdue debts the Group's Credit group sends invoice remainders, makes contact by phone or uses a variety of other measures to collect the overdue debt. Depending on the negotiations with the customer it is

possible to agree exceptional payment terms and plans to help customers pay their invoices. The policies regarding the commencement of court proceedings to recover overdue debt have also been defined.

At the end of December 2010 only receivables from Tallinna Kommunaalamet exceeded 5% of total receivables constituting 57.1% of the total receivables (2009: 2.3%).

Trade receivables

as of 31 December 2010	Balance	Not due	Overdue		
			up to 60 days	61 to 180 days	181 to 360 days
Commercial entities, incl	9 453	4 049	3 376	679	1 349
<i>partially impaired</i>	19	0	1	3	15
Private persons, incl	3 219	3 130	73	11	5
<i>partially impaired</i>	257	0	89	100	68
Total	12 672	7 179	3 449	690	1 354
<i>Proportion</i>	<i>100%</i>	<i>56,7%</i>	<i>27,2%</i>	<i>5,4%</i>	<i>10,7%</i>

Trade receivables

as of 31 December 2009	Balance	Not due	Overdue		
			up to 60 days	61 to 180 days	181 to 360 days
Commercial entities, incl	2 697	2 258	260	103	76
<i>partially impaired</i>	475	123	173	103	76
Private persons, incl	3 332	3 216	80	4	32
<i>partially impaired</i>	81	24	21	4	32
Total	6 029	5 474	340	107	108
<i>Proportion</i>	<i>100%</i>	<i>90,8%</i>	<i>5,6%</i>	<i>1,8%</i>	<i>1,8%</i>

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

Liquidity risk

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

Financial liabilities in terms of payment (undiscounted amounts):

as of 31 December 2010	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Non-interest bearing	7 233	30	192	1 410	9	8 874
Floating interest rate instruments	29	67	8 966	77 516	14 529	101 107
Total	7 262	97	9 158	78 926	14 538	109 981
<i>Proportion</i>	<i>6,6%</i>	<i>0,1%</i>	<i>8,3%</i>	<i>71,8%</i>	<i>13,2%</i>	<i>100,0%</i>

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as of 31 December 2009	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total
Non-interest bearing	6 061	69	249	230	9	6 617
Floating interest rate instruments	0	0	1 064	53 155	26 302	80 522
Total	6 061	69	1 313	53 385	26 311	87 139
<i>Proportion</i>	<i>7,0%</i>	<i>0,1%</i>	<i>1,5%</i>	<i>61,3%</i>	<i>30,2%</i>	<i>100,0%</i>

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

Equity risk management

The Group ensures the management of the Group's capital structure in accordance with the Business Plan approved by the Supervisory Council. The long-term borrowing contracts limit the Parent Group's equity ratio to a minimum of 35% of the total assets.

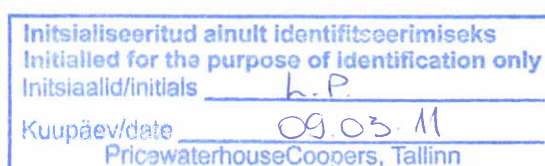
	as of 31 December	
	2010	2009
Equity	73 363	88 914
Total assets	183 856	171 417
Equity ratio	39,9%	51,9%

Fair value

Fair values of cash and cash equivalents, accounts receivable, short-term borrowings and accounts payable do not vary significantly from their carrying amount because their realization will take place within 12 months from the date the balance sheet was composed.

At the end of 2010 all Group's long-term borrowings had floating interest rates and because Group's long-term borrowings risk margins were smaller than risk margin currently applicable to Group the fair value of its long-term borrowings on 31.12.2010 was 2 856 thousand euros smaller than their carrying amount (2009: 7 740 thousand euros smaller).

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



NOTE 4. CRITICAL ACCOUNTING ESTIMATES

Management has made an assessment the key assumptions concerning the future and other key sources of uncertainty at the balance sheet date that may have risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year. The most important areas of estimates contained in the financial statements are the following:

- Management has estimated the useful lifetime of property, plant and equipment and intangible assets. The results of the estimates are disclosed in the note 2 in section 'Property, plant and equipment, and intangible assets' and the information about the carrying amounts is disclosed in note 9.

As of 31 December 2010 Group owns property, plant and equipment, and intangible assets with a book value of 146 997 mln euros (31.12.2009: 140 606 mln euros) and annual depreciation was 5,7 mln euros in 2010 (2009: 5,7 mln euros). If the depreciation/amortization rates decreased / increased by 5 %, the depreciation/amortization expense would increase / decrease respectively by 288 thousand euros (2009: 288 thousand euros).

- The Group has assumed an obligation to construct water and wastewater and storm water pipelines with an estimated construction cost of up to 41 mln euros (2009: 43 mln euros) in 2008-2012. The construction of pipelines is compensated by local governments with the grants receivable in 2008-2014. Compensations received from local governments are recognised as government grants - compensations received or receivable are deducted from the book value of the constructed pipeline. Any amount exceeding the construction cost of the pipeline is recognized as income upon the completion of construction works. The part of the compensation that is received after the completion of the construction works is recognized in the balance sheet as a receivable from local government at its present value. Recognition of the above compensations is dependent on several uncertain circumstances and the estimates of the Management Board, in particular those regarding the total cost of the project and the fair value of the compensations receivable. As construction works continue until 2012 and the exact extent thereof can change, there is no certainty regarding the total cost of the construction of the pipelines and the profitability of the project. In recording income from government grants (Note 20) in these financial statements the best knowledge and estimates of the Management Board of the profit rates of the project have served as the basis for calculation. If the actual construction costs increased compared to these estimates by 5%, the profit of 2010 would decreased by 297 thousand euros (2009: 476 thousand euros).

As compensation for pipelines will be received until June of 2014 and the exact extent of compensation depends on water consumption, the fair value of compensation receivable is also based on estimates. In the estimates compensation is receivable for 2008-2014 and has been discounted using a rate of 9.4% (2009: 9.4%). If the discount rate would be decreased/increased by 0.5%, the profit of the accounting period would increase/decrease up to 64 thousand euros (2009: up to 32 thousand euros).

- Accounts receivable - for the evaluation of doubtful debts the individual debts are grouped by age and, based on past experience, the following percentages are applied in the doubtful debt calculation:

61 to 90 days over due date	10%;
91 to 180 days over due date	30%;

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181 to 360 days over due date 70%;
 over 360 days over due date 100%.

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

NOTE 5. CHANGE IN REGULATION

In the 3rd quarter of 2010, the Law of Establishing Price Limits for Monopolies was passed by the Parliament and approved by the President. The key impact for the Company will be related to the fact that from 1 November onwards the tariff approval process of AS Tallinna Vesi was transferred from the City of Tallinn to the Competition Authority (CA). The main aim of the Law of Establishing Price Limits for Monopolies is to control the profits of the water companies. The CA has issued their recommendations for calculating the allowed return and revenues for the water companies. The Company finds it regrettable that the regulator-to-be has yet only considered the price sensitivity of the customers and ignored fully their expectations regarding the product and service quality.

Another major issue arising from the proposed draft methodology for calculating water and wastewater tariffs concerns one of the primary objectives of any regulator - to guarantee an acceptable return on invested capital for investors. Within the current methodology it appears that the Competition Authority is failing to take into account any aspects of any of the contracts signed between the Company, UUTBV and the City of Tallinn on privatisation. One of these contracts, the Services Agreement contains the tariff mechanism which has been used to regulate tariffs and profitability since 2001. The values within the tariff mechanism were bid and won under a market led procurement process designed to deliver the lowest possible tariffs needed to meet the much higher quality standards and deliver an acceptable rate of return on the capital invested by the winning bidder

On 9 November, AS Tallinna Vesi submitted its tariff application in accordance with the terms and conditions of the Services Agreement. Furthermore, in order to give greater confidence in the tariff application the Company had its application independently verified based upon a best practice regulatory methodology for privatized utilities, such as that favoured by Ofwat in the UK. In its tariff application the company has requested that the Competition Authority should ensure it applies internationally acceptable principles of economic regulation and takes into account all aspects of the privatisation agreement when assessing the application. This would ensure that the privatisation contract was not unilaterally broken and would respect the investments made in good faith into Estonia by our investors on the basis of the privatisation contracts.

AS Tallinna Vesi has published its tariff application on its website and on the Tallinn Stock Exchange and will keep its investors informed of all future developments regarding the further key developments regarding the processing of the tariff application. However, at this point in time the company is unable to say what next year's tariffs will be as it is unclear at the moment how the CA intends to analyze and proceed with the tariff application.

NOTE 6. CASH AND CASH EQUIVALENTS

	as of 31 December	
	2010	2009
Cash in hand and in bank	651	24
Short-term deposits	12 584	18 668
Total cash and cash equivalents	13 235	18 692

NOTE 7. TRADE RECEIVABLES

	as of 31 December	
	2010	2009
Accounts receivable	13 825	6 891
Allowance for doubtful receivables	-1 152	-862
Total trade receivables	12 673	6 029

Impairment loss of receivables:**for the year ended 31 December**

	2010	2009
Write off of uncollectible receivables	-12	-3
Receipt of receivables previously written off as uncollectible	0	12
Change in allowance for doubtful receivables	-290	-640

NOTE 8. ACCRUED INCOME AND PREPAID EXPENSES

	as of 31 December	
	2010	2009
Accrued interest	9	58
Other accrued income (Note 26)	7 256	5 957
Prepaid expenses	151	183
Total accrued income and prepaid expenses	7 416	6 198

The Group's current assets (Notes 7, 8) in the amount of 20 470 thousand euros (2009: 12 549 thousand euros) have been pledged as a security to the bank loans (Note 10).

NOTE 9. PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

	Property, plant and equipment				Assets in progress				Intangible assets		Total
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Construction in progress	Construction in progress - unfinished pipelines	Prepayment for fixed assets	Unfinished intangible assets	Development costs	Acquired licenses and other intangible assets	Property, plant and equipment and intangible assets
As of 31 December 2008 adjusted											
Acquisition cost	23 522	146 038	37 431	1 174	1 411	5 878	118	174	1 134	3 986	220 868
Accumulated depreciation	-4 299	-45 414	-23 279	-783	0	0	0	0	-944	-1 575	-76 293
Book value	19 223	100 625	14 152	392	1 411	5 878	118	174	190	2 412	144 575
Transactions in the period 01.01.2009 - 31.12.2009											
Acquisition in book value (Note 24C)	0	0	0	0	6 346	9 212	0	492	0	0	16 050
Write off and sale of property, plant and equipment, and intangible assets in book value	0	0	-3	-3	0	0	0	0	0	0	-6
Compensated by government grants (Note 13)	0	0	0	0	0	-9 277	0	0	0	0	-9 277
Reclassification	391	4 935	1 681	132	-5 006	-2 211	-26	-571	303	268	-103
Depreciation (Note 19)	-268	-2 475	-2 185	-79	0	0	0	0	-141	-550	-5 698
Total transactions in the period 01.01.2009- 31.12.2009	123	2 459	-507	50	1 340	-2 276	-26	-79	162	-282	965
As of 31 December 2009 adjusted											
Acquisition cost	23 913	150 807	38 587	1 179	2 752	3 602	92	95	889	4 752	226 667
Accumulated depreciation	-4 566	-47 723	-24 942	-737	0	0	0	0	-612	-2 547	-81 127
Book value	19 347	103 084	13 646	441	2 752	3 602	92	95	277	2 205	145 541
Transactions in the period 01.01.2010 - 31.12.2010											
Acquisition in book value (Note 24C)	0	0	0	0	9 967	7 505	0	62	0	0	17 534
Write off and sale of property, plant and equipment, and intangible assets in book value	0	0	-4	-9	0	0	0	0	0	0	-13
Compensated by government grants (Note 13)	0	0	0	0	0	-7 080	0	0	0	0	-7 080
Reclassification	155	4 928	1 890	54	-7 058	-77	-25	-37	4	32	-135
Depreciation (Note 19)	-272	-2 593	-2 081	-84	0	0	0	0	-180	-486	-5 694
Total transactions in the period 01.01.2010 - 31.12.2010	-117	2 336	-196	-39	2 908	347	-25	25	-175	-454	4 610

	Property, plant and equipment				Assets in progress			Intangible assets		Total	
	Land and buildings	Facilities	Machinery and equipment	Other equipment	Const- ruction in progress	Const- ruction in progress - unfinished pipelines	Prepayme nt for fixed assets	Unfinished intangible assets	Develop- ment costs	Acquired licenses and other intangible assets	property, plant and equipment and intangible assets
As of 31 December 2010											
Acquisition cost	24 067	155 727	39 738	1 157	5 660	3 950	68	119	714	4 518	235 718
Accumulated depreciation	-4 838	-50 307	-26 288	-755	0	0	0	0	-612	-2 767	-85 567
Book value	19 229	105 420	13 450	402	5 660	3 950	68	119	102	1 751	150 151

Property, plant and equipment and intangible assets are written off if the condition of the asset do not enable further usage for production purposes.

As of 31 December 2010 and 2009 the net balance sheet value of finance leases related assets was respectively 257 thousand euros and 332 thousand euros.

The Group's non-current assets in the amount of 35 246 thousand euros (2009: 29 370 thousand euros) have been pledged as a security (Note 10).

A mortgage in the amount of 33 221 thousand euros (2009: 34 814 thousand euros) serves as a security to the bank loans for the Group's non-current assets (land and buildings)(Note 10).

NOTE 10. BORROWINGS

	as of 31 December	
	2010	2009
Current borrowings		
Current portion of long-term bank loans	7 482	0
Current portion of long-term finance lease liabilities	124	124
Total current borrowings	7 606	124
Non-current borrowings		
Long-term bank loans	87 446	74 911
Long-term finance lease liabilities	0	124
Total non-current borrowings	87 446	75 034

Bank loans at 31 December 2010

Currency EUR (euro)	Balance	Effective interest rate
Borrowings at floating interest rate	94 928	1,03% - 2,20%

Bank loans at 31 December 2009

Currency EUR (euro)	Balance	Effective interest rate
Borrowings at floating interest rate	74 911	2,01% - 2,71%

Collateral of loans and pledged assets

		Collateral at book value as of 31 December	
Type of collateral	Specification and location of collateral	2010	2009
Commercial pledge	Movables of the Group (Notes 7, 8, 9)	55 717	41 918
Mortgage	Real estates located at Paljassaare põik 14 and Järvevana tee 3, Tallinn, Estonia (Note 9)	33 221	34 814

NOTE 11. TRADE AND OTHER PAYABLES

Liabilities as of 31 December 2010	Balance amount	Short-term portion	Long-term portion	Maturity date
Trade payables - operating expenditures	1 120	1 120	0	
Trade payables - capital expenditures	2 276	2 276	0	
Payables to related parties (Note 26)	200	200	0	
Payables to employees*	773	667	106	02.2012
Interest payable	157	157	0	
Derivatives	2 267	963	1 304	11.2013-11-2015
Other accrued expenses	163	163	0	
Long-term guarantee deposit**	9	0	9	04.2012
Taxes payable (Note 12)	1 785	1 785	0	
Total trade and other payables	8 750	7 331	1 419	

Liabilities as of 31 December 2009	Balance amount	Short-term portion	Long-term portion	Maturity date
Trade payables - operating expenditures	1 062	1 062	0	
Trade payables - capital expenditures	1 837	1 837	0	
Payables to related parties (Note 26)	245	245	0	
Payables to employees*	730	624	106	02.2012
Interest payable	170	170	0	
Derivatives	1 030	1 030	0	
Other accrued expenses	89	89	0	
Long-term guarantee deposit**	9	0	9	04.2102
Taxes payable (Note 12)	1 198	1 198	0	
Total trade and other payables	6 370	6 255	115	

* Long-term payable includes the performance related pay that will realise in 2012 in case of the successful delivery of the project.

** Long-term deposit is presented at cost.

NOTE 12. TAXES PAYABLE

	as of 31 December		
	2010	2009	Tax rates
Income tax	125	132	21% (2009: 21%)
VAT	408	352	20 % (01.01.2009 - 30.06.2009 18 %, since 01.07.2009 20%)
Tax on special use of water	208	193	0,0281 – 0,0675 €/m ³ (2009: 0,023 - 0,061 €/m ³)
Pollution taxes	748	204	414 – 13 759 €/t (2009: 376 – 11 964 €/t)
Social security tax	230	268	33%
Other	66	50	0,3 -21%
Total (Note 11)	1 785	1 198	

NOTE 13. GOVERNMENT GRANTS

Government grants for assets

Government grants receivable as compensations for constructing pipelines taken into use in the financial year amounted to 10 390 thousand euros (2009: 11 922 thousand euros) (Note 24A). Property, plant and equipment have been reduced by the amount receivable as government grants of 7 080 thousand euros (2009: 9 277 thousand euros). See also note 9 and 20.

NOTE 14. CONTINGENT LIABILITIES

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

The Group's distributable retained earnings as at 31 December 2010 amounted to 34 568 thousand euros (2009: 50 120 thousand euros). Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 9 189 thousand euros (2009: 13 323 thousand euros).

NOTE 15. PREPAYMENTS AND DEFERRED INCOME

	as of 31 December	
	2010	2009
Prepayments for water and sewerage services	52	62
Prepayments for pipelines (Note 24A and 24B)	757	685
Total prepayments	810	747
Deferred income from connection fees	5 765	5 365

NOTE 16. SHARE CAPITAL

At 31 December 2009 and 2008 the nominal value of the share capital was 200 001 000 (two hundred million one thousand) kroons (12 782 394 euros), composed of 20 000 000 shares with nominal value of 10 kroons (0.6 euros) per share (A-share) and one preferred share with a nominal value of 1 000 kroons (63.9 euros) (B-share).

One B-share has been issued giving the right of veto to the shareholder when voting on the following issues: change in the Articles of Association, increase and decrease of share capital, issuance of replacement bonds, termination of the Group's activities, merging, sharing and rearrangements, acquisition of own shares and, on demand of the management or supervisory board, deciding other issues related to the activities of the Group 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 (639 euros).

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

Restrictions on the transfer of shares are disclosed in chapter 'Description of capital stock and corporate governance' of the IPO offering circular of AS Tallinna Vesi shares. The circular is available on the website (www.tallinnavesi.ee).

As of 31 December 2010 and 2009 United Utilities (Tallinn) B.V. owned 7 060 870 (35.3%) A-shares, the City of Tallinn owned 6 939 130 (34.7%) A-shares and one B-share, with 6 000 000 shares

in free float. Other direct shareholders owned less than 5% of the shares as of 31 December 2010.

As of 31 December 2009 Credit Suisse Securities (Europe) Ltd Prime Brokerage A/C customers 1 134 948 (5.67%) and HSBC Bank PLC RE Parvus European Absolute Opportunities Master Fond customers owned 869 568 (4.35%) shares. Other direct shareholders owned less than 5% of the shares as of 31 December 2009.

As of 31 December 2010 and 2009 from Supervisory and Management Board members only Siiri Lahe owned 700 shares.

Dividends declared and paid are disclosed in note 22.

Contingent income tax on the dividend payments from retained earnings is described in note 14.

NOTE 17. REVENUE

	for the year ended 31 December	
Revenues from main operating activities	2010	2009
Total water supply and waste water disposal service, incl:	45 167	45 212
<u>Private clients, incl:</u>	<u>23 797</u>	<u>24 243</u>
Water supply service	13 232	13 510
Waste water disposal service	10 565	10 734
<u>Corporate clients, incl:</u>	<u>17 108</u>	<u>17 469</u>
Water supply service	9 441	9 720
Waste water disposal service	7 667	7 749
<u>Outside service area clients, incl:</u>	<u>3 415</u>	<u>2 557</u>
Water supply service	840	501
Waste water disposal service	2 575	2056
<u>Over pollution fee</u>	<u>848</u>	<u>942</u>
Storm water treatment and disposal service	3 286	3 001
Fire hydrants service	193	197
Other works and services	1 034	959
Total revenue	49 680	49 368

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

NOTE 18. STAFF COSTS

	for the year ended 31 December	
	2010	2009
Salaries and wages	-4 340	-4 563
Social security and unemployment insurance taxation	-1 445	-1 520
Staff costs total (Note 19)	-5785	-6 083
Number of employees at the end of reporting period	319	336

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

	for the year ended 31 December	
	2010	2009
Cost of goods sold		
Tax on special use of water	-847	-734
Chemicals	-1 433	-1 283
Electricity	-2 704	-2 136
Pollution tax	-2 290	-1 081
Staff costs (Note 18)	-4 030	-4 491
Development	-8	-2
Depreciation and amortization (Note 9)	-5 092	-5 177
Transport	-1 209	-1 114
Other costs of goods sold	-3 070	-2 136
Total cost of goods sold	-20 684	-18 155
Marketing expenses		
Staff costs (Note 18)	-320	-289
Depreciation and amortization (Note 9)	-334	-333
Other marketing expenses	-133	-95
Total cost of marketing expenses	-787	-717
General administration expenses		
Staff costs (Note 18)	-1 435	-1 303
Depreciation and amortization (Note 9)	-194	-188
Other general administration expenses	-2 022	-1 928
Total cost of general administration expenses	-3 651	-3 419

NOTE 20. OTHER INCOME / EXPENSES

	for the year ended 31 December	
	2010	2009
Profit from government grant (Note 13, 24A)	3 310	2 644
Other income / expenses (-)	-404	-199
Total other income / expenses	2 906	2 446

NOTE 21. FINANCE INCOME AND EXPENSES

	for the year ended 31 December	
	2010	2009
Interest income	1 059	1 615
Interest expense, incl swap interests	-2 373	-2 327
Change in swap fair value	-1 237	-1 030
Other financial expenses	-14	-2 147
Total finance income / expenses	-2 565	-3 890

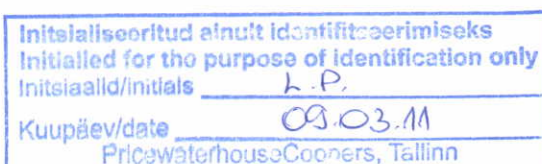
NOTE 22. DIVIDENDS

	for the year ended 31 December	
	2010	2009
Dividends declared during the period	31 956	14 700
Dividends paid during the period	31 956	14 700
Income tax on dividends paid	-8 495	-3 908
Income tax accounted for	-8 495	-3 908
The income tax rates were 21/79 in 2010 and 2009.		
<i>Paid-up dividends per share:</i>		
Dividends per A-share (in kroons)	1,60	0,73
Dividends per B-share (in kroons)	639	639

NOTE 23. EARNINGS PER SHARE

	for the year ended 31 December	
	2010	2009
Net profit for the period ended 31.12 less B-share preference rights (in kroons)	16 404	21 725
Weighted average number of ordinary shares for the purposes of basic earnings per share (in pieces)	20 000 000	20 000 000
Earnings per A share (in kroons)	0,82	1,09
Earnings per B share (in kroons)	639	639

Diluted earnings per share for the periods ended 31 December 2010 and 2009 do not vary significantly from the earnings per share figures stated above.



NOTE 24. NOTES TO THE CASH FLOW STATEMENT

for the year ended 31 December

NOTE 24A. COMPENSATIONS RECEIVED FOR
CONSTRUCTION OF PIPELINES

	2010	2009
Income		
Connection fees and government grants received for pipelines taken into use (Note 13 and 20)	10 468	14 454
Change in prepayments for pipelines (Note 15 and 24B)	73	-512
Change in accounts receivable from pipelines (Note 24B)	-3 102	1 328
Change in accrued income for government grants	-1 299	-5 314
Proceeds from connection fees	6 139	9 956
Acquisition cost of pipelines taken into use (Note 9 and 20)	-7 155	-11 418

The connection fees from and the acquisition costs of pipelines taken into use are eliminated from "Cash flows of operating activities" as these are recorded within "Cash flows from investing activities". In 2010 the net amount eliminated was -3 312 thousand euros (2009: -3 037 thousand euros) (Note 20).

NOTE 24B. CHANGE IN CURRENT ASSETS AND
LIABILITIES

In addition to the changes in the balance sheet, current assets and liabilities have been adjusted as follows:

Current assets	2010	2009
Change in balance sheet	-2 464	-9 038
<u>Adjustments:</u>		
Change in cash and cash equivalents	-5 458	4 002
Movements between non-current and current assets	-5 325	103
Change in accrued interests	-50	9
Change in accounts receivable from pipelines (Note 24A)	3 102	-1 328
Change in accrued income for government grants	1 299	5 314
Total change in current assets	-8 895	-938
Current liabilities		
Change in balance sheet	8 528	-4 943
<u>Adjustments:</u>		
Change in non-current borrowings	-248	5 285
Change in trade payables – capital expenditures (Note 24C)	-479	-462
Swap reclassification	-1 304	0
Prepayment of single and developing areas	-129	0
Change in prepayments for the sale of property, plant and equipment, and deposits	3	2
Change in prepayments for pipelines (Note 15 and 24A)	-73	512
Total change in current liabilities	6 297	394

ANNUAL REPORT**FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2010****(thousand EUR)****NOTE 24C. ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT, AND INTANGIBLE ASSETS****for the year ended 31 December**

	2010	2009
Acquisition of property, plant and equipment, and intangible assets (Note 9)	-17 534	-16 050
<i>Adjustments:</i>		
Change in trade payables – capital expenditures (Note 24B)	479	462
Total acquisition of property, plant and equipment and intangible assets	-17 055	-15 588

NOTE 25. OPERATING LEASE**Leased assets****for the year ended 31 December**

	2010	2009
Total operating lease expenses for computers and vehicles	393	495

Following period operating lease payments from the non-cancellable contracts are as follows:**as of 31 December**

Less than 1 year	236	320
1-5 years	261	296
Total minimum lease payments	497	617

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

NOTE 26. RELATED PARTIES

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

Shareholders having the significant influence**as of 31 December**

Balances recorded in working capital on the statement of financial position of the Group	2010	2009
Accounts receivable	7 194	138
Accrued income (Note 8)	7 256	5 957
Trade and other payables (Note 11)	200	245

ANNUAL REPORT**FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2010****(thousand EUR)**

	for the year ended 31 December	
	2010	2009
Transactions with the related parties		
Sales services	3 440	3 179
Compensation receivable from the local governments for constructing new pipelines (Note 13)	10 390	11 922
Purchase of administrative and consulting services	1 032	1 237
Financial income	732	642
Management Board fees excluding social tax	199	163
Supervisory Board fees excluding social tax	38	38

The fees disclosed above are contractual payments made by the Group to the Management Board and Supervisory Board members. In addition to this some Board Members have also received direct compensations from the companies belonging to the group of United Utilities (Tallinn) B.V. as overseas secondees.

Market prices were checked and used in the transactions with related parties.

The information about AS Tallinna Vesi shares belonging to the related parties is disclosed in note 16. Paid-up dividends are described in note 22.

NOTE 27. SUBSIDIARIES AND BUSINESS COMBINATIONS

Subsidiary	Location	Activity	Holding (%) at 31.12.2010	Holding (%) at 31.12.2009
		Provision of non-core services related to water business		
Watercom OÜ	Tallinn, Estonia		100	0

AS Tallinna Vesi registered its subsidiary Watercom OÜ on 25.05.2010.

NOTE 28. EVENTS AFTER THE BALANCE SHEET DATE

On the 1st January 2011 Estonia joined the Eurozone and Estonian kroon (EEK) was replaced by euro (EUR). As a result of that, since that day the Group converted its accounting into euros and the financial statements of 2011 and further years will be compiled in euros.

Comparative data will be converted by an official exchange rate for transition of 15.6466 EEK/EUR.

NOTE 29. SUPPLEMENTARY DISCLOSURES ON THE PARENT COMPANY OF THE GROUP

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company the same accounting policies have been used as in preparing the consolidated

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(thousand EUR)

financial statements. The accounting policy for reporting subsidiaries has been amended in the separate primary financial statements disclosed as supplementary information in the Annual Report in conjunction with IAS 27, Consolidated and Separate Financial Statements.

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

The separate reports on the parent company

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

STATEMENT OF FINANCIAL POSITION

	as of 31 December		as of 1 January
ASSETS	2010	2009	2009
CURRENT ASSETS		adjusted	adjusted
Cash and cash equivalents	13 093	18 692	14 691
Trade receivables, accrued income and prepaid expenses	20 029	12 227	7 199
Receivables from subsidiary	18	0	0
Inventories	305	244	240
Non-current assets held for sale	76	77	73
TOTAL CURRENT ASSETS	33 522	31 241	22 203
NON-CURRENT ASSETS			
Long-term loan receivable from subsidiary	524	0	0
Investment in subsidiary	3	0	0
Property, plant and equipment	147 892	142 964	141 800
Intangible assets	1 972	2 577	2 776
TOTAL NON-CURRENT ASSETS	150 391	145 541	144 575
TOTAL ASSETS	183 913	176 782	166 778
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Current portion of long-term borrowings	7 624	124	5 295
Trade and other payables	6 309	5 225	5 578
Derivatives	963	1 030	0
Payables to subsidiary	8	0	0
Short-term provisions	117	228	159
Prepayments and deferred income	810	747	1 265
TOTAL CURRENT LIABILITIES	15 831	7 354	12 296
NON-CURRENT LIABILITIES			
Deferred income from connection fees	5 765	5 365	3 225

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Borrowings	87 428	75 034	69 321
Derivatives	1 304	0	0
Other payables	115	115	47
TOTAL NON-CURRENT LIABILITIES	94 612	80 514	72 593
TOTAL LIABILITIES	110 443	87 868	84 890
EQUITY			
Share capital	12 782	12 782	12 782
Share premium	24 734	24 734	24 734
Statutory legal reserve	1 278	1 278	1 278
Retained earnings	34 675	50 120	43 094
TOTAL EQUITY	73 470	88 914	81 889
TOTAL LIABILITIES AND EQUITY	183 913	176 782	166 778

STATEMENT OF COMPREHENSIVE INCOME

	for the year ended 31 December	
	2010	2009
Revenue	49 434	49 368
Costs of goods sold	-20 404	-18 155
GROSS PROFIT	29 031	31 213
Marketing expenses	-729	-717
General administration expenses	-3 646	-3 419
Other income/ expenses (-)	2 916	2 446
OPERATING PROFIT	27 571	29 523
Financial income	1 059	1 615
Financial expenses	-3 624	-5 505
PROFIT BEFORE TAXES	25 007	25 633
Income tax on dividends	-8 495	-3 908
NET PROFIT	16 512	21 726
TOTAL COMPREHENSIVE INCOME	16 512	21 726

CASH FLOW STATEMENT

	for the year ended 31 December	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating profit	27 571	29 523
Adjustment for depreciation/amortisation	5 599	5 698
Adjustment for profit from government grants and connection fees	-3 312	-3 037
Other finance expenses	-14	-1 866
Profit (-)/loss(+) from sale of property, plant and equipment, and intangible assets	-3	-10
Write down of property, plant and equipment	86	0
Change in current assets involved in operating activities	-8 809	-938
Change in liabilities involved in operating activities	6 201	394
Interest paid	-2 443	-2 479
Total cash flow from operating activities	24 876	27 285
CASH FLOWS FROM INVESTING ACTIVITIES		
Granted loans	-524	0
Acquisition of property, plant and equipment, and intangible assets	-17 174	-15 588
Compensations received for construction of pipelines	6 139	9 956
Proceeds from sale of property, plant and equipment, and intangible assets	425	15
Interest received	1 109	964
Total cash flow used in investing activities	-10 024	-4 654
CASH FLOWS FROM FINANCING ACTIVITIES		
Received loans	20 000	44 800
Repayment of loans	0	-44 821
Dividends paid	-31 956	-14 700
Income tax on dividends	-8 495	-3 908
Total cash flow used in financing activities	-20 451	-18 629
Change in cash and cash equivalents	-5 600	4 002
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	18 692	14 691
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	13 093	18 692

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(thousand EUR)

STATEMENT OF CHANGES IN EQUITY




	Share capital	Share premium	Statutory legal reserve	Retained earnings	Total equity
31 December 2008	12 782	24 734	1 278	43 094	81 889
Dividends	0	0	0	-14 700	-14 700
Net profit of the financial year	0	0	0	21 726	21 726
31 December 2009	12 782	24 734	1 278	50 120	88 914
Dividends	0	0	0	-31 956	-31 956
Net profit of the financial year	0	0	0	16 512	16 512
31 December 2010	12 782	24 734	1 278	34 675	73 470

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 Kuupäev/date 09.03.11
 PricewaterhouseCoopers, Tallinn

CONFIRMATION OF THE MANAGEMENT AND SUPERVISORY BOARDS

The Management Board has prepared the management report and the financial statements of AS Tallinna Vesi on 25 February 2011. The Supervisory Board of AS Tallinna Vesi has reviewed the annual report, prepared by the Management Board, consisting of Management Report and the financial statements, the Management Board's proposal for profit distribution and the independent auditors' report, and has approved the annual report for presentation on the Shareholders' General Meeting.

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

Name	Position	Signature	Date
Ian John Alexander Plenderleith	Chairman of the Management Board		25/2/11
Robert Thomas Yuille	Member of the Management Board		25/2/11
Siiri Lahe	Member of the Management Board		25.02.11
Robert John Gallienne	Chairman of the Supervisory Board	_____	_____
Leslie Anthony Bell	Member of the Supervisory Board	_____	_____
Simon Gardiner	Member of the Supervisory Board	_____	_____
Andrew James Prescott	Member of the Supervisory Board	_____	_____
Mart Mägi	Member of the Supervisory Board	_____	_____
Rein Ratas	Member of the Supervisory Board	_____	_____
Ardo Ojasalu	Member of the Supervisory Board	_____	_____
Deniss Boroditš	Member of the Supervisory Board	_____	_____
Valdur Laid	Member of the Supervisory Board	_____	_____



INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS Tallinna Vesi

We have audited the accompanying consolidated financial statements of AS Tallinna Vesi and its subsidiary, which comprise the consolidated statement of financial position as of 31 December 2010 and the consolidated statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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



Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS Tallinna Vesi and its subsidiary as of 31 December 2010, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read "Tiit Raimla".

Tiit Raimla
Auditor's Certificate No.287

A handwritten signature in blue ink, appearing to read "Stan Nahkor".

Stan Nahkor
Auditor's Certificate No.508

9 March 2011

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