AS LHV Group

Consolidated Annual Report 2007

(Translation of the Estonian original)

Consolidated annual report	**01.01.2007 – 31.12.2007**

Business name	AS LHV Group
Commercial Register no.	11098261
Legal address	Tartu mnt. 2, 10145 Tallinn
Phone	(372) 6800400
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E-mail	lhv@lhv.ee
Main activities	Activities of holding company, EMTAK 64201
	Security brokerage, EMTAK 66121
	Financial advisory, EMTAK 66191
	Fund management activities, EMTAK 66301
	Finance leasing, EMTAK 64911
Management Board	Rain Lõhmus
Supervisory Board	Andres Viisemann
	Tiina Mõis
	Tarmo Sild
Auditor	AS PricewaterhouseCoopers

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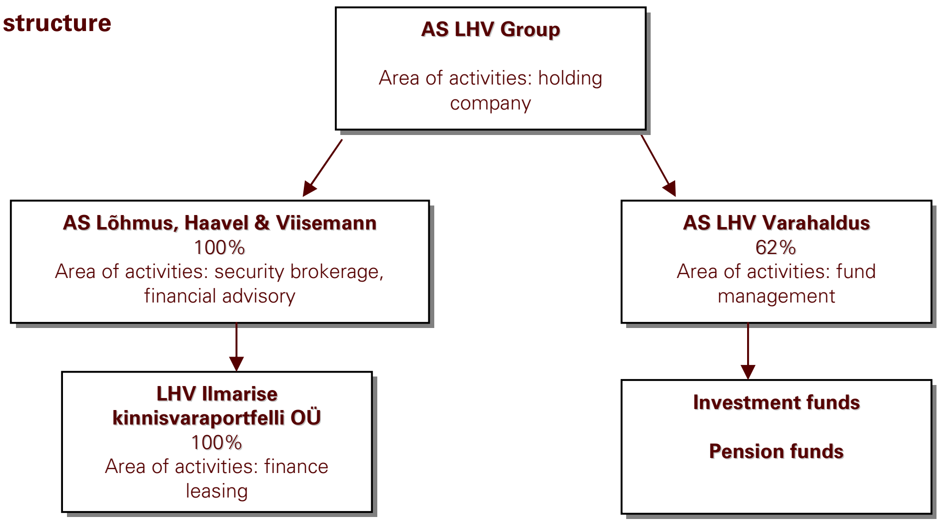
MANAGEMENT REPORT

Key events of AS LHV Group in 2007:

- Cancellation of treasury shares and increase of share capital to 66 400 thousand kroons at the year-end 2007. Rain Lõhmus, AS Lõhmus Holdings and Viisemann Holdings OÜ subscribed for the new shares.

- Increasing of ownership interest in AS LHV Varahaldus to 62% – the funds received from the increase of share capital were invested in the equity of AS LHV Varahaldus, as a result of which AS LHV Group acquired majority ownership in the share capital of the company and control over the subsidiary.

Group structure



As of 31.12.2007, the Group had almost 50 employees (2006: 38). Remuneration paid in the financial year totalled 16.4 million kroons (2006: 9.3 million kroons). No remuneration was paid to the members of the management board of AS LHV Group

In December 2007, LHV Investeerimiskeskus (*LHV Investment Centre*) providing services to the clients of all group companies was moved to larger offices on the first floor of the City Plaza and the offices were expanded to the 17th floor in addition to the 18th floor of the City Plaza.

AS Lõhmus, Haavel & Viisemann - business environment and results of operations

The goal of AS Lõhmus, Haavel & Viisemann (LHV) is to be the most professional internet-based investment bank in the Baltic States and the most popular financial news portal in Estonia, offering high quality securities brokerage services in international financial markets, personal advisory and asset management services in Estonia, Latvia and Lithuania.

During 2007, Baltic stock exchanges were impacted by sharp movements in global stock markets and faster than expected cooling off of local economies. During the first half of the year, Estonian, Latvian and Lithuanian stock markets were moving sideways, but US-induced credit problems put negative pressure on global liquidity and investors' risk tolerance , thus leaving a strong footprint on the Baltic stock exchanges along with declining economy and growth of domestic consumption. The Vilnius Stock Exchange was the only stock exchange to increase during the year, whereas Tallinn and Riga Stock Exchanges ended the year at a lower level than at the beginning of the year.

The returns during the year 2007 were modest in the US stock markets. The year started in a bullish mode and continued so throughout most of the year. However, the year-end turned out to be quite negative for investors. Problems which began in the US real estate market caused a global credit and liquidity crisis and most of the banks had to write down loans en masse. This has also weakened the growth outlook for companies and the economy as a whole as well as consumers' confidence in their future consumption. Several global and American companies have switched themselves to "sleep mode" cutting their investments and adjusting to demands of slowing economic growth environment.

Nasdaq 100 had the highest return in 2007, driven by technology companies such as Apple and Google, increasing by approximately 15%. The return of SP500 was more modest, increasing by less than 5%. The small-cap Russell 2000 Index which is the index most sensitive to economic changes had a negative return for the year. During the fourth quarter of 2007, the US GDP rate increased only 0.6% and expectations for growth in 2008 are also low. All this will have an effect on the companies' profits as corporate margins remain at historical highs. In 2008, US corporate margins are expected to shrink and capital expenditures to be cut which will put negative pressure on the labour market and consumption.

One major problem during 2007 was inflation, related to an increase in the prices of raw materials and agricultural products. Oil prices penetrated the magic $100 per barrel level, creating an "extra tax" for the consumer and fewer opportunities to incur general expenditures. Oil and metal prices are also expected to come down in light of a global economic slowdown which from the point of view of the consumer is quite positive news. It also provides greater freedom for the central banks to conduct their business.

The US recession has an effect on the rest of the world. Europe and Asia have tight economic ties with the USA and therefore, a global economic slowdown is to be expected. The slowdown in the USA has led the Federal Reserve to lower interest rates, thereby stimulating consumption and alleviating pressure on those who suffer under mortgage payment problems. It is possible that European central banks need to lower interest rates considering that the Central Bank of England has already done that. Financial markets could also be impacted by the US presidential campaign in 2008. The presidential campaign has historically put positive pressure on stock markets and considering also the US Federal Reserve's potentially aggressive policy to cut interest rates, these two processes together may offer positive surprises.

Expectations for returns in 2008 in the US and European stock markets are low considering the aforementioned problems, however, the markets should offer higher volatility. The selection of investment regions and a clearer vision about sectors and companies will become more important. Some Asian markets as well as Russia and the Persian Gulf Region may offer some opportunities for investors due to their reasonable price levels.

The year 2007 was very successful for LHV – gross revenue increased by 77% as compared to revenue of 2006. Interest income demonstrated the highest growth in percentage terms, related to leveraged loans. However, the majority of LHV's turnover is still generated by service fee income from securities brokerage.

Financial information (in thousand EEK)	**2007**	**2006**	**Growth**
Net service fee income	38 038	21 816	74%
Net interest income	7 272	3 285	121%
Volume of leveraged loans	57 538	44 297	30%

The Estonian market is currently it most important region with regard to service fee income – in 2007, 84% of the respective income was generated in Estonia. The second most important market is Lithuania with 14 percent, followed by currently insignificant Latvia with 2 percent. The Latvian and Lithuanian share in service fee income is expected to grow over the next few years, as these markets are somewhat behind Estonia in their development, but we expect the development levels to equalise over the next 5 years. Last year, the Latvian market had the highest growth rate, where the revenue increased more than 20 times. In addition to the general fast development of the market, the growth was also propelled by the growing familiarity with LHV and the low revenue base in 2006. Lithuanian service fee income more than doubled and growth in Estonia was about 60%.

The most significant region for generating interest income is Lithuania, which contributed 53% to total interest income earned in 2007. The Estonian market followed with 45% and Latvia with its currently insignificant 2% share. However, the situation was the opposite in 2006, when Estonia contributed almost three-fourth to interest income (followed by Lithuania). Lithuania surpassed Estonia with its fast growth of 334% (Estonia's growth reached 33%). The fast growth of the Lithuanian market may be attributed to its good sales activities. Last year, the total volume of collateral loans granted by LHV in three Baltic States increased by 30% to 44 million kroons.

A lot of people interested in investing have become LHV's clients through its seminars, the financial portal www.lhv.ee and other channels. In 2007, the number of LHV´s clients increased by 29% (9 573 clients) and the number of the users of the financial portal was 24% (14 831 users). The growth in the number of clients was the highest in Lithuania, where the number of clients doubled. The total volume of assets under management of LHV grew by 10%, whereby the assets of Lithuanian clients grew by 21%.

Along with the growth in the number of clients, assets under management and popularity of investing, the number of trades made through LHV and the number of clients have increased year after year. In 2007, a total of 3 453 clients made their securities trades through LHV, which represents 38% growth as compared to the previous year.

Last year, LHV introduced the Personal Advisory service as an extension of its investment account which helps people use the knowledge and skills of the specialists of LHV when making investments. We have created a centre for analysing Baltic stocks for our clients called LHV Balti Pro within the framework of the Personal Advisory service, and the next step is to launch Fondi PRO, providing an overview of the funds. The most important innovation last year in the investment account was the addition of Central and Eastern European markets. Russia's stock market has become the most popular new stock market.

AS LHV Varahaldus - business environment and results of operations

AS LHV Varahaldus (LHV Asset Management) is a company engaged in investment fund management. In 2007, the main business activity of the company was to provide fund management services to five mandatory pension funds, one supplementary pension fund and two new equity Eurofunds.

In 2007, the best performing fund among pension funds with a progressive investment strategy (share of equities: up to 50%) was LHV New Markets Pension Fund which was the only fund to achieve a double digit net returns. The success of LHV New Markets was attributable to a larger share of Southeast Asian and Latin Americas equities in the fund's portfolio. The return of LHV Global Equities Pension Fund, which invests proportionally more into developed industrial markets (Western Europe, USA, Japan) was lower, as the returns on the stock markets in developed regions remained weaker or were even negative in some markets in 2007.

Comparison of progressive pension funds	NAV 31.12.2006	NAV 31.12.2007	Growth of the NAV
LHV New Markets PF	**13.62**	**15.07**	**10.65%**
SEB Ühispank PF Progressive	15.71	17.17	9.29%
Sampo Pension 50	14.96	16.05	7.29%
Ergo Future PF	15.73	16.64	5.79%
LHV Global Equities PF	**16.65**	**17.58**	**5.59%**
Hansa PF K3	16.07	16.96	5.54%

LHV Balanced Strategy Pension Fund showed the best results among the pension funds with balanced strategies (share of equities: up to 25%), the unit of which increased by 5.16% in a year. This is the third consecutive year, in which LHV shows the best results in this category.

Comparison of balanced pension funds	NAV 31.12.2006	NAV 31.12.2007	Growth of the NAV
LHV Balanced Strategy PF	**12.41**	**13.05**	**5.16%**
Sampo Pension 25	12.97	13.55	4.47%
Hansa Pension Fund K2	13.45	14.05	4.46%

Although LHV's conservative pension funds (all assets are invested in fixed income instruments) have on average been the best performing funds since the inception of the pension system in Estonia, we did not come in first in 2007. Lower returns were partly attributable to a lower share of government bonds, which was one of the few asset classes to perform well in the second half of 2007, when a credit crisis spread in the financial markets. LHV is underweight in government bonds as the risk of rising risk-free interest rates is high, especially as the current levels are low considering historical levels and inflation is still a concern for the global economy.

Comparison of conservative pension funds	NAV 31.12.2006	NAV 31.12.2007	Growth of the NAV
Sampo Pension Interest	11.22	11.60	3.39%
Hansa Pension Funds K1	11.47	11.75	2.44%
LHV Dynamic Bonds PF	**12.56**	**12.78**	**1.75%**
Ergo Stable PF	11.49	11.65	1.39%
SEB Ühispank PF Conservative	11.24	11.38	1.25%
LHV Quality Bonds PF	**11.85**	**11.98**	**1.10%**

LHV Supplementary Pension Fund, which on average invests 75% of its investment portfolio in equity markets, increased by 7.68% last year. A higher share of equities enabled the fund to achieve a higher return as compared to our II pillar progressive fund LHV Global Equities PF; however, it underperformed our other II pillar fund LHV New Markets PF, as more investments are made in the equities of developed industrial regions where the returns on the stock markets were weaker in 2007.

Comparison of supplementary pension funds	NAV 31.12.2006	NAV 31.12.2007	Growth of the NAV
SEB Ühispank PF Active (100)	16.40	18.58	13.34%
SEB Ühispank PF Balanced (35)	17.50	19.30	10.30%
Sampo Pension Fund (50)	17.47	19.08	9.20%
Hansa PF V3 (100)	21.23	23.06	8.62%
LHV Supplementary PF (75)	**17.18**	**18.50**	**7.68%**
Hansa Pension Funds V2 (60)	15.98	16.95	6.07%
Hansa Pension Funds V1 (30)	19.03	19.81	4.10%

Two equity Eurofunds, founded in 2007, started their investment activities at a relatively unfavourable time in light of the prevailing trends in the global equity markets. The credit crisis, which emerged due to US sub-prime problems, weighed down global equity markets in the second half of the year, whereas Eastern Europe, which is the target region for LHV Emerging Europe Alpha Fund, was one the funds with the weakest return. The return of LHV World Equities Fund was positive last year due to its share of Asian and Latin-American equities.

LHV Eurofunds	NAV at inception	NAV 31.12.2007	Change in the NAV
LHV World Equities Fund	10.0000	10.3776	3.78%
LHV Emerging Europe Alpha Fund	10.0000	8.6648	-13.35%

At the end of 2007, the total volume of assets under management of LHV Varahaldus was 500 million kroons, out of which 89% was made up of mandatory pension funds. At the end of 2006, the total volume of the assets under management was 331 million kroons.

Priorities for 2008

In its activities, AS LHV Group continues to focus on the financial sector.

In 2008, the company plans to expand its choice of equity funds. In the first quarter of the year, LHV Persian Gulf Fund was launched, which invests mostly in the listed equities of members states of the Gulf Cooperation Council (GCC), including Bahrain, Oman, Qatar, Kuwait, and the United Arab Emirates. LHV Persian Gulf Fund sees growth and opportunities outside the energy sector and therefore invests in banking, insurance, infrastructure, communication, construction, and utility businesses.

In 2008, the objective of LHV Varahaldus is to increase its market share in the mandatory pension fund market and increase the volume of assets under management in its equity funds through generation of positive returns as well as finding new investors.

The priorities of LHV in 2008 include the expansion of the range of investment products, increasing the client base and improvement of the organisation's support services, such as IT and risk management.

On 15 May 2008, LHV filed the application for the authorisation of the credit institution with the Financial Supervision Authority. With the bank license, LHV will have more opportunities than previously – to grant loans, deposit clients' assets and raise debt more easily. The bank license provides assurance to the clients that their deposits and invested assets are protected by the security requirements established for the banks. Obtaining the license may take 6-12 months.

Since October 2007, LHV issues the magazine ***Investeeri!,*** where saving and investment themes are discussed and well-known people speak of their experience and provide opinion on investing. This magazine will be published three times a year. In addition to its magazine, LHV provides investment related education to its clients and other interested parties within the framework of LHV Investment School.

CONSOLIDATED FINANCIAL STATEMENTS

Management Board's declaration

The Management Board confirms the correctness and completeness of the consolidated 2007 financial statements of AS LHV Group presented on pages 9-49.

The Management Board confirms that:

- the consolidated financial statements have been compiled in accordance with International Financial Reporting Standards as adopted in the European Union;
- the consolidated financial statements present a true and fair view of the Group's financial position, the results of operations and its cash flows;
- AS LHV Group and the companies belonging to its group for consolidation purposes are going concerns.

/signed/

Rain Lõhmus

Chairman of the Management Board

Tallinn, 10.06.2008

Consolidated income statement

(in thousand Estonian kroons)

	Note	2007	2006
Fee and commission income	5	50 053	27 768
Fee and commission expense	5	-8 906	-5 854
Net fee and commission income		**41 147**	**21 914**
Interest income	6	9 662	4 701
Interest expense	6	-2 188	-1 219
Net interest income		**7 474**	**3 482**
Net gains less losses from trading	7	2 620	1 496
Net gains less losses from investment securities	7	-279	1 340
Other expenses related to financial assets	7	-4 051	0
Dividend income	7	3	83
Net (loss) / gain from securities		**-1 707**	**2 919**
Other operating income	8	16 423	2 423
Operating expenses	9	-51 004	-29 117
Operating profit		**9 350**	**1 621**
Share of profit/loss of joint ventures	18	775	-1 977
Profit/(loss) for the year from continued operations		**13 108**	**-356**
Profit for the year from discontinued operations	24	**0**	**23 072**
Total profit for the year		**13 108**	**22 716**
Attributable to equity holders of the parent company		**14 205**	**22 716**
Attributable to minority interest		**-1 097**	**0**

The notes on pages 14 to 49 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

(In thousand Estonian kroons)

	Note	31.12.2007	31.12.2006
Assets			
Cash and bank	11	10 796	14 980
Loans to customers	12	57 538	44 297
Receivables from customers	13,29	2 893	1 819
Derivatives	14	53	64
Other financial assets at fair value through profit or loss	15	57 691	278
Finance lease receivables	16	4 410	4 582
Other assets	17	2 418	766
Investments in associates	18	0	18 164
Goodwill	18	8 723	0
Property, plant and equipment and intangible assets	19	5 952	607
Total assets		**150 474**	**85 557**
Liabilities			
Derivatives	12	0	30
Loans received	20	29 797	30 218
Other financial liabilities	29	0	10 661
Accrued expenses and other liabilities	21	10 511	3 271
Bonds issued	22	4 485	6 426
Provisions	23	4 880	4 880
Total liabilities		**49 673**	**55 486**
Equity			
Minority interest		19 561	0
Equity attributable to shareholders of the parent company			
Share capital	25	66 400	40 300
Share premium		10 096	532
Statutory legal reserve		2 830	2 830
Retained earnings/(accumulated deficit)		1 914	-9 308
Treasury shares		0	-4 283
Total equity attributable to shareholders of the parent company		**81 240**	**30 071**
Total equity		**100 801**	**30 071**
Total liabilities and equity		**150 474**	**85 557**

The notes on pages 14 to 49 are an integral part of these consolidated financial statements.

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PricewaterhouseCoopers, Tallinn

Consolidated cash flow statement

(In thousand Estonian kroons)

	Note	2007	2006
Cash flows from operating activities			
Fee and commission income received		68 515	30 590
Fee and commission expense	5	-8 906	-5 854
Operating and other expenses paid		-50 183	-27 894
Finance lease receivables paid by customers		188	6 258
Interest received		9 808	4 179
Settlement of foreign currency forward contracts		-19	-152
Net acquisition/disposal of trading portfolio		-1 201	415
Change in loans granted		-13 069	-30 157
Change in other liabilities		544	-7 581
Change in the stock exchange security deposit		-49	1 204
Released previously frozen bank accounts	11	861	26 913
Cash flows from operating activities related to discontinued operations		*0*	*7 619*
Net cash generated from operating activities		**6 489**	**5 540**
Cash flows from investing activities			
Purchase of non-current assets	19	-5 858	-381
Proceeds from sale of non-current assets	19	16	0
Proceeds from sale of investment securities		0	828
Purchase of additional shares in joint ventures	18	-22 251	-11 414
Cash and cash equivalents of a joint venture in	18	577	0
Amounts paid for the repurchase of the share option of subsidiary	29	-14 713	0
Purchase of shares of subsidiaries		0	-385
Sale of shares of subsidiaries		0	1 800
Dividends received from investment securities	7	3	83
Cash flows of investment activities from discontinued operations		*0*	*490*
Net cash used in investing activities		**-42 226**	**-8 979**
Cash flows from financing activities			
Share capital increase	25	36 964	12 532
Treasury shares purchased	25	0	-2 859
Redeemed bonds	22	-1 919	-5 440
Loans received		124 937	54 546
Loan repayments		-125 580	-42 472
Interest paid		-1 988	-1 122
Cash flows of financing activities from discontinued operations		*0*	*-8 543*
Net cash from financing activities		**32 414**	**6 642**
Total net cash flows from activities of discontinued operations		0	434
Cash and bank of discontinued operations at beginning of the year		0	-23 500
Dividends distributed to Group from discontinued operations		0	11 310
Cash handed out by the Group in the process of de-merger of discontinued operations	24	0	-5 716
Net cash flows of discontinued operations		**0**	**-17 475**
Net increase/decrease in cash and cash equivalents		**-3 323**	**-14 269**
Cash and cash equivalents at beginning of the year	11	14 119	28 388
Cash and cash equivalents at end of the year	**11**	**10 796**	**14 119**

The notes on pages 14 to 49 are an integral part of these consolidated financial statements.

Consolidated statement of changes in shareholders' equity

(In thousand Estonian kroons)

	Share capital	Share premium	Treasury shares	Statutory reserve capital	Currency translation differences	Retained earnings/ (accumulated deficit)	**Total**	Minority interest	**Total**
Balance as of 01.01.2006	**28 300**	**0**	**-2 806**	**871**	**-128**	**46 108**	**72 345**	**2 758**	**75 103**
Transfer to statutory legal reserve	0	0	0	1 959	0	-1 959	0	0	**0**
Increase of share capital	12 000	532	0	0	0	0	12 532	0	**12 532**
Treasury shares repurchased	0	0	-1 477	0	0	0	-1 477	0	**-1 477**
Currency translation differences arising from foreign subsidiaries	0	0	0	0	-8	0	-8	0	**-8**
Net profit for 2006 from continued operations	0	0	0	0	0	-356	-356	0	**-356**
Net profit for 2006 from discontinued operations (Note 24)	0	0	0	0	0	23 246	23 246	-174	**23 072**
Total net profit for 2006	*0*	*0*	*0*	*0*	*0*	*22 890*	*22 890*	*-174*	***22 716***
Net assets transferred in de-merger of the discontinued operations (Note 24)	0	0	0	0	136	-76 347	-76 211	-2 584	**-78 795**
Balance as of 31.12.2006	**40 300**	**532**	**-4 283**	**2 830**	**0**	**-9 308**	**30 071**	**0**	**30 071**
Balance as of 01.01.2007	**40 300**	**532**	**-4 283**	**2 830**	**0**	**-9 308**	**30 071**	**0**	**30 071**
Transfer to statutory legal reserve	27 400	8 564	0	0	0	0	36 964	0	**36 964**
Cancellation of treasury shares	-1 300	0	4 283	0	0	-2 983	0	0	**0**
Minority interest in acquired subsidiary	0	0	0	0	0	0	0	20 658	**20 658**
Net profit for 2007	0	0	0	0	0	14 205	0	-1 907	**13 108**
Balance as of 31.12.2007	**66 400**	**10 096**	**0**	**2 830**	**0**	**1 914**	**81 240**	**19 561**	**100 801**

More detailed information is provided in Note 25.

The notes on pages 14 to 49 are an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

NOTE 1. General information

AS LHV Group is a holding company whose subsidiary company AS Lõhmus, Haavel & Viisemann (LHV) provides investment and securities brokerage and management services to clients in Estonia, Latvia and Lithuania. The subsidiary of LHV – LHV Ilmarise Kinnisvaraportfelli OÜ – provides real estate transaction and leasing services.

AS LHV Group is a limited liability company incorporated and domiciled in Estonia. The address of its registered office is Tartu mnt. 2, Tallinn. These consolidated financial statements were authorised for issue by the Management Board on 10 June 2008.

NOTE 2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied at the Group to all period years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2007 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below: "financial assets at fair value through profit or loss", including derivatives.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates in several areas. It also requires management to exercise its judgement in the process of applying accounting policies. The areas involving a higher degree of judgement or complexity, or the areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 3.

The financial year started on 1 January 2007 and ended on 31 December 2007. The financial figures in the financial statements have been presented in thousands of Estonian kroons, unless otherwise stated.

Certain new International Financial Reporting Standards, amendments to existing standards and the interpretations of the standards have been published by the time of compiling these consolidated financial statements which became mandatory for the Group's accounting periods beginning on or after 1 January 2007. The overview of these standards and the Group's management estimate of the potential impact of applying the new standards and interpretations is provided below:

(a) International Financial Reporting Standards, amendments to existing standards and interpretations of the International Financial Reporting Interpretations Committee (IFRIC) that became effective in 2007 and have significant influence the financial statements of the Group

IAS 1 (amendment) – *Presentation of Financial Statements:* Capital Disclosures

The standard requires additional disclosures in the financial statements and presents additional requirements for the parent company's capital and capital management. The adoption of IAS 1 did not have any impact on accounting policies. The Group made certain changes in presentation and new disclosures are made in these financial statements (comparatives provided).

IFRS 7 – *Financial Instruments: Disclosures and supplementary annex IAS 1, Presentation of Financial Statements*

IFRS 7 introduces new requirements for the notes in order to improve the presentation of information in the financial statements. This requires presentation of qualitative and quantitative information on the risks arising from financial instruments, containing specific minimum requirements for credit risk, liquidity risk and market risk (incl. sensitivity analysis of these risks). This replaces standard IAS 30 *Disclosures in the Financial Statements and Other Financial Institutions* and adds to and replaces some of the requirements in IAS 32 *Financial Instruments: Disclosure and Presentation*. This standard is effective for all companies preparing their financial statements in accordance with International Financial Reporting Standards. The adoption of the standard did not have any impact on accounting policies. The Group made certain changes in presentation and new disclosures are made in these financial statements (comparatives provided).

(b) Published standards, amendments and interpretations to existing standards, that are mandatory for the Group's accounting periods beginning on or after January 2008

IAS 1 (amendment) *– Presentation of Financial Statements (effective from 1 January 2009)*

The amendments introduced relate mainly to the presentation of changes in equity and are intended to improve the ability of the users of financial statements to analyse and compare the information included in the financial statements. The Company shall apply the amended IAS 1 from January 2009.

IAS 27 (amended) *– Consolidated and Separate Financial Statements (effective from 1 January 2009)*

The standard requires that the effects of transactions with minority shareholders be recognized directly in equity, on the condition that control over the entity is retained by the parent company. In addition, the Standard elaborates on the accounting treatment of the loss of control over a subsidiary, i.e. it requires that the remaining shares be restated to fair value, with the resulting difference recognized in the income statement. The Group shall apply the amended IAS 1 from January 2009.

(c) The Group's management is of opinion that the amendments to and revisions of the following standards and interpretations that became effective for Group's financial statements in 2007 and have been adopted for the first time in these financial statements did not have a significant effect on the financial statements of the Group.

IFRIC 7 – Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Environments (effective 1 March 2006)

IFRIC 8 – Share-based Compensations as defined in IFRS 2 (effective 1 March 2006)

IFRIC 9 – Reassessment of Embedded Derivatives (effective 1 June 2006)

IFRIC 10 – Interim Financial Reporting and Impairment (effective 1 November 2006)

IFRIC 11 – IFRS 2 • Group Treasury Share Transactions (effective 1 March 2007)

(d) The following standards, amendments and interpretations to existing standards are not effective and are not relevant for the Group's operations

IAS 23 (amendment) – Borrowing costs (effective from January 2009)

IAS 1, IAS 32 (amendment) - Puttable financial instruments and obligations arising on liquidation—IAS 32 and IAS 1 Amendment (effective from 1 January 2009).

IFRS 2 (amended) – Vesting Conditions and Cancellations - IFRS 2 „ Share-based Payment" (effective from 1 January 2009)

IFRS 3 (amended) – Business Combinations (effective from 1 January 2009)

IFRS 8 – Operating Segments (effective from 1 January 2009)

IFRIC 12 – Service Concession Arrangements (effective from 1 January 2009)

IFRIC 13 – Customer Loyalty Programmes (effective from July 2008)

IFRIC 14, IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction (effective from 1 January 2008)

2.2 Consolidation

A subsidiary is an entity controlled by the parent company. Control is presumed to exist when the parent company owns, directly or indirectly through its subsidiaries, more than 50% of the voting power of the subsidiary or otherwise has power to govern the financial and operating policies of the subsidiary.

The purchase method of accounting is used to account for the acquisition of subsidiaries (except for acquisitions among entities under common control). The cost of acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. According to the purchase method, the identifiable assets and liabilities of the acquired subsidiary are recognised at their fair values on the acquisition date, irrespective of the extent of any minority interest, and the excess of the cost of acquisition over the fair value of the identified net assets of the acquired subsidiary is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Goodwill represents the excess of the cost of an acquisition over the fair value of the company's share of the net assets acquired at the date of acquisition, reflecting the part of the acquisition cost that was paid for the assets that are not separately identifiable for the balance sheet purposes. Goodwill acquired in acquisition of a subsidiary is recorded in the balance sheet as an intangible asset in a separate line. Goodwill is not amortised, but an annual impairment test is performed for goodwill. The impairment test is performed by comparing the carrying amount of goodwill with its recoverable amount. Goodwill is allocated to cash-generating units for the purpose of impairment testing and the recoverable amount is determined by discounting the expected cash flows of the relevant cash generating unit. An impairment loss is recognised for the amount by which the carrying amount of goodwill exceeds its recoverable amount.

In the consolidated financial statements, the financial information of all subsidiaries under the control of the parent company is combined on a line-by-line basis. All intragroup receivables and liabilities and the Group's intra-company transactions and the resulting income and losses as well as unrealised gains on these transactions have been eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Minority interests in the net income and equity is included within equity in the consolidated balance sheet separately from the equity attributable to the shareholders of the parent company and as a separate item in the consolidated income statement.

Revenue and expenses of the subsidiaries acquired during the financial year are consolidated in the Group's income statement starting from the date of acquisition until the end of the financial year. The results of operations of subsidiaries disposed of during the year are consolidated in the Group's income statement from the beginning of the financial year until the date of disposal. If necessary, the accounting policies of subsidiaries have been changed to correspond to the accounting policies of the Group.

The 2007 consolidated financial statements include the financial statements of AS Lõhmus, Haavel & Viisemann (parent company) and its subsidiaries AS Lõhmus, Haavel & Viisemann (Estonia, 100% interest), LHV Ilmarise Kinnisvaraportfelli OÜ (Estonia–100% interest) and ,AS LHV Varahaldus (61.96% interest).

Pursuant to the Accounting Act of the Republic of Estonia, information on the separate primary financial statements of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company, the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policies for reporting subsidiaries and joint ventures have been amended in the separate primary financial statements appended to these consolidated financial statements in accordance with IAS 27 "Consolidated and Separate Financial Statements".

In the parent's separate primary financial statements, which are appended to these consolidated financial statements (see Note 30), the investments into the shares of subsidiaries are accounted for at cost less any impairment losses recognised.

2.3 Joint ventures

A joint venture is based on a joint ownership and management control according to which two parties carry out their jointly controlled economic activities. The Group's interests in jointly controlled entities are accounted for by the equity method.

Investments in joint ventures are initially recognised at cost and subsequently adjusted with the changes that have occurred in the venturer's interest in the net assets of the jointly controlled entity after the acquisition. The Group's share of its joint ventures' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. In the income statement, the venturer accounts for its interest in the operating results, financial income and financial expenses in the jointly controlled entity in a separate line "share of profit/loss from joint venture". Dividends received are adjusted against the carrying amount of the investment. Accounting policies have been changed where necessary to ensure consistency with the policies adopted by the Group.

AS LHV Varahaldus was reported as a joint venture in the financial statements of AS LHV until AS LHV Group acquired an additional interest in AS LHV Varahaldus so that AS LHV Varahaldus became the subsidiary of AS LHV Group and is consolidated in these financial statements.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Estonian kroons, which is the parent company's functional and presentation currency.

(b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia (Central Bank) prevailing at the dates of the transactions. Monetary assets and liabilities and non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing on the balance sheet date. Gains and losses on translation from monetary assets and liabilities are recorded in the income statement in the line "net gains less losses from trading". Changes in the fair value of monetary financial assets (investment) denominated in a foreign currency classified as available for sale are recognised as follows – translation difference in the line "net gains less losses from investment securities" and other changes in the carrying amount are recognised in the fair value reserve in equity. Translation differences on non-monetary assets, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the line "net gains less losses from trading". Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

2.5 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, term deposits with original maturities of three months or less, that are available for use without any significant restrictions.

2.6 Financial assets

The Group classifies its financial assets into the following categories:

- at fair value through profit or loss
- loans and receivables
- available-for-sale financial assets

The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

- financial assets held for trading (incl. derivatives, Note 2.8))
- financial assets designated at fair value through profit or loss at inception

A financial asset is classified as **held for trading** if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets. Regular purchases and sales of financial assets are recognised on the settlement date in the balance sheet. Financial assets held for trading are recognised at fair value net of transaction costs, which is the fair value of the consideration received from or paid for the financial asset. After initial recognition, financial assets in this category are measured at fair value. Changes in fair values of these assets are recognised consistently, either as a profit or loss in the income statement of the accounting period under "net profit/loss from trading". Dividend income on financial assets reported at fair value through profit or loss is included in the income statement line „Dividend income" when the Group has the right to receive dividends.

In case of listed securities (i.e. the securities for which an active market exists), the current bid price is considered as the fair value of investments. To find the fair value of investments not actively traded in the market, alternative methods such as the price of recent transactions (under market conditions), the discounted cash flow method or option valuation models are used. As of the year-end, the Company did not carry any such investments in its balance sheet whose valuation would have required the usage of alternative valuation methods.

Financial assets designated at fair value through profit or loss at inception - securities are classified in this group, if the Company has upon initial recognition designated the securities to be recorded as at fair value through profit or loss and as a result, the changes in the fair value of these securities are consistently recognized in the profit or loss of the reporting period.

Financial assets and financial liabilities are designated at fair value through profit or loss when:

- doing so significantly reduces measurement inconsistencies
- certain investments, such as debt or equity investments, are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are recognised in the balance sheet when cash is paid to the customer or the right to receivable has been established and they are initially recognised at fair value plus transaction costs and are derecognized only when they are repaid or written-off, regardless of the fact that some of them may be recognised as costs through providing allowances for loans. After initial recognition, the Group recognises loans and receivables at amortised cost (less principal payments and any potential impairment losses, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest rate method.

Trade receivables arise from providing services to the customers and are recognised initially at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest rate method (less a provision for impairment, see 2.7).

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months after the balance sheet date.

In the current reporting period, the Group does not have any available-for-sale financial assets.

2.7 Impairment of financial assets

The Group assesses at least on each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are recognised only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can reliably be estimated.

For valuation of loans and receivables several risks are prudently considered. The collection of each specific receivable is assessed individually, taking into consideration all known information on the solvency of the debtor. The Group assesses whether objective evidence of impairment exists considering such situations as: the buyers' financial difficulties, bankruptcy or inability to fulfil their obligations to the Group. For assessment of estimated loan losses, the probability of collecting the loan and interest payments over the coming periods are considered, as well as discounted present value of estimated collections, discounted at the financial asset's original effective interest rate, and anticipated proceeds from the realisation of collateral (if the loan is secured, excluding future credit losses that have not been incurred), which together help to assess the amount of the loan loss incurred. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. A relevant allowance has been established for these estimated and incurred loan losses. Impairment loss is recognised as an expense in the income statement. Doubtful receivables are written down in the balance sheet to the collectible amount.

If the circumstances which form the basis for evaluation of receivables change (improvement of client's credit rating) and that change can objectively be related to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement. Irrecoverable receivables are removed from the balance sheet against the related allowance for loan impairment.

Interest income on loans is presented in the income statement line "Interest income".

2.8 Derivative financial instruments

Derivative financial instruments (forward, swap and option contracts) are initially recognised in the balance sheet at fair value, net of transaction costs on the settlement date and are subsequently valued at fair value through profit or loss. If derivatives are quoted in an active market, market value is used as fair value. Otherwise, valuation techniques are used to find fair value. Gains and losses from derivatives are recognised as income or expense of the period in the income statement under "net gains less losses from trading". These transactions are booked in the balance sheet as assets, if their market value is positive and as liabilities, if their market value is negative. The fair values of derivative assets and liabilities recorded in the balance sheet are not netted. The Company does not use hedge accounting rules to account for its derivative financial instruments.

2.9 Finance lease receivables

Finance lease transactions are lease transactions under which all significant risks and rights from using the assets are immediately transferred from the Group to the lessee. Legal ownership of assets is transferred to the customer at the end of the lease term. Receivables arising from finance lease agreements are recognised at the net present value of the minimum lease payments receivable. Each lease payment received from the lessee is allocated between principal payments of the finance lease receivable and financial income. Financial income is allocated over the lease term under the assumption that the lessor's periodic rate of return is constant in respect of the outstanding net investment of the finance lease. In case initial service fees are collected at issuance, these are included into the calculation of effective interest rate and lessor's net investment.

The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased object and excess collateral, the financial position and trustworthiness of the customer. Impairment of receivables is shown as a negative amount within the respective asset category. Impairment of lease receivables is assessed similarly to the principles described above in note 2.7.

2.10 Property, plant and equipment

Property, plant and equipment are non-current assets used in the operating activities of the Group with a useful life of over one year. An item of property, plant and equipment is initially recognised at its cost which consists of the purchase price (incl. customs duties and other non-refundable taxes) and other expenditures directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. Subsequent costs incurred for items of property, plant and equipment are recognised as non-current assets only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the asset can be measured reliably. All other repair and maintenance costs are charged to operating expenses during the period in which they are incurred.

An item of property, plant and equipment is carried in the balance sheet at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers, furniture and fixtures is 33%, for improvements of rental space either 20% per annum or amortisation throughout the rental period, depending on which is shorter. Previously, the rate of 15% was used for rental space improvements. Because as of 1.01.2007 there were no capitalized improvements, management is of opinion that the change in rates does not have any influence on the balance sheet or the income statement. Depreciation is calculated starting from the month of acquisition until the carrying amount is equal to the residual value of the asset. In case the residual value becomes greater than the carrying amount of the asset, no further depreciation expense is calculated.

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if it is appropriate, at each balance sheet date. The Group performs an impairment test whenever there is any indication that the carrying amount may not be recoverable. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's net selling price and its value in use), it is written down immediately to its recoverable amount and impairment losses are recognised in the income statement for the period.

Gains and losses on disposal on non-current assets, determined by subtracting the carrying amount from the proceeds, are reported in the income statement lines" Other operating income"/"Other operating expenses".

2.11 Intangible assets

Intangible assets are separately identifiable, non-monetary assets without physical substance and currently comprise acquired software licences. An intangible asset is initially measured at cost, comprising its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis. The annual amortisation rate for purchased licenses is 33% per annum. At each balance sheet date, the appropriateness of amortisation rates, methods and residual values are assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in the income statement in the amount by which the carrying amount exceeds the recoverable amount, which is the higher of the two indicators: fair value of the asset less costs to sell and its value in use.

2.12 Financial liabilities

Borrowings and issued bonds are initially recognised at fair value which also includes all transaction costs incurred (received money less transaction costs). Other financial liabilities (supplier payables, accrued expenses and other liabilities) are initially recognised at their acquisition cost, which includes all transaction costs related to acquisition. After initial recognition, financial liabilities are measured at amortised cost using the effective interest rate method. Borrowing costs are included in the effective interest rate calculations. Any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the instrument using the effective interest rate. Interest expenses are recorded in the income statement line under "Interest expenses".

2.13 Payables to employees

Payables to employees include vacation pay accrual calculated in accordance with employment contracts and the laws of the Republic of Estonia in force as of the balance sheet date. The liability related to the payment of vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the balance sheet and as personnel costs in the income statement.

2.14 Provisions and contingent liabilities

Commitments arising from an obligating event before the balance sheet date that have either a legal or contractual basis or that have arisen from the Company's current operating practice (legal or constructive obligation) that require the giving up of assets, whose realisation is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and whose cost can reliably be estimated but whose timing or amount are not definitely known are recognised as provisions in the balance sheet. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the balance sheet in the amount which according to management is necessary as of the balance sheet date for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and expense from change in carrying amount of provisions is included within expenses in the accounting period. Provisions are not set up to cover future losses.

When it is a probable that the provision is expected to realise later than 12 months after the balance sheet date it is recorded at the discounted value (present value of expected outflows), unless the discounting effect is immaterial.

Other possible obligations (promises, guarantees and other commitments) whose realisation is less probable than non-realisation or whose accompanying costs cannot be determined reliably but that in certain circumstances may become obligations, are disclosed in the notes to the financial statements as contingent liabilities. Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it is probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in extremely rare circumstances where no reliable estimate can be made).

2.15 Distinction between current and non-current assets and liabilities

Financial assets, the benefits of which are expected to flow to the Group within 12 months are recognised as current assets. The financial assets some of the expected benefits of which occur later than 12 months after the balance sheet date are recognised as non-current assets to the extent the cash flow is expected to be received after the 12 month period.

Financial liabilities are classified as current when they are due within twelve months after the balance sheet date or if the Group does not have an unconditional right to defer payment for later than 12 months after the balance sheet date. Loans whose due date is within 12 months after the balance sheet date but which are refinanced as non-current after the balance sheet date but before the financial statements are authorised for issue are recognised as current. Loans that the lender has the right recall at the balance sheet date as a consequence of a breach of contractual terms are also classified as current.

For all non-current assets and liabilities, the non-current portion is separately disclosed in a respective note to these consolidated financial statements.

2.16 Revenue and expenses

Revenue and expenses are accounted for using the accrual basis of accounting. Revenue is recognised when it is probable that future economic benefits associated with the transaction will flow to the Group and the amount of the revenue can be measured reliably. Revenue from services provided in the ordinary course of business is recognised at the fair value of the consideration received and receivable. Expenses are recognised when the Group has committed to the expense and/or received the goods or services, if the latter is earlier.

Fee and commission income (incl. custody and portfolio management fees) are usually recognised on an accrual basis when the service has been provided and the Company has established the right to receive them. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction from a third party (purchase or sale of businesses, acquisitions, etc.) are recognised on completion of the underlying transaction. Portfolio management, other consultation fees and management fees related to investment funds are recognised according to agreement, usually over the period for which the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance linked fees or fee components are recognised when the performance criteria are fulfilled. Other one-time service revenue and other revenue is recognised on an accrual basis at the time of executing the respective transactions.

Fee and commission expenses are recognised after the service has been provided and when the liability is incurred.

Interest income and expense is recognised in the income statement for all interest-bearing financial instruments carried at amortised cost using the effective interest rate method. Interest income also includes similar income on interest bearing financial instruments classified at fair value through profit or loss (i.e. tradable bonds, derivatives, etc).

The effective interest rate method is a method for calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate which exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future impairment losses. The calculation includes all significant fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flows discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Dividend income is recognised when the legal right to receive dividends is established.

2.17 Asset management services

The Group is engaged in providing asset management services. Such assets that have been given to the Group to manage by third parties and that the Group does not own are not included in the balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

2.18 Finance and operating leases - Group as the lessee

Leases of property, plant and equipment where the lessee acquires substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases.

Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of minimum lease payments. Each lease payment is allocated between the repayment of the liability and finance charges. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period (effective interest rate method). Property, plant & equipment acquired under finance leases are depreciated similarly to acquired assets over the shorter of the useful life of the asset and the lease term. In the financial year, the Group did not have any finance lease agreements.

Payments made under operating leases are charged to the income statement on a straight-line basis over the lease term. The Group uses mainly the operating lease for renting the premises, cars and computer equipment. Rental expense is recognised in the income statement as "Operating expenses".

2.19 Taxation and deferred income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. From 1 January 2008, the tax rate on the net dividends paid out of retained earnings is 21/79 (in 2007: 22/78 and in 2006: 23/77). In certain circumstances, it is possible to distribute dividends without any additional income tax expense. The Income Tax Act stipulates further reduction of the income tax rate until 2011: in 2009, the tax rate will be 20/80, in 2010: 19/81 and from 2011, the tax rate will be 18/82 of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid. An income tax liability is due at the 10th day of the month following the payment of dividends.

Due to the nature of the taxation system, the companies registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise. A contingent income tax liability which would arise due the payment of dividends is not recognised in the balance sheet. The maximum income tax liability which would accompany the distribution of Company's retained earnings is disclosed in the notes to the financial statements.

2.20 Offsetting of assets and liabilities

Financial assets and financial liabilities are not offset in the balance sheet unless the Group has a legal right for the offsetting of the asset and liability and it is probable that collection and payables occurs on a net basis.

2.21 Statutory reserve capita

Statutory reserve capital is formed to comply with the requirements of the Commercial Code. Reserve capital is formed from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be transferred to reserve capital, until it reaches one-tenth of share capital. Statutory reserve capital may be used to cover a loss, or to increase share capital. Payments to shareholders from reserve capital are not allowed.

2.22 Discontinued operations

A discontinued operation is a component of the Group that either has been disposed of, or that is classified as held for sale, and: (a) represents a separate major line of business or geographical area of operations; (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) is a subsidiary acquired exclusively with a view to resale. Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented.

NOTE 3 Risk policy and management

3.1 MANAGEMENT OF FINANCIAL RISKS

The principles of identification, management and control of risks at AS LHV Group are set out in the policies and procedures of risk management approved by the Supervisory Board. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of Group in order to ensure reliability, stability and profitability of group companies. The risk management system of the Group is mostly centralised, in order to ensure effective application of risk management principles in all group companies. The rules and procedures of risk management are constantly revised and updated in case of need.

The main financial risks arising from the activities of Group are:

- ✓ credit risk,
- ✓ market risk,
- ✓ liquidity risk,

3.1.1 Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet its obligations to the Group. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, but mostly credit exposures to customers, including outstanding loans, finance lease receivables, other receivables and other committed transactions. In order to hedge credit risk, the operations and financial position both of customers as well as business partners are analysed. The Management Board of the subsidiary AS Lõhmus, Haavel & Viisemann (*LHV*) is responsible for managing credit risk and the finance department is engaged in monitoring.

LHV grants margin loans backed with securities to its clients, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account and on the overall limit set by LHV, which currently is 1 million kroons (or the equivalent in a foreign currency) per client through LHV portal. The margin loan can be up to 50% of the securities accepted as collateral. The list of accepted financial instruments and the levels of required collateral are published on LHV's website www.lhv.ee. The credit risk involved with financial leverage is mitigated by constant monitoring of the market values of highly liquid securities required as collateral.

The main instruments that LHV accepts as collateral are:

- cash in bank
- local and international fund units
- securities quoted on Baltic, US and other stock exchanges

The brokerage unit monitors the collateral values daily. According to special conditions for leveraged trades, if values falls below 50%, the broker has the right to:

- request the client to transfer additional collateral to the account
- to refund the loan in the client's account without prior client's transaction order by expropriating the collateral.

The legal title of the property leased by LHV Ilmarise Kinnisvaraportfelli OÜ belongs legally to the Company until lease receivables have been collected in full. Therefore, the Company does not have any significant credit risk assuming that prices do not decrease that significantly in the real estate market due to which the value of collateral would fall below the nominal value of the amount of all receivables. According to the assessment reports of apartments from 2004, the collaterals are adequate to cover the finance lease receivables. The prices in the real estate market have significantly increased since then, on account of which there are no risks involved with the collateral.

AS LHV Varahaldus (*LHV Asset Management*) provides fund management services to investment and pension funds. Fund management fees are determined in accordance with issue prospectuses and LHV Varahaldus receives a monthly management fee which is transferred by the fund manager from the fund's account to the fund manager's account as a result of which there is no significant credit risk.

Analysis of credit quality	31.12.2007			31.12.2006		
	Finance lease receivables	Loans	Total	Finance lease receivables	Loans	Total
Receivables not yet due and not impaired	4 393	57 361	61 754	4 571	44 147	48 718
Past due receivables	17	217	234	11	201	212
Gross	**4 410**	**57 578**	**61 988**	**4 582**	**44 348**	**48 930**
Impaired receivables	0	-40	-40	0	-51	-51
Net	**4 410**	**57 538**	**61 948**	**4 582**	**44 297**	**48 879**

As of 31.12.2007, the Group's maximum credit risk exposure without any collateral would equal the carrying amount of these loans and finance lease receivables or 61 948 thousand kroons (31.12.2006: 48 879 thousand kroons).
The maximum credit risk exposure of derivatives is their fair value which as of 31.12.2007 is 53 thousand kroons (31.12.2006: 64 thousand kroons).
The maximum credit risk exposure of other financial assets recognised at fair value through profit or loss is the carrying amount of these financial assets or 57 691 thousand kroons (31.12.2006: 278 thousand kroons).
As of 31.12. 2007, the maximum credit risk exposure of other client receivables is also their carrying amount or 2 893 thousand kroons (31.12.2006: 1 819 thousand kroons).

3.1.2 Market risk

Market risk arises from LHV's trading and investment activities in interest rate, foreign exchange or equity markets. Market risk is a potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. In order to hedge market risk, conservative limits have been established for the trading portfolio and open foreign exchange positions at LHV. These limits are monitored by the finance department. LHV Varahaldus invests over half of its capital into the investment fund units under its management. The Management Board of LHV Varahaldus is responsible for identifying and monitoring market risk.

✓ ***Foreign exchange risk***

Foreign exchange risk may arise from acquisition of securities mostly denominated in foreign currencies; or foreign currency receivables and liabilities. The custody and risk management department of LHV is responsible for daily monitoring of the open foreign currency positions. If the open foreign currency position exceeds the limits set in regulatory acts, the measures are immediately implemented to reduce such positions (hedging the risk with relevant instruments, like foreign currency forwards or futures). Foreign exchange rate risks are managed under the following limits:

- Currency positions of OECD member states shall not exceed 15% of net assets owned
- Open position in any other currency (excl. euro, lats, litas) shall not exceed 5% of net assets owned
- Open positions for Estonian kroon, Latvian lats and Lithuanian litas are without limits, as these currencies are pegged to euro.

Information about assets and liabilities which carry the currency risk is presented in tables on pages 26-27. The main currencies, in which the Group has open positions, are USD, SEK and LVL. Open positions have not significantly changed throughout 2007 since with the balance sheet date of 31.12.2007.

A sensitivity analysis has been carried out for open currency positions and their possible reasonable effect on the income statement as of 31.12.2007. If USD strengthened by 10% against the Estonian kroon with all other variables held constant, additional profit of 4 thousand kroons would be possible, mainly as a result of foreign exchange gains on translation of USD denominated loans and receivables, hedged by the currency forward. If LVL strengthened by 0.5% against the Estonian kroon, additional profit as a result of LVL denominated loans would be 13 thousand kroons. If SEK strengthens by 6% against the Estonian kroon, the loss as a result of SEK denominated loans and somewhat bigger SEK sales forward would be 8 thousand kroons. The whole effect from foreign exchange rate appreciation would be additional revenue of 9 thousand kroons. If the respective currencies weakened against Estonian kroon, the potential loss would be 9 thousand kroons.

Open currency positions

The following tables present the risks arising from open foreign currency positions. Assets and liabilities denominated in foreign currencies are presented in EEK equivalent in respective columns, according to the exchange rate on the balance sheet date. Derivatives reported at fair value in the balance sheet have been included within contractual amounts among contingencies and commitments. Open currency positions and the volume of financial assets and liabilities of the Group on the balance sheet date do not differ significantly from the average positions during the year.

As of 31.12.2007

Assets bearing currency risk	EEK	LTL	LVL	EUR	SEK	USD	Other	**Total**
Cash and cash equivalents	8 445	4	2	1 172	170	232	771	**10 796**
Financial assets at fair value through profit or loss	29 042	0	0	28 329	22	87	211	**57 691**
Loans to customers	15 165	25 950	2 610	3 275	2 570	7 057	911	**57 538**
Receivables from customers	1 824	0	0	100	103	691	175	**2 893**
Other assets	1 502	18	0	898	0	0	0	**2 418**
Total assets bearing currency risk	**55 978**	**34 910**	**2 612**	**24 836**	**2 865**	**8 067**	**2 068**	**131 336**
Assets not bearing currency risk								
Finance lease receivables	4 410	0	0	0	0	0	0	**4 410**
Goodwill	8 723	0	0	0	0	0	0	**8 723**
Property, plant and equipment and intangible assets	5 952	0	0	0	0	0	0	**5 952**
Total assets not bearing currency risk	**19 085**	**0**	**0**	**0**	**0**	**0**	**0**	**19 085**
Total assets *	**75 063**	**34 910**	**2 612**	**24 836**	**2 865**	**8 067**	**2 068**	**150 421**
Contingencies at contractual amounts (Note 14)	**10 711**	**0**	**0**	**0**	**0**	**0**	**0**	**10 711**
Liabilities bearing currency risk								
Loans received	18 677	0	0	10 929	0	191	0	**29 797**
Accrued expenses	9 462	764	243	35	0	7	0	**10 511**
Total liabilities bearing currency risk	**28 139**	**764**	**243**	**10 964**	**0**	**198**	**0**	**40 308**
Liabilities not bearing currency risk								
Provisions	4 880	0	0	0	0	0	0	**4 880**
Bonds issued	4 485	0	0	0	0	0	0	**4 485**
Total liabilities not bearing currency risk	**9 365**	**0**	**0**	**0**	**0**	**0**	**0**	**9 365**
Total liabilities *	**37 504**	**764**	**243**	**10 964**	**0**	**198**	**0**	**49 673**
Commitments at contractual amounts (Note 14)	**0**	**0**	**0**	**0**	**2 825**	**7 833**	**0**	**10 658**
Shareholders' equity	100 801	0	0	0	0	0	0	100 801
Open foreign currency position	**-52 531**	**34 146**	**2 369**	**13 872**	**40**	**36**	**2 068**	**0**

***** the difference in total assets and total liabilities from their balance sheet values is attributable to the fair value of the derivatives, which is shown here at full contractual amounts.

LHV

As of 31.12.2006

Assets bearing currency risk	EEK	EUR	LTL	LVL	SEK	USD	Other	**Total**
Cash and bank	14 076	15	1	2	0	882	4	**14 980**
Financial assets at fair value through profit or loss	0	131	0	0	52	77	18	**278**
Loans to customers	12 821	3 370	21 294	423	1 875	3 827	687	**44 297**
Receivables from customers	931	0	0	0	0	672	216	**1 819**
Investments in joint ventures	18 164	0	0	0	0	0	0	**18 164**
Other assets	524	0	82	89	0	71	0	**766**
Total securities bearing currency risk	**46 516**	**3 516**	**21 377**	**514**	**1 927**	**5 529**	**925**	**80 304**
Assets not bearing currency risk								
Finance lease receivables	4 582	0	0	0	0	0	0	**4 582**
Property, plant and equipment and intangible assets	607	0	0	0	0	0	0	**607**
Total assets not bearing currency risk	**5 189**	**0**	**0**	**0**	**0**	**0**	**0**	**5189**
Total assets *	**51 705**	**3 516**	**21 377**	**514**	**1 927**	**5 529**	**925**	**85 493**
Contingencies at contractual amounts (Note 14)	**4 658**	**0**	**0**	**0**	**0**	**0**	**0**	**4 658**
Liabilities bearing currency risk								
Loans received	24 823	3 484	1 911	0	0	0	0	**30 218**
Other financial liabilities	10 661	0	0	0	0	0	0	**10 661**
Accrued expenses	2 742	33	462	34	0	0	0	**3 271**
Provisions	0	0	0	0	0	4 880	0	**4 880**
Total liabilities bearing currency risk	**38 226**	**3 517**	**2 373**	**34**	**0**	**4 880**	**0**	**49 030**
Liabilities not bearing currency risk								
Bonds issued	6 426	0	0	0	0	0	0	**6 426**
Total liabilities not bearing currency risk	**6 426**	**0**	**0**	**0**	**0**	**0**	**0**	**6 426**
Total liabilities *	**44 652**	**3 517**	**2 373**	**34**	**0**	**4 880**	**0**	**55 456**
Commitments at contractual amounts (Note 14)	**0**	**0**	**0**	**0**	**2 248**	**2 376**	**0**	**4 624**
Shareholders' equity	30 071	0	0	0	0	0	0	30 071
Open foreign currency position	**-18 360**	**-1**	**19 004**	**480**	**-321**	**-1 727**	**925**	**0**

***** the difference in total assets and total liabilities from their balance sheet values is attributable to the fair value of the derivatives, which is shown here at full contractual amounts.

✓ ***Price risk***

Financial instruments bearing price risk are securities in the trading portfolio of LHV and those in the investment portfolio of LHV Varahaldus. The limits are set for the size of the trading portfolio of LHV. The trading portfolio is managed by the head of the brokerage team and adherence to the limit is monitored by an employee in the custody and risk management department.

The goal of the investment portfolio of LHV Varahaldus is to invest its available funds similarly to how the assets under management of LHV Varahaldus are managed; therefore, LHV Varahaldus invests more than half of its capital in the funds under its management. For the purpose of ensuring liquidity, the rest of the available funds are deposited in liquid securities, including bonds and deposits.

The management of LHV is of opinion that a possible average change in the prices of stocks in the trading portfolio during the next 12 months is around 20% and the possible average change in the prices of fund units is around 10%. If the prices of shares and fund units increase by 20% and 10%, respectively, with other variables held constant, the possible additional profit from this change will amount to 38 thousand kroons. If stock prices fall by 20% and fund prices fall by 10%, the potential loss will amount to 38 thousand kroons.

According to the Investment Funds Act, the mandatory interest of LHV as a fund manager in each of the mandatory pension funds under its management is 1% of the number of units. The investment portfolio of LHV Varahaldus comprises both units of pension funds as well as units of investment funds under its management. Management estimates that the average change of prices of fund units in the portfolio is 5% in the next 12 months, and if prices increase, additional revenue will amount to 2 000 thousand and it they fall, the loss will amount to 2 000 thousand kroons. If the prices of shares in the investment portfolio increase by 20%, the additional profit will be 41 thousand kroons and if prices fall by 20%, the loss will be 41 thousand kroons.

✓ ***Interest rate risk***

To reduce the cash flow risk arising from possible change in interest rates, LHV primarily uses fixed interest rates both for taking loans as well as granting them. In 2007, the fixed interest rate on loans granted was between 7.75-12.75% (2006: 6.5-11.25%). Interest rates for loans granted are changed once a month according to fluctuations of market interest rates. When taking loans, the relation between the weighed average interest rate on loans granted and loans received is followed. Interest rates on loans received in 2007 were a maximum of 8% (2006: 7%). Interest rate risk is also reduced by framing up the due dates of loans – loans are taken mostly with short, but extendable due dates. The limits are set for granting loans as presented in the note on credit risk – up to 1 million kroons per client through LHV portal. Prior to granting bigger loans, a liquidity analysis is carried out and the decision for granting such loans is made by the management board.

The investment portfolio of LHV Varahaldus contains two types of bonds:

- coupon bonds with fixed interest rates which do not carry interest rate risk exists;
- coupon interest rate risk with floating interest rates as a result of which the expected cash flows from investments may differ from the actual ones.

The management of Asset Management considers the expected return on the last bonds issued to be reasonably good and will thus tolerate some interest rate risk.

The finance lease receivables and issued bonds of LHV Ilmarise Kinnisvaraportfelli OÜ are with fixed interest rates of 6-8% and 5.8%, respectively. The redemption of bonds is performed in accordance with the scheduled collection of finance lease receivables. If customers wish to terminate finance lease agreements before the due date then the Group has the right to redeem the issued bonds in the additionally collected amount. Due to this, the Group does not bear significant interest rate risk.

The floating interest rate of the deposit in Estonian kroons was between 3.3-5.25% (2006: 2.6-3.3%) and that of the deposit in USD was a maximum of 5%. As the portfolio of loans granted and loans received is short-term in its nature, the change in market interest rates does not have significant influence on the fair value of these loans.

3.1.3 Liquidity risk

Liquidity risk relates to the solvency of LHV to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The finance department of LHV is responsible for the management of liquidity risk. In order to hedge liquidity risk, regular monitoring of the probable net position of receivables and liabilities by maturities is carried out and an adequate number of liquid assets is kept in each time period. The sources of financing are replenished on an ongoing basis when their due dates have arrived or clients take additional loans. In case of diminishing volumes of loans granted, the financing sources are reduced accordingly, as the loans received are all short-term. As of 31.12.2007 and 31.12.2006, the Group does not have any debts past due.

Undiscounted cash flows of issued bonds up to 1 year are in the amount of 404 thousand kroons, between 1-5 years in the amount of 1 629 thousand kroons and over 5 years in the amount of 5 332 thousand kroons. The corresponding undiscounted cash flows from finance lease receivables up to 1 year are in the amount of 436 thousand kroons, between 1-5 years in the amount 1 651 thousand kroons and over 5 years in the amount of 5 303 thousand kroons.

The following tables present the division of financial assets and liabilities by due dates. The balance sheet values are used in analyses, except for derivatives, for which the contractual amounts are used. Explanation about the fair value of these financial assets and liabilities is presented Note 3.2.

As of 31.12.2007

Financial assets	**up to 3 month**	**3-12 months**	**1-5 years**	**over 5 years**	**Total**
Cash and bank	10 796	0	0	0	**10 796**
Financial assets at fair value through profit or loss	4 440	15 271	0	37 980	**57 691**
Derivatives	2 033	845	0	0	**2 878**
Loans to customers	55 130	2 408	0	0	**57 538**
Receivables from customers	2 199	694	0	0	**2 893**
Finance lease receivables	41	125	669	3 575	**4 410**
Other receivables and assets	**74 639**	**19 343**	**669**	**41 555**	**136 206**
Financial liabilities					
Derivatives	1 994	831	0	0	**2 825**
Loans received	29 797	0	0	0	**29 797**
Accrued expenses and other liabilities	9 273	1 238	0	0	**10 511**
Bonds issued	35	173	674	3 603	**4 485**
Total	**41 099**	**2 242**	**674**	**3 603**	**47 618**

As of 31.12.2006

Financial assets	**up to 3 month**	**3-12 months**	**1-5 years**	**over 5 years**	**Total**
Cash and bank	14 119	861	0	0	**14 980**
Financial assets at fair value through profit or loss	278	0	0	0	**278**
Derivatives	64	0	0	0	**64**
Loans to customers	43 682	615	0	0	**44 297**
Receivables from customers	1 819	0	0	0	**1 819**
Finance lease receivables	80	81	676	3 745	**4 582**
Other receivables and assets	0	537	229	0	**766**
Total	**60 042**	**2 094**	**905**	**3 745**	**66 786**
Financial liabilities					
Derivatives	22	8	0	0	**30**
Loans received	27 234	2 984	0	0	**30 218**
Accrued expenses and other liabilities	3 271	0	0	0	**3 271**
Bonds issued	1 846	111	683	3 786	**6 426**
Total	**32 373**	**3 103**	**683**	**3 786**	**39 945**

3.2 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Group estimates that the fair values of the assets and liabilities carried in the balance sheet at amortised cost do not differ significantly from their carrying amounts as of 31.12.2007 and 31.12.2006. Loans granted to customers that have been issued with fixed interest rates are sufficiently short-term and issued at the market terms, so that the fair market rate and respectively the fair value of the loan does not differ significantly during the loan term. Loans received also bear fixed interest rates, but similarly to the loans granted, these are of very short maturity and therefore the fair value does not change significantly during the loan term. Information on liquidity is presented in the section above.

Receivables from clients, accrued expenses and other liabilities have arisen in operating activities and are payable in the short term, and therefore, management is of opinion that their fair value does not differ significantly from their carrying amount. These receivables and liabilities are interest-free.

Both finance lease receivables and bonds issued are with significantly longer due dates and the fair value of these expected cash flows at the current market rates might differ from the carrying amounts of the lease receivables and bonds issued. However as the lease holders have the right to exit the contracts effectively at any time during the lease period and as this has been very actively used, it would not be appropriate to consider these cash flows from the currently valid contracts as expected cash flows according to the loan schedules specified in the contracts. Bonds have been redeemed in exactly the same volume as the finance lease contracts repaid. Therefore, management has evaluated and concluded that there is no significant difference in the net fair value of lease receivables and issued bonds combined as compared to their current net carrying amount. The bonds are quoted on the Tallinn Stock Exchange. Since their first quotation on the stock exchange on 13.10.2005 until 31.12.2007, there have been no transactions with bonds and thus there is no information on price movements. As there have been no transactions with these bonds on the secondary market either, the fair value of bonds is not reliably determinable, which is why this value is not presented here. The Company's management is of opinion that there are no indications for this value to be significantly different from the carrying amount. In the period between concluding the finance lease agreements and the balance sheet date, the 6-month Euribor has increased from 2.253% to 4.707%, which gives a general indication of change in variable market rates during that period.

3.3 CAPITAL MANAGEMENT

The Group's objectives when managing capital, which is a broader concept than the 'equity' on the face of balance sheets, are:

- ✓ to comply with the capital requirements set by the regulators;
- ✓ to ensure the Group's ability to continue as a going concern and provide returns for shareholders;
- ✓ to maintain a strong capital base which supports the development of business.

The finance department monitors capital adequacy and the use of regulatory capital and reports it to the monitoring authority on a quarterly basis. Specific requirements have been set for the Group to cover the risks both on an individual as well as consolidated basis. In 2007,there were no problems related to meeting the demands of capital adequacy. The Group's own funds consist of Tier 1, Tier 2 and Tier 3 own funds. The Group does not have any Tier 2 or Tier 3 own funds (subordinated loans, preferred shares). As of 31.12.2007, the Group's consolidated Tier 1 own funds totalled 91 949 thousand kroons (31.12.2006: 30 016 thousand kroons).

The regulatory capital of LHV as an investment company has to be at least equal to or exceed the minimum requirement for share capital set out in the Securities Market Act (730 thousand euros i.e. 11 422 thousand kroons) and 25 percent of the Company's fixed overhead. The own funds of LHV Varahaldus as a fund manager shall at any given time period exceed the minimum amount of share capital laid down in the Investment Funds Act (3 000 euros or 46 940 thousand kroons), 25 per cent of fixed overheads and 2% of the market value of pension funds under management.

The loan capital is managed pursuant to internal rules, following the principles explained in the sections dealing with credit risk, liquidity risk and interest rate risk.

Consolidated own funds	**31.12.2007**	**31.12.2006**
Paid-in share capital	76 496	40 832
Reserve capital	2 830	2 830
Retained earnings/(-losses)	1 914	-9 308
Minority interest	19 561	0
Intangible assets (negative)	-8 852	-55
Treasury shares	0	-4 283
Total Tier 1 own funds	**91 949**	**30 016**

3.4 OPERATING RISK

Operating risk is a potential loss caused by human, process or information system flaws. When executing transactions, transaction limits and competence systems are used to minimise potential losses and the principle of duality is used in LHV's working procedures, according to which there should be an approval by at least two employees or units for carrying out the transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of LHV and to evaluate capital requirements. The analysis on cases gathered into database enables LHV to identify the flaws in rules of procedures, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The heads of units are responsible for collecting information and the management board of LHV deals with the analysis and implementing necessary measures.

Compliance control and internal audit have an important role in evaluating, monitoring and hedging the operating risk. The main task of the compliance control specialist is, as specified in the Securities Market Act, to define risks of non-compliance of the activities of LHV with legislation, recommended guidelines of the Financial Supervisory Authority and rules of procedures of LHV, reckoning with the nature, range and complexity of business and services rendered, and arrangement of hedging or avoiding those risks. Internal audit is an independent and objective, assuring and consulting activity that is targeted at improving the Company' performance and creating additional value. Internal audit helps achieve the goals of the Company, using a systematic and disciplined approach to improve risk management, control and the organisational management process.

3.5 CHANGES IN GLOBAL FINANCIAL MARKETS

From the second half of 2007, there has been a sharp increase in foreclosures in the US subprime market due to payment difficulties. The effects of it have spread beyond the US real estate market as global investors have re-evaluated their risk tolerance, which has led to greater volatility and lower liquidity in the financial markets of fixed interest instruments, equity instruments and derivatives. Despite the fact that the situation in the European markets is better as compared to the US, the appreciation of euro, tighter credit conditions and higher inflation have an impact on the volatility and liquidity in the Group's retail markets. Changes in financial markets may impact the Group's ability to borrow new funds and refinance its current borrowings on such terms that were available just recently. The changed economic climate may also affect the liquidity of the Group's clients which in turn impacts their payment behaviour and ability to pay the Group on time. The Group's management is unable to reliably estimate the impact of a further decline in liquidity and volatility of financial markets on the Group's financial position.

NOTE 4 Significant management estimates and assumptions

In accordance with IFRS, several financial figures presented in the consolidated financial statements are based on critical accounting estimates and assumptions made by management, which will affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements on the balance sheet date and the reported amounts of revenue and expenses for the reporting period during the next financial years. Although these estimates have been made to the best of management's knowledge and their judgement of current events and actions, the actual outcome and the results ultimately may not coincide and may significantly differ from those estimates.
Management's estimates have primarily been applied to:

- recognising impairment losses of loans, receivables and investments;
- fair valuation of investments using valuation techniques;
- determining useful lives of non-current assets (see Note 2.10, 2.11 and 19);
- assessing provisions and contingent assets / liabilities;
- evaluating the Company's risks.

Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Changes in management's estimates are reported in the income statement of the period in which the change occurred. In these financial statements there are no significant positions, whose carrying amount would be influenced by specific judgements of management.

NOTE 5 Net fee and commission income

According to Estonian version of NACE (EMTAK) code, the gross revenue of 2007 was divided as follows: financial advisory revenue 1 995 thousand kroons, security brokerage (incl. asset management) revenue 44 847 thousand kroons and fund management revenue 3 211 thousand kroons. In 2006, financial advisory revenue was 2 120 thousand kroons and security brokerage revenue was 25 648 thousand kroons.

	2007	2006
Fee and commission income		
Financial advisory services	1 995	2 120
Security brokerage and commissions	40 417	21 489
incl. related parties (note 29)	*2 078*	*530*
Assets management and fund management	7 641	4 159
incl. related parties (note 29)	*2 305*	*20*
Total	**50 053**	**27 768**
Fee and commission expense		
Financial advisory and other similar services purchased	-1 744	-1 365
incl. related parties (note 29)	*0*	*-180*
Security brokerage and commissions paid	-7 162	-4 489
Total	**-8 906**	**-5 854**
Net fee and commission income	**41 147**	**21 914**

* The client base of LHV grew steadily in 2007 and a lot of new traders have joined in. In addition to growing activeness of clients, the growth of fee and commission income has been influenced by volatile markets.

Fee and commission income by client location:	2007	2006
Estonia	42 503	24 627
Latvia	893	38
Lithuania	6 657	3 103
Total	**50 053**	**27 768**

NOTE 6 Net interest income

	2007	2006
Interest income		
Cash and bank accounts	2 145	1 097
Finance lease (Note 16)	280	552
Collateral loans and lending of securities (Note 12)	6 994	2 662
Other loans (Note 12)	243	390
incl. loans to related parties (Note 29)	*0*	*2*
Total	**9 662**	**4 701**
Interest expense		
Bonds issued (Note 22)	-268	-500
Loans received (Note 20)	-1 920	-719
incl. loans from related parties (Note 29)	*-196*	*- 182*
Total	**-2 188**	**-1 219**
Net interest income	**7 474**	**3 482**

* Using financial leverage has increased significantly due to a growing number of trades in 2007. Lithuanian clients have shown especially great activity in this regard. At the end of financial year, the volume of collateral loans amounted to 57 million kroons, while in the summer of 2007, the volume amounted even to 75 million kroons, as a result of which interest income has grown considerably.

Interest income by client location:	2007	2006
Estonia	4 354	3 521
Latvia	192	1
Lithuania	5 116	1 179
Total	**9 662**	**4 701**

NOTE 7 Revenue from financial assets

	2007	2006
Net gains/losses from trading		
Due to changes in foreign exchange rates:	2 736	1 687
- translation gains	73	432
- transactions gains from client trades	2 663	1 255
Net profit from revaluation and sales of equities and fund shares	-116	-191
Net gain from trading	**2 620**	**1 496**

Net gains/losses from investments recognised at fair value through profit or loss at acquisition		
Net gains less losses from changes in fair value of bonds	539	49
Net loss / gain from change in fair value of shares and fund units	-818	1 291
Net (loss)/ gain from investments	**-279**	**1 340**
Other income and expenses		
Dividend income from trading portfolio securities	3	83
Cost related to repurchasing of option concluded on shares of subsidiary (Note 29)	-4 051	0
Total	**-4 048**	**83**
Net (loss)/gain from financial assets	**-1 707**	**2 919**

NOTE 8 Other revenue

	2007	2006
Accounting services rendered	679	1 992
Other income (investment seminars to clients, etc.)	421	431
Received fines and penalties	25	0
Revenue from transactions with related parties (Note 29)	8 043	0
Revenue from transactions with other parties	7 255	0
Total other revenue	**16 423**	**2 423**

NOTE 9 Operating expenses

	Note	2007	2006
Personnel expenses			
Wages, salaries and bonuses		16 419	9 297
Social security and other taxes		5 208	2 788
Total		**21 627**	**12 085**
Marketing expenses		6 592	944
Other purchased services		4 955	4 229
Costs related to setting up provisions	23	2 957	0
Operating lease payments	26	2 922	1 652
Information services and bank services		1 904	1 540
IT expenses		1 857	1 659
Office expenses		1 551	866
Training and travelling expenses of employees		1 222	868
Transportation and communication costs		1 061	853
Other administrative expenses		1 302	3 245
Depreciation	19	571	864
Other expenses		2 483	312
Total operating expenses		**51 004**	**29 117**

NOTE 10 Corporate income tax

According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Instead of taxing the net profit, the distribution of retained earnings is subject to taxation at the rate of 21/79 (until 31.12.2006: 22/78) of net dividend paid. In 2007, no dividend payments were made to the shareholders. In 2006, dividends were paid to the shareholders from discontinued operations in the amount of 19 853 thousand kroons, the income tax on which totalled 5 665 thousand kroons (See Note 25 regarding potential income tax liability calculated on retained earnings).

NOTE 11 Cash and cash equivalents

	31.12.2007	31.12.2006
Demand deposits	10 796	14 119
Total cash and cash equivalents	**10 796**	**14 119**
Other receivables from financial institutions (Note 23)	0	861
Total cash and bank	**10 796**	**14 980**

NOTE 12 Loans to customers

	Loan balance 31.12.2007	Loan balance 31.12.2006	Interest rate
Loans to companies	6 058	30 775	7.75%-12.75%
Loans to private persons	51 520	13 573	7.75%-12.75%
Allowances for loans	-40	-51	
Total loans	**57 538**	**44 297**	

The distribution of loans to customers by currency is presented in Note 3 on pages 26-27 and by due dates in Note 3 on page 29. Loans granted are secured by securities and can be terminated by the client at any time. Information about positions open to credit risk, securities accepted as collateral and loans past due is presented in Note 3 on page 25.

According to customer location:	31.12.2007	31.12.2006
Estonia	12 223	14 733
Latvia	1 664	0
Lithuania	43 651	29 564
Total loans	**57 538**	**44 297**

Interest rates on loans in different currencies at the Group as of 31.12.2007:

EEK	11.00%	LVL	11.00%	GBP	12.75%
EUR	11.00%	HRK	12.50%	SEK	10.50%
LTL	11.00%	USD	12.25%	JPY	7.75%

The nominal interest rates for most of the loans granted is equal to their effective interest rates as there have been no significant other fees received at issuance and the market rate of interest for similar loans has not changed significantly during the loan period.

NOTE 13 Receivables from customers

	31.12.2007	31.12.2006
Securities brokerage fees from intermediaries	1 500	1 070
Asset management fees from clients	1 223	310
Other fees for providing services to customers	170	439
incl. related parties (Note 29)	*808*	*0*
Total	**2 893**	**1 819**

All fees are receivable within 12 months after the balance sheet date, and therefore should be considered current assets.

NOTE 14 Derivative financial instruments

	Receivable / liability (fair value)	Contingent assets (contract amount)	Commitments (contract amount)
As of 31.12.2007			
Foreign currency future contract (USD)	0	7 833	7 833
Foreign currency forward contracts (SEK)	53	2 878	2 825
Total derivatives	**53**	**10 711**	**10 658**
As of 31.12.2006			
Foreign currency forward contracts (USD)	64	2 440	2 376
Foreign currency forward contracts (SEK)	-30	2 218	2 248
Total derivatives	**34**	**4 658**	**4 624**

The foreign currency forward contracts have been concluded to hedge the foreign exchange risk related to the loans, receivables and securities and they are denominated in Swedish kroons and/or US dollars. The currency future contract has been concluded in USD for the same purpose. The currency future is tradable on the stock exchange and daily gains/losses are immediately transferred to the bank account of LHV. Therefore, the carrying amount of the currency future is zero. The due dates of contracts are between 1 and 5 months after the balance sheet date (2006: 2-5 months).

NOTE 15 Other financial assets at fair value through profit or loss

	31.12.2007	31.12.2006
Shares	38	54
Fund units	388	224
Bonds	4 044	0
Total financial assets held for trading	**4 470**	**278**
Shares	207	0
Fund units	40 156	0
incl. investments in managed pension funds	*29 042*	*0*
incl. investments in managed investment funds	*8 938*	*0*
Bonds	12 888	0
Financial assets designated at fair value through profit or loss at inception	**53 251**	**0**
Total financial assets	**57 691**	**278**

LHV

NOTE 16 Finance lease receivables

Net investment by due dates	**31.12.2007**	**31.12.2006**
Up to 1 year	166	161
Between 1 and 5 years	669	676
Over 5 years	3 575	3 745
Total net investment	**4 410**	**4 582**
Future interest income by due dates		
Up to 1 year	270	284
Between 1 and 5 years	982	1 039
Over 5 years	1 727	1 998
Total future interest income	**2 979**	**3 321**
Gross investment by due dates		
Up to 1 year	436	445
Between 1 and 5 years	1 651	1 715
Over 5 years	5 302	5 743
Total gross investment	**7 389**	**7 903**

On 21.01.2005, LHV Ilmarise Kinnisvaraportfelli OÜ, the subsidiary of the parent company AS Lõhmus, Haavel & Viisemann, acquired the portfolio of lease receivables of OÜ Ilmarise Kvartal arising from finance lease agreements concerning finance lease payments in the amount of 18 529 thousand kroons (contractual principal payments) from a third party. The underlying currency of finance lease agreements is the Estonian kroon. The annual interest rate on the finance lease agreements is between 6% and 8% and it is fixed. In addition, OÜ Ilmarise Kvartal made an irrevocable payment of 141 thousand kroons to cover the credit risks associated with these lease receivables and the clients in these lease contracts. This is effectively accounted for as part of the acquisition cost of these lease receivables and deducted from the payment to reach the effective interest rate for these lease receivables (see interest expense in Note 6).

These lease contracts are for the leasing of apartments by the lessees and according to the contract, the lessees will become owners of these apartments upon payment of all lease payments. The lessees have the right to pay the full amount of the net investment early and to acquire the apartment before the end of the lease term. In 2007, ownership of 1 apartment was transferred (purchased by lessees) for the total amount of 71 thousand kroons and additionally principal payments were made for the apartments not yet transferred in the amount of 115 thousand kroons. In 2006, ownerships of 8 apartments were transferred for the total amount of 5 827 thousand kroons and principal payments were made in the amount of 432 thousand kroons. By the time of compiling this report, 8 apartments have not yet been purchased.

All finance lease receivables have been pledged to secure issued bonds. AS Sampo Pank acts as a guarantee agent and custodian of pledged assets (see Note 22). For past due receivables, see the table for credit risk in Note 3 page 25.

NOTE 17 Other assets

	31.12.2007	**31.12.2006**
Guarantee deposits of Baltic stock exchanges	279	229
Prepayments of legal costs	0	71
Prepayments of marketing costs	1 125	0
Prepayments to Financial Supervision Authority	507	172
Other prepayments *	507	294
Total	**2 418**	**766**

* Prepayments are for office rent, insurance, periodicals.

Prepayments are expected to be received or used within 12 months after the balance sheet date, and therefore are considered as current assets. Guarantee deposits at the Baltic Stock Exchanges are held to guarantee execution of securities on Tallinn, Riga and Vilnius stock exchanges, and should therefore be considered as non-current assets. The increase in guarantee deposits relates to calculations performed in accordance with the rules of the Tallinn Stock Exchange and trading volumes of LHV's clients on Baltic stock exchanges.

NOTE 18 Subsidiaries and joint ventures

In 2006, and until 30.09.2007 **AS LHV Varahaldus** was accounted for as a joint venture according to the shareholders' contract regulating that shareholders have joint control over the parent company.

Ownership % at beginning of 2006	21.58%
Carrying amount of investment at beginning of 2006	8 727
Cost of acquired interest	11 414
Losst from equity method	-1 977
Ownership % at end of 2006	30.74%
Ownership interest at end of 2006	**18 164**
Ownership % at beginning of 2007	30.74%
Ownership interest at beginning of 2007	18 164
Profit from equity method	775
Ownership % at 30.09.2007	30.74%
Ownership interest at 30.09.2007	**18 939**

At the end of 2006, the share capital AS LHV Varahaldus was increased by issuing new shares, according to which AS LHV Group subscribed for new shares for 7 439 thousand kroons and increased its interest by 4.96%. AS LHV Group obtained an additional interest of 4.20% by purchasing shares from AS Seesam Elukindlustus for 3 975 thousand kroons. As a result of these transactions, the ownership of the Group increased from 21.58% to 30.74%. Goodwill arose in the process of acquiring additional shares of AS LHV Varahaldus in the amount of 2 243 thousand kroons.

In October 2007, AS LHV Group acquired an additional interest of 31.22% in AS LHV Varahaldus, as a result of which AS LHV Varahaldus became a subsidiary of AS LHV Group with an ownership interest of 61.96%.

Purchase price analysis

Purchase of shares of AS LHV Varahaldus at acquisition cost of 11.31 kroons per share	30.09.2007
Cash and bank accounts	577
Receivables	771
Financial investments	56 953
Non-current assets	1 258
Liabilities	5 250
Equity	54 309
Acquired interest	31.22%
Net assets acquired	16 955
Cost	**22 251**
Goodwill	5 296

As of 31.12.2007, the Group's subsidiaries that have been consolidated in these financial statements are:

- AS Lõhmus, Haavel & Viisemann (interest: 100%)
- LHV Ilmarise Kinnisvaraportfelli OÜ (interest 100%)
- AS LHV Varahaldus (interest 61.96%)

Goodwill in the consolidated balance sheet of AS LHV Group comprises:

- Positive goodwill which arose in the acquisition of interests in AS LHV Varahaldus in the amount of 7 539 thousand kroons
- Goodwill included in the balance sheet of AS LHV Varahaldus which arose in the acquisition of the subsidiary (former fund manager AS Seesam Varahaldus) in the amount of 1 184 thousand kroons.

A goodwill test was performed as of 31.12.2007. The cash-generating unit for goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

1) The cash flow forecast for 2008- 2014 is based on the business plan approved by management, according to which the annual average growth of income is 8% and the growth of operating expenses is 10%;
2) the discount rate used is 12%;
3) key assumptions are based on historical experience.

The test of the value in use shows that the recoverable amount of goodwill exceeds significantly its carrying amount; therefore, no impairment losses have been recognised.

NOTE 19 Non-current assets

Balance as of 31.12.2005	Property, plant and equipment	Intangible assets	Total
Cost	6 939	1 170	8 109
Accumulated depreciation and amortisation	-3 214	-983	-4 197
Carrying amount	**3 725**	**187**	**3 912**
Changes occurred in 2006			
Purchase of non-current assets	336	45	381
Depreciation and amortisation charge	-828	-36	-864
Property, plant and equipment of discontinued operations	-2 681	-141	-2 822
Balance as of 31.12.2006			
Cost	3 040	441	3 481
Accumulated depreciation and amortisation	-2 488	-386	-2 874
Carrying amount	**552**	**55**	**607**
Changes occurred in 2007			
Purchase of non-current assets	5 754	104	5 858
Non-current assets sold at carrying amount	-13	-3	-16
Non-current assets of AS LHV Varahaldus at cost	95	21	116
Accumulated depreciation and amortisation of AS LHV Varahaldus as of 30.09.2007	-35	-7	-42
Depreciation and amortisation charge	-530	-41	-571
Balance as of 31.12.2007			
Cost	7 147	562	7 709
Accumulated depreciation and amortisation	-1 324	-433	-1 757
Carrying amount	**5 823**	**129**	**5 952**

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Capitalised reconstruction expenses and furniture and other furnishings related to the new investment centre make up the major part of non-current assets acquired in the reporting period, totalling 5 442 thousand kroons. Computers and other office technology have been purchased for 312 thousand kroons.

During the financial year property, plant and equipment with the acquisition cost of 1 726 thousand kroons was disposed of. The carrying amount of the disposed assets was nil. No profit or loss was recognised on disposal.

No indications of impairment of property, plant and equipment or intangible assets was evident in 2007 or 2006.

NOTE 20 Loans received

	Loan balance 31.12.2007	Loan balance 31.12.2006	Interest rate
Loans from shareholders and related companies (Note 29)	6 015	5 276	5-7%
Loans from financial institutions	0	4 862	6,25%
Loans from private persons	3 281	1 394	5-8%
Loans from companies	20 501	18 686	5-8%
Total	**29 797**	**30 218**	

The loans received are denominated in Estonian kroons, Euros and US dollars. The distribution by currencies is presented in Note 3 on pages 26-27 and due dates on page 29. Interest liabilities as of 31.12.2007 in the amount of 339 thousand kroons are included in the balance of loans received (31.12.2006: 127 thousand kroons).

Nominal interest rates for most of the loans is equal to their effective interest rates as there have been no other significant other fees paid.

NOTE 21 Accrued expenses and other financial liabilities

	31.12.2007	31.12.2006
Supplier payables	1 424	690
Payables to employees	6 765	1 430
Tax liabilities	1 837	1 151
Other short-term liabilities	485	0
Total	**10 511**	**3 271**

Supplier payables are expected to be paid within 12 months after the balance sheet date, and therefore are considered current liabilities. Payables to employees consist of unpaid salaries for the accounting period, bonus accruals and vacation pay accrual. Tax liabilities on salaries and VAT payable are recognised as other liabilities in the balance sheet. All tax liabilities are expected to be paid within 12 months after the balance sheet date, and therefore should be considered as current liabilities.

NOTE 22 Bonds issued

Maturities of liabilities	**31.12.2007**	**31.12.2006**
Up to 1 year	208	1 957
Between 1 and 5 years	674	683
Over 5 years	3 603	3 786
Total issued bonds	**4 485**	**6 426**

On 19 January 2005, AS LHV carried out a placement of securitised bonds backed by finance lease agreements in the amount of 18 529 thousand kroons, disclosed in Note 16.

Bonds carry a coupon interest of 5.8% per annum. The redemption payments of bonds and the interest payments to bond holders take place on a quarterly basis in the month following the end of the quarter.

By the time of signing the Annual Report, the following principal and interest payments have been made to bond holders:

Date	Number of bonds	Amount of principal payment	Cumulative principal payment	Amount of interest payment	Cumulative interest payment
19.04.2005	23 875	2 387	2 387	269	269
19.07.2005	30 128	3 013	5 400	236	505
19.10.2005	13 359	1 336	6 736	190	695
Total redeemed in 2005	**67 362**	**6 736**	**6 736**	**695**	**695**
19.01.2006	9 491	949	7 685	171	866
19.04.2006	22 767	2 277	9 962	157	1 023
19.07.2006	8 558	856	10 818	124	1 147
19.10.2006	13 586	1 359	12 177	112	1 259
Total redeemed in 2006	**54 402**	**5 440**	**12 176**	**564**	**1 259**
19.01.2007	17 435	1 743	13 920	92	1 351
19.04.2007	356	36	13 956	67	1 418
19.07.2007	1 054	105	14 061	66	1 484
19.10.2007	342	34	14 095	65	1 549
Total redeemed in 2007	**19 187**	**1 919**	**14 095**	**290**	**1 549**
19.01.2008	345	35	14 130	64	1 613
Total	**141 296**	**14 130**	**14 130**	**1 613**	**1 613**

NOTE 23 Provisions

On 1 November 2005, the US Securities and Exchange Commission (US SEC) filed a court action charging two employees or LHV with electronic fraud and illegal profit making. All assets in the accounts of AS LHV were initially were frozen. In 2006, most of the frozen LHV own accounts were released and the last part of 861 thousand kroons was released at the beginning of 2007 (Note 11). Based on the results of preliminary negotiations, the fine was expected not to exceed 400 thousand US dollars. As of 31.12.2006, a provision was recognised in the balance sheet in the amount of 4 880 thousand Estonian kroons. In March 2007, LHV reached an agreement with SEC, according to which SEC agreed to disclaim and LHV to pay the forfeit in amount of 650 thousand US dollars (for provision expense, see Note 9). The court affirmed the agreement in June 2007, and herewith the case is closed.

AS LHV Varahaldus has given DVD-players and gift-cards to clients joining the pension funds in previous periods, which are handled as expenses related to business. As the discussion with tax authorities is still in progress on the date of compiling these financial statements, whether to recognise these items as purely advertising costs or gifts, a short-term provision has been set up in the balance sheet for possible corporate income tax and interest liabilities in the total amount 4 880 thousand kroons. As the management board can not assess the time of final conclusions of the discussion, the provision is recognised as a current liability.

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NOTE 24 Assets and liabilities of discontinued operations

In September 2006, the general meeting of shareholders approved the division of the Group into two separate business lines. AS LHV Group transferred all shares of AS GILD Financial Advisory Services (100% ownership interest) and AS GILD Latvia (100% ownership interest) in the total amount of 7 580 thousand kroons to the new company AS GILD Professional Services. Cash from AS LHV Group bank accounts in the amount of 5 716 thousand kroons and loans to clients in the amount 2 057 thousand kroons were also transferred to AS GILD Professional Services. Available-for-sale financial assets in the amount of 20 108 thousand kroons were transferred to AS GILD Holdings.

	2006
Cash	5 716
Loans to clients	2 057
Available-for-sale financial assets	20 108
Investments in subsidiaries	7 580
Net assets transferred in the process of division	**35 461**
Retained earnings (incl. net profit for the period 01.01.2006 – 30.09.2006 in the amount of 23 072 thousand kroons)	43 334
Total assets transferred in the process of de-merger	**78 795**

NOTE 25 Owners' equity

The ultimate controlling party of AS LHV Group is Rain Lõhmus with 61% of the voting rights. As of 31.12.2007, significant influence is exercised by Andres Viisemann with 33% of the voting rights. As of 31.12.2006, Rain Lõhmus had control with 57% of the voting rights and Andres Viisemann had significant influence with 43% of the voting rights.

	31.12.2007	**31.12.2006**
Share capital *(in thousand kroons)*	66 400	40 300
Number of shares	664 000	403 000
Par value of a share *(in kroons)*	10	10

According to the articles of association, the company's minimum share capital is 17 500 thousand and maximum share capital is 70 000 thousand kroons.

As of 31.12.2006, AS LHV Group had 13 000 treasury shares worth 4 283 thousand kroons.
In 2007, treasury shares were cancelled and the loss from the cancellation of treasury shares is recognised in the statement of changes in equity.

At the end of 2006, an increase of share capital was carried out and the new share capital is 40 300 thousand kroons. A total of 120 000 new shares with the nominal value of 100 kroons were issued. Shares were issued at 104.43 kroons per share. A total of 12 532 thousand kroons was paid in cash. The increase of share capital was registered in the Commercial Register on 19.03.2007.

At the end of 2007, an additional increase of share capital was carried out and the amount of new share capital is 66 400 thousand kroons. A total of 274 000 new shares with the nominal value of 100 kroons were issued. The issue price was 134.91 kroons per share. Cash was paid for the increase of share capital totalling 36 964 thousand kroons. The increase of share capital was entered in the Commercial Register on 13.03.2008.

In 2007, AS LHV Group did not pay any dividends to shareholders. In 2006, dividends from discontinued operations were paid to the holders of ordinary shares in the amount of 11 310 thousand kroons and to the holders of preferred shares in the amount of 8 543 thousand kroons (Note 29); no dividends were paid from continuing operations.

Upon the payment of dividends, from 1 January 2008, the corporate income tax on dividends amounts to 21/79 (until 31. 12.2006: 22/78) of net dividend paid. In accordance with the Commercial Code, it is possible to pay out the portion of net profit which exceeds the amount of the share capital of the parent company and the reserves as dividends. It was not possible to pay dividends to the shareholders on the basis of the operating results of 2006.
As of 31.12.2007, the retained earnings of the Group totalled 1 914 thousand kroons. Upon the payment of dividends to owners, from 1 January 2008, the accompanying income tax expense amounts to 21/79 of net dividends paid. Thus, as of the balance sheet date, it is possible to pay out dividends out of retained earnings in the amount of 1 512 thousand kroons and the income tax on dividends would amount to 402 thousand kroons.

NOTE 26 Operating lease

The Company leases cars, office space and computers under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period amounts to 15 721 thousand kroons (2006: 3 679 thousand kroons), the current portion of which amounts to 4 014 thousand (2006: 1 149 thousand kroons) and the non-current portion amounts to 11 707 thousand kroons (2006: 2 530 thousand kroons).

Operating lease payments recognised in operating expense:	**2007**	**2006**
Office space	2 787	1 484
Cars	108	123
Computers	27	45
Total (Note 9)	**2 922**	**1 652**

NOTE 27 Contingencies and commitments

The Group, operating as an account manager for its customers, has custody of or intermediates the following customer assets:

	31.12.2007	**31.12.2006**
Cash balance of customers	**119 422**	**225 423**
incl. group companies	19	0
incl. shareholders and related companies	15 073	266
Securities of customers	**1 853 966**	**1 589 233**
incl. group companies	17 203	8 682
incl. shareholders and related companies	110 741	68 174
Total	**1 973 388**	**1 814 656**

Management fees for the management of these assets have been in the range of 0.015 - 0.025 % (for respective income, see Note 5).

NOTE 28 Contingent liabilities

Tax authorities have the right to review the Company's tax records for up to 6 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Company during 2006 - 2007. The Company's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on the Company.

NOTE 29 Transactions with related parties

In preparing the consolidated financial statements of AS LHV, the following entities have been considered as related parties:

- owners (parent company and owners of the parent company);
- undertakings in the consolidation group (incl. other subsidiaries and associates of the parent company);
- management and supervisory board members
- close relatives of the persons mentioned above and the companies related to them;

In 2006, former group companies AS GILD Financial Advisory Services and AS GILD Arbitrage were also treated as related parties.

Transactions	Note	2007	2006
Interest revenue from related parties	6	0	2
Interest expenses to related parties	6	196	182
Net interest income/expense		**-196**	**-180**
Group companies		2 302	0
Shareholders and related companies		2 081	550
Total fee and commission income	**5**	**4 383**	**550**
Former group companies		0	180
Total fee and commission expense	**5**	**0**	**180**
Former group companies		0	739
Total fee and commission expense	**9**	**0**	**739**
Shareholders and related companies		7 255	0
Group companies		788	700
Former group companies		0	1 004
Total other income	**8**	**8 043**	**1 704**
Former group companies		0	340
Profit/loss from forward transactions		**0**	**340**

Balances		31.12.2007	31.12.2006
Group companies		805	0
Shareholders and related companies		3	0
Receivables as of the year-end	**13**	**808**	**0**
Group companies		0	4 295
Shareholders and related companies		6 015	981
Loans received as of the year-end	**20**	**6 015**	**5 276**
Call option to shareholders of AS LHV Group		0	10 661
Liabilities as of the year-end		**0**	**10 661**

Call option available to the shareholders of AS LHV Group:

According to the financing contract of the investment services department entered into in 2001 and supplemented at the end of 2005, an agreement was reached with LHV's shareholders AS Lõhmus Holdings and AS Viisemann Holdings to make an additional investment in AS Lõhmus, Haavel & Viisemann (LHV) in the total amount of 10 661 thousand kroons. According to the terms of the contract, the parent company AS LHV Group had the obligation to transfer its 42.4% interest in LHV. In 2006, pursuant to the contract, the last contributions were made by shareholders to equity in the amount of 2 894 thousand kroons. In complying with the other terms of the option issued, the shareholders of AS LHV Group had the right to acquire 42.4% of the shares of the Group's subsidiary AS LHV in 2007. In October 2007, this contract was terminated and AS LHV Group repurchased the option to acquire the shares of its subsidiary from its shareholders at the price of 14 713 thousand kroons (at the fair value at the time of acquisition), as a result of which the sole shareholder of LHV continues to be AS LHV Group. As a result of the transaction, AS LHV Group incurred a loss in the amount of 4 051 thousand kroons in 2007 (Note 7), which is the difference between the liability recognised from the option as of 31.12.2006 in the amount of 10 661 thousand kroons and the repurchase price. The equity of LHV was not changed in the course of the transaction.

In 2007, salaries and other compensations paid to the key management of AS LHV totalled 1 964 thousand kroons (2006: 786 thousand kroons). As of 31.12.2007, remuneration for December and accrued holiday pay in the amount of 363 thousand kroons has been reported as a payable to management (as of 31.12.2006: 87 thousand kroons) (Note 21). The Company did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as of 31.12.2007 and 31.12.2006 (such as pension liabilities, termination benefits, etc.).

Information on assets of related parties held by the Company as an account manager is presented in Note 27.

NOTE 30 Separate financial statements

In accordance with the Estonian Accounting Act, information on the separate primary financial statements of a consolidating entity (parent company) shall be disclosed in the notes to the financial statements.

Income statement of the parent company

(In thousand Estonian kroons)

	2007	2006
Interest income	208	343
Interest expense	-14	-97
Net interest income	**194**	**246**
Netgains less losses from trading	0	457
Net gains less losses from investments	0	834
Other expenses related to financial assets	-13 019	0
Dividend income	0	11 310
Net gains less losses from financial assets	**-13 019**	**12 601**
Other income	39	98
Operating expenses	-117	-382
Profit for the year	**-12 903**	**12 563**

Balance sheet of the parent company

(In thousand Estonian kroons)

	31.12.2007	31.12.2006
Assets		
Cash and bank	4 266	1 144
Loans to customers	0	2 985
Investments in subsidiaries	61 891	18 906
Investments in joint ventures	0	20 734
Total assets	**66 157**	**43 769**
Liabilities		
Other financial liabilities	0	1 694
Accrued expenses and other liabilities	21	0
Total liabilities	**21**	**1 694**
Shareholders´ equity		
Share capital	66 400	40 300
Share premium	28 255	18 691
Statutory legal reserve	2 830	2 830
Retained earnings/(accumulated deficit)	-31 349	-15 463
Treasury shares	0	-4 283
Total equity	**66 136**	**42 075**
Total liabilities and equity	**66 157**	**43 769**

Cash flow statement of the parent company

(In thousand Estonian kroons)

	2007	2006
Cash flows from operating activities		
Fee and commission income received	39	98
Operating and other expenses paid	-96	-382
Interest received	218	268
Interest paid	0	-97
Change in loans granted	2 975	-3 000
Net cash generated from/(used in) operating activities	**3 136**	**-3 113**
Cash flows from investing activities		
Purchase of shares of joint ventures	-22 251	-11 414
Amounts paid for the repurchase of option on shares of subsidiary	-14 713	0
Purchase of shares of subsidiaries	0	-385
Sale of shares of subsidiaries	0	1 800
Dividends received	0	11 310
Cash handed out in the process of de-merger of discontinued operations	0	-5 716
Net cash used in investing activities	**-36 964**	**-4 405**
Cash flows from financing activities		
Share capital increase	36 964	12 532
Treasury shares purchased	0	-2 859
Loans received	37 800	3 370
Loan repayments	-37 800	-5 370
Interests paid	-14	0
Net cash generated from financing activities	**36 950**	**7 673**
Net increase/decrease in cash and cash equivalents	**3 122**	**155**
Cash and cash equivalents at beginning of the year	1 144	989
Cash and cash equivalents at end of the year	**4 266**	**1 144**

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Statement of changes in shareholders' equity

(In thousand Estonian kroons)

	Share capital	Share premium	Repurchased treasury shares	Statutorylegal reserve	Accumulated deficit	Total
Balance as of 01.01.2006	**28 300**	**18 159**	**-2 806**	**871**	**9 394**	**53 918**
Share capital increase	12 000	532	0	0	0	12 532
Transfer to statutory reserve	0	0	0	1 959	-1 959	0
Treasury shares repurchased	0	0	-1 477	0	0	-1 477
Net profit for 2006	0	0	0	0	12 563	12 563
Discontinued operations	0	0	0	0	-35 461	-35 461
Balance as of 31.12.2006	**40 300**	**18 691**	**-4 283**	**2 830**	**-15 463**	**42 075**
Carrying amount of holdings under control and significant influence	0	0	0	0	-39 640	-39 640
Value of holdings under control and significant influence under equity method	0	0	0	0	27 636	27 636
Adjusted consolidated equity on 31.12.2006	**40 300**	**18 691**	**-4 283**	**2 830**	**-27 467**	**30 071**
Balance as of 01.01.2007	**40 300**	**18 691**	**-4 283**	**2 830**	**-15 463**	**42 075**
Share capital increase	27 400	9 564	0	0	0	36 964
Treasury shares repurchased	-1 300	0	4 283	0	-2 983	0
Net profit for 2007	0	0	0	0	-12 903	-12 903
Balance as of 31.12.2007	**66 400**	**28 255**	**0**	**2 830**	**-31 349**	**66 136**
Carrying amount of holdings under control and significant influence	0	0	0	0	-61 891	-61 891
Value of holdings under control and significant influence under equity method	0	0	0	0	76 995	76 995
Adjusted consolidated equity on 31.12.2007	**66 400**	**28 255**	**0**	**2 830**	**-16 245**	**81 240**

AS PricewaterhouseCoopers
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INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholders of AS LHV Group

We have audited the accompanying consolidated financial statements of AS LHV Group and its subsidiaries (the Group) which comprise the consolidated balance sheet as of 31 December 2007 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

/signed/	/signed/
Urmas Kaarlep AS PricewaterhouseCoopers	Relika Mell Authorised Auditor

12 June 2008

* *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.*

Proposal for profit allocation

The Management Board of AS LHV proposes to the General Meeting of Shareholders to use the net profit of 2007 in the amount of 13 108 thousand kroons as follows:

Statutory reserve capital	655 thousand kroons
Retained earnings	12 453 thousand kroons

Signatures of the Management Board and the Supervisory Board to the 2007 Annual Report

The Management Board has prepared the management report and the financial statements of AS LHV Group for the financial year ended on 31. december 2007.

The Supervisory Board has reviewed the annual report, which consists of management report and financial statements, auditor´s report and the proposal for profit allocation and approved it for presentation at the General Meeting of Shareholders.

MANAGEMENT BOARD
10.06.2008

Member of the Management Board:

Rain Lõhmus /signed/

SUPERVISORY BOARD
30.06.2008

Members of the Supervisory Board:

Andres Viisemann /signed/

Tiina Mõis /signed/

Tarmo Sild /signed/