AS LHV Group

Consolidated Annual Report 2008

(translation of the Estonian original)

Consolidated annual report	**01.01.2008 – 31.12.2008**
Business name	AS LHV Group
Commercial Registry 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 companies
	Security brokerage
	Financial advisory
	Fund management
	Finance lease
Management Board	Rain Lõhmus
Supervisory Board	Andres Viisemann
	Tiina Mõis
	Hannes Tamjärv
	Heldur Meerits
Auditor	AS PricewaterhouseCoopers

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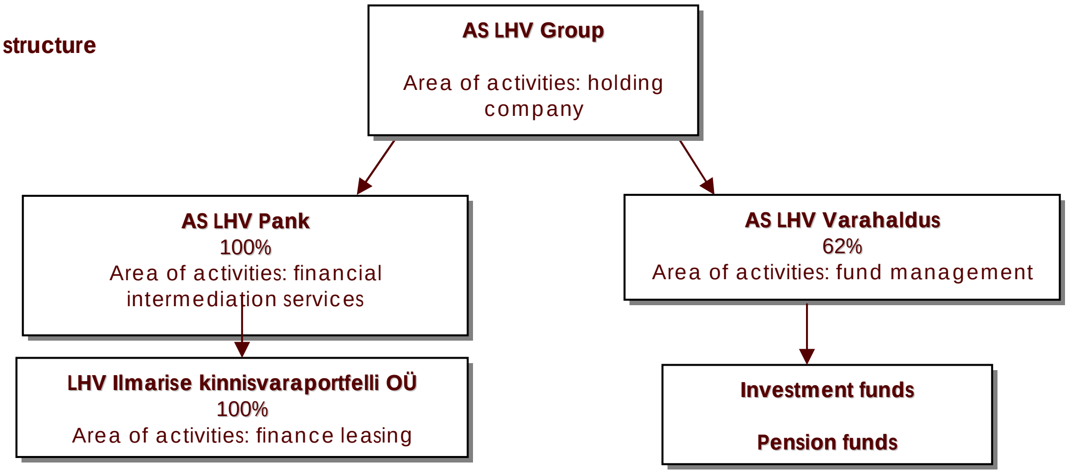
MANAGEMENT REPORT

Group structure



Key events in 2008 and at the beginning of 2009:

- **Application for a license of a credit institution.**

At 15 May 2008, AS Lõhmus, Haavel & Viisemann (LHV) applied for a license of a credit institution with the Estonian Financial Supervision Authority. The banking license will provide more opportunities for LHV than previously – to grant loans, deposit the assets of customers and also raise debt more easily. The banking license will provide assurance to customers that their deposits and invested assets are protected with security measures set for banks. The Estonian Financial Supervision Authority issued the banking license to LHV at 6 May 2009. The business name of LHV was changed at 12 May 2009 and the new name is AS LHV Bank (hereinafter: LHV or LHV Bank).

- **New products**.

At the beginning of 2008, AS LHV Varahaldus (hereinafter: LHV Varahaldus) introduced a new product to the market: LHV Persian Gulf Fund, the investment region of which is the Near East.

- **Share issues**.

In June 2008, AS LHV Group issued shares as a motivation package for the Group's employees whereby 22 300 shares of AS LHV Group were issued to the employees. In conjunction with the launch of the banking operations, the share capital of LHV Bank was increased to 100 million kroons. Prior to this, a new share issue was arranged at the beginning of 2009, as a result of 475 850 shares were subscribed for by current as well as new shareholders. The increase in share capital was registered in the Commercial Register at 13.04.2009 and the amount of the share capital of AS LHV Group is 116 215 thousand kroons.

As at 31.12.2008, the Group had almost 60 employees (2007: almost 50). In the financial year, employee wages and salaries totalled 19.8 million kroons (2007: 16.4 million kroons). No remuneration was paid to the members of the Management Board of AS LHV Group.

AS LHV Bank

The investment company, founded in 1999, operates in Estonia, Latvia and Lithuania. By now, the investment company has become a credit institution. Almost five thousand customers use the security brokerage and investment services of LHV Bank. LHV Bank manages Estonia's most popular investment portal that is used by approximately twenty thousand people every week.

In 2008, the fast development of the Company continued and pursuant to its strategic goal, the Company applied for the licence of a credit institution. As a bank, the Company plans to expand its range of services with three important products – deposits, loans and settlements. Deposits held at call and term deposits will be raised both from private investors as well as legal persons. The lending activities of LHV Bank will be targeted at entities. Joining the settlement systems will enable customers to open regular bank accounts at LHV, and to make domestic and foreign payments between other banks.

At 13 May 2008, AS LHV Group decided to increase the share capital of LHV Bank through a bonus issue in the amount of 23.4 million kroons, as a result of which the Company's share capital increased to 36 million kroons. In 2009, the sole shareholder made an additional contribution to share capital and at 24.04.2009, the share capital of LHV Bank in the amount of 100 million kroons was registered in the Commercial Register. The articles of association of LHV Bank were changed at 14.04.2009.

With the goal of strengthening the Company's management competencies in the banking sector, two more members were added to the Supervisory Board of LHV with the resolution of the sole shareholder at 18 December 2008. Hannes Tamjärv and Heldur Meerits were appointed as new members of the Supervisory Board. From 18 December 2008, the Supervisory Board of LHV Bank has five members. In addition to the aforementioned two persons, the other members are Rain Lõhmus, Andres Viisemann and Tiina Mõis. In 2008, changes also occurred in the Management Board of LHV Bank and Erki Kilu assumed the position of the Chairman of the Management Board. The Management Board of LHV Bank has five members, and the members also include Kerli Lõhmus, Jüri Heero, Erki Kert and Indrek Nuume.

In 2008, the internal control department was established in the Company's organisational structure which covers all management and operating levels of LHV Bank in order to ensure efficiency of operations, reliability of reporting, control over risks and adoption of decisions on the basis of reliable and appropriate information. The internal control department consists of three positions; Internal Auditor, Compliance Officer and Risk Analyst.

Financial information *(in thousand Estonian kroons)*	**2007**	**2008**	**Growth**
Net fee and commission income	38 038	38 625	2%
Net interest income	7 271	7 411	2%
Volume of leveraged loans	57 538	33 099	-42%

In a year, net fee and commission income increased by 2%, to 38.6 million kroons. Fees from securities intermediation made up the largest share, i.e. 76% of the gross fee income. The number of customer trades intermediated into the markets increased by 18% in a year, to 246 thousand transactions which is almost three times more than the total number of transactions placed on the Tallinn Stock Exchange in 2008. Of the gross fee income, 79% was earned from intermediation of US shares, options and futures, 10% from the Baltic shares and 11% from other shares and fund units. By countries, 67% of the gross fee income was earned in Estonia (decline of -12%), 10% in Latvia (growth of 301%) and 23% in Lithuania (growth of 22%).

Net interest income increased by 2% as compared with last year, to 7.4 million kroons. As at the year-end, the volume of lending backed by securities (margin loans) provided to the customers was 22 million kroons. 60% of the loans were issued in Estonia, 4% in Latvia and 36% in Lithuania. The volume of loans issued to other entities was 11 million kroons at the year-end.

In 2008, operating expenses increased by 9% and the loss for the year totalled almost 3 million kroons. As compared with the previous year, the loss was primarily related to the financial expense from trading and higher office expenses.

The member of customers, whose assets asre under LHV Bank's management increased by 20% in a year, to 4 800 customers which is a very decent result considering the cooler economic environment in the Baltic States. However, the volume of assets under management decreased by 19%, to 1 632 million kroons, due to the overall decline in the markets.

AS LHV Varahaldus

AS LHV Varahaldus is an investment fund management company. In 2008, the Company's main business activity was to provide fund management services to five mandatory pension funds, one supplementary pension fund and three equity Eurofunds.

Of pension funds with progressive investment strategies (up to 50% of the assets are invested in equities) offered in Estonia, LHV Global Equities Pension Fund and LHV New Markets Pension Fund managed by the Company were the second and third best funds. On the background of declining equity markets and the financial crisis, the returns of all progressive funds were negative in 2008.

Of the pension funds with balanced investment strategies (up to 25% of the assets are invested in equities), LHV Balanced Strategy Pension Fund managed by the Company also ranked second in terms of return. Similarly to progressive funds, all balanced funds had negative returns in 2008.

The returns of conservative funds investing only in bonds were better in 2008. However, on the background of the financial crisis, the corporate bonds that LHV Dynamic Bonds Pension Fund and LHV Quality Bonds Pension Fund managed by LHV Varahaldus invest in had negative returns, therefore the returns of funds were not positive, but slightly negative.

The supplementary funded pension funds offered in Estonia differ from one another with regard to their share invested in equities; therefore it is more difficult to compare the returns of different funds. LHV Supplementary Pension Fund invests an average of 75% of its portfolio in equity markets, but the share of equities was kept significantly lower in 2008 which was a difficult year for the financial markets. Similarly to mandatory pension funds investing in equities, all supplementary funded pension funds had also negative returns in 2008.

The Company manages three Eurofunds that invest in equities. The results of equity funds were strongly impacted by the significant decline in equity markets, which occurred primarily in the last months of the year. The decline of the value of units of LHV World Equities and LHV Persian Gulf Fund were 42% and 44 %, respectively but LHV Emerging Europe Alpha Fund declined by 67%.

At the end of 2008, the total amount of assets managed by LHV Varahaldus was 559 million kroons, out of which 85% was in mandatory pension funds. At the end of 2007, the total amount of assets under management was 500 million kroons.

Priorities for the year 2009

AS LHV Group will continue to focus on the financial sector in his activities.

AS LHV Varahaldus plans to increase its market share in the market of mandatory pension funds and increase the volume of assets in equity funds through positive returns and attracting of new investors.

LHV Bank will primarily focus on the development of banking functions and services with regard to processes, IT, legal aspect, etc. More active provision of banking services to the Estonian customers will take place in the second half of 2009. The development of securities brokerage will be the main focus in Latvia and Lithuania.

CONSOLIDATED FINANCIAL STATEMENTS

Management Board's declaration

The Management Board confirms the correctness and completeness of the 2008 consolidated financial statements of LHV Group as presented on pages 7-49.

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 its operations and the cash flows;
- AS LHV Group and the entities in its consolidation group are going concerns.

/signed/

Rain Lõhmus
Member of the Management Board

Tallinn, 18.05.2009

Consolidated income statement

(in thousand Estonian kroons)

	Note	2008	2007
Fee and commission income	5	59 794	50 053
Fee and commission expense	5	-7 045	-8 906
Net fee and commission income		**52 749**	**41 147**
Interest income	6	9 976	9 662
Interest expense	6	-2 072	-2 188
Net interest income		**7 904**	**7 474**
Net gain/loss from trading	7	-3 799	2 620
Net gain/loss from investments	7	-9 332	-279
Other expenses on financial assets	7	0	-4 051
Dividend income	7	1	3
Net loss from financial assets		**-13 130**	**-1 707**
Other income	8	7 211	16 423
Operating expenses	9	-65 436	-51 004
Operating loss/profit		**-10 702**	**12 333**
Share in profit/loss of joint venture	18	0	775
Loss/profit for the financial year		**-10 702**	**13 108**
Loss/profit attributable to shareholders of the parent		**-8 086**	**14 205**
Minority interest		**-2 616**	**-1 097**

The notes on pages 12 to 49 are an integral part of these consolidated financial statements.

LHV

Consolidated balance sheet

(in thousand Estonian kroons)

	Note	31.12.2008	31.12.2007
Assets			
Cash and cash equivalents	11	21 854	10 796
Loans to customers	12	26 462	57 538
Receivables from customers	13,28	3 231	2 893
Derivatives	14	96	53
Other financial assets at fair value through profit or loss	15	45 112	57 691
Finance lease receivables	16	4 246	4 410
Other assets	17	2 185	2 418
Goodwill	18	8 723	8 723
Property, plant and equipment, and intangible assets	19	7 644	5 952
Total assets		**119 553**	**150 474**
Liabilities			
Loans received	20	12 224	29 797
Financial liabilities at fair value through profit or loss	15	542	0
Accrued expenses and other liabilities	21	6 642	10 511
Deferred income		1 345	0
Finance lease liabilities		414	0
Value of bonds issued	22	4 342	4 485
Provisions	23	600	4 880
Total liabilities		**26 109**	**49 673**
Shareholders' equity			
Minority interest		16 945	19 561
Shareholders' equity attributable to shareholders of the parent			
Share capital	24	68 630	66 400
Share premium		11 211	10 096
Statutory reserve capital		3 485	2 830
(Accumulated deficit) / retained earnings		-6 827	1 914
Total shareholders' equity attributable to shareholders of the parent		**76 499**	**81 240**
Total shareholders' equity		**93 444**	**100 801**
Total liabilities and shareholders' equity		**119 553**	**150 474**

The notes on pages 12 to 49 are an integral part of these consolidated financial statements.

LHV

Consolidated cash flow statement

(in thousand Estonian kroons)

	Note	2008	2007
Cash flows from operating activities			
Fee and commission income received		64 741	68 515
Fee and commission expense	5	-7 045	-8 906
Operating and other expenses paid		-64 986	-50 183
Finance lease receivables paid by customers		174	188
Interest received		11 986	9 808
Settlement of foreign currency forward contracts		-42	-19
Net acquisition/disposal of trading portfolio		-11 176	-1 201
Change in loans granted		30 751	-13 069
Change in other liabilities		-513	544
Change in stock exchange security deposit		60	-49
Change in deferred income		1 336	861
Net cash generated from operating activities		**25 286**	**6 489**
Cash flows from investing activities			
Purchase of non-current assets	19	-4 214	-5 858
Proceeds from disposal of non-current assets	19	29	16
Investments in joint venture		0	-22 251
Cash and cash equivalents of joint venture upon assuming control		0	577
Amounts paid for the repurchase of the share option of subsidiary	7	0	-14 713
Purchase of long-term financial investments	15	-4 694	0
Disposal of long-term financial investments	15	11 122	0
Dividends received on securities in trading portfolio	7	1	3
Net cash used in investing activities		**2 244**	**-42 226**
Cash flows from financing activities			
Issue of share capital	24	3 345	36 964
Finance lease payments made	25	-119	0
Bonds issued		904	0
Redeemed bonds	22	-142	-1 919
Loans received		66 878	124 937
Repayment of loans		-84 985	-125 580
Interest paid		-2 353	-1 988
Net cash used in financing activities		**-16 472**	**32 414**
Net increase/decrease in cash and cash equivalents		**11 058**	**-3 323**
Cash and cash equivalents at beginning of the year	11	10 796	14 119
Cash and cash equivalents at end of the year	**11**	**21 854**	**10 796**

The notes on pages 12 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 Capital Reserves	Retained earnings / accumulated deficit	**Total**	Minority interest	**Total**
Balance as at 01.01.2007	**40 300**	**532**	**-4 283**	**2 830**	**-9 308**	**30 071**	**0**	**30 071**
Increase of share capital	27 400	8 564	0	0	0	36 964	0	**36 964**
Redemption of treasury shares	-1 300	0	4 283	0	-2 983	0	0	**0**
Minority interest in equity of acquired subsidiary	0	0	0	0	0	0	20 658	**20 658**
Net profit for 2007	0	0	0	0	14 205	14 205	-1 907	**13 108**
Balance as at 31.12.2007	**66 400**	**10 096**	**0**	**2 830**	**1 914**	**81 240**	**19 561**	**100 801**
Balance as at 01.01.2008	**66 400**	**10 096**	**0**	**2 830**	**1 914**	**81 240**	**19 561**	**100 801**
Increase of share capital	2 230	1 115	0	0	0	3 345	0	**3 345**
Transfer to statutory reserve	0	0	0	655	-655	0	0	**0**
Net loss for 2008	0	0	0	0	-8 086	-8 086	-2 616	-10 702
Balance as at 31.12.2008	**68 630**	**11 211**	**0**	**3 485**	**-6 827**	**76 499**	**16 945**	**93 444**

More detailed information is presented in Note 24.

The notes on pages 12 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 AS LHV Bank provides investment and securities brokerage and management services to Estonian, Latvian and Lithuanian customers. Term deposits have been added and settlements will be added in the near future. LHV's subsidiary LHV Ilmarise Kinnisvaraportfelli OÜ offers real estate brokerage and financial lease services. The other subsidiary of LHV Group, AS LHV Varahaldus provides fund management service.

AS LHV Group is a limited liability company incorporated in 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 at 18 May 2009.

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 to all the years presented and to all the companies in the Group, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2008 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, exept as disclosed in some of the accounting policies below: "financial assets at fair value through profit or loss", including derivatives.

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

The financial year started at 1 January 2008 and ended at 31 December 2008. The financial figures have been presented in thousands of Estonian kroons unless specifically referred differently in specific disclosure.

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 2008. The overview of these standards and the Group management estimate of the potential impact of applying the new standards and interpretations is given below.

(a) Standards, amendment and interpretations of current standards which are not yet effective but may have an impact on the Group's financial statements

Reclassification of Financial Assets – amendments to standards IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" and consequential amendment: Reclassification of Financial Assets: Effective Date and Transition. The amendments allow entities the following options (a) to reclassify a financial asset out of the held-for-trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale or held-for-trading asset to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The Group has not applied reclassification options in the reporting period; therefore, the amendments do not affect the Group's financial statements.

IFRIC 11 IFRS 2 - Group and Treasury Share Transactions (effective for annual periods beginning at or after 1 March 2007). The interpretation contains guidelines on the following issues: applying IFRS 2 "Share-based Payment" for transactions of payments with shares which are entered into by two or more related entities; and adopting an accounting approach in the following instances: an entity grants its employees rights to its equity instruments that may or must be repurchased from a third party in order to settle obligations towards the employees of an entity, or its owner grants the entity's employees rights to the entity's equity instruments, and the provider of those instruments is the owner of the entity. The interpretation does affect the Group's financial statements.

(b) New standards, amendments and interpretations that are mandatory for the Group and are effective for annual periods beginning at or after 1 January 2008.

IAS 1 (amendment) – Presentation of Financial Statements (effective 1 January 2009):
The main change in IAS 1 is the replacement of the income statement by the statement of comprehensive income which also includes all non-owner changes in equity, such as revaluation of available-for-sale financial assets. Alternatively, entities are allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its financial statements but not the recognition or measurement of specific transactions and balances. The Group applies the amendments from 1 January 2009.

IAS 27 (revised) – Consolidated and Separate Financial Statements (effective from 1 January 2009):
The standard requires recognition of transactions with minority shareholders directly in equity under the condition that the parent retains control over the entity. In addition, the standard clarifies accounting for control ceased over the subsidiary or revaluation of shares to fair value whereby the differences are taken to profit or loss. The Group applies the amendments from 1 January 2009.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method for making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group estimates that the amendments will not affect the financial statements.

(c) Standards, amendments and interpretations not yet effective but which may affect the Group's financial statements

IFRS 8 – Operating Segments (effective from 1 January 2009)
IAS 23 (amendment) – Borrowing Costs (effective from 1 January 2009)
Amendment to IAS 32 and IAS 1 - Puttable Financial Instruments and Obligations Arising on Liquidation (effective from 1 January 2009).
Improving Disclosures about Financial Instruments - amendment to IFRS 7 "Financial Instruments: Disclosures" (effective for reporting periods beginning at or after 1 January 2009). The amendment requires additional disclosures about measurement of fair value and liquidity risk. An entity shall disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) explains that the liquidity analysis of liabilities by contractual maturities shall include financial guarantees issued in the maximum amount of the guarantee and in the earliest period in which the guarantee can be collected; and (b) requires disclosure of remaining contractual maturities of financial derivatives when information about contractual maturities is material for understanding the timing of cash flows. In addition, an entity shall disclose an analysis of financial assets held for the hedging purposes by maturities when this information is useful for the readers of the financial statements in order to understand the nature and scope of liquidity risk.

(d) Standards, amendments and interpretations of current standards which are not yet effective and which are not relevant to the operations of the Group
IFRS 3 (revised) – Business Combinations (effective from 1 July 2009)
IFRIC 12 – Service Concession Arrangements (effective from 1 January 2009).
IFRIC 13 – Customer Loyalty Programmes (effective from 1 January);
IFRIC 14, IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective from 1 January 2009);
IFRIC 15 – Arrangements for the Construction of Real Estate (effective from 1 January 2009)
IFRIC 16 – Hedges of a Net Investment in a Foreign Operation (effective from 1 October 2008)
IFRIC 17 – Distributions of Non-cash Assets to Owners (effective from 1 July 2009)
IFRIC 18 – Transfers of Assets from Customers (effective from 1 July 2009)
IFRS 1 – First-time Adoption of International Financial Reporting Standards (effective from 1 July 2009)
IFRS 1 and amendment to IAS 27 – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (effective from 1 January 2009)
IAS 39 "Financial Instruments: Recognition and Measurement: "Eligible Hedged Items" (effective from 1 July 2009)

2.2 Consolidation

A subsidiary is an entity which the parent has sufficient control over. Control is presumed to exist when the parent owns, directly or indirectly, more than one half of the voting power of the subsidiary or otherwise has control in the other entity, governing their financial and operating policies.

Acquisitions of subsidiaries are accounted for by applying the purchase method (except for business combinations involving entities under common control). The purchase price is measured at the fair value of assets given, equity instruments issued and the liabilities incurred or assumed at the date of exchange plus any directly attributable expenditure. Under the purchase method, the identifiable assets and liabilities of the acquired subsidiary are recognised at their fair values as at the date of acquisition, irrespective of the existence of any minority interest. The excess of cost over the fair value is recognised 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 Group's share of the net assets acquired at the date of acquisition, reflecting the part of the cost that was paid for the assets of the acquired entity that cannot be distinguished and separately accounted for. Goodwill which arose on acquisition of subsidiaries is recognised separately as an intangible asset in the balance sheet. Goodwill which arose in a business combination is not amortised, instead, an impairment test is performed annually. In an impairment test, the carrying amount of the asset is compared with the recoverable amount. For the purpose of the impairment test, goodwill is allocated to cash-generating units and for determining the recoverable amount, the present value of expected cash flows which is expected to be received from the cash-generating unit, is calculated. Goodwill is written down to the extent by which the recoverable amount of the asset is less than is carrying amount.

In the consolidated financial statements, the financial information of all subsidiaries under the control of the parent is combined line by line. Intragroup receivables and liabilities, transactions between group entities and the resulting unrealised gains have been eliminated. Unrealised losses have also been eliminated unless the transaction indicates an impairment loss. Minority interests in the net income and shareholders' equity is included within shareholders' equity in the consolidated balance sheet separately from the shareholders' equity attributable to the shareholders of the parent and in a separate item in the consolidated income statement.

Revenues and expenses of the subsidiaries acquired within the financial year are consolidated into the group income statement starting from the date of acquisition to the end of the financial year. Result of operations of subsidiaries disposed of during the year is consolidated into group income statement from the beginning of the financial year until the date of disposal.

The 2008 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank (Estonia – 100% owned), LHV Ilmarise Kinnisvaraportfelli OÜ (Estonia–100% owned) and AS LHV Varahaldus (61,9% interest).

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

In the parent separate primary financial statements, disclosed to these consolidated financial statements (see Note 29), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

2.3 Joint ventures

A joint venture is based on joint ownership and control whereby two or more parties undertake an economic activity that is subject to joint control. The Group's interest in jointly controlled entities is accounted for under the equity method. Investments in joint ventures are initially recognised at cost which is thereafter adjusted for the post-acquisition change in the venturer's share in the investee's equity. The Group's interest in post-acquisition gains and losses is reported in the income statement and its interest in post-acquisition changes in reserves is recognised in reserves. The carrying amount of the investment is adjusted by the changes occurred after the acquisition. The Company recognises its interest in the operating profit, finance income and finance costs of the jointly controlled entity in a separate line of the income statement "Share of profit/loss from joint venture". Dividends received are adjusted against the carrying amount of the investment. The accounting policies have been changed as needed to ensure consistency in applying the policies used at the Group.

In the annual report of AS LHV Group, AS LHV Varahaldus was recognised as a joint venture until AS LHV Group acquired an additional interest in AS LHV Varahaldus in 2007 so that AS LHV Varahaldus became a subsidiary of AS LHV Group and it has been consolidated in these financial statements from the time of assuming control.

2.4 Foreign currency transactions and balances

(a) Functional and presentation currecny

The Group's functional and presentation currency is the Estonian kroon.

(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 at the balance sheet date. Gains and losses on translation form monetary assets and liabilities are recorded in the income statement under the line "net profit/loss from trading". Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss as "net profit/loss from trading", and other changes in the carrying amount are recognised in fair value reserve in equity. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss on line "net profit/loss 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

Group classifies its financial assets into the following categories:

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

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)
- 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 investments are recognised on the settlement date in the balance sheet. Financial assets at fair value through profit or loss are initially recognised at fair value net of transaction costs, which is the fair value of the consideration received from or paid for the financial investment. 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".

In case of listed securities (i.e. the securities which have active market), the current purchase (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 at 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 into 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

In the current reporting period the Group did not designate any financial assets as at fair value through profit or loss at inception.

(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 recognized in the balance sheet when the cash is paid to the customer and are initially recognized at fair value plus transaction costs and are derecognized only when they are repaid or written-off, regardless of the fact that part of them may be recognized 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 impairments, 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 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 of 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 at 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 incurred 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 group of financial assets that can be reliably estimated.

For valuation of loans and receivables several risks are prudently considered. The collection of each specific receivable is assessed on an individual basis, 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 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 realization of collateral (if the loan is secured, excluding future credit losses that have not been incurred), which together help to assess the amount of loss incurred of the loan. 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. For these assessed incurred loan losses, the relevant allowance has been established. Any impairment losses are charged to the income statement. Doubtful receivables are written down in the balance sheet to the collectible amount.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), 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 on the income statement under "Interest income".

2.8 Derivative financial instruments

Derivative financial instruments (forward-, swap- and option contracts) are carried at their fair value, net of transaction costs at the trade date. They are subsequently measured at fair value. If derivatives are quoted in an active market, the market value is used as fair value. In other cases, valuation methods are used to determine fair value. Gains/losses from revaluation of derivate financial instruments are recognised as profit or loss in the income statement line Gains/losses from investments. These transactions are recognised as assets in the balance sheet when their fair value is positive and as a liability when the market value is negative. The carrying amounts of assets and liabilities on derivative financial instruments are not offset. Hedge accounting rules are not used to account for 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

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 are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to operating expenses during the financial 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% or amortization throughout the rental period, depending on which is shorter. Earlier the rate of 15% has been used for rental space improvements. Because as at 01.01.2007 there were no capitalized improvements, the management board is of opinion that the change of rate does not have any influence on balance sheet or profit and loss statement. Depreciation is calculated starting from the month of acquisition until the carrying value reaches the residual value of the asset. In case the residual value becomes to be greater than the carrying value 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 that has become appropriate, at each balance sheet date. 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 recognising impairment loss in income statement for the period.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in operating expenses /other income in the income statement for the period.

2.11 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of 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%. At each balance sheet date the appropriateness of amortization 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 recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use.

2.12 Financial liabilities

Loans assumed and bonds issued are initially recognised at fair value less transaction costs (cash proceeds less transaction costs). Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognised at cost, including all directly attributable expenditure.

A financial liability at fair value through profit or loss is an instrument held for trading purposes or is recognised at fair value at initial recognition. All other financial liabilities are subsequently measured at amortised cost using the effective interest rate method. Borrowing costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the income statement during the term of the instrument using the effective interest rate. Interest costs are included in the income statement line "Interest costs".

Structured bonds consist of a deposit and an option embedded in the bond. As the value of the option depends on the return on the underlying asset being the value of the fund unit, it represents a derivative which is not closely related and the Group has therefore elected to recognise the option portion of the bonds at fair value based on the market value. The interest payable on the deposit is recognised under "Interest expense" and the change in the fair value of the option under "Net gain/loss from trading".

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 at 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 the management is necessary as at 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 value 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 discounted value (present value of expected outflows), unless the discounting effect is immaterial.

Other potential or existing liabilities (promises, guarantees and other commitments) whose realisation is less probable than non-realisation or whose accompanying costs cannot be determined reliably, 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 becomes 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 the extremely rare circumstances where no reliable estimate can be made).

2.15 Distinction between short- and long-term financial assets and liabilities

Any financial assets from which the resources are expected to flow to the Group within 12 months are recognised as current assets. Assets with expected inflows also after 12 months period after the balance sheet date are recognised as long-term assets in the part to be received after the 12 months 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 the 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 due to violation of contractual terms are also classified as current.
For all long-term financial assets and liabilities the long-term part is separately disclosed in respetive disclosure 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 the economic benefits associated with the transaction will flow to the Group and the amount of the revenue can be measured reliably. Expenses are recognised when the company 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 accrual basis when the service has been provided and the Group has a right of claim to the receivable. 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 for 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 recognized according to agreement, usually over the period in 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 recognized when the performance criteria are fulfilled. Other one-time service revenues and other revenues are recognized on accrual basis at the moment of executing the respective transactions.

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

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

The effective interest method is a method of calculating the amortized 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 that 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 flow 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 recognized 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 – fiduciary activities

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 or the present value of the minimum lease payments. Each lease payment is allocated between the repayment of a liability and finance charges (interest expense). 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). Tangible non-current assets acquired under finance leases are depreciated similarly to acquired assets over the shorter of the useful life of the asset or 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 operating lease for renting the premises, cars and computer equipment. Rental expense is recognized in income statement as “operating expenses”.

2.19 Taxation and deferred income tax

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. Instead of net profit, dividends payable out of retained earnings are subject to taxation at rate of 21/79 (until 31.12.2007 taxation rate of 22/78 was applied). The corporate income tax arising from the payment of dividends is accounted for as an expense in the period which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid for.

2.20 Offsetting

Offsetting between financial assets and liabilities are performed only when there is a legal right for it and these amounts are designed to be settled simultaneously or on a net basis.

2.21 Statutory reserve

Statutory reserve 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 the statutory reserve, until reserve reaches one-tenth of share capital. Statutory reserve may be used to cover a loss, or to increase share capital. Payments to shareholders from statutory reserve are not allowed.

NOTE 3 Risk policy and risk management

The principles of identification, management and control of risks at AS LHV Group have been established by the Supervisory Board. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of group entities in order to ensure reliability, stability and profitability of group entities. The Group's risk management system is centralised in order to ensure effective application of risk management principles. The rules and procedures of risk management are constantly reviewed and updated as needed. Independent of risk-assuming units, control over risk management is performed by the unit of internal control. Risk management processes and rules are reviewed regularly at least once a year and are updated as needed.

3.1 Capital risk management

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

- ✓ 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.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department which submits quarterly reports to the regulators. Capital requirements have been set for the Group to cover the Group's risks both on an individual and consolidated basis. In 2008, there have been no problems related to meeting the requirements of capital adequacy. The Group's own funds consist of Tier 1, 2 and 3 own funds. The Group does not have any Tier 2 or 3 own funds (subordinated loans, preference shares). As at 31.12.2008, the Group's consolidated Tier 1 own funds totalled 84 499 thousand kroons (31.12.2007: 91 949 thousand kroons).

As at 31.12.2008, the current LHV Bank was an investment company and the limits for own funds laid down in the Securities Market Act applied to it, according to which own funds have to be at least equal to or exceed the minimum amount of share capital (730 thousand euros or 11 422 thousand kroons) and 25 percent of the investment company's fixed overhead. From the time of issuing the license to LHV Bank at 06.05.2009, the limits laid down in the Credit Institutions Act apply to it, according to which the bank's own funds need to exceed the minimum amount of share capital or 5 million euros (78 233 thousand kroons).

The own funds of LHV Varahaldus as the fund manager need at any given time 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 overhead and 2% of the market value of managed pension funds. In 2008, the Group incurred a financial loss in the amount of 10 039 thousand kroons related to the decline in the market value of funds units managed by the Group. Due to this loss, the Group's own funds declined considerably. In order to meet the minimum requirement set for own funds in the Act, the Group issued on three occasions subordinated bonds denominated in euros in the total amount of 12 517 thousand kroons with the interest rate of 16% and maturity of 7 years. The parent AS LHV Group purchased the bonds.

Consolidated own funds	**31.12.2008**	**31.12.2007**
Paid-in share capital	79 841	76 496
Reserve capital	3 485	2 830
Retained earnings/accumulated deficit	3 875	-11 194
Profit/loss for the current reporting period	-10 702	13 108
Minority interest	16 945	19 561
Intangible assets (subtracted)	-8 945	-8 852
Total Tier 1 own funds	**84 499**	**91 949**
Risk-weighted assets	**83 823**	**128 034**
Carrying amount of assets in category I	13 329	8 890
Carrying amount of assets in category II	21 842	10 796
Carrying amount of assets in category III	9 662	9 721
Carrying amount of assets in category IV	74 624	121 014
Risk-weighted off-balance sheet transactions		
Capital requirement against foreign currency risk	1 203	2 883
Capital requirement against trading portfolio risks	661	163
Capital requirement against credit risk exposures exceeding risk concentration limits of trading portfolio	0	0
Total capital requirements *	**10 251**	**15 852**

* Total capital requirements = 10% *(risk-weighted assets + off-balance sheet transactions) + capital requirement against foreign currency risk + capital requirement against trading portfolio + capital requirement against exposures exceeding the concentration limits

Loan capital is managed according to internal rules, on the basis of principles explained in subparagraphs of financial risk management.

3.2 Financial risk management

The main financial risks arising from the Group's activities are:

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

3.2.1 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, derivatives, and deposits at banks and other financial institutions, but mostly from granting loans to customers, including outstanding loans, finance lease receivables, other receivables and committed transactions. In order to hedge credit risk, LHV analyses the operations and financial position of its customers and business partners. After authorising the loan, the solvency of the customer and the value of the collateral are constantly monitored.

LHV Bank gives margin loans backed by securities to its customers, 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 general limit set by LHV Bank which is currently 1 million kroons (or an equivalent in a foreign currency) per customer. The granting of major loans assumes an analysis of the portfolio offered as collateral by the customer and the decision is within the competence of the Management Board. The list of acceptable marketable financial instruments and the levels of the required collateral of LHV Bank are published on its website www.lhv.ee. The credit risk arising from financial leverage is mitigated by constant monitoring of the market values of the financial instruments required as collateral. When the value of the collateral assets falls below the established limit, LHV Bank is entitled to demand a transfer of additional collateral to the account or pay off the loan in the customer's account without the customer's trade order, liquidating the collateral asset for this purpose.

LHV Varahaldus provides fund management services to investment and pension funds. The management fees of funds are calculated in accordance with the issue prospectuses and LHV Varahaldus receives a monthly management fee which is transferred to the account of the management company by the management company as a result of which no material credit risk arises.

The legal title of the property leased by LHV Ilmarise Kinnisvaraportfelli OÜ under finance lease agreements remains with the Company until lease receivables have been collected in full. Therefore, the Company does not have any significant credit risk under the assumption that prices do not decrease significantly in the real estate market due to which the value of collateral would fall below the nominal value of all receivables. The prices in the real estate market which had significantly increased until now have by now fallen to the year 2004 level at which time according to the assessment reports, the collaterals were adequate for covering of finance lease receivables and there were no risks arising from the collateral.

The following table provides an overview of the credit quality analysis:

	31.12.2008				**31.12.2007**			
	Finance lease receivables	Loans to private persons	Loans to legal persons	Total	Finance lease receivables	Loans to private persons	Loans to legal persons	Total
Current and not impaired	4 238	12 728	13 373	30 639	4 393	51 350	6 011	61 754
Past due but not impaired	8	27	49	84	17	170	47	234
Gross	**4 246**	**12 755**	**13 722**	**30 723**	**4 410**	**51 520**	**6 058**	**61 988**
Individually impaired	0	-15	0	-15	0	-40	0	-40
Net	**4 246**	**12 740**	**13 722**	**30 708**	**4 410**	**51 480**	**6 058**	**61 948**

The Group does not have any receivables that have been individually written down.

As at 31.12.2008, the Group's maximum credit risk exposure without considering collaterals would be the carrying amount of these loans and finance lease receivables, i.e. 37 380 thousand kroons (31.12.2007: 61 948 thousand kroons).
The maximum credit risk exposure from derivatives is their fair value which is 96 thousand kroons as at 31.12.2008 (31.12.2007: 53 thousand kroons).

The maximum credit risk exposure from other financial assets designated at fair value through profit or loss is the carrying amount of bonds, i.e. 18 720 thousand kroons (31.12.2007: 4 014 thousand kroons).
The maximum credit risk exposure from other receivables from customers is also their carrying amount: 3 231 thousand kroons (31.12.2007: 2 893 thousand kroons).
By the time of preparing the financial statements, the receivable in the amount of 573 thousand kroons with the due date of July 2009 has not been collected. The remaining receivables have been collected.

3.2.2 Market risk

Market risk arises from trading and investment activities of LHV Bank in the financial markets from interest rate products, foreign exchange and stock markets. Market risk is a potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. The VaR (Value at Risk) method is used to assess potential losses. The method calculates the maximum potential loss at a particular trade date from a particular portfolio with 99% probability. Options portfolios are limited to the open delta limit of the total portfolio. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures, the monitoring responsibility of which lies with the internal control department.

LHV Varahaldus invests over half of its capital in the units of investment funds managed by it. The management of LHV Varahaldus is responsible for assuming and monitoring of the market risk.

✓ ***Foreign currency risk***

Foreign currency risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. Open foreign currency positions are monitored daily. If the open currency position exceeds the limits set in regulatory acts, measures are immediately implemented to reduce such positions (hedging the risk with relevant instruments, like foreign currency forwards or futures).

Foreign currency rate risk is managed under the following limits:
- Open currency positions of OECD member states cannot exceed 15% of net own funds
- Open currency positions of any other currency (excl. euro, lats, litas) cannot exceed 5% of net own funds
- Open currency positions of the Estonian kroon, Latvian lats and Lithuanian litas are without limits, as the kroon and the litas are pegged to the Euro using a fixed exchange rate and the fluctuation of the lats is fixed at +/-1% to the Euro.

Information regarding assets and liabilities bearing currency risk is presented in the tables on pages 27-28. The main currencies, in which LHV has open currency exposures, are USD, SEK and LVL. Open currency exposures have not significantly changed throughout 2008 in comparison with the balance sheet date of 31.12.2008.

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to open currency positions on the income statement.

	Changer	**2008**	**Change**	**2007**
USD exchange rate	+10%	-57	+10%	4
	-10%	57	-10%	-4
SEK exchange rate	+5%	-4	+6%	-8
	-5%	4	-6%	8
LVL exchange rate	+5%	31	+0,5%	13
	-5%	-31	-0,5%	-13
Total effect of appreciation of exchange rates		**-30**		**9**
Total effect of depreciation of exchange rates		**30**		**-9**

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PricewaterhouseCoopers, Tallinn

Open currency exposures

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

								As at 31.12.2008
Assets bearing currency risk	**EEK**	**EUR**	**LTL**	**LVL**	**SEK**	**USD**	**Other**	**Total**
Cash and cash equivalents	21 106	490	201	57	0	0	0	21 854
Financial assets at fair value through P/L	18 830	25 950	297	0	1	34	0	45 112
Loans to customers	7 076	5 842	7 216	267	334	4 677	1 050	26 462
Receivables from customers	2 368	156	0	0	0	573	134	3 231
Other assets	1 819	351	7	8	0	0	0	2 185
Total assets bearing currency risk	**51 199**	**32 789**	**7 721**	**332**	**335**	**5 284**	**1 184**	**98 844**
Assets not bearing currency risk								
Finance lease receivables	4 246	0	0	0	0	0	0	4 246
Goodwill	8 723	0	0	0	0	0	0	8 723
Property, plant and equipment and intangible assets	7 644	0	0	0	0	0	0	7 644
Total assets not bearing currency risk	**20 613**	**0**	**0**	**0**	**0**	**0**	**0**	**20 613**
Total assets *	**71 812**	**32 789**	**7 721**	**332**	**335**	**5 284**	**1 184**	**119 457**
Contingencies at contractual amounts (Note 14)	**4 570**	**0**	**0**	**0**	**0**	**0**	**0**	**4 570**
Liabilities bearing currency risk								
Loans received	3 963	8 261	0	0	0	0	0	12 224
Finance lease liabilities	0	414	0	0	0	0	0	414
Other financial liabilities	379	2	161	0	0	0	0	542
Accrued expenses	5 960	154	426	91	0	11	0	6 642
Total liabilities bearing currency risk	**10 302**	**8 831**	**587**	**91**	**0**	**11**	**0**	**19 822**
Liabilities not bearing currency risk								
Bonds issued	4 342	0	0	0	0	0	0	4 342
Deferred income	9	1 336	0	0	0	0	0	1 345
Provisions	300	0	0	0	0	0	0	300
Total liabilities not bearing currency risk	**4 651**	**1 336**	**0**	**0**	**0**	**0**	**0**	**5 987**
Total liabilities *	**14 953**	**10 167**	**587**	**91**	**0**	**11**	**0**	**25 809**
Commitments at contractual amounts (Note 14)	**0**	**0**	**0**	**0**	**572**	**3 902**	**0**	**4 474**
Total shareholders' equity	93 744	0	0	0	0	0	0	93 744
Open foreign currency position	**-32 315**	**22 622**	**7 134**	**241**	**-237**	**1 371**	**1 184**	**0**

* the balances of total assets and total liabilities differ from the carrying amounts by the fair value of the derivatives, which are shown here at their full contractual amounts.

								As at 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 P/L	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**
Total 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 balances of total assets and total liabilities differ from the carrying amount by the fair value of the derivatives, which are shown here at their full contractual amounts.

✓ ***Price risk***

Financial instruments bearing price risk are the securities held for trading by LHV Bank and the securities held for investing by LHV Varahaldus. The limits are set for the size of the trading portfolio at LHV Bank. The head of the brokerage team oversees the trading portfolio and the internal control department monitors the compliance with limits.

Sensitivity analysis of the securities of LHV Bank held for trading:

Effect on income statement	**Changes**	**2008**	**Changes**	**2007**
Shares	+10%	461	+20%	11
	-10%	-461	-20%	-11
Fund units	+10%	27	+10%	27
	-10%	-27	-10%	-27
Bonds	+20%	881		
	-20%	-881		
Total effect of price appreciation		**1 349**		**38**
Total effect of price depreciation		**-1 349**		**-38**

The goal of the investment portfolio of LHV Varahaldus is to invest available funds similarly to how the assets of the funds managed by LHV Varahaldus are invested as a result of which LHV Varahaldus invests more than one half of capital in the funds managed by it. In order to ensure liquidity, the remaining available funds are invested in securities, including bonds and deposits. The loss due to a 20% price decline in the bonds in the investment portfolio of LHV Varahaldus would amount to 2 863 thousand kroons of loss.

Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 1% of the number of units in each of the mandatory pension fund managed by it.. The investment portfolio of LHV Varahaldus consists of both pensions fund units as well as the units of investment funds managed by it. Management cannot reasonable certainty assess the price change of the units of funds managed by it over the following 12 months, as result of which the possible effect on the income statement is not presented here. Major financial losses due to the decline in the market value of the funds were incurred in 2008 and management believes that by the year-end 2009, the market values will increase as compared to the year-end 2008.

✓ ***Interest rate risk***

To reduce the cash flow risk arising from a possible change in interest rates, LHV Bank primarily uses fixed interest rates both for taking loans as well as granting them. In 2008, the fixed interest rate on loans granted was between 7.5-20.5% (2007: 7.75-12.75%). Interest rates on loans granted are changed once a month at most according to fluctuations in 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 2008 were as high as 8% (2007: 8%). 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 finance lease receivables of LHV Ilmarise Kinnisvaraportfelli OÜ and issued bonds 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 maturity date, the Group is entitled to redeem the issued bonds in the additionally collected amount. Due to this, the Group does not bear significant interest rate risk.

As the portfolio of loans granted and loans received is of short-term nature, the change in market interest rates does not have a significant influence on the fair value of these loans.

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

- coupon bonds with fixed interest rates which do not carry interest rate risk (31.12.2008: carrying amount of 6 875 thousand kroons);
- coupon bonds with floating interest rates as a result of which the expected cash flows from investments may differ from the actual ones (31.12.2008: carrying amount of 7 440 thousand kroons).

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.

3.2.3 Liquidity risk

Liquidity risk relates to the solvency of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The finance department of LHV Bank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period. The sources of funding are constantly supplemented when due dates arrive or when customers take additional loans. In case the volume of loans granted to customers declines, the sources of funding are reduced accordingly, as all loans received are short-term. As at 31.12.2008 and 31.12.2007, the Group does not have any debts past due.

The undiscounted cash flows of issued bonds up to 1 year total 415 thousand kroons, between 1-5 years, 1 631 thousand kroons and over 5 years, 4 915 thousand kroons. The undiscounted cash flows from the corresponding finance lease receivables up to 1 year total 422 thousand kroons, between 1-5 years, 1 650 thousand kroons and over 5 years, 4 883 thousand kroons.

The global liquidity crisis prevailing in 2008 has not affected LHV's funding opportunities because due to the crisis in the stock markets, the volume of leverage used by the customers of LHV Bank has declined and hence, the need to raise debt has decreased.

The following tables present the distribution of financial assets and liabilities by due dates. The carrying amounts are used in the analysis, except for derivatives, for which the contractual amounts are used. Explanation of the fair value of these financial assets and liabilities is presented in Note 3.3.

As at 31.12.2008

Financial assets	up to 3 months	3-12 months	1-5 years	over 5 years	Total
Cash and cash equivalents	21 854	0	0	0	**21 854**
Financial assets at fair value through profit and loss	9 940	1 111	11 558	22 503	**45 112**
Derivatives	668	0	0	0	**668**
Loans to customers	15 482	10 980	0	0	**26 462**
Receivables from customers	2 657	574	0	0	**3 231**
Finance lease receivables	39	122	712	3 373	**4 246**
Other receivables and assets	437	637	893	218	**2 185**
Total	**51 077**	**13 424**	**13 163**	**26 094**	**103 758**

Financial liabilities					
Derivatives	572	0	0	0	**572**
Loans received	7 247	4 977	0	0	**12 224**
Other financial liabilities	542	0	0	0	**542**
Deferred income	343	1 002	0	0	**1 345**
Finance lease liabilities	22	67	325	0	**414**
Accrued expenses and other liabilities	3 521	3 121	0	0	**6 642**
Bonds issued	37	189	717	3 399	**4 342**
Provisions	0	300	0	0	**300**
Total	**12 284**	**9 656**	**1 042**	**3 399**	**26 381**

As at 31.12.2007

Financial assets	up to 3 months	3-12 months	1-5 years	over 5 years	Total
Cash and cash equivalents	10 796	0	0	0	**10 796**
Financial assets at fair value through profit and 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**
Total	**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**

3.3 Fair value of financial assets and liabilities

The Group estimates that the fair values of the assets and liabilities denominated at amortised cost in the balance sheet do not differ significantly from their carrying amounts as at 31.12.2008 and 31.12.2007. The loans granted to customers that have been issued with fixed interest rates are sufficiently short-term and issued at market terms, therefore the fair market rate and respectively, the fair value of the loan does not change significantly during the loan term. The loans received and structured bonds are also of a very short maturity and therefore, their fair value does not differ significantly during the loan or deposit term. Information regarding liquidity is presented in the subparagraph presented above.

Receivables from customers, accrued expenses and other liabilities have arisen in the normal course of business and are payable shortly, due which the Management Board estimates that their fair value does not differ significantly from their carrying amount. These receivables and liabilities do not carry any interest.

Both finance lease receivables and bonds issued are of significantly longer maturity and the fair value of these expected cash flows at the current market rates might differ from the carrying amounts of the finance lease receivables and bonds issued. The bonds issued are quoted on the Tallinn Stock Exchange. Since their first quotation on the stock exchange at 13.10.2005 until 31.12.2008, there have been no transactions with the bonds and therefore, there is no information available on price movements. As there have been no transactions with bonds in the secondary market, the fair value of bonds is not reliably determinable as a result of which this value is not presented here. The lessees are entitled to terminate their agreement at any time during the lease period; therefore it would not be appropriate to consider these cash flows from current agreements as expected cash flows on the basis of schedules established in the agreements. Bonds have been redeemed in exactly the same volume as purchased finance lease agreements. Therefore, the Management Board has evaluated and concluded that the combined fair value of lease receivables and bonds issued does not significantly differ from their carrying amounts.

3.4 Operating risk

Operating risk is a potential loss caused by human, process or information system flaws. When completing 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 in order to carry out a 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 collected into the 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 of the database of operating risk and the Management Board of LHV Bank is responsible for dealing with the analysis of information and implementing necessary measures.

Compliance control and internal audit have an important role in valuating, monitoring and mitigating the operating risk. Pursuant to the Securities Market Act, the main task of Compliance Officer is to define non-compliance risks of the activities of the Group to legislation, recommended guidelines of the Financial Supervisory Authority and procedure rules of the Group, considering the nature, range and complexity of business and services rendered, and arrangement of mitigating or avoiding those risks. Internal audit is an independent and objective, assuring and consulting activity that is targeted at improving the Company's performance and adding value. Internal audit helps achieving the goals of the Company, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

3.5 Effects of the economic crisis

Management has evaluated the effects of the global liquidity crisis and the related overall economic crisis on the Company's business. An important factor affecting the Group's operations is the decline in the trading activity of customers related to the decline in the value of instruments traded in the financial markets and the decline in the market value of the funds managed by the Group and the related financial loss. Due to the decline in the market value of funds, management fees have also declined. Fee and commission income from brokerage services in 2008 was maintained at the same level as in 2007. Management cannot reliably predict the effect of the economic crisis on the Group's activities and financial position in 2009. Management believes that it has taken all necessary measures to ensue the sustainability and growth of group entities in the current circumstances.

NOTE 4 Significant management decisions and estimates

In accordance with IFRS, several financial figures presented in the consolidated financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the balance sheet date, and the reported amounts of revenue and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates.

Management's estimates have been primarily applied to:

- recognition of impairment losses of loans, receivables and investments;
- in the absence of an active market, fair valuation of investments using valuation techniques;
- determination of useful lives of non-current assets (see Notes 2.10, 2.11 and 19);
- provisions and contingent liabilities
- evaluation of 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 in 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, management estimates have been used to value bonds (see Note 15).

NOTE 5 Net fee and commission income

Fee and commission income	2008	2007
Financial advisory services	284	1 995
Security brokerage and commissions	39 793	40 417
incl. related parties (Note 28)	*454*	*2 078*
Asset and fund management	19 717	7 641
incl. related parties (Note 28)	*11 895*	*2 305*
Total	**59 794**	**50 053**
Fee and commission expense		
Financial advisory and other similar services purchased	0	-1 744
Security brokerage and commissions paid	-7 045	-7 162
Total	**-7 045**	**-8 906**
Net fee and commission income	**52 749**	**41 147**

Fee and commission income by customer location:	2008	2007
Estonia	47 757	42 503
Latvia	3 774	893
Lithuania	8 263	6 657
Total	**59 794**	**50 053**

NOTE 6 Net interest income

Interest income from	2008	2007
Cash and bank	3 060	2 145
Finance lease (Note 16)	270	280
Margin loans and lending of securities (Note 12)	6 456	6 994
Other loans (Note 12)	190	243
Total	**9 976**	**9 662**
Interest costs on		
Bonds issued (Note 22)	-252	-268
Loans received (Note 20)	-1 820	-1 920
incl. loans to related parties (Note 28)	*-68*	*-196*
Total	**-2 072**	**-2 188**
Net interest income	**7 904**	**7 474**

Interest income by customer location:	2008	2007
Estonia	3 469	4 354
Latvia	667	192
Lithuania	5 840	5 116
Total	**9 976**	**9 662**

NOTE 7 Gains and losses from financial assets

	2008	2007
Net gain/loss from securities		
Related to changes in foreign exchange rates:	2 907	2 736
- translation gains less losses	-117	73
- transactions gains less losses from customer trades	3 024	2 663
Gain from securities recognised at fair value	-6 706	-116
Net gain from trading	**-3 799**	**2 620**
Net gain/loss from investments recognised at fair value through profit or loss		
Loss/gain from changes in fair value of bonds	1 664	539
Loss from changes in fair value of shares and fund units	-10 996	-818
Net loss/gain from securities	**-9 332**	**-279**
Other income and expenses from financial assets		
Dividend income from trading portfolio securities	1	3
Cost related to repurchase of the option entered into for the shares of subsidiary *	0	-4 051
Total	**1**	**-4 048**
Net loss/gain from securities	**-13 130**	**-1 707**

* Bid option to the shareholders of AS LHV Group:

According to the funding contract of the Investment Services Department entered into in 2001 and supplemented at the end of 2005, an additional investment into the former AS Lõhmus, Haavel & Viisemann by AS Lõhmus Holdings and AS Viisemann Holdings was agreed upon with the shareholders in the total amount of 10 661 thousand kroons. According to the terms of the contract, the parent AS LHV Group had the obligation to transfer 42.4% ownership interest in LHV. Under the contract, the last payments were made by the shareholders into equity totalling 2 894 thousand kroons. Upon meeting other terms of the option issued, the shareholders of AS LHV Group had the right to acquire a 42.4% interest in the shares of the subsidiary LHV at the end of 2007. In October 2007, this contract was terminated and .AS LHV Group repurchased the option to acquire the shares of the subsidiary from its shareholders at the price of 14 713 thousand kroons (which was fair value at that time), 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, which is difference between the liability recognised from the options as at 31.12.06 in the amount of 10 661 thousand kroons as at 31.12.2006 and the repurchase price. The equity of LHV did not change in the process.

NOTE 8 Other income

	2008	2007
Accounting services rendered	0	679
Other income from customers	474	421
Fines and penalties received	0	25
Income from transactions with related parties (Note 28)	1 455	8 043
Income from transactions with other parties	402	7 255
Income related to release of provision (Note 23)	4 880	0
Total other income	**7 211**	**16 423**

NOTE 9 Operating expenses

	Note	2008	2007
Staff costs			
Wages, salaries and bonuses		19 801	16 419
Social security and other taxes		6 607	5 208
Total		**26 408**	**21 627**
Marketing expenses		9 318	6 592
Total services purchased		9 745	4 955
Operating lease payments	25	4 443	2 922
Information services and bank services		2 155	1 904
IT expenses		2 280	1 857
Office expenses		2 577	1 551
Training and travelling expenses of employees		1 704	1 222
Transportation and communication costs		1 510	1 061
Other administrative expenses		1 339	1 302
Depreciation	19	3 025	571
Costs related to setting up provisions	23	600	2 957
Other operating expenses		332	2 483
Total operating expenses		**65 436**	**51 004**

Due to the addition of new rental premises and appreciation of rental prices, the operating lease payments and office expenses increased in 2008. Deprecation has also significantly increased as a result of capitalisation of repair costs and purchase of furniture and furnishings. Other purchased services have increased as a result the expenses related to legal counselling and personnel recruitment. Other operating expenses included the cost related to the relocation of the Company to the 16th floor of City Plaza in 2007.

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 31.12.2007: 21/79). In 2008 or 2007, no dividend payments were made to the shareholders.

NOTE 11 Cash and cash equivalents

Deposits held at call	**31.12.2008**	**31.12.2007**
With Moody´s long-term rating of A1 at banks	21 840	10 013
With FitchRatings long-term rating of AA- at banks	14	783
Total cash and cash equivalents	**21 854**	**10 796**

NOTE 12 Loans granted to customers

	Loan balance 31.12.2008	Loan balance 31.12.2007	Interest rate
Loans to entities	13 721	6 058	7%-18%
Loans to private persons	12 755	51 520	7%-18%
Allowances for loans	-15	-40	
Total loans to customers	**26 461**	**57 538**	

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PricewaterhouseCoopers, Tallinn

LHV

Customer's interest in leveraged loans depends on the situation in the financial markets. In a declining market, interest has significantly decreased, and therefore, the volume of loans has also decreased considerably.

Distribution of loans to customers by currencies is presented in Note 3 on pages 27-28 and by due dates in Note 3 on page31 . Loans granted are backed by securities and can be terminated by the customer at any time. Information regarding credit risk exposures, securities accepted as collateral for loans and loans past due is presented in Note 3 on page 25.

By customer location:	**31.12.2008**	**31.12.2007**
Estonia	17 933	12 223
Latvia	774	1 664
Lithuania	7 754	43 651
Total loans	**26 461**	**57 538**

Interest rates used by the Group for loans in different currencies as at 31.12.2008:

EEK	12.75%	LVL	17.50%	SEK	10.75%	HRK	16.00%	JPY	7.25%
EUR	10.25%	LTL	12.75%	CAD	9.25%	HUF	18.00%	PLN	12.75%
USD	8.00%	GBP	10.00%	CHF	8.00%	CZK	9.75%	RUB	20.00%

Interest rates used by the Group for loans in different currencies 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	7.5%

The interest rates of most loans are generally equal to their effective interest rate as no significant fees have been received at issuance.

Deferred income includes accrued interest on loans issued to customers in the amount of 1 336 thousand kroons. For interest income on loans granted, see Note 6.

NOTE 13 Receivables from customers

	31.12.2008	**31.12.2007**
Securities brokerage fees from intermediaries	752	1 500
Asset management fees from customers	1 181	1 223
Other fees for providing services to customers	1 329	170
incl. related parties (Note 28)	*662*	*808*
Total	**3 231**	**2 893**

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

NOTE 14 Foreign currency derivatives

	Receivable / liability (at fair value)	**Contractual amount as contingency**	**Contractual amount as commitment**
Balance as at 31.12.2008			
Foreign currency futures contract (USD)	0	3 902	3 902
Foreign currency forward contracts (SEK)	96	668	572
Total derivatives	**96**	**4 570**	**4 474**

Balance as at 31.12.2007			
Foreign currency futures contract (USD)	0	7 833	7 833
Foreign currency forward contracts (SEK)	53	2 878	2 825
Total derivatives	**53**	**10 711**	**10 658**

Foreign currency forward contracts have been entered into to hedge the currency risk related to the loans, receivables and securities denominated in Swedish kronas. The foreign currency futures contract has been entered into in US dollars for the same purpose. The foreign currency futures contract is traded on a stock exchange and daily losses/gains are immediately transferred to the bank account of LHV Bank with a foreign broker. As a result, the carrying amount of the foreign currency future is zero. The terms of contracts are in between 2-3 months of the balance sheet date (2007: 1-5 months).

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

Financial assets	**31.12.2008**	**31.12.2007**
Shares	4 372	38
Bonds	4 405	4 044
Fund units	506	388
Total financial assets held for trading	**9 283**	**4 470**
Shares	0	207
Bonds	14 315	12 888
Fund units	21 514	40 156
incl. investments in managed pension funds	*14 766*	*29 042*
incl. investments in managed investment funds	*6 748*	*8 938*
Financial assets designated at fair value through profit or loss at inception	**35 829**	**53 251**
Total financial assets	**45 112**	**57 691**

As at 31.12.2008, the trading portfolio's share positions include assets acquired for the purpose of hedging the risk of underwritten options.

With regard to listed securities, the fair value of investments is their bid price. The discounted cash flow model has been used for bonds, the market price of which is difficult to determine. The valuation method considers the current condition and the expected rate of return at the date of valuation and may not accurately reflect market conditions before and after the valuation date.

The Company has adjusted its return expectations derived from increased market interest rates and the risk level. All securities are reported at fair value in the financial statements. Of the total bond position (both trading and investment portfolio), securities in the amount 2 230 thousand kroons and bonds in the amount of 16 490 thousand kroons valued using the discounted cash flow model are recognised at the market value based on the quotes in an active market.

In 2007, the Company did not use alternative valuation methods and all securities are reported at the market price based on the quote in an active market.

In 2008, the units of pension funds were sold back for 11 122 thousand kroons and the units sold were deleted from the register. The cost of the units of pension funds recognised at fair value totalled 12 000 thousand kroons. The units of investment funds were acquired at their nominal value and the cost of the fund units totalled 14 082 thousand kroons (incl. for 9 388 thousand kroons in 2007 and 4 694 thousand kroons in 2008).

Held for trading:	**31.12.2008**	**31.12.2007**
Options embedded in structured bonds (Note 22)	2	0
Underwritten options	540	0
Total financial liabilities	**542**	**0**

LHV Bank underwrites options for the securities traded on Baltic stock exchanges.
The Black & Scholes model is used to value options. If an underlying asset pays dividends, the Roll, Geske & Whaley model is used. The variables entered into the price formation include the price of the underlying asset, strike prices (future trade price), volatility, *smile, strike-smile, smile step*, interest, date of paying dividends and the amount of expected dividends. The price of the underlying asset is determined according to the market price, i.e. the price of a put option is calculated using the bid price and the price of a call option is calculated using the ask price of the underlying asset. In order to determine volatility, the function of the Bloomberg terminal is used and it is monitored that no arbitrage opportunities arise between various strike prices. Interest used for valuation depends on the value of money for LHV Bank and as at 31.12.2008 the interest rate used was 8%.

NOTE 16 Finance lease receivables

	31.12.2008	**31.12.2007**
Net investment by due dates		
Up to 1 year	161	166
Between 1 and 5 years	712	669
Over 5 years	3 373	3 575
Total net investment	**4 246**	**4 410**
Future interest income by due dates		
Up to 1 year	261	270
Between 1 and 5 years	939	982
Over 5 years	1 509	1 727
Total future interest income	**2 709**	**2 979**
Gross investment by due dates		
Up to 1 year	422	436
Between 1 and 5 years	1 650	1 651
Over 5 years	4 883	5 302
Total gross investment	**6 955**	**7 389**

At 21.01.2005, LHV Ilmarise Kinnisvaraportfelli OÜ acquired the portfolio of lease receivables arising from finance lease agreements of Ilmarise Kvartal OÜ against finance lessees concerning finance lease payments in the amount of 18 529 thousand kroons (principal payments according to contracts) from a third party. The underlying currency of finance lease agreements is the Estonian kroon. The annual interest rates on the finance lease agreement are between 6% and 8%. Interest rates are 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 customers 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 (for interest cost, see Note 6).

These finance lease agreements cover the leasing of apartments by the lessees and upon payment of all lease payments according to the contract, the lessees will become owners of these apartments. Upon the early payment of the full amount of the net investment of the lease agreement, the lessees are entitled to acquire the apartment before the end of the lease term. In 2008, no apartments were transferred, principal payments for apartments not yet transferred totalled 128 thousand kroons. In 2007, one apartment ownership was transferred for the total amount of 71 thousand kroons and principal payments were additionally made in the amount of 115 thousand kroons. By the time of compiling this report, 8 apartments have not yet been purchased.

All finance lease receivables have been pledged as collateral for the bonds issued. Danske Bank A/S Estonia Branch acts as a guarantee agent and custodian of the pledged assets (see Note 22). For receivables past due, see the credit risk table in Note 3 on page 25.

NOTE 17 Other assets

	31.12.2008	31.12.2007
Guarantee deposits of Baltic stock exchanges	218	279
Prepayment of marketing expenses	466	1 125
Prepayments to Financial Supervision Authority	743	507
Other prepayments *	758	507
Total	**2 185**	**2 418**

* Prepayments include office rent, insurance, periodicals.

Prepayments are expected to be received or used within 12 months of the balance sheet date, and are therefore considered current assets. Guarantee deposits on the Baltic stock exchanges are held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius, and should therefore be considered long-term assets. A change in guarantee deposits is related to calculations performed in accordance with the Rules and Regulations of the Tallinn Stock Exchange, and the volumes of LHV's customer trades on the Baltic stock exchanges.

NOTE 18 Subsidiaries and joint ventures

Until 30.09.2007, **AS LHV Varahaldus** was recognised as a joint venture according to the contract of shareholders which regulates that the shareholders have joint control over the entity.

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 the subsidiary of AS LHV Group with the ownership interest of 61.96%.

As at 31.12.2008, the Group's subsidiaries include and they have been consolidated in these financial statements:

- AS LHV Bank (ownership interest 100%)
- LHV Ilmarise Kinnisvaraportfelli OÜ (ownership interest 100%)
- AS LHV Varahaldus (ownership interest 61.9%)

Goodwill recognised in the consolidated balance sheet of AS LHV Group (EEK 8 723 thousand) includes:

- Positive goodwill which arose in the acquisition of the ownership interests of AS LHV Varahaldus in the total amount of 7 539 thousand kroons
- Goodwill which arose in the acquisition of the subsidiaries reported in the balance sheet of AS LHV Varahaldus (former management company AS Seesam Varahaldus) in the amount of 1 184 thousand kroons.

An impairment test was performed as at 31.12.2008. The cash generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

1) the cash flow forecast for the years 2009-2014 is based on the assumptions which have become known by now, i.e. that the payments to the II pillar pension funds will not be made in 2010, and it is assumed that in 2011 payments will be half of regular level and from 2012, payments will be restored to their regular level
2) due to the economic environment, modest growth of 3% in operating is expected per annum (this year, the operating expenses will actually decline);
3) the discount rate used is 12%;

Based on the results of the impairment test, the recoverable amount of goodwill is higher than its carrying amount as a result of which no impairment losses have been recognised.

NOTE 19 Property, plant and equipment, and intangible assets

Balance as at 31.12.2006	**Property, plant and equipment**	**Intangible assets**	**Total**
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
Proceeds from disposal of non-current assets at carrying amount	-13	-3	-16
Addition of non-current assets of AS LHV Varahaldus at cost	95	21	116
Accumulated depreciation of AS LHV Varahaldus as at 30.09.2007	-35	-7	-42
Depreciation/amortisation charge	-530	-41	-571
Balance as at 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**
Changes occurred in 2008			
Purchase of non-current assets	4 565	182	4 747
Proceeds from disposal of non-current assets at carrying amount	-29	0	-29
Depreciation/amortisation charge	-2 936	-89	-3 025
Balance as at 31.12.2008			
Cost	11 673	744	12 417
Accumulated depreciation and amortisation	-4 251	-522	-4 773
Carrying amount	**7 422**	**222**	**7 644**

The majority of the non-current assets purchased in 2008 and 2007 are capitalised repair costs as well as furniture and other furnishings related to the investment centre opened in April 2008. In both years, non-current assets were disposed of at the carrying amount and neither additional income arose nor were additional expenses incurred. In 2008 and 2007, there was no indication of impairment of property, plant and equipment, and intangible assets.

NOTE 20 Loans received

	Balance 31.12.2008	Balance 31.12.2007	Interest rate
Loans from shareholders and related entities (Note 28)	0	6 015	5-7%
Loans from private persons	828	3 281	5-8%
Loans from legal persons	11 396	20 501	5-8%
Total	**12 224**	**29 797**	

Loans received are denominated in Estonian kroons and euros. The distribution of loans by currencies is presented in Note 3 on pages 27-28 and due dates on page 31. The balance of loans received as at 31.12.2008 includes the interest liability in the amount of 47 thousand kroons (31.12.2007: 339 thousand kroons). For interest costs, please see Note 6.
Loans received include the deposit portion of structured bonds, which as at 31.12.2008 totals 827 thousand kroons, incl. from private persons in the amount of 723 thousand kroons and from legal persons in the amount of 104 thousand kroons. As at 31.12.2007, the Company had not issued any structured bonds.
The nominal interest rates of most loans equal their effective interest rates as no other significant fees have been paid.

NOTE 21 Accrued expenses and other liabilities

	31.12.2008	31.12.2007
Trade payables	1 536	1 424
Payables to employees	1 912	6 765
Tax liabilities	3 194	1 837
Other short-term payables	0	485
Total	**6 642**	**10 511**

Trade payables are paid within 12 months of the balance sheet date and are recognised as current liabilities. Payables to employees consist of accrued wages and salaries, bonus and holiday reserve liabilities. Tax liabilities in the balance sheet include tax liabilities on wages and salaries and value added tax liability. All tax liabilities are payable within 12 months after the balance sheet date and are therefore, current liabilities. In 2007, payables to employees also included the annual bonus. No bonuses were paid on the basis of the financial results for the year 2008.

NOTE 22 Bonds issued

The balance sheet line of bonds includes the bonds related to finance lease agreements.

Distribution of liabilities by due dates	**31.12.2008**	**31.12.2007**
Up to 1 year	226	208
Between 1 and 5 years	717	674
over 5 years	3 399	3 603
Total value of bonds issued	**4 342**	**4 485**

At 19 January, the former investment company and the current LHV Bank carried out a placement of securitised bonds backed by finance lease agreements in the total amount of 18 529 thousand kroons.
Interest on coupon bonds is 5.8% per annum. The redemption payments of bonds and interest payments to bond holders take place on a quarterly basis in the month following the end of the quarter.

As at 31.12.2008, the following principal and interest payments have been made to the bond holders:

Date	Number of bonds	Amount of principal payment	Cumulative principal payment	Amount of interest payment	Cumulative principal payment
Redeemed in 2005	67 362	6 736	6 736	695	695
Redeemed in 2006	54 402	5 440	12 176	564	1 259
Redeemed in 2007	19 187	1 919	14 095	290	1 549
Redeemed in 2008	1 419	142	14 237	254	1 803
Total redeemed	**142 370**	**14 237**	**14 237**	**1 803**	**1 803**

Structured bonds include two portions, the deposit position is included within loans received, see Note 20, and the option position is included within financial liabilities recognised at fair value, see Note 15. Structured bonds were issued at 01.10.2008 with the maturity in 1 year and the return on bonds depending on the return of the fund unit of LHV Persian Gulf Fund.

NOTE 23 Provisions

AS LHV Varahaldus has given DVD-players and gift cards to clients joining the pension funds in previous periods, which are treated as expenses related to business. There was an ongoing discussion with the Tax Board in earlier years as to whether to recognise these items as purely advertising costs or gifts, as a result of which a short-term provision was formed in balance sheet to cover potential corporate income tax and interest liabilities. As at the date of preparation of the annual report, additional information has been received on the approach of the Tax Board with regard to these expenses. Based on the additional information and as a result of consultations with the Tax Board, it was concluded that the amount of 4 880 000 kroons recognised as a provision in the balance sheet for 2007 can be released and income from such released provision is recognised within other operating income in the income statement (see Note 8).
A provision has been provided in the balance sheet related to LHV Bank in conjunction with potential court fees and other expenses in the amount of 600 000 kroons, the cost of which is included within operating expenses (see Note 9).

NOTE 24 Shareholders' equity

As at 31.12.2008, the ultimate controlling party of AS LHV Group is Rain Lõhmus with 65% of the voting rights and Andres Viisemann has significant influence with 32% of the voting rights. As at 31.12.2007, the ultimate controlling party was Rain Lõhmus with 67% of the voting rights and Andres Viisemann had significant influence with 33% of the voting rights.

	31.12.2008	31.12.2007
Share capital *(in thousand Estonian kroons)*	68 630	66 400
Number of shares (pcs)	686 300	664 000
Nominal value of shares *(in kroons)*	10	10

According to the articles of association amended at 27.01.2009, the minimum share capital of AS LHV Group is 40 000 thousand and the maximum share capital is 160 000 thousand kroons.

In spring 2008, the share capital was increased and the amount of new share capital is 68 630 thousand kroons. A total of 22 300 new shares with the nominal value of 100 kroons each were issued. The issue price was 150 kroons per share. The share capital was paid in cash and the total amount is 3 345 thousand kroons. The entry of the increase in share capital was made at 24.07.2008.

From 1 January 2009, the corporate income tax on net dividends payable out of retained earnings is 21/79 (until 31.12.2008: 21/79). In accordance with the Commercial Code, it is possible to pay out that portion of net profit as dividends which exceeds the amount of the share capital of the parent and the reserves. Based on the financial results for 2008, it is not possible to pay any dividends to the shareholders. As at 31.12.2007, the Group's retained earnings totalled 1 914 thousand kroons, of which it would have been possible to pay out 1 512 thousand kroons as dividends and the corporate income tax on dividends would have amounted to 402 thousand kroons. In 2008 and 2007, no dividends were paid to the shareholders.

NOTE 25 Finance and operating lease

The Group leases passenger cars and office space 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 17 316 thousand kroons (2007: 15 721 thousand kroons), the current portion of which amounts to 3 928 thousand (2007: 4014 thousand kroons) and the non-current portion which amounts to 13 388 thousand kroons (2007: 11 707 thousand kroons).

Operating lease payments recognised in operating expense:	**2008**	**2007**
Office space	4 298	2 787
Passenger cars	106	108
Computers	39	27
Total (Note 9)	**4 443**	**2 922**

In addition, the Group leases one passenger car under finance lease terms. Interest expenses in the amount of 19 thousand kroons which have arisen from the payment of finance lease principal payments have been included within interest expenses. Finance lease principal payments totalled 119 kroons and they are reported as a reduction of the finance lease liability in the balance sheet. The due date of the finance lease agreement is 15.03.2013, the interest rate is 5.53% and the agreement is denominated in EUR.

NOTE 26 Contingencies and commitments

LHV Bank, operating as an account manager for customers, has custody of or intermediates the following customer assets:

	31.12.2008	**31.12.2007**
Assets in custody	**97 922**	**119 422**
incl. shareholders and related entities	100	15 052
Securities & loans	**1 421 885**	**1 853 966**
incl. shareholders and related entities	112 296	110 741
Total	**1 519 807**	**1 973 388**

Asset management fees for the management of these assets are in the range of 0.015 – 0.025 % (see respective income in Note 5).

NOTE 27 Contingent liabilities

Tax authorities have the right to review the Group'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 Group in 2007 - 2008. The Group's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on the Company.

NOTE 28 Transactions with related parties

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

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

Transactions	Note	2008	2007
Group entities		11 894	2 302
incl. shareholders and related entities		455	2 081
Total service fee and commission income	**5**	**12 349**	**4 383**
incl. shareholders and related entities		1 455	7 255
Group entities		0	788
Total revenue	**8**	**1 455**	**8 043**
incl. shareholders and related entities	6	-30	-196
Total interest expenses		**-30**	**-196**

Balances		31.12.2008	31.12.2007
Group entities		858	805
incl. shareholders and related entities		662	3
Receivables as at the year-end	**13**	**1 520**	**808**
incl. shareholders and related entities		0	6 015
Loans granted as at the year-end	**20**	**0**	**6 015**

In 2008, salaries and other compensations paid to the subsidiaries of AS LHV Group totalled 4 703 thousand kroons (2007: 1 964 thousand kroons). As at 31.12.2008, remuneration for December and accrued holiday pay in the amount of 398 thousand kroons (as at 31.12.2007: 363 thousand kroons) is reported as a payable to management, see Note 21. The Group did not have any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 31.12.2008 and 31.12.2007 (pension liabilities, termination benefits, etc.).

Information on assets of related parties held by the Company as an account manager is presented in Note 26.

NOTE 29 Events after the balance sheet date

The proposal of the Government of the Republic of Estonia to halt the payments to the II pillar pension funds until the end of 2010 will mean declining revenue for AS LHV Varahaldus. Due to the disappearance of the entrance fees charged on new payments, the revenue of the management company will decrease additionally by about 8.5% in 2009 and 15% in 2010. The management company has already factored in the disappearance of such fees in its business model because due to the changes in the pension system, it will occur from 2011 anyway, regardless of the temporary halting of payments. In addition, the halting of the payments of the II pillar will also impact the growth in the volume of pension funds. Until the end of 2010, the funds will only increase on account of investment gains and the payments of those customers who decide to continue voluntary payments. The management fees are not expected to increase higher than 30% on the II pillar pension funds which would be the expected return in case there is no interruption in payments.

The share capital of AS LHV Group was increased in April 2009 to 116 215 thousand kroons. As a result of the transaction, Rain Lõhmus is the controlling party of the Group with his 57% voting rights and the interest of Andres Viisemann is19%. The rest of the share capital, 24%, is divided between minority shareholders.

NOTE 30 Separate financial statements

According to the Accounting Act of Estonia, the separate financial statements of the consolidation group's parent are disclosed in the notes to the financial statements.

Income statement of the parent

(in thousand Estonian kroons)

	2008	**2007**
Interest income	542	208
Interest expenses	-37	-14
Net interest income	**505**	**194**
Other expenses on financial assets	0	-13 019
Net loss/gain from securities	**0**	**-13 019**
Other income	0	39
Operating expenses	-1 072	-117
Loss for the financial year	**-567**	**-12 903**

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Kuupäev/date 18.05.09
PricewaterhouseCoopers, Tallinn

Balance sheet of the parent

(in thousand Estonian kroons)

	31.12.2008	31.12.2007
Assets		
Cash and bank	823	4 266
Loans granted	12 837	0
Investments in subsidiaries	61 891	61 891
Total assets	**75 551**	**66 157**
Liabilities		
Loans received	6 637	0
Accrued expenses and other liabilities	0	21
Total liabilities	**6 637**	**21**
Equity		
Share capital	68 630	66 400
Share premium	29 370	28 255
Statutory reserve capital	3 485	2 830
Accumulated deficit	-32 571	-31 349
Total shareholders' equity	**68 914**	**66 136**
Total shareholders' equity and liabilities	**75 551**	**66 157**

Cash flow statement of the parent

(in thousand Estonian kroons)

	2008	2007
Cash flows from operating activities		
Service and commission fee income received	0	39
Operating and other expenses	-1 093	-96
Interest received	222	218
Change in loans granted	-12 517	2 975
Cash flows from operating activities	**-13 388**	**3 136**
Cash flows from investing activities		
Investments in joint ventures	0	-22 251
Amounts paid for the repurchase of the subsidiary's share option	0	-14 713
Net cash flows from investing activities	**0**	**-36 964**
Cash flows from financing activities		
Increase of share capital	3 345	36 964
Loans received	6 600	37 800
Repaid loans	0	-37 800
Interest paid	0	-14
Net cash flows from financing activities	**9 945**	**36 950**
Increase/decrease in cash and cash equivalents	**-3 443**	**3 122**
Cash and cash equivalents at beginning of the financial year	4 266	1 144
Cash and cash equivalents at the end of the financial year	**853**	**4 266**

Statement of changes in shareholders' equity

(in thousand Estonian kroons)

	Share capital	Share premium	Repurchased treasury shares	Statutory reserve	(Accumulated deficit)	Total
Balance as at 01.01.2007	**40 300**	**18 691**	**-4 283**	**2 830**	**-15 463**	**42 075**
Increase of share capital	27 400	9 564	0	0	0	36 964
Repurchased treasury shares	-1 300	0	4 283	0	-2 983	0
Net loss for 2007	0	0	0	0	-12 903	-12 903
Balance as at 31.12.2007	**66 400**	**28 255**	**0**	**2 830**	**-31 349**	**66 136**
Carrying amount of interests under control and significant influence	0	0	0	0	-61 891	-61 891
Value of interests under control and significant influence under the equity method	0	0	0	0	76 995	76 995
Total adjusted shareholders' equity as at 31.12.2007	**66 400**	**28 255**	**0**	**2 830**	**-16 245**	**81 240**
Balance as at 01.01.2008	**66 400**	**28 255**	**0**	**2 830**	**-31 349**	**66 136**
Increase of share capital	2 230	1 115	0	0	0	3 345
Share premium	0	0	0	655	-655	0
Net loss for 2008	0	0	0	0	-567	-567
Balance as at 31.12.2008	**68 630**	**29 370**	**0**	**3 485**	**-32 571**	**68 914**
Carrying amount of interests under control and significant influence	0	0	0	0	-61 891	-61 891
Value of interests under control and significant influence under the equity method	0	0	0	0	69 476	69 476
Total adjusted shareholders' equity as at 31.12.2008	**68 630**	**29 370**	**0**	**3 485**	**-24 986**	**76 499**

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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 2008 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 2008, 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/

Tiit Raimla
AS PricewaterhouseCoopers

/signed/

Relika Mell
Authorised Auditor

18 May 2009

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

Proposal for covering the loss

The Management Board of AS LHV Group proposes to the General Meeting of Shareholders to add the net loss for 2008 in the amount of 10 702 thousand kroons to retained earnings.

Signatures of the Management Board and the Supervisory board to the consolidated financial statements

The Management Board has prepared the management report of AS LHV Group and the consolidated financial statements for the annual year ended 31 December 2008.

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

MANAGEMENT BOARD
18.05.2009

Member of the Management Board:

Rain Lõhmus /signed/

SUPERVISORY BOARD
18.05.2009

Member of the Management Board:

Andres Viisemann /signed/

Tiina Mõis /signed/

Hannes Tamjärv /signed/

Heldur Meerits /signed/

Allocation of revenue according to EMTAK 2008

EMTAK	Activity	2008
66301	Fund management	14 248
66121	Security and commodity contracts brokerage	45 262
66191	Financial consultancy services	284
64911	Financial leasing	270
64929	Other credit granting (except pawnshops)	6 646
	Total revenue	**66 710**