AS LHV Group

Consolidated Annual Report 2010

(translation of the Estonian original)

Consolidated annual report **01.01.2010 – 31.12.2010**

Business name	AS LHV Group
Commercial Registry no.	11098261
Legal address	Tartu Road 2, 10145 Tallinn
Phone	(372) 6800400
Fax	(372) 6800410
E-mail	lhv@lhv.ee
Main activities	Activities of holding companies
	Banking
	Security brokerage
	Financial advisory
	Finance lease and other lending
Management Board	Rain Lõhmus
Supervisory Board	Andres Viisemann
	Tiina Mõis
	Hannes Tamjärv
	Heldur Meerits
	Raivo Hein
Auditor	AS PricewaterhouseCoopers

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Table of contents

MANAGEMENT REPORT 4
CONSOLIDATED FINANCIAL STATEMENTS 10
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME 10
CONSOLIDATED BALANCE SHEET 11
CONSOLIDATED CASH FLOW STATEMENT 12
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY 13
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 14
NOTE 1 General information 14
NOTE 2 Summary of significant accounting policies 14
NOTE 3 Risk management 26
NOTE 4 Significant management estimates and assumptions 40
NOTE 5 Subsidiaries and associated companies, goodwill 40
NOTE 6 Net fee and commission income 42
NOTE 7 Net interest income 42
NOTE 8 Gain/loss from financial assets 43
NOTE 9 Operating expenses 43
NOTE 10 Balances with central bank, other banks and investment companies 43
NOTE 11 Foreign currency derivatives 44
NOTE 12 Other financial assets and liabilities at fair value through profit or loss 44
NOTE 13 Loans granted 45
NOTE 14 Receivables from customers 46
NOTE 15 Other assets 46
NOTE 16 Tangible and intangible assets 46
NOTE 17 Loans received and deposits from customers 47
NOTE 18 Accrued expenses and other liabilities 47
NOTE 19 Provisions 47
NOTE 20 Subordinated loans 47
NOTE 21 Shareholders' equity in the public limited company 48
NOTE 22 Finance and operating lease 48
NOTE 23 Assets under management from fiduciary activities 49
NOTE 24 Contingent liabilities 49
NOTE 25 Transactions with related parties 49
NOTE 26 Events after the balance sheet date 50
NOTE 27 Separate financial statements of parent company 51
INDEPENDENT AUDITOR'S REPORT 55
PROPOSAL FOR COVERING THE LOSS 56
SIGNATURES OF THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD TO THE CONSOLIDATED ANNUAL REPORT 57
ALLOCATION OF INCOME ACCORDING TO EMTAK 58

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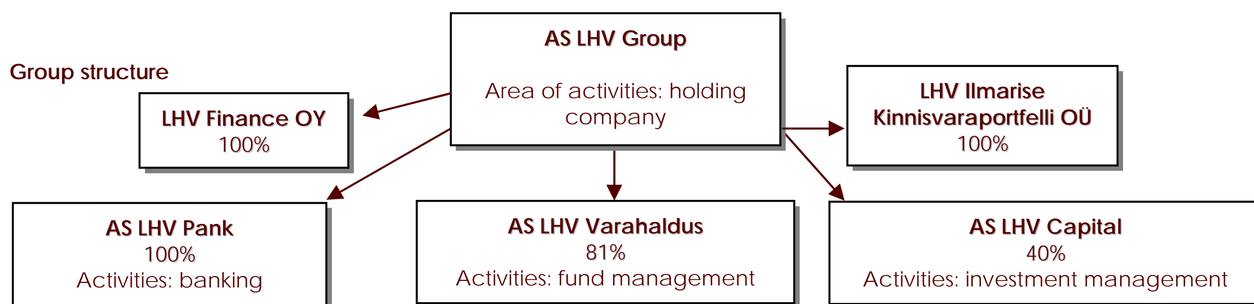
MANAGEMENT REPORT

Group structure



Key events in 2010 and at the beginning of 2011:

- **Changes in group structures**

AS LHV Capital, which operates in private capital investment management in the Baltic states, was established in autumn 2010. Group has 40% share in the entity and other shareholders are Management and Supervisory Board members of the company. In connection with the acquisition of Finnish loan portfolio in summer 2010 LHV Finance Oy was established, which acquired Luottotalo Fenno Oy's trademarks. As of today the Group does not use acquired trademarks and has transitioned to use its own trademark LHV-luotto. In March 2011 LHV Ilmarise Kinnisvaraportfelli OÜ was liquidated as the entity's assets were acquired by AS LHV Pank.

- **Changes in share capital**

The share capital of AS LHV Group was initially increased in February 2010 by 1,3 million kroons and additionally in August 2010 by 24,2 million kroons. In October 2010 the conversion of share capital into Euros was adopted by the Shareholder's meeting so that every share with the nominal value of 100 kroons was changed to 6,391165 shares with the nominal value of 1 Euro.

- **Issuing subordinated bonds**

In October 2010 convertible subordinated bonds in the amount of 3 million Euros were issued. The due date of the bonds is 7 years and at the end of the second year investors have conversion option at the valuation of 2,5 Euros per one LHV Group share. Conditional increase of share capital in the amount 1,2 million Euros were registered in Commercial Register.

- **New banking services**

In 2010, AS LHV Pank expanded its service offering at the market with payment settlement services and continued with the launch of direct debit services at the beginning of 2011. In parallel, also new online bank and financial portal was opened. In summer 2011, the debit and credit cards will be issued to the customers.

AS LHV Pank

The mission of LHV Pank is to foster Estonia's economy and social sustainability. The vision of LHV Pank is to be the primary and preferred bank of the new generation in Estonia. For provision of convenient services to customers, there is a clear and simple online bank. Payments with the debit card of LHV Pank can be made anywhere. Cash can be withdrawn from ATMs of all banks. The key values of LHV Pank are direct communication and convenience. Each customer has a personal bank assistant who knows the customer's needs and opportunities. It is always easy and convenient to use the bank's services.

LHV Pank is based on Estonian capital. The bank's customers are both individuals as well as small and medium-sized companies. The branch offices of LHV Pank are located in Tallinn, Tartu, Riga, Vilnius and Helsinki. LHV Pank employs over 100 people. Over 15 000 customers in Estonia, Latvia and Lithuania and 8 000 customers in Finland use the bank's services. As compared to other banks, LHV Pank is more focused on increasing the assets of customers and managing their investments. LHV Pank is the third largest broker on NASDAQ OMX Baltic Stock Exchanges.

The goal of LHV Pank is to encourage people to invest their funds and teach customers to better understand the area of investments. For educating investors, the bank has launched an annual series of seminars "Investment School" and a virtual stock game "Börsihai" ("Stock Exchange Shark"). LHV Pank publishes the largest investment magazine in Estonia, "Investeeri" ("Invest") and operates the most active portal of financial markets. In 2009, LHV Pank and Estonian Business School signed a collaboration agreement, laying down a foundation for earning a bachelor's degree in investment management.

In 2010, the volume of the deposits of LHV Pank continued to grow at a fast pace, reaching EEK 1,8 billion by the year-end. Of this amount, demand deposits totalled EEK 0,3 billion and term deposits totalled EEK 1,5 billion. By the year-end, the volume of the loan portfolio grew to EEK 0,5 billion (excluding impairment losses) and the volume of the bond portfolio grew to EEK 0,3 billion.

From 1 April 2010, LHV Pank harmonised the interest rates on kroon and euro deposits and increased the interest rates of deposits in order to be more competitive in the market and actively grow the volume of its deposits. In June, a major advertising campaign for the deposits was carried out in Estonia and a smaller one in Latvia. In order to market its loan products, the bank conducted seminars in various cities of Estonia in the second quarter, targeted at the largest businesses in the region.

In the first half of the year, two largest development projects were completed. From 4 March 2010, the bank's online environment can be accessed and transactions can be made with the new security elements of ID cards, mobile-IDs and PIN calculators. From 3 May 2010, settlement services - domestic and international settlements - are provided to customers. Customer accounts are in their own name and accounts have new numbers, starting with 77. From June, customers can make defined payments in the online bank and enter into standing order agreements. In June, LHV Pank also joined the transfer system for inter-bank settlement services.

From 22 May 2010, the amendments to the Law of Obligations Act became mandatory for the banks operating in Estonia, which brought about several changes to payment service agreements. The new law is based on EU Directive on Payment Services, the goal of which is to use uniform rules for provision of payment services in the European Economic Area (EEA). In conjunction with this, new general conditions and conditions for payment service contracts were introduced at LHV Pank at 22 May 2010. New online banking conditions were also introduced for launching settlement and clearing services and a new price list was adopted. In September, the bank renewed all other remaining contracts terms and adopted a new process for registering new customers and opening accounts.

At the meeting of the Supervisory Board held at 22 April 2010, the largest development projects were mapped and approved: settlement services (incl. direct debits, e-invoices), a new online bank (incl. financial portal, homepage) and bank cards. In conjunction with this, a decision was approved to significantly increase investments in the enhancement of IT development capability, hiring of necessary employees and outsourcing IT services. At 19 May 2010, LHV Pank became a full member of MasterCard. At the beginning of July, the bank launched two major outsourced IT development projects – development of card administration software and a new financial portal. In the 4th quarter, the improvements to the information systems were completed due to the adoption of the euro on the Vilnius Stock Exchange, joining with TARGET2 system and adoption of the euro in Estonia. Immediately after the adoption of the euro in Estonia, a new online bank, a financial portal and homepage of the bank were opened in all Baltic States, as well as direct debits (standing orders) were made available in Estonia. In the summer of 2011, the Company plans to introduce bank cards in the market.

At the meeting of the Supervisory Board held at 22 April 2010, a decision was adopted to make an offer by LHV Pank to Luottotalo Fenno Oy to purchase the latter's loan portfolio and the related significant assets thereof, and another offer to LHV Ilmarise Kinnisvaraportfelli OÜ for the acquisition of the portfolio of finance lease agreements. The acquisition of the portfolio of LHV Ilmarise Kinnisvaraportfelli OÜ was completed on 28 May 2010 and that of Luottotalo Fenno on 28 June 2010. Most of the finance lease agreements acquired were restructured to loans.

In July and August, LHV Pank focused on the necessary preparations for cross-border business in Finland and primarily for issuance of new loans. The major tasks included upgrading of the product portfolio, pricing, conditions, contract forms, the credit risk assessment model, and necessary internal rules and regulations. Book-keeping, reporting and risk management were also rearranged. In August, both the Financial Supervision Authorities of Estonia and Finland granted their approval for provision of cross-border services in Finland. In September, the bank commenced issuance of loans to individuals in Finland, and marketing and sales activities to offer loans to current

customers. In October, the Management Board of LHV Pank adopted a decision to establish a branch in Finland. The license was granted by the Financial Supervision Authority of Finland in March 2011.

At 1 October, a bank office was opened in Tartu with two employees. In September, an additional floor on the 19th floor of City Plaza office building was taken into use and a lease agreement for use of the whole ground floor from summer 2011 was entered into.

Business environment

The recession which commenced in 2008 was replaced by moderate economic growth in all Baltic States during 2010 and in the last quarter, relatively decent growth rates were already demonstrated. The recovery has primarily been aided by growing export volumes, supported by stabilisation of the economies of export partners and moderate strengthening of the competiveness of the Baltic States due the decline in wages and prices. In 2010, domestic consumption still remained modest in all Baltic States and we are forecasting a greater effect to economic growth from it in 2011. The risks to the recovery of global economic growth have significantly decreased as compared to 2009 and despite a debt crisis emerging in Europe, continuance of growth is also forecast for the upcoming years.

The loan volumes continued to contract in the banking sector in 2010. The balance of loans granted to businesses declined by 6,5% in a year and the downward trend did not yet show any signs of deceleration as at the year-end. As a positive change, business investments started to grow at the year-end, signalling growth of confidence and laying a foundation for activation of the commercial loan market and growth of loan volumes in this area. The decline of the loan balance of individuals seems to have stabilised and although it contracted by 3,3% in a year, the speed of the decline decelerated at the year-end. As a positive change, the share of past due loans has stabilised and the volume of deposits of both individuals as well as businesses grew moderately. The term and demand deposits of businesses and individuals totalled EUR 9,2 billion, which is 8,7% more than last year. The Estonian banking sector as a whole returned to profitability by the year-end.

The real estate market has stabilised after the Estonian real estate bubble burst and the number of transactions as well as the average price remained relatively stable in 2010. It can be noted that in conjunction with the adoption of the euro, the expected price increase and activation of the market did not essentially happen.

The growth of global stock exchanges continued and the Tallinn Stock Exchange increased by a remarkable 70% in 2010, followed by the stock exchanges of Riga and Vilnius with the growth rates of 40% and 55%, respectively. Despite fast growth of stock market indices, the trading activity on the Baltic stock exchanges remained at last year's relatively low levels. Delisting of the securities of several entities, especially Eesti Telekom (Estonian Telecom) had a negative effect on trading volumes. In Europe, the USA and Asia, the stock markets grew modestly, with growths remaining between 5% and 15%. The raw materials markets recovered similarly to stock markets.

Financial results

In 2010, interest income and other financial income grew significantly. Interest income on leveraged loans made up 22%, on corporate loans 30%, on consumer loans 38% and on deposits 10% on total interest income. Income on the investment portfolio made up 64% and that on currency exchange revenues made up 36% of other financial income. As compared to 2009, other financial income increased by 62% and net interest income doubled.

With regard to fee and commission income, brokerage fees made up 66%, management fees 16% and other fees 18% of fee and commission income. As compared to 2009, the income earned from securities intermediation has been 7% lower. The trading activity has been lower, the customers have invested more and used actively leveraged loans offered by LHV Pank. With regard to brokerage income, intermediation of US shares, options and futures made up 70%, Baltic shares 15-20% and other shares and fund units 10-15% of the total. With regard to brokerage fees by country, 78% was earned in Estonia (2% growth), 7% in Latvia (16% decline) and16% in Lithuania (34% decline). Management fees were 64% higher than last year. The change was related to addition of new customers as well as an increase of market value of assets.

Finance income was made up from income on investment portfolio of 64% and on foreign exchange transactions of 36%.

Net fee and commission income, and net interest income of LHV Pank (EEK thousand):

Due to the acquisition of a portfolio of Finnish consumer loans, new employees, one-off expenses related to the acquisition of the portfolio and other contracts related to rendering services, as well as the general development costs of the bank, the staff costs and also other operating expenses increased by 52%.

Results (EEK million)	2010	2009	change
net fee and commission income	39,0	39,3	-1%
net interest income	15,9	8,0	99%
other financial income	14,4	8,9	62%
total net operating revenues	69,3	56,2	23%
other income	3,9	4,4	-11%
operating expenses	-86,7	-57,0	52%
net profit/loss	-13,5	3,6	-

Balance sheet figures (EEK million)	31.12.2010	31.12.2009	change
loan portfolio	595,7	142,5	318%
investment portfolio	266,4	61,8	331%
deposits	1 796,4	505,2	256%
equity	88,8	102,6	-13%
total assets	1 985,9	640,3	210%
number of customers	16 275	13 112	24%
number of employees	102	60	70%

At the year-end, the volume of margin loans backed by securities totalled EEK 150,4 million (annual growth of 319%), the volume of loans issued to corporate entities totalled EEK 268,5 million (annual growth of 282%) and the volume of consumer loans was EEK 173,9 million.

The number of customers who have deposited their funds at LHV Pank increased by 24% in a year, to 16 275 customers. The volume of customer securities increased by 40% in a year and totalled EEK 3 billion. With regard to services, portfolio management volumes continued to grow rapidly, increasing by 62% in a year, reaching almost EEK 460 million.

Sponsorship

LHV Pank takes social responsibility seriously. To the extent possible, the bank supports the Estonian society and the acts fostering it's development. The key collaboration partners of LHV Pank include:

Estonian Football Association. LHV Pank sponsors both the Estonian national team as well as the development of children and youth football. Football is the most popular sport in Estonia and one of the few areas in which training of children and youth is conducted in a systematic and serious manner. LHV Pank is the key sponsor of the Estonian Football Association in 2010-2015.

Estonian Traditional Music Centre. LHV Pank helps to arrange Viljandi Traditional Music Festival in the summer as well as year-round activities of the centre. With the help of its collaboration partner the Estonian Traditional Music Centre, the bank can make its contribution to the preservation of the Estonian national culture.

Estonian Optimist Class Association. LHV Pank sponsors young sailors by purchasing new Optimist yachts. The yachts are rented out to clubs and schools where young people interested in sailing can use the yachts for a symbolic fee. The association is using the rental fees received from clubs and schools to arrange competitions and camps for children, and trainings for their coaches.

AS LHV Varahaldus

AS LHV Varahaldus is a fund management company for pension and investment funds. In 2010 the main business activity of the company was to provide fund management services to five mandatory pension funds, one supplementary pension fund and three equity funds (UCITSs).

2nd pillar pension funds

Out of pension funds with progressive investment strategies (up to 50% of the assets are invested in equities) offered in Estonia, LHV Pension Fund L and LHV Pension Fund XL managed by the Company were the first and second best funds in terms of their rates of return.

Comparison of progressive pension *	NAV 31.12.2009	NAV 31.12.2010	Change in NAV
LHV Pension Fund L	**17,6633**	**20,5095**	**16,11%**
LHV Pension Fund XL	**15,1800**	**17,5993**	**15,94%**
ERGO Pension Fund 2P2	15,2017	17,3294	14,00%
Nordea Pension Fund A	12,4288	13,7779	10,85%
Swedbank Pension Fund K3	13,5047	14,9090	10,40%
Sampo Pension 50	15,4607	17,0465	10,26%
SEB Progressiivne	13,4345	14,6800	9,27%

Among pension funds with balanced investment strategies (up to 25% of the assets are invested in equities, LHV Pension Fund M under the Company's management ranked first in terms of their rates of return.

Comparison of balanced pension *	NAV 31.12.2009	NAV 31.12.2010	Change in NAV
LHV Pension Fund M	**14,4498**	**15,9849**	**10,62%**
Nordea Pension Fund B	12,0350	12,9051	7,23%
Sampo Pension 25	13,4769	14,4183	6,99%
Swedbank Pension Fund K2	12,0694	12,8214	6,23%
SEB Optimaalne	11,8413	12,5376	5,88%

Among the funds investing only in bonds, i.e. conservative funds, LHV Pension Fund X and LHV Pension Fund XS under the Company's management ranked first and second in terms of their rates of return.

Comparison of conservative pension *	NAV 31.12.2009	NAV 31.12.2010	Change in NAV
LHV Pension Fund XS	**14,4476**	**15,4575**	**6,99%**
LHV Pension Fund S	**15,7555**	**16,8190**	**6,75%**
SEB Konservatiivne	12,6621	13,3481	5,42%
ERGO Pension Fund 2P1	12,9396	13,4620	4,04%
Sampo Pension Intress	12,3819	12,8052	3,42%
Nordea Pension Fund C	11,5039	11,8643	3,13%
Swedbank Pension Fund K1	11,3239	11,5926	2,37%

When at the beginning of 2010 the total number of active clients in 2nd pillar pension funds was 33 thousand, then this figure grew up to 53 thousand clients by the beginning of 2011.

3rd pillar

The supplementary funded pension fund plans offered in Estonia differ from each other in respect of the percentage invested in equities, therefore, it is more difficult to compare their rates of return. On average, LHV Supplementary Pension Fund invests 75% in equities. In the financial year, the fund was the sixth in respect of its rate of return.

Comparison of supplementary pension funds *	NAV 31.12.2009	NAV 31.12.2010	Change in NAV
ERGO Pension Fund 3P3 (100)	12,5665	15,2070	21,01%
Sampo Pension 100 Pluss (100)	17,6853	21,2420	20,11%
SEB Aktiivne PF (100)	12,1769	14,5467	19,46%
Nordea PF Aktsiad 100 (100)	14,0569	16,7441	19,12%
ERGO Pension Fund 3P2 (75)	12,0732	14,2877	18,34%
LHV Täiendav Pension Fund (75)	**16,5779**	**19,4080**	**17,07%**
Swedbank Pension Fund V3 (100)	13,6904	15,9611	16,59%
ERGO Pension Fund 3P1 (50)	11,6266	13,2476	13,94%
Swedbank Pension Fund V2 (60)	11,8963	13,1513	10,55%
SEB Tasakaalukas PF (35)	15,9028	17,1879	8,08%
Swedbank Pension Fund V1 (30)	15,9027	16,7754	5,49%
Sampo Pension Intress Pluss (30)	10,7374	11,1092	3,46%

* All comparative net asset values in the tables above are disclosed based on the information of www.pensionikeskus.ee

The number in parentheses after the name of the fund shows the maximum allowed percentage of equities in the fund in accordance with the funds' prevailing terms and conditions.

Equity Funds

The Company manages three UCITS funds that invest in equities. All investment funds are publicly offered in Estonia, Latvia and Lithuania and LHV Persian Gulf Fund is also publicly offered in Sweden, Finland and Norway.

LHV UCITS funds	NAV 31.12.2009	NAV 31.12.2010	Change in NAV
LHV World Equities Fund	7,8335	9,0822	15,94%
LHV Persian Gulf Fund	6,2300	7,4893	20,21%
LHV Emerging Europe Alpha Fund	3,8018	4,5130	18,71%

Volume of assets under management

At the end of 2009, the total amount of assets managed by LHV Varahaldus was 834 million kroons and it grew up to 1 331 million kroons by the end of 2010 and at the beginning of 2011 up to 1 781 million kroons (EUR 113,8 million).

In 2011, the objective of the Company is to increase its market share in the mandatory pension market and increase the volume of assets under management in its equity funds through positive returns as well as attracting new investors.

CONSOLIDATED FINANCIAL STATEMENTS

Consolidated statement of comprehensive income

(in thousands Estonian kroons)

	Note	2010	2009
Fee and commission income	6	72 323	61 881
Fee and commission expense	6	- 11 121	-8 085
Net fee and commission income		**61 202**	**53 796**
Interest income	7	41 489	16 033
Interest expense	7	- 26 692	-7 738
Net interest income		**14 797**	**8 295**
Net gain/loss from trading	8	5 108	3 644
Net gain from financial assets designated at fair value	8	2 971	14 560
Dividend income	8	0	17
Net gain/loss from financial assets		**8 079**	**18 221**
Other income		3 759	4 446
Operating expenses	9	- 130 883	-83 612
Operating profit / loss		**- 43 046**	**1 146**
Loss for impairment of investment in associate	5	- 1 953	-24 268
Loss for the year		**- 44 999**	**-23 122**
Comprehensive loss for the year		**- 44 999**	**-23 122**
Loss and comprehensive loss attributable to shareholders of the parent		**- 41 729**	**-22 425**
Minority interest		**- 3 270**	**-697**

The notes on pages 14 to 54 are an integral part of these consolidated financial statements.

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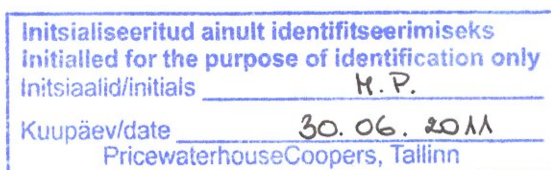
Kuupäev/date 30.06.2011
PricewaterhouseCoopers, Tallinn

Consolidated balance sheet

(in thousands Estonian kroons)

	Note	31.12.2010	31.12.2009
Assets			
Balances with other banks	10	319 146	294 054
Balances with investment companies	10	45 911	37 486
Balances with central bank	10	710 848	88 525
Derivatives	11	0	3 003
Other financial assets at fair value through profit or loss	12	320 560	113 058
Loans granted	13	595 719	146 607
Recievables from customers	14	30 978	4 173
Other assets	15	13 375	3 136
Goodwill	5	16 332	16 332
Tangible assets	16	3 770	4 834
Intangible asets	16	3 361	574
Investment in subsidiary	5	162	0
Total assets		**2 060 162**	**711 782**
Liabilities			
Loans received and deposits from customers	17	1 820 508	527 780
Financial liabilities at fair value through profit or loss	12	0	123
Accrued expenses and other liabilities	18	20 783	20 918
Deferred income	13	2 891	460
Finance lease liabilities		225	325
Bonds issued		0	4 190
Provisions	19	200	1 100
Subordinated loans	20	44 493	0
Total liabilities		**1 889 100**	**554 896**
Shareholders' equity			
Minority interest		6 120	7 642
Shareholders' equity attributable to shareholders of the parent			
Share capital	21	141 678	116 215
Share premium		89 222	58 796
Share options	20	3 286	0
Reserves		3 485	3 485
Accumulated deficit		- 72 729	-29 252
Total shareholders' equity attributable to shareholders of the parent		**164 942**	**149 244**
Total shareholders' equity		**171 062**	**156 886**
Total liabilities and shareholders' equity		**2 060 162**	**711 782**

The notes on pages 14 to 54 are an integral part of these consolidated financial statements.



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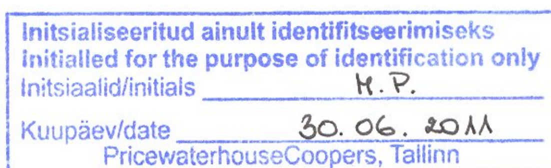
Consolidated cash flow statement

(in thousands Estonian kroons)

	Note	2010	2009
Cash flows from operating activities			
Fee and commission income received		81 356	69 628
Fee and commission expense		- 11 121	-8 085
Operating and other expenses paid		- 127 482	-79 581
Dividends received		0	17
Interest received		42 412	18 066
Interest paid		- 26 788	-7 494
Cash flows from operating activities before change in operating assets and liabilities		**- 41 623**	**-7 449**
Change in operating assets			
Settlement of foreign currency forward contracts		3 003	-2 907
Net acquisition/disposal of trading portfolio		8 617	3 230
Loans granted and receivables from customers		- 480 038	-116 991
Term deposits with other banks		81 382	-81 461
Mandatory reserve in central bank		- 21 362	-88 525
Stock exchange security deposit		-9 017	11
Other receivables and prepayments		- 1 693	-962
Change in operating liabilities			
Demand deposits of customers		163 731	113 929
Term deposits of customers		1 117 796	391 184
Loans received		11 701	11 252
Issued bonds		0	-810
Financial liabilities of trading portfolio		- 123	-419
Other liabilities and deferred income		2 232	14 341
Net cash generated from operating activities		**834 606**	**234 423**
Cash flows from investing activities			
Purchase of tangible assets	16	- 5 154	-964
Net cash handed over less proceeds from disposal of subsidiary	5	- 2 115	-41 667
Change in investment portfolio		- 214 204	-58 252
Net cash used in investing activities		**- 221 473**	**-100 883**
Cash flows from financing activities			
Paid in share capital	21	55 889	95 170
Finance lease payments made		- 101	-89
Redeemed bonds		0	-152
Interest paid		0	-244
Subordinated loans issued	20	46 940	0
Net cash generated from financing activities		**102 728**	**94 685**
Net increase in cash and cash equivalents		**715 861**	**228 225**
Cash and cash equivalents at beginning of the year	10	250 079	21 854
Cash and cash equivalents at end of the year	**10**	**965 940**	**250 079**

The notes on pages 14 to 54 are an integral part of these consolidated financial statements.



Consolidated statement of changes in equity

(in thousands Estonian kroons)

	Share capital	Share premium	Share options	Reserves	Retained earnings / accumulated deficit	Total	Minority interest	Total
Balance as at 01.01.2009	**68 630**	**11 211**	**0**	**3 485**	**-6 827**	**76 499**	**16 945**	**93 444**
Paid in share capital	47 585	47 585	0	0	0	95 170	0	95 170
Purchase of minority interest	0	0	0	0	0	0	-8 606	-8 606
Total comprehensive loss for 2009	0	0	0	0	-22 425	-22 425	-697	-23 122
Balance as at 31.12.2009	**116 215**	**58 796**	**0**	**3 485**	**-29 252**	**149 244**	**7 642**	**156 886**
Balance as at 01.01.2010	**116 215**	**58 796**	**0**	**3 485**	**-29 252**	**149 244**	**7 642**	**156 886**
Paid in share capital	25 463	30 426	0	0	0	55 889	0	**55 889**
Issuance of share options	0	0	3 286	0	0	3 286	0	**3 286**
Change in minority interest	0	0	0	00	-1 748	-1 748	1 748	**0**
Total comprehensive loss for 2010	0	0	0	0	-41 729	-41 729	-3 270	**-44 999**
Balance as at 31.12.2010	**141 678**	**89 222**	**3 286**	**3 485**	**-72 729**	**164 942**	**6 120**	**171 062**

More detailed information is provided in Note 21.

The notes on pages 14 to 54 are an integral part of these consolidated financial statements.

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Notes to the consolidated financial statements

NOTE 1 General information

AS LHV Group is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu Road 2, Tallinn. AS LHV Group is a holding company whose subsidiary AS LHV Pank provides banking, financial advisory and securities brokerage services to Estonian, Latvian and Lithuanian customers. AS LHV Varahaldus provides fund management service. LHV Ilmarise Kinnisvaraportfelli OÜ offers real estate leasing services.

These consolidated financial statements were authorised for issue by the Management Board at 30 June 2011.

The ultimate controlling party of AS LHV Group is Rain Lõhmus with 54% of voting rights (see Note 21).

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 2010 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. The consolidated financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, for example "financial assets and liabilities at fair value through profit or loss", including derivatives.

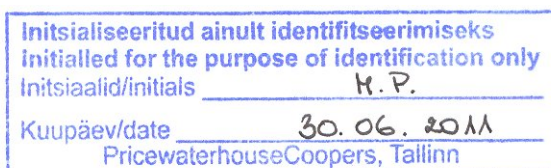
The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying accounting policies. The areas involving a higher degree of judgement or complexity,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

The financial year started at 1 January 2010 and ended at 31 December 2010. 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 2010. 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) International Financial Reporting Standards, published amendments to existing standards and interpretations by International Financial Reporting Standars Committee (IFRIC), that became effective on 1 January 2010

IFRS 3 (revised) – Business Combinations, (revised in January 2008, effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009).
The revised IFRS 3 allows entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer has to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in the comprehensive income for the year. Acquisition-related costs are accounted for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separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer has to recognise at the acquisition date a liability for any contingent purchase consideration. The Group estimates that IFRS 3 had an impact on the financial statements, as additional ownership interest in subsidiary was acquired in 2010.

Amendment to IFRS 5, Non-current Assets Held for Sale and Discontinued Operations (and consequential amendments to IFRS 1) (effective for annual periods beginning on or after 1 July 2009). This amendment to IFRS 5 is part of the IASB's annual improvements project published in May 2008. The amendment clarifies that an entity committed to a sale plan involving loss of control of a subsidiary would classify the subsidiary's assets and liabilities as held for sale. The revised guidance should be applied prospectively from the date at which the entity first applied IFRS 5. The amendment did not have an impact on Group's financial statements

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39 (issued in March 2009). The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The amendments did not have a material impact on the Group's financial statements.

IFRIC 11 Interpretation, IFRS 2 - Group Cash-settled Share-based Payment Transactions The interpretation contains guidelines on the following issues: 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; or 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 application of the interpretation did not have a material impact on the Group's financial statements.

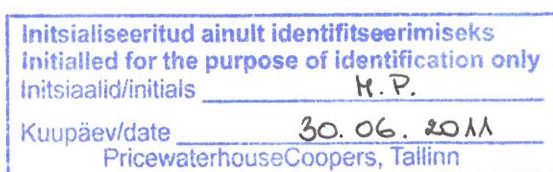
IFRIC 14, IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction - The interpretation contains general guidance on how to assess the limit of the surplus fair value of a defined benefit plan over the present value of its liabilities which can be recognised as an assets, in accordance with IAS 19. The application of the interpretation did not have a material impact on the Group's financial statements.

IAS 1 Presentation of Financial Statements - The main change in IAS 1 is the replacement of the income statement by the statement of comprehensive income which also includes all changes in equity not related to owners, such as changes in revaluation reserve of available-for-sale financial assets. Two statements are allowed to be presented as an alternative: a separate income statement and a statement of comprehensive income. The Group has selected to present the statement of comprehensive income as one statement. The revised IAS requires the disclosure of the financial position (balance sheet) for the opening balances of the comparable period when comparative information has been adjusted due to reclassifications, changes in accounting policies or correction of errors. The revised standard IAS 1 impacted the presentation of the Group's primary financial statements, but it did not impact the recognition of transactions and balances as well as accounting policies.

Improving Disclosures about Financial Instruments – Amendments to IFRS 7 - 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 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. In these financial statements, information has been disclosed according to improved requirements.

(b) New standards, amendments and interpretations that are mandatory for the Group from 1 January 2010 but are not relevant to the Group´s operations

IFRIC 12, Service Concession Arrangements
IFRIC 15, Agreements for the Construction of Real Estate



IFRIC 16, Hedges of a Net Investment in a Foreign Operation
IFRIC 17, Distributions of Non-Cash Assets to Owners
IFRIC 18, Transfers of Assets from Customers
Eligible Hedged Items—Amendment to IAS 39
Classification of Rights Issues - Amendment to IAS 32
IAS 27, Consolidated and Separate Financial Statements
IFRS 1, First-time Adoption of International Financial Reporting Standards and Additional Exemptions for First-time Adopters

(c) standards, amendments to standards and interpretations effective from annual periods beginning on or after 1 January 2011 which the Group has not early adopted

IFRS 9, Financial Instruments Part 1: Classification and Measurement (issued in November 2009 effective for annual periods beginning on or after 1 January 2013) - IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:

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

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

(d) New standards, amendments and interpretations to standards that are not yet effective and are not expected to have a material impact on the Group's financial reporting

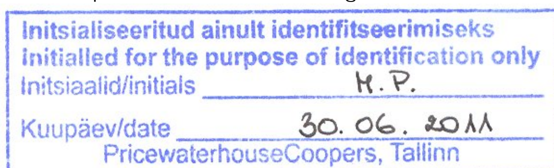
Amendment to IAS 24, Related Party Disclosures, (issued in November 2009, effective for annual periods beginning on or after 1 January 2011). The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The amendment will not have any impact on the Group's financial statements.

IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments; (effective for annual periods beginning on or after 1 July 2010). This interpretation clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the profit and loss account based on the fair value of the equity instruments compared to the carrying amount of the debt. The amendment will not have any impact on the Group's financial statements.

Prepayments of a Minimum Funding Requirement – Amendment to IFRIC 14; (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement. The amendment will not have any impact on the Group's financial statements.

Deferred Tax: Recovery of Underlying Assets – Amendment to IAS 12; (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU). The amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. The amendment will not have any impact on the Group's financial statements.

Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters – Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU). The amendments will provide relief for first-time adopters of IFRSs from having to reconstruct transactions that occurred before their date of transition to IFRSs,



and guidance for entities emerging from severe hyperinflation either to resume presenting IFRS financial statements or to present IFRS financial statements for the first time. The amendment will not have any impact on the Group's financial statements.

Improvements to International Financial Reporting Standards, issued in May 2010 (effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011; the improvements have not yet been adopted by the EU). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 21, IAS 28, IAS 31, IAS 34, IFRIC 13. The Group does not expect the amendments to have any material impact on its financial statements.

2.2 Consolidation

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

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

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

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

Revenues and expenses of the subsidiaries acquired within the financial year are consolidated into the Group's statement of comprehensive income 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's statement of comprehensive income from the beginning of the financial year until the date of disposal.

The 2010 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank, AS LHV Varahaldus and LHV Ilmarise Kinnisvaraportfelli OÜ(Estonia, 100% ownership interest until 30.06.2009).

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

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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 27), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

Non-controlling interest

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, which is attributable to interests which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity.

Transactions with non-controlling interests

As of 1 January 2010 the Group treats transactions with non-controlling interests as transactions with equity owners of the group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity. Until 31 December 2009 transactions with non-controlling interests were recorded similarly as transactions with third parties. Gains or losses on disposals to non-controlling interests were recorded in Group's statement of comprehensive income. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary was recorded as goodwill.

2.3 Associates

An associate is an entity over which the Group has significant influence but which it does not control. Generally, significant influence is assumed to exist when the Group holds between 20% and 50% of the voting rights.

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognised at cost which is thereafter adjusted for post-acquisition changes in the investor's share of the investee's equity (changes both in the profit/loss of the associate as well as other equity items) and with elimination or depreciation/amortisation of the differences between fair values and carrying amounts of the investee's assets, liabilities and contingent liabilities as determined in the purchase analysis. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the assets.

When the Group's share of losses in the associate accounted under the equity method exceeds the carrying amount of the associate, the carrying amount of the investment is reduced to zero and such long-term loans granted to the associate that in substance form a part of the investment are written down. Further losses are carried off-balance sheet. When the Group has guaranteed or incurred obligations on behalf of the associate, the respective liability as well as the loss under the equity method are recorded in the balance sheet. Other receivables from the associate are valued by the probability of proceeds.

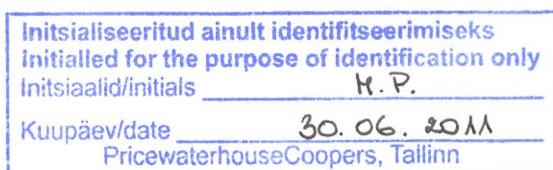
An investment in the assets and liabilities of the acquired associate and goodwill that arose on acquisition is presented as a net amount in the balance sheet line "Investments in associates".

At each balance sheet date, it is assessed whether there is any indication that the recoverable amount of the investment has fallen below its carrying amount. If any such indications exist, an impairment test is performed. To determine the recoverable amount of the investment, the principles described in section 2.8 are used as the basis.

2.4 Foreign currency translation

(a) Functional and presentation currency

The functional and presentation currency of the entities in the Group 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 from monetary assets and liabilities are recorded in the statement of comprehensive income under the line "Net gains/losses from financial assets". 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 in the line "Foreign currency gains and translation differences".

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 central bank and other 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

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

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

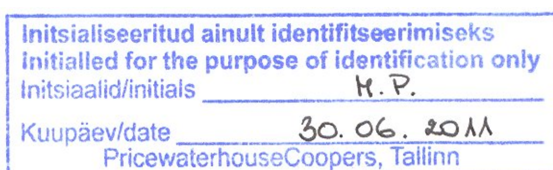
Financial assets at fair value through profit or loss include

- 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. Regular purchases and sales of financial investments are recognised at the settlement date in the balance sheet. Financial instruments included in this category are initially recognised at fair value; transaction costs are taken directly to the consolidated income statement. 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 statement of comprehensive income of the accounting period under "Net gains from financial assets". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognised in the line "Dividend income" of the statement of comprehensive income when the right to receive dividends by the Group is established.

In case of listed securities (i.e. the securities which have an active market), the current bid price is considered as the fair value of investments. To find the fair value of investments not actively traded in the market, alternative methods such as the price of recent transactions (under market conditions), the discounted cash flow method or option valuation models are used.

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



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 statement of comprehensive income.

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

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

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are 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 some 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 repayments and any potential impairment losses, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest rate method.

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. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of minimum lease payments (plus any unguaranteed residual value of the leased asset). Each lease payment received from the lessee is allocated between the receivable and finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. When there are service fees attributable to the conclusion of lease agreements, they are included in the calculation of the effective interest rate of the lease and calculation of a finance lease receivable. The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased asset and excess collateral, the financial position and reliability of the customer. Impairment of receivables is shown as a negative amount within the respective asset category in the balance sheet.

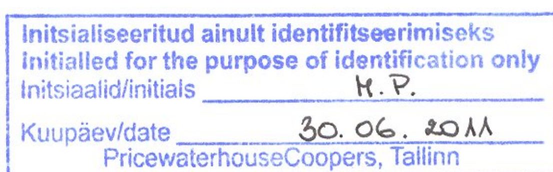
Loan receivables which have been acquired as a pool (portfolio of consumer loans of Finnish individuals) are recognised at fair value at the time of acquisition. When the nominal value of the acquired portfolio is higher than its fair value (i.e. the portfolio is acquired at a discount because some of the credit losses have already been incurred by the time of acquisition), the nominal amount and the respective impairment loss are recognised in the contra-asset account. The portfolio of receivables acquired as a pool is subsequently recognised on the portfolio basis, using the effective interest rate determined at the time of acquisition of the pool of assets. In case the actual cash flows earned on the portfolio differ from the estimated cash flows at the time of acquisition, the difference is discounted at the initial effective interest rate either as an impairment loss of the asset (actual cash flows are lower than estimated ones) or income (actual cash flows are higher than the estimated ones) in the statement of comprehensive income.

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

The impairment of loans and receivables is assessed in accordance with the principles described in clause 2.6.

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.



The Group assesses the risks conservatively, taking into consideration all known information about the solvency of the debtor and whether there are any objective circumstances indicating impairment (the buyer's financial difficulties, bankruptcy or inability to meet its obligations to the Group). The Group assesses individually whether there is any objective evidence of impairment of financial assets which are individually significant, and individually or jointly of those financial assets which are not individually significant.

Corporate loans are assessed individually, based on the financial position of the company, industry situation, reliability of the borrower, the competence of its management, timely fulfilment of obligations laid down in loan contracts and other factors. Margin loans backed by securities both to legal as well as physical persons are assessed individually, using primarily the market value of collateral as the basis. Consumer loans issued to individuals as borrowers are assessed as a group. Physical persons who are borrowers are assessed in terms of their timely fulfilment of obligations, solvency, age, education, length of employment, savings habits and other factors impacting credit risk.

For the purpose of recognition of group-based impairment losses, financial assets are grouped on the basis of homogeneous credit risk features. Future cash flows of loan groups assessed as a group are assessed on the basis of contractual cash flows of assets and historical losses of these assets. Historical loan losses are adjusted on the basis of current observable data, to account for the effect of conditions at the time, which did not impact that period on which historical losses are based and to eliminate those effects of previous periods, which are currently absent. The Group regularly reviews future cash flow assessment methods and assumptions, in order to reduce potential differences between loss estimates and actual losses.

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 assess the amount of a 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 statement of comprehensive income. Doubtful receivables are written down in the balance sheet to the collectible amount.

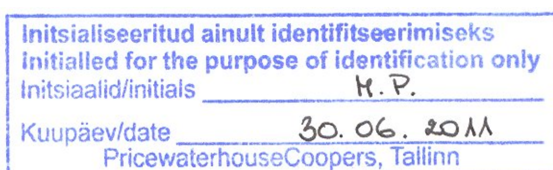
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The reversal of the impairment loss is recognised as income in the line "Loan losses" in the statement of comprehensive income.

If the loan is uncollectible, it is written off against the respective impairment loss of the loan. Such loans are written off after implementation of all required procedures and determination of the loss amount. The loans, the due dates of which have been extended, are not considered to be past due loans, but regular ones.

Interest income on loans is presented on the statement of comprehensive income under "Interest income".

2.8 Tangible assets

Tangible assets are non-current assets used in the operating activities of the Group with a useful life of over one year. An item of tangible assets 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 tangible assets 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% p.a. or amortization throughout the rental period, depending on which is shorter. Depreciation is calculated starting from the month of acquisition until the carrying amount reaches the residual value of the asset. In case the residual value is greater than the carrying amount of the asset, no further depreciation expense is calculated.

The appropriateness of the assets´ residual values, depreciation methods used and useful lives are reviewed, and adjusted if that has become appropriate, at each balance sheet date. The Group performs an impairment test when there are circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell and its value in use), it is written down immediately to its recoverable amount recognising an impairment loss in the statement of comprehensive income 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 statement of comprehensive income for the period.

2.9 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 is 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 fair value less costs to sell and value in use.

2.10 Goodwill

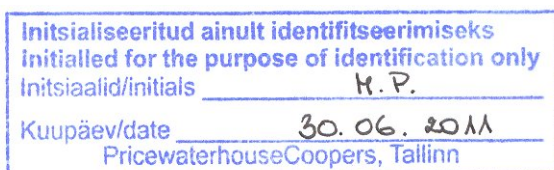
Goodwill represents the excess of the cost of an acquisition over the fair value of the company's share of the net assets acquired at the date of acquisition, reflecting the part of the acquisition cost that was paid for the assets that are not separately identifiable for the balance sheet purposes.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

2.11 Financial liabilities

Deposits from customers are initially recorded at the value date at their fair value less transaction costs and are subsequently measured at amortised cost using effective interest rate method in the balance sheet line "Loans received and deposits from customers", accrued interest liabilities are included in the same line. Interest expense is recognised in the statement of comprehensive income line "Interest expense" on the accrual basis.

Loans received, bonds issued and similar subordinated loans are initially recognised at fair value, less transaction costs (cash received less transaction costs). The subordinated loans are those liabilities, which in case of a termination of a credit institution or declaration of bankruptcy, are settled after the satisfaction of the justifiable claims of other creditors. Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognised at fair value.

A financial liability at fair value through profit or loss is an instrument held for trading purposes and is recognised at fair value at each reporting date. 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 statement of comprehensive income during the term of the instrument, using the effective interest rate. Interest costs are included in the statement of comprehensive income line "Interest expenses".

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 decided to recognise the option portion of the bonds in a separate balance sheet line "financial liabilities at fair value through profit or loss" at fair value based on the market value. The interest payable on the deposit is recognized in the statement of comprehensive income under "Interest expense" using the effective interest rate and method and the change in the fair value of the option under "Net gains/losses from trading".

2.12 Financial Guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payments when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognised in the financial statements at fair value at the date the guarantee was given. Subsequent to initial recognition, the liabilities under such guarantees are recognised at the outstanding value of the guarantee stated as the higher of unamortized fees and a provision under IAS 37, based on experience with similar transactions and judgement of the management. In the statement of comprehensive income, the fee income earned on a guarantee is recognised on a straight line basis over the life of the guarantee. The amounts to be disbursed to settle the guarantee obligation are recognised in the balance sheet as a provision at the date it becomes evident that it is probable that the guarantee is to be disbursed.

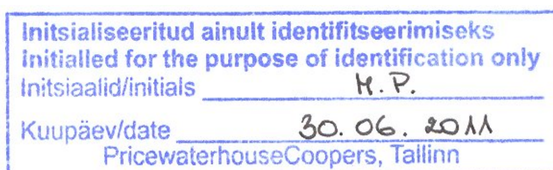
2.13 Payables to employees

Payables to employees include a 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 a 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 statement of comprehensive income.

2.14 Provisions and contingent liabilities

Liabilities 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 amount 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, other than financial 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 respective disclosure to these consolidated financial statements.

2.16 Revenues and expenses

Revenues 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, the amount of the revenue can be measured reliably and services were rendered by the Group. Revenue from services rendered in the ordinary course of business by the Group is recognised at the fair value of the fee received or receivable. Expenses are recognised when the company has received the goods or services.

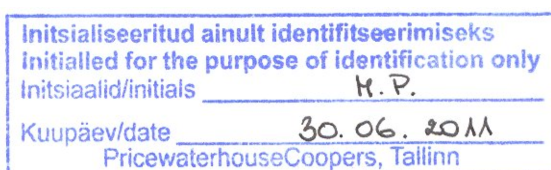
Fee and commission income (incl. custody and portfolio management fees) are recognised on an accrual basis when the service has been provided and the Group has a right of claim to the receivable. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commissions and fees arising from provision of advisory services to third parties (purchase or sale of businesses, acquisitions, etc.) are generally recognised upon completion of the underlying transaction or when a service is provided over a longer period of time, based on the stage of completion method. Portfolio management, other consultation fees and management fees related to investment funds are recognized according to the agreement, usually over the period during which the service is provided. The same principle is applied to 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 or based on the stage of completion. Other one-time service revenues and other revenues are recognized on an accrual basis at the moment of executing the respective transaction.

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

Interest income and expense is recognized in the statement of comprehensive income for all financial instruments carried at amortized cost using the effective interest rate method.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and 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 flows discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is 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 tangible assets where the lessee acquires substantially all the risks and rewards of ownership are Leases of tangible assets 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 commencement of the lease at the lower of the fair value of the leased property and 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 statement of comprehensive income 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 statement of comprehensive income on a straight-line basis over the lease term. The Group primarily uses an operating lease for renting the premises and cars. A rental expense is recognized in the statement of comprehensive income as "Operating expenses".

2.19 Taxation and deferred income tax

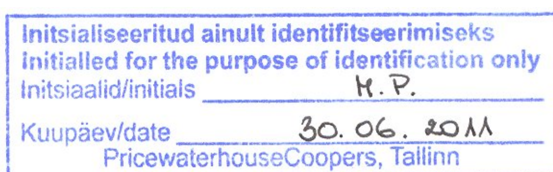
According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia and thus there are no temporary differences between the tax bases and carrying amounts of assets and liabilities and no deferred tax assets or liabilities arise. Instead of net profit, dividends payable out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

2.20 Offsetting

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

2.23 Statutory reserve

Statutory reserve capital is formed from annual net profit allocations to comply with the requirements of the Commercial Code. 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.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NOTE 3 Risk management

The principles of identification, management and control of risks at the Group are set out in the policies and procedures approved by the Supervisory Board and on daily basis risk management is carried out by the Management Boards of Group's subsidiaries. The purpose of risk management is to identify, assess, manage and control all risks related to the activities of the Group in order to ensure the reliability, stability and profitability of the entities of the Group. Independent from the units taking risk positions, the internal control department carries out control over the risk management. The rules and procedures of risk management are constantly revised and updated in case of need.

3.1 Capital management

The goal of the Group's capital (incl. debt) management is to:

- ✓ comply with capital requirements as established by supervision authorities;
- ✓ ensure continuity of the Group's business and ability to generate returns for its shareholders;
- ✓ maintain a strong capital base supporting the development of business.

Debt is managed according to internal rules and the Asset and Liability Management Committee (ALCO) oversees capital management. The ALCO is involved in the development of an optimal balance sheet structure, it monitors liquidity and interest rate risk, and makes recommendations for raising additional share capital, if necessary, in order to ensure the bank's further development and to comply at any given time with the prudential requirements established for credit institutions.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. Reports dealing with the compliance with prudential and capital requirements for covering the risks are submitted quarterly to supervision authorities. In 2010, the Group did not experience any problems in respect of compliance with capital adequacy requirements. The Group does not use internal rating based (IRB) models for calculating capital requirements.

Capital adequacy

(in thousands Estonian kroons)

Capital base	**31.12.2010**
Paid-in share capital	141 678
Share premium	89 222
Reserves	3 485
Accumulated deficit	- 31 000
Net loss for accounting period	-41 729
Intangible assets (subtracted)	-19 693
Total Tier 1 capital	**141 963**
Subordinated loans	46 940
Total Tier 2 capital	**49 940**
Net own funds (NOF) for capital adequacy calculation	**188 903**
Capital requirements	
Central government and central banks with standardised approach	
Credit institutions and investment companies with standardised approach	12 859
Retail claims with standardised approach	39 407
Investment funds´s shares with standardised approach	4 023
Other assets with standardised approach	6 437
Total capital requirements for covering the credit risk and counterparty credit risk	**62 726**
Capital requirement against foreign currency risk	3 709
Capital requirement against interest position risk	7 212
Capital requirement against equity portfolio risks	133
Capital requirement against option derivatives	0
Capital requirement for operational risk with standardised approach	9 572
Total capital requirements for adequacy calculation	**83 552**
Capital adequacy (%)	**22,61**
Tier 1 Capital Ratio (%)	**16,99**

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(in thousands Estonian kroons)

Capital base	**31.12.2009**
Paid-in share capital	116 215
Share premium	58 796
Reserves	3 485
Accumulated deficit	-6 827
Net loss for accounting period	-22 425
Intangible assets (subtracted)	-16 906
Total Tier 1 capital = Net own funds (NOF) for capital adequacy calculation	**132 338**
Capital requirements	
Central government and central banks with standardised approach	4 426
Credit institutions and investment companies with standardised approach	21 684
Retail claims with standardised approach	8 161
Investment funds´s shares with standardised approach	2 906
Other assets with standardised approach	2 648
Total capital requirements for covering the credit risk and counterparty credit risk	**39 825**
Capital requirement against foreign currency risk	3 263
Capital requirement against interest position risk	2 574
Capital requirement against equity portfolio risks	149
Capital requirement against option derivatives	32
Capital requirement for operational risk with standardised approach	7 087
Total capital requirements for adequacy calculation	**52 930**
Capital adequacy (%)	**25,00**
Tier 1 Capital Ratio (%)	**25,00**

The own funds of the LHV Bank as an credit institution at any time shall be equal to or exceed the minimum amount of share capital prescribed in the Credit Institutions Act (EUR 5 million or EEK 78 230 thousand). Capital adequacy level, i.e. the ratio of the bank's own funds to risk-weighted assets shall be at least 10%. LHV Pank maintains the capital adequacy level at 15%, to cover potential risks arising from fast growth. Each year, an internal capital adequacy evaluation process is performed, the goal of which is to identify potential capital needs in addition to regulatory capital requirements.

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.

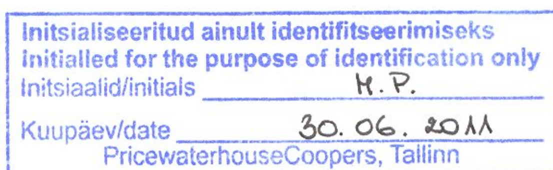
3.2 Financial risk management

The main financial risks arising from the activities of the Group 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 with banks and other financial institutions, but mostly credit exposures to customers, including outstanding loans, other receivables and committed transactions. In order to hedge credit risk, the Group 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 regularly monitored.



Distribution of credit risks

The Group classifies the financial assets exposed to credit risk in the following key categories:

a) bonds
b) loans and advances to banks
c) margin loans backed by securities
d) corporate loans
e) consumer loans with cash flows as collateral

a) Bonds

The Credit Committee sets limits for taking credit risk associated with bonds considering the issuer's rating. The ALCO or authorised employees make decisions regarding investments within the limits set.

The Group's debt securities according to ratings given by Standard & Poor's or equivalent:

Rating	31.12.2010	31.12.2009
AA- to AA+	62 190	4 814
A- to A+	125 986	38 319
Lower than A-	91 457	31 984
Without a rating	0	8 105
Total (Note 12)	**279 633**	**83 042**

b) Loans and advances to banks

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating) are held as follows:

Rating	31.12.2010	31.12.2009
AA- to AA+	75 146	77 915
A- to A+	277 202	139 701
Lower than A-	0	102 275
Without a rating	723 557	100 174
Total (Note 10)	**1 075 905**	**420 065**

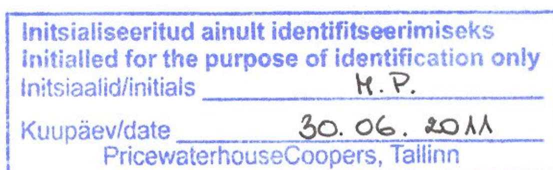
c) Leverage loans

LHV Pank 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 Pank which is currently 100 thousand euros (or an equivalent in a foreign currency) per customer through LHV Pank's website. 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 Credit Committee. The list of acceptable marketable financial instruments and the levels of the required collateral are published on LHV Pank's 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 collateral assets falls below the established limit, LHV Pank 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.

Stress tests are carried out for evaluating the credit risk of leveraged loans in order to determine potential losses in case of changes in the value of collateral and for evaluating the credit risk of other loans, the probability of the lender becoming insolvent, the amount of loans not covered by collateral at the time of insolvency and the amount of the resulting related expected loss is assessed. If necessary, decisions are made in respect of allocating additional risk capital in order to cover credit risk.

d) Corporate loans

Since 2009, LHV Pank also issues corporate loans. Prior to issuing a loan, a credit risk analysis is performed for each customer, including an analysis of the customer's economic activities, reporting and cash flows, background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checks, the company's structure, management and owners' related risk, an analysis of the industry and economic environment. The Credit Committee makes decisions in respect of risk-taking on the basis of a unanimous resolution. The maximum limit of a loan issued to a customer by LHV Pank is 20% of net own funds (NOF, whereby the legal limit is 25% of NOF). The requirements for loan collateral are established in the bank's Credit Policy. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance. After issuing the loan, follow-up monitoring of each customer's financial position is performed at least once a quarter. Problem loans are monitored continuously.

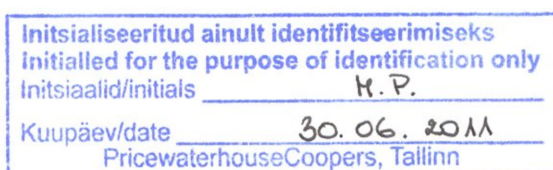
LHV Pank considers the loan as non-performing and writes it down when the loan payments have not been collected by the due date and/or the expected cash flows from the realisation of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments. Due to the small size of the bank's corporate loan portfolio, LHV Pank evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the residual value of the receivable and expected cash flows discounted at the effective interest rate. In 2010 and 2009, no impairment losses were recognised for corporate loans.

c) Consumer loans

At 28.06.2010, LHV Pank purchased a consumer loan portfolio of Finnish individuals with a 20% discount from its nominal value. The majority of the portfolio was past due and submitted to the bailiff for proceedings. Over the following couple of months, LHV Pank upgraded the credit scoring model for issuing the loans of the acquired portfolio that had been in use previously, and started issuing new loans in September 2010. In addition to the customer's previous payment behaviour and income, the new credit scoring model also takes into account other statistical parameters, which have previously been collected by types of customer in order to evaluate potential disruptions in the payment behaviour of the scoring group. Different maximum limits for the loans to be issued have been set for various scoring groups. Consumer loans are issued only to individuals and using cash flows as collateral.

Consumer loans are homogeneous loans and they are not assessed individually, but they are provisioned on a group basis. For the purpose of recognition of group-based impairment losses, the receivables are grouped into subclasses on the basis of homogeneous credit risk features, considering customers' payment practice, past due time and the time passed from initiation of proceedings by the bailiff. For the receivables that have been grouped, the amount of the impairment loss is the multiple of the carrying amount of the receivables in the group and the group's percentage rate of impairment loss. The model for assessment of homogeneous receivables and setting up of provisions currently in use at the bank was developed in the second half of 2010. In the initial stage, to identify potential shortcomings, the model is being validated on an ongoing basis and thereafter reviewed at least once a year. As at 31.12.2010, the group-based impairment reserve makes up 18% of consumer loans and the related interest receivables. In the second half of 2010, receivables, in respect of which the bailiff has sent a notice regarding the termination of the proceedings, have been written off the balance sheet against the impairment loss of the acquired portfolio.

The bank accounts for the acquired loan portfolio on a gross basis, i.e. showing contractual receivables from customers at nominal value, considering the actual effective interest rate of the contract and the impairment loss in the contra asset account. For calculation of interest income, the bank uses the expected rate of return of 10% on the portfolio acquired at fair value determined at the time of acquisition. The differences between the interest receivables calculated using the effective interest rate and the interest receivables calculated using the expected rate of return are adjusted in the contra asset account "Impairment of receivables" in the balance sheet.



3.2.2 Credit quality

As at 31.12.2010	Receivables not impaired and not past due	Receivables impaired and past due	Total	Impairment booked *	Net
Loans to legal persons					
Leverage loans	78 612	0	78 612	0	**78 612**
Corporate loans	268 549	0	268 549	0	**268 549**
Finance lease	749	0	749	0	**749**
Loans to individuals					
Leverage loans	71 808	0	71 808		**71 808**
Consumer loans	0	212 052	212 052	-38 169	**173 883**
Housing loans and finance lease	2 118	0	2 118	0	**2 118**
Total loans and advances to customers	**421 836**	**212 052**	**633 888**	**-38 169**	**595 719**
Loans and advances to banks	1 075 905	0	1 075 905	0	**1 075 905**
Total (Notes 10 and 13)	**1 497 741**	**212 052**	**1 709 793**	**-38 169**	**1 671 624**

* Impairment of a homogeneous portfolio, there are no receivables that have been impaired individually.

As at 31.12.2009	Receivables not impaired and not past due	Total
Loans to legal person		
Margin loans backed by securities	21 478	21 478
Corporate loans	*95 320*	*95 320*
Finance lease	773	773
Loans to individuals		
Margin loans backed by securities	25 691	25 691
Finance lease	3 345	3 345
Total loans and advanced to customers	**146 607**	**146 607**
Loans and advances to banks	420 065	420 065
Total (Notes 10 and 13)	**566 672**	**566 672**

The loans, for which interest or principal payments had not been paid as at 31.12.2010, are divided to past due categories according to the past due time from the last scheduled payment as follows:

Structure of loans impaired according to past due time	31.12.2010	Impairment	Net
No past due payments	44 012	-330	43 682
Past due receivables	168 040	-37 839	130 201
1-30 days	*19 484*	*-381*	*19 103*
31-60 days	*9 339*	*-277*	*9 062*
61-90 days	*4 315*	*-256*	*4 060*
91-180 days	*8 265*	*-827*	*7 438*
181-360 days	*22 638*	*-4 437*	*18 201*
More than 360 days	*103 998*	*-31 662*	*72 337*
Total	**212 052**	**-38 169**	**173 883**

There were no past due loans as at 31.12.2009.

Distribution of loans by internal ratings	31.12.2010	31.12.2009*
Excellent	150 421	51 287
Good and very good	70 631	46 960
Satisfactory	189 205	41 552
Weak or doubtful	223 631	6 808
Total	**633 888**	**146 607**

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Distribution of internal ratings:

- Excellent – margin loans backed by securities and corporate loans with very low business risk.
- Good and very good – corporate loans with lower business risks and consumer loans, with no past due payments.
- Satisfactory – corporate loans with average business risk and consumer loans up to 60 days past due.
- Weak or doubtful – all remaining consumer loans (past due more than 60 days and portfolio in proceedings by the bailiff) and corporate loans carrying high business risk.

In addition to the loans granted, loan contracts have been concluded and signed whereby the unused loan commitment was EEK 44 247 thousand as at 31.12.2010 (as at 31.12.2009, EEK 16 860 thousand), see also Note 26. There are no restructured loans and receivables.

A portfolio of consumer loans of individuals makes up a third of the loan portfolio of LHV Pank, which is unsecured (issued for cash flows). In 2009, there were no unsecured loans.

Structure of collateral of secured leveraged and corporate loans	2010	2009
Listed securities	33%	33%
Unlisted equity securities	15%	17%
Mortgages	26%	1%
Surety of KredEx and Rural Development Foundation	11%	15%
Pledges of rights of claim or deposit	9%	32%
Others	6%	2%

The maximum credit risk exposure	31.12.2009	31.12.2009
Balances with banks and investment companies (Note 10)	1 075 905	420 065
Derivatives (Note 11)	0	3 003
Other financial assets designated at fair value (bonds) (Note 12)	279 634	83 042
Loans and advances to clients (Note 13)	595 719	146 607
Receivables from customers (Note 14)	30 978	4 173
Other assets (Note 15)*	9 224	207
Totalassets	**1 991 460**	**657 097**
Off-balance sheet liabilities (Note 26)	55 031	25 623
Total maximum credit risk exposure	**2 046 491**	**682 720**

* excluding prepayments, which carry no credit risk.

Credit quality of other receivables	31.12.2010	31.12.2009
Receivables not impaired and not past due	5 068	2 702
Receivables past due (not impaired)	80	77
incl. receivables from individuals	*34*	*67*
incl. receivables from legal persons	*46*	*8*
Impaired receivables acquired at net value	25 830	0
incl. receivables from individuals	*25 830*	*0*
Total (Note 14)	**30 978**	**2 779**

3.3 Market risk

Market risk arises from LHV Pank's trading and investment activities in the financial markets from interest rate products, foreign exchange and stock markets as well as lending activities and taking in financial resources. 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. 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. The bank does not hold an active trading

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portfolio, therefore, there is no major risk due to trading and the VaR method is primarily used for assessment of collateral value of margin loans.

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. The risk management department of LHV Pank is responsible for daily monitoring of open foreign currency positions. 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, such as 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. Estonian kroon, euro, Latvian lats, Lithuanian litas) cannot exceed 5% of net own funds
- Open currency positions of the Latvian lats and Lithuanian litas are without limits, as the litas is pegged to the euro using a fixed exchange rate and the fluctuation of the lats is fixed at +/-1% to the euro.

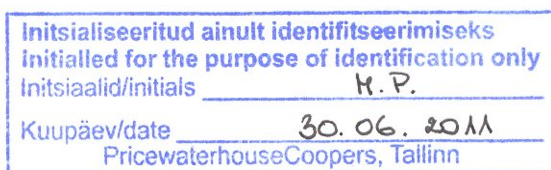
Information regarding assets and liabilities bearing currency risk is presented in the tables on the following pages. The main currencies, in which LHV Pank has open currency exposures, are USD, SEK, LTL and LVL.

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 at 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 31.12.2010	EEK	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk								
Balances with other banks and inv. companies	890 708	159 796	7 110	775	2 248	10 715	4 553	1 075 905
Financial assets at fair value through profit or loss	7	288 986	0	287	8	31 260	12	320 560
Loans granted	110 064	447 785	8 873	3 088	1 323	21 513	3 073	595 719
Receivables from customers	2 497	27 529	10	19	0	639	284	30 978
Other assets	2 325	2 017	3	13	0	9 017	0	13 375
Total assets bearing currency risk *	**1 005 601**	**926 113**	**15 996**	**4 182**	**3 579**	**73 144**	**7 922**	**2 036 537**
Liabilities bearing currency risk								
Loans received and deposits from customers	1 277 719	519 552	10 256	1 969	5 020	44 300	6 185	1 865 001
Deferred income	0	2 891	0	0	0	0	0	2 891
Accrued expenses and other liabilities	9 670	10 459	381	258	2	13	0	20 783
Total liabilities bearing currency risk *	**1 287 389**	**532 902**	**10 637**	**2 227**	**5 022**	**44 313**	**6 185**	**1 888 675**
Contingencies at contractual amounts *	0	29 337	0	0	0	0	0	29 337
Commitments at contractual amounts *	0	0	0	0	0	29 337	0	29 337
Open foreign currency position *	**-281 788**	**422 549**	**5 359**	**1 955**	**-1 443**	**-506**	**1 737**	**147 863**

* the balances of total assets and total liabilities bearing currency risk above do not include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts as contingencies and commitments (see



also Note 11); also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

As at 31.12.2009	EEK	EUR	LTL	LVL	SEK	USD	Other	Total
Assets bearing currency risk								
Balances with other banks and inv. companies	237 453	147 919	4 385	953	1 491	21 769	6 095	420 065
Financial assets at fair value through profit or loss	21 323	91 587	73	0	9	62	4	113 058
Loans granted	20 805	99 053	8 627	1 242	497	9 742	6 641	146 607
Receivables from customers	2 248	233	7	554	4	916	211	4 173
Other assets	2 788	340	0	8	0	0	0	3 136
Total assets bearing currency risk *	**284 617**	**339 132**	**13 092**	**2 757**	**2 001**	**32 489**	**12 951**	**687 039**
Liabilities bearing currency risk								
Loans received and deposits from customers	274 443	205 316	8 313	834	1 785	34 982	2 107	527 780
Other financial liabilities	105	0	18	0	0	0	0	123
Accrued expenses and other liabilities	10 658	9 609	524	106	12	0	9	20 918
Deferred income	9	451	0	0	0	0	0	460
Finance lease liabilities	325	0	0	0	0	0	0	325
Bonds issued	4 190	0	0	0	0	0	0	4 190
Total liabilities bearing currency risk *	**289 730**	**215 376**	**8 855**	**940**	**1 797**	**34 982**	**2 116**	**553 796**
Contingencies at contractual amounts *	0	123 217	0	0	0	126 220	0	249 437
Commitments at contractual amounts *	0	123 217	0	0	0	123 217	0	246 434
Open foreign currency position	**-5 113**	**123 756**	**4 237**	**1 817**	**204**	**510**	**10 835**	**136 246**

* the balances of total assets and total liabilities bearing currency risk above do not include derivatives at their fair value, but they are shown here at their full contractual cash flow amounts as contingencies and commitments (see also Note 11); also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity.

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to open currency positions on the income statement, with the assumption of other conditions remaining constant.

Impact on statement of comprehensive income	Change	2010	Change	2009
USD exchange rate	10%	51	10%	47
	-10%	-51	-10%	-47
SEK exchange rate	10%	144	5%	12
	-10%	-144	-5%	-12

✓ *Price risk*

Financial instruments bearing price risk in LHV Pank and LHV Varahaldus are securities held in trading portfolio (intermediating trades to the clients of the bank) and investment portfolio (investing liquid assets). The limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for bonds in investment portfolio. The internal control department monitors the compliance with limits.

Sensitivity analysis of the impact to net result from the risk exposures against reasonable possible change:

Impact on statement of comprehensive income	Change	2010	Change	2009
Shares in trading portfolio	20%	91	30%	224
	-20%	- 91	-30%	-224
Fund units in trading portfolio	15%	37	15%	32
	-15%	- 37	-15%	-32
Bonds in investment portfolio	5%	13 982	15%	12 455
	-5%	- 13 982	-15%	-12 455

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Kuupäev/date 30.06.2011
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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.

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. Value growth of fund units continued in 2010 and the management does not estimate significant decrease in market value for 2011.

✓ *Interest rate risk*

The goal of monitoring, measuring and managing interest rate risk is to evaluate the profitability of the bank's interest-bearing products, to forecast interest income and to set limits for risk management in order to prevent significant reduction of income through limitation of risks in two aspects:

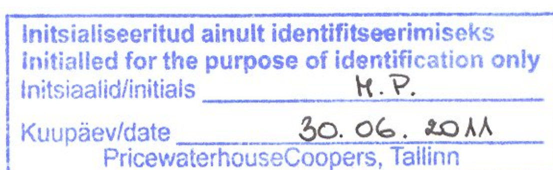
- cash flow interest rate risk whereby in case of a 1% change in market interest rates, a change in annual net interest income is limited as compared to the estimated actual income based on the term structure of instruments currently in the balance sheet;
- fair value interest rate risk whereby in case of a 1% change in market interest rates, a change in the bank's intrinsic value is limited (fair value of assets and liabilities is determined by discounting the future cash flows at the market rate of interest).

To reduce the cash flow risk arising from possible change in interest rates, the Group primarily uses fixed interest rates for taking in deposits. The interest rates of the deposits from customers were up to 4,5% in 2010 (up to 7% in 2009). The interest rate on loans granted was between 4,5-23% in 2010 (7,5-20,5% in 2009). The interest rates for leverage loans granted are changed at most once a month according to fluctuations in market interest rates. In 2010, the interest rate on loans received for specific purposes was 1,5% and the effective interest rate of subordinated loans was 8% (2009: loans taken for specific purposes 1,5%).

As the share of cash in the Group's balance sheet is high due to the growth stage, and the liabilities are with longer maturities in a year's perspective, an increase in market interest rates has a positive effect on the expected net interest income of the Group this year. As at 31.12.2010, a 1% increase in interest rates would increase the Group's annual interest income by EEK 255 thousand (a decline of 1% in interest rates would lower the income by EEK 255 thousand). As at the balance sheet date of 2009, the effect of a 1% increase in interest rates would have been EEK +351 thousand (effect of 1% decline EEK -351 thousand).

An 1% increase in market interest rates would lower the Group's economical value by EEK -3 million (2009: EEK -2,4 million). The effect on the Group's economical value is negative due to the longer than average duration of interest-earning assets than the average duration of interest-bearing liabilities.

The table below shows the structure of the interest-earning assets and interest-bearing liabilities of LHV Pank according to the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.



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31.12.2010	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Assets					
Balances with other banks and inv. companies	1 075 683	0	0	0	**1 075 683**
Financial investments and securities	0	12 298	180 603	70 019	**262 920**
Loans granted	207 517	137 349	196 659	46 316	**587 841**
Total	**1 283 200**	**149 647**	**377 262**	**116 335**	**1 926 444**
Liabilities					
Loans received and deposits from customers	1 007 269	673 755	100 408	27 546	**1 808 978**
Subordinated loans '	0	0	46 940	0	**46 940**
Total	**1 007 269**	**673 755**	**147 348**	**27 546**	**1 855 918**
Total Interest pricing gap	**275 931**	**-524 108**	**229 914**	**88 789**	**70 526**

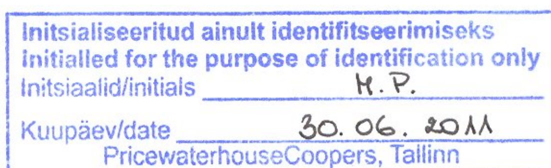
31.12.2009	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Assets					
Balances with other banks and inv. companies	323 225	96 840	0	0	**420 065**
Financial investments, incl. derivatives	110	12 049	21 632	49 251	**116 061**
Loans granted	61 235	34 390	41 061	5 803	**146 607**
Finance lease receivables	4 173	0	0	0	**4 173**
Other assets	0	0	0	0	**207**
Total financial assets	**388 743**	**143 279**	**62 693**	**59 172**	**687 113**
Liabilities					
Loans received and deposits from customers	303 010	182 022	20 098	22 650	**527 780**
Other financial liabilities	0	0	0	0	**123**
Bonds issued	0	0	0	4 190	**4 190**
Other liabilities	9	8 775	0	0	**8 928**
Total financial liabilities	**303 019**	**190 797**	**20 098**	**26 840**	**541 021**
Total interest repricing gap	**85 724**	**-47 518**	**42 595**	**32 332**	**146 092**

3.4 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 Pank 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, as well the concentration of bank's liabilities by maturities are monitored. The Group does not have any debts past due as at 31.12.2010 and 31.12.2009.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and therefore, the tables do not reconcile to the positions in balance sheet. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows) rather than being included in a single bucket when the instrument matures.

Explanation of the fair value of these financial assets and liabilities is presented in Note 3.6. LHV Pank has sufficient supply of liquid resources to enable issuing standby loans. To enable covering unexpected monetary outflows, it is possible to sell security investments, which are held for a purpose to ensure liquidity.



31.12.2010	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates					
Loans received and deposits from customers	1 093 030	618 128	121 724	9 213	**1 842 095**
Subordinated loans	0	2 347	15 031	52 110	**69 488**
Other liabilities	20 882	0	200	0	**21 082**
Unused loan commitments	44 247	0	0	0	**44 247**
Financial guarantees by contractual amounts	6 939	2 803	1 042	0	**10 784**
Total liabilities	**1 165 098**	**623 278**	**137 997**	**61 323**	**1 987 696**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	1 075 905	0	0	0	**1 075 905**
Financial investments and securities	4 717	23 888	206 773	96 389	**331 767**
Loans granted	184 131	161 183	230 656	82 475	**658 445**
Receivables from customers	11 606	6 458	12 915	0	**30 979**
Total assets held for managing liquidity risk	**1 276 359**	**191 529**	**450 344**	**178 864**	**2 097 096**
Maturity gap from assets and liabilities	**111 261**	**-431 749**	**312 347**	**117 541**	**109 400**

31.12.2009	Up to 3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities by contractual maturity dates					
Loans received and deposits from customers	303 787	187 483	38 318	6 295	**535 883**
Other financial liabilities	123	0	0	0	**123**
Bonds issued	99	307	1 632	4 517	**6 555**
Other liabilities	9 596	12 366	500	0	**22 462**
Unused loan commitments	16 860	0	0	0	**16 860**
Financial guarantees by contractual amounts	8 763	0	0	0	**8 763**
Total liabilities	**339 228**	**200 156**	**40 450**	**10 812**	**590 646**
Assets held for managing liquidity risk by contractual maturity dates					
Balances with other banks and inv. companies	323 346	100 234	0	0	**423 580**
Financial investments	1 297	15 373	38 063	58 751	**113 484**
Loans granted	70 212	25 667	46 256	3 731	**145 866**
Finance lease receivables	117	317	1 650	4 482	**6 566**
Receivables from customers	4 173	0	0	0	**4 173**
Total assets held for managing liquidity risk	**399 145**	**141 591**	**85 969**	**66 964**	**693 669**
Maturity gap from assets and liabilities	**59 917**	**-58 565**	**45 519**	**56 152**	**103 023**

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3.5 Risk concentration

Distribution of assets and liabilities by geography is presented below:

As at 31.12.2010									
Asset distribution by geography	**Estonia**	**Latvia**	**Lithuania**	**Sweden**	**Finland**	**Denmark**	**USA**	**Other**	**Total**
Balances with banks and inv. companies	815 752	2 212	19 470	770	65 904	106 369	39 359	26 068	**1 075 905**
Financial investments	64 086	28 055	25 597	34 358	33 557	42 272	6 600	86 035	**320 560**
Loans granted	383 012	12 561	21 773	0	173 883	0	0	4 490	**595 719**
Receivables from customers	4 727	124	138	0	25 830	0	0	159	**30 978**
Other assets	4 224	82	52	0	0	0	9 017	0	**13 375**
Goodwill and associates	16 494	0	0	0	0	0	0	0	**16 494**
Tangible assets	7 069	55	7	0	0	0	0	0	**7 131**
Total assets	**1 295 365**	**43 089**	**67 037**	**35 128**	**299 174**	**148 641**	**54 976**	**116 752**	**2 060 162**
Distribution of liabilities by geography									
Loans and deposits from customers	1 790 255	4 971	13 681	0	592	114	4 609	6 286	**1 820 508**
Subordinated loans	44 493	0	0	0	0	0	0	0	**44 493**
Other liabilities	21 514	286	1 001	0	1 296	0	0	2	**24 099**
Total liabilities	**1 856 262**	**5 257**	**14 682**	**0**	**1 888**	**114**	**4 609**	**6 288**	**1 889 100**

Unused loan commitments to Estonian residents amount to EEK 44 247 thousand (2009: EEK 16 860 thousand)

As at 31.12.2009									
Asset distribution by geography	**Estonia**	**Latvia**	**Lithuania**	**Sweden**	**Finland**	**Denmark**	**USA**	**Other**	**Total**
Balances with banks and inv. companies	159 473	106 564	7 900	626	69 711	29 080	29 799	16 912	**420 065**
Financial investments, incl. derivatives	45 766	0	17 890	15 194	13 328	0	6 630	17 253	**116 061**
Loans granted	134 188	2 476	9 922	0	0	0	0	21	**146 607**
Receivables from customers	3 065	81	181	18	0	0	9	819	**4 173**
Other assets	3 002	82	52	0	0	0	0	0	**3 136**
Goodwill	16 332	0	0	0	0	0	0	0	**16 332**
Tangible and intangible assets	4 996	309	103	0	0	0	0	0	**5 408**
Total assets	**366 822**	**109 512**	**36 048**	**15 838**	**83 039**	**29 080**	**36 438**	**35 005**	**711 782**
Distribution of liabilities by geography									
Loans and deposits from customers	506 879	6 470	11 347	1	974	6	1 135	968	**527 780**
Other financial liabilities	109	0	14	0	0	0	0	0	**123**
Finance lease liabilities	325	0	0	0	0	0	0	0	**325**
Bonds issued	4 190	0	0	0	0	0	0	0	**4 190**
Other liabilities	12 459	115	1 104	15	0	0	9	8 776	**22 478**
Total liabilities	**523 962**	**6 585**	**12 465**	**16**	**974**	**6**	**1 144**	**9 744**	**554 896**

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Kuupäev/date 30.06.2011
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Distribution of loans granted by industry

	31.12.2010	%	31.12.2009	%
Private individuals	285 977	45,11%	29 036	18.03%
Financial services	41 691	6,58%	22 515	15.80%
Wholesale and retail	49 264	7,77%	16 913	11.87%
Administration and support services	35 446	5,59%	14 777	10.37%
Construction	21 541	3,40%	13 565	9.52%
Manufacturing	71 483	11,28%	7 496	5.26%
Information and communication	13 286	2,10%	6 758	4.74%
Other services	5 577	0,88%	5 732	3.48%
Real estate	35 147	5,54%	3 961	2.78%
Professional, scientific and technical activities	31 012	4,89%	0	0,00%
Health and social care	20 209	3,19%	18 865	11,69%
Accommodation and catering	9 951	1,57%	48	0,03%
Other	13 304	2,10%	6 941	18.14%
Total	**633 888**	**100%**	**146 607**	**100%**

As at 31.12.2010 seven loans (as at 31.12.2009 two loans) were issued with high risk concentration, i.e. individually or via group risk more making up more than 10% of Group's net capital / net own funds (NOF).

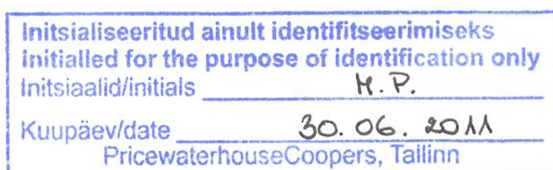
3.6 Fair value of financial assets and financial liabilities

According to the management of the Group, the carrying values of assets and liabilities recognised at amortised cost in the consolidated balance sheet do not materially differ from their fair values as at 31.12.2010 and 31.12.2009.

Leveraged loans granted to customers are of sufficiently short-term nature and they have been issued at market terms, therefore the fair market rate of interest and also the fair value of loans do not change significantly during the loan term. The portfolio of corporate loans is too small due to the bank's early stage of business, each customer is reviewed separately and interest rates vary on the basis of customer's risk level, as a result of which a homogeneous interest rate based on similar transactions cannot be used for discounting the future cash flows of these loans. As the bank competes with other credit institutions when issuing loans and offers higher interest rates for customers than its competitors, the Management Board estimates that the loans have been issued at market conditions and their fair value is definitely not lower than their carrying amount as at 31.12.2010 and 31.12.2009. The fair value of consumer loans and the related other receivables is 2,37% lower than their carrying amount as at 31.12.2010.

The average maturity of deposits with fixed interest rates is half a year, as a result of which the deposits are short-term and have been issued at market conditions. In the second half of 2010, the market yield curve has not significantly changed, as a result of which the fair value of deposits found by discounting future cash flows does not significantly differ from their fair value.

Trade receivables (other than the receivables related to consumer loans, which have been included within loans for assessment of fair value), and accrued expenses and other liabilities have been incurred in the course of ordinary business and are payable in the short-term, therefore, the management estimates that their fair value does not significantly differ from their carrying amount. These receivables and liabilities are interest-free.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The following tables gives an overview of the hierarchy of valuation techniques used for valuation of financial assets and liabilities measured at fair value:

	31.12.2010				31.12.2009			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value through profit or loss								
Trading portfolio								
shares	455	0	0	**455**	749	0	0	**749**
fund units	244	0	0	**244**	208	0	0	**208**
Investment portfolio								
bonds	279 633	0	0	**279 633**	74 937	0	8 105	**83 042**
fund units	40 228	0	0	**40 228**	29 059	0	0	**29 059**
Derivatives	0	0	0	**0**	0	3 003	0	**3 003**
Total financial assets				**320 560**	**104 953**	**3 003**	**8 105**	**116 061**
Financial liabilities at fair value through profit or loss								
Derivatives	0	0	0	**0**	123	0	0	**123**
Total financial liabilities	**0**	**0**	**0**	**0**	**123**	**0**	**0**	**123**

Levels used in hierarchy:

Level 1– quoted prices in active market

Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)

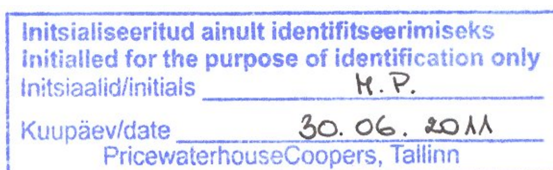
Level 3 – other valuation techniques (f.ex discounted cash flow method) with judgemental inputs

3.7 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 the Group'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 the Group and to evaluate capital requirements. The analysis on cases collected into the database enables 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 risk manager of the bank is responsible for collecting information and the Management Board of LHV Pank is responsible for dealing with the analysis and implementing necessary measures.

Compliance control and internal audit have an important role in evaluating, monitoring and mitigating the operating risk. Pursuant to the Credit Institutions Act and 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 Group entities, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.



NOTE 4 Significant management estimates and assumptions

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 (Notes 10, 12 and 13);
- in the absence of an active market, fair valuation of investments using different valuation techniques (Note 12);
- assessment of provisions and contingent assets / liabilities (Note 19);
- 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 statement of comprehensive income of the period in which the change occurred.

NOTE 5 Subsidiaries and associated companies, goodwill

As at 31.12.2010, the Group's subsidiaries which have been consolidated in these financial statements, include:

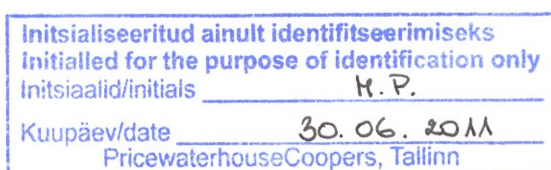
- AS LHV Pank (ownership interest 100%)
- AS LHV Varahaldus (ownership interest 83,72%)
- AS LHV Finance (ownership interest 100%)
- LHV Ilmarise Kinnisvaraportfelli OÜ (ownership interest 100%)

At 31.05.2010, the finance lease receivables of the Group's wholly-owned subsidiary, LHV Ilmarise Kinnisvaraportfelli OÜ were sold at their carrying amount to AS LHV Pank. As agreed with the investors, the Company used the proceeds to prematurely redeem all bonds listed at the stock exchange at that time and the bonds were deleted from the Estonian Central Register of Securities. In the summer of 2010, a decision was adopted to liquidate LHV Ilmarise Kinnisvaraportfell and by the time of signing the annual report, a respective entry has also been made in the Commercial Register.

In 2010 the Group's associate is a Finnish company Luottotalo Fenno OY (Fenno) which issues consumer loans. AS LHV Group made an investment in the amount of EEK 24 268 thousand into the shares of Fenno, thereby acquiring a 24,53% ownership interest in the entity. The acquisition was made with a goal that Fenno would obtain the license of a credit institution, enabling it to raise deposits as a cheaper source of financing instead of issued bonds and the company's growth will continue. Considering the additional information which became available after the events after the balance sheet date and significant loan provisions made during the Company's audit review of the financial year, management has written down the investment in shares in full. Pursuant to the agreement entered into earlier, the Group made an additional investment in the Company which was written down similarly to the previous one.

In 2010, the wholly-owned subsidiary LHV Finance OY was acquired. The objective of the acquisition of the ownership interest was holding of Fenno trademarks necessary for operation in Finland within the Company. At the beginning of 2011, a new trademark LHV-luotto was taken into use and the acquired Fenno trademarks are no longer in use.

In the autumn of 2010, AS LHV Capital was founded which the Group acquired a 40% ownership interest in. AS LHV Capital manages the investments in the portfolio previously based on the private capital of the bank's shareholders.



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As at 31.12.2008, AS LHV Group held 61,96% of the shares of AS LHV Varahaldus. At 15.06.2009, AS LHV Group entered into a contract with EBRD (European Bank for Reconstruction and Development), pursuant to which it acquired a 19,04% ownership interest in AS LHV Varahaldus which was previously held by EBRD. After the transaction, the ownership interest of AS LHV Group in AS LHV Varahaldus is 81%. In accordance with the contract, the share purchases took place in four parts, with two payments made in 2009 and two made in 2010. In October 2010, the capital of AS LHV Varahaldus was increased, the only investor of which was the majority shareholder AS LHV Group and as a result of which the ownership interest of the majority shareholder increased another 2,72% to 83,72%.

Acquisition of the shares of AS LHV Varahaldus for the price of EEK 14.50 per share	17.10.2010
Cash and bank	18 931
Receivables and accrued income	2 369
Financial investments	45 673
Non-current assets	334
Liabilities	24 877
Equity	42 430
Acquired ownership interest	2,72%
Acquired net assets	13 534
Cost	**15 282**
Change in equity (non-controlling interest)	1 748

The difference in the amount of EEK 1 748 thousand which arose during the subscription for shares is carried as a reduction of retained earnings in equity arising from a change in IFRS adopted during the reporting period, according to which goodwill can no longer be accounted for as an intangible asset in transactions with non-controlling interests.

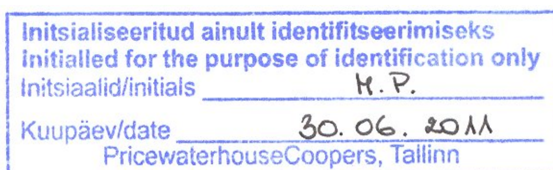
As at 31.12.2010, goodwill in amount EEK 16 332 thousand in the consolidated balance sheet of AS LHV Group consists of:

- positive goodwill which had arisen on the acquisition of the ownership interests in AS LHV Varahaldus in the amount of EEK 7 539 thousand
- positive goodwill which had arisen after the conclusion of a purchase contract entered into in 2009 in the amount of EEK 8 793 thousand.

An impairment test was performed as at 31.12.2010. 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 2011-2015 is based on the current assumptions that the contributions to mandatory funded pension by the state resumed in 2011 and the contributions made by clients resumed in accordance with a scheme established by the state (2009: under the assumptions that the suspension of the contributions to mandatory funded pension by the state in 2009, more than one half of the clients of Varahaldus continued to make voluntary contributions to the pension funds in 2010 and further cash flows will be generated according to scheme established by the state);
2) due to the economic environment, modest growth of 4% in operating is expected per annum (2009: 4%)
3) the discount rate used is 13% (2009: 13%)
4) when using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations.

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.



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NOTE 6 Net fee and commission income

Fee and commission income	**2010**	**2009**
Financial advisory services	478	210
Security brokerage and commissions	38 303	41 661
incl. related parties (Note 25)	*2*	*470*
Asset management and similar fees	31 369	20 010
incl. related parties (Note 25)	*21 673*	*13 265*
Other fee and commission income	2 173	*0*
Total	**72 323**	**61 881**
Fee and commission expense		
Financial advisory and other similar services purchased	- 22	-15
Security brokerage and commissions paid	-9 160	-8 070
Collection costs	-1 939	0
Total	**- 11 121**	**-8 085**
Net fee and commission income	**61 202**	**53 796**

Fee and commission income by customer location:	**2010**	**2009**
Estonia	60 269	49 209
Finland	1 939	0
Latvia	2 750	3 124
Lithuania	7 365	9 548
Total	**72 323**	**61 881**

NOTE 7 Net interest income

Interest income	**2010**	**2009**
From balances with other banks and investment companies	4 508	6 013
From balances with central bank	723	57
Finance lease	193	261
Margin loans and lending of securities (Note 13)	11 026	5 711
Customer loans (Note 13)	9 963	0
Other loans (Note 13)	15 076	3 991
Total	**41 489**	**16 033**
Interest costs		
Bonds issued	0	-244
Loans received and deposits from customers (Note 17)	-26 692	-7 494
incl. loans from related parties (Note 25)	*-401*	*0*
Total	**- 26 692**	**-7 738**
Net interest income	**14 797**	**8 295**

Interest income by customer location, excl other banks, investment companies and central bank:	**2010**	**2009**
Estonia	23 045	7 615
Finland	9 963	0
Latvia	625	235
Lithuania	2 770	2 113
Total	**36 403**	**9 963**

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NOTE 8 Gain/loss from financial assets

Gain/loss from financial assets	2010	2009
Related to changes in foreign exchange rates:	5 241	3 247
- *translation gains less losses*	1 001	-423
- *transactions gains less losses from customer trades*	4 240	3 670
Net gain/loss on trading portfolio securities recognised at fair value	-133	397
Incl. revaluation gains/losses	-133	79
Incl. interest income on bonds	*0*	*318*
Dividend income from trading portfolio securities	*0*	*17*
Gain from investment portfolio securities designated at fair value	2 971	14 560
Incl. revaluation of fund units	*4 217*	*5 807*
Incl. revaluation of bonds	*-6 217*	*6 491*
Incl. interest income on bonds	*4 971*	*2 262*
Net gain/loss from financial assets	**8 079**	**18 221**

NOTE 9 Operating expenses

Staff costs	Note	2010	2009
Wages, salaries and bonuses		35 932	24 467
Social security and other taxes		11 469	8 163
Total		**47 401**	**32 630**
Marketing expenses		36 498	17 249
Total services purchased		14 538	9 767
IT expenses		7 924	4 149
Information services and bank services		3 362	2 852
Office expenses		3 364	2 296
Transportation and communication costs		2 095	1 100
Training and travelling expenses of employees		2 153	935
Other administrative expenses		3 997	2 832
Operating lease payments	23	5 884	4 531
Depreciation	16	3 432	3 200
Impairment lof goodwill	5	0	1 184
Costs related to setting up provisions	20	-130	500
Other operating expenses		365	387
Total operating expenses		**130 883**	**83 612**

NOTE 10 Balances with central bank, other banks and investment companies

	31.12.2010	31.12.2009
Demand deposits *	234 978	195 962
Term deposits with original maturity less than 3 months *	130 000	54 117
Term deposits with maturity more than 3 months	0	80 000
Statutory reserve capital at central bank	109 743	88 507
Balances with central bank	600 962	0
Accrued interest	222	1 479
incl from central bank	*143*	*18*
Total	**1 075 905**	**420 065**
* cash and cash equivalents in statement of cash flows	965 940	250 079

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Distribution of receivables by countries is presented in note 3.5. Balances with investment companies included in demand deposits amounts to 45 911 thousand kroons (2009: 37 485 thousand kroons). All other demand and term deposits are held at credit institutions. Balances with central bank include the balance of mandatory banking reserve, which all Estonian banks, including LHV Pank, are required to hold in central bank at the level of 2% (31.12.2009: 15%) of all financial resources taken in (loans received and deposits from customers). Reserve requirement ist o be fulfilled as a monthly average in Estonian kroons or in the foreign securities preapproved by central bank.

NOTE 11 Foreign currency derivatives

Balance as at 31.12.2010	Asset / liability (fair value)	Contingent assets (contractual amount)	Commitments (contractual amount)
Foreign currency forward contracts (USD)	0	29 337	29 337
Total derivatives	**0**	**29 337**	**29 337**
Balance as at 31.12.2009			
Foreign currency future contract (USD)	0	123 217	123 217
Foreign currency forward contracts (USD)	3 003	126 220	123 217
Total derivatives	**3 003**	**249 437**	**246 434**

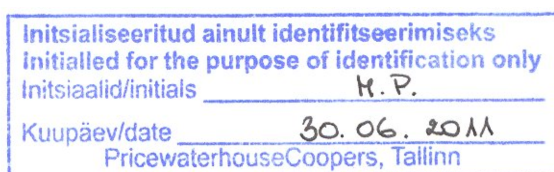
A foreign currency future is traded on the stock exchange, and daily gains or losses are immediately transferred to LHV Pank's account as a result of which the carrying amount of the contract is 0. LHV Pank uses foreign currency futures for hedging the currency risk arising from open foreign currency exposures. The foreign currency forward contracts have been concluded for customer service purposes in order for the client to hedge USD currency exchange rate risk and LHV Pank has hedged that foreign currency exchange rate risk arising from forward contracts by entering into opposite foreign currency future contracts. All contracts are with 3 months maturity.

NOTE 12 Other financial assets and liabilities at fair value through profit or loss

Securities held for trading:	31.12.2010	31.12.2009
Shares	455	749
Fund units	244	208
Designated at inception:		
Fund units	40 228	29 059
incl. investments in managed pension funds	*30 332*	*20 673*
incl. investments in managed investment funds	*9 896*	*8 386*
Bonds	279 633	83 042
Total financial assets	**320 560**	**113 058**

Shares as at 31.12.2009 include the underlying assets purchased for hedging the risk of written options. In February 2010, the Group terminated underwriting of options to its customers involving the securities traded on Baltic stock exchanges. Options were valued using the Black & Scholes model. According to the model, the price of the underlying asset is determined on the basis of the market price, with the price of call options being calculated on the basis of the bid-price of the underlying asset and the price of put options being calculated on the basis of the ask price of the underlying asset. In order to determine volatility, the function of the Bloomberg terminal was used and it was monitored that no arbitrage opportunities arise between various strike prices. Interest used for valuation depends on the value of money for LHV Pank and as at 31.12.2009, the interest rate used was 8%. As at 31.12.2009, the financial liabilities held for the purpose of trading included options with the market value of EEK 123 thousand.

With regard to listed securities, the fair value of investments is their bid price. The discounted cash flow model has been used for bonds for which the market price 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. In 2010, all securities are carried at fair value and market price. In 2009, the bank adjusted its return expectations due to higher market interest rates and the risk level. All securities were reported at fair value. Debt securities have not been pledged as collateral for loans received or any other liabilities.

NOTE 13 Loans granted

	Intrest rate	Loan balance 31.12.2010	Intrest rate	Loan balance 31.12.2009
Loans to entities		**347 910**		**117 571**
inc. leveraged loans	*6%-20%*	*78 612*	*7%-18%*	*21 478*
inc. corporate loans	*4%-11%*	*268 549*	*7%-11%*	*95 320*
inc. finance lease	*6%-8%*	749		*773*
Loans to private persons		**285 978**		**29 036**
Inc. leveraged loans	*6%-20%*	*71 808*	*7%-18%*	*25 691*
inc. consumer loans	*10%-25%*	*212 052*		*0*
inc. finance lease and housing loans	*6%-8%*	*2 118*	*6%-8%*	*3 345*
Total		**633 888**		**146 607**
Impairment loss		-38 169		0
Total		**595 719**		**146 607**

The impairment provision has been set up for the portfolio of consumer loans acquired with a discount. The receivables were not recognised at their net amount, but they were accounted for at nominal value in the balance sheet and the impairment loss was accounted for separately. Therefore, there are no costs related to the impairment loss in the income statement.

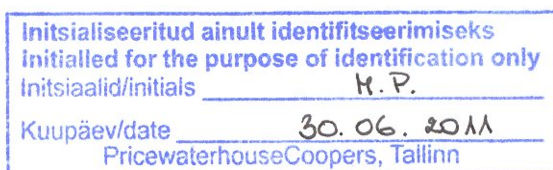
In 2010, the average effective interest rate of consumer loans issued to individuals was between18,3-22,8%. Interest income on the acquired portfolio is calculated on the basis of the effective interest rate of 10% which was the expected rate of return of the portfolio at the time of acquisition. In the second half of 2010, the cash flows from portfolio have been in line with the expected IRR of 10%. Interest receivables from customers are accounted for using the effective interest rate calculated on the basis of the customer's contractual payments, and the difference between the customer's effective interest rate and the effective interest rate found upon acquisition is adjusted in the impairment account under assets. In 2010, the impairment account was adjusted by EEK 9 million due to the difference in calculation of interest income. Interest income on new consumer loans issued is recognised in the income statement using their actual effective interest rate.

The contractual interest rate of leveraged loans issued to individuals is generally equal to their effective interest rate, because no other significant fees have been received upon their issue.

Deferred income includes service fees of loans in the amount of EEK 2 892 thousand (2009: EEK 451 thousand), which are released to interest income over the loan term and the current portion of which totals EEK 1 678 thousand (2009: 301 thousand) and the non-current portion totals EEK 1 214 thousand (2009: EEK 150 thousand).

As at 31.12.2010 and 31.12.2009, no loans have been issued to related parties.

For interest income on loans granted, see Note 7.
For credit risk exposures and loan collateral, see Note 3.2.
Distribution of loans granted by currencies is disclosed in Note 3.3.
Distribution of loans granted by due dates is disclosed in Note 3.4.
The regional distribution of loans granted is disclosed in Note 3.5.



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NOTE 14 Receivables from customers

	31.12.2010	31.12.2009
Securities brokerage fees from intermediaries	269	749
Asset management fees from customers	3 190	1 838
incl. related parties (Note 25)	*2 102*	1 306
Other fees for providing services to customers	*1 689*	1 051
incl. related parties (Note 25)	*266*	*258*
Payments in transit	0	535
Allowances for impairment of receivables	25 830	0
Total	**30 978**	**4 173**

All fees, excluding fees from customer loans, are receivable within 12 months of the balance sheet date, and are considered current assets.

NOTE 15 Other assets

	31.12.2010	31.12.2009
Guarantee deposits of Baltic stock exchanges	207	207
MasterCard guarantee deposits	9 017	0
Prepayment of marketing expenses	113	200
Prepayments to Financial Supervision Authority	866	1 322
Other prepayments *	3 172	1 407
Total	**13 375**	**3 136**

* Prepayments include office rent, insurance, communication services and 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 the deposit of MasterCard to guarantee credit card transactions, and should therefore both be considered non-current assets.

NOTE 16 Tangible and intangible assets

	Tangible assets	Intangible assets	Total
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**
Changes occurred in 2009:			
Purchase of non-current assets	476	488	964
Depreciation/amortisation charge	-3 064	-136	-3 200
Balance as at 31.12.2009			
Cost	12 149	1 232	13 381
Accumulated depreciation and amortisation	-7 315	-658	-7 973
Carrying amount	**4 834**	**574**	**5 408**
Changes occurred in 2010:			
Purchase of non-current assets	2 065	3 089	5 077
Depreciation/amortisation charge	- 3 129	-302	-3 274
Balance as at 31.12.2010			
Cost	14 214	4 321	18 535
Accumulated depreciation and amortisation	-10 444	-960	-11 404
Carrying amount	**3 770**	**3 361**	**7 131**

In 2010 and 2009, there was no indication of impairment of tangible and intangible assets.

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NOTE 17 Loans received and deposits from customers

	Private individuals	Private legal entities	Public entities	31.12.2010 Total	Private individuals	Private legal entities	Public entities	31.12.2009 Total
Demand deposits	112 077	164 923	660	**277 660**	40 963	72 413	553	113 929
Term deposits	691 014	686 615	119 840	**1 497 469**	211 926	166 524	9 970	388 420
Loans recieved	0	3 803	30 046	**33 849**	0	0	22 650	22 650
Accrued interest liability	6 481	4 237	812	**11 530**	1 542	1 193	46	2 781
Total	**809 572**	**859 578**	**151 358**	**1 820 508**	**254 431**	**240 130**	**33 219**	**527 780**
Incl related parties (Note 25)	*159*	*243*	*0*	*393*	*8*	*996*	*0*	*1 004*

Loans received from public entities are from Maaelu Edendamise Sihtasutus (Rural Development Foundation) with intended purpose to finance loans to small enterprises operating in rural areas.

Distribution of loans received and deposits from customers by currency is presented in Note 3.3.
Distribution of loans received and deposits from customers by maturity is presented in Note 3.4.
Distribution of loans received and deposits from customers by geography is presented in Note 3.5.

The nominal interest rates of most loans received and deposits from customers equal their effective interest rates as no other significant fees have been paid.

NOTE 18 Accrued expenses and other liabilities

	31.12.2010	31.12.2009
Financial liabilities:		
Financial guarantee contracts issued	126	144
Liabilities for purchase of shares *(Note 5)*	0	8 775
Trade payables	6 917	2 941
Other liabilities:		
Tax liabilities	4 229	3 359
Payables to employees	6 840	4 576
Payments in transit	2 671	1 114
Other short-term liabilities	0	9
Total	**20 783**	**20 918**

Payables to employees consist of unpaid salaries; bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in number of employees during the year. Payments in transit are liabilities to clients arising from securities brokerage. All the liabilities, except for financial guarantees, are payable within 12 months and are therefore recognized as current liabilities.

NOTE 19 Provisions

In the balance sheet as of 31.12.2010, a provision has been recognised in the amount of 200 thousand kroons, the respective expense is included within operating expenses (see Note 9). Provision is recognized as a long-term liability. In 2010, some of the provisions were paid out and the amount of provisions was partially corrected by reducing it.

NOTE 20 Subordinated loans

In October 2010, the Group issued subordinated bonds in amount 3 million euros (EEK 46 940 thousand). The due date of the bonds is 7 years and at the end of the second year investors have conversion option. The interest rate on subordinated bonds is 5% in the first two-year period and 7.5% + 12-month Euribor in the subsequent five-year period, with the due date at 15.10.2017. Investors' have the right to convert these bonds to share capital in October 2012.

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The bonds are recorded in balance sheet with internal rate of return of 9% p.a. Options in amount 210 thousand euros (EEK 3 286 thousand) are separated from bonds and are recorded in equity. Interest expenses on subordinated bonds in the amount of EEK 839 thousand are included within interest income in the income statement.

NOTE 21 Shareholders' equity in the public limited company

The ultimate controlling party of AS LHV Group is Rain Lõhmus with 54% of the voting rights. Andres Viisemann has significant influence with 19% of the voting rights.

	31.12.2010	**31.12.2009**
Share capital *(in thousand Estonian kroons)*	141 678	116 215
Number of shares (pcs)	9 054 836	1 162 150
Par value of a share	1 EUR	100 EEK

According to the Company's articles of association, the minimum share capital is 5 million euros (78 million kroons) and the maximum share capital is 20 million euros (313 million kroons). The share capital has been fully paid in cash.

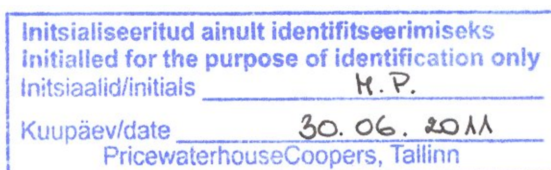
The share capital of AS LHV Group was increased in February 2010 by 1 282 thousand kroons and additionally in August by 24 181 thousand kroons. The share capital was paid in cash and was subscribed at premium: in February the issue price was 210 kroons per share and in August 220 kroons per share with the nominal value of 100 kroons. In November 2010 the share capital was converted into Euros and the amount of the new share capital is 9 055 thousand Euros. During the conversion of share capital, the nominal value of shares was changed so that shareholders received 6,391165 shares with the nominal value of EUR 1 for each former share with the nominal value of EEK 100.

From 1 January 2008, the corporate income tax on net dividends payable out of retained earnings is 21/79. In accordance with the Commercial Code, it is possible to pay out that portion of net profit as dividends which exceed the amount of the share capital of the parent and the reserves. Based on the financial results for 2010 and 2009, it is not possible to pay any dividends to the shareholders.

NOTE 22 Finance and operating lease

The Group leases cars, office space and computers under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period amounts to 23 278 thousand kroons (2009: 14 957 thousand kroons), the current portion of which amounts to 6 274 thousand kroons (2009: 3 640 thousand kroons) and the non-current portion which amounts to 17 004 thousand kroons (2008: 11 317 thousand kroons). In 2010, the operating lease payments for office premises in the amount of 5 884 thousand kroons (2009: 4 531 thousand kroons) and operating lease payments for cars in the amount of 225 thousand kroons (2009: 88 thousand kroons) are included within operating expenses.

In addition, the Group leases one car under finance lease terms. Interest expenses in the amount of 18 thousand kroons (2009: 21 thousand kroons) which have arisen from the payment of finance lease principal payments have been included within interest expenses. Finance lease principal payments totalled 101 thousand kroons (2009: 89 thousand 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. The carrying value of the car under finance lease term as of 31.12.2010 is 225 thousand kroons (31.12.2009: 325 thousand kroons).



NOTE 23 Assets under management from fiduciary activities

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

	31.12.2010	31.12.2009
Cash balance of customers	**82 081**	**70 173**
Securities of customers	**2 793 600**	**1 873 069**
incl. members of the Management and Supervisory Board and legal entities controlled by them	100 534	52 128
Total	**2 875 681**	**1 943 242**

Asset management fees for the management of these assets have been in the range of 0,015 – 0,025 % (for respective income, see Note 6).

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by LHV Pank, have been recognised as off-balance sheet assets. Due to the nature of the system, LHV Pank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by LHV Pank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. LHV Pank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the bank's balance sheet. LHV Pank has provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), whereas the primary collateral being the securities used as collateral for leveraged loans. In its current practice, no such losses in respect of which the guarantee provided by LHV Pank would apply have incurred and LHV Pank has not paid any compensation relating to the guarantee.

NOTE 24 Contingent liabilities

Irrevocable transactions	Unused loan commitments	Financial guarantees	Total
Liability in contractual amount 31.12.2010	44 247	10 784	**55 031**
Liability in contractual amount 31.12.2009	16 860	8 763	**25 623**

Tax authorities have the right to review the Company's tax records for up to 6 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Company during 2009 - 2010. The Group's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on a Group company.

NOTE 25 Transactions with related parties

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

- owners (parent company and owners of the parent);
- entities in the consolidation group (incl. fellow subsidiaries and associates);
- members of the management board, head of internal audit unit and legal entities controlled by them;
- close relatives of the persons mentioned above and the entities related to them;

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Transactions	Note	2010	2009
Total service fee and commission income	**6**	**21 675**	**13 735**
Incl. managed funds		*21 672*	*13 265*
Incl. entities in the consolidation group		*0*	*470*
Incl. members of the management board and legal entities controlled by them		*3*	*0*
Total other income		**266**	**2 360**
Incl. members of the management board and legal entities controlled by them		*266*	*2 360*
Interest expenses	*7*	**401**	**0**
Incl. members of the management board and legal entities controlled by them		*401*	*0*

Balances	Note	31.12.2010	31.12.2009
Receivables as at the year-end		**2 368**	**1 564**
Incl. members of the management board and legal entities controlled by them	*14*	*266*	*258*
Incl. managed funds	*14*	*2 102*	*1 306*
Liabilities as at year-end		**393**	**1 005**
Incl. members of the management board and legal entities controlled by them	*17*	*393*	*67*
Incl. entities in the consolidation group	*17*	*0*	*938*

The receivables have arisen from the provision of services, they do not bear interest and have been collected by the time of preparation of the financial statements. Related party transactions are based on market prices and the interest rates of term deposits do not differ from the interest rates offered to other customers.

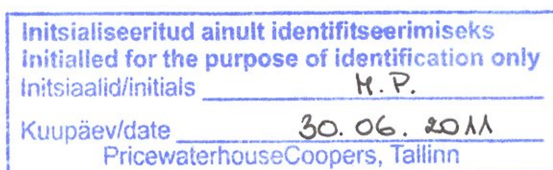
In 2010, the remuneration and other compensation paid to the managements of the subsidiaries of AS LHV Group totaled 5 195 thousand kroons (2009: 5 028 thousand kroons). As at 31.12.2010, the payable of the management consists of the remuneration for the month of December and accrued holiday pay in the amount of 1 533 thousand kroons (as at 31.12.2009: 490 thousand kroons) (Note 18). As at 31.12.2010 and 31.12.2009, the Group does not have any long-term obligations related to the members of the Management and Supervisory Boards (pension insurance, termination benefits, etc.). No remuneration was paid to the members of the Group's Supervisory Board in 2010 and in 2009.

Information on assets of related parties held by the Group as an account manager is presented in Note 23.

During the reporting period loans have been received from the members of the Management Board and legal entities controlled by them in the amount of 43 810 thousand kroons and all the loans were repaid during the reporting period. The interest rates of loans were 5 % p.a.

NOTE 26 Events after the balance sheet date

On 1 January 2011, the Republic of Estonia joined the Euro area and adopted the Euro as its national currency, replacing the Estonian kroon. Consequently, starting from 2011, the bank's functional currency is Euro and the statutory financial statements of 2011 and later periods will be presented in Euros. Comparative figures will be recalculated to euros using the conversion rate of 15,6466 EEK/EUR. The exchange rate has been the same during previous periods.



NOTE 27 Separate financial statements of parent company

In accordance with the Estonian Accounting Act, information on the separate primary financial statements of the parent of the consolidation group shall be disclosed in the notes to the financial statements.

Statement of comprehensive income of the parent
(in thousand Estonian kroons)

	2010	2009
Interest income	2 323	3 555
Interest expenses	- 1 646	-1 840
Net interest income	**677**	**1 715**
Revaluation of investments	-11 929	0
Operating expenses	- 361	-186
Impairment of investment in associate	- 1 953	-24 268
Loss for the financial year	**- 13 566**	**-22 739**
Comprehensive income/loss for the year	**- 13 566**	**-22 739**

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Balance sheet of the parent

(in thousand Estonian kroons)

	31.12.2010	31.12.2009
Assets		
Balances with other banks and investment companies	9 191	15 688
Loans granted	63 541	9 936
Investment in subsidiary	158 657	143 330
Investment in associate	162	0
Total assets	**231 551**	**168 954**
Liabilities		
Loans received	0	18 834
Other financial liabilities	104	8 775
Subordinated loans	44 493	0
Total liabilities	**44 597**	**27 609**
Shareholders' equity		
Share capital	141 678	116 215
Share premium	89 222	76 955
Share options	3 286	0
Statutory reserve capital	3 485	3 485
Accumulated deficit	- 50 717	-55 310
Total shareholders' equity	**186 954**	**141 345**
Total shareholders' equity and liabilities	**231 551**	**168 954**

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Cash flow statement of the parent

(in thousand Estonian kroons)

	2010	2009
Cash flows from operating activities		
Operating and other expenses	- 361	-186
Interest received	2 323	3 555
Interest paid	- 1 646	-1 840
Change in other receivables	-406	0
Change in other financial liabilities	- 7 832	8 775
Net cash flows from operating activities	**- 7 922**	**10 304**
Cash flows from investing activities		
Loans granted	- 53 199	0
Repayments of loans granted	0	2 901
Acquisition of subsidiary and joint ventures	- 17 442	-105 707
Change in investment portfolio	- 11 929	0
Net cash flows from investing activities	**- 82 570**	**-102 806**
Cash flows from financing activities		
Payment to share capital	55 889	95 170
Loans received	0	145 117
Repayment of loans received	- 18 834	-132 920
Subordinated loans received	46 940	0
Net cash flows from financing activities	**83 995**	**107 367**
Increase/decrease in cash and cash equivalents	**- 6 497**	**14 865**
Cash and cash equivalents at beginning of the financial year	15 688	823
Cash and cash equivalents at the end of the financial year	**9 191**	**15 688**

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Statement of changes in shareholders' equity
(in thousand Estonian kroons)

	Share capital	Share options	Share premium	Statutory reserve	Retained earnings	Total
Balance as at 01.01.2009	**68 630**	**0**	**29 370**	**3 485**	**-32 571**	**68 914**
Paid in share capital	47 585	0	47 585	0	0	95 170
Total comprehensive loss for 2009	0	0	0	0	-22 739	-22 739
Balance as at 31.12.2009	**116 215**	**0**	**76 955**	**3 485**	**-55 310**	**141 345**
Carrying amount of holdings under control and significant influence	0	0	0	0	-143 330	-143 330
Value of holdings under control and significant influence under equity method	0	0	0	0	151 229	151 229
Adjusted unconsolidated equity as at 31.12.2009	**116 215**	**76 955**	**3 485**	**-47 411**	**149 244**	
	116 215	**0**	**76 955**	**3 485**	**-47 411**	**149 244**
Balance as at 01.01.2010	**116 215**	**76 955**	**0**	**3 485**	**-55 310**	**141 345**
Paid in share capital	25 463	30 426	0	0	0	**55 889**
Issuance of share options	0	0	3 286	0	0	**3 286**
Total comprehensive loss for 2010	0	0	0	0	-13 566	**-13 566**
Loss covered from share premium	0	-18 159	0	0	18 159	**0**
Balance as at 31.12.2010	**141 678**	**89 222**	**3 286**	**3 485**	**-50 717**	**186 954**
Carrying amount of holdings under control and significant influence	0	0	0	0	-158 657	-158 657
Value of holdings under control and significant influence under equity method	0	0	0	0	136 645	136 645
Adjusted unconsolidated equity as at 31.12.2010	**141 678**	**89 222**	**3 286**	**3 485**	**-72 729**	**164 942**

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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, which comprise the consolidated balance sheet as of 31 December 2010 and the consolidated statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

AS PricewaterhouseCoopers

/signed/

Tiit Raimla
Auditor's Certificate No.287

30 June 2011

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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 2010 in the amount of 44 999 thousand kroons to retained earnings.

Signatures of the Management Board and the Supervisory Board to the consolidated annual report

The Management Board has prepared the management report and the consolidated financial statements of AS LHV Group for the financial year ended 31 December 2010.

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

MANAGEMENT BOARD
30.06.2011

Member of the Management Board

Rain Lõhmus / signed / ....

SUPERVISORY BOARD
30.06.2011

Members of the Supervisory Board

Andres Viisemann / signed / ....

Tiina Mõis / signed / ....

Hannes Tamjärv / signed / ....

Heldur Meerits / signed / ....

Raivo Hein / signed / ....

Allocation of income according to EMTAK

EMTAK	Activity	2010	2009
66121	Security and commodity contracts brokerage	49 429	46 987
64191	Credit institutions (banks) (granting loans)	41 296	15 772
66301	Fund management	22 416	14 684
66191	Financial consultancy services	478	210
64911	Financial leasing	193	261
	Total income	**113 812**	**77 914**