AS LHV Varahaldus

Annual Report 2012

(Translation of the Estonian original)

Annual Report	**01.01.2012 - 31.12.2012**
Business Name	AS LHV Varahaldus
Commercial Registry No.	10572453
Legal address	Tartu mnt. 2, Tallinn 10145
Phone	(372) 6800400
Fax	(372) 6800402
Main activities	Fund management, EMTAK 66301 (Estonian version of NACE)
Management Board	Mihkel Oja
	Kerli Lõhmus
Supervisory Board	Andres Viisemann
	Rain Lõhmus
	Erki Kilu
Auditor	AS PricewaterhouseCoopers

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MANAGEMENT REPORT

AS LHV Varahaldus is a fund management company for investment funds.

In 2012, the main activity of the Company was the provision of fund management services to five compulsory pension funds, one voluntary pension fund and two UCITSs investing in equities.

Overall, 2012 was a positive year for stock markets – the world equities index rose by 14,3%. Among developed markets, the strongest was the German stock market that increased 29%, while the US stock market gained 11,4%, in euros. The stock index of European large corporations was up 13,8%. The developing market index was up 16,4% in euros, while specific markets were performing very differently. For instance, markets of developing Asia were up 20%, whereas Russia's stock market gained only 12% and Latin America was up by only 7%. For Estonian investors, the important thing was the significant growth in the Estonian stock market – in 2012, Tallinn stock index increased as much as 38,2%. Lithuanian stock index was up by 18,8% and that of Latvia gained 7%.

For the Eurozone debt crisis, 2012 was characterized by a certain solution that was reached in the second half of the year and by the slowdown of the global economic growth between March and October. Intervention by central banks, however, helped to overcome the macroeconomic problems during the year and helped to strengthen stock markets. As for the debt crisis, it was important that the European Central Bank became the so-called lender of the last resort. As no other institution in the Eurozone had fulfilled this role earlier, Europe had been significantly different from the US. It was also a reason why in the last few years, investors were much more worried about the problems in the Eurozone than about the massive US public debt and budget deficit. When the head of the European Central Bank in August announced that ECB was ready, if necessary, to financially support Eurozone countries that were in trouble, it removed several major risks from financial markets and had a positive impact on the prices of risky assets.

2012 was a successful year in performance of LHV funds. Returns of compulsory pension funds of LHV varied between 9,13% and 14,37%, whereas in comparison with competing pension funds, LHV funds were best in return in comparison with all four strategies (conservative, balanced, progressive and aggressive). In 2012, the voluntary pension fund of LHV posted the best return (14,62%) among third pillar pension funds. The return of the LHV Persian Gulf Fund was 12,19% and the return of the LHV World Equities Fund was 11,52%.

During the year, the volume of fund assets managed by the Company increased from EUR 144 million (at the end of 2011) to EUR 252 million (at the end of 2012). The number of active clients of compulsory pension funds also increased from 84 thousand to 106 thousand (market share of 16,6%).

The conditions of compulsory pension funds changed at the beginning of 2012. The most significant change was in the strategy of Pension Fund XL so that instead of investing up to 50% of its assets in the equity markets (so-called progressive strategy), the Fund can now invest up to 75% of its assets in the equity markets (so-called aggressive strategy). The conditions of equity funds were amended because of regulatory changes effective from 1 July 2012 (so-called UCITS IV changes).

As at 31.12.2012, the Company had 34 employees (31.12.2011: 26 employees). In the reporting period, total remuneration of EUR 471 962 was paid (2011: EUR 346 663), of which the members of the Management Board were paid EUR 83 962 (2011: EUR 56 373). No fees were paid to the members of the Supervisory Board for participation in the Supervisory Board. Employment contracts signed with employees only provide for payment of fixed wages. The Company has not established principles for other type of remuneration.

FINANCIAL STATEMENTS

Balance Sheet

(in euros)

Assets	Note	31.12.2012	31.12.2011
Current assets			
Cash and cash equivalents	2	101 631	43 958
Short term financial investments	3	1 001 150	905 836
Loans receivable	13	0	12 536
Other receivables	13	372 534	226 508
Accrued income		33 215	0
Other prepaid expenses		136 878	123 602
Total currents assets		**1 645 408**	**1 312 440**
Non-current assets			
Units of managed pension funds	4	2 883 192	1 991 552
Units of managed investment funds	4	162 131	437 196
Tangible assets	5	3 690	2 301
Intangible assets	5	38 114	25 417
Total non-current assets		**3 087 127**	**2 456 466**
Total assets		**4 732 535**	**3 768 906**
Liabilities and equity			
Current liabilities			
Supplier payables	6,13	66 861	228 226
Accrued expenses and other liabilities	7	110 534	96 392
Current portion of long-term borrowings	8	102 148	65 328
Total current liabilities		**279 543**	**389 946**
Non-currents liabilities			
Subordinated liabilities	8	1 000 000	1 000 000
Total non-current liabilities		**1 000 000**	**1 000 000**
Equity			
Share capital		4 000 000	5 100 000
Share premium		0	495 605
Accumulated losses		-671 040	-1 200 012
Net profit/loss for financial year		124 032	-2 016 633
Total equity	9	**3 452 992**	**2 378 960**
Total liabilities and equity		**4 732 535**	**3 768 906**

The Notes to these financial statements presented on pages 9 – 18 are an integral part of the Annual Report.

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Income statement

(in euros)

	Note	2012	2011
Fee income	10,13	3 804 332	2 376 688
Other operating income		26 250	26 003
Total operating income		**3 830 582**	**2 402 691**
Operating expenses	11,13	-3 387 539	-3 607 395
Personnel expenses			
Wages and salaries	11	-471 962	*-346 663*
Social security costs		-150 153	*-108 653*
Unemployment insurance expense		-4 919	-3 736
Total personnel expenses		-627 034	-459 052
Depreciation and amortization	5	-20 036	-6 149
Other operating expenses		-3 118	-6 089
Total operating expenses		**-4 037 727**	**-4 078 685**
Operating loss		**-207 145**	**-1 675 994**
Financial income and expenses			
Profit from revaluation of short-term securities	3	133 344	11 581
Profit from revaluation of units of managed funds	4	316 290	-219 970
Interest income	2,13	677	1 597
Interest expense	8,13	-118 623	-133 513
Foreign exchange losses		-511	-334
Total financial income and expense		**331 177**	**-340 639**
Net profit/loss for the financial year		**124 032**	**-2 016 633**

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Statement of cash flows

(in euros)

	Note	2012	2011
Cash flow from operating activities			
Operating loss		-207 145	-1 675 994
Adjustments:			
Depreciation and amortization	5	20 036	6 149
Change in receivables and prepayments		-192 517	-97 201
Change in supplier payables		-147 223	37 944
Interests paid		-81 803	-97 095
Total change in working capital		**-401 507**	**-150 203**
Total cash used in operating activities		**-608 652**	**-1 826 197**
Cash flow from investing activities			
Purchase of non-current assets	5	-34 122	-25 417
Sale of non-current assets	5	0	11 127
Loans granted	13	0	-20 700
Repayments of loans granted		12 496	7 981
Purchase of short-term financial investments	3	-182 420	-446 797
Sale of short-term financial investments	3	180 740	353 580
Purchase of long-term financial investments	4	-742 171	-493 178
Sale of long-term financial investments	4	441 886	415 457
Dividends and interest received		40 427	46 480
Total cash flow from investing activities		**-283 164**	**-151 467**
Cash flow from financing activities			
Finance lease payments	12	0	-14 355
Issue of share capital	9	0	592 500
Covering of losses through monetary contributions	9	950 000	1 400 000
Issue of subordinated bonds	8	0	1 000 000
Redemption of subordinated bonds	8	0	-1 000 000
Total cash used in / cash flow from financing		**950 000**	**1 978 145**
Total cash flow		**58 184**	**481**
Cash and cash equivalents at beginning of the period	2	43 958	43 811
Change in cash and cash equivalents		**58 184**	**481**
Effect of exchange rate differences[1]		-511	-334
Cash and cash equivalents at the end of the period	2	**101 631**	**43 958**

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[1] In this line the effect of exchange rate differences of bank accounts is recorded

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Statement of changes in equity

(in euros)

	Share capital	Share premium	Other reserves	Accumulated loss	Total equity
Balance at 01.01.2010	**4 026 434**	**262 038**	**0**	**-1 717 955**	**2 570 517**
Share premium used to cover the loss for previous periods	0	-262 038	0	262 038	0
Issue of share capital	673 566	303 105	0	0	976 671
Net loss for financial year	0	0	0	-1 114 095	-1 114 095
Balance at 31.12.2010	**4 700 000**	**303 105**	**0**	**-2 600 012**	**2 403 093**
Balance at 01.01.2011	**4 700 000**	**303 105**	**0**	**-2 600 011**	**2 403 093**
Issue of share capital	400 000	192 500	0	0	592 500
Monetary contributions to cover losses	0	0	1 000 000	400 000	1 400 000
Other reserves used to cover losses	0	0	-1 000 000	1 000 000	0
Net loss for financial year	0	0	0	-2 016 633	-2 016 633
Balance at 31.12.2011	**5 100 000**	**495 605**	**0**	**-3 216 645**	**2 378 960**
Balance at 01.01.2012	**5 100 000**	**495 605**	**0**	**-3 216 645**	**2 378 960**
Covering the loss of previous periods	-1 100 000	-495 605	0	1 595 605	0
Monetary contributions to cover losses	0	0	0	950 000	950 000
Net profit for financial year	0	0	0	124 032	124 032
Balance at 31.12.2012	**4 000 000**	**0**	**0**	**-547 008**	**3 452 992**

More detailed information on share capital is provided in Note 9.

The Notes to these financial statements presented on pages 9 – 18 are an integral part of the Annual Report.

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Notes to the Financial Statements

Note 1 Accounting policies and measurement bases adopted in the preparation of the financial statements

1.1 General principles

The financial statements of AS LHV Varahaldus have been prepared in accordance with the accounting principles generally accepted in Estonia, whose main requirements are prescribed by the Accounting Act of the Republic of Estonia and that are supplemented by the guidelines issued by the Accounting Standards Board. The financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below. The financial statements are presented in euros.

1.2 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise deposits held at call with banks, as well as term deposits with original maturities of three months or less.

1.3 Shares and securities

Securities held for the purpose of trading are classified as short-term shares and other securities. Other long-term shares and securities include securities not expected to be sold within the next 12 months. Purchases of shares and securities are recognised at the settlement date.

Short and long-term investments in shares and other equity instruments are subsequently carried at fair value, if their fair value can be measured reliably. Shares and other equity instruments which fair value cannot be measured reliably are recognised at cost (that is acquisition cost less any impairment, when the carrying amount of the investment is not recoverable). Fund units are recognised at their NAV (net asset value). The fair value of listed securities (for which an active market exists) is their current bid price, For determining the fair value of investments that are not actively traded in the market, alternative methods such as the prices used in recent transactions (if they occur under active market conditions), the discounted cash flow model or the option pricing model are used.

Short-term and long-term financial investments in bonds and other debt instruments are recognised at fair value. The fair value is based on the quoted market price of a financial instrument.

The changes in the fair value of shares and other securities held for trading as well as those in the fair value of long-term financial investments are taken to profit or loss of the reporting period. To account for the purchases and sales of financial assets at fair value through profit or loss, the change in the value of assets to be acquired in the period between the transaction and balance sheet date is taken to profit or loss of the reporting period.

All financial investments in this annual report are accounted at fair value.

1.4 Trade receivables

All receivables (accrued income, loans granted and other short and long-term receivables) are carried at amortised cost. The amortised cost of the short- term receivables normally equals their cost value (less any impairment); therefore short-term receivables are stated in the balance sheet in their redemption value. Long-term receivables are initially recognised at the fair value of the consideration receivable and subsequently interest income is calculated on the receivable using the effective interest rate method. Receivables acquired for selling purposes are measured at fair value.

Impairment of trade receivables is accounted in case there is objective evidence that the estimated collections do not correspond to initial terms of contract. Such situations, that indicate possible downturn of value of trade receivables, are the buyers' bankruptcy or significant financial difficulties and inability to fulfil their obligations. Impairment of trade receivables (i.e. the need for allowance) is assessed individually of each specific debtor, on basis of estimated present value of future cash flows. The value of impairment loss of trade receivables is the difference between the carrying value of these receivables and present value of future cash flows, using effective interest rate method. The carrying value of trade receivables is reduced by the amount of impairment loss of receivables and loss from impairment is charged to the income statement as operating expenses. If the receivable is assessed to be irrecoverable, it is removed from the balance sheet. The collection of previously recognised impairment loss is reversed by adjusting the allowance account.

1.5 Tangible assets

Tangible assets are assets used in the operations of the Company 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 (inc. 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. An item of tangible assets is carried in the balance sheet at its cost less any accumulated depreciation and any impairment losses. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's net selling price and its value in use), it is written down immediately to its recoverable amount.

Items of tangible assets leased under the finance lease terms are accounted for similarly to acquired non-current assets.

Subsequent expenditures on tangible assets are accounted as non-current assets when it is probable that the company will gain future economic benefit from these assets and the cost of the asset can be measured reliably. Other repair and maintenance costs are recognised as expenses at their occurrence.

Depreciation is calculated on the straight-line basis. The annual depreciation rate for software is 33% and 20% for the equipment and machinery leased under the finance lease terms. Depreciation is commenced at the time when the asset can be used for the purpose intended by management and is terminated when the residual value exceeds the carrying amount, until the final removal of the asset from use or upon reclassification into "non-current assets held for sale". At each balance sheet date, the validity of depreciation rates, the depreciation method and the residual value is assessed. The accounting of an item of tangible assets is terminated when asset is sold or when no more economic benefits can be gained from use or sale of the asset. The gain or loss from disposal of non-current asset is recognised in income statement as other operating revenues or other operating expenses.

1.6 Intangible assets

An intangible asset is initially recognised at cost, comprising of its purchase price and any directly attributable expenditure. After initial recognition, an intangible asset is carried in the balance sheet at its cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets with indefinite useful lives (goodwill which arose in a business combination) are not subject to amortisation, but an impairment test is carried out at each balance sheet date to review their value. The impairment test on intangible assets that are amortised is carried out when there are indications that the value of the assets may have impaired. If their recoverable amount turns out to be lower than their carrying amount, they are written down to their recoverable amount. The recoverable amount of the asset is the higher of the fair value less costs to sell or its value in use. For the purpose of assessing impairment, the recoverable amount is assessed either for each individual asset or the smallest group of assets for which it is possible to distinguish cash flow. The impairment loss of assets is reported as expenses in the accounting period. The depreciation rate for intangible assets with definite useful lives is 33%.

1.7 Finance and operating leases

Leases of Tangible assets which transfer substantially all the risks and rewards incidental to ownership to the lessee are classified as finance leases. Other leases are classified as operating leases.

Finance leases are recognised in the balance sheet as assets and liabilities at the lower of the fair value of the leased asset and the present value of minimum lease payments. Each lease payment is apportioned between the finance charges (interest expense) and reduction of the outstanding liability. The finance cost (interest expense) is charged to the income statement over the lease period so as to achieve a constant periodic rate of interest on the remaining balance of the liability. The assets acquired under finance lease are depreciated similarly to purchased assets over the shorter of the useful life of the asset and the lease term. The costs identified as directly attributable to activities performed by the lessee for a finance lease are added to the amount recognised as an asset.

Leases of Tangible assets where all significant risks and rewards of ownership are not transferred to the lessee are classified as operating lease. Payments made under operating leases are charged to the income statement on a straight-line basis over the lease term.

1.8 Financial liabilities

All financial liabilities (supplier payables, accrued expenses, issued bonds and other short-term) are initially recorded at the acquisition cost that includes all transaction costs related to acquisition. After initial recognition, financial liabilities are measured at amortised cost.

The amortised cost of non-current financial liabilities normally equals their nominal value, therefore non-current financial liabilities are stated in the balance sheet at their redemption value. To calculate the amortised cost of long-term financial liabilities, they are initially recorded at fair value of the proceeds received (less transaction costs), taking into consideration the interest expense in following periods using effective interest rate method. Financial liabilities are classified as short-term, when their payment date is within 12 months after the balance sheet date or the Company does not have an unconditional right to postpone the settlement of the liability for later than 12 months after the balance sheet date. Borrowings that are due within 12 months after the balance sheet date, but that are refinanced after the balance sheet date but before the financial statements are authorised for issue as non-current, are recognised as short-term. Also, borrowings are classified as short-term that the lender could recall at the balance sheet date due to the breach of conditions set forth in the agreement.

1.9 Provisions and contingent liabilities

Commitments arising from an obligating event before the balance sheet date, which realisation time or amount are not certain, 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. Other possible or existing contingent obligations, for which it is not probable that an outflow of resources will be required to settle the obligation; or the amount of the obligation cannot be measured with sufficient reliability, are disclosed in the notes to the financial statements as contingent liabilities.

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1.10 Foreign currency transactions and assets and liabilities denominated in a foreign currency

All currencies, except for the euro (i.e. the functional currency of the Company) are considered as foreign currencies. Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary financial assets and liabilities and non-monetary financial assets and liabilities denominated in foreign currencies, which are measured at fair value, are translated into euros at the balance sheet date based on the foreign currency exchange rates of the European Central Bank. Profits and losses from foreign currency transactions are recognised in the income statement as income or expenses for that period.

Non-monetary assets and liabilities denominated in foreign currency (prepayments, non-current assets) are not revaluated on balance sheet date, but accounted continuously at the European Central Bank rate as of transaction date.

1.11 Revenues and expenses

Revenues and expenses have been recognised under the accrual basis of accounting. Revenue is recognised when the sold service has been provided and the risks and benefits have been transferred to the buyer and AS LHV Varahaldus has the right for the receivable. The management fees related to activities of investment funds are accounted during the period of providing services. Revenue arising from interest and dividends is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably. Interest income is recognised taking into account the effective interest rate. Dividends are recognised when the right to receive payment is established.

1.12 Corporate income tax

According to income tax legislation currently in force the profit for financial year of a company is not a subject for taxation. Income tax is paid for dividends, fringe benefits, gifts, sponsorship, guest admission expenses, expenses not related to business and transfer pricing corrections. From 1.01.2008 the distribution of retained earnings is subject to a dividend tax of 21/79 of net dividend paid. In certain circumstances the dividends received can be distributed forward without additional income tax expense. The corporate income tax related to dividend payments is accounted as liability and tax expense in income statement the same period the dividend is announced, no matter for which period the dividend is announced or when the dividend payment is actually carried out. The liability for income tax payment is on the 10 day of the next month of dividend payment.

Arising from individuality of taxation there are no differences related to tax calculations and book values of assets and derived from that also not deferred tax receivables or liabilities. Contingent tax liabilities, that would arise from dividend payments from retained earnings, are not accounted in balance sheet. The maximum tax liability, that would

1.13 Statutory reserve capital

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

Note 2 Cash and cash equivalents

	31.12.2012	31.12.2011
Bank accounts, except related parties	61 155	4 215
Account at AS LHV Pank (Note 13)	40 476	39 743
Total cash and cash equivalents	**101 631**	**43 958**

In 2012, the interests earned on bank accounts totals 308 euros (2011: 446 euros).

Note 3 Short term financial investments

	31.12.2012	31.12.2011
Shares	890	3 819
Bonds	1 000 260	902 017
Total at fair value through profit or loss	**1 001 150**	**905 836**

In 2012 and 2011, the total bond position was accounted for on the basis of market prices quoted in an active market.

Note 4 Long-term financial investments

	31.12.2012	31.12.2011
Units of pension funds	2 883 192	1 991 552
Units of investment funds	162 131	437 196
Total at fair value through profit or loss	**3 045 323**	**2 428 748**

In 2012, the units of pension funds under management were acquired in the total amount of EUR 742 171 (2011: EUR 493 178) and redeemed in the total amount of EUR 119 772 (2011: EUR 306 824). The acquisition cost of the units of pension funds recognised at fair value in the balance sheet is EUR 2 503 261. During the accounting period, the units of investment funds under management were redeemed in the total value of EUR 322 114. The units of investment funds were purchased at their nominal value and the total acquisition cost of these fund units is EUR 200 000. In 2011, LHV Emerging Europe Alfa Fund was liquidated and the units of the Fund were redeemed for EUR 108 633.

Note 5 Tangible and intangible assets

In 2008, the Company acquired a passenger car under the finance lease agreement for 34 054 euros
In July 2011, the passenger car was sold with the carrying value of 11 127 euros, see Note 12.

	Tangible assets		Intangible assets	
	Computer technology	Machinery and equipment	Licences	Goodwill
Carrying value at 31.12.2010	**4 499**	**15 078**	**0**	**0**
Changes occurred in 2011				
Purchased non-currents assets	0	0	25 417	0
Sold non-current assets at carrying value	0	-11 127	0	0
Depreciation/amortization	-2 198	-3 951	0	0
Balance at 31.12.2011				
Acquisition cost	17 182	0	0	0
Accumulated depreciation	-14 881	0	0	0
Carrying value	**2 301**	**0**	**25 417**	**0**
Changes occurred in 2012				
Purchased non-currents assets	3 495	0	30 627	0
Depreciation/amortization	-2 106	0	-17 930	0
Balance at 31.12.2012				
Acquisition cost	18 025	0	56 044	0
Accumulated depreciation	-14 335	0	-17 930	0
Carrying value	**3 690**	**0**	**38 114**	**0**

In 2011, computing equipment with the acquisition cost of EUR 2 652 was derecognised, with the residual value being zero, and a means of transport was sold at its residual value.

Note 6 Accounts payable

	31.12.2012	31.12.2011
Accounts payable (except related parties)	47 324	208 411
Liabilities to related parties (Note 13)	19 537	19 815
Total accounts payable	**66 861**	**228 226**

Note 7 Accrued expenses and other liabilities

	31.12.2012	31.12.2011
Payables to employees	66 119	41 308
Tax liabilities	44 415	55 084
incl. social security tax	25 263	17 691
incl. personal income tax withheld	14 324	10 540
incl. unemployment insurance premium	2 381	1 949
incl. contributions to mandatory pension	1 371	802
incl. corporate income tax	-24	1 937
incl. value-added tax	1 100	22 165
Total	**110 534**	**96 392**

Note 8 Subordinated liabilities

AS LHV Varahaldus has issued subordinated bonds to comply with the standards imposed by law on the management company's own funds. In 2008 and 2010, the bonds were purchased by parent company AS LHV Group. The interest rate of bonds issued in 2008 was higher, because bonds were issued then to cover the financial losses that were created under the conditions of the financial crisis. The bonds issued in 2010 and 2011 were aimed at covering losses arising from an increase in the market share through the active marketing activities. In 2011, the bonds issued to the parent company were repurchased and, in place of them, new bonds were issued that were acquired by an independent party. The underlying currency of subordinated bonds is the euro and the maturity date of bonds is seven years.

Subordinated bonds	Interest rate	Amount
Issue in 2008	16%	800 000
Redemption in 2009		-200 000
Balance at 31.12 2009		**600 000**
Issue in 2010	10%	400 000
Balance at 31.12 2010		**1 000 000**
Issue in 2011		-1 000 000
Redemption in 2011	11,65%	1 000 000
Balance at 31.12 2011		**1 000 000**
Balance at 31.12 2012		**1 000 000**

No bonds were issued or redeemed in 2012. As at 31.12.2012, the amount due of subordinated loans with maturities of 1 to 5 years was 0 euros (31.12.2011: 0 euros) and that of loans with maturities of more than 5 years was 1 000 000 euros (31.12.2011: 1 000 000 euros).

Interest expenses on subordinated loans in the amount of 116 819 euros are included within interest expenses in the income statement (2011: 132 351 euros). In the balance sheet, the current portion of non-current liabilities includes an interest payable in the amount of 102 148 euros (31.12.2011: 65 328 euros).

Note 9 Own funds

	31.12.2012	31.12.2011
Share capital (in euros)	4 000 000	5 100 000
Issued shares (pcs)	4 000 000	5 100 000
Nominal value of shares	1	1

In 2011, the share capital was increased. 400 000 new shares were issued, including 150 000 shares with a price of 1,45 euros and 250 000 shares with a price of 1,50 euros. The increase of share capital was paid in cash and in the total amount of 592 500 euros.

In 2012, the share capital in the amount of 1 100 000 euros was used to cover the loss for previous periods.

The Company's own funds consist of:	31.12.2012	31.12.2011
Tier 1 own funds	**3 290 846**	**2 353 543**
Share capital, incl. share premium	4 000 000	5 595 605
Accumulated losses	-671 040	-1 200 012
Net profit/loss for the financial year	0	-2 016 633
Intangible assets	-38 114	-25 417
Tier 2 own funds	**1 000 000**	**1 000 000**
Subordinated fixed-term liabilities	1 000 000	1 000 000
Total own funds	**4 290 846**	**3 353 543**

Note 10 Fee income

	2012	2011
Pension fund management (note 13)	3 605 644	2 197 694
Investment fund management (note 13)	98 716	126 336
Fund issue and redemption fees	99 972	52 658
Total	**3 804 332**	**2 376 688**

In the financial year and in 2011, the Company's services were rendered only in Estonia.

Note 11 Operating expenses

	2012	2011
Marketing expenses	2 422 510	2 765 013
Advertising expenses	25 774	113 756
Other purchased services	280 738	238 274
Office expenses	65 604	66 605
Depository fees	274 109	178 027
Registration fees	91 424	94 332
Supervision and guarantee fees	39 704	34 161
Legal consultations and audit	25 193	26 233
Communication costs	8 639	28 131
Travel and training cots	10 582	16 730
Transport expenses	19 294	23 505
Bank services, management and transaction fees	2 132	2 075
IT expenses	121 836	20 553
Total operating expenses	**3 387 539**	**3 607 395**

In the reporting period, the wages and salaries of employees totalled EUR 388 000 (2011: EUR 290 290) and the average number of employees was 29 (2011: 26), of whom 15 worked part-time. Employment contracts signed with employees only provide for payment of fixed wages and salaries. The Company has not established principles for other type of remuneration. The amount of management remuneration is disclosed in Note 13.

In the calculation of minimum requirements of the pension fund manager´s own funds for covering the general expenses, fixed general expenses also include the depreciation of non-current assets and other operating expenses that are reported in the income statement under a separate item.

Note 12 Finance and operating lease

The Company leases passenger cars and office space under the operating lease terms and leased a passenger car under the finance lease terms. In the reporting period, the rent for the office space in the total amount of 50 439 euros (2011: 48 499 euros) and rent for passenger cars in the total amount of 15 188 euros (2011: 18 754) were recognized under other operating expenses in the income statement. Interest expenses in the amount of 1 804 euros (2011: 1 162 euros) arising from payment of financial and operating lease instalments are recognized under interest expenses in the income statement. In 2011, principal payments of the finance lease totalled 14 355 euros and they are recognized as a deduction of financial lease liabilities. The finance lease agreement was terminated in July 2011 upon the consent of both parties.

All lease agreements are cancellable upon the consent of both parties. The minimum amount of unilaterally cancellable agreements in the subsequent periods is 25 530 euros (2011: 39 310 euros), the current portion of which is 10 848 euros (2011: 10 848 euros) and the non-current portion is 14 682 euros (2011: 28 462 euros).

Note 13 Related party transactions

For the purpose of preparation of the annual report of AS LHV Varahaldus, the related parties include:

- owners (parent company and owners of the parent company);
- other subsidiaries and associates of the parent company;
- members of the Management Board, manager of the internal audit department and the entities under their control (together referred to as management);
- members of the Supervisory Board
- close relatives of the persons mentioned above and the companies related to them;
- funds managed by LHV Varahaldus

As at 31.12.2012, the owner of AS LHV Varahaldus was AS LHV Group (ownership interest: 100%).
AS LHV Varahaldus conducted transactions with managed funds in the following amounts (see also Note 4):

Management fees	**Revenues 2012**	**Receivable as at 31.12.2012**	**Revenues 2011**	**Receivable as at 31.12.2011**
Pension funds (note 10)	3 605 644	364 578	2 197 694	217 648
Investment funds (note 10)	98 716	7 956	126 336	8 860
Total	**3 704 360**	**372 534**	**2 324 030**	**226 508**

In 2012, LHV pension and investment funds were repaid the management fees and commissions in the total amount of EUR 31 377 (2011: EUR 29 212).

As at 31.12.2012, AS LHV Pank's (LHV's) account held demand deposits in the amount of EUR 40 476 (31.12.2011: EUR 39 743), see also Note 2.

In 2012 the rental, advertising and administrative services were purchased from LHV in the total amount of EUR 184 327 (2011: EUR 182 178). The expenses are included in the income statement under the other operating expenses. As at 31.12.2012, the balance sheet includes a payable to LHV in the amount of EUR 18 313 (31.12.2011: EUR 19 815). In 2012, the advertising, training and consultation services were sold to LHV in the total amount of EUR 26 000 (2011: EUR 34 848).

As registrar, LHV mediated to AS LHV Varahaldus subscription and redemption fees of LHV World Equities Fund and LHV Persian Gulf Fund in the amount of EUR 10 121. In 2011, subscription and redemption fees of investment funds were paid directly to the funds.

In 2011, the subordinated bonds were repurchased from parent AS LHV Group. In 2011, the interest expense amounted to EUR 26 937. In 2012, no bonds were issued nor redeemed.

In 2012, the parent AS LHV Group made a contribution to the equity reserves of AS LHV Varahaldus in the amount of EUR 950 000, of which EUR 500 000 was used in June 2012 and EUR 450 000 was used in November 2012 to cover the losses of previous periods. In 2011, the parent made a contribution in the amount of EUR 1 400 000 that was used in December 2011 to cover the loss of previous periods.

The Company has signed contracts with the members of the Management Board, which do not provide for severance benefits upon termination of the contract. In any matters not regulated by the contract, the parties adhere to the procedure specified in the legislation of the Republic of Estonia. In the reporting period, the members of the Management Board were paid total remuneration of EUR 83 962 (2011: EUR 56 373). Supervisory Board member remunerations were not paid. Members of the Supervisory Board with an employment contract were paid the total remuneration of EUR 38 086 (2011: EUR 20 040). As at 31.12.2012, the payables to members of the Management Board totalled EUR 5 521 (31.12.2011: EUR 10 482). As at 31.12.2012, payables to members of the Supervisory Board total EUR 9 751 (31.12.2011: EUR 1 552).

In 2012 and 2011, no impairments were made with regard to receivables from the related parties.

Note 14 Contingent liabilities

Tax authorities have the right to review to 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 Company's management estimates that there are not any circumstances which may lead tax authorities to impose additional taxes on the Company.

LHV

Signatures of the Management Board to the 2012 Annual Report

The Management Board has prepared the management report and the financial statements of AS LHV Varahaldus for the financial year ended on 31 December 2012. The financial statements present a true and fair view of the financial position, the results of operations and the cash flows of the Company.

15.04.2013

Members of the Management Board:

Mihkel Oja /signed/

Kerli Lõhmus /signed/

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

To the Shareholder of AS LHV Varahaldus

We have audited the accompanying financial statements of AS LHV Varahaldus (the Company), which comprise the balance sheet as of 31 December 2012 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in Estonia, and for such internal control as the Management Board determines is necessary to enable the preparation of 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 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 financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with accounting principles generally accepted in Estonia.

AS PricewaterhouseCoopers

/signed/	/signed/
Tiit Raimla Auditor's Certificate No.287	Erki Mägi Auditor's Certificate No.523

15 April 2013

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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.*

Profit allocation proposal

The Management Board of AS LHV Varahaldus proposes to the General Meeting of Shareholders to allocate the net profit for financial year ended 31 December 2012 as follows:

Transfer to statutory reserve capital	6 206 euros
Transfer to accumulated losses	117 826 euros

Signatures of the Supervisory Board to the Annual Report

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

24.04.2013

Chairman of the Supervisory Board:

Andres Viisemann /signed/

Members of the Supervisory Board:

Rain Lõhmus /signed/

Erki Kilu /signed/

The revenue of AS LHV Varahaldus according to EMTA classificator

EMTAK	Field of activity	2012	2011
66301	Fund management	3 830 582	2 402 691
	Total	**3 830 582**	**2 402 691**

Report of compulsory pension funds' management

(in euros)	**2012**
Fee income	**3 648 871**
Management fees	3 564 609
Redemption fees	84 262
Fee expenses	**-465 468**
Depositary fees	-274 109
Registrar fees	-132 127
Other fee expenses	-59 232
incl. other fee expenses to related parties	-23 904
Personnel and operating expenses	**-3 364 141**
Wages and salaries	-505 917
Supervisory fees	-37 719
Guarantee Fund fees	-73 026
Marketing and advertising fees	-2 436 374
Other operating expenses	-311 105
incl. other operating expenses to related parties	-772
Other income and expenses	**-5 097**
Operating profit/loss	**-185 835**
Financial income and expenses	**310 141**
Net profit/loss for the financial year	**124 306**

Report of compulsory pension funds' management is composed according to accounting policies and procedures of AS LHV Varahaldus. In the calculation of income and expenses related to compulsory pension funds' management are recognized in accordance with fund manager's income and expenses in the related income statement. Direct costs of compulsory pension funds' management are calculated using the direct method. Indirect costs are allocated proportionally according to the volume of assets. Costs not related to compulsory pension funds' management are eliminated.