AS Lõhmus, Haavel & Viisemann

2005 Annual Report

(Translation from Estonian original)

AS Lõhmus Haavel & Viisemann

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Reg.no 10 53 95 49

Annual Report for 01.01.2005.-31.12.2005

Business name	AS Lõhmus, Haavel & Viisemann
Commercial Registry no.	10 53 95 49
Legal address	Tartu mnt 2, Tallinn 10145
Phone	(372) 6 800 401
Fax	(372) 6 800 410
Main activity	Investment banking and securities brokerage
Management Board	Rain Tamm
	Andres Viisemann
Supervisory Board	Tarmo Jüristo
	Tõnis Haavel
	Maili Kalmus
Auditor	AS PricewaterhouseCoopers

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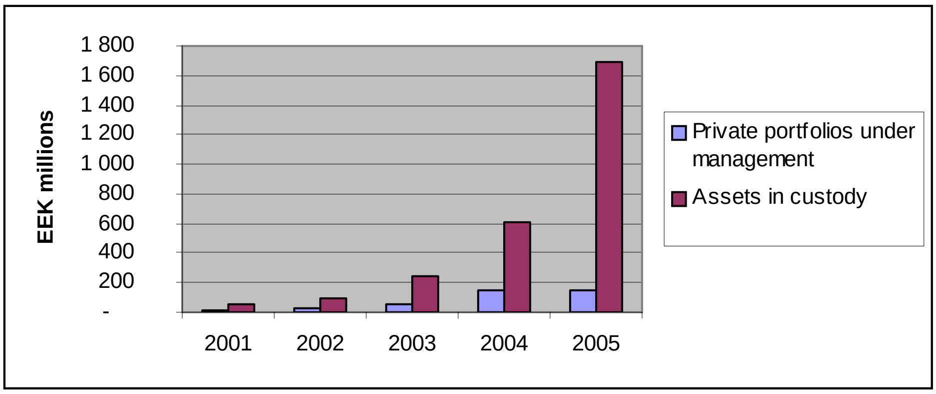
Management report for 2005

The year 2005 presented various challenges and experiences for AS Lõhmus Haavel & Viisemann (LHV) – both significant successes as well as painful setbacks. The growth of core activities and development of new areas led to the Company's restructuring in the summer of 2004. The Company which had offered a wide spectrum of investment banking services became a company focusing on securities brokerage and portfolio management. The departments of Corporate and structured finance were transferred to the newly established sister company AS LHV Financial Advisory Services at 1 July 2004.

The first 10 months of the year were the most successful months ever for the Company with regard to securities brokerage and portfolio management. In the last months of 2004, these areas had achieved a major breakthrough and a level was reached at which revenue consistently exceeded operating expenses. In 2005, the number of customers, turnover and operating profit increased from month to month. The total turnover of 2005 amounted to over 38 million kroons as compared to 29 million kroons in 2004. Despite extraordinary legal costs, the net profit for 2005 reached almost one million kroons. This success is attributable to the favourable climate prevailing in the world's stock exchanges as well as the Company's more dynamic marketing activities. Total assets under custody reached almost 1.7 billion kroons, increasing by 1.8 times during the year. The growth of private portfolios managed by the Company remained modest, increasing by 2% during the year. Total assets of private portfolios under management reached 151 million kroons at the end of 2005. The number of customers increased by 25% during the year, reaching approximately five thousand by the end of the year.



In 2005, equities in almost all markets had significantly higher returns than bonds. The stock exchanges of the Arab countries, Eastern Europe and Latin America had the highest growth. The main equity indices increased by more than 20% in Europe. The European small cap companies had even higher returns. The stock exchanges of the Baltic countries also increased significantly in the first half of the year. The key event of the Estonian and the whole Baltic securities market was the departure of Hansapank from the stock exchange. However, for the first time in several years, three new companies were listed in Tallinn Stock Exchange – Tallinna Vesi, Starman and Tallink Grupp. LHV acted as a co-writer of the initial public offering for the first two of those companies.

The year 2005 brought along an important strategic change for LHV. LHV started to offer services to international financial institutions and expanded its securities brokerage to Lithuania. Also, preparations were started for opening the Latvian operations. One of the most important steps in this process was establishment of a fundamental research department for the equities of the Baltic countries. The goal was to create a team offering overviews and fresh ideas both to international financial institutions as well as local investors. Last year, the first institutional customers were obtained. At the year-end, LHV employed 36 people, 56% more than last year.

Management report for 2005 (continues)

At 1 November 2005, LHV learned that on the basis of its charges, the Securities Exchange Commission of the United States of America (SEC) had frozen all customer accounts of AS LHV in the US. The Company and two of its former employees were accused of using insider information in the market. AS LHV started to decisively solve the case and cooperated with regulatory bodies of both the US and Estonia in order to protect the interests of its customers. At the end of the year, majority of the customer accounts were unfrozen and the normal operations of the Company were restored. By the time of authorising the financial statements we are very close to reaching an out-of-court settlement with the SEC, which would enable to close the matter for LHV in the near future.

LHV has a positive stance towards the world economic development and believes that the fast growth of the Baltic countries will continue this year. The team of LHV strives at offering interesting investment ideas to its customers both from nearby and far away.

The strategic goal of LHV is to offer high quality investment services in all Baltic countries available to many people. LHV strives at making the investment process interesting and useful for its clients.

In the reporting period, employee wages and salaries amounted to 5.5 million kroons and remuneration and other benefits and compensations paid to the Management Board amounted to 1.5 million kroons.

Financial statements

Management Board's declaration

The Management Board confirms the correctness and completeness of the 2005 financial statements of AS Lõhmus, Haavel & Viisemann presented on pages 6-32.

The Management Board confirms that:

- the financial statements have been compiled in accordance with International Financial Reporting Standards as adopted in the European Union;
- the financial statements present a true and fair view of the Company's financial position, the results of operations and its cash flows;
- AS Lõhmus, Haavel & Viisemann is a going concern.

		Date	Signature
<u>Management Board:</u>			
Member of the Management Board	Andres Viisemann	20.06.2006	*/signed/*
Member of the Management Board	Rain Tamm	20.06.2006	*/signed/*

Balance sheet

(In thousand Estonian kroons)	Note	31.12.2005	31.12.2004
Assets			
Cash and bank	4	30 497	7 031
Trading portfolio	5	884	394
Derivatives	6	0	215
Loans to clients	7	11 710	8 555
Other receivables from customers		532	973
Investment portfolio			
- at fair value through profit or loss	8	828	6 300
- available for sale	8	0	997
Other receivables and assets	9	3 277	8 539
Receivables related to the Group's restructuring	10	0	26 015
Investments into subsidiaries	11	40	40
Property, plant and equipment and intangible assets	12	1 090	1 602
Total assets		**48 858**	**60 661**
Liabilities			
Derivatives	6	117	0
Loans received	13	14 000	440
Other liabilities	14	10 475	12 617
Accrued expenses	15	2 875	1 220
Tax liabilities	16	836	699
Provisions	17	5 430	0
Total liabilities		**33 733**	**14 976**
Shareholders' equity			
Share capital	18	12 600	30 000
Share premium		0	454
Reserves		1 518	1 046
Retained earnings		1 007	16 065
Treasury shares	18	0	-1 880
Total shareholders' equity		**15 125**	**45 685**
Total liabilities and shareholders' equity		**48 858**	**60 661**

Income statement

(In thousand Estonian kroons)	**Note**	**2005**	**2004**
Fee and commission income	22	38 594	29 378
Fee and commission expense	22	-20 765	-8 224
Net fee and commission income		**17 829**	**21 154**
Interest income	23	3 022	2 092
Interest expense	23	-194	-157
Net interest income		**2 828**	**1 935**
Net profit/loss from trading	24	1 327	267
Net profit/loss from investment securities	24	763	595
Dividend income	24	30	454
Net profit/loss from securities		**2 120**	**1 316**
Operating expenses	25	-27 885	-18 969
Impairment of loans and receivables		0	-65
Other income	26	7 316	4 225
Operating profit		**2 208**	**9 596**
Profit/ loss from shares of subsidiaries	11	0	-278
Profit/ loss from shares of associates	11	0	-280
Profit before income tax		**2 208**	**9 038**
Corporate income tax expense	27	-1 251	-475
Net profit for the financial year		**957**	**8 563**

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Kuupäev/date 22.06.06
PricewaterhouseCoopers, Tallinn

Cash flow statement

(In thousand Estonian kroons)	Note	2005	2004
Cash flows from operating activities			
Fee and commission income received		45 779	31 993
Fee and commission, operating and other expenses paid		-41 884	-28 420
Interest received		3 184	2 030
Interest paid		-117	-154
Settlement of foreign currency forward contracts	19	-81	389
Net acquisition/disposal of trading portfolio		-642	-128
Change in loans granted	7	-3 155	-1 205
Change in other liabilities		8 285	-7 463
Increasing of the stock exchange security deposit		-1 110	-71
Corporate income taxpaid on dividends	27	-1 251	-475
Freezing of cash and bank accounts	4	-4 591	0
Total cash flows from operating activities		**4 417**	**-3 504**
Non-current assets acquired	12	-318	-695
Purchase of investment securities		-473	-1 627
Sale of investment securities		7 916	3 907
Paid for the acquisition of associates	11	-8 229	0
Proceeds from sale of associates	11	7 480	0
Paid for acquisition of subsidiaries	11	0	-4 578
Proceeds from sale of investments related to restructuring	10	26 015	0
Dividends received from investment securities	24	23	418
Total cash flows from operating activities		**32 414**	**-2 575**
Treasury shares purchased	18	-27 554	-430
Treasury shares sold		0	1 925
Loans received	19;13	19 000	440
Loan repayments	19;13	-5 440	-1 280
Dividends paid	27	-3 962	-1 353
Total cash flows from financing activities		**-17 956**	**-698**
Total cash flows		**18 875**	**-6 777**
Cash and cash equivalents at beginning of the period	4	7 031	13 808
Cash and cash equivalents at end of the period	4	25 906	7 031
Net increase/decrease in cash and cash equivalents		**18 875**	**-6 777**

Statement of changes in shareholders' equity

(In thousand Estonian kroons)	Share capital	Share premium	Treasury shares	Statutory reserve	Exchange rate differences	Retained earnings	Total
Balance as at 01.01.2004	**30 000**	**206**	**-3 127**	**675**	**-269**	**9 226**	**36 711**
Transfer to statutory reserve	0	0	0	371	0	-371	0
Dividends paid	0	0	0	0	0	-1 353	-1 353
Treasury shares repurchased	0	-177	-253	0	0	0	-430
Sale of repurchased treasury shares	0	425	1 500	0	0	0	1 925
Realisation of unrealised exchange rate differences	0	0	0	0	269	0	269
Net profit for 2004	0	0	0	0	0	8 563	8 563
Balance as at 31.12.2004	**30 000**	**454**	**-1 880**	**1 046**	**0**	**16 065**	**45 685**
Transfer to statutory reserve	0	0	0	472	0	-472	0
Dividends paid	0	0	0	0	0	-3 964	-3 964
Treasury shares repurchased	0	0	-27 554	0	0	0	-27 554
Cancellation of treasury shares and decreasing of share capital	-17 400	-454	29 433	0	0	-11 579	0
Net profit for 2005	**0**	**0**	0	0	0	957	957
Balance as at 31.12.2005	**12 600**	**0**	**0**	**1 518**	**0**	**1 007**	**15 125**

More detailed information is provided in Note 18.

Notes to the financial statements

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

Basis of preparation

The financial statements of AS Lõhmus, Haavel & Viisemann (LHV) for the financial year 2005 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. These financial statements are the first financial statements prepared in accordance with IFRS as adopted in the European Union. A detailed overview of the transition to IFRS, amendments to accounting policies and their effect is presented in Note 3.

Until the end of 2004, LHV prepared its financial statements in accordance with the accounting principles generally accepted in Estonia. The generally accepted accounting principles in Estonia do not differ substantially from IFRS. In accordance with the requirements of standards, additional disclosures are presented in the notes to the financial statements. In conjunction with the transition to IFRS, the presentation of the balance sheet and the income statement has been amended, providing a better overview of the income received from core operations as well as assets and liabilities. The comparative data for 2004 has been restated to correspond to new presentation.

The financial statements have been prepared under the historical cost convention, except as disclosed in the accounting policies below. The accounting policies below have been consistently used for all periods presented in the financial statements, except for certain cases that have been disclosed separately.

The financial year started at 1 January 2005 and ended at 31 December 2005. The financial figures have been presented in thousands of Estonian kroons unless referred differently.

In 2004, the corporate structure of LHV was changed. The departments of corporate finance and structured finance (investment products) were brought under separate management and legal company – AS LHV Financial Advisory Services (LHV FAS). Other long-term investments were transferred to the new holding company AS LHV Group. LHV retained its 100% holding in LHV Ilmarise Kinnisvaraportfelli OÜ. From 01.07.2004 AS Lõhmus, Haavel& Viisemann offers to its customers mostly investment services and management of private portfolios. More detailed information on restructuring is presented in Note 10.

Consolidation

In 2005, LHV has not prepared consolidated financial statements as its 100% parent company AS LHV Group prepares and discloses consolidated audited financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union. The consolidated financial statements of AS LHV Group will be available from 01.07.2006 at the Company's main office located at Tartu mnt.2, Tallinn.

Subsidiaries

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 an enterprise 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). According to the purchase method, the assets and liabilities of the acquired subsidiary are recognised at their fair values and the difference between the cost of acquisition and the fair value of the net assets of the acquired subsidiary is recorded as goodwill. Goodwill is not amortised, but an annual impairment test is performed for goodwill. Subsidiaries are accounted for under the cost method.

Associates

An associate is an enterprise over which the Group has significant influence, but which it does not control. Significant influence is generally presumed to exist when the Group holds between 20% and 50% of the voting power of the associate. Investments in associates are accounted for under the cost method of accounting.

Functional and presentation currency

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

Foreign currency transactions and assets and liabilities denominated in foreign currencies

Foreign currency transactions are recorded based on the foreign currency exchange rates of the Bank of Estonia prevailing at the dates of the transactions. Monetary financial assets and liabilities and non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies as at the balance sheet date are translated into Estonian kroons based on the foreign currency exchange rates of the Bank of Estonia prevailing at the balance sheet date. Profits and losses from foreign currency transactions are recognised in the income statement as income or expenses of that period.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, term deposits with original maturities of three months or less, and money-market fund shares.

Investments

Depending on the purpose of acquisition, the Company classifies its financial assets into the following categories:

- Financial assets at fair value through profit or loss;
    - Trading portfolio
    - Investment portfolio at fair value through profit or loss at acquisition;
- Loans and receivables
- Held-to-maturity investments of the investment portfolio;
- Available-for-sale assets, which include the investments in the investment portfolio, whose fair value cannot be determined reliably and which are reported at cost (less any impairments).

The purchases and sales of financial investments are recognised on the settlement date in the balance sheet. In the accounting period, the Company has not classified any of its financial assets as "held-to-maturity investments".

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading purposes (i.e. a financial asset acquired or incurred principally for the purpose of reselling or repurchasing in the near term or a derivative financial instruments which is not designated as a hedging instrument) and other financial assets which have been designated as at fair value through profit or loss at initial recognition. Financial assets at fair value through profit or loss are initially recognised at cost, which is the fair value of the consideration received from or paid for the financial investment (excluding transaction costs). After initial recognition, financial assets in this category are measured at fair value. Changes in fair values of these assets are recognised consistently, either as a profit or loss in the income statement of the accounting period.

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

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition, the Company recognises loans and receivables at amortised cost (less principal payments and any potential impairments, if necessary), calculating interest income on the receivable in subsequent periods using the effective interest rate method.

When it is probable that the Company is unable to collect all amounts due as per the terms of receivables, a provision is set up for the impairment of these receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount. The recoverable amount is the expected future cash flows discounted at the market rate of interest for similar borrowers. The collection of each specific receivable is assessed on an individual basis, taking into consideration all known information on the solvency of the debtor. Any impairment losses are charged to the income statement. Doubtful receivables are written down in the balance sheet to the collectible amount. Irrecoverable receivables are removed from the balance sheet.

Trade receivables

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. The assets are written down due to impairment if there is objective evidence that the Company is unable to collect all amounts due as per the terms of receivables. Such situations may be the buyers' financial difficulties, bankruptcy or inability to fulfil their obligations to the Company. The amount of the impairment is the difference between the carrying amount and the recoverable amount, which is calculated as expected future cash flows discounted at the market rate of interest of similar borrowers.

Derivative financial instruments

Derivative financial instruments (futures, forward, swap and option contracts) are recognised in the balance sheet at fair value. Profits and losses from derivatives are recognised as income or expense of the period in the income statement. The Company does not use hedge accounting to account for its derivative financial instruments.

Property, plant and equipment

Property, plant and equipment are non-current assets used in the operating activities of the Company with a useful life of over one year. An item of property, plant and equipment is initially recognised at its cost which consists of the purchase price (incl. customs duties and other non-refundable taxes) and other expenditures directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. An item of property, plant and equipment is carried in the balance sheet at its cost less any accumulated depreciation and any accumulated 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. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers is 33%, for office furniture and for fixtures it is 33% and for improvements of rental space it is the lower of 15% and the lease term.

Intangible assets

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%.

Financial liabilities

All financial liabilities (supplier payables, borrowings, accrued expenses and other borrowings) are initially recognised at cost which is the fair value of the consideration receivable for financial liabilities and which also includes all transaction costs incurred. After initial recognition, financial liabilities are measured at amortised cost.

The amortised cost of the short-term liabilities normally equals their nominal value; therefore short-term liabilities are stated in the balance sheet in their redemption value. The amortised cost of long-term liabilities is calculated using the effective interest rate method. Financial liabilities are classified as current when they are due within twelve months after the balance sheet or if the Company 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. Borrowing costs are expensed in the period in which they are incurred.

Payables to employees

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

Provisions

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

The Company has set up a provision for all legal disputes and potential legal disputes yet to come, for which the binding liability has arisen from the occasion occurred before the balance sheet date and the dispute is likely to result in certain expenses and such potential expenses can be determined reliably.

Contingent liabilities

Promises, guarantees and other commitments that in certain circumstances may become obligations, but 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.

Revenue and expenses

Revenue and expenses are accounted for using the accrual basis of accounting. Fee and commission income (incl. custody and portfolio management fees) are recognised after the service has been provided and the Company has a right of claim to the receivable. 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 of the effective interest rate, except if the receipt of interest is uncertain. In such cases interest income is accounted for on a cash basis. Dividend income is recognised when the legal right to receive dividends is established.

Asset management

The Company is engaged in providing asset management services. Such assets that have been given to the Company to manage by third parties and that the Company 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.

Finance and operating leases

Leases of property, plant and equipment where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases. In the financial year, the Company did not have any finance lease agreements. Payments made under operating leases are charged to the income statement on a straight-line basis over the lease term.

Deferred income tax

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

Offsetting

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

Statutory reserve

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

New International Financial Reporting Standards and interpretations of the International Financial Reporting Interpretations Committee (IFRIC)

By the time of preparing these financial statements, new International Financial Reporting Standards and their interpretations have been published which will become mandatory for the Group from 1 January 2006 and which the Company has not adopted early. The following IAS amendments affect the Company:

IAS 1 (Amendment) - Presentation of Financial Statements: Capital Disclosures which is effective from 1 January 2007 or later. The standard requires additional disclosures in the financial statements.

IFRS 7 Financial Instruments: Disclosures and supplementary annex IAS 1, Presentation of Financial Statements, which is effective from 1 January 2007. IFRS 7 introduces new requirements for the notes in order to improve the presentation of information in the financial statements. This requires presentation of qualitative and quantitative information on the risks arising from financial instruments, containing specific minimum requirements for credit risk, liquidity risk and market risk (incl. sensitivity analysis of market risk). This replaces standard IAS 30, Disclosures in the Financial Statements and Other Financial Institutions and IAS 32 Financial Instruments: Disclosure and Presentation. This standard is effective for all companies preparing their financial statements in accordance with International Financial Reporting Standards. The revision to IAS 1 presents additional requirements for the Company’s capital and capital management. The Company's considers the adoption of this revision.

The Company's management is of opinion that the amendments to and revisions of the following standards do not have a significant effect on the financial statements of the Company:

IAS 19 (revision) – Employee Benefits

IAS 21 (amendment) - The Effects of Changes in Foreign Exchange Rates

IAS 39 (revision) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions

IAS 39 (revision) – Fair Value Option

IAS 39 and IFRS 4 (revision) – Financial Guarantee Contracts

IFRS 6 - Exploration for and Evaluation of Mineral Resources

IFRIC 4 – Determining Whether an Arrangement Contains a Lease

IFRIC 5 – Right to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

IFRIC 6 – Liabilities arising from Participating a Specific Market – Waste Electric and Electronic Equipment

IFRIC 7 – Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Environments

IFRIC 8 – Share-based Compensations as defined in IFRS 2

IFRIC 9 – Reassessment of Embedded Derivatives.

Note 2. Significant management decisions and estimates

In accordance with IFRS, several financial figures presented in the financial statements are based on management's estimates, which will affect the assets and liabilities presented in the financial statements during the next financial year. Although these estimates have been made to the best of management's knowledge, they may not coincide with subsequent actual results.

Management's estimates have primarily been applied to recognising impairment losses of loans, receivables and investments, determining useful lives of non-current assets and assessing contingent receivables and liabilities. In the current financial year, the most important of them was the setting up of a provision relating to the court proceedings started by the US Securities and Exchange Commission. Detailed information on this case is provided in Note 17.

Changes in management's estimates are reported in the income statement of the period in which the change occurred.

Note 3. Transfer to IFRS and the effect on the financial statements

These financial statements are the first financial statements prepared in accordance with IFRS. The requirements of IFRS 1 "First-time Adoption of International Financial Reporting Standards" have been used as the basis. The transition date is 1.01.2004 and the adoption date is 1.01.2005. Upon the transfer to IFRS, the Company has used the following exception allowed by IFRS "First-time Adoption of International Financial Reporting Standards":

a) business combinations – the Company has used this exception and has not adjusted business combinations set up before 1.01.2004;

The remaining allowed exceptions were either not relevant for LHV or they have not been applied.

IFRS 1 also sets out four mandatory exceptions, which LHV has followed.

a) derecognition of financial assets and financial liabilities – the Company has not retrospectively recognised financial assets or financial liabilities in the balance sheet, which had been derecognised before the transfer date;
b) hedge accounting – the Company does not use hedge accounting;
c) exception regarding estimates – in the IFRS financial statements, the Company has used the same estimates as at 1.01.2004 as the ones used to prepare the financial statements in accordance with the generally accepted accounting principles of Estonia as at 1.01.2004.;
d) assets held for sale and discontinued operations – the Company applies IFRS 5 retrospectively from 1.01.2005.

At 01.01.2004, in accordance with the requirements of IFRS, subsidiaries and associates were remeasured at cost, by eliminating the profits and losses arised from the equity method of accounting in previous periods (see the table below). As a result of this adjustment, investments into subsidiaries as at 01.01.04 increased by 264 thousand kroons and investments into associates increased by 618 thousand kroons in the opening balance of IFRS as compared to the report prepared in accordance with the generally accepted accounting principles of Estonia. Retained earnings increased respectively by 882 thousand kroons.

As all investments presented in the table below were sold during 2004, the proceeds from the sale of subsidiaries and associates is 882 thousand kroons lower in the income statement prepared in accordance with IFRS as compared to the income statement prepared in accordance with the accounting principles generally accepted in Estonia in 2004. The sales profit of subsidiaries is respectively 264 thousand kroons lower and the sales profit of associates is 618 thousand kroons lower. The transfer to IFRS did not result in any other effects and adjustments.

	Carrying amount according to generally accepted accounting principles (equity method)	**IFRS adjustments**	**Carrying amount in the opening balance of IFRS (at cost)**
	31.12.2003		**01.01.2004**
Investments into subsidiaries			
AS NEV Media	409	-9	400
Online Kauplemissüsteemid OÜ	41	-1	40
AS LHV Arbitrage	400	0	400
AS LHV Latvia	3 579	274	3 853
Total	**4 429**	**264**	**4 693**
Investment into associates			
AS LHV- Seesam Varahaldus	8 232	618	8 850
OÜ Consolidated Auctions	1	0	1
Total	**8 233**	**618**	**8 851**
Total subsidiaries and associates	**12 662**	**882**	**13 544**

Note 4. Cash and bank

	31.12.2005	**31.12.2004**
Cash and cash equivalents		
Demand deposits	2 723	7 031
Other receivables from financial institutions (up to 3 months) (Note 17)	23 183	0
Total cash and cash equivalents	**25 906**	**7 031**
Other receivables from financial institutions (over 3 months) (Note 17)	4 591	0
Total cash and bank	**30 497**	**7 031**

Note 5. Trading portfolio

	31.12.2005	**31.12.2004**
Shares	534	153
Fund units	350	241
Total trading portfolio	**884**	**394**

Note 6. Derivatives

	Balance sheet receivable/ (liability)	Contractual amount as off-balance sheet asset	Contractual amount as off-balance sheet liability
As at 31.12.2005			
Foreign currency forward contracts	-117	27 082	27 199
Total derivatives	**-117**	**27 082**	**27 199**
As at 31.12.2004			
Foreign currency forward contracts	215	4 976	4 761
Total derivatives	**215**	**4 976**	**4 761**

The foreign currency forward contracts of AS LHV have been concluded in US dollars, Lithuanian litas and Swedish kroons in order to hedge the foreign currency risk of fixed loans, receivables and securities. The due dates of contracts are between 1 and 4 months after the balance sheet date (2004: 2-5 months).

Note 7. Loans to customers

	Loan balance	Loan balance	Due date	Interest rate
Borrower	**31.12.2005**	**31.12.2004**		
Loans to related parties (Note 19)	350	3 184	Note 30	4,7%-9%
Loans to customers	11 360	5 371	Note 30	7,5%-12%
Total loans	**11 710**	**8 555**		

Note 8. Investment portfolio

Financial assets at fair value through profit or loss	**31.12.2005**	**31.12.2004**
Fund units	828	1 764
Listed bonds	0	2 338
Listed shares	0	2 198
Total	**828**	**6 300**
Available for sale investments		
Shares of Tallinn Stock Exchange	0	997
Total	**0**	**997**

Note 9. Other receivables and assets

	31.12.2005	**31.12.2004**
Guarantee deposits of Baltic stock exchanges	1 433	323
Accrued interest	45	200
Prepayments	1 799	536
Amount due from the sale of associate (Note 11)	0	7 480
Total	**3 277**	**8 539**

Note 10. Corporate restructuring

In 2004, AS LHV was restructured, as a result of which the recently set up AS LHV Group became the parent company of the Group and the previous parent company AS LHV became a wholly-owned subsidiary of AS LHV Group. AS LHV Group was set up by the shareholders of AS LHV at 26.08.2004. A non-monetary contribution in the form of shares of AS LHV was made. During the restructuring, AS LHV sold almost all of its holdings in subsidiaries and associates as well as other long-term financial investments. Only LHV Ilmarise Kinnisvaraportfelli OÜ remained wholly-owned by AS LHV. The purchase and sales contracts was entered into with AS LHV Group at 26.12.2004.

AS LHV continues to offer investment services and manage private portfolios. From 1 July 2004, a current sister -company of AS LHV, AS LHV Financial Advisory Services (hereinafter LHV FAS) provides advisory services and structured finance (or investment products).

In conjunction with the restructuring and the sales transaction, LHV had on outstanding receivable from AS LHV Group in the amount of 26 015 thousand kroons, which was collected in 2005 and consisted of the following:

	31.12.2004
Amoutns due fom the sale of subsidiaries	8 996
Amounts due from the sale of associates	9 320
Amounts due from the sale of other long-term investments and loans	7 699
Total	**26 015**

Note 11. Subsidiaries and associates

The subsidiaries and associates of AS Lõhmus, Haavel & Viisemann before the restructuring in 2004 were:

- **NEV Media** - subsidiary AS NEV Media, the main activity is the acquisition and management of holdings in companies, location: Tartu mnt 2, 10145 Tallinn.
- **Online Kauplemissüsteemid** - subsidiary OÜ Online Kauplemissüsteemid, the main activity is the production, maintenance and sale of software, location: Tartu mnt 2, 10145 Tallinn.
- **Arbitrage** - subsidiary AS LHV Arbitrage, the main activity is investing on account of equity and debt instruments, location: Tartu mnt 2, 10145 Tallinn.
- **LHV Latvia** – subsidiary A/S LHV Latvia (previously A/S LHV Securities), the main activity is financial advisory services, location: Brivibais iela 40-31, Riga, Republic of Latvia.
- **FAS** – subsidiary AS LHV Financial Advisory Services, the main activity is the financial services, location: Tartu mnt 2, 10145 Tallinn.
- **GO** – subsidiary AS LHV Global Opportunity, the main activity is investing on account of equity and debt instruments, location: Tartu mnt 2, 10145 Tallinn.
- **Ilmarine** – subsidiary AS LHV Ilmarise Kinnisvaraportfelli OÜ, the main activity is real estate transactions, location: Tartu mnt 2, 10145 Tallinn.
- **Hermis** – subsidiary Hermis Finansai UAB, the main activity is providing financial services, locations: Tilto st 35/4, LT-01101, Vilnius, Republic of Lithuania.
- **Varahaldus** - subsidiary AS LHV Varahaldus, the main activity is management of pension funds, location: Tartu mnt 2, 10145, Tallinn.
- **CA** – subsidiary AS Consolidated Auctions, the main activity is management of companies engaged in internet auctions, location: Tartu mnt 2, 10145 Tallinn.

	NEV Media	Online	Arbit-rage	LHV Latvia	FAS	GO	Ilma-rine	Hermis	Vara-haldus	CA	Total
Ownership % at beginning of 2004	**100%**	**100%**	**100%**	**100%**	**0%**	**0%**	**0%**	**0%**	**18,6%**	**30,5%**	
Cost at beginning of 2004	**400**	**40**	**400**	**3 853**	**0**	**0**	**0**	**0**	**8 850**	**1**	**13 544**
Acquired holdings in 2004											
% of acquired holdings	**0%**	**0%**	**0%**	**0%**	**100%**	**100%**	**100%**	**51%**	**14,1%**	**0%**	
Cost of acquired holdings	0	0	0	0	400	400	55	996	8 229	0	10 050
Increasing of share capital	0	0	0	0	3 600	0	0	0	0	0	3 600
Holdings sold and transferred in 2004											
% of holdings sold and transferred	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**0%**	**51%**	**32,7%**	**30,5%**	
Sale of associate outside the Group	0	0	0	0	0	0	0	0	7 480	0	7 480
Sales proceeds upon restructuring (Note 10)	409	41		3 580	4 000		0	966	9 320	1	18 316
Sales profit/loss, other expenses	9	1	0	-273	0	0	-15	0	-280	0	-558
Holdings transferred as a non-monetary contribution of LHV FAS	0	0	400	0	0	400	0	0	0	0	800
Ownership % at end of 2004	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**	**100%**	**0%**	**0%**	**0%**	
Holdings at end of 2004	**0**	**0**	**0**	**0**	**0**	**0**	**40**	**0**	**0**	**0**	**40**
Ownership % at end of 2005	**0**	**0**	**0**	**0**	**0**	**0**	**100%**	**0**	**0**	**0**	
Holdings at end 2005	**0**	**0**	**0**	**0**	**0**	**0**	**40**	**0**	**0**	**0**	**40**

Subsidiaries

At 08.01.2004, AS LHV set up a subsidiary AS LHV Financial Advisory Services with the share capital of 400 thousand kroons, which started its operations at 01.07.2004. AS LHV increased the share capital of the subsidiary AS LHV Financial Advisory Services to 3 600 thousand kroons, of which monetary contribution amounted to 2 726 thousand kroons and non-monetary contribution amounted to 874 thousand kroons. The holdings of AS LHV Arbitrage and AS LHV Global Opportunity in the amount of 800 thousand kroons and non-current asset in the amount of 74 thousand kroons were the target of the non-monetary contribution.

The subsidiary AS LHV Global Opportunity was set up with the share capital of 400 thousand kroons at 17.06.2004.

At 12.07.2004, AS LHV acquired a majority interest of 51% in the company UAB Hermis Finansai. The acquisition price and the fair value of the acquired net assets were 966 thousand kroons.

At 23.08.2004, the subsidiary LHV Ilmarise Kinnisvaraportfelli OÜ was acquired with the share capital of 40 thousand kroons. The purchase price and the fair value of the net assets of the acquired subsidiary were 40 thousand kroons. In 2005, LHV Ilmarise Kinnisvaraportfelli OÜ completed a purchase transaction for the acquisition of apartments and the related finance lease receivable in Ilmarise kvartal residential area, Tallinn. At the same time a placement of securitised bonds backed with the above mentioned finance lease agreements was carried out in the total amount of 18 529 thousand kroons. At 13.10.2005, the bonds of LHV Ilmarise Kinnisvaraportfelli OÜ were listed on Tallinn Stock Exchange.

	Assets	Liabilities	Equity
LHV Ilmarise Kinnisvaraportfelli OÜ as at 31.12.2004	40	0	40
LHV Ilmarise Kinnisvaraportfelli OÜ as at 31.12.2005	12 165	12 072	93

Associates

At the end of 2004, AS LHV Varahaldus acquired a 100% holding in a public limited company Seesam Varahaldus from AS Seesam Elukindlustus and signed a merger agreements with AS Seesam Varahaldus. At the same time, LHV sold a 11.1% holding in AS LHV Varahaldus to AS Seesam Elukindlustus. Previously, AS LHV had acquired a 14.1% holding from other shareholders. At 09.03.2005, a merger permit for AS LHV Varahaldus and AS Seesam Varahaldus was granted by the Financial Supervision Authority. The companies were merged as at 01.01.2005. As a result of the transaction, the ownership of AS LHV increased from 18.6% to 21.6%. As at 31.12.2004, AS LHV had a receivable from AS Seesam Elukindlustus LHV Varahaldus for the sale of shares in the amount of 7 480 thousand kroons (Note 9) and a liability to other shareholders for the purchase of shares of LHV Varahaldus in the amount of 8 229 thousand kroons (Note 14).

Note 12. Property, plant and equipment and intangible assets

	Property, plant and equipment	Intangible assets	Total
Balance as at 31.12.2004			
Cost	2 597	816	3 413
Accumulated depreciation	-1 047	-764	-1 811
Net book amount	**1 550**	**52**	**1 602**
Changes occurred in 2005			
Purchase of property, plant and equipment	293	25	318
Depreciation charge	-799	-31	-830
Balance as at 31.12.2005			
Cost	2 890	841	3 731
Accumulated depreciation	-1 846	-795	-2 641
Net book amount	**1 044**	**46**	**1 090**

	Property, plant and equipment	Intangible assets	Total
Balance as at 31.12.2003			
Cost	4 065	855	4 920
Accumulated depreciation	-2 481	-733	-3 214
Net book amount	**1 584**	**122**	**1 706**
Changes occurred in 2004			
Purchase of property, plant and equipment	695	0	695
Paid by non-monetary contribution	-74	0	-74
Depreciation of non-current assets disposed	-51	-2	-53
Depreciation charge	-604	-68	-672
Balance as at 31.12.2004			
Cost	2 597	816	3 413
Accumulated depreciation	-1 047	-764	-1 811
Net book amount	**1 550**	**52**	**1 602**

Note 13. Loans received

	Loan balance 31.12.2005	Loan balance 31.12.2004	Interest
Loans from group companies (Note 19)	5 500	440	3-4%
Loans from shareholders and companies related to them (Note 19)	8 500	0	0%
Total	**14 000**	**440**	

The loans received are denominated in Estonian kroons. The due dates are presented in Note 30, in tables summarising liquidity risks.

Note 14. Other borrowings

	31.12.2005	31.12.2004
Payables related to the sale of associates (Note 11)	0	8 229
Liabilities arising from investment contract (Note 26)	174	2 372
Quarantee deposit received from companies related to shareholders (Note 19)	1 400	0
Other payables to companies related to shareholders (Note 19)	3 819	0
Other payable to customers	5 082	2 016
Total	**10 475**	**12 617**

Note 15. Accrued expenses

	31.12.2005	31.12.2004
Supplier payables	1 914	597
Payables to employees	877	556
Other accrued expenses	84	67
Total	**2 875**	**1 220**

Note 16.Tax liabilities

	31.12.2005	31.12.2004
Personal income tax	163	119
Social security tax	272	188
Unemployment and pension insurance payments	23	17
Corporate income tax on fringe benefits	4	4
Value added tax	374	371
Total	**836**	**699**

Note 17. Litigation provisions

At 1 November 2005, the US Securities and Exchange Commission (US SEC) filed a court action charging AS LHV and two of its employees with electronic fraud and illegal profit making. All accounts opened in the USA under the name of AS LHV, which contained almost exclusively the funds of LHV customers, were frozen. At 8 November, a preliminary agreement was reached with the US SEC and the case was continued to be resolved outside the court. Due to close cooperation with the US SEC, the assets of uninvolved investors were all unfrozen by 29 January 2006. Assets belonging to the persons that the US SEC suspects may have misused insider information continue to be frozen. As at 31.12.2005, the claim of AS LHV against a broker in the USA amounted to 27 774 thousand kroons (Note 4). The Company hopes to be able to reach an out-of-court settlement with the US SEC in the near future.

Based on the results of preliminary negotiations, the fine is expected not to exceed 400 thousand US dollars. Based on judgements of the lawyers the settlement amount may remain between 150 to 800 thousand US dollars which will consist net fee and commission income from the deals under suspicion and potential fine. A provision has been set up in the amount of 5 430 thousand kroons in the financial statements for 2005.

Note 18. Shareholders' equity

	31.12.2005	31.12.2004
Share capital *(in thousand Estonian kroons)*	12 600	30 000
Number of shares	1 260 000	3 000 000
Par value of a share *(in kroons)*	10	10

According to the Company's articles of association, the minimum share capital is 12 000 000 and the maximum share capital is 48 000 000 kroons. The share capital has been fully paid in cash.

As at 31.12.2003, AS LHV had 295 000 treasury shares. In 2004, AS LHV repurchased 25 000 treasury shares and sold 150 000 treasury shares. As at 31.12.2004, the Company had 170 000 treasury shares. In 2005, a total of 1 570 000 treasury shares were repurchased from the parent company AS LHV Group amounting to 27 554 thousand kroons. In June 2005, a resolution was adopted to cancel all 1 740 000 treasury shares and decrease share capital to 12 600 thousand kroons. The decrease of shares was registered in the Estonian Central Depository of Securities at 25 October 2005 and in the Commercial Registry at 5 January 2006.

In 2005, dividends in the amount of 3 962 thousand kroons were declared and paid to the shareholders. In 2004, this amount was 1 352 thousand kroons.

As at 31.12.2005, the Company's retained earning amounted to 1 007 thousand kroons (31.12.2004: 16 065 thousand kroons). Upon the payment of dividends, from 1 January 2006, the corporate income tax on dividends amounts to 23/77 (until 31. 12.2005: 24/76) of net dividend paid. Thus, as at the balance sheet date, it is possible to pay out dividends to the shareholders out of retained earnings amounting to 775 thousand kroons and accompanying income tax on dividends would amount to 232 thousand kroons. As at 31.12.2004, it would have been possible to pay out 12 209 thousand kroons, and the accompanying income tax would have amounted to 3 856 thousand kroons (Note 27).

Note 19.Transactions with related parties

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

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

Movements and balances of loans granted	2005	2004
Group companies	1 500	700
Shareholders and related companies	850	2 326
Total loans granted	**2 350**	**3 026**
Group companies	1 500	700
Shareholders and related companies	3 684	4 342
Loan repayment received	**5 184**	**5 042**
Shareholders and related companies	350	3 184
Loans granted as at the year-end (Note 7)	**350**	**3 184**

Movements and balances of loans received	2005	2004
Parent company	1 000	0
Group companies	9 500	440
Shareholders and related companies	8 500	0
Loans received	**19 000**	**440**
Parent company	1 000	0
Group companies	4 440	0
Shareholders and related companies	0	1 280
Loans repaid	**5 440**	**1 280**
Group companies	5 500	440
Shareholders and the related companies	8 500	0
Loans received as at the year-end (Note 13)	**14 000**	**440**

Transactions	2005	2004
Group companies	9 001	1 744
Total services purchased	**9 001**	**1 744**
Parent company	141	0
Group companies	1 651	5 166
Shareholders and related companies	307	**0**
Total services sold	**2 099**	**5 166**
Group companies	-20	389
Profit/(loss) from forward transactions	**-20**	**389**
Shareholders and related companies	5 546	-1 100
Total other income/(expenses) (Note 26)	**5 546**	**-1 100**

Other balances	31.12.2005	31.12.2004
Parent company	47	26 146
Group companies	168	197
Shareholders and related companies	36	0
Receivables as at the year-end	**251**	**26 343**
Group companies	159	295
Shareholders and related companies	5 424	7 075
Liabilities as at the year-end	**5 583**	**7 370**

The 100% parent company of AS LHV is AS LHV Group, which in turn belongs to private persons who as partners are actively engaged in the daily management of the companies. In 2005, salaries and other compensations paid to the management of AS LHV totalled 1 532 thousand kroons (2004: 1 752 thousand kroons). As at 31.12.2005, remuneration for

December and accrued holiday pay in the amount of 20 thousand kroons has been reported as a payable to the management; as at 31.12.2004: 105 thousand kroons. The Company did not have any long-term payables to the members of the Management Board and the Supervisory Board as at 31.12.2005 and 31.12.2004 (pension liabilities, termination benefits, etc.). Information on assets of related parties held by the Company as an account manager is presented in Note 21. Information on treasury shares purchased from shareholders is disclosed in Note 18.

Note 20. Finance and operating lease

The Company leases cars, office space and computers under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period amounts to 3 229 thousand kroons, the current portion of which amounts to 1 204 thousand and the non-current portion amounts to 2 025 thousand kroons.

Operating lease payments	**2005**	**2004**
Office space	1 547	1 499
Cars	201	673
Computers	18	0
Total (Note 25)	**1 766**	**2 172**

Note 21. Off-balance sheet assets and liabilities

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

	31.12.2005	**31.12.2004**
Cash balance of customers	**347 749**	**41 333**
incl. group companies	10 835	3 143
incl. shareholders and related companies	141 750	1 261
Securities of customers	**1 399 756**	**550 175**
incl. parent company	42 999	0
incl. group companies	20 350	29 941
incl. shareholders and related companies	75 469	27 329
Total	**1 747 505**	**591 508**

Note 22. Net fee and commission income

	2005	**2004**
Fee and commission income		
Financial advisory services	4 162	12 231
Securities brokerage and commissions	28 600	11 426
Assets management and similar fees	5 832	5 721
Total	**38 594**	**29 378**
Fee and commission expense		
Financial advisory and other similar services purchased	-13 820	--5 396
Securities brokerage and commissions paid	-6 945	-2 828
Total	**-20 765**	**-8 224**
Net fee and commission income	**17 829**	**21 154**

Note 23. Net interest income

	2005	2004
Interest income from		
Cash and bank accounts	1 160	422
Fixed income securities	8	0
Margin loans and lending of securities	1 242	975
Loans	612	695
Total	**3 022**	**2 092**
Interest expense		
Loans received	-194	-157
Total	**-194**	**-157**
Net interest income	**2 828**	**1 935**

Note 24. Profit/loss from securities

	2005	2004
Net profit/loss from trading		
Foreign exchange:	1 167	89
- translation gains less losses	344	-555
- transactions gains less losses	823	644
Profit/loss from revaluation and sales of shares and fund units	160	178
Total	**1 327**	**267**
Net profit/ loss from investment securities		
Profit/loss from revaluation and sale of bonds	143	73
Profit/loss from revaluation and sale of shares and fund units	620	522
Total	**763**	**595**
Dividend income	**30**	**454**
Trading securities	7	36
Investment securities	23	418
Total	**30**	**454**
Net profit/loss from securities	**2 120**	**1 316**

Note 25. Operating expenses

	Note	2005	2004
Staff costs			
Wages, salaries and bonuses		5 461	4 328
Social security and other taxes		1 637	2 491
Total		**7 098**	**6 819**
Administrative expenses		12 464	7 077
Depreciation	12	830	725
Operating lease payments	20	1 766	2 172
Other operating expenses	17	5 727	2 176
Total operating expenses		**27 885**	**18 969**

Note 26. Other income

In 2001, AS LHV concluded a supplementary investment contract with two shareholders for financing the department of investment services and sharing its losses and profits. Under this contract, the shareholders participated both in the department's profits and losses, recognised respectively as a profit or loss in the income statement of AS Lõhmus, Haavel & Viisemann.

At the end of 2005, this contract was supplemented, according to which the additional investment of AS Lõhmus Holdings and AS Viisemann Holdings was agreed in the amount of 10.7 million kroons. Upon reaching certain conditions, the parent company AS LHV Group has an obligation to transfer a 42.4% ownership in AS Lõhmus, Haavel& Viisemann to the above mentioned companies. Under the agreement of amending and supplementing the investment contract, AS Lõhmus Holdings and AS Viisemann Holdings waived their claims against AS Lõhmus, Haavel and Viisemann totalling 3 500 thousand kroons, which is one part of the additional investment. In 2005, income from the investment contract was recognised in the income statement in the amount of 5 546 thousand kroons and expenses for 2004 in the amount of 1 100 thousand kroons (Note 19).

As at 31.12.2005, the liability of AS LHV arising from the investment contracts to its shareholders totalled 174 thousand kroons (2004: 2 372 thousand kroons), (Notes 14 and 19).

Note 27. Corporate income tax

According to the Income Tax Act, the annual profit earned by enterprises is not taxed in Estonia. Instead of taxing the net profit, the distribution of retained earnings is subject to taxation at rate of 23/77 (until 31.12.2004: 24/76) of net dividend paid. In 2005, dividends were paid to the shareholders in the amount of 3 962 thousand kroons and in 2004, in the amount of 1 353 thousand kroons, on which corporate income tax amounted to 1 251 thousand and 475 thousand kroons, respectively.

Note 28. Contingent liabilities

Tax authorities have the right to review the Company's tax records for up to 6 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Company during 2004-2005. The Company's management estimates that there are not any circumstances which may lead the tax authorities to impose significant additional taxes on the Company.

Note 29. Fair value of financial assets and financial liabilities

As at 31.12. 2005 and 31.12. 2004, the carrying amounts of financial assets and financial liabilities do not significantly differ from their fair values.

Note 30. Risk management

Risk management policy

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

The main risks arising from the activities of LHV are:

- market risk,
- credit risk,
- liquidity risk,
- operating risk.

Credit risk

Credit risk is the potential loss which would arise from the counterparty's inability to meet is obligations to LHV. In order to hedge credit risk, LHV analyses the operations and financial position both of its customers as well as business partners. Credit risk related to margin loans has been hedged through constant monitoring of the value of securities accepted as collateral. The limit of margin is up to 50% of the value of securities accepted as a collateral. The Management Board of LHV is responsible for managing credit risk and the finance department is engaged in control.

Market risk

Market risk arises from LHV's trading and investment activities in the markets of interest rate products and foreign exchange and stock exchanges. Market risk is a potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. Foreign exchange risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. In order to hedge market risk, conservative limit of the trading portfolio and open foreign exchange positions have been set which are monitored by the finance department.

To reduce the interest rate risk, LHV primarily uses fixed interest rates both for taking loans as well as granting them. In 2005, the fixed interest rate on loans was between 9-12% (2004: 7.5- 12%). The interest rates on loans received were up to 4% (2004: 3%). The floating interest rate of the deposit in Estonian kroons was between 1.4- 2.6% and that of the deposit in USD was up to 3.8%.

The following tables present market risk derived from the the location of assets or customers.

	31.12.2005	**31.12.2004**
Cash and bank accounts (by location)		
Estonia	2 723	6 702
USA	27 774	0
Other	0	329
Total	**30 497**	**7 031**

Trading portfolio and investment portfolio at fair value through profit or loss	31.12.2005	31.12.2004
Shares and bonds		
Estonia	341	0
Lithuania	131	0
Russia	0	2 338
Europe	0	129
USA	62	2 222
Total	**534**	**4 689**

Fund (by investment strategy)		
Europe	0	1 427
Investments with fixed rates of return	828	363
Global and other strategies	350	215
Total	**1 178**	**2 005**

The following tables present the risks arising from open foreign currency positions. Assets and liabilities denominated in foreign currencies have been presented in EEK equivalent in respective columns. Derivatives reported at fair value in the balance sheet have been included within contractual amounts among off-balance sheet assets and liabilities.

As at 31.12.2005

Assets	EEK	EUR	LTL	LVL	SEK	USD	Other	Total
Cash and bank	2 723	0	0	0	0	27 774	0	**30 497**
Trading portfolio	341	188	131	0	15	198	11	**884**
Trade receivables	246	110	0	0	0	26	150	**532**
Loans to clients	3 662	735	4 423	90	526	2 274	0	**11 710**
Investment portfolio								
- at fair value through profit or loss	0	828	0	0	0	0	0	**828**
Investments into subsidiaries	40	0	0	0	0	0	0	**40**
Property, plant and equipment and intangible assets	1 090	0	0	0	0	0	0	**1 090**
Other receivables and assets	1 873	0	82	0	0	1 322	0	**3 277**
Total assets	**9 975**	**1 861**	**4 636**	**90**	**541**	**31 594**	**161**	**48 858**
Off-balance sheet assets at contractual amounts (Note 6)	**27 082**	**0**	**0**	**0**	**0**	**0**	**0**	**27 082**
Liabilities								
Loans received	14 000	0	0	0	0	0	0	**14 000**
Other payables	5 393	0	0	0	0	5 082	0	**10 475**
Accrued expenses	1 598	16	14	31	0	1 216	0	**2 875**
Tax liabilities	836	0	0	0	0	0	0	**836**
Provisions	0	0	0	0	0	5 430	0	**5 430**
Total liabilities	**21 827**	**16**	**14**	**31**	**0**	**11 728**	**0**	**33 616**
Off-balance sheet assets at contractual amounts (Note 6)	**0**	**0**	**5 438**	**0**	**168**	**21 593**	**0**	**27 199**
Shareholders' equity	15 125	0	0	0	0	0	0	15 125
Open foreign currency position	**105**	**1 845**	**-816**	**59**	**373**	**-1 726**	**161**	**0**

As at 31.12.2004

Assets	EEK	EUR	LTL	LVL	SEK	USD	Other	**Total**
Cash and bank	6 689	0	0	0	0	21	321	**7 031**
Trading portfolio	177	125	0	0	0	92	0	**394**
Trade receivables	853	0	0	0	0	0	120	**973**
Loans to clients	3 547	485	0	0	0	4 523	0	**8 555**
Investment portfolio	0	0	0	0	0	0	0	**0**
- at fair value through profit or loss	2 372	1 737	0	0	0	2 191	0	**6 300**
- at cost	997	0	0	0	0	0	0	**997**
Investment into subsidiaries	40	0	0	0	0	0	0	**40**
Property, plant and equipment and intangible assets	1 602	0	0	0	0	0	0	**1 602**
Other receivables and assets	8 539	0	0	0	0	0	0	**8 539**
Receivables relating to Group's restructuring	26 015	0	0	0	0	0	0	**26 015**
Total assets	**50 831**	**2 347**	**0**	**0**	**0**	**6 827**	**441**	**60 446**
Off-balance sheet assets at contractual amounts (Note 6)	**4 976**	**0**	**0**	**0**	**0**	**0**	**0**	**4 976**

Liabilities								
Loans received	440	0	0	0	0	0	0	**440**
Other payables	10 756	485	0	0	0	1 376	0	**12 617**
Accrued expenses	1 189	31	0	0	0	0	0	**1 220**
Tax liabilities	699	0	0	0	0	0	0	**699**
Total liabilities	**13 084**	**516**	**0**	**0**	**0**	**1 376**	**0**	**14 976**
Off-balance sheet assets at contractual amounts (Note 6)	**0**	**0**	**0**	**0**	**0**	**4 761**	**0**	**4 761**
Shareholders' equity	45 685							46 685
Open foreign currency position	**-2 962**	**1 831**	**0**	**0**	**0**	**690**	**441**	**0**

Liquidity risk

Liquidity risk relates to the solvency of LHV to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The CFO of LHV is responsible for the management of liquidity risk. In order to hedge liquidity risk, a regular monitoring of the probable net position of receivables and liabilities by maturities is carried out and adequate amount of liquid assets are kept in each time period.

As at 31.12.2005

Assets	**up to 3 months**	**3-12 months**	**1-5 years**	**over 5 years**	**Total**
Cash and bank	25 906	4 591	0	0	**30 497**
Trading portfolio	884	0	0	0	**884**
Trade receivables	532	0	0	0	**532**
Loans to clients	10 756	500	454	0	**11 710**
Investment portfolio					
- at fair value through profit or loss	0	828	0	0	**828**
Investments into subsidiaries	0	0	0	40	**40**
Property, plant and equipment and intangible assets	0	0	1 090	0	**1 090**
Other receivables and assets	0	1 845	1 432	0	**3 277**
Total assets	**38 078**	**7 764**	**2 976**	**40**	**48 858**
Liabilities					
Derivatives	117	0	0	0	**117**
Loans received	8 500	5 500	0	0	**14 000**
Other payables	10 301	174	0	0	**10 475**
Accrued expenses	2 791	84	0	0	**2 875**
Tax liabilities	836	0	0	0	**836**
Provisions	0	5 430	0	0	**5 430**
Total liabilities	**22 545**	**11 188**	**0**	**0**	**33 733**
Liquidity gap	**15 533**	**-3 424**	**2 976**	**40**	**15 125**
Total equity					***15 125***

As at 31.12.2004

Assets	**up to 3 months**	**3-12 months**	**1-5 years**	**over 5 years**	**TOTAL**
Cash and bank	7 031	0	0	0	**7 031**
Trade receivables	394	0	0	0	**394**
Derivatives	215	0	0	0	**215**
Trade receivables	973	0	0	0	**973**
Loans to clients	2 016	6 539	0	0	**8 555**
Investment portfolio					
- at fair value through profit or loss	0	5 472	828	0	**6 300**
- at cost	0	997	0	0	**997**
Investments into subsidiaries	0	0	0	40	**40**
Property, plant and equipment and intangible assets	0	0	1 602	0	**1 602**
Other receivables and assets	0	8 216	0	323	**8 539**
Receivables relating to Group's restructuring	0	26 015	0	0	**26 015**
Total assets	**10 629**	**47 239**	**2 430**	**363**	**60 661**
Liabilities					
Loans received	40	400	0	0	**440**
Other payables	2 017	10 600	0	0	**12 617**
Accrued expenses	1 162	58	0	0	**1 220**
Tax liabilities	699	0	0	0	**699**
Total liabilities	**3 918**	**11 058**	**0**	**0**	**14 976**
Liquidity gap	**6 711**	**36 181**	**2 430**	**363**	**45 685**
Total equity					***45 685***

Operating risk

Operating risk is a potential loss caused by insufficient or non-operating processes, employees and information systems or external factors. The Management Board of LHV is responsible for regular assessment and management of operating risk, which ensures involvement of employees in the process of assessing risks and improves overall risk analysis. When completing transactions, transactions limits and competence systems are used to minimize potential losses and the principle of duality is used in LHV's working procedures, according to which there should be an approval by at least two employees independent of each other or the unit for carrying out the transaction or procedure. The Risk Manager of LHV and internal audit have a directing, helping, controlling and summarising function.

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AUDITOR'S REPORT

(Translation of the Estonian original)

To the shareholder of AS Lõhmus, Haavel & Viisemann

We have audited the accompanying balance sheet of AS Lõhmus, Haavel & Viisemann (the Company) as of 31 December 2005 and the related statements of income, cash flows and changes in shareholders' equity for the year then ended. These financial statements as set out on pages 6 to 32 are the responsibility of the Company's Management Board. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as of 31 December 2005 and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

/signed/

Urmas Kaarlep
AS PricewaterhouseCoopers

/signed/

Tiit Raimla
Authorised Auditor

22 June 2006

Proposal for profit allocation

The Management Board of AS LHV proposes to the General Meeting of Shareholders to add the net profit of 2005 in the amount of 957 thousand kroons to retained earnings.

Signatures of the Management Board and the Supervisory Board of AS Lõhmus, Haavel & Viisemann to the 2005 annual report

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

	Name	Date	Signature
Management Board:			
Member of the Management Board	Andres Viisemann	26.06.2006	*/signed/*
Member of the Management Board	Rain Tamm	26.06.2006	*/signed/*
Supervisory Board:			
Member of the Supervisory Board	Tarmo Jüristo	26.06.2006	*/signed/*
Member of the Supervisory Board	Tõnis Haavel	26.06.2006	*/signed/*
Member of the Supervisory Board	Maili Kalmus	26.06.2006	*/signed/*