merko

CONSOLIDATED ANNUAL REPORT

2017

AS MERKO EHITUS

GROUP

CONSOLIDATED ANNUAL REPORT
01.01.2017 – 31.12.2017

Business name:	AS Merko Ehitus
Main activities:	Holding companies General contracting of construction Real estate development
Commercial Register No.:	11520257
Address:	Järvevana tee 9G, 11314 Tallinn
Postal address:	Pärnu mnt 141, 11314 Tallinn
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Fax:	+372 650 1251
E-mail:	group@merko.ee
Web site:	group.merko.ee
Auditor:	AS PricewaterhouseCoopers
Supervisory Board:	Toomas Annus, Teet Roopalu, Indrek Neivelt
Management Board:	Andres Trink, Tõnu Toomik

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MAIN FACTS

The largest listed construction company in the Baltics

AS MERKO EHITUS CONSISTS OF:

- Estonia's leading construction company AS Merko Ehitus Eesti
- Latvian market oriented SIA Merks
- UAB Merko Statyba operating on the Lithuanian market
- Norwegian construction company Peritus Entreprenør AS
- The real estate development business unit along with real estate holding companies.

Merko Ehitus group focuses on general contracting of construction and on providing complete solutions in professional construction and real estate development. Long-term experience in various countries, a wide scope of construction services, flexibility, reliability and meeting the deadlines and primarily quality have helped group companies to achieve a strong position in the Baltics.

2017 new contracts signed
EUR 335 mln

2017 revenue
EUR 317.6 mln

COMPETITIVE ADVANTAGES:

- Broad range of construction services and products, comprehensive solutions offered to clients
- Strong quality management system
- Experienced project managers and engineers
- Longstanding experience on the subcontractors and suppliers market
- Innovative technological approaches and construction solutions
- Strong financial capability
- Inventory of residential development projects and a strong brand

2017 EBITDA
EUR 22.2 mln

2017 net profit
EUR 14.7 mln

31.12.2017
757 employees

VALUE OFFERING

AS GENERAL CONTRACTOR, WE OVERSEE THE ENTIRE CONSTRUCTION PROCESS AND ARE RESPONSIBLE FOR THE COMPLETION OF THE CONSTRUCTION PROJECT AS A WHOLE:

- Integrated project management and construction service, provision of strategic consultation to the contracting entity throughout the process
- As needed, combined use of subcontractors and Merko workforce (concrete works, road construction, electrical constructions both indoor and outdoor)
- Real estate investments and development, managing the entire apartment development process: design, construction, sales, warranty-period service
- Co-investing, risk distribution and participation in PPP (public-private partnership) projects
- International quality, environmental protection and occupational safety certificates ISO 9001, ISO 14001 and OHSAS 18001

Estonia's leading builder of substations

STATEMENT OF THE CHAIRMAN OF THE SUPERVISORY BOARD

TOOMAS ANNUS
AS MERKO EHITUS
CHAIRMAN OF THE
SUPERVISORY BOARD

We can be satisfied with last year's financial results of Merko Ehitus. Both, the revenue and profit were decent; our more than 750 employees have made good effort to gain that. The fact that we made profit mainly from real estate operations and were not able to make reasonable profit from construction works as per construction contracts, provides reason to be cautious. In case of tenders for construction works, today, unfortunately, only the price counts. When in the car market an understanding has developed about the differences in price, driving comfort, aftermarket price of used cars and other factors, and a similar understanding is emerging also in the apartment market, then the same, regrettably, cannot be said in case of building for clients, especially for the state. The mentality of "is it really not possible to get any cheaper?" is probably not cost efficient, if one considers the whole life cycle of the construction object and its expected life period. It is difficult to guess where the construction market is developing. We are not the cheapest builders, we have waited for more than 10 years for quality and responsibility to start dominating over price, but so far this has not happened.

Big changes await the construction market also regarding the so-called zero energy requirements. In our home markets, it seems that they are going to be established differently and their impact is difficult to predict. It might happen that the prices of well-lit apartments with large windows that are being built today make a jump upwards, if building of these is not allowed in the future (if this is not reconsidered?). Developers who are able to get building permits for the next 5-10 years, before the new requirements kick in, might gain a great competitive edge.

In addition to other areas, the role of the state is increasing also in construction and real estate sector. Besides Riigi Kinnisvara, Tallinna Sadam is emerging as a similarly distinguished real estate company whose shares are being brought to the stock exchange. Also, state subsidised housing construction is becoming a reality. We hope that this short-sighted choice is also short-lived. Merko Ehitus still has to find a spot for its small market share somewhere between state-run undertakings, state-run real estate development and state-run housing construction, state-run road construction and state-run road maintenance, and all other such activities.

It is reasonable for conservative people with limited risk appetite to invest in monopolies and companies with significant market power, where cost-based profitability is guaranteed. Future belongs to those who are able to set their sights accordingly and make the right choices.

Toomas Annus

STATEMENT OF THE CHAIRMAN OF THE MANAGEMENT BOARD

Dear shareholders,

ANDRES TRINK
AS MERKO EHITUS
CHAIRMAN OF THE
MANAGEMENT BOARD

2017 was a year of growth in the Baltic construction market – the volumes grew in Estonia, Latvia and Lithuania. The sales revenue of the Merko group also increased in all our home markets and for the first time after 2007 exceeded 300 million euros. Our portfolio of new construction contracts also grew in 2017, reaching 340 million euros by the end of the year. The growth of the construction market continued to be supported by investments into residential buildings and commercial property, as well as public sector investments into buildings and infrastructure.

The group's profitability and return on equity also improved in 2017, the latter showing the highest level in the past nine years. However, looking behind the figures we have to admit that the profit primarily came from the area of real estate development and in the past year we performed several transactions that had been prepared over a longer period. At the same time, the profitability of providing construction services to clients remains below our ROE objective. As construction contracts are still awarded based on the lowest price and the construction companies' willingness to accept ever increasing risks, the profitability of main contractors in the market as a whole is too low on the backdrop of rapidly growing input prices and labour costs. Growing construction volumes in the light of increasing risks and low profitability is not a sustainable strategy. Therefore, the future poses great challenges in the construction industry. We strive to respond to these by improved efficiency and risk management, the use of new construction technologies, and more clearly focused construction offers.

Merko continues to value quality, good trustworthy cooperation with clients in finding the most optimal solutions, and expert project management. We are glad that in the satisfaction survey conducted among our clients in 2017, the respondents noted the availability of Merko's key persons, work culture and attitude, and willingness to work together in the future. We also place great importance on good cooperation with our suppliers and subcontractors for whom we wish to be a reliable and professional cooperation partner. In that spirit we carried out a campaign to recognise our cooperation partners in Estonia, Latvia and Lithuania. Our partners actively participated in the campaign and we received good feedback.

We are also glad that Merko's brand as an apartment developer continues to be strong and that residential construction is one of the most important areas in our business portfolio. In the past year, we sold nearly 400 new apartments and started the construction of 500 new apartments in the Baltic region. Considering the continually favourable real estate market and strong demand for Merko's apartments, we wished to launch even more development projects, but the pace of processing plans and building permits did not allow us to do so. The quality and speed of preparation of development projects will remain in our focus also in the future. In 2017, we invested nearly 60 million euros into real estate development, including continued investments to registered immovables in order to ensure the future potential of apartment development. Our aim is to create a high-quality and modern living environment in the Baltic capitals – an environment that meets the needs and expectations of homebuyers. For that purpose, we have acquired various large residential development areas in Tallinn, Riga and Vilnius in recent years.

In the past year, Merko was again awarded the title of the most competitive Estonian construction company, Sergejs Perinecs, the project manager of our Latvian subsidiary, was awarded the title of the Project Manager of the Year in Latvia, and our energy class A apartment development project Kražių Namai received the Product of the Year award in Lithuania. These and other tokens of recognition are a sign of our team's great contribution to the development of the group and the achievement of our objectives, for which I thank all the employees of our group companies.

We will strive to stay competitive also in the future!

Andres Trink

MERKO GROUP

VISION

Our vision is reliable solutions and quality performance for customers' ideas.

VALUES

RESPONSIBILITY
We decide based on business thinking, awareness and ethical beliefs. We offer enduring and environmentally friendly solutions.

KEEPING PROMISES
We give realistic promises to the shareholders, contracting entities, cooperation partners, employees and we keep our promises. Good solutions are born in cooperation, the keeping of one's promises is mutual.

COMPETENCE
We value quality and professionalism. We constantly develop our professional knowledge and skills.

INITIATIVE
We manage processes and are result-oriented. We accept challenges, which presume more.

CREATIVITY
We are open, innovative and creative in working out and implementing the solutions. We have the will to carry out forward-looking ideas.

MERKO EHITUS EESTI DESIGNED AND BUILT TELIA OFFICE BUILDING RECEIVED DIGITAL BUILDING OF THE YEAR SPECIAL AWARD FROM THE MINISTRY OF ECONOMIC AFFAIRS AND COMMUNICATIONS AT THE 2017 CONSTRUCTION PROJECTS COMPETITION

STRATEGY

The business strategy of AS Merko Ehitus subsidiaries is focussed on improving profitability and enhancing the efficiency of the cost base, offering general contracting services in the field of construction of buildings and infrastructure facilities and developing residential real estate in its main home markets Estonia, Latvia, Lithuania and Norway. Merko Ehitus aims to be a preferred partner to its clients for construction works.

FINANCIAL OBJECTIVES

The Management Board and Supervisory Board of AS Merko Ehitus have approved the company's strategic development directions and long-term financial objectives for the period 2013 to 2018, which are:

average return on equity at least
10%

dividend rate
50-70%
of annual profit

equity ratio at least
40%

Considering the competitive situation of the Baltic construction and real estate market and the overall low interest rate environment, as well as the company's high equity base, the strategy and financial objectives are focused towards improving the return on invested capital and on increasing the efficiency of the balance sheet.

In 2017, the group fulfilled all set financial objectives:

return on equity
11.9%

dividend rate
120%
of annual profit

equity ratio
47%

In 2017, the group's return on equity was 11.9% (2016: 5.0%). and the equity ratio 47.0% (2016: 51.6%). In general, the profitability of the main contractors in the construction sector has been under strong pressure for several years. This trend is continuing and increasing. In 2017, the group's productivity was improved by nonrecurring real estate transactions, the preparation for which spanned a longer period. Considering the high equity level of the group and modest debt level, the group's management has made the proposal to pay dividends to shareholders above the current dividend policy rate. Due to that, the estimated dividend rate for 2017 is 120% (2016: 119%).

FULFILLMENT OF LONG-TERM FINANCIAL OBJECTIVES 2013-2017

	2017	**2016**	**2015**	**2014**	**2013**	**AVERAGE**
Return on equity, ROE (on yearly basis)	11.9%	5.0%	8.0%	10.1%	8.8%	8.8%
Dividend rate	120%*	119%	90%	58%	70%	91%
Equity ratio 31.12.	47.0%	51.6%	59.5%	51.0%	50.9%	52.0%

** Pursuant to the Management Board's proposal*

IN 2017, THE SECOND STAGE OF SVIBY PORT RECONSTRUCTION WAS COMPLETED ON ESTONIAN ISLAND VORMSI

BUSINESS MODEL: CONSTRUCTION SERVICES TO CUSTOMERS

In the framework of general construction contracting Merko offers strategic advisory services and high-quality full-scale solutions throughout the whole process pursuant to the customer's needs: preparation, design, construction, fittings and warranty-period service. If the customer so chooses, we also offer commercial real estate development service, covering preparation for construction along with performance of the construction works. For the best outcome, Merko should be engaged already at the outset of the construction project planning period, and cooperation should take place in the framework of the design and construction agreement.

SUITABLE PLOT AND DETAIL PLAN

- detailed plan for the customer's property
- industrial, business and residential properties in the portfolio
- property search / acquisition

CONCEPT

- mapping customer needs
- advisory services / development
- readiness to take part in PPP projects

OFFER AND PRICE ESTIMATE

- the relevant department at Merko is responsible for well-thought-out and realistic offers and estimates
- the necessary departments are involved, e.g. design and construction, concrete and electricity department, road work company

ENGINEERING AND DESIGN

- BIM (Building Infomation Modeling) general contracting
- in-house design department
- necessary specialists are involved (electricity, heating, ventilation, water and sewerage)

GENERAL CONSTRUCTION CONTRACTING

- site office and team based physically on the site every day, team includes at least project manager, site manager and engineer
- back-office support (occupational safety, quality oversight, budgeting staff, designers, financial experts, lawyers, etc.)
- in-house specialists: electricity, heating, ventilation, water and sewerage fields
- own workers (concrete, electricity, external networks department)
- use of BIM system
- long-term, reliable partners and suppliers

FITTINGS

- interior designs and fittings/furnishings pursuant to customer's needs and standards

WARRANTY-PERIOD SERVICE

- the construction-period site team is responsible for warranty problems and ensures continuity and quality

BUSINESS MODEL: PROPERTY DEVELOPMENTS

Merko has become the leading residential development company in the Baltics – we have developed and built over 4,000 apartments in Estonia, Latvia and Lithuania, with over 500 apartments in construction currently and thousands of new homes in long-term development. To ensure the best quality, we manage all phases of the development project: planning, design development, construction, sales, and service during the warranty period. As a developer of apartments, Merko focuses on developing an integral residential environment with apartment buildings planned for a specific potential customer target group and suitable for its surroundings, boasting distinguished architecture, functional floor plans, high-quality interior finishing materials and high energy efficiency.

THE OPTIMUM PLOT

- appropriate residential-zoned plots in the portfolio of immovable property
- finding new properties, analysis and acquisition

PLANNING THE AREA

- analysis of the area, including of the nearby urban space
- developing a concept suitable for the location and target group
- terms of reference for the competition
- planning competition, involving experienced planners
- proceedings on the detailed plan
- invitational architecture competition open to prominent architects and architecture practices

CONCEPT OF DEVELOPMENT

- application of Merko's more than 25 years of experience and customer feedback
- common areas and integral living environment – green space around the building, (interior) courtyard, multifaceted landscaping
- convenient parking solutions
- well-designed apartment floor plans, interior architect on board
- interior finishing packages suitable for the nature of the project, developed in collaboration with interior architect
- storage room for each apartment

ENGINEERING AND DESIGN

- BIM general contracting
- professional reliable partners in the field of design, supported by the company's own design development department
- involvement of necessary specialists (electricity, heating, ventilation, water supply and sewerage)
- use of contemporary solutions (energy efficiency, soundproofing, healthy indoor climate, insolation that meets the standards, passive cooling, etc.)

GENERAL CONSTRUCTION CONTRACTING

- site office and team based physically on the site every day, team includes at least project manager, site manager and engineer
- back-office support (occupational safety, quality oversight, budgeting staff, designers, financial experts, lawyers, etc.)
- in-house specialists: electricity, heating, ventilation, water and sewerage fields
- own workers (concrete, electricity, external networks department)
- use of BIM system
- long-term, reliable partners and suppliers

SALES AND MARKETING

- Merko itself organises sales and marketing
- professional sales managers involved throughout the development process who know the product as a whole
- quality, realistic sale and marketing materials

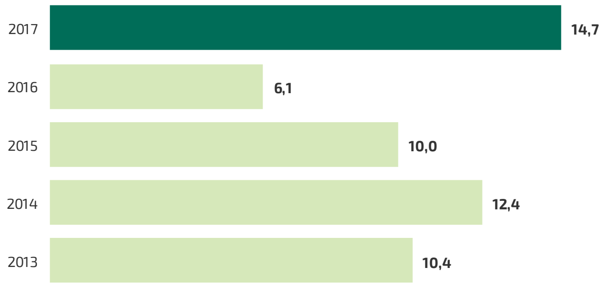
WARRANTY-PERIOD SERVICE

- a warranty specialist is the main contact in all matters related to the warranty
- apartment buyer satisfaction surveys
- analysis of feedback during warranty period and use in planning new development projects

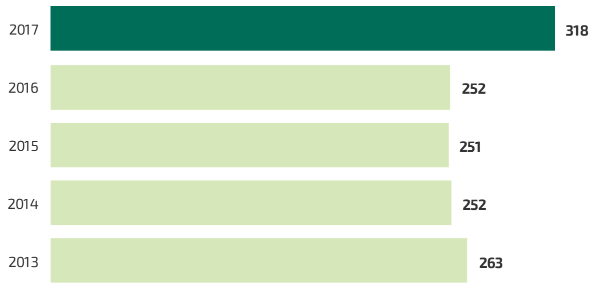
MANAGEMENT REPORT

BRIEF OVERVIEW OF 2017

NET PROFIT
in million euros



REVENUE
in million euros



PROFITABILITY

Net profit in 2017 was EUR 14.7 million (2016: EUR 6.1 million), having increased by 140.0% compared to last year. Net profit margin increased to 4.6% (2016: 2.4%). Profit before tax in 2017 was EUR 18.8 million (2016: EUR 7.3 million), which is equivalent to a profit before tax margin of 5.9% (2016: 2.9%).

REVENUE

Revenue in 2017 was EUR 317.6 million (2016: EUR 252.0 million), which has increased by 26.0% compared to last year. The share of revenue earned outside of Estonia was 40% (2016: 32%) and the share of revenue earned in Estonia was 60% (2016: 68%).

REAL ESTATE DEVELOPMENT

The number of apartments sold in 2017 (392 units, incl. 17 apartments in joint ventures) has decreased by 20.5%, while the revenue from apartment sales (EUR 47.1 million) has decreased by 16.8% (2016: 493 units, incl. 21 apartments in joint ventures, revenues of EUR 56.6 million). The average apartment price has been higher than in 2016.

SECURED ORDER BOOK

In 2017, group companies signed new contracts in the amount of EUR 334.9 million (2016: EUR 202.4 million). As at 31 December 2017, the group's secured order book stood at EUR 344.4 million (31 December 2016: EUR 269.6 million).

CASH POSITION

At the end of the reporting period, the group had EUR 39.2 million in cash and cash equivalents and equity EUR 130.2 million (47.0% of total assets). Comparable figures as at 31 December 2016 were EUR 33.5 million and EUR 122.8 million (51.6% of total assets) respectively. As at 31 December 2017, the group had net debt of EUR 20.1 million (31 December 2016: EUR 12.5 million).

PROPOSAL FOR DISTRIBUTION OF PROFITS

The Management Board proposes to distribute to shareholders EUR 17.7 million (EUR 1 per share) in dividends from retained earnings in 2018. This is equivalent to a 120% dividend rate for 2017.

		2017	2016	CHANGE
Revenue	million EUR	317.6	252.0	+26.0%
EBITDA	million EUR	22.2	11.2	+98.2%
EBITDA margin	%	7.0	4.4	
Operating profit	million EUR	19.5	7.7	+153.1%
Operating profit margin	%	6.2	3.1	
Profit before tax	million EUR	18.8	7.3	+157.9%
PBT margin	%	5.9	2.9	
Net profit attributable to equity holders of the parent	million EUR	14.7	6.1	+140.0%
Net margin	%	4.6	2.4	
Earnings per share	EUR	0.83	0.35	+140.0%
Dividends per share	EUR	1.0*	0.41	+143.9%

** Pursuant to the Management Board's proposal*

		31.12.2017	31.12.2016	CHANGE
Return on equity (annual)	%	11.9	5.0	
Equity ratio	%	47.0	51.6	
Order book	million EUR	344.4	269.6	+27.8%
Total assets	million EUR	277.1	237.8	+16.5%
Number of employees	people	757	797	-5.0%

Calculation of ratios is provided on page 123 of the report.

THE MAIN FACTORS INFLUENCING THE CONSTRUCTION MARKET IN 2017

CONSTRUCTION SERVICES

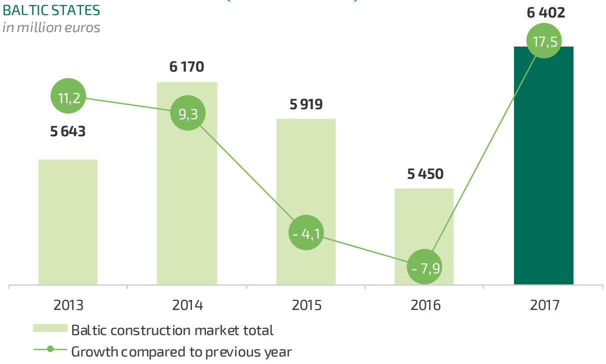
	2017			2016		
	Estonia	**Latvia**	**Lithuania**	**Estonia**	**Latvia**	**Lithuania**
GDP annual change in current prices	+4.9%	+4.5%	+3.8%	+2.1%	+2.2%	+2.3%
Construction price index annual change	+1.5%	+1.9%	+3.1%	-0.8%	-0.5%	+1.6%
Labour force	*+2.4%*	*+4.5%*	*+8.3%*	*+1.2%*	*+4.8%*	*+5.3%*
Construction machines	*+1.4%*	*+1.0%*	*+0.9%*	*-1.1%*	*+1.1%*	*+0.2%*
Building materials	*+1.0%*	*+1.4%*	*+0.8%*	*-1.8%*	*-3.2%*	*-0.5%*

Source: Local national statistical offices / Eurostat.

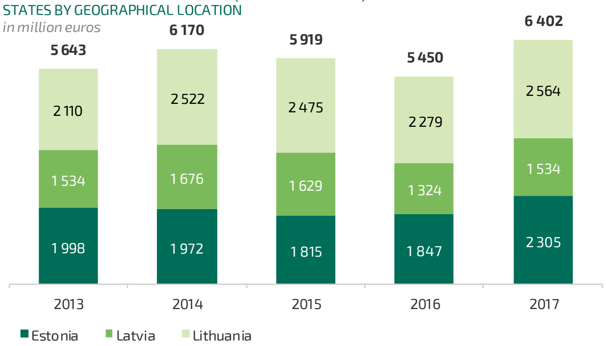
Whereas GDP growth in Estonia, Latvia and Lithuania was quite modest in 2016, barely outstripping the European Union average (+2.0%), it was quite a different picture in 2017. All three Baltic states saw strong economic growth. While the average GDP growth in the European Union was +2.3%, Estonia placed among the top five member states with its +4.9%. Also, Latvia's +4.5% and Lithuania's +3.8% were clearly above the average. The situation in all three countries was a reflection of the improved economic environment throughout Europe. Naturally, better economic performance of the Baltics' primary export partners played a direct role. A shift has taken place in the structure of economic growth. Up to this point, growth had been driven by strong domestic consumer spending backed by low unemployment and a constant rapid increase in the average wages; but now investments, including into construction, have started setting the tone.

The surge in activity has raised construction prices as well. While in 2016, construction prices were in a slight decline in Estonia and Latvia, in 2017, growth has been palpable in all three countries and in all three components: workforce, machinery and materials. A significant change has taken place in construction materials in particular. To a certain extent, local construction is competing for materials with international markets. When the economy is on the upswing and construction activity is more active abroad, it also raises prices of materials for the Baltics. A similar trend can be seen in regard to construction machinery, although prices are more stable in this component. As to workforce, faster growth has been seen in the past few years namely in Latvia and Lithuania, while developments in Estonia have been more modest in this component. In general, it should be borne in mind that the construction market is not completely homogeneous. For instance, there are clear differences between general contractors and subcontractors. With the construction sector active in general, but still only a limited number of major projects on the market, competition is particularly stiff among main contractors and the pressure on profitability can be felt on both the income and expenses side. Due to stiff competition, general contractors find it hard to raise sale prices, while there is a shortage of high-quality subcontractors, which increases costs. In general, the change in the construction price index is not necessarily very great, but its impact on construction market participants varies.

CONSTRUCTION MARKET VOLUME (WITH OWN FORCES) AND GROWTH IN THE BALTIC STATES
in million euros



CONSTRUCTION MARKET VOLUMES (WITH OWN FORCES) IN THE BALTIC STATES BY GEOGRAPHICAL LOCATION
in million euros

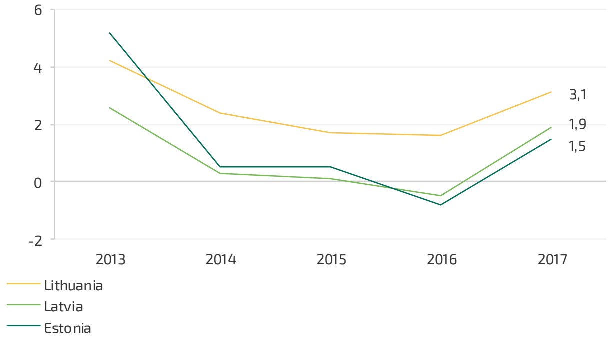


Source: Local statistical services.

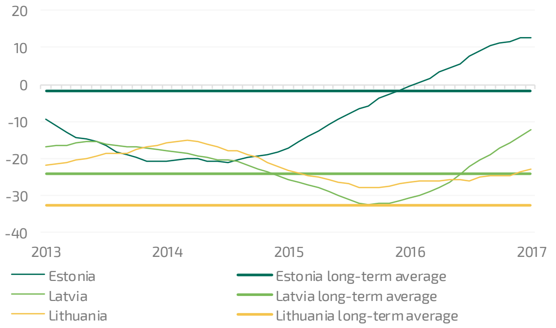
In 2017, contracting companies performed EUR 6,402 million in construction work using their own personnel, this being close to EUR 1,000 million more than a year before (EUR 5,450 million). The construction market grew 17.5% in current prices (decline in 2016: -7.9%). In current prices, the Baltic construction markets are still well below their peak level during the boom era (2007-2008): approximately -20% overall, and about -10% in Estonia, -30% in Lithuania and -40% in Latvia. In 2017, all three markets grew: +25% in Estonia (2016: +2%), +16% in Latvia (2016: -19%), +12% in Lithuania (2016: -8%). In terms of volume, Lithuania is still the leader, with a 40% share of the Baltic construction market (2016: 42%). Estonia's share is 36% (2016: 34%) and Latvia is still at 24% (2016: 24%).

After three years with relatively little or even negative change, the construction price index returned to growth in Latvia and Estonia. In Latvia, construction prices rose +1.9% (decline in 2016: -0.5%) and in Estonia, the increase was +1.5% (decline in 2016: -0.8%). In Lithuania, a price rise seen already earlier increased and accelerated: +3.1% (2016: +1.6%). Just as the construction price index has been impacted by the general uptick in activity, is the construction sector confidence indicator is also clearly rising, exceeding the long-term average in all three Baltics.

CHANGE IN CONSTRUCTION PRICE INDEX
percentages



CONSTRUCTION CONFIDENCE INDICATOR (12 month running average)
difference between percentages of pos. and neg. responses



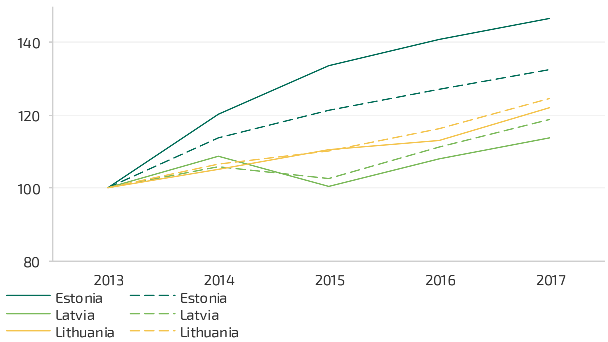
Source: Local statistical services / Eurostat.

The indicator in Latvia and Lithuania is still negative (the percentage of those who have a negative sentiment regarding the outlook for construction exceeds positive sentiment), but the long-term average figures have also been low on these markets. In Estonia, however, the indicator climbed into positive territory, with the long-term average on this market being near zero. In 2017, confidence was strongly correlated with the growth in construction volumes. Growth was highest in Estonia (+25%) and confidence has grown rapidly. Of the three countries, Latvia's growth was in the middle, yet strong as well (+16%); and there a strong recovery of confidence can also be seen. In Lithuania, growth was more moderate (+12%), which is expressed also in the stability of confidence.

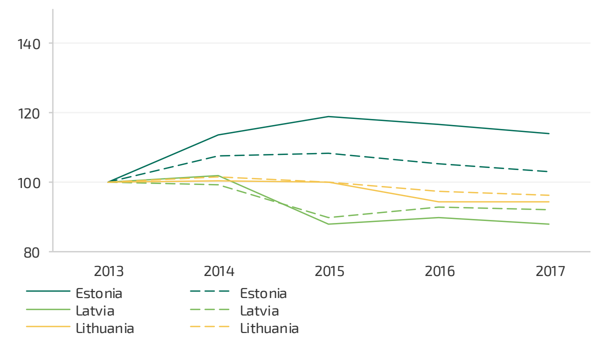
APARTMENT DEVELOPMENT

On housing markets, price dynamics in the Baltics has been somewhat different in recent years. In Estonia, there has been a constant growth, which was highest in 2014 (+13.7%, including +20.2% in new buildings) and in the last two years, it has started to taper off (2017: +5.5%, 2016: +4.7%). The price rise in new housing has clearly outpaced that of older dwellings. A few more expensive projects have had an influence in that regard. In Latvia and Lithuania, there has been greater similarity between the price rise of new and old housing; in fact the older housing has gained even more in price. Latvia saw a more than 3% correction in prices in 2015, and in the last two years the price increase continued (2017:+8.8%, 2016: +8.5%). Lithuania meanwhile witnessed a small, less than 1% correction in prices in 2012, followed by a moderate rise ever since, with the fastest rise seen last year (2017: +8.9%, 2016: +5.4%). Insofar as the price rise in Estonia has been the fastest in recent years, while many new development projects have increased the supply, the Estonian market is the clearest case where sales periods of less attractive developments have become longer.

NEW AND ALL (dotted line) DWELLINGS HOUSE PRICE INDEX (2013=100)



RATIO OF NEW AND ALL (dotted lines) DWELLINGS HOUSE PRICE INDEX TO AVERAGE MONTHLY GROSS WAGES INDEX (2013 = 100)



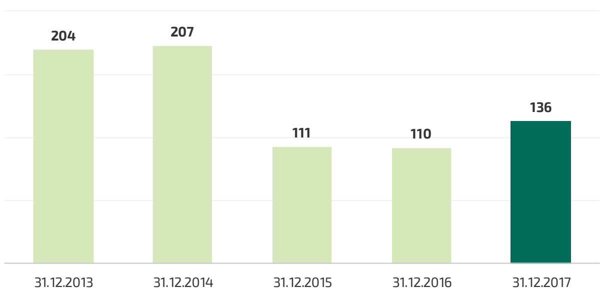
Source: Local statistical services / Eurostat.

Comparing the change in the average wage to the housing price index, we see that prices in Estonia have outpaced wages in recent years, especially in the years of the highest price rise: 2013-2014. After this period, wages have caught up to the price rise and in the last two years, housing has become relatively cheaper, i.e., prices have continued to grow, but they have been outpaced by the rise in average earnings.

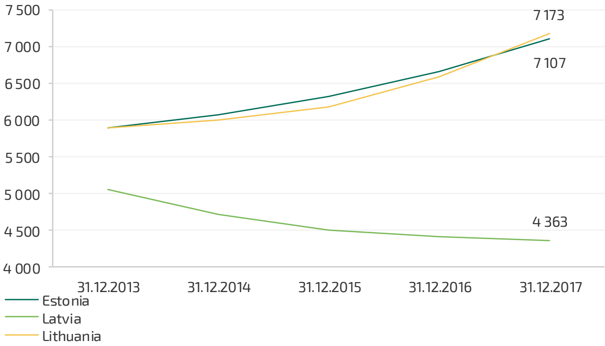
The rise in wages in Latvia and Lithuania has been just as fast as in Estonia, but prices have risen more slowly, with small corrections along the way. For this reason, in recent years, housing has become comparatively more affordable for wage earners in Latvia and Lithuania, than in Estonia. This dynamic is substantially different from the experience during the boom years of 2007-2008, when wages experienced strong growth, but the growth in housing prices was even faster. A real estate bubble developed. In the light of statistics from recent years, these kinds of trends are not showing up today. Although prices have risen, they have gone up at the same pace as or more slowly than wages. Purchasing power is sufficient to justify the higher price levels.

Just as in 2016, last year can be characterised by the continued launch of development projects in all three Baltic capitals. The activity level in Riga continues to be significantly lower, though. The supply of new apartments has grown and the sales periods have become longer. There is increasing market differentiation of more attractive projects.

STOCK OF LOANS GRANTED TO HOUSING DEVELOPMENT PROJECTS IN ESTONIA
in million euros



STOCK OF HOUSING LOANS
in million euros



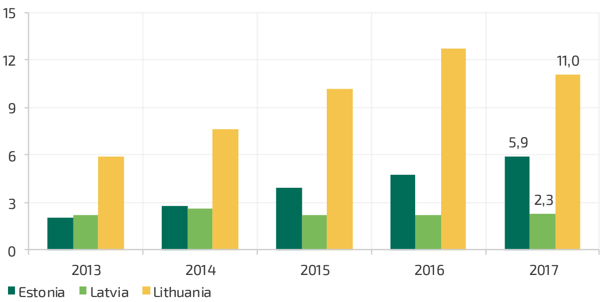
Source: Local central banks.

As the level of construction activity rose in 2017 and new development projects have come on to the market, the balance of loans for housing development projects has also risen slightly in Estonia (2017: EUR 136 million; 2016: EUR 110 million). The growth has been moderate – larger developers continue to finance new projects largely from their own equity and customers' prepayments. Banks are still ready to provide financing, but have become more selective – smaller developers and those who lack history/references have a tough time finding major financing. They are required to have a high proportion of preliminary agreements in place (up to 50% of the project cost) and greater self-financing. Being a real estate developer with a long history and extensive references, Merko Ehitus group thus holds a competitive edge in bringing new development projects to the market.

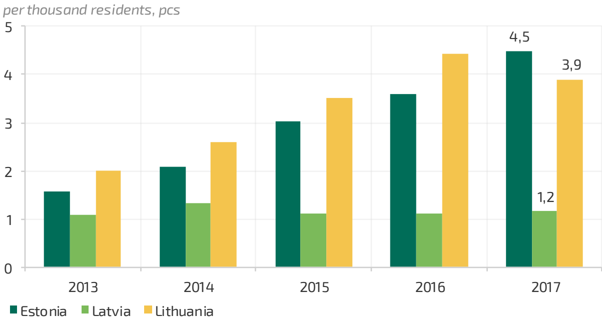
Considering the limited access that smaller developers with less experience have to bank financing, crowdfunding has become more popular. To this point, investor interest remains high, insofar as it continues to be difficult to find good returns in the general financial environment while crowdfunding offers quite good rates. The critical test for this means of financing will be when the first insolvent projects crop up. So far, these have been avoided, thanks to the generally favourable market situation. In any event, crowdfunding currently offers smaller developers a chance to enter the market and thus influence the market situation (including price level).

The housing loan balance continued to increase at an increasing pace in Estonia and Lithuania (Lithuania 2017: +8.9%; 2016: +6.8%; Estonia 2017: +6.7%; 2016 +5.3%). Lithuania has regained the leader position from Estonia in terms of loan balance (Lithuania EUR 7173 million; Estonia EUR 7107 million), a status it lost in 2013. In Latvia, the loan portfolio continued decreasing in 2017 (-1.1%; 2016: -2.0%), a trend that started after 2008, while the loan portfolio reached a bottom back in 2012 in the other two countries. Access to loans is good – in all three markets interest rates are low, self-financing and income requirements are not excessively restrictive. There is no indication that loan terms in the Latvian market are significantly different compared to Estonia and Lithuania. Rather, the general demand in Latvia is still low.

THE NUMBER OF USE AND OCCUPANCY PERMITS ISSUED FOR NEW RESIDENTIAL PREMISES
thousand pcs



THE NUMBER OF USE AND OCCUPANCY PERMITS ISSUED FOR NEW RESIDENTIAL PREMISES
per thousand residents, pcs



Source: Local statistical services.

In regard to the number of use and occupancy permits issued, Estonia has seen constant growth since 2012 (2017: +25%; 2016: +19%). Indeed, in 2017, close to 5,900 new residential units reached the market (2016: approx. 4,700). In comparison, at the height of the boom era in 2007, this figure was about 7,100. In Lithuania, more energetic growth started in 2011 and peaked in 2016, when about 12,700 authorisations were issued. In 2017, 13% fewer authorisations were issued, (approx. 11,000). At the peak of the boom in 2008, the number was about 11,800. As a result of the decrease in 2017, Estonia took the lead from Lithuania in regard to number of use and occupancy permits per thousand residents (Estonia 4.5; Lithuania 3.9; 2016: Estonia 3.6; Lithuania 4.4). In Latvia, the volumes of residential space authorised for use have not grown significantly since the deep downturn after the last booming years, remaining around 2,300 (2016: 2,200; peak in 2007: 9,300), for a figure of just 1.2 residential units per 1,000 of population (2016: 1.1). The figures for Estonia and Lithuania show that activity is high on these markets – comparable with the boom era in terms of volume. At the same time, as noted above, price levels and incomes are significantly better balanced today and overheating of the kind seen last decade is not apparent. In Latvia, developments remain fairly muted.

OUTLOOK FOR 2018

CONSTRUCTION SERVICES

In 2018, we are expecting economic growth to remain relatively strong in all three Baltic states, yet likely to be under the 2017 level. In general, though, the economies of Estonia, Latvia and Lithuania depend directly on how both Europe as a whole and the countries in the vicinity of the Baltics fare. Globally, protectionist risks remain present, just as they were in 2017. An important issue as regards the neighbourhood is what will happen on the Swedish real estate market. Prices started falling in bigger cities there in late 2017. The question is: did it stem only from an imbalance in the structure between demand and supply, in which case a correction could have a positive effect, or were there broader reasons? In the latter case, the consequences could be more sweeping, extending to Baltic markets as well. Unlike the era ten years ago, Baltic banks have much better local capitalisation. That means problems in Sweden should have a milder effect on the liquidity of Baltic banks and therefore result in a lesser need to pare down lending activity.

Another question concerns how possible cooling of the real estate market in Sweden will affect export demand in the Baltics, especially in Estonia. For the local construction market, the effects are twofold. On one hand, general demand could decrease if Estonian export slows. On the other hand, if demand for construction materials drops in Sweden, this could improve their availability in the Baltic market and lower input prices, i.e. the cost base, for local market participants as well. That would in turn help to improve profitability in the construction sector, which has been under considerable pressure (especially for general contractors) and ease the risks of on-time completion of projects stemming from the long waiting periods for orders for construction materials to be filled.

For 2018, we project that competition between general contractors will remain strong and that the number of major projects will remain limited. This will have a more acute impact on profitability of general contractors, the risk-to-return ratio of whose activity is developing to negative direction. Customers' expectations are rising, and the projected construction terms are also becoming shorter. This confronts general contractors with serious decisions, whether to continue bidding at any cost or to become more selective about which projects they vie for. If they are forced to focus only on increasing their revenue/market share, the end result in such an environment may not be positive. This kind of growth could come at the detriment of profits and start to become a burden on the companies' equity. Aggressive bidding continues to be seen on the market, with hopes staked on input prices dropping or changes in project designs, which may not however come to fruition. The direct and indirect risks for customers have thus increased (including the risk of getting a building that does not meet expectations, financial difficulty on the part of contractors and delays in completion as a result, potential disputes between parties over compensation for changes and additional work that arises in projects, etc.), and these will be neglected, if customers pursue favourable prices alone.

A separate question is to what extent the government sector will activate the use of the structural funds during the EU's 2014-2020 financing period. To this point, modest use has been made of these funds, but the final deadline is nearing. This could mean larger orders in the coming years. The increase in such demand among general contractors could mean a more reasonable competitive situation. At the same time, the construction market is already quite active, meaning that additional demand could start raising the construction price index and making the shortage of subcontractors even more acutely felt. Due to major price competition, the Merko group has not been very successful tendering at public procurements. We believe that below a certain price level, quality starts to suffer, and we are not willing to make concessions in this regard. Merko Ehitus group's focus in construction activity will continue to remain on private capital investments into manufacturing, logistics and other business real estate. We are looking to supply integral engineering, design and construction service, high-quality, optimum construction solutions, an efficient construction process, and the certainty that projects will be completed on schedule. We believe that a professional partner who shoulders responsibility for the entire construction process as a whole ensures more reliably a building that meets expectations. As customers are continuing to focus on cheaper construction prices, often with quality suffering as a result, it remains complicated to differentiate from general contractors in regard to more basic, smaller construction sites, and risks are still posed by the increased likelihood of underbidding.

Considering the demands of customers in terms of guarantees and long payment terms, the burden on construction companies' current assets remains high, and to stay competitive it is important that companies be adept at managing cash flows. Merko companies are able to draw on group's relatively strong financial position as a competitive edge in negotiating payment terms.

Under the directive of the European Parliament and of the Council on the energy efficiency of buildings, starting in 2019 all new and substantially renovated public sector buildings must meet nearly-zero-energy requirements. Starting in 2021, the requirements will apply to new and renovated buildings in all sectors. The scope of the impact of the new requirements on the construction sector is unclear. It will certainly mean higher prices, as more costly materials and additional technologies (such as solar panels) will have to be used. The question is to what extent customers are prepared to accept the higher prices. In addition, the existing detailed plans will have to be updated in some regard to meet the new requirements to enable efficient use of technical solutions (e.g. taking into account exposure to and angle of sunlight when it comes to situating buildings on a plot). The design requirements stemming from the new rules will impose additional requirements on competence on all parties involved in the design process, both in the private and public sector. Considering the increasing costs, revisions to detailed plans and need for additional skill sets from all parties, there is a risk that from next year on, public sector demand for building construction will decrease and that the decline in demand will extend to the market for the construction of all buildings starting in 2021.

Being one of the largest general contracting enterprises in the Estonian construction sector, AS Merko Ehitus's subsidiary AS Merko Ehitus Eesti competes effectively in all segments of activity. In the general construction segments, there are certainly many general contractors on the market, and the price competition is stiff, but it often comes at the detriment of quality and contractual risks. In Latvia, the AS Merko Ehitus's subsidiary SIA Merks is among the leading general contractors and in Lithuania, AS Merko Ehitus's subsidiary UAB Merko Statyba has focused in its construction activity above all on apartment developments and the buildings (general construction) segment, where competition at procurements is still very high. The primary focus of Peritus Entreprenør AS, which operates in the Norwegian market, is the construction of buildings in the general construction field, but it is looking to expand its profile of services. On other home markets (Latvia, Lithuania, Norway), the Merko group prefers to increase the share of construction activity in the consolidated sales revenue, but does so selectively, concentrating on only projects whose profitability is sufficient to ensure sustainable development.

APARTMENT DEVELOPMENT

We forecast that Tallinn and Vilnius apartment market will remain active, without significant change in demand or prices. Stabilisation will continue, and among other things, the sales period for projects with a weaker location and quality, and offering less integral solutions for their surroundings, will become longer. The markets will remain receptive to long-term projects with a high quality that have been carried out by developers with good reputation, and we thus believe Merko is in a good position. In Riga, the apartment market remains at a lower ebb. For this reason, special care must be taken in this market in planning developments and executing them according to market expectations.

In an environment characterised by expanded supply and ever more discerning customers, apartment buyers are increasingly oriented to trustworthiness (the developer's and builder's reputation and experience) and construction quality (energy performance, soundproofing) and make their decisions based on infrastructure in the area as well (parking, services, logistics). Customers also place more importance on the environment of a neighbourhood as a whole.

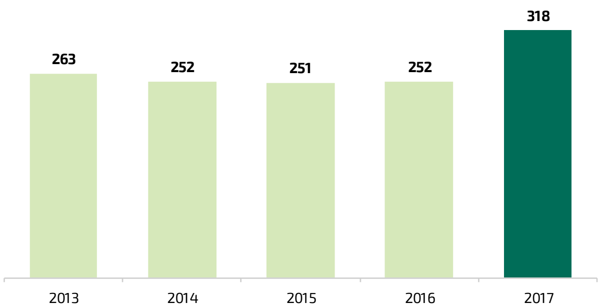
In the Baltics, banks have strong capitalisation and the ratio of loans to deposits is relatively low. This, along with low prime interest rate levels, ensures good accessibility to bank loans for individuals in 2018 as well. Barring major external shocks, loan volumes might well start rising slightly in Latvia, too, where banks' home loan portfolios have been decreasing. The activity of that market unfortunately remains below that of Estonia and Lithuania. Incomes are continuing to grow in all three countries, and unemployment is low. Consumer confidence is healthy, which promotes home-buying as a decision with long-term impact. Based on increasing savings over the last 10 years and the fact that unlike the last boom period (2007-2008), there is no disparity between apartment prices and incomes, people are making a large share of their real estate acquisitions and construction from their own funds.

Merko's goal is to continue carrying out apartment development projects mainly in the medium price range, ensuring high quality and an integral living environment. Through carefully selected projects, we also carry out individual developments in lower and higher price categories.

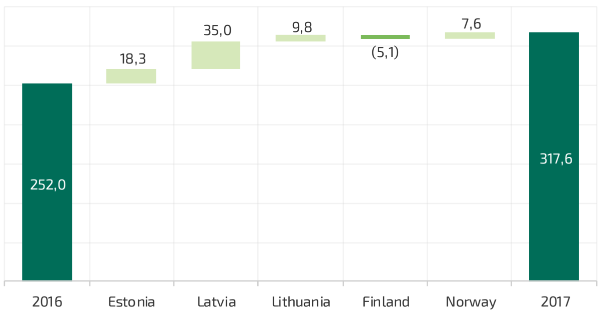
OPERATING RESULT

REVENUE AND PROFIT

GROUP REVENUE
in million euros



GROUP REVENUE
in million euros

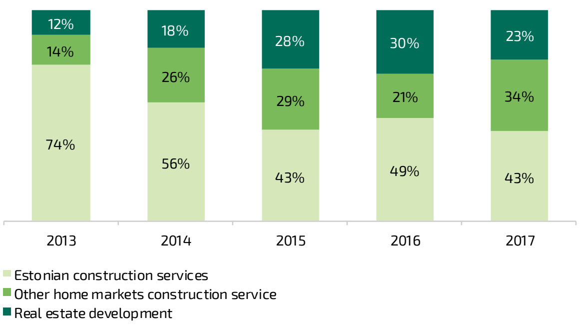


In 2017, the revenue of Merko Ehitus group was EUR 317.6 million. (2016: EUR 252.0 million). 60.1% of the period's revenue was generated in Estonia, 25.2% in Latvia, 10.9% in Lithuania, and 3.8% in Norway (2016: 68.6% in Estonia, 17.8% in Latvia, 9.8% in Lithuania, 2.0% in Finland and 1.8% in Norway). Compared to 2016, the group's revenue increased by 26.0%, including a 10.6% increase in Estonia, 77.9% in Latvia, 39.6% in Lithuania and 170,2% in Norway. In Finland, the revenue decreased by 99.5%.

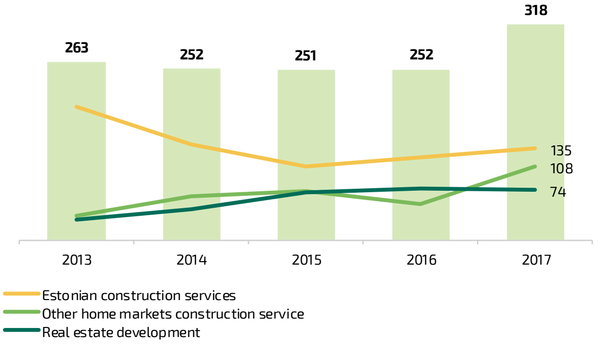
The sales revenue increased on all of group's home markets – in Estonia, Latvia, Lithuania and Norway. The last time sales revenue reached above EUR 300 million was 10 years ago (2007). The group's revenue increased mostly because of the growth in construction contracts concluded with private sector customers in the last two years. Large construction objects have been put to work and revenue from those was partly recognised in 2017 and will also be recognised in 2018 according to construction schedule.

The main changes in the revenue structure compared to the same period last year lie in the growth in revenue from other home markets construction services' general construction projects and in the decrease in the sales revenue of the real estate development segment. The revenue growth in the other home markets construction services has been supported mainly by major construction contracts in Latvia. Merko Ehitus is focused on successfully completing these projects and keeping the future volumes stable. Considering the increasing price competition among main contractors in construction services in Estonia and on other home markets as well as the simultaneous increase in input prices, the group is seriously weighing which construction projects to bid for.

DISTRIBUTION OF GROUP REVENUE ACCORDING TO SEGMENTS
percentages



DISTRIBUTION OF GROUP REVENUE ACCORDING TO SEGMENTS
in million euros

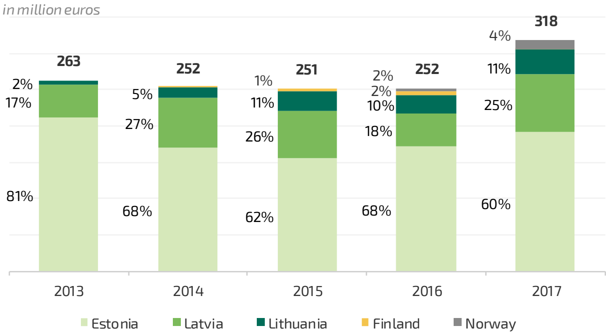


Estonian construction service segment contributed 43% (2016: 49%), other home markets construction service segment 34% (2016: 21%) and real estate development segment 23% (2016: 30%) of the group's revenue.

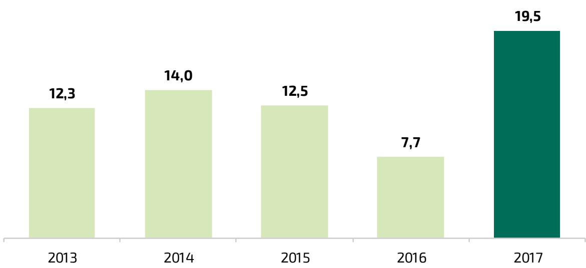
By country, Estonian sales continued to account for the largest share of revenue – 60% (2016: 68%) – at the same time the group's percentage of revenue from outside of Estonia increased to 40% (2016: 32%). It is one of the group's strategic objectives to increase the proportion of revenue generated from other home markets outside Estonia (Latvia, Lithuania, Norway) to approximately half.

In 2017, the group's operating profit from development and construction activities totalled EUR 19.5 million (2016: EUR 7.7 million). The 2017 operating profit margin (6.2%) has increased by 3.1 pp compared to last year (2016: 3.1%). Making the internal processes more efficient, as well as factors of a one-time nature have played their role in that. Considering the latter, sales of immovables that had been in the works for a longer period took place, also some inventory was revalued.

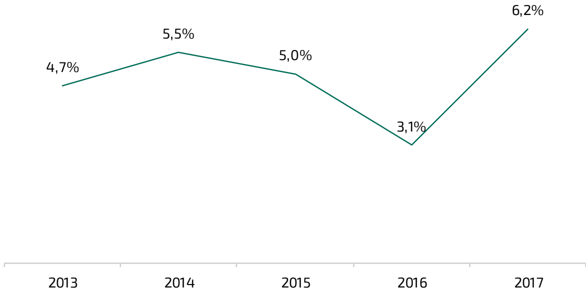
DISTRIBUTION OF GROUP REVENUE BY GEOGRAPHICAL LOCATION
in million euros



GROUP OPERATING PROFIT
in million euros



GROUP OPERATING PROFIT MARGIN
percentages

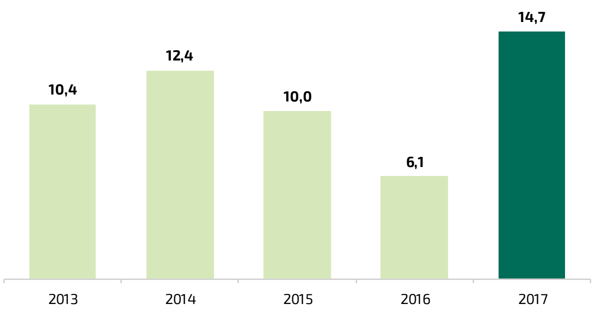


The group's aim is to preserve profitability in both the Estonian, but also other home markets' construction service domain, in spite of the prevailing competition situation between the main contractors, limited capabilities of sub-contractors and increasing input prices. The group continues to be geared towards moderate increase of operational volumes, but only in a capacity, which ensures that the risk profile of the business does not grow substantially more agressive. Profitability is supported by apartment development, which remains the group's central business line.

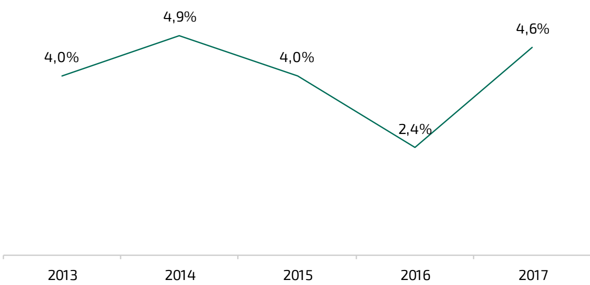
The scarcity of large scale projects and the ever-tightening competition in the construction sector poses a great challenge in maintaining the current level of operating profits in all segments. The number of companies participating in tenders and the risk of overly aggressive pricing bids is high in all three Baltic states.

In 2017, the group's pre-tax profit totalled EUR 18.8 million and the net profit attributable to owners of the parent company was EUR 14.7 million, compared to the pre-tax profit of EUR 7.3 million and net profit attributable to owners of the parent company of EUR 6.1 million in 2016. The group's profit before tax margin was 5.9% (2016: 2.9%) and net margin was 4.6% (2016: 2.4%).

GROUP NET PROFIT
in million euros



GROUP NET PROFIT MARGIN
percentages



In the second quarter of 2017, the group paid EUR 7.3 million in dividends, which incurred additional income tax expense in the amount of EUR 0.9 million. The situation in the second quarter of 2016 was alike, when the group paid EUR 9.0 million in dividends and incurred additional income tax expense in the amount of EUR 0.6 million.

BUSINESS ACTIVITIES

The group operates mainly in Estonian, Latvian, Lithuanian and Norwegian market through its subsidiaries. Depending on the country, the group offers construction services and real estate development services across the following business segments: Estonian construction service (incl. construction services on project basis in Finland), other home markets construction service (incl. construction services in Latvia, Lithuania and Norway) and real estate development. See additionally the detailed management structure on page 49.

ESTONIAN CONSTRUCTION SERVICE

OTHER HOME MARKETS CONSTRUCTION SERVICE

REAL ESTATE DEVELOPMENT

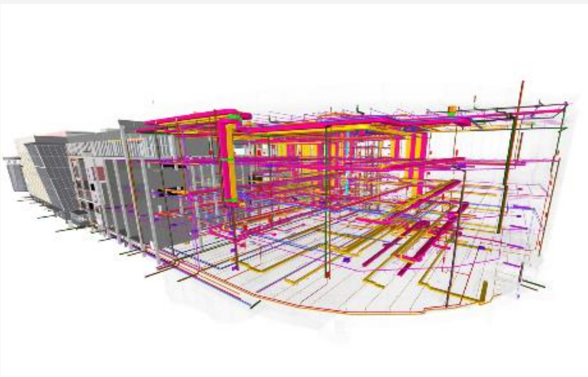
Pursuant to the international financial reporting standards (IFRS 8), the group discloses in the external financial reporting an aggregate overview of the business segments in countries that constitute a smaller share in operations, in accordance with the requirements established for the disclosure of business segments.

The business operations of the Estonian construction service, other home markets construction service and real estate development includes construction projects where the group operates in the following fields:

- **GENERAL CONSTRUCTION:** construction of various buildings, including commercial and office buildings, retail and entertainment centres, hotels and spas, as well as public buildings, dwellings and specific industrial buildings. In the context of main contracting, we provide high quality complete solutions to meet the client's needs.
- **CIVIL ENGINEERING:** design and construction of infrastructure facilities. The field includes port, waste handling and road infrastructure (bridges, tunnels, overpasses, roads), various environment protection facilities, drinking water and waste water treatment facilities, water and sewerage mains built using both open and no-dig methods, and various other engineering and technical sites.
- **ELECTRICAL CONSTRUCTION:** above all, medium and high voltage substation and cable line engineering configuration and construction. Merko has a professional project management team with good cooperation experience with local and international customers.
- **ROAD CONSTRUCTION:** various road maintenance services in Estonia: road construction, maintenance repair of roads, supervision of excavation works and the condition of roads, provision of repair services for machinery.
- **CONCRETE WORKS:** solutions for buildings and infrastructure constructed of prefabricated or concrete panels by group companies and out-of-house customer.
- **REAL ESTATE DEVELOPMENT:** development of apartment projects, long-term real estate investments and real estate projects for business purposes.

One of the keys to Merko's success is the wide scale of its operations – if a certain business segment has more or less work, it is possible to re-assign staff and manage risks. Another competitive advantage is the professional team of project managers and engineers and experience in implementing complex projects using contemporary engineering solutions. Merko' strength is also in completing simultaneously various complex and long-term projects, while providing high quality construction services to customers with different requests.

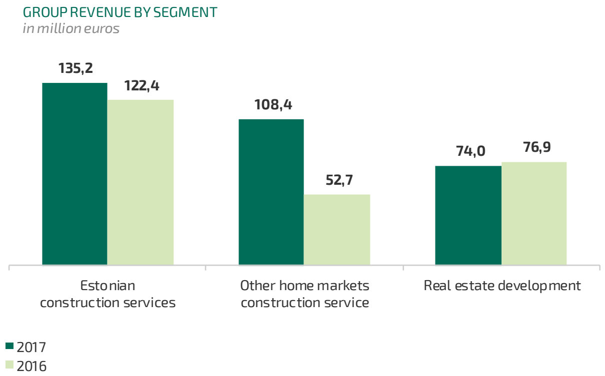
BUILDING INFORMATION MODELING

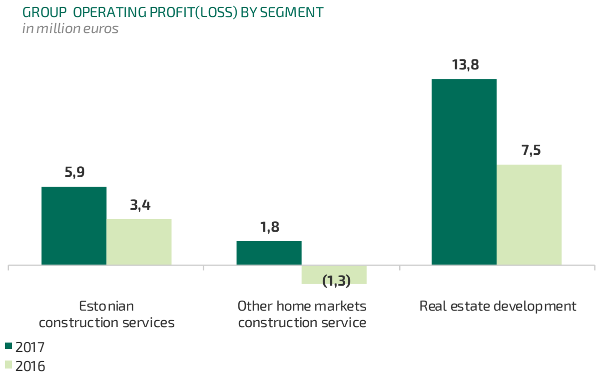


With the goal of offering customers more integral and higher quality service and bolstering the effectiveness of cooperation between different parties, Merko has adopted BIM – building information modeling. BIM leads to a better understanding of the building and its shape and structure, enabling to check for conflicts in project documentation, calculate structural volumes of the project and produce 3D visuals. BIM also enables improved estimations of future energy needs, maintenance costs and ease of use of the building.

Of the projects completed in 2017, BIM was used in the construction of Telia Estonia headquarters, Staapli 4 and Paepargi 51 and 53 apartment buildings. Telia headquarters has received the 2017 digital building of the year special award.

CHANGE IN GROUP REVENUE AND OPERATING PROFIT ACROSS BUSINESS SEGMENTS





ESTONIAN CONSTRUCTION SERVICE

The Estonian construction service segment consists of services in the field of general construction, civil engineering, electricity, external networks and road construction, as well as concrete works and construction services on project basis in Finland.

million EUR

	2017	2016	CHANGE
Revenue	135.2	122.4	+10.5%
% of total revenue	42.6%	48.6%	
Operating profit	5.9	3.4	+72.2%
Operating profit margin	4.3%	2.8%	

In 2017, the revenue of the Estonian construction service segment was EUR 135.2 million (2016: EUR 122.4 million), having increased by 10.5% from the same period last year. Estonian construction service revenue includes revenue from Finnish projects in the amount of EUR 0.02 million (2016: EUR 0.6 million). The increase in revenue in the segment is primarily influenced by the fact that several large-scale general construction projects launched in 2016.

The Estonian construction service segment revenues for 2017 were 42.6% of the group's revenue, forming the largest proportion in the group's revenue, having decreased by 6.0 pp in the yearly comparison.

In 2017, the group earned an operating profit of EUR 5.9 million in this segment (2016: EUR 3.4 million). In 2017, the operating profit margin of the Estonian construction service segment was 4.3%, which increased by 1.5 pp compared to 2016 (2.8%). The profitability indicator has improved due to the increased efficiencies of internal project management processes.

The competition in main contracting in the area of general construction is getting increasingly tighter in the Estonian construction services market. The number of construction objects in the market is limited and therefore contractors tend to leave an increasingly small buffer for profitability and adverse developments when competing in price. This is particularly evident in public procurements where Merko is finding it increasingly difficult to successfully participate. Thus, the share of the public sector in Merko's Estonian construction services portfolio has considerably decreased since 2013, dropping to approximately one fifth in 2017. The depression in sales prices is accompanied by an increasing cost pressure from growing construction prices. The prices of labour, construction equipment and building materials have all increased. In order to ensure sustainable profitability, the group has to continue improving the efficiency of internal project management processes and optimizing the placement of resources and the cost base.

Among the substantial projects in process that started in 2017 and earlier and will continue in 2018 are the construction works of Öpiku office building B, Viimsi State Gymnasium, Tallink office building, extension works to the complex of the air traffic control centre, Embassy of the People's Republic of China residence, extension works of Wendre production building and construction works for clean up of the residual pollution of the Maadevahe and Priimetsa asphalt concrete plant. Also, the design and construction works of T1 shopping centre and Pärnu road 22 office building will continue.

LARGEST PROJECTS COMPLETED IN 2017

PROJECT NAME		LOCATION
Telekom office building	new	Mustamäe st. 3 and 3a, Tallinn
Airport tramline infrastructure	new	Tallinn
BAUHAUS DIY store	new	Kaerävälja st. 3, Rannamõisa st. 4b, 4c and 4d, Tallinn
Barracks of the Tapa military base	new	Loode 35, Tapa, Lääne-Viru county

PROJECT NAME		LOCATION
Viru Infantry Battalion technology park buildings and facilities	new	Pargi 55, Jõhvi, Ida-Viru county
Extension of KTN logistics centre II stage in Tallinn	new	Klauske st. 1, Muuga, Jõelähtme municipality
Passenger walkway at Vanasadama Harbour quay No 5	new	Sadama 25, Tallinn
Juuliku junction and road section of the Tallinn roundabout	new	E265/T-11 Tallinn roundabout 24,1 km to 29,6 km
Käina substation 35/10 kV	rec	Luguse village, Käina municipality, Hiiu county
Rakke substation 35/10 kV	rec	Suure-Rakke village, Rakke municipality, Lääne-Viru county
Saare substation 110 kV	rec	Saarjärve village, Saare municipality, Jõgeva county
Tööstuse substation 110 kV	rec	Tähe 144a, Tartu
Elektrilevi OÜ grid connection in Mustamäe 110/6 kV substation	new	Vilde st. 92a, Tallinn
Soodevahe village, wastewater and pressure booster pumps	new	Soodevahe village, Rae municipality, Harjumaa
Sviby port reconstruction, II stage	rec	Vormsi, Läänemaa
Luige-Kangru lightway road	new	Kangru and Luige boroughs, Kiili municipality, Harjumaa
Tabasalu Ranna street II stage	new	Ranna st, Tabasalu

THE TALLINN AIRPORT TRAMLINE

Through various projects, Merko has contributed to the renewal of the Tallinn public transport network. A recent example is the tramline no. 4 extension completed in November 2017, which ensures a fast link between the city centre, airport and the train station at Ülemiste – the future main terminal for Rail Baltic. The extension starts from a turning area along the Peterburi Road thoroughfare, passes through a tunnel under the railway and Suur-Sõjamäe streets, rises through a channel to re-emerge at the surface on Keevise Street and ends with a turnaround circle at the airport. During establishment of the 150-metre-long enclosed part of the tunnel – Estonia's first tram tunnel – and the 125 metres of ramp, about 10,000 m^3 of limestone and 6,000 m^3 of soil were removed. A total of 1,000 m^3 of concrete was poured or assembled, plus the tramlines and load-bearing structures totalling about 700 m^3.

JUULIKU ROAD JUNCTION

As a result of various engineering works, Merko has done its part to make traffic safer. In 2017, the group's subsidiary Tallinna Teede AS completed construction on the Juuliku junction, in which the segment of the Tallinn roundabout (E265/T-11) between 24.1 km and 29.6 km – i.e. between the Kanama and Saku overpasses – was renovated into a category 1 highway (2+2 travel lanes). A 3.35 km segment of the Juuliku-Tabasalu connecting road was built on a new road clearance, along with the multi-level Juuliku interchange, and the dangerous Jälgimäe intersection was closed at E265/T-11 28.29 km. Two overpasses and two bridges were built in the course of construction on the junction.

OTHER HOME MARKETS CONSTRUCTION SERVICE

The other home markets construction service segment consists of general construction work in Latvia, Lithuania and Norway, as well as civil engineering and electricity construction services in Latvia.

million EUR

	2017	2016	CHANGE
Revenue	108.4	52.7	+105.6%
% of total revenue	34.1%	20.9%	
Operating profit (loss)	1.8	(1.3)	
Operating profit margin	1.7%	(2.5%)	

The revenue of the other home markets construction service segment amounted to EUR 108.4 million in 2017 (2016: EUR 52.7 million), which is doubled compared to year 2016. If the other home markets construction service segment revenues of 2016 formed 20.9% of the group's revenue, then during 2017 this has increased to 34.1%. The revenue has increased in all other home markets (in Latvia, Lithuania and Norway) due to large projects being implemented.

In 2017, the operating profit of the other home markets construction service segment amounted to EUR 1.8 million (2016: EUR operating loss 1.3 million) and the operating profit margin was 1.7% (2016: -2.5%). In Latvia, Merko has gained a stronger position among general contractors than previously, which provides opportunities to grow business volumes. In Lithuania, the group is continuing with a strategic plan to focus on foreign customers, who make up the predominant part of the group's Lithuanian secured order book. In Lithuania, we have also entered more widely the public procurement sphere in the field of general construction. In Norway, group signed two major construction contracts in 2017, in the amount of EUR 4.3 million and EUR 6.4 million, as well as performed several smaller-scale agreements. The group is facing tough competition and growing costs also in other home markets (primarily Latvia and Lithuania). We are therefore carefully deliberating in participating in procurements in those markets and submit tenders for contracts in which we consider the risk to reward ratio to be sufficiently good. In 2018, the primary focus in this segment is on the successful completion of large projects in progress.

Among the substantial projects in process that started in 2017 and earlier and will continue in 2018 are the construction works of Multifunctional Centre Akropole and of Alfa Shopping Centre, finishing works of Z-Towers complex in Riga and the construction works of music school and concert hall in Ventspils. In Vilnius, the larger projects were the construction works of Radisson Blu Hotel Lietuva extension and, the reconstruction of Neringa Hotel and, in Klaipeda, reconstruction and extension construction works of Philip Morris plant. In Norway, the larger projects included construction works for an extension of Blakstad Hospital building, and renovation and building works of Akersgata 8 office building in Oslo.

LARGEST PROJECTS COMPLETED IN 2017

PROJECT NAME		LOCATION	COUNTRY
Kauno/Algirdo residential complex with office premises	new	Kauno 16 / Algirdo 42, Vilnius	Lithuania
Narbuto 5 office building	new	Narbuto 5, Vilnius	Lithuania
Jasmīnu 10 residential complex	new	Jasmīnu 10, Jurmala	Latvia
Kalku apartment building	new	Kalku 20, Riia	Latvia

BRITISH INTERNATIONAL SCHOOL

In 2017, the Latvian subsidiary SIA Merks completed the construction of the British International School in Riga. The school is one of the eight prestigious British King's College schools in the world. King's College has been operating in the education system of the United Kingdom and other countries for 45 years. The school provides education to children of all age groups, starting from pre-school to secondary school, with studies being conducted by teachers from the United Kingdom. The school territory spans 1.5 hectares and includes several sports grounds and playgrounds. The two-storey school building contains 32 classrooms, an art studio, music rooms, a nature science laboratory, a computer classroom and a diner. The building has been constructed so that it can be expanded in the future.

REAL ESTATE DEVELOPMENT

The real estate development segment includes residential real estate development and construction of joint venture projects, long-term real estate investments and commercial real estate projects in Estonia, Latvia and Lithuania. In the interests of the finest quality and maximum convenience and assurance for buyers, Merko handles all phases of development: acquisition of the real estate, planning, design of the development project, construction, sales and marketing, and warranty-period customer service.

million EUR

	2017	2016	CHANGE
Revenue	74.0	76.9	-3.7%
incl. apartments revenue	47.1	56.6	
incl. construction service to joint venture projects	18.5	7.7	
incl. revenue from immovable properties	5.2	9.2	
% of total revenue	23.3%	30.5%	
Operating profit	13.8	7.5	+84.0%
Operating profit margin	18.6%	9.7%	

A total of 392 apartments (incl. 17 apartments in joint ventures) were sold in 2017 at the total value of EUR 47.1 million (excl. VAT), compared to 493 apartments (incl. 21 apartments in joint ventures) and EUR 56.6 million in 2016. Of the 392 apartments sold 289 were located in Estonia, 68 in Latvia, 35 in Lithuania. In 2017, the group earned EUR 5.2 million of revenue from the sale of immovable properties (2016: EUR 9.2 million). The construction service revenue from projects developed by joint ventures in 2017 was EUR 18.5 million (2016: EUR 7.7 million).

In 2017, the share of revenue from the real estate development segment formed 23.3% of the group's total revenue (2016: 30.5%), having decreased over the year by 7.2 pp. The main reason for the decrease of the share is the rapidly grown volumes of construction services in the other home markets. At the same time, the sales revenue of real estate development declined by 3.7%, mainly due to decrease in the sales of apartments. At the end of 2016, the group's apartment stock was somewhat lower than in the preceding year and therefore the group had fewer apartments to sell. The demand for apartments developed by Merko remains at a good level. In the light of that, the group in 2017 increased the number of apartments it developed, thus also increasing the apartment stock by the end of the year.

In 2017, operating profit of the real estate development segment amounted to EUR 13.8 million (2016: EUR 7.5 million) and the operating profit margin was 18.6% (2016: 9.7%), which increased by 8.9 pp compared to the same period previous year. The profitability of the apartment development projects varies by project and depends greatly on the cost structure of the specific project, incl. the land acquisition price. The segment's profitability was positively influenced by the one-off factors: the sale of immovable properties that are strategically not needed by the group, and revaluation of inventories. At the same time, the operating profit margin has been reduced, in comparison with 2016, by the growth in the volume of construction service projects developed by joint ventures. Profit from construction has been recognised in the course of construction and the profit from development is realised at a later stage, upon sale of apartments to the final customer, based on the equity method.

RINKTINĖS URBAN RESIDENTIAL AREA

In the real estate development field, Merko focuses on establishing comprehensive modern environments, and the Rinktinės Urban project, developed by group company UAB Merko statyba, in the city centre of Vilnius certainly fits this bill. The first phase of the development is now under construction, including three energy class A apartment buildings with more than 120 apartments, hotel "Ibis" with 164 rooms and an underground two-level garage serving the whole development area, providing convenient parking for cars and bicycles. Between the buildings, an interior courtyard with playground and exercise equipment will take shape, and storefronts on the lower levels will ensure necessary services to residents. The first phase will be completed by the end of 2018, and the second phase of the development will add three apartment buildings and an underground garage.

Managing a substantial portfolio of immovables requires careful and detailed planning of the whole process: the development of apartment buildings starts by organising the detailed planning, designing and construction and ends with the sale of completed production and warranty service. The underlying idea of our development activities is to value land through detailed planning and building development, to find customers for the property and sell the property as developed real estate.

Merko manages all development phases of new housing – planning, designing, building and sales. Homes developed and built by Merko are characterised by integrated living environments, high energy efficiency, good sound insulation from indoor and outdoor noise as well as healthy interior climate.

Our objective is always to create homes that architecturally fit the specific region, have an attractive living environment, functional design solutions, quality interior design materials, optimal construction cost and energy efficiency. A home that is being offered for customers must be of high quality and maintain its value in years to come.

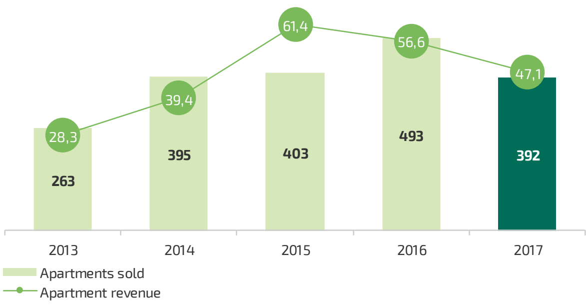
In real estate development joint projects, Merko brings its knowledge and experience of real estate development and construction to the partnership and the other party provides the plot and/or investment. The relationships between the parties are regulated by a stakeholders' contract that specifies the liability, rights and responsibility of each partner.

JOINT PROJECT NOBLESSNER HOME PORT

In cooperation with BLRT Group, Merko is developing the Noblessner port area from a historical industrial region into a modern residential and business environment. The Home Port project includes over 200 apartments in four apartment buildings and nearly 3,700 m² of office and commercial premises. The 66-apartment building completed at the end of 2017 is the most seaward apartment building in Estonia, located just seven metres from the sea. The remaining three apartment buildings will be complete by the end of 2018. In developing the 15-hectare territory, BLRT will also renovate the historical industrial buildings, build a beach promenade, a new urban square and a breakwater, additional access roads for car and light traffic, restore the yacht club building, expand the yacht harbour and repair the foundry, which has become a well-known concert venue.

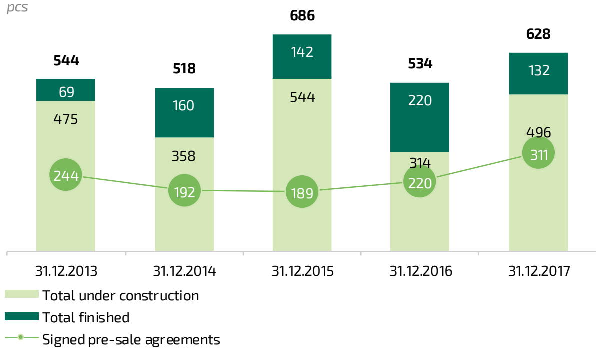
APARTMENTS SOLD / APARTMENT REVENUE

pcs / in million euros



GROUP APARTMENTS INVENTORY

pcs



At the end of the period, Merko Ehitus group's inventory of apartments amounted to 628 units, of which 132 were completed and 496 in construction. 311 apartments were covered with preliminary agreements, incl. 36 completed apartments (28 in Estonia, 5 in Latvia and 3 in Lithuania) and 275 apartments under construction (185 in Estonia, 25 in Latvia and 65 in Lithuania). The sale of these apartments had not yet been finalised and the apartments had not been delivered to customers, as the development sites are still under construction or the sites were completed at the end of the reporting period and the sales transactions have not all been finalised yet.

As at 31 December 2017, Merko Ehitus group had a total of 317 apartments for active sale (as at 31 December 2016: 314 apartments), for which there are no pre-sale agreements and of which 96 have been completed (47 in Estonia, 44 in Latvia and 5 in Lithuania) and 221 are under construction (95 in Estonia, 71 in Latvia and 55 in Lithuania).
The number of apartments on sale as at 31 December 2017 has increased, compared to 31 December 2016, mainly due to the higher volume of projects launched in 2017: launch of construction of 496 new apartments, compared to the 344 new apartments in 2016.

APARTMENT PROJECTS IN PROGRESS AND INDICATIVE DATE OF COMPLETION

PROJECT	PLACE/COUNTRY	COMPLETION DATE	NO. OF UNSOLD APARTMENTS *	INCL. PRE-SOLD APARTMENTS
Fizikų 8	Vilnius, Lithuania	Completed	4	2
Tartu road 52 stage I & II	Tallinn, Estonia	Completed	23	1
Krokuvos 73	Vilnius, Lithuania	Completed	4	1
Grostonas 12 stage I (Skanstes Parks)	Riga, Latvia	Completed	6	-
Grostonas 12 stage II (Skanstes Parks)	Riga, Latvia	Completed	43	5
Paepargi 53 (Paepargi towers)	Tallinn, Estonia	Completed	2	2
Staapli 4 (Noblessner Homeport) ***	Tallinn, Estonia	Completed	50	25
			132	**36**
Started in 2017				
Gaiļezers residential complex stage I	Riga, Latvia	Beginning of 2018	96	25
Ceikiniu 3 (Rinktinės Urban) **	Vilnius, Lithuania	Second half of 2018	120	65
Staapli 3 (Noblessner Homeport) ** / ***	Tallinn, Estonia	End of 2018	103	58
Staapli 8 (Noblessner Homeport) ***	Tallinn, Estonia	End of 2018	18	-
Paepargi 43 and 47 (Paepargi)	Tallinn, Estonia	Summer of 2018	66	65
Paepargi 39,41 and 45 (Paepargi)	Tallinn, Estonia	Autumn of 2018	93	62
			496	**275**
Total			**628**	**311**

** The completed apartments indicate the number of apartments that are unsold and where possession has not been given to customers.*

*** The number of apartments has been corrected compared to the information provided at the start of project.*

**** Project developed by a joint venture. Group revenue generated through provision of construction services, and profit of development activities recognised based on the equity method.*

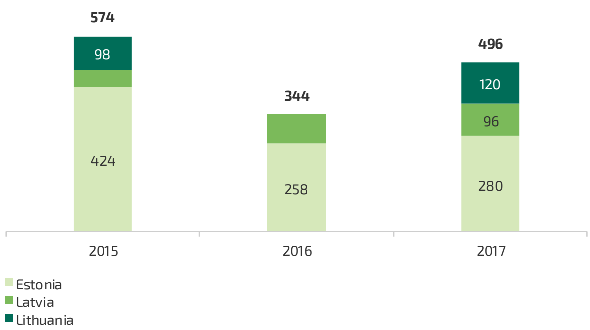
In 2017, we launched the construction of a total of 496 new apartments (incl. 121 apartments in a joint venture) in the Baltic states (2016: 344 apartments (incl. 66 apartments in a joint venture).

After the balance sheet date, the group has also launched three apartment development projects:

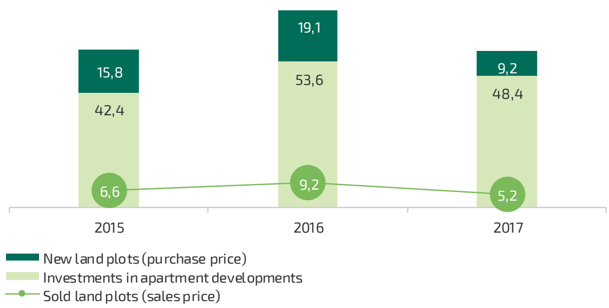
- the Basteja Life residential development project with 75 apartments, located in the old town of Vilnius
- the Rand residential development project with total of 31 apartments and 6 commercial premises, located at Suur-Patarei 20 in Tallinn
- the Tähepargi residential development project with total of 13 apartments, located at Öö 3 and Pargi 19 in Tartu

In 2017, the group invested a total of EUR 48.4 million (2016: EUR 53.6 million) in new development projects launched in 2017 as well as projects already in progress from previous year.

APARTMENTS LAUNCHED BY GEOGRAPHICAL LOCATION
pcs



INVESTMENTS IN APARTMENT DEVELOPMENT PROJECTS AND LAND PLOT ACQUISITIONS AND DISPOSALS
in million euros



We will continue to invest in residential real estate projects and depending on the apartment market developments in 2018, the group will launch the construction of approximately 650-700 new apartments in the Baltic states. In 2017, construction of 496 apartments was started, which is about 150 units less than the level planned in early 2017 (650-700 new apartments), mainly due to the delay in receiving building permits for projects. The planned investment level in 2018 in both development projects initiated in the previous years and new projects to be launched in 2018 is nearly EUR 60 million (2017: EUR 48.4 million invested).

One of the group's objectives is to keep the land plot portfolio at a level that ensures stable inventory of property development projects, considering the market conditions. At 31 December 2017, the group's inventories included land plots with development potential, where the construction works had not started, of EUR 63.6 million (31.12.2016: EUR 63.2 million).

GROUP'S INVENTORIES WITH DEVELOPMENT POTENTIAL BY COUNTRY AS AT 31.12.

million EUR

	31.12.2017	**31.12.2016**
Estonia	28.9	26.6
Latvia	26.5	28.1
Lithuania	8.2	8.5
Total	**63.6**	**63.2**

In 2017, the group purchased new land plots at an acquisition cost of EUR 9.2 million for development purposes, incl. EUR 5.1 million in Estonia and EUR 4.1 million in Latvia (2016: acquired different new land plots in Estonia at an acquisition cost of EUR 16.8 million and in Lithuania at an acquisition cost of EUR 2.3 million). In 2017, the group acquired approximately 1.5 hectare development area in Riga city centre, allowing to build nearly 350 apartments in the upcoming years. In Estonia, the group purchased immovable properties located on the Maarjamäe limestone cliff in the Lasnamäe district of Tallinn. Considering the registered immovables in this area that were already owned by the group, there is now potential to establish more than 1000 apartments. The development has a long-term perspective and will take place in multiple phases.

THE SPECIFICATIONS OF PROJECTS COMPLETED IN 2017

PROJECT		**LOCATION**	**SIZE**
Paepargi 35, 37	new	Tallinn, Estonia	2,171 m^2, 41 apartments
Paepargi 51	new	Tallinn, Estonia	3,709 m^2, 60 apartments
Paepargi 53	new	Tallinn, Estonia	3,709 m^2, 60 apartments
Staapli 4 *	new	Tallinn, Estonia	6,475 m^2, 66 apartments
Grostonas 12 II stage (Skanstes parks)	new	Riga, Latvia	8,277 m^2, 77 apartments

** A project developed by a joint venture.*

Projects completed in 2017 had a total of 304 apartments, of which 95 have not been sold by the year-end and of which 32 apartments had a preliminary agreement signed but where the sale had not yet been finalised and delivered to customers.

SATISFACTION SURVEYS AMONG APARTMENT BUYERS

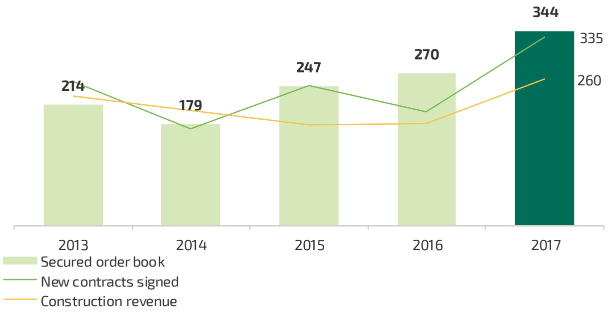
In 2017, Merko conducted satisfaction surveys among Estonian apartment buyers. Respondents had bought homes in the Tartu mnt 52 residential quarter, and the buildings at Sõpruse pst 33, Paepargi 35, 37 and 51 in Tallinn. The results indicate that the Merko trademark is held in high regard among the buyers. The study measured Merko's general recommendation index, and the average result for the projects in question proved to be +70 (on a scale of -100 to +100). In addition, customer satisfaction with sale and marketing materials, the purchasing process, the design and construction quality of apartments and the residential environment created was also gauged. All projects achieved an average score of more than 8 on a 10-point scale; this can be considered a very strong result. The satisfaction surveys give Merko valuable feedback on how to improve products and services further.

SECURED ORDER BOOK

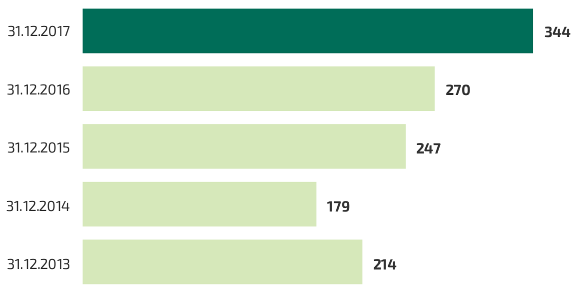
As at 31 December 2017, the group's secured order book (excluding own property developments) amounted to EUR 344.4 million as compared to EUR 269.6 million as at 31 December 2016. The secured order book excludes the group's proprietary residential development projects and work related to developing real estate investments.

In 2017, new construction contracts worth EUR 334.9 million were signed (excludes property developments) as compared to EUR 202.4 million in the prior year.

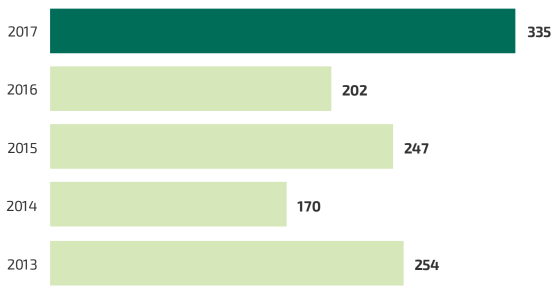
SECURED ORDER BOOK
in million euros



SECURED ORDER BOOK
in million euros



NEW CONTRACTS SIGNED
in million euros



LARGEST CONSTRUCTION CONTRACTS SIGNED IN 2017

in millions of euros (as announced during 2017 on Nasdaq Tallinn stock exchange)

BRIEF DESCRIPTION OF CONTRACT	COUNTRY	COMPLETION DATE	COST
Contract to perform design and construction works of Öpiku maja second office building in Tallinn	Estonia	August of 2018	15.5
Design-build contract with the groups 50% joint venture Kodumaja OÜ for the establishment of the apartment building at Staapli 3 *	Estonia	End of 2018	15.3
Design and construction works of extension of Wendre production building in Pärnu	Estonia	August of 2018	6.0
Construction contract for renovation to the Embassy of the People's Republic of China official embassy residence in Tallinn	Estonia	September of 2018	6.0
Construction contract for the constructing an extension to the complex of the air traffic control centre in Tallinn	Estonia	May of 2018	5.2
Construction contract for the construction of residential building in Toom-Kuninga 21, Tallinn	Estonia	December of 2018	5.1
Construction contract for the constructing of Viimsi State Gymnasium	Estonia	Autumn of 2018	4.9
			58.0
Contract to perform construction works of multifunctional centre Akropole in Riga	Latvia	January of 2019	100.0
Construction contract for the completion of construction of multifunctional Z-Towers Complex in Riga	Latvia	September of 2018	36.0
Construction contract for the constructing an extension to the Alfa Shopping Centre in Riga	Latvia	July of 2019	34.0
			170.0
Contract to perform design and construction works of the residential complex in Šaltiniu Namai quarter in Vilnius	Lithuania	January of 2019	10.8
Construction contract for the reconstruction and renovation to the Neringa hotel building in Vilnius	Lithuania	December of 2018	7.0
			17.8
Construction contract for the renovation and re-building to the office building in Oslo	Norway	March of 2019	6.4
Contract to performe design and construction works of an extension of a building at Blakstad Hospital in Asker	Norway	December of 2018	4.3
			10.7
Total			**256.5**

On 7 April 2017, AS Merko Ehitus 100% subsidiary SIA Merks concluded a 100-million euro contract with SIA M257 (the client) for construction of the multifunctional Akropole centre at Maskavas street 257, Riga. The main contractor, SIA Merks, has engaged UAB Mitnija as a 50:50 partner in the management of the project. The contract is fully included in the secured order book, as SIA Merks remains directly responsible to the contracting entity.

Of the contracts signed in 2017, private sector orders continued to account for the vast majority, which is also represented in the group's secured order book as at the end of the reporting period, where private sector orders from projects in progress constitute 85.9% and public sector orders make up 14.1% (31.12.2016: 71.5% private sector and 28.5% public sector). The group continues to focus on comprehensive supply of the design and construction contracts.

Traditionally, the share of Estonian construction activity has been the highest in the group's revenues. To diversify group's operating portfolio, a strategic goal is to increase construction service revenues outside Estonia. Thus, the group continues to identify and strengthen its competitive advantages and are closely monitoring the development and opportunities in both the Baltic states and the Nordic countries, especially in Norway. At the same time, it has to be ensured that the growth is profitable. The group is therefore focused on ensuring that sales revenue is grown only on the basis of projects with an acceptable risk to reward ratio.

SATISFACTION SURVEYS AMONG CONTRACTING ENTITIES

In 2017, Merko also conducted satisfaction surveys in Estonia among institutions and companies who contracted services for Merko. Feedback was requested regarding projects completed in 2016 and 2017.

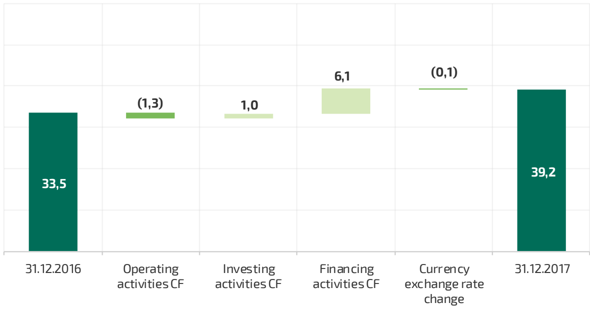
The results showed that Merko's general recommendation index, customer loyalty index, was +50 in 2016 and +54 in and in 2017 (on a scale of -100 to +100). Going topic by topic, Merko received a score of more than 8 out of 10 in both years in availability of key persons, willingness to work together in future, and Merko employees' work ethic, communication and attitude.

CASH FLOWS

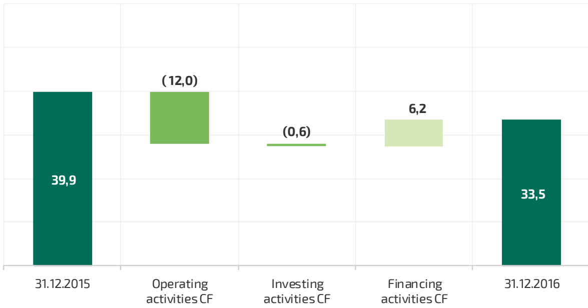
The change in short-term investments and cash equivalents in 2017 of Merko Ehitus group was positive EUR 5.7 million and as at 31 December 2017 the group had cash and cash equivalents in the amount of EUR 39.2 million (31.12.2016: EUR 33.5 million).

The operating cash flows of 2017 were negative by EUR 1.3 million (2016: negative by EUR 12.0 million), the cash flows from investment activities were positive by EUR 1.0 million (2016: negative by EUR 0.6 million) and cash flows from financing activities were positive by EUR 6.1 million (2016: positive by EUR 6.2 million).

CHANGE IN CASH AND CASH EQUIVALENTS
in million euros



CHANGE IN CASH AND CASH EQUIVALENTS
in million euros



The cash flow from operating activity had positive impacts from EBITDA of EUR 22.2 million (12 months of 2016: positive EUR 11.2 million) and from the change of provisions EUR 0.6 million (2016: negative impact of EUR 0.5 million). Negative impacts came from the net change in receivables and liabilities connected with operating acitvity of EUR 7.2 million (2016: negative impact of EUR 9.0 million), change in inventory of EUR 4.9 million (2016: negative impact of EUR 14.1 million), change in the receivables and liabilities related to construction contracts recognised under the stage of completion method EUR 8.5 million (2016: positive change of EUR 3.7 million), and from the corporate income tax paid on dividends EUR 1.3 million (2016: negative impact EUR 1.7 million).

Cash flows from investing activities include negative cash flow from the acquisition of non-current assets in the amount of EUR 1.4 million (12 months of 2016: EUR 3.0 million) and positive cash flow from the sale of non-current assets in the amount of EUR 1.9 million (12 months of 2016: EUR 1.1 million). The acquisitions and disposals of non-current assets were mostly made in the road construction activity.

To support cash flows from operating activities, the group has judiciously raised additional external capital. At the same time, the debt ratio has remained at a moderate level (21.4% of total assets as at 31.12.2017; 19.3% as at 31.12.2016). The largest negative items in cash flows from financing activities were the dividend payment of EUR 7.3 million (12 months of 2016: EUR 9.0 million) and finance lease principal repayments in amount of EUR 0.8 million (12 months of 2016: EUR 0,9 million). The positive net effect of EUR 14.3 million (12 months of 2016: positive net effect in amount EUR 16.0 million) to cash flow from financing activities came from the net change of loans received and loans repaid in connection with acquisitions of immovable properties, as well as financing of construction costs of development. In the end of 2016, EUR 12.5 million was engaged in short-term loan from the parent company AS Riverito to purchase the Veerenni development area, which was refinanced at the beginning of 2017 with long-term loans from various credit institutions.

RATIOS

(attributable to equity holders of the parent)

INCOME STATEMENT SUMMARY		2017	2016	2015
Revenue	million EUR	317.6	252.0	251.0
Gross profit	million EUR	30.9	19.0	23.0
Gross margin	%	9.5	7.5	9.1
Operating profit	million EUR	19.5	7.7	12.5
Operating profit margin	%	6.2	3.1	5.0
Profit before tax	million EUR	18.8	7.3	11.7
EBT margin	%	5.9	2.9	4.7
Net profit	million EUR	15.8	6.0	9.8
attributable to equity holders of the parent	million EUR	14.7	6.1	10.0
attributable to non-controlling interest	million EUR	1.1	(0.1)	(0.2)
Net margin	%	4.6	2.4	4.0

Other income statement indicators		**2017**	**2016**	**2015**
EBITDA	million EUR	22.2	11.2	15.5
EBITDA margin	%	7.0	4.4	6.2
General expense ratio	%	4.6	5.3	4.8
Labour cost ratio	%	10.1	11.7	12.2
Revenue per employee	thousand EUR	434	325	322

Other significant indicators		**31.12.2017**	**31.12.2016**	**31.12.2015**
Return on equity	%	11.9	5.0	8.0
Return on assets	%	5.8	2.8	4.4
Return on invested capital	%	11.4	5.1	7.9
Equity ratio	%	47.0	51.6	59.5
Debt ratio	%	21.4	19.3	14.8
Current ratio	times	2.2	2.9*	3.2
Quick ratio	times	1.1	1.1*	1.2
Accounts receivable turnover	days	40	37	39
Accounts payable turnover	days	40	38	39
Average number of employees (total group)	people	732	776	779
Order book	million EUR	344.4	269.6	246.9

Calculation of ratios is provided on page 123 of the report.

** As at 31 December 2016, in the formula for calculating the current ratio and the quick ratio, the amount of current liabilities has been reduced by EUR 12.5 million as a result of refinancing of the short-term loan received from the parent company AS Riverito at the end of 2016 with long-term bank loans at the beginning of 2017. Additional information has been disclosed in Note 33 of the financial statements.*

RISK MANAGEMENT

Risk management is part of strategic management and is inseparable from daily operations of the company. In managing risks, the main objective of the company is to determine larger and significant risks and to optimally manage these risks so that the company achieves its strategic and financial objectives. The company considers it important to assess aggregate group risks, instead of the impact factors of individual risks. Turning constant attention to risk management enables to exclude or minimise a possible financial loss. The following are deemed by the company to be the most significant risks: market risk, operational risk and financial risk, including interest rate risk, foreign currency risk, credit risk, liquidity risk, equity risk and legal risks. Detailed description of financial risks is provided in Note 35 of the financial statements. Because of the group's balance sheet structure and the market position, none of these risks has a significant impact as at the date of this report.

Group risk management is coordinated by the management board. In addition, the management board of each subsidiary develops, implements and maintains processes covering subsidiary's activities for the management of all material risks impacting the activity and results of the group. Each group company and business unit must ensure that risks are managed on an ongoing basis with reference to the objectives it has been assigned. Risk-taking is a normal part of business, but in doing so, one must be convinced that if the risk materialises, purposeful and sustainable activity is maintained with reference to the strategy of the company and business unit. The group assesses ongoing business risks and risks affecting investments in a calculated manner.

Merko Ehitus divides risks into four main categories:

- **BUSINESS RISK**
- **MARKET RISK**
- **FINANCIAL RISK**
- **OPERATIONAL RISK**
  - **HEALTH AND SAFETY RISK**
  - **ENVIRONMENTAL SAFETY RISK**

Business risk

The group takes calculated risks for the purpose of increasing revenue. The biggest business risks relate to the entry of Merko Ehitus to new markets and segments, the management of existing inventories and investments and the execution of awarded construction contracts. One of the peculiarities of construction activities is the fact that the execution of the contracts concluded is a long-term process, making the sector inert to changes in the economic environment. Due to this, both positive and negative changes in the economic environment reach the construction industry with a lag of approximately 12-18 months. This time lag enables the sector to arrange its activities to be prepared for potential setbacks as well as booms.

Operating in several different markets requires orientation in the environments of various countries. The main areas of attention are the cyclicality attributes of economies and legal, cultural and political differences. The main objective of Merko Ehitus is to expand into new segments in existing markets. When entering new markets, the company thoroughly studies local customs and peculiarities before making final investment decisions and makes sure that the environment is sufficiently stable and a competent team is assembled.

From the investments point of view, the main risks relate to the portfolio of properties and implementation of property development projects. Merko Ehitus carries out real estate development projects as an integrated process, comprising all activities from the acquisition of the property, proceedings related to the detailed plan, handling design and construction and finally sale of finished apartments to the customer and warranty service. The group uses standard policies for implementing real estate development projects in order to ensure the use of best practices that the entire group has accumulated over years. Merko Ehitus continuously analyses its existing inventory of land with development potential to ensure that the portfolio contains a sufficient number of properties to carry out developments suitable to the market. Investments in new properties or projects of up to EUR 3 million are decided on the supervisory board level of subsidiaries, while larger projects are further approved by the supervisory board of the group.

Market risk

Significantly more attention is being paid to potentially major volatility of input prices in the construction sector that could complicate the budgeting process, completion of projects at planned costs, cause additional risks in carrying out fixed-price construction contracts and weaken projects' profitability. Therefore, the overall economic development is being closely monitored and taking excessive price risks already in the bidding phase is avoided.

The residential development is one of the main sources of market risk arising from the value of real estate for Merko Ehitus group. The real estate market has become more selective and in pre-launch risk assessment, consideration is given to such important aspects as the project's location, development volume, planning solutions and the target group. Taking into account low interest rates on loans, increased income and savings, the demand and transaction activity on the apartment market has grown. Due to the selectiveness of the real estate market, setting the right sale price for new development projects in the given region has become very important. For managing the area's price risk, price statistics collected by the group and available from other public sources is being constantly analysed.

Market risk that is partially related to financial risks also includes *currency risk and interest rate risk*. The analysis of these risks is provided in Note 35 of the financial statements.

Financial risk

Financial risks include risks related to adequate capitalisation level and financing, currency, interest rate and credit risk. Financial risks are managed by the accounting and finance rules, as well as audit. The group's finance department is responsible for forecasting the cash flows of Merko Ehitus, continuously monitoring various subsidiaries' cash positions and forecasts. The group has enacted a regular budgeting procedure whereby the group's annual forecasts are updated as a minimum three times per year.

The analysis on *credit, liquidity and legal risks* is provided in Note 35 of the financial statements.

Operational risk

Operational risks are risks caused by inadequate or ineffective processes, people, equipment, systems or external events. The main goal of operational risk management is to reduce the effect of unwanted events. In order to meet the objective, the group is developing internal processes and control systems. In order to ensure the group's high level of project management, project teams are continuously trained, business processes are improved and results are monitored.

Considering the group's field of business, it is essential in operational risk management that the improvement and application of safety standards and regulations continues and that supervision of compliance with environmental requirements is increased. One measure for managing operational risks is the implementation of quality and environmental management systems. Risks related to occupational health and safety in construction are assessed and managed in all units and process stages of the group. The largest construction companies of the group, Merko Ehitus Eesti, Merko Infra, Merko Tartu, Tallinna Teedes and and Latvian and Lithuanian subsidiaries, have implemented quality management system ISO 9001 and environmental management system ISO 14001 and health and safety management system OHSAS 18001. All management systems are certified. The group employs 8 (2016: 9) full-time quality specialists who are responsible for developing quality, safety and management systems and ensuring their functioning.

Insurance is used as additional mitigation of operational risks, especially for risks that cannot otherwise be mitigated. The group concludes total risk insurance contracts with insurance companies in order to hedge the risk of unanticipated loss events occurring in the construction process. The general policy is entered into for one year and it compensates the customer, subcontractors and third parties for any losses caused by Merko Ehitus or its subcontractor. The risks of the projects, which the annual policy does not cover (water construction, railroad construction, bridges, etc.), are additionally mapped out and an insurance contract is concluded separately for each object taking into consideration its specifics. In concluding contracts for services involving design work, an insurance contract for professional liability is required from subcontractors or an insurance contract at own expense is concluded, covering the damage arising from design, erroneous measurement, advice and instructions. The services of insurance brokers are used in mapping out risks, concluding insurance contracts and handling loss events. In 2017, indemnity applications submitted to insurance companies totalled EUR 0.46 million (2016: EUR 0.12 million), and insurance benefits were received in the amount of EUR 0.43 million (2016: EUR 0.12 million).

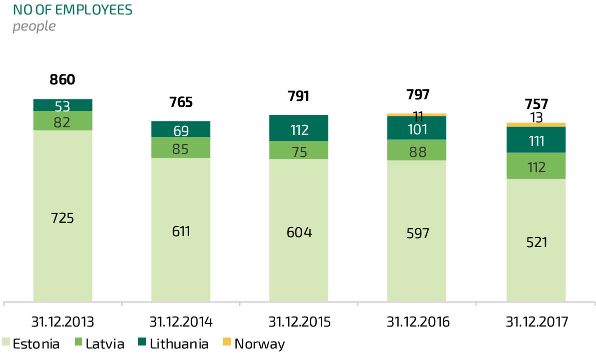
A warranty provision has been provided at the company to cover for the construction errors, which have become evident during the warranty period. In 2017, warranty provisions were set up at the group in the total amount of EUR 1.15 million (2016: EUR 0.94 million) and disbursements amounted to EUR 0.74 million (2016: EUR 0.80 million). As at the year-end, the company's warranty provision amounted to EUR 2.87 million (31.12.2016: EUR 2.48 million). With regard to work performed by subcontractors, the subcontractors are responsible for elimination of defects that became evident during the warranty period. With regard to critically significant contracts, the performance of contractual obligations of the contractor arising from contracts of services is guaranteed with bank guarantees to be paid upon first demand.

EMPLOYEES

Compared to the same period last year, the number of the group's employees decreased by 40 (-5.0%) and as at 31 December 2017, the group had a total of 757 employees (including fixed-term and part-time employees).

159 people joined and 199 people left (2016: 176 people joined and 170 people left) Merko group in the financial year (including both termless and fixed-term contracts).

In 2017, the number of employees has decreased mainly due to partial disposal of road maintenance activity in Estonia, but on the other hand, the number of employees has increased, due to increase of construction volumes in Latvia, Lithuania and Norway.



TOTAL NUMBER OF EMPLOYEES BY EMPLOYMENT CONTRACT

	2017		2016	
Permanent contract	679	90%	713	89%
Temporary contract	78	10%	84	11%
Total	**757**	**100%**	**797**	**100%**

TOTAL NUMBER OF PERMANENT EMPLOYEES BY EMPLOYMENT TYPE

	2017		2016	
Full-time	644	95%	685	96%
Part-time	35	5%	28	4%
Total	**679**	**100%**	**713**	**100%**

TOTAL NUMBER OF EMPLOYEES BY GENDER

	2017		2016	
Male	640	85%	691	87%
Female	117	15%	106	13%
Total	**757**	**100%**	**797**	**100%**

TOTAL NUMBER OF EMPLOYEES BY GEOGRAPHICAL LOCATION

	2017		2016	
Estonia	521	69%	597	75%
Latvia	112	15%	88	11%
Lithuania	111	15%	101	13%
Norway	13	1%	11	1%
Total	**757**	**100%**	**797**	**100%**

TOTAL NUMBER OF EMPLOYEES BY EMPLOYMENT POSITION

	2017		2016	
Management	19	2%	24	3%
Middle management, specialists	481	64%	464	58%
Workers	257	34%	309	39%
Total	**757**	**100%**	**797**	**100%**

SECTOR'S BIGGEST TAXPAYER

Merko puts a premium on doing honest business, and takes pride in being a trustworthy and stable employer. We create a work environment that promotes high performance, with occupational safety and employee development opportunities as inseparable elements.

In 2017, the group's Estonian construction company AS Merko Ehitus Eesti once again paid the most taxes of any company in the construction sector, including taxes on workforce. Merko's Estonian subsidiary's total for the year was over EUR 11.9 million in state taxes paid and more than EUR 6 million in workforce taxes paid.

PERSONNEL POLICY

As at 31 December 2017 Merko Ehitus employed a total of 757 people in Estonia, Latvia, Lithuania and Norway, including office staff, project managers and on-site team members. Experienced professionals are the company's key strength.

The group's personnel policy supports achievement of the company's goals, ensuring sustainability of the organisation and management, staying competitive, maintaining and increasing the value of the organisation and constant development of competence.

We develop responsible management throughout the organisation, guided by company strategy, management system, applicable law, ethical values and good organisation management practice. We treat employees as partners, involving them in the decision-making process and perceiving that the right to make decisions includes responsibility. We support people's achievement of their professional goals and the advancement of their career in the company by encouraging existing employees to apply for vacant or new positions within the company. We ensure an adequate, fair and competitive salary and motivation package that corresponds to the contribution of the employee.

We provide employees with conditions for professional development and career opportunities by supporting studies and acquisition of professional knowledge and experience. We support our employees for developing their competence and skills.

In 2017, the number of new grievances about labour practices against Merko group amounted to 0 (2016: none), the number of grievances (both from current and previous years) addressed was 0 (2016: none) and the number of grievances (both from current and previous years) resolved was 0 (2016: none).

THE NUMBER OF EMPLOYEES WHO RECEIVED AN ANNUAL PERFORMANCE REVIEW

	2017		2016	
Estonia	132	25%	145	24%
Norway	-	-	2	18%
Latvia	35	31%	26	30%
Lithuania	111	100%	101	100%
Total	**278**	**37%**	**274**	**34%**

INTERNS

In 2017, Merko had 14 interns: six construction students and three electric engineering students from the Tallinn University of Technology, three students from Tallinn University of Applied Sciences, one from the Estonian University of Life Sciences and one from Denmark. The interns were supervised by teams from eight different construction sites and by the electrician and budget department. Based on student feedback, students had the highest regard for the fact that they felt that supervisors trusted them, their work was supervised and commented on, there was a cordial, friendly and supportive attitude with regard to each other and partners in cooperation. At the end of the internship, three students stayed on to work for AS Merko Ehitus Eesti.
Merko considers it important to offer students real work experience – over the last four years, a total of 85 people have had their internship at the company.

HEALTH AND SAFETY

Creating a safe working environment for well trained, healthy and motivated employees, both in offices and on construction sites, has always been an important aspect in the operations of the group's construction companies. Our goal is to shape and furnish jobs, allocate work equipment and personal protective devices to make it possible to prevent on-the-job accidents and health damage and preserve the work capacity and well-being of workers. Thus, pre-construction risk analysis remains constantly in our focus, aimed at identifying common protection needs of site workers, measures and requirements for use of personal protection equipment. Constant training in the field of occupational health and safety forms part of our personnel policy. Regularly held occupational health and safety trainings provide knowhow and skills that enables to prevent risks, analyse them and find the most suitable technical and economic solutions. All new employees (including office workers) undergo an occupational safety training after they are hired. In addition, we notify our cooperation partners of the fire safety and occupational safety requirements and expect our contractual partners' employees on Merko sites to comply with these requirements. The management system for occupational health and safety, that was certified in 2004 and complies with the OHSAS 18001 standard, allows to effectively monitor working environment in construction sites and offices. Basic and supplementary training has always been available for inspectors to guarantee their competence.

Periodic health inspection provided by the occupational health partner to assess work-related risk factors helps to prevent employee health problems, plan safer working environments or, with the partial support of the company, to allow employees to use the necessary health rehabilitation measures. Additionally, the company organises for its employees free vaccinations and, naturally, provides its on-site personnel with comfortable compliant work clothes and footwear.

77% of Merko Ehitus group's employees worked in companies with an international health and safety certificate OHSAS 18001 in 2017 (2016: 71%).

A balanced personal life and a healthy way of living provide a counterbalance to stressful work. In order to promote recreational sports and to maintain working ability we pay our employees sports and health allowance.

In accordance with the GRI guidelines, the rates of injury, occupational diseases, lost days, and absenteeism presented below are related to the number of employees, not the number of hours worked. The factor 200,000 is derived from 50 working weeks at 40 hours per week, per 100 employees.

The total number of injuries/accidents (excluding minor first-aid level injuries/accidents) increased from 6 cases in 2016 to 9 cases in 2017, leading to an increased injury rate of 1.3 per 100 employees. As in 2016, the total number of occupational illnesses remained 0 also in 2017, meaning also an occupational diseases rate of 0.0 per 100 employees.

The total number of lost days due to occupational illnesses or injuries/accidents decreased by 45% to 282 while the total number of absentee days increased by 14% percent to 7,700, leading to a lost days rate of 41.2 per 100 employees and an absentee rate of 4.5% in a year for all employees.

TOTAL NUMBER AND RATES OF INJURIES, OCCUPATIONAL ILLNESSES, LOST AND ABSENTEE DAYS AND FATALITIES

	2017	**2016**	**2015**
Total number of injuries/accidents excluding minor (first-aid level) injuries/accidents	9	6	8
Total number of occupational illnesses	0	0	0
Total number of lost days due to occupational injuries/accidents or illnesses	282	510	343
Total number of absentee days	7,700	6,767	6,286
Total number of fatalities *	0	0	0
Injury rate (per 100 employees)	1.3	0.9	1.2
Occupational diseases rate (per 100 employees)	0.0	0.0	0.0
Lost days rate (per 100 employees)	41.2	72.9	50.0
Absentee rate per year (%)	4.5	3.9	3.7

Calculation of ratios is provided on page 123 of the report.
** In 2017, subcontractors employees working on-site to whom the organisation is liable for the general safety of the working environment had 2 injuries (2016: 0; 2015: 1) and 1 fatal accident (2016: 0; 2015: 0).*

PERSONNEL DEVELOPMENT AND RECOGNITION

Work at Merko demands great responsibility but also offers variety, new challenges and opportunities for study and development. For Merko as an employer, valuing employees means:

- offering employees work which they are trained to do and interested in doing and which offers possibilities for development;
- providing fair remuneration to our employees, taking into account their contribution to achieving the company's objectives;
- recognising employees who achieve or outperform the agreed objectives.

We value and support employees' personal development, offer various training courses internally and externally both as team training and as individual study. Once a year, at an annual employee review, we determine employees' needs for training and career and development desires. A training plan is drawn up on the basis of summaries of annual reviews. Professional, self-development trainings account for the largest share. Quality and environment-themed trainings, language learning and joint team trainings are also highly valued.

To train the young employees of the future, we have been engaged in developing and training students for years, offering them internships and visiting schools to deliver lectures. We have also organised workshops and competitions, excursions to sites. In 2017, we had 14 interns from the Tallinn University of Technology, the Tallinn University of Applied Sciences and the Tallinn School of Construction. We provide multifaceted support and recognition for teaching at school and acquiring a diploma.

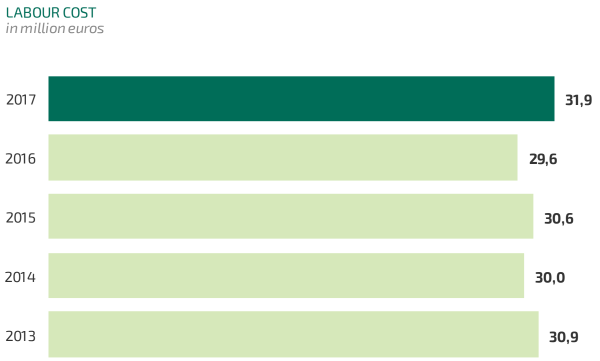
We celebrate together with our employees their personal events. Company events for employees welcome everybody together with their spouses or companions and family events welcome the whole family. We offer additional benefits in the form of holiday days to our long-time employees and recognise them with the company's gold, silver and bronze pins.

We highly value teamwork and a strong sense of team identity. In order to recognise the most prominent employees of the company and the best business partners, employees annually elect AS Merko Ehitus Eesti and Tallinna Teede AS Achievers of the Year.

REMUNERATION

The group's objective is to pay its employees competitive salary. The interests of employees and the company are balanced by performance-based remuneration.

The group defines labour cost as salary (incl. fixed salary, additional pay (night work, overtime and public holidays), holiday pay and bonus), taxes based on salary, fringe benefits and taxes based on fringe benefits. In 2017, the labour cost was EUR 31.9 million (2016: EUR 29.6 million), up 7.9% from the previous year.



Benefits that are standard for full-time employees and not offered to part-time employees are not separately disclosed in Merko group companies, except with regard to part-time employees employed under a contract for a specified term, who are not entitled to all of the benefits offered to company employees.

ETHICAL BUSINESS PRACTICES

Merko's core values include ethical business practices, which are an important success factor in the long run. By following highly ethical policies, we promote profitable growth, gain the trust of our stakeholders and support fair competition and equal treatment. Unethical business practices carry serious consequences – including hindering the functioning of a fair market and distorting competition.

AS Merko Ehitus group does not tolerate any form of corruption. We have undertaken the obligation to engage in honest business and to be in compliance with anti-corruption laws in each country where we operate. We are guided by ethical principles in our actions. We make sure that our employees know these principles and adhere to them in their work. In order to facilitate this, the group has enacted a Code of Business Ethics, which all Merko group employees are obliged to read and adhere to. The code of business ethics includes, among other things, guidelines on the following matters:

- conflicts of interests;
- confidentiality obligation;
- handling of insider information and insider transactions;
- bribery and corruption;
- hospitality and gifts;
- competition rules;
- equal treatment;
- protection and proper use of assets.

The topic of business ethics has been thoroughly covered on the group's website http://group.merko.ee/en/corporate-governance-2/responsibility/ethical-business-practices/. All employees, partners and customers can report clear or potential unethical conduct via various anonymous channels, to which the http://group.merko.ee/en/corporate-governance-2/responsibility/reporting-channels/ website provides an overview. The reporting and information analysis system implemented in AS Merko Ehitus ensures security, confidentiality and, if so desired, anonymity at every stage of the process. Each reported misconduct will be investigated by an independent cooperation partner – AS Merko Ehitus's contractual cooperation partner Ernst & Young – and will lead to appropriate action.

The reports forwarded via the report form, the reporting hotline or e-mail will not be forwarded to Merko – Ernst & Young will only give Merko a summary of the content of reports that need investigation, without any reference to the source of the information. Information will also be kept confidential and used solely for the purposes of solving the relevant incidents by Merko's managers and the audit committee to whom a report has been made. In 2017, the group received no hints that would have led to an internal investigation (2016: no hints received).

REPORT FORM	E-MAIL	HOTLINE	DIRECT COMMUNICATION

In addition, key persons at Merko Ehitus are obliged to file a declaration of personal interests that covers data on holdings in companies, positions held on management bodies of companies and other legal persons, membership of professional organisations, information on valid registrations of economic activities and other data that might indicate a possible conflict of interest. In 2017, no conflict of interest cases were identified by the group.

ENVIRONMENT

Our goal is to offer our customers modern, high-quality buildings with a high consumer value. We are always looking to find the solution that is most suitable to the needs and opportunities of our customer and optimum from a construction technology standpoint.

The environmental management system that complies with ISO 14001 standard continues to focus on waste handling issues of construction sites, highlighting the need to sort waste in the most appropriate location and handing waste over only to such service providers that are licensed to handle such waste. In cooperating with such companies, we have often discovered polluted soil and waste containing hazardous substances. For years, the company has been recording the quantities of waste created in construction sites and submitted respective annual reports to the Environmental Authority.

In environmentally sensitive tenders, we have always considered the requirements to the environmental impact assessment of projects, carried out preliminary research if necessary or conducted replacement planting, if it has been inevitable to fell trees when preparing the construction site.

Our environment-related goals are the conservation-minded use of all resources (materials, fuel, energy and water), reducing the amount of waste generated and supporting recovery of materials. To achieve all this, we promote awareness among our employees and partners in cooperation of the environment as a whole. In designing and building, the group has followed the main principles of the Quality and Sustainable Real Estate Lifecycle standard, and in selecting materials we strive to make sure that the materials are VOC *(volatile organic compounds)* free and the producers hold an ISO 14001 certificate.

RENDERING RESIDUAL CONTAMINATION HARMLESS

Commissioned by the Estonian Ministry of the Environment, AS Merko Ehitus Eesti carries out works with KMG Inseneriehituse AS to render the residual contamination of the former Maadevahe and Priimetsa asphalt concrete factories harmless. The Maadevahe factory, which operated in Saaremaa in 1959–1993, contaminated the surrounding soil, the groundwater and the Maadevahe River. The territory of the Priimetsa asphalt concrete factory that operated in Valga in 1956-1992 contains soil and groundwater contamination and there is a risk of contamination reaching the Pedeli River. In order to eliminate the contamination, nearly 21,000 m^3 of contaminated soil will be excavated at Maadevahe and nearly 10,000 m^3 at Priimetsa. The contaminated soil will be handed over to waste processing plants and replaced with clean soil, restoring the natural condition.

In the European Union, the energy efficiency of buildings is regulated by Directive 2010/31/EU of the European Parliament and of the Council, which is enforced by the Republic of Estonia Regulation No. 55 of the Minister of Economic Affairs and Infrastructure "Minimum requirements for the energy efficiency of buildings". On the basis of that, nearly zero energy requirements have to be fulfilled. That will mean that all buildings to be constructed or renovated must have a piece of equipment that generates renewable energy that offsets the building's energy consumption.

In cooperation with a number of customers, Merko has already now, with energy prices increasing, adopted new technologies, materials and technical solutions and used various architectural techniques to achieve buildings with the most economical solutions possible without compromising on other aspects of office or residential environments. Merko's current crop of buildings under construction include ones certified using the LEED (Leadership in Energy and Environmental Design) system used in the US and evaluated according to the conditions for Britain's BREEAM (Building Research Establishment Environmental Assessment Method) certificate rating system, which have also been submitted to EGBC (Estonian Green Building Council) competition "The Most Sustainable Building in Estonia".

SUSTAINABILITY STANDARDS

In November 2017, the Narbuto 5 business building was completed in Vilnius. Merko Statyba adhered to international BREEAM requirements in the construction process. This was the first Merko-constructed building to be awarded BREEAM certificate at a level of "Very Good" for all stages.

Merko's customers are also seeking sustainability certification for the following sites currently under construction: the T1 Mall of Tallinn and Öpiku Maja in Tallinn (LEED in both cases), Akropole shopping centre (BREEAM) and Krasta Street office building in Riga (LEED), the expansion of Radisson Hotel and the Ibis Hotel in Rinktinės Urban development in Vilnius (both BREEAM).

SOCIAL RESPONSIBILITY

The group is responsible for its decisions and activities that have an impact on our employees, customers and partners and, more broadly, on local communities.

In 2017, Merko Ehitus continued its long-term sponsorship projects in the same fields:

- we support sports and recreational sport projects that help create ways for entire communities to participate in sports and recreation;
- we support education in order to develop specialised education and plant the seeds for a new generation of professionals;
- we support keeping art and culture vital and make them available to more people, focusing on sites that are nationally important and have broad appeal.

During the year, the group supported sports, culture and education and made charitable donations in a total amount of EUR 0.32 million (2016: EUR 0.29 million).

SPORTS AND RECREATIONAL SPORTS

The company's largest sponsored project is the Estonian Health Trails (www.terviserajad.ee) project founded in 2005 in collaboration with Swedbank and Eesti Energia. The aim of the project is to fix up and develop Estonian exercise and sports tracks to ensure the availability of year-round free of charge possibility for active exercise in nature for all interested people, and popularise sporty lifestyle. Today, 109 recreational trails are open all over the country, while SA Eesti Terviserajad (Estonian Health Trails Foundation) has taken on a noteworthy role in shaping people's exercise habits and popularising active lifestyle through a network of health trails, various events and active outreach.

From 2005 to 2017, SA Eesti Terviserajad invested, with its founders' support, a total of EUR 4.5 million into developing recreational trails. The investments were made into all Estonian counties, with the biggest ones in Harju County, Tartu County and Ida-Viru County. Based on the preferences of the population in the respective locations of the trails and level of active use, the biggest investments were made into the facilities and tracks at Pirita and Nõmme-Harku in Tallinn, and Kõrvemaa and Jõulumäe.

The total investments made in the 2004-2017 period (includes not only the SA Eesti Terviserajad's investments, but also state and local government investment and assistance from the European Union) into the development of the recreational trails network amount to approximately EUR 38 million. Of the counties, Harju County, Ida-Viru County, Põlva County and Viljandi County have received the most investments.

OVER 4 MILLION USERS ON 109 TRAILS

Estonia now has 109 recreational trails all over the country and 1,000 km of footpaths and exercise tracks, of which soft-surfaced paths make up 800 km, hard-surfaced paths account for 200 km and illuminated paths make up around 200 km. Estonia has an average of 59.8 km of maintained trails and tracks and 15.4 km of illuminated recreational trails or tracks per 100,000 people. They get approximately four million visits per year.

Two new trails were added in 2017 – the lighted Tädu path in Viimsi and the 1.7-km-long Joaoru health trail in Narva. In addition, four trails were opened in 2017 in urban environments: Emajõgi River circuit in Tartu and three trails in the Põhja-Tallinn district.

In 2017, two new trails were added to the network. In Viimsi Municipality, the 2.6 km long illuminated Tädu trail was opened, which includes sports equipment for stretching and resistance training. In Narva, the 1.7-km-long Joaoru recreational trail was opened; it offers a multifaceted landscape and picturesque views of the River Narva. A stretching wall stands at the trailhead. In 2017, the biggest developments took place on Valgehobusemägi, Narva's Pähklimägi, Viimsi's Karulaugu and Rapla trail. Investments into trail grooming and snow making equipment were made at Pähklimägi in Narva, Kuningamägi in Põltsamaa, Lähte, Kuressaare, Tamsalu, Võru, Kõrvemaa, Palivere, Jüri and Värska.

To simplify navigation for the trail users, 75 large-format maps were installed and 58 trails use markings designed and installed by the foundation. All over Estonia 34 stretching walls have been installed for warm-up and cool-down stretching after exercise. The foundation has produced a total of 70 instructional videos in the Estonian and Russian language, in addition to inspirational video interviews with celebrities and video overviews from the trails and events. The videos received a total of 1.7 million views in 2017.

With the aim of emphasising the importance of regular physical activity and to facilitate activity also inside the buildings, the foundation has developed a concept of an indoor health trail. In cooperation with various organisations, enterprises and schools, tracks suitable for the buildings have been prepared, taking advantage of staircases, corridors and the courtyard areas. As of the end of 2017, SA Eesti Terviserajad had laid out 47 indoor tracks that are used by 50,000 people every day. Institutions and companies that use these paths to encourage their staff to be physically active include the Estonian National Opera, the Narva Vocational Education Centre, the Tartu Vocational Education Centre, Tallinn University, Tallinn University of Technology, four prefectures of the Police and Border Guard Board, Omniva, Antsla Upper Secondary School, Estonian Public Broadcasting, the Ministry of Social Affairs, the Tax and Customs Board, Telliskivi Creative City, Swedbank and Eesti Energia. In 2018, the Estonian National Library and the North Estonia Medical Centre will open indoor tracks in their respective buildings.

TEAM HAANJA

For many years, Merko has supported Estonian skiing with the goal of contributing to development of top athletes and encouraging more people in Estonia to engage in sport and exercise. Starting from 2015, Merko has supported skiing by sponsoring Team Haanja. The goal of Team Haanja is to take new athletes to the top of the international heap and keep veteran skiers competitive, creating conditions for training fully in line with modern requirements.

Team Haanja is made up of 10 athletes: Algo Kärp, Raido Ränkel, Aivar Rehemaa, Marko Kilp, Alvar Johannes Alev, Karl Erik Rabakukk, Karel Tammjärv, Andreas Veerpalu, Anette Veerpalu and Kaarel Kasper Kõrge.

THE ESTONIAN TENNIS ASSOCIATION AND JÜRGEN ZOPP

Starting from 2015, Merko has been the gold sponsor of the Estonian Tennis Association, providing support for top-level adult tennis and international tournaments. Merko contributes to the development of Estonia's best male tennis player Jürgen Zopp and, in summers, the organising of the Merko Estonian Open in Pärnu.

In 2017, Jürgen Zopp and Kaia Kanepi won the Estonian Open in front of adoring home crowds.

CULTURE AND EDUCATION

Merko has a successful partnership since 2007 with Tallinn University of Technology (TUT) for the objective of developing specialised education and train the next generation. In cooperation with the Development Fund of Tallinn University of Technology (www.ttu.ee/en/?id=99374) AS Merko Ehitus Eesti gives out eponymous scholarships. A EUR 3,300 scholarship is awarded in construction specialities to a young lecturer/scientist up to 40 years of age, possessing a Doctoral level degree, in TUT and there is also another scholarship for EUR 2,000 awarded to a successful student of the third, fourth or fifth year in the Faculty of Civil Engineering, in TUT. In 2017, the young researcher and teaching staff member scholarship awarded by Merko Ehitus Eesti went to Endrik Arumägi, who heads up the nearly-zero-energy (NZE) residential buildings project at the Tallinn University of Technology for developing standardised solutions and sample projects for NZE apartment buildings, terraced and detached houses.

In 2016, a three-year cooperation agreement was signed between Merko and Noored Kooli SA (Youth to School Foundation). The mission of the programme is to value the role of the teacher and raise the availability of high-quality education, bringing people from different walks of life to school and creating conditions for them to become outstanding teachers and leaders.

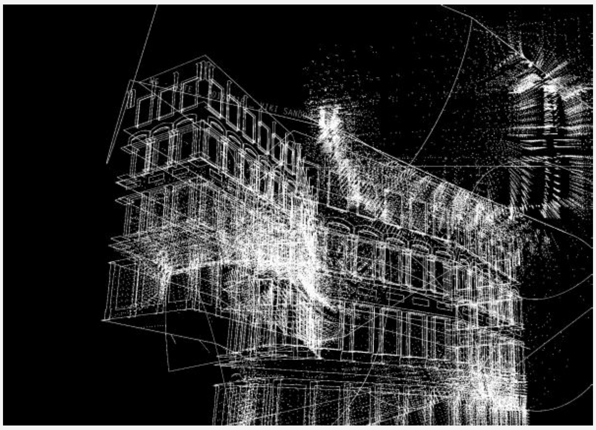
BERNT NOTKE'S DANSE MACABRE

In the period of 2017–2019 Merko is supporting the development of a new exhibition solution for the Danse Macabre, including a design and engineering project, the multimedia solution for presenting the visual identity and iconography and the exhibition scheme for visitors with special needs. Mentioned for the first time in 1603 and housed in Tallinn St. Nicholas Museum, Lübeck master Bernt Notke's Danse Macabre is Estonia's best-known and most acclaimed late medieval artwork of all time. The work is extraordinary throughout northern Europe as it is the only medieval painting in this genre on canvas, has unusual programmatic imagery and is one of the best known works by Notke.

Photograph: Workshop of Lübeck master Bernt Notke. Danse macabre. Detail. Late 15th century. Art Museum of Estonia.

In 2017, SIA Merks supported the Reinhold Schmaeling conference in Latvia, organised by the Riga city architect's office and which this year focused on public involvement into planning a better future for the city of Riga. Both local and foreign professionals from the field of architecture and construction and related fields discussed topics of inclusive urbanism and the trends and challenges in the field of architecture and urban planning. With Merks support, the conference was recorded on video and made available online publicly at https://www.youtube.com/channel/UCdAFP-3zQ5DVJSSJZlOPCeQ. In addition, in 2017 SIA Merks supported the preparation of a book surveying a century of Latvian construction. The encyclopaedia-style volume will be published in 2018, the country's national centenary year.

THE ESTONIAN ACADEMY OF ARTS' ENERGY EFFICIENCY PROFESSORSHIP



With Merko support, the Estonian Academy of Arts' Faculty of Architecture opened an energy efficiency professorship in autumn 2016. In the framework of continuing cooperation in the 2017/2018 academic year, an Austrian architect and top energy efficiency expert Bernhard Sommer and an architect and energy design lecturer Galo Moncayo have been teaching at the Academy of Arts' Department of Architecture and Urban Design.

The goal of the professorship is to establish the best contemporary international know-how in the field of energy efficiency and thereby to deepen skills and knowledge among future architects so that energy efficiency is taken into consideration already in the building design phase.

RECOGNITIONS 2017

In 2017, the following AS Merko Ehitus group companies were recognised:

BALTIC MARKET AWARDS 2016

At an award gala held in the first quarter of 2017 – the Baltic Market Awards 2016 - NASDAQ Baltic stock exchanges announced the companies of the year with the best investor relations. The goal of the competition was to raise the general level of investor relations among listed companies by recognising the ones that stood out during the year with first-class investor relations. In 2016, the publicly listed companies received awards in five categories; in addition, the year's best stock exchange member was selected. AS Merko Ehitus received third place in the main category "The Best Investor Relations in the Baltic Countries" for the third year in a row and also third place in the category "The Best Annual and Corporate Governance Report".

BUILDING OF THE YEAR 2016

SIA Merks received two awards in the "Newly erected public building" category of the "The Year's Best in Latvia 2016" competition in Latvia. The grand prize went to Exupery International School in Pinki, which is situated half way between Riga and Jurmala. The new school building accommodates 200 pupils, with more than 120 kindergarten places. Second prize went to the Riga-based congregation house (Church of Jesus Christ of Latter-day Saints).

THE EUROPEAN UNION PRIZE FOR CULTURAL HERITAGE / EUROPA NOSTRA AWARDS

The Rode altarpiece technical investigation and conservation project "Rode Altarpiece in Close-up", which was supported by Merko Ehitus in 2014-2016, received the most reputable heritage award in Europe – the European Union Prize for Cultural Heritage and Europa Nostra Award for 2017. A total of 29 laureates from 18 countries were recognised for their outstanding accomplishments. Juries of independent experts reviewed 202 nominees for the award by individuals and organisations from 39 countries across Europe and then selected the laureates.
The project focused on the conservation of the retable of the high altar in St. Nicholas' Church, in Tallinn. The retable is one of the grandest and best-preserved North German altars from the Late Middle Ages. It arrived in Tallinn in 1481 and has remained in its place for more than 500 years. More than 6 metres in width and 3.5 metres in height when opened, the conservation work on the retable can also be viewed on site at the museum.

PROJECT MANAGER OF THE YEAR TITLE IN LATVIA

Merko group's Latvian subsidiary SIA Merks project manager Sergejs Periņecs was awarded the title of project manager of the year at the Latvian construction industry's Grand Prix ceremony for the on-time completion of the Exupery International School, which met high quality standards. Besides the project manager of the year honour, Periņecs also won special prizes for professional collaboration from the companies Bauroc, Knauf and Doka Latvija. Periņecs has been working for Merks since 2005 and has managed construction on many complex sites. He is currently responsible for the construction work at the Akropole multifunctional shopping centre.

The construction industry's Grand Prix is awarded by the Latvian Construction Engineers in cooperation with other public organisations in the industry and the magazine Būvinženieris.

AN ATTRACTIVE EMPLOYER AMONGST STUDENTS

At a competition recognising Estonia's most attractive employers, organised by CV Keskus job site, Merko Ehitus was the only construction company to break into the top 20 companies, placing 16th. The annual study produced by CV Keskus.ee reveals Estonia's most attractive employers – companies where people in Estonia most want to work. Eesti Energia state energy company, which has claimed the top spot in four of the last five years, came in first in 2017 as well, with Telia and Swedbank rounding out the top three. This year, more than 6,000 respondents from different age groups all over Estonia took part in the survey.

A job expectation survey conducted by the employer branding agency Instar among students at higher education and vocational education institutions found that Merko placed third out of 184 employers in terms of attractiveness as a place to work. This year, the company has engaged in more active cooperation with schools and students, which has included joint visits to construction job sites, lectures, other joint events and supervision of interns. The survey respondents totalled 3,700 students from 16 Estonian higher educational institutions and 1,100 youth in vocational education.

BEST REAL ESTATE DEVELOPER AS CHOSEN BY EUROMONEY

In its 2017 Real Estate Survey, Euromoney business and investment magazine named AS Merko Ehitus as Estonia's best real estate developer, both overall and in the residential and multifunctional real estate categories. In addition, Merko Ehitus subsidiary SIA Merks was again named Latvia's best residential real estate developer.

Conducted in May and June 2017, Real Estate Survey is based on opinions from other market participants and specialists – consultants, developers, investors, banks, business clients and end users. Respondents are asked, which companies they see as having stood out as the best goods and service providers in the real estate sector. Over 2,400 respondents took part in the survey, representing 1,200 companies in 75 countries.

MOST COMPETITIVE CONSTRUCTION COMPANY 2017

In 2017, AS Merko Ehitus was again declared Estonia's most competitive construction company. It was the 11th time the company had been tapped for the honour. The competitive rankings are compiled to provide incentive for a rise in the competitiveness of Estonian companies and, by that means, contribute to faster development of the economy.

In 2017, 364 companies took part. For more information about the competition, visit the website at http://ettevotluskonkurss.ee/2017. The Estonian company competitive rankings have a history going back to 2003, when the Chamber of Commerce and Industry initiated the first rankings. The Estonian Institute of Economic Research assists in performing technical calculations rankings in cooperation with the Lausanne Institute for Management Development.

MINISTRY OF DEFENCE DECORATION FOR PROJECT MANAGER

The expansion of the Tapa military barracks is one of the largest and most complex defence-related buildings in Estonia, comparable to the construction of Ämari Air Base. As a contract from the state Centre for Defence Investment, Merko group companies built by autumn 2017 two four-storey buildings and surrounding roads and plazas at the Tapa Defence Forces base. Defence Minister Jüri Luik bestowed his ministry's decoration, a silver chest pin, on the main project manager, representing Tallinna Teede AS/Merko Ehitus Eesti AS, Meelis Mõisja, for leading the construction to early completion.

LITHUANIAN PRODUCT OF THE YEAR 2017

The Kražių Namai apartment development project established near the Old Town in central Vilnius by UAB Merko Statyba, a Merko subsidiary, won the gold medal at a competition held by the Lithuanian Confederation of Industrialists – Lithuanian Product of the Year. The buildings established at Kražių Namai are among the first energy class A apartment buildings in Lithuania.

LATVIA'S MOST ENERGY-EFFICIENT BUILDING 2017

At a competition held to recognise Latvia's most energy efficient building in 2017, the Grostonas 21 apartment building in the Skanstes Mājas development, built by Merko group subsidiary SIA Merks won second prize in the category "Most energy-efficient apartment building. New building". The building was completed in 2015, but at this competition, energy performance is evaluated on the basis of actual results over a two-year period of use.

SKANSTES RESIDENTIAL DEVELOPMENT

Skanstes is one of Riga's up-and-coming neighbourhoods, encompassing new commercial and public buildings. Merko group company Merks has been developing a modern, integral living environment here since 2007. A total of 10 apartment buildings with approximately 1,000 apartments have been established in the course of three development projects (Skanstes Virsotnes, Skanstes mājas and Skanstes Parks) along with close to 900 parking spaces for the use of the residents. Besides playgrounds and leisure areas in the courtyards, a public park will also be completed this year next to the residential environment. Also adjacent to the projects is Arēna Rīga, a multifunctional facility. A tramline connecting the neighbourhood to the city centre will be established on Skanstes Street in 2021 and the Riga conference and concert centre is being planned across the street.

SHARE AND SHAREHOLDERS

The shares of Merko Ehitus are listed in the Main List of NASDAQ Tallinn. As at 31 December 2017, the company has 17,700,000 shares. The number of shares did not change during 2017.

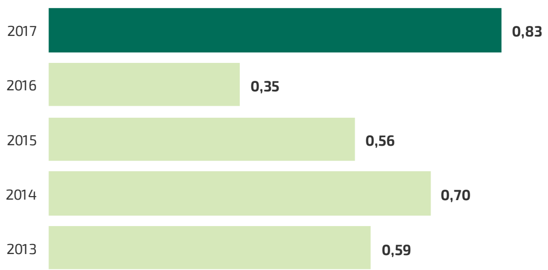
In 2017, 2203 transactions were conducted with the shares of Merko Ehitus in the course of which 0.51 million shares were traded (2.9% of shares outstanding), with the total monetary value of transactions at EUR 4.69 million (comparative data for 2016: 2312 transactions, in the course of which 0.63 million shares were traded (3.6% of shares outstanding) and the total monetary value of transactions was EUR 5.35 million). The lowest share price was EUR 8.75 and the highest share price was EUR 9.69 (2016: EUR 7.60 and EUR 9.22 respectively). The closing price of the share as at 31.12.2017 was EUR 8.81 (31.12.2016: EUR 9.05). As at 31.12.2017, the market capitalisation of AS Merko Ehitus was EUR 155.9 million, down 2.7% compared to the end of the equivalent period in the prior year (31.12.2016: EUR 160.2 million).

The number of shares that belong to the members of Supervisory Board and Management Board as at 31 December 2017 was 9,962,334 (31 December 2016: 9,964,734 shares) that accounted for 56.3% of the total number of shares (31 December 2016: 56.3%). A more detailed presentation of the members of the Supervisory Board and Management Board and the number of shares they own are provided in the Report on Good Corporate Governance.

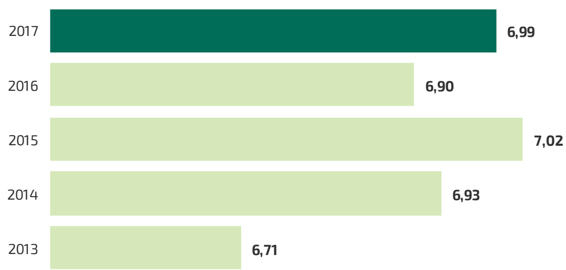
INFORMATION ON SECURITY

Issuer	AS Merko Ehitus
Name of security	Share of Merko Ehitus
Ticker	MRK1T
Residency of issuer	Estonia
Stock Exchange List	NASDAQ Tallinn, Baltic Main List
Industry	Construction
ISIN	EE3100098328
Nominal value	without nominal value
Number of securities	17,700,000
Volume of issue	12,000,000
Currency	EUR
Listing date	11.08.2008

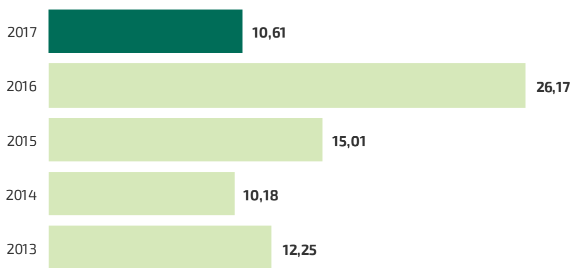
EARNINGS PER SHARE (EPS)
euros



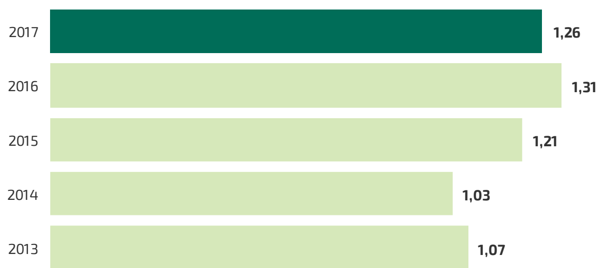
EQUITY PER SHARE
euros



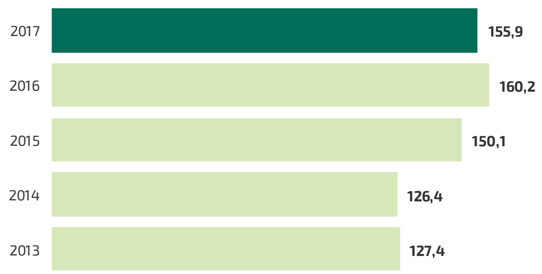
P/E RATIO
times



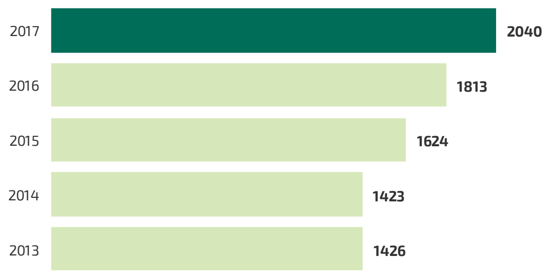
P/B RATIO
times



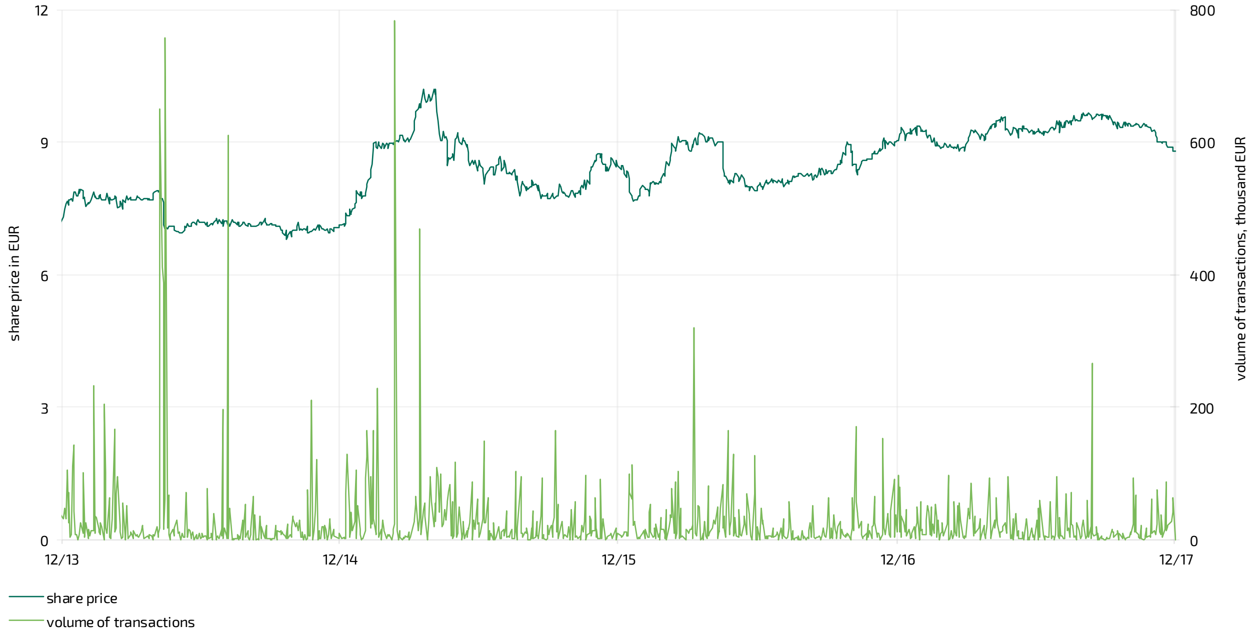
MARKET VALUE
in million euros



NUMBER OF SHAREHOLDERS AT YEAR-END
pcs



CHANGE IN THE PRICE AND VOLUME OF AS MERKO EHITUS SHARE AT NASDAQ TALLINN STOCK EXCHANGE



TRADING HISTORY OF SECURITY, IN EUROS

	2017	2016	2015
Highest	9.69	9.22	10.50
Lowest	8.75	7.60	7.06
Average	9.27	9.05	8.47
Closing at 31.12	8.81	8.44	8.48
Change at 31.12, %	(2.65)	+6.72	+18.77
Traded shares, pcs	508,339	633,185	897,409
Turnover, million EUR	4.69	5.35	7.71
Market value at 31.12, million EUR	155.9	160.2	150.1

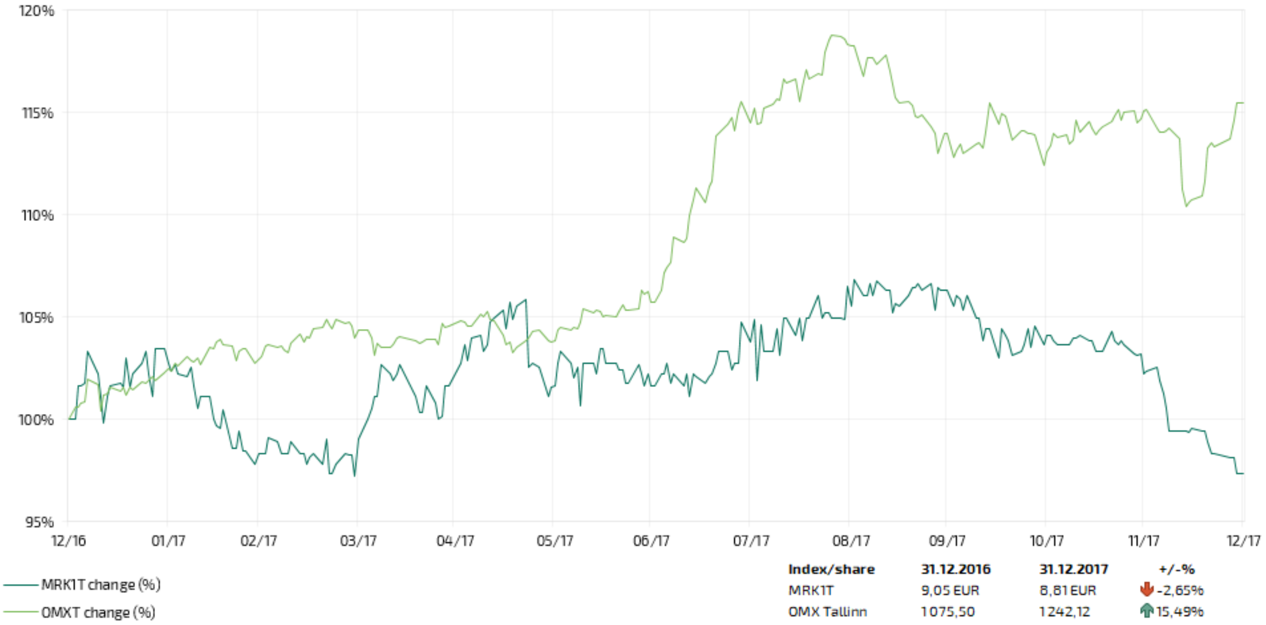
STRUCTURE OF SHAREHOLDERS ACCORDING TO NUMBER OF SHARES AS AT 31.12.2017

NUMBER OF SHARES	NUMBER OF SHAREHOLDERS	% OF SHAREHOLDERS	NUMBER OF SHARES	% OF SHARES
1 000 001 - …	1	0.05%	12,742,686	71.99%
100 001 – 1 000 000	11	0.54%	2,806,884	15.86%
10 001 – 100 000	36	1.76%	1,003,238	5.67%
1001-10 000	260	12.75%	721,645	4.08%
101-1000	1,015	49.75%	388,263	2.19%
1-100	717	35.15%	37,284	0.21%
Total	**2,040**	**100%**	**17,700,000**	**100%**

STRUCTURE OF SHAREHOLDERS ACCORDING TO HOLDER CATEGORIES AS AT 31.12.2017

CATEGORY	NUMBER OF SHAREHOLDERS	% OF SHAREHOLDERS	NUMBER OF SHARES	% OF SHARES
Foreign controlled non-financial corporations	1	0.05%	900	0.01%
Insurance corporation	1	0.05%	143,887	0.81%
Non-profit institutions serving households	1	0.05%	100	0.00%
Non-MMF investment funds	4	0.20%	727,880	4.11%
Captive financial institutions and money lenders	10	0.49%	83,943	0.47%
Financial auxiliaries	11	0.54%	237,603	1.34%
Other financial intermediaries	19	0.93%	186,554	1.05%
Deposit-taking corporations except the central bank	29	1.42%	2,226,660	12.58%
National private non-financial corporations	226	11.08%	13,160,638	74.37%
Household	1,738	85.19%	931,835	5.26%
Total	**2,040**	**100%**	**17,700,000**	**100%**

PERFORMANCE OF THE SHARE OF MERKO EHITUS AND COMPARISON INDEX OMX TALLINN IN 2017



Index/share	31.12.2016	31.12.2017	+/-%
MRK1T	9,05 EUR	8,81 EUR	-2,65%
OMX Tallinn	1075,50	1242,12	15,49%

SHAREHOLDERS OF AS MERKO EHITUS AS AT 31.12.2017 AND CHANGE COMPARED TO THE PREVIOUS YEAR

	NUMBER OF SHARES	% OF TOTAL 31.12.2017	% OF TOTAL 31.12.2016	CHANGE
AS Riverito	12,742,686	71.99%	71.99%	-
ING Luxembourg S.A. AIF Account	974,126	5.50%	5.50%	-
Firebird Republics Fund Ltd	363,094	2.05%	2.20%	(26,338)
SEB S.A. UCITS client assets	232,222	1.31%	1.31%	-
Firebird Avrora Fund Ltd	220,519	1.25%	1.25%	-
Skandinaviska Enskilda Banken AB, Swedish customers	211,260	1.19%	1.47%	(49,553)
OÜ Midas Invest	163,025	0.92%	0.78%	24,840
State Street Bank and Trust Omnibus Account A Fund No OM01	153,018	0.86%	0.86%	-
SEB Elu- ja Pensionikindlustus AS	143,887	0.81%	0.81%	-
Firebird Fund L.P.	131,331	0.74%	0.74%	-
Total largest shareholders	**15,335,168**	**86.64%**	**86.93%**	**(51,051)**
Total other shareholders	2,364,832	13.36%	13.07%	51,051
Total	**17,700,000**	**100%**	**100%**	**-**

DIVIDENDS AND DIVIDEND POLICY

The distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

At its meeting held on 8 April 2013, the Management Board and Supervisory Board reviewed the company's strategic direction and confirmed the long-term financial objectives until 2018, as a part of this a new objective was set to pay out 50-70% of the annual profit as dividends to shareholders.

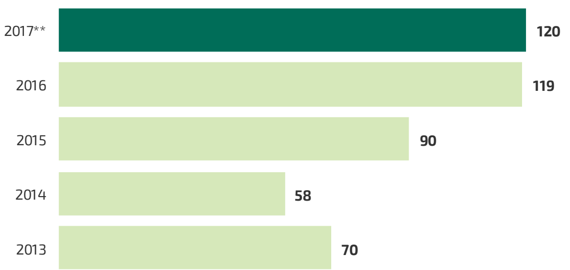
The annual general meeting of shareholders of AS Merko Ehitus held at 28 April 2017 approved the Supervisory Board's proposal to pay the shareholders the total amount of EUR 7.3 million (EUR 0.41 per share) as dividends from net profit brought forward, which is equivalent to a 119% dividend rate and a 4.5% dividend yield for the year 2016 (using the share price as at 31 December 2016), (comparable figures in 2016 were accordingly: EUR 9.0 million (EUR 0.51 per share) as dividends, which is equivalent to a 90% dividend rate and a 6.0% dividend yield for the year 2015 (using the share price as at 31 December 2015)).

According to the Estonian Income Tax Law §50 section 1^{1} AS Merko Ehitus can pay dividends without any additional income tax expense and liabilities occurring in the amount that it has received dividend payments from its subsidiaries that are resident companies of a Contracting State of the European Economic Area Agreement subject to income tax. Taking into account the dividends already paid to the parent company by the subsidiaries, the group incurred additional income tax expense in connection with the disbursement of dividends of EUR 0.9 million in Estonia in the second quarter of 2017 (2016 second quarter: EUR 0.6 million).The dividend payment to the shareholders took place on 26 May 2017.

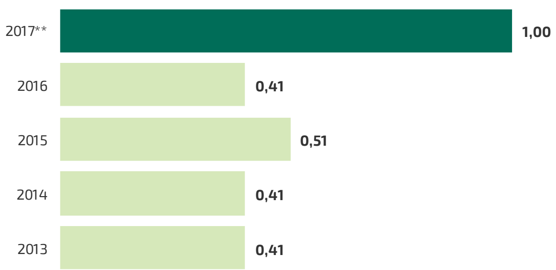
The Management Board proposes to pay the shareholders EUR 17.7 million as dividends from net profits brought forward (EUR 1.00 per share) in 2018, which is equivalent to a 120% dividend rate and a 11.4% dividend yield for the year 2017 (using the share price as at 31 December 2017). Taking into account the dividends already paid to the parent company and planned to be paid by foreign subsidiaries in the second quarter of 2018, the group will not incur income tax expenses in Estonia in connection with disbursement of dividends.

In the past five years, the shareholders have received dividends from the net profit for the accounting year as follows:

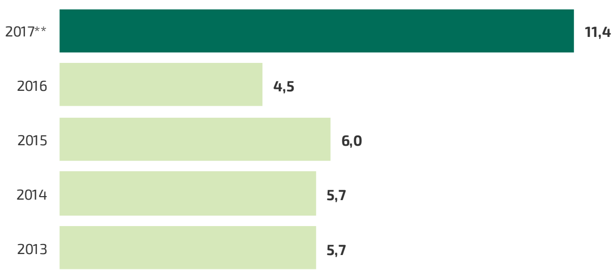
DIVIDEND RATE
percentages



DIVIDEND PER SHARE
euro



DIVIDEND YIELD *
percentages



** Using share price as at 31.12*
*** 2017 figures based on Management Board proposal regarding dividend payment.*

Dividend payments are carried out in the next fiscal year in accordance with the decisions of the general meeting of the shareholders, regarding the previous fiscal year.

REPORT ON GOOD CORPORATE GOVERNANCE

CORPORATE GOVERNANCE AND STRUCTURE

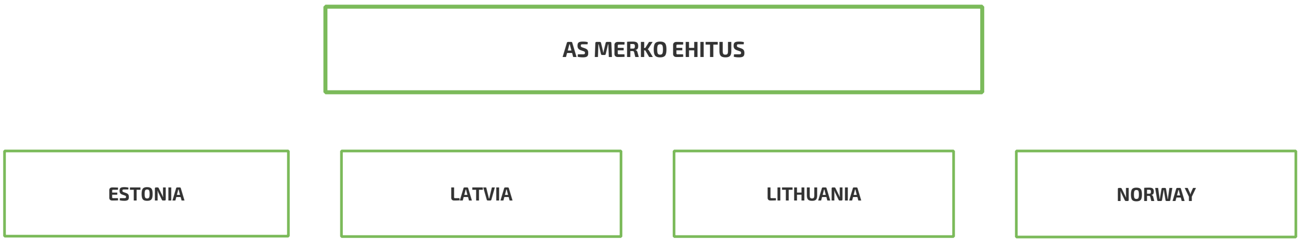
Adherence to the principles of Good Corporate Governance is part of the management of AS Merko Ehitus. Generally, this system is regulated by relevant legislation, the company's articles of association and the company's internal policies. Starting from 1 January 2006, issuers of shares listed on the NASDAX Tallinn Stock Exchange are recommended to adhere to the principles of Good Corporate Governance approved by the Financial Supervisory Authority that covers good practices of enterprise management and treatment of shareholders. AS Merko Ehitus has followed these principles throughout 2017.

AS Merko Ehitus is dedicated to following high standards of corporate governance, for the implementation of which the Management Board and the Supervisory Board are responsible to shareholders. Our objective is to be transparent in our economic activity, in disclosing information and in relations with shareholders.

AS Merko Ehitus operates as a holding company whose companies in Estonia, Latvia, Lithuania and Norway offer complete solutions in the field of construction and real estate development. In the construction sector, the group's largest companies are AS Merko Ehitus Eesti (100%), SIA Merks (100%), UAB Merko Statyba (100%) and the companies belonging to the AS Merko Ehitus Eesti group: Tallinna Teede AS (100%) and AS Merko Infra (100%).

The main activity of the holding company is development and implementation of the strategies of Merko Ehitus group's separate business areas primarily through long-term planning of resources. The holding company AS Merko Ehitus has a two-member Management Board: Andres Trink and Tõnu Toomik.

It is important to maintain a simple organisational structure in the group, and in management to be guided primarily by the group's objectives and requirements. For the purposes of maximum efficiency in group management, we in some cases differentiate the management structure and legal structure. The group's management is carried out on a country basis. The group's country and business area detailed management structure as at 31 December 2017 is the following:



As at 31 December 2017, the group comprises of 45 companies (31.12.2016: 46). The group's legal structure is predominantly based on tax efficiency and there is not in all cases a direct linear relationship with the group's effective management structure. The detailed list of group companies is provided in Notes 18 and 19 of the financial statements.

GENERAL MEETING OF SHAREHOLDERS

The Company's highest governing body is the General Meeting of Shareholders, the authorities of which are regulated by legislation and the articles of association of the Company. The general meeting of shareholders decides, among others, the appointment and recall of members of the Supervisory Board, appointment of the auditor, approval of the results of the financial year and the payment of dividends. The annual general meeting of shareholders is held at least once a year and shall approve the annual report within six months of the end of the financial year.

The general meeting of shareholders was held on 28 April 2017. The general meeting resolved to approve the annual report and the profit allocation proposal for 2016. The dividends in the sum of EUR 7.3 million (EUR 0.41 per share) were paid out to shareholders on 26 May 2017.

In addition, it was decided at the general meeting of shareholders that the Supervisory Board will have 3 members who will be elected for the term of next 3 years and also to extend the terms of office of members of the Supervisory Board Toomas Annus, Teet Roopalu and Indrek Neivelt until 28 April 2020, i.e. for a period of three years from the decision for the extension. The remuneration of members of the Supervisory Board did not change and will continue based on terms and conditions approved at general meeting of shareholders of AS Merko Ehitus, held on 31 October 2008.

The Management Board made a presentation on the company's financial results and future prospects.

In accordance with the Commercial Code, its Articles of Association and Good Governance Code, AS Merko Ehitus calls the annual and extraordinary general meeting of shareholders by notifying the shareholders through the Tallinn Stock Exchange and by publishing a meeting call in one national daily newspaper and on its website at least 3 weeks in advance. The general meeting shall be held at the place shown in the notice, on a working day and between 9 a.m. and 6 p.m., enabling most of the shareholders to participate in the General Meeting of Shareholders.

Before their publication, agendas at annual and extraordinary general meetings of the company's shareholders are approved by the Supervisory Board that shall also present to the general meeting subjects for discussion and voting. Agenda items of the general meeting, recommendations of the Supervisory Board with relevant explanations, procedural guidance for participation in the general meeting and how and when new agenda items can be proposed are published together with the notice on calling the general meeting.

General meetings can be attended by any shareholder or his or her authorised representative. AS Merko Ehitus does not allow participation in general meetings by electronic means of communication equipment since the deployment of reliable solutions for the identification of shareholders, some of whom live abroad, while ensuring the privacy of participating shareholders, would be too complicated and costly. No picture taking or filming is allowed at the general meeting, because it may disturb the privacy of shareholders.

Annual and extraordinary general meeting of shareholders shall be chaired by an independent person. In 2017, the general meeting was chaired by attorney-at-law Vesse Võhma who introduced the procedure for conducting the general meeting and the procedure of asking questions from the Management Board and Supervisory Board about the company's activities.

On behalf of the company, usually the Chairman of the Management Board and the Chairman of the Supervisory Board shall participate in the General Meeting of AS Merko Ehitus, and if necessary, other members of the Management and Supervisory Boards shall be involved. If necessary, the company's auditor shall participate.

The annual general meeting of shareholders of AS Merko Ehitus held in 2017 was attended by Andres Trink (Chairman of the Management Board), Tõnu Toomik (Member of the Management Board), Signe Kukin (Group Chief Financial Officer) and Ago Vilu (Auditor).

SUPERVISORY BOARD

The Supervisory Board shall plan the activities of the company, organise the management of the company and supervise the activities of the Management Board. The Supervisory Board shall notify the general meeting of shareholders of the results of a review. The Chairman of the Supervisory Board organises the work of the Supervisory Board. The main duties of the Supervisory Board are to approve the group's material strategic and tactical decisions and to supervise the activities of the group's Management Board. The Supervisory Board's actions are guided by the company's articles of association, guidelines of the general meeting and law.

According to the Articles of Association of Merko Ehitus, the Supervisory Board has 3 to 5 members who shall be elected for the term of three years.

At the annual general meeting of shareholders held at 28 April 2017, it was decided to extend the term of office of Supervisory Board members Toomas Annus, Teet Roopalu and Indrek Neivelt until 28 April 2020, i.e. for three years from the decision of the extension. Mr. Olari Taal's mandate as a Member of the Supervisory Board was not renewed, at his own discretion, and expired on 30 April 2017. According to decision of the Supervisory Board of AS Merko Ehitus of 6 June 2017, Mr. Toomas Annus will continue as the Chairman of the Supervisory Board.
As at 31 December 2017, the Supervisory Board of AS Merko Ehitus had three members of whom, in accordance with the requirements of the Good Governance Code, Indrek Neivelt is an independent member:

Toomas Annus
Chairman of the Supervisory Board

Positions held:
2011-... AS Merko Ehitus, Chairman of the Supervisory Board
2014-... E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
2009-2014 E.L.L. Kinnisvara AS, Member of the Management Board
2008-... Järvevana OÜ, Member of the Management Board
1999-2009 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
1997-2008 AS Merko Ehitus, Chairman of the Supervisory Board
1996-... AS Riverito, Chairman of the Management Board
1991-1996 AS EKE Merko, Chairman of the Management Board
1989-1991 EKE MRK, director of the company

Education:
Tallinn University of Technology, industrial and civil engineering
Tallinn Technical School of Building and Mechanics, industrial and civil engineering

Number of shares: 8,322,914 (AS Riverito)

Teet Roopalu
Member of the Supervisory Board

Positions held:
2004-… AS Merko Ehitus, Member of the Supervisory Board
2010-… AS Riverito, Member of the Management Board
2003-… E.L.L. Kinnisvara AS, Member of the Supervisory Board
2015-… Järvevana OÜ, Member of the Management Board
2002-2004 AS Merko Ehitus, Adviser to the Management Board
Has worked for different construction companies, including as a director of finance. Has been in charge of economic activities in the EKE system as a chief economist; worked as a bank director; and has also worked in building design.
Member of Supervisory Boards of group subsidiaries.
Education:
Tallinn University of Technology, construction economics and organisation
Number of shares: -

Indrek Neivelt
Member of the Supervisory Board

Positions held:
2008-… AS Merko Ehitus, Member of the Supervisory Board
2015-… AS Pocopay, Member of the Management Board
2016-… OÜ Poco Holding, Member of the Management Board
Has held various executive positions in Hansapank (now Swedbank), incl. Director General of the Group, Chairman of the Management Board and also in Bank Saint Petersburg as the Chairman of the Supervisory Board.
Belongs to Supervisory Boards of various companies.
Education:
Tallinn University of Technology, civil engineering economics and management.
Stockholm University, banking and finance, MBA
Number of shares: 31,635 (Trust IN OÜ)

The meetings of the Supervisory Board generally take place once a month, except in summer months. In 2017, the Supervisory Board held 13 regular meetings. No extraordinary Supervisory Board meetings were held. Participation of members of the Supervisory Board at meetings:

NAME	PARTICIPATION IN MEETINGS	PARTICIPATION %
Toomas Annus	12	92%
Teet Roopalu	13	100%
Indrek Neivelt	12	92%
Olari Taal (until 30.04.2017)	6	100%

The Supervisory Board fulfilled all its obligations laid down in legal acts. The Supervisory Board has set up an audit committee as its work body. The Supervisory Board has not considered it necessary to set up a remuneration committee or appointment committee. Remuneration of the members of the Supervisory Board is approved by the general meeting of shareholders. The valid procedure for remuneration of Supervisory Board members was approved by the general meeting of shareholders held at 31 October 2008.

No termination benefits are paid to the members of the Supervisory Board upon the termination or non-extension of the contract. In the 2017 and 2016 financial years, the members of the Supervisory Board were remunerated as follows (in euros):

NAME	2017	2016
Toomas Annus	42,182	42,182
Teet Roopalu	38,347	38,347
Indrek Neivelt	38,347	38,347
Olari Taal (until 30.04.2017)	12,782	38,347
TOTAL	**131,658**	**157,223**

Remuneration, less the statutory taxes, to the members of the Supervisory Board is paid on a monthly basis.

MANAGEMENT BOARD

The Management Board is a governing body, which represents and manages AS Merko Ehitus in its daily activities in accordance with the law and the Articles of Association. The Management Board has to act in the most economically purposeful manner, taking into consideration the best interests of all shareholders and ensuring the company's sustainable development in accordance with set objectives and strategy. To ensure that the company's interests are met in the best way possible, the Management and Supervisory Boards shall extensively collaborate. At least once a month, a joint meeting of the members of the Supervisory and Management Boards shall take place, in which the Management Board shall inform the Supervisory Board of significant issues regarding the company's business operations, the fulfilment of the company's short- and long-term goals and the risks impacting them. For every meeting of the Supervisory Board, the Management Board shall prepare a management report and submit it well in advance of the meeting so that the Supervisory Board can study it. The Management Board prepares reports for the Supervisory Board also in between the meetings, if it is considered necessary by the Supervisory Board or its Chairman.

Pursuant to the Articles of Association approved at the general meeting of shareholders in 2012, the Management Board may have up to three members. AS Merko Ehitus has a two-member Management Board: Andres Trink (Chairman of the Management Board) and Tõnu Toomik (Member of the Management Board).

Andres Trink *Chairman of the Management Board*
Appointed: 1 January 2012
Term ends: 1 January 2021

Positions held:
2012-… AS Merko Ehitus, Chairman of the Management Board; Chairman of the Supervisory Board of Merko Ehitus Eesti AS, SIA Merks and UAB Merko Statyba
2016-… Swedbank Investeerimisfondid AS, Member of the Supervisory Board
Has held various executive positions in the private and public sector. Before being hired at Merko Ehitus, worked for 15 years in the financial sector, including as a Member of the Management Board of Baltic banking at Hansapank (now Swedbank).
Education:
Tallinn University of Technology, automated management systems specialty (summa cum laude).
Estonian Business School, international business administration.
Graduate of the INSEAD University (France), executive management programme.
Number of shares: 600

Tõnu Toomik *Member of the Management Board*
Appointed: 6 June 2013
Term ends: 6 June 2019

Positions held:
2013-… AS Merko Ehitus, Member of the Management Board
2014-… E.L.L. Kinnisvara AS, Member of the Supervisory Board
2011-2013 AS Merko Ehitus, Member of the Supervisory Board
2009-2014 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
2008-2011 AS Merko Ehitus, Chairman of the Supervisory Board
1999-2009 E.L.L. Kinnisvara AS, Member of the Supervisory Board
1997-1999 E.L.L. Kinnisvara AS, Chairman of the Supervisory Board
1997-2008 AS Merko Ehitus, Chairman of the Management Board
1996-… AS Riverito, Member of the Management Board
1993-1996 AS EKE Merko, Estonian Regional Director
1993-1993 AS EKE Merko, Project Manager
Member of the Supervisory Board of Merko Ehitus Eesti AS, SIA Merks and UAB Merko Statyba
Education:
Tallinn University of Technology, industrial and civil engineering
Number of shares: 1,607,185 (AS Riverito)

The responsibilities of Andres Trink, Chairman of the Management Board, include, among others, fulfilling daily obligations of the CEO of AS Merko Ehitus, managing and representing the company, ensuring compliance with the Articles of Association, legal acts, organising the work of the Management Board and supervisory boards of the more important subsidiaries, coordinating the development of strategies and providing for their implementation, being responsible for business development and finance. Tõnu Toomik is responsible for the management of the portfolio of properties and coordination of construction segment development activities across the whole group.

Members of the Management Board have entered into three-year contracts of service with the company. The procedure and principles of remuneration of Management Board members are approved by the Supervisory Board. The members of the Management Board are paid a fee for fulfilling their official duties. Bonuses payable to the Management Board depend on the fulfilment of the targets of the given financial year by the group and the Management Board. The members of the Management Board are paid bonuses once a year based on the fulfilment of the targets of the previous financial year.

In the 2017 and 2016 financial years, the Management Board members' remuneration incl. service fees and bonuses, accrued for the reporting year were as follows (in euros):

NAME	2017	2016
Andres Trink	254,257	226,060
Tõnu Toomik	237,698	211,050
TOTAL	**491,955**	**437,110**

Changes in the management of AS Merko Ehitus

On 13th December 2017, the Supervisory Board of AS Merko Ehitus extend the powers of the Chairman of the Management Board, Mr. Andres Trink for three years, starting from 1 January 2018.

SUPERVISORY AND MANAGEMENT BOARDS OF SUBSIDIARIES

Authorisation and responsibility of supervisory boards of subsidiaries of AS Merko Ehitus are based on their Articles of Association and intergroup rules. Generally, Supervisory Boards of subsidiaries consist of members of the Management Board and Supervisory Board of the company that is the main shareholder of the specific subsidiary. Supervisory Board meetings of the most significant subsidiaries are held usually once a month, otherwise according to the group's needs, Articles of Association of subsidiaries and legal provisions. Generally, no separate fee is paid to members of the Supervisory Board of subsidiaries. Members of the Supervisory Board will also receive no termination benefit in case their contract of service is terminated before due date or not extended.

The chairman or member of the Management Board of the subsidiary shall be named by the subsidiary's Supervisory Board. Below are the supervisory boards and management boards of the most significant subsidiaries that are wholly-owned by AS Merko Ehitus as at 31 December 2017:

COMPANY *	SUPERVISORY BOARD	MANAGEMENT BOARD
AS Merko Ehitus Eesti *(35,829,718 euros)*	Andres Trink (Chairman), Teet Roopalu, Tõnu Toomik	Keit Paal (Chairman), Jaan Mäe, Alar Lagus, Veljo Viitmann
AS Merko Infra *(7,391,220 euros)*	Keit Paal (Chairman), Veljo Viitmann, Mihkel Mugur	Boris Tehnikov (Chairman), Marek Hergauk, Leino Lootus
Tallinna Teede AS *(14,434,983 euros)*	Tõnu Toomik (Chairman), Keit Paal, Alar Lagus, Veljo Viitmann	Jüri Läll (Chairman), Jüri Helila
AS Merko Tartu *(4,876,353 euros)*	Jaan Mäe (Chairman), Veljo Viitmann, Alar Lagus	Juhan Varik, Mihkel Mugur
OÜ Merko Investments *(21,580,756 euros)*	-	Andres Trink, Priit Roosimägi
SIA Merks *(34,729,564 euros)*	Andres Trink (Chairman), Tõnu Toomik, Priit Roosimägi	Oskars Ozoliņš (Chairman), Jānis Šperbergs
SIA Merko Investments *(35,750,653 euros)*	-	Andres Trink (Chairman), Oskars Ozoliņš
UAB Merko Statyba *(8,877,913 euros)*	Andres Trink (Chairman), Tõnu Toomik, Priit Roosimägi	Saulius Putrimas (Chairman), Jaanus Rästas
OÜ Merko Property *(5,538,300 euros)*	-	Andres Trink, Priit Roosimägi
UAB Balsiu mokyklos SPV *(3,041,922 euros)*	-	Virginijus Verbickas
OÜ Metsailu *(7,746,831 euros)*	-	Tiit Kuusik, Ines Prual

** The figure in brackets indicates the amount of equity held by the parent company's owners in significant subsidiaries as at 31 December 2017.*

Changes in the management of group subsidiaries

On 17 January 2017, the Supervisory Board of AS Merko Infra, Estonian subsidiary, part of AS Merko Ehitus group, decided to extend the powers of the Chairman of the Management Board, Mr. Arno Elias and the Member of the Management Board, Mr. Boris Tehnikov for three years, i.e. from 23 January 2017 until 22 January 2020. The Board appointed Mr. Marek Hergauk as a new member of the Management Board from 23 January 2017 until 22 January 2020. Mr. Tarmo Pohlak's mandate as a Member of the Management Board was not renewed and expired on 22 January 2017. The Management Board of AS Merko Infra will continue with three members: Mr. Arno Elias (The Chairman), Mr. Boris Tehnikov and Mr. Marek Hergauk.

On 31 March 2017, the Supervisory Board of AS Merko Infra, Estonian subsidiary, part of AS Merko Ehitus group, decided to appoint Mr. Leino Lootus as a new member of the Management Board for three years, from 31 March 2017 until 27 March 2020. The Supervisory Board of AS Merko Infra additionally decided to recall the former chairman of the Management Board Mr. Arno Elias and appoint Mr. Boris Tehnikov, former Management Board Member, as the new Chairman of the Management Board. The Management

Board of AS Merko Infra will continue with three members: Mr. Boris Tehnikov (The Chairman), Mr. Marek Hergauk and Mr. Leino Lootus.

On 24 July 2017, the Supervisory Board of Tallinna Teede AS – the subsidiary of AS Merko Ehitus Eesti, part of AS Merko Ehitus group – decided to extend the powers of the Chairman of the Management Board, Mr. Jüri Läll from 31 July 2017 till 30 January 2020. The Management Board of Tallinna Teede AS will continue in a former two-member panel: Mr. Jüri Läll (The Chairman) and Mr. Jüri Helila.

On 28 July 2017, the Supervisory Board of AS Merko Ehitus Eesti, part of AS Merko Ehitus group, decided to extend the powers of the Member of the Management Board, Mr. Alar Lagus for three years, i.e. from 1 August 2017 till 31 July 2020. On 14 November 2017, the Supervisory Board of AS Merko Ehitus Eesti decided to extend the powers of the Members of the Management Board, Mr. Jaan Mäe and Veljo Viitmann for three years, i.e. from 1 January 2018 till 31 December 2020. The Management Board of AS Merko Ehitus Eesti will continue in a former four-member panel: Mr. Keit Paal (The Chairman), Mr. Jaan Mäe, Mr. Alar Lagus and Mr. Veljo Viitmann.

On 17 November 2017, the Management Board of AS Merko Ehitus Eesti, part of AS Merko Ehitus group, decided to extend the powers of the Members of the Supervisory Board of AS Merko Tartu, Mr. Alar Lagus and Mr. Veljo Viitmann for three years, i.e. till 23 December 2020. The Supervisory Board of AS Merko Tartu will continue in a former three-member panel: Mr. Jaan Mäe (The Chairman), Mr. Veljo Viitmann and Mr. Alar Lagus.

On 17 November 2017, the Supervisory Board of AS Merko Tartu, part of AS Merko Ehitus group, decided to extend the powers of the Member of the Management Board, Mr. Mihkel Mugur for three years, i.e. till 17 November 2020. The Management Board of AS Merko Tartu will continue in a former two-member panel: Mr. Juhan Varik and Mr. Mihkel Mugur.

As per the decision of AS Merko Ehitus Management Board on 21 December 2017, starting from 1 January 2018, Priit Roosimägi will be a member of the Supervisory Boards of group companies UAB Merko statyba and SIA Merks, and a member of the Management Boards of group companies OÜ Merko Property and OÜ Merko Investments, replacing the current member, Signe Kukin.

According to a decision of the Management Board of AS Merko Ehitus from 8 January 2018, the powers of the Members of the Supervisory Board of AS Merko Ehitus Eesti, Mr. Andres Trink, Mr. Tõnu Toomik and Mr. Teet Roopalu have been extended from 1 January 2018 until 31 December 2020. The Supervisory Board of AS Merko Ehitus Eesti will continue with three members: Mr. Andres Trink (The Chairman), Mr. Tõnu Toomik and Mr. Teet Roopalu.

The fees to the members of the management board of the major subsidiaries is provided in Note 33 of the financial statements.

AUDIT COMMITTEE

The Supervisory Board of AS Merko Ehitus has formed an audit committee as its work body. The responsibility of the audit committee is advising the Supervisory Board in supervision related issues. The Committee executes supervision over the whole group (incl. subsidiaries): a) arrangement of accounting, b) preparation and approval of the financial budget and reports, c) management of financial risks, d) performance of external audit, e) functioning of an internal control system and f) legality of the activities. Subsidiaries have not formed audit committees.

As at 10 January 2011, the company's Supervisory Board set up a 3-member audit committee. On November 1, 2017, the Supervisory Board of AS Merko Ehitus decided to amend the composition of the Audit Committee by appointing Viktor Mõisja as a new member and recalling Olari Taal. AS Merko Ehitus Audit Committee continues with three members: Teet Roopalu (the Chairman), Indrek Neivelt and Viktor Mõisja.

A member of the committee is elected for a term of indefinite period, but at the decision of the Supervisory Board, a member of the committee may be recalled at any given time.

Members of the audit committee are not separately remunerated.

REPORTING AND FINANCIAL AUDIT

Availability of adequate and timely information is the basis for obtaining quality management decisions. It is important to ensure that reporting is factual, but also forward-looking. This will enable to manage, to the best of one's knowledge, risks and, in competition with other market operators, turn them into opportunities. The company's reporting can be roughly divided into: a) financial reporting and b) management reporting.

Financial reporting consists of interim reports of consolidated economic indicators and annual reports of companies that belong to the AS Merko Ehitus group, that are made public through the stock exchange system of NASDAQ Tallinn and that are available to all shareholders, potential investors and analysts covering the company.

On the other hand, management reporting is meant for the company's internal use. It is appropriate to separate reporting on various operating indicators that focuses on the performance of business segments and different group companies as well as return on equity. The refinement of reporting is a continuous process during which indicators affecting the achievement of agreed objectives are reviewed. Management reporting includes budgets and forecasts that AS Merko Ehitus does not disclose.

Financial audits are conducted on the basis of International Standards on Auditing. The auditor of AS Merko Ehitus is approved by the general meeting of shareholders. The selection process is managed by the Supervisory Board and its findings are presented to the general meeting for approval. As a result of the tender and with the resolution made by the general meeting in 2015, the financial auditor for annual reports of 2015-2017 is AS PricewaterhouseCoopers (PwC). Auditors authorised to sign the report differ, depending on the country of residence of the group company. Chartered auditor Ago Vilu is responsible for the consolidated audit report.

AS Merko Ehitus considers it important to ensure independence of the financial auditor and to avoid conflicts of interest. In 2017, PwC provided to AS Merko Ehitus tax and other advisory services permitted under Estonian Audit Act. We find that the financial audit conducted in 2017 was in compliance with regulative acts, international standards and expectations. PwC presented the results in two stages: a) as part of an interim audit and b) with regard to the final audit before the independent auditor's report was issued. The auditor's report is presented on pages 110-116.

In 2017, the fees for financial audit of AS Merko Ehitus group amounted to EUR 130 thousand (2016: EUR 91 thousand) and for other counselling services (incl. tax advisory and information systems consultations) to EUR 39 thousand (2016: EUR 43 thousand).

CONFLICT OF INTEREST AND HANDLING OF INSIDER INFORMATION

It is important to appropriately handle insider information in order to protect shareholders' interests and ensure honest and fair trading of shares. Significant information about AS Merko Ehitus and its subsidiaries must be available in a timely, consistent and equal manner for all shareholders and potential new shareholders. It is inevitable that persons related to AS Merko Ehitus and its subsidiaries have, because of their job, at certain times and in certain cases more information about the group than investors and the public. To prevent the misuse of such information, we have adopted internal rules in the group's companies on maintaining and publication of insider information and on making transactions on the basis of insider information (hereinafter: insider information rules). Insider information rules include a reporting system under which employees who may develop a conflict of interest when fulfilling their job duties are required to disclose their economic interests and confirm their independence by self-assessment.

The members of the Management and Supervisory Board of AS Merko Ehitus are users of insider information (so-called insiders). They have signed a relevant statement, are aware of insider information rules of AS Merko Ehitus and together with people connected with them are registered in the list of the company's insiders. Moreover, the list of insiders includes the financial employees of the parent company who have access to the group's consolidated operating results as well as members of the Management and Supervisory Boards of the more important subsidiaries together with the employees who are responsible for preparing and presenting accounting information.

As at 31 December 2017, the company's insider register lists 69 persons with permanent access (31.12.2016: 62 persons). The group keeps records on insiders in accordance with requirements set forth in the Securities Market Act and NASDAQ Tallinn rules and regulations.

To the best of our knowledge, in the financial year 2017 there were no cases of any misuse of insider information or conflicts of interest. No transactions with related parties were made at other than market terms.

OWNERSHIP INTERESTS OF AS MERKO EHITUS MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD (OVER 5%) IN OTHER COMPANIES

NAME	RELATED COMPANY
Toomas Annus	AS Riverito, Kardispordi Arendamise OÜ, Kemtal OÜ, Kemtal Grupp OÜ
Teet Roopalu	Teet Konsult OÜ
Indrek Neivelt	Trust IN OÜ
Andres Trink	None
Tõnu Toomik	AS Riverito, Loode Kalur OÜ

No members of the company's supervisory or management board hold shares in an entity that operates in the core business area of AS Merko Ehitus – construction sector.

An overview of transactions with related parties in 2017 is provided in Note 33 of the financial statements.

DISCLOSURE OF INFORMATION

In disclosing information, AS Merko Ehitus shall follow Estonian law, the rules and regulations of NASDAQ Tallinn Stock Exchange and guidelines of the Financial Supervision Authority of Estonia and immediately disclose important information regarding the company's activities to the shareholders after obtaining reasonable assurance as to its correctness and that the disclosure of such information shall not harm the interests of the company and its business partners.

The group has adopted an information disclosure procedure that describes the main policies in communication with investors and the public. The objective of the information disclosure procedure is to ensure access to adequate and yet accurate information about the group and its operations that will form the basis for the price of the securities issued by the company. Information will be disclosed without undue delay and impartially. The main principles of information disclosure of Merko Ehitus are consistency, impartiality, transparency, truthfulness and preventive approach.

The group discloses information about its financial condition and strategy in its financial statements, annual report and interim reports pursuant to the schedule that has been set. The disclosure dates of each next financial year will be announced before the end of the previous financial year.

Merko immediately discloses all decisions, issues and events that in the company's view may significantly change the price of the securities issued by the company and that are to be discloses pursuant to laws and regulations. Stock exchange releases are published in Estonian and English.

Stock exchange releases are always published regarding the following subjects:

- financial statements, interim reports;
- amendments to previously published strategies and financial objectives;
- profit warnings;
- major projects and construction contracts;
- major investments and financial arrangements;
- significant corporate reorganisations and partnership agreements;
- significant reorganisation, streamlining or discontinuation of functions or operations;
- management board's proposals to the annual general meeting and resolutions adopted in the annual meeting;
- significant legal actions, legal proceedings or actions of the authorities.

Merko discloses information about projects in the form of stock exchange notice if contract value exceeds EUR 3 million excluding VAT and in case of public procurements without the customer's reserve (price limit subjected to construction contracts by Merko). Generally, Merko will only make disclosures about awarded contracts, i.e. information is disclosed after the contract is signed. We emphasize the fact that the said EUR 3 million limit is not absolute but a criterion for making it easier for investors to understand which projects Merko covers in its press releases sent via the stock exchange information system. In certain cases, there may be a need to send out press releases via the stock exchange information system on contracts smaller than that amount, if these exert a significant influence on the price of the company's securities or are relevant to current and prospective investors.

Important information shall be disclosed through the stock exchange system and on the company's website. In 2017, AS Merko Ehitus published 53 stock exchange releases through the stock exchange system.

NUMBER OF RELEASES	CONTENT OF RELEASE
22	New construction contracts
5	New development projects
5	Operating results
11	Changes in structure and management
3	General meeting
7	Other releases

We will publish 2018 consolidated interim reports as follows:

KUUPÄEV	SÜNDMUS
10.05.2018	2018 3 months and I quarter unaudited interim report
09.08.2018	2018 6 months and II quarter unaudited interim report
08.11.2018	2018 9 months and III quarter unaudited interim report

In 2018, reports will be published before the start of the trading day, at 8 am local Estonian time (EET). Annual accounts of subsidiaries are not generally published, but they can be obtained, if necessary, from AS Merko Ehitus or the local Commercial Registries.

Our objective is to support fair pricing of Merko shares through constant and continued distribution of information to all market operators. Moreover, our objective is to maintain the loyalty of existing shareholders towards the company and to create interest in new shareholders and analysts.

It is our responsibility to prepare quarterly and annual reports, stock exchange releases and presentation and to plan and organise investor meetings with shareholders and analysts. We also collect and analyse feedback from investors and analysts in order to increase the value of information to be disclosed.

The company shall not hold meetings with analysts or presentations for investors immediately before the dates of disclosure of financial reporting (interim reports, annual report). AS Merko Ehitus communicates regularly with its larger shareholders and potential investors and, if requested, holds meetings. The information presented in these meetings is public, i.e. available from the company's reports, website or other public sources. We carefully monitor insider information rules during these meetings.

The investor calendar published on the AS Merko Ehitus website http://group.merko.ee/en/investors/investor-calendar/ provides an overview of investor meetings both past and upcoming. Current shareholders can request their participation in planned meetings shown on the investor calendar. Requests should be made in a timely fashion. In addition to the investor meeting date, time and names of participants, Merko's website has a section with the presentations used at the meetings. In 2017, AS Merko Ehitus organised 12 investor meetings (2016: 14), including 1 investor tour (2016: 1).

For informing the company's shareholders, an annual general meeting of shareholders is called at least once a year where all shareholders can ask questions from members of the company's Management Board and Supervisory Board.

The main analysts who cover AS Merko Ehitus are:

SWEDBANK AS	AS LHV PANK
Liivalaia 8, 15040 Tallinn, Estonia	Tartu mnt 2, 10145 Tallinn, Estonia
phone +372 631 0310	phone +372 680 0457
e-mail info@swedbank.ee	e-mail research@lhv.ee
www.swedbank.ee	www.lhv.ee

Information on investor relations of AS Merko Ehitus is available from:

ANDRES TRINK	PRIIT ROOSIMÄGI	AS MERKO EHITUS
Chairman of the Management Board	Head of Group Finance Unit	Delta Plaza, 7th Floor
phone +372 650 1250	phone +372 650 1250	Pärnu mnt 141, 11314 Tallinn, Estonia
fax +372 650 1251	fax +372 650 1251	phone +372 650 1250
e-mail andres.trink@merko.ee	e-mail priit.roosimagi@merko.ee	group.merko.ee

DECLARATION OF CONFORMITY TO RECOMMENDATIONS OF GOOD CORPORATE GOVERNANCE CODE

The Corporate Governance Code (CGC) is based on the principle of follow or explain, according to which a publicly traded company shall explain its standpoints and activities with regard to those CGC provisions, which it does not follow.

We have assessed the structure and functions of the management of AS Merko Ehitus on the basis of Good Corporate Governance Code. Above we have described significant components of corporate governance. Having assessed the compliance of the structure and functioning of the company's management system, we find that our organisation and activities are in significant part in compliance with the Good Corporate Governance Code. Also, our activities comply with the Estonian legislation that regulates several principles provided in the code in more detail. We hereby declare that AS Merko Ehitus has followed all the recommendations of CGC, with exception of Section 2.2.7, that is provided below with the explanation why the company is not following it at the present:

CORPORATE GOVERNANCE RECOMMENDATIONS	EXPLANATIONS BY MANAGEMENT AND SUPERVISORY BOARDS
2.2.7 Basic wages, performance pay, severance packages, other benefits payable and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on the website of the issuer and in the Corporate Governance Recommendations report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the issuer or the amount of foreseeable expense as of the day of disclosure.	AS Merko Ehitus publishes in its annual report the total amount of remuneration and bonuses paid to member of the Management Board, as it believes that public disclosure of individual income items does not create value added for shareholders, but does violate the privacy of members of the Management Board.

MANAGEMENT DECLARATION

The Management Board declares and confirms that according to their best knowledge, the year 2017 annual accounts, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, present a correct and fair view of the assets, liabilities, financial position and profit or loss of AS Merko Ehitus and the undertakings involved in the consolidation as a whole, and the management report gives a true and fair view of the development and results of the business activities and financial status of AS Merko Ehitus and the undertakings involved in the consolidation as a whole and contains a description of the main risks and doubts.

Andres Trink	Chairman of the Management Board	27.03.2018
Tõnu Toomik	Member of the Management Board	27.03.2018

FINANCIAL STATEMENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

in thousands of euros

	Note	2017	2016
Revenue	3	317,598	251,970
Cost of goods sold	4	(286,747)	(232,961)
Gross profit		**30,851**	**19,009**
Marketing expenses	5	(3,215)	(3,281)
General and administrative expenses	6	(11,289)	(10,076)
Other operating income	7	3,793	2,466
Other operating expenses	8	(601)	(399)
Operating profit		**19,539**	**7,719**
Finance income	9	4	46
Finance costs	10	(849)	(649)
Profit from sale of subsidiary	18	14	-
Profit (loss) from joint ventures	19	64	163
Profit before tax		**18,772**	**7,279**
Corporate income tax expense	11	(3,020)	(1,275)
Net profit for financial year		**15,752**	**6,004**
incl. net profit attributable to equity holders of the parent		14,694	6,122
net profit attributable to non-controlling interest		1,058	(118)
Other comprehensive income (loss), which can subsequently be classified in the income statement			
Currency translation differences of foreign entities		(74)	19
Comprehensive income for the period		**15,678**	**6,023**
incl. attributable to equity holders of the parent		14,637	6,140
attributable to non-controlling interest		1,041	(117)
Earnings per share for profit attributable to equity holders of the parent (basic and diluted, in EUR)	12	0.83	0.35

The notes set out on pages 64-108 are an integral part of these consolidated financial statements.

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Initsiaalid/initials L.K.
Kuupäev/date 27.03.18
PricewaterhouseCoopers, Tallinn

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

in thousands of euros

	Note	31.12.2017	31.12.2016
ASSETS			
Current assets			
Cash and cash equivalents	14	39,210	33,544
Trade and other receivables	15	75,844	45,566
Prepaid corporate income tax		492	617
Inventories	17	118,421	123,364
		233,967	**203,091**
Non-current assets			
Investments in joint ventures	19	79	434
Other long-term loans and receivables	20	17,163	15,371
Deferred income tax assets	21	5	1,325
Investment property	22	15,719	4,108
Property, plant and equipment	23	9,665	12,838
Intangible assets	24	497	673
		43,128	**34,749**
TOTAL ASSETS		**277,095**	**237,840**
LIABILITIES			
Current liabilities			
Borrowings	26	24,218	21,485
Payables and prepayments	27	74,972	56,259
Income tax liability		413	278
Short-term provisions	28	4,569	5,637
		104,172	**83,659**
Non-current liabilities			
Long-term borrowings	26	35,138	24,516
Deferred income tax liability	21	1,259	1,122
Other long-term payables	29	1,789	2,061
		38,186	**27,699**
TOTAL LIABILITIES		**142,358**	**111,358**
EQUITY			
Non-controlling interests	18	4,567	3,692
Equity attributable to equity holders of the parent			
Share capital	31	7,929	7,929
Statutory reserve capital		793	793
Currency translation differences		(702)	(645)
Retained earnings		122,150	114,713
		130,170	**122,790**
TOTAL EQUITY		**134,737**	**126,482**
TOTAL LIABILITIES AND EQUITY		**277,095**	**237,840**

The notes set out on pages 64-108 are an integral part of these consolidated financial statements.

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

in thousands of euros

	Equity attributable to equity holders of the parent					Non-controlling interest	Total
	Share capital	Statutory reserve capital	Currency translation differences	Retained earnings	Total		
Balance as at 31.12.2015	**7,929**	**1,200**	**(663)**	**117,232**	**125,698**	**3,268**	**128,966**
Profit (loss) for the financial year	-	-	-	6,122	6,122	(118)	6,004
Other comprehensive income (loss)	-	-	18	-	18	1	19
Total comprehensive income (loss) for the financial year	**-**	**-**	**18**	**6,122**	**6,140**	**(117)**	**6,023**
Transactions with owners							
Contribution to subsidiary's share capital (Note 18)	-	-	-	-	-	108	108
Increase of share capital by non-monetary contribution and acquisition of non-controlling interest	-	-	-	(21)	(21)	472	451
Non-controlling interest of acquired subsidiary	-	-	-	-	-	283	283
Option over shares relating to non-controlling interests	-	-	-	-	-	(322)	(322)
Reserve capital reduction	-	(407)	-	407	-	-	-
Dividends (Note 13)	-	-	-	(9,027)	(9,027)	-	(9,027)
Total transactions with owners	**-**	**(407)**	**-**	**(8,641)**	**(9,048)**	**541**	**(8,507)**
Balance as at 31.12.2016	**7,929**	**793**	**(645)**	**114,713**	**122,790**	**3,692**	**126,482**
Balance as at 31.12.2016	**7,929**	**793**	**(645)**	**114,713**	**122,790**	**3,692**	**126,482**
Profit (loss) for the financial year	-	-	-	14,694	14,694	1,058	15,752
Other comprehensive income (loss)	-	-	(57)	-	(57)	(17)	(74)
Total comprehensive income (loss) for the financial year	**-**	**-**	**(57)**	**14 694**	**14 637**	**1,041**	**15,678**
Transactions with owners							
Non-controlling interest of sold subsidiary (Note 18)	-	-	-	-	-	123	123
Option over shares relating to non-controlling interests	-	-	-	-	-	(182)	(182)
Dividends (Note 13)	-	-	-	(7,257)	(7,257)	(107)	(7,364)
Total transactions with owners	**-**	**-**	**-**	**(7,257)**	**(7,257)**	**(166)**	**(7,423)**
Balance as at 31.12.2017	**7,929**	**793**	**(702)**	**122,150**	**130,170**	**4,567**	**134,737**

The notes set out on pages 64-108 are an integral part of these consolidated financial statements.

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CONSOLIDATED CASH FLOW STATEMENT

in thousands of euros

	Note	2017	2016
Cash flows from (used in) operating activities			
Operating profit		19,539	7,719
Adjustments:			
Depreciation	22-24	2,675	3,488
(Profit)/loss from sale of non-current assets	7	(571)	(444)
(Profit)/loss from sale of a business unit		(474)	-
Change in receivables and liabilities related to construction contracts recognised under the stage of completion method	32	(8,488)	3,711
Interest income from operating activities	7	(1,979)	(1,856)
Change in provisions	28	572	(520)
Change in trade and other receivables related to operating activities		(19,301)	(17,954)
Change in inventories	17	(4,851)	(14,128)
Change in trade and other payables related to operating activities		12,058	8,945
Interest received	7, 9, 15,20	1,709	1,515
Interest paid	10, 27	(879)	(732)
Other finance income and costs		(28)	(32)
Corporate income tax (paid)/reclaimed		(1,284)	(1,733)
Total cash flows from (used in) operating activities		**(1,302)**	**(12,021)**
Cash flows from investing activities			
Acquisition of subsidiaries	18	328	1,276
Disposal of subsidiary	18	(7)	-
Purchase of investment properties	22	(6)	-
Purchase of property, plant and equipment	23, 26	(1,186)	(2,834)
Proceeds from sale of property, plant and equipment	7, 23	1,924	1,098
Purchase of intangible assets	24	(181)	(191)
Sale of a business unit		113	-
Interest received	9, 15	6	47
Total cash flows from investing activities		**991**	**(604)**
Cash flows from (used in) financing activities			
Proceeds from borrowings	26	61,651	36,839
Repayments of borrowings	26	(47,380)	(20,807)
Finance lease principal payments	26	(818)	(855)
Contributions to the subsidiary's share capital from non-controlling shareholder	18	-	108
Dividends paid	13	(7,364)	(9,027)
Total cash flows from (used in) financing activities		**6,089**	**6,258**
Net increase/decrease in cash and cash equivalents		**5,778**	**(6,367)**
Cash and cash equivalents at the beginning of the period	14	**33,544**	**39,905**
Effect of exchange rate changes		**(112)**	**6**
Total at the end of the period	14	**39,210**	**33,544**

The notes set out on pages 64-108 are an integral part of these consolidated financial statements.

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NOTES

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.1. GENERAL INFORMATION

The consolidated financial statements of AS Merko Ehitus (hereinafter the parent) and its subsidiaries (hereinafter collectively the group) for the financial year ended 31 December 2017 were signed by the Management Board on 27 March 2018.

Pursuant to the Commercial Code of the Republic of Estonia, the annual report prepared by the Management Board and approved by the Supervisory Board and which also includes the consolidated financial statements shall be approved at the General Meeting of Shareholders. Shareholders have the right not to approve the annual report prepared and presented by the Management Board and require preparation of a new annual report.

AS Merko Ehitus is a corporation registered in the Republic of Estonia (Commercial Register No.: 11520257, address: Järvevana tee 9G, Tallinn) and it operates mainly in Estonia, Latvia, Lithuania and Norway. Its main activities are construction and real estate development.

From 22 July 1997, the shares of AS Merko Ehitus are listed on NASDAQ Tallinn Stock Exchange. As at 31 December 2017, the majority shareholder AS Riverito owned 71.99% of the Company's shares through which the ultimate controlling person is Toomas Annus.

AS Merko Ehitus was established in 2008 in the demerger of the former AS Merko Ehitus, currently Järvevana OÜ, as a result of which all operating areas, i.e. all assets and liabilities other than the liabilities related to the criminal proceeding, were transferred to the new entity.

From 1 January 2012, the group's construction operations in Estonia were transferred to AS Merko Ehitus Eesti. Thereafter, AS Merko Ehitus operates as a holding entity with no independent production activities. It has 100% ownership interests in construction entities in Estonia, Latvia and Lithuania, a majority holding in a construction entity in Norway, and a real estate development unit consisting of entities holding real estate properties.

1.2. BASES FOR PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements of Merko Ehitus group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The consolidated financial statements have been prepared under the historical cost convention.

Several financial figures are based on management's estimates, including, for example, assessment of profitability of construction contracts using the stage of completion method, assessment of the useful lives of items of property, plant and equipment, estimation of allowances for receivables and inventories, recognition of provisions for warranty obligations. Management's estimates have been made to the best of its knowledge, but they may turn out to be inaccurate. The effect of changes in accounting estimates is reported in the financial statements of the period in which the change occurred.

Assets and liabilities are classified as current and non-current in the statement of financial position. Current assets include assets that are expected to be realized in the course of ordinary operating cycle. Current liabilities include liabilities the due date of which is within 12 months after the balance sheet date. The remaining assets and liabilities are classified as non-current.

Expenses are classified according to their function in the income statement.

Items included in the financial statements of Merko Ehitus group entities are measured using the currency of their primary economic environment (the functional currency): the euro and the Norwegian krone. The consolidated financial statements are presented in euros. The primary financial statements and notes are presented in thousands of euros.

1.3. NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS, AMENDMENTS TO PUBLISHED STANDARDS AND INTERPRETATIONS OF THE INTERNATIONAL FINANCIAL REPORTING INTERPRETATIONS COMMITTEE (IFRIC)

ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The new or revised standards or interpretations, which became effective in the financial year starting 1 January 2017, do not have a material impact on the group.

NEW ACCOUNTING STANDARDS, INTERPRETATIONS AND CHANGES

Certain new or revised standards and interpretations have been issued that are mandatory for the group's annual periods beginning on or after 1 January 2018, and which the group has not early adopted:

IFRS 9, Financial Instruments: Classification and Measurement (effective for annual periods beginning on 1 January 2018).
Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets, but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

The group assesses that IFRS 9 does not have a significant effect on its financial reporting as of 1 January 2018, because the write-downs of receivables have been historically immaterial and cash and deposits are kept in credit institutions with high ratings; therefore the expected credit loss model, including assessment of forward-looking information, does not bring forth material loss from decrease in value. All financial assets (excluding derivative instruments, which the group does not have) meet the SPPI requirement and they are held to maturity, therefore they continue to be reported in amortized cost.

IFRS 15, Revenue from Contracts with Customers (effective for annual periods beginning on 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.
A comprehensive check-list based on IFRS 15 standard has been prepared by the group, based on which the group entities assess and report revenue from contracts with customers according to the new standard. Group's management finds the impact of the amendments to existing construction contracts and also to new contracts with customers immaterial.

IFRS 16, Leases (effective for annual periods beginning on 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The group assesses the impact of the amendments on its financial statements immaterial, as the operating lease payments in the future do not have a material impact for the group (see Note 25)

Transfers of Investment Property – Amendments to IAS 40 (effective for annual periods beginning on 1 January 2018). The amendment clarified that to transfer to, or from, investment properties there must be a change in use. This change must be supported by evidence; a change in intention, in isolation, is not enough to support a transfer. The group assesses the impact of the amendments on its financial statements immaterial.

Long-term Interests in Associates and Joint Ventures – Amendments to IAS 28 (effective for annual periods beginning on 1 January 2019). The amendments clarify that reporting entities should apply IFRS 9 to long-term loans, preference shares and similar instruments that form part of a net investment in an equity method investee before they can reduce such carrying value by a share of loss of the investee that exceeds the amount of investor's interest in the investee. The group assesses the impact of the amendments on its financial statements immaterial as of the preparation of this report and in the light of existing investments.

The other new or revised standards or interpretations, which are not yet effective, are not expected to have a material impact on the group.

1.4. CONSOLIDATION

Subsidiaries include all entities under the control of the group. The group controls the entity, if it receives or is entitled to variable profits arising from its role in the entity and the group can influence the amount of profit by exerting influence over the entity.
Subsidiaries are consolidated in the financial statements from the date of acquiring control until the date at which control ceases. The financial figures of the parent company and the subsidiaries have been consolidated on a line-by-line basis in the consolidated annual financial statements. Upon consolidation, intra-group transactions, balances and unrealised profits arising from intra-group transactions have been eliminated. Unrealised losses have also been eliminated, unless a loss is caused by impairment.
Group entities use uniform accounting policies.

Investments are recognised in the parent company's unconsolidated financial statements at acquisition cost, less any accumulated impairment losses.

1.5. BUSINESS COMBINATIONS

The group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group makes an election whether to recognise any non-controlling interest in the acquiree at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. From the date of acquisition, the revenue and expenses of the acquired entity are reported in the income statement of the group and goodwill is reported in the statement of financial position of the group.

The excess of the consideration transferred, the amount of any non-controlling interests in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the statement of comprehensive income.

Goodwill is subsequently measured at its cost less any impairment losses. Goodwill arising in a business combination is not amortised. Instead, an impairment test is carried out once a year. Goodwill is written down to its recoverable amount if the carrying amount is not recoverable (Note 1.10).

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

TRANSACTIONS WITH NON-CONTROLLING INTERESTS

The group treats transactions with non-controlling interests as transactions with equity owners of the group. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying amount of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

1.6. JOINT VENTURES

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to common control. Joint ventures are accounted for under the equity method. A holding in a jointly controlled entity is initially recognised at cost and subsequently adjusted for the post-acquisition changes that have occurred in the group's share of the net assets under common control. The income statement of the group includes the group's share in the profits or losses of the entity under common control. Unrealised gains and losses from transactions between the group and its joint ventures are eliminated.

1.7. JOINTLY CONTROLLED OPERATIONS

Under IFRS 11 Joint Arrangements, jointly controlled operations are joint operations with third parties, whereby the assets and other resources of venturers are used without the establishment of a new entity or another unit or creation of a separate financial structure. Each venturer uses its own property, plant and equipment and carries its own inventories in the statement of financial position. The venturer also incurs its own expenses and liabilities and raises its own funds which represent its own obligations. In respect of its interest in jointly controlled operations, a venturer recognises in its financial statements:

- the assets that it controls and the liabilities that it incurs;
- the expenses that it incurs and its share of revenue that it earns from the sale of goods or services of the jointly controlled operation.

In 2017 and 2016, the group had no jointly controlled operations.

1.8. FOREIGN CURRENCY

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 denominated in foreign currencies at the balance sheet date are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the balance sheet date. Exchange rate differences from translation are reported in the income statement of the reporting period.

The functional currency of subsidiaries located abroad is the currency of their business environment; therefore the financial statements of such subsidiaries are translated into euros for consolidation purposes; the asset and liability items are translated using the foreign exchange rates of the European Central Bank prevailing at the balance sheet date, income and expenses using the weighted average foreign exchange rates for the year and other changes in equity using the foreign exchange rates at the date at which they arose. Exchange rate differences arising from translation are reported in the equity item Currency translation differences and in the consolidated comprehensive income item Currency translation differences of foreign entities.

1.9. FINANCIAL ASSETS

The purchases and sales of financial assets are recognised at the trade date.
Depending on the purpose for which financial assets were acquired, financial assets are classified into the following categories at the group:

- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity investments;
- available-for-sale financial assets.

Management determines the classification of its financial assets at initial recognition.
The Company does not have any held-to-maturity investments, financial assets at fair value through profit or loss and available-for-sale financial assets. The group does not have any derivatives either.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are included within current assets except for maturities greater than 12 months after the balance sheet date. Such assets are classified as non-current assets. Loans and receivables are initially recognised at their fair value less transaction costs. After initial recognition, the group carries loans and receivables at amortised cost (less any impairment losses), calculating interest income on the receivable in the following periods using the effective interest rate method.

Receivables are assessed based on the collectible amounts. Each receivable is assessed separately considering all known information about the solvency of the party to the transaction. Receivables whose collection is improbable are written down during the reporting period (see also 1.10).

1.10. IMPAIRMENT OF ASSETS

FINANCIAL ASSETS AT AMORTISED COST

The group assesses at each balance sheet date whether there is any indication that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (loss events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated. Objective evidence that a financial asset or a group of financial assets is impaired includes observable data that is available to the group regarding the following events:

- significant financial difficulties of the debtor;
- a breach of contract, such as a default or delinquency in payments;
- probability that the debtor will enter bankruptcy;
- disappearance of an active market for that financial asset because of financial difficulties;
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a financial asset or a group of financial assets, although the decrease cannot yet be measured reliably.

If there is objective evidence that an impairment loss has incurred for loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have already been recognised), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

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

NON-FINANCIAL ASSETS

Assets that have indefinite useful lives are not subject to amortisation but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and compared with the carrying amount. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit). Non-financial assets that suffered an impairment loss are reviewed at each reporting date and if necessary, the impairment loss is reversed except for impairment of goodwill.

1.11. INVENTORIES

Inventories are initially recorded in the statement of financial position at cost, which consists of the purchase costs, production costs, transportation and other costs incurred in bringing the inventories to their present location and condition.

In case of separately identifiable inventory items, their cost is determined based on expenditure incurred specifically for the acquisition of each asset. If inventory items are not clearly distinguishable from each other, then the weighted average cost method is used.

Inventories are measured in the statement of financial position at the lower of acquisition cost and net realisable value. The net realisable value is the sales price less estimated costs to sell.

Expenditure incurred for real estate development is reported either as work-in-progress or finished goods, depending on the stage of completion in the line Inventories in the statement of financial position. When the development of property is financed with a loan, the borrowing costs incurred during development are included in the cost of the property. Borrowing costs incurred during the period of construction are capitalised until a permit for use is obtained for the project. Interest expenses associated with maintenance or usage of the property are not capitalised.

A completed real estate property is sold either in units (by houses, apartments, office spaces, etc.) or as a whole. Revenue is recognised as income from the sale of goods (Note 1.20). Upon the sale of real estate properties, the group and the acquirer enter into a notarised agreement for transferring the property, and a respective entry is made in the land register.

1.12. INVESTMENT PROPERTY

Investment property is real estate property, which is primarily held for the purpose of earning rental income or for capital appreciation or for both, but not for the production of goods or services, administrative purposes or sale in the ordinary course of business. Investment property is measured using the cost method, i.e. at cost less any accumulated depreciation and any accumulated impairment losses.

Buildings included in investment properties are depreciated on a straight-line basis over the period of 12.5 to 33.3 years. Land is not depreciated.

1.13. PROPERTY, PLANT AND EQUIPMENT

An item of property, plant and equipment is an asset used for production, provision of services or administrative purposes over a period longer than one year.

An item of property, plant and equipment is carried in the statement of financial position at its cost less any accumulated depreciation. The cost consists of the purchase price and other costs directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. Subsequent expenditure incurred for items of property, plant and equipment is recognised as non-current assets when it is probable that future economic benefits associated with the asset will flow to the Company and the cost of the asset can be measured reliably. Other repair and maintenance costs are recognised as expenses at the time they are incurred. Items of property, plant and equipment leased under the finance lease terms are accounted for similarly to purchased property, plant and equipment.

Depreciation is calculated on a straight-line basis over the following useful lives:

- buildings 10-33.3 years;
- machinery and equipment 2-20 years;
- other items of property, plant and equipment 2.5-5 years;
- right of superficies 50 years.

Land is not depreciated.

At each balance sheet date, the validity of applied depreciation rates, the depreciation method and the residual values applicable to assets are assessed.

If an item of property, plant and equipment consists of separately identifiable components with different useful lives, these components are accounted for as separate assets and accordingly, separate depreciation rates are set for them depending on their useful lives.

Items of property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition of items of property, plant and equipment are included either within other operating income or other operating expenses in the income statement.

Non-current assets are written down to their recoverable amount if the latter is lower than their carrying amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

1.14. INTANGIBLE ASSETS

Intangible assets are recognised in the statement of financial position when the asset can be controlled by the Company, the expected future benefits attributable to the asset will flow to the Company and the cost of the asset can be measured reliably. The cost of an intangible asset consists of its purchase price and other expenditure directly related to the purchase. Intangible assets are carried in the statement of financial position at cost less any accumulated amortisation and any accumulated impairment losses. Goodwill is not amortised.

SOFTWARE AND INFORMATION SYSTEMS

The costs related to the development of information systems and software which are reported as intangible assets, are depreciated under a straight-line method over their estimated useful lives (2-10 years).

1.15. FINANCE AND OPERATING LEASES

Leases of property, plant and equipment that transfer all significant risks and rewards of ownership to the lessee are classified as finance leases. All other leases are recognised as operating leases.

Assets and liabilities leased under the finance lease terms are reported in the statement of financial position at the lower of fair value of the leased asset and the present value of minimum rental payments. Items of property, plant and equipment leased under the finance lease terms are depreciated over the shorter of the lease term and the useful life.

Finance lease liabilities are reduced by principal payments; interest expenses on lease payments are included within finance costs in the income statement. Finance costs are allocated to the rental period to achieve a constant periodic rate of interest on the remaining balance of the liability.

Operating lease payments are reported in the income statement as expenses on a straight-line basis over the lease term.

1.16. FINANCIAL LIABILITIES

All financial liabilities of the group belong to the category "other financial liabilities at amortised cost".

All financial liabilities (trade payables, borrowings, and other short and long-term borrowings) are initially recognised at their fair value and are subsequently carried at amortised cost, using the effective interest rate method. The amortised cost of current financial liabilities normally equals their nominal value; therefore current financial liabilities are stated in the statement of financial position at their redemption value. To calculate the amortised cost of non-current financial liabilities, they are initially recognised at fair value of the proceeds received (net of transaction costs incurred) and an interest cost is calculated on the liability in subsequent periods using the effective interest rate method.

Financial liabilities are classified as current when they are due to be settled within twelve months after the balance sheet date; or the group does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Borrowings that are due within 12 months after the balance sheet date, but which are refinanced after the balance sheet date as non-current, are recognised as current ones. Also, borrowings are classified as current if the lender had a contractual right at the balance sheet date to demand immediate repayment of the borrowing due to the breach of conditions set forth in the agreement.

Borrowing costs directly related to the construction of a real estate property until the property is ready for use or sale, are capitalised. In other cases, borrowing costs are recognised as an expense in the period in which they are incurred.

1.17. INCOME TAX

According to the Income Tax Act of the Republic of Estonia, legal entities are not subject to income tax on profits earned. Corporate income tax is paid on fringe benefits, gifts, donations, costs of entertaining guests, dividends and payments not related to business operations. Thus, in Estonia there are no differences between the tax bases and the carrying amounts of assets, which would give rise to a deferred income tax asset or liability. From 1 January 2015, the tax rate on dividends payable is 20/80 of the amount paid out as net dividends. The corporate income tax arising from the payment of dividends is accounted for as an expense in the period when dividends are declared. From 2019, tax rate of 14/86 can be applied to dividend payments. The more beneficial tax rate can be used for dividend payments in the amount of up to the average dividend payment during the three preceding years that were taxed with the tax rate of 20/80. When calculating the average dividend payment of three preceding years, 2018 will be the first year to be taken into account.

Corporate income tax on profits and deferred income tax expense or income of the subsidiaries located in Latvia, Lithuania and Norway as well as corporate income tax on dividends and deferred income tax cost on dividends of Estonian entities are reported in the consolidated income statement.

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying amounts. Deferred tax assets are recognised in the group's statement of financial position if their future realisation is probable.

CORPORATE INCOME TAX IN LATVIA

In accordance with the tax law effective until 2017, profits of entities in Latvia were taxable with income tax. Therefore, until that, deferred tax was provided for on all temporary differences arising between the tax bases of assets and liabilities of Latvian subsidiaries and their carrying amounts in the consolidated financial statements. In accordance with the new Corporate Income Tax Law, starting from 1 January 2018, corporate income tax with a rate of 20/80 is levied on profits arisen after 2017 only upon their distribution. Transitional provisions of the law allow for reductions in the income tax payable on dividends, if the entity has unused tax losses or certain provisions recognised by 31 December 2017.

Due to the new tax law, there are no longer differences between the tax bases and carrying amounts of assets and liabilities, and hence, deferred income tax assets and liabilities no longer arise in respect of subsidiaries in Latvia. All deferred tax assets and liabilities recognised in previous periods were derecognised in 2017 and related income tax expense/income was recorded in the statement of profit or loss.

Legal entities in Latvia, Lithuania, Finland, Norway and Russia that are part of the group calculate taxable income and corporate income tax in accordance with the legislation of the Republic of Latvia, the Republic of Lithuania, the Republic of Finland, the Kingdom of Norway and the Russian Federation. The profits of entities located in the Republic of Latvia are taxed at the rate of 15% (2016: 15%), in the Republic of Lithuania at the rate of 15% (2016: 15%), in the Republic of Finland at the rate of 20% (2016: 20%), in the Kingdom of Norway at the rate of 24% (2016:25%) and in Russian Federation at the rate of 20% (2016: 20%).

1.18. EMPLOYEE BENEFITS

TERMINATION BENEFITS

Termination benefits are payable when employment is terminated by the group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without a possibility of withdrawal; or providing termination benefits as a result of another offer made to encourage voluntary redundancy. Termination benefits are discounted to their present value.

PROFIT-SHARING AND BONUS PLANS

The Company recognises a liability and an expense for bonuses and profit-sharing plans, based on a formula that takes into consideration the profit attributable to the parent's owners after certain adjustments. The group recognises a provision where contractually obliged or when there is past practice that has created a constructive obligation.

1.19. PROVISIONS

Provisions are constructive or legal obligations, which arise as a result of events occurring before the balance sheet date. Setting up of provisions or increasing existing provisions is recognised as an expense in the income statement of the reporting period.

Provisions are recognised in the statement of financial position based on the best estimate of the management board at the present value of the expenditure expected to be sufficient to settle the obligation. A pre-tax rate of discount is used, which reflects current market valuations of the time value of money and the risks associated with liabilities that are not already included in the best estimate of the related expenses.

Pursuant to respective building acts, the construction companies of the group provide 2-year warranties on their buildings. The calculation of warranty provisions is based on management estimates and previous periods' experience with regard to actual warranty expenses.

The expected loss arising from construction contracts must be immediately recognised as an expense. A provision is recognised for onerous construction contracts, which have not yet been completed (Note 1.21).

A provision for expenses yet to be incurred and invoices not yet received is formed for sold apartment projects, which is recognised in the income statement as an expense and in the balance sheet as a liability.

1.20. REVENUE

Revenue is measured at the fair value of the consideration received or receivable.

Sale of construction services is recognised as revenue under the stage of completion method (see Note 1.21) in accordance with IAS 11 Construction Contracts. Proceeds from the sale of own real estate development projects (private houses, apartments, office premises, etc. that have been built on the registered immovables owned by entities of Merko Ehitus group) is recognised as revenue in accordance with IAS 18 Revenue when significant risks and rewards of ownership of the goods are transferred to the buyer, the receipt of payment is probable and the costs incurred in respect of the transaction can be measured reliably.

When goods are sold or swapped in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue. Revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents received or paid. When the fair value of the goods or services received cannot be measured reliably, revenue is measured at the fair value of the goods or services exchanged, adjusted by the amount of any cash or cash equivalents received or paid.

Sale of services is recognised based on the stage of completion of the service at the balance sheet date.

Income arising from interest and dividends is recognised when it is probable that future economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably.

1.21. CONSTRUCTION CONTRACTS IN PROGRESS

The stage of completion is determined on the basis of the relationship between the actual costs incurred by the balance sheet date and the estimated costs of the contract. The actual costs of the contract consist of direct and overhead costs of the construction contract.

If the invoices issued to the customer by the balance sheet date are either higher or lower than the revenue calculated under the stage of completion method, then the difference is recognised as a liability or as a receivable in the statement of financial position.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately and in full.

1.22. CASH AND CASH EQUIVALENTS

In the statement of financial position and the cash flow statement, cash and cash equivalents comprise highly liquid funds with low variation in value, such as cash on hand, cash in bank accounts and term deposits with maturities of three months or less. Management regards deposits with maturities greater than 3 months as investments and hence does not include them in cash and cash equivalents. The indirect method has been used for the preparation of the cash flow statement.

1.23. LOANS GRANTED

Loans granted are recognised in the group based on business principles and the loans are issued to companies with whom contracts are in place for the purpose of co-financing development projects. Real estate developers are granted loans on condition that the group receives an opportunity to provide construction service in the developments being financed. Due to the direct link between the loans and the group's business activity, the said loans and the related interests received are recognised in the cash flow statement under cash flows from operating activities (Note 16).

1.24. CONTINGENT LIABILITIES

Contingent liabilities are those liabilities the realisation of which is less probable than non-realisation or the amount of which cannot be determined reliably. Contingent liabilities are not recognised in the statement of financial position, but they are disclosed in the notes to the financial statements (Note 34).

1.25. STATUTORY RESERVE CAPITAL

Reserve capital is formed to comply with the requirements of the Commercial Code. 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. Reserve capital may be used to cover a loss, or to increase share capital. Payments shall not be made to shareholders from reserve capital.

1.26. EVENTS AFTER THE BALANCE SHEET DATE

The financial statements of the reporting period include material circumstances affecting the assessment of assets and liabilities that became evident between the balance sheet date and the date of preparing the financial statements but that are related to transactions in the reporting period or previous periods. Material events after the balance sheet date not related to transactions in the reporting period or previous periods are not reported in the statement of financial position but they are disclosed in the notes to the financial statements.

1.27. DIVIDENDS

The distribution of dividends to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

1.28. SEGMENT REPORTING

According to IFRS 8 Operating Segments, segment reporting is applicable to operating segments whose results are regularly reviewed by the entity's chief operating decision maker to make business-related decisions. Operating segments are components of the entity for which it is possible to obtain discrete financial information to make decisions about resources to be allocated to the segment and assess its performance.

1.29. CHANGES IN THE PRESENTATION OF INFORMATION

AS Merko Ehitus presented gross profit as per segment reporting of Estonian construction, other home markets construction and real estate development in previous reporting periods. Based on the resolution of the AS Merko Ehitus management board to monitor the revenue and the operating profit (loss) as the main financial indicators in the segment reporting, the operating profit (loss) is presented according to segments in this annual report.
The comparative data for previous periods has been adjusted accordingly to new presentation in 2017 consolidated annual report.

NOTE 2 MANAGEMENT ESTIMATES

The preparation of the financial statements in conformity with International Financial Reporting Standards requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates. However, it can be stated that seasonality and cyclicality do not have a significant effect on the group's activities within a year. The areas involving a higher degree of judgement or complexity where assumptions and estimates have an impact on the consolidated financial statements of Merko Ehitus group, are disclosed below. The effect of changes in management's estimates are reported in the income statement of the period of the change.

REVENUE UNDER THE STAGE OF COMPLETION METHOD

Revenue from construction in progress is recognised under the stage of completion method (Note 1.21), which also assumes that the stage of completion of construction contracts can be determined reliably. A precise, systematic calculation and estimation of costs, forecasting and reporting of income and expenses has been introduced for determining the stage of completion. The estimated final result to be derived from each construction project is being constantly monitored, deviations from the budget are analysed and if necessary, the profit estimate is adjusted. As at 31.12.2017, the amount of the provision for onerous contracts was EUR 224 thousand (2016: EUR 79 thousand), which was determined after the evaluation of the stage of completion of construction contracts (Note 28). The risk analysis showed that a change in the estimated costs of construction projects in the range of +/-5% would result in a change in the net profit between EUR -24,077/+11,277 thousand (2016: EUR -17,767/+6,843 thousand).

INVENTORY WRITE-DOWN

Inventories are valued separately by individual properties (registered immovable or building). A business plan is prepared for each property based on its nature (intended use and building rights currently effective or being effected) and the project's costs are compared with expected income. If the property's costs exceed the expected revenue to be generated from the realisation of the project (net realisable value), the group shall write down assets in the amount by which the costs exceed income. Due to the volatility of the construction market and low liquidity of the real estate market, determination of the net realisable value of the assets depends largely on management estimates. The sensitivity analysis of inventories showed that had the net realisable value been overestimated by 10% (i.e. income would be 10% lower upon the disposal of assets), the company's write-down of inventories (work-in-progress, finished goods, acquisition of real estate properties for sale) would have been EUR 1,977 thousand higher in 2017 (2016: EUR 274 thousand higher), incl. real estate properties for sale in the amount of EUR 1,383 thousand (2016: EUR 0 thousand), work-in-progress in the amount of EUR 524 thousand (2016: EUR 190 thousand) and finished goods in the amount of EUR 70 thousand (2016: EUR 84 thousand). Had the value been underestimated by 10% (income would be 10% higher upon the disposal of assets), the write-down of inventories for the year 2017 would have been EUR 293 thousand lower (2016: EUR 37 thousand), incl. finished goods in the amount of EUR 293 thousand (2016: EUR 37 thousand).

VALUATION OF RECEIVABLES

For valuation of receivables, each receivable is analysed separately. For determining the need for a complete or partial write-down of receivables, the debtor's financial position, the guarantees provided, the solutions offered to pay off the loan and the previous payment behaviour of the debtor are considered (Note 15).

PROVISION FOR WARRANTY OBLIGATIONS

For determining the provision for warranty obligations, the historical cost of the Company's warranty works is considered (Note 28).

VALUATION OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLES

At each balance sheet date, an impairment test is performed for the intangible assets with indefinite useful lives including goodwill, and the carrying amount is written down to its recoverable amount if it is lower than the carrying amount. An impairment test is also carried out for property, plant and equipment and intangibles when an event or change in circumstances indicates that impairment may have occurred. Based on management estimates, as at 31.12.2017 and 31.12.2016, no impairment tests were performed, as there were no indications of impairment of assets. As at 31.12.2017, the carrying amount of property, plant and equipment was EUR 9,665 thousand euros (31.12.2016: EUR 12,838 thousand) and the carrying amount of intangible assets was EUR 497 thousand (31.12.2016: EUR 673 thousand) (Note 23, 24).

VALUATION OF INVESTMENT PROPERTY

Investment properties are recognised at cost, less any accumulated depreciation and any impairment losses. Management estimates that the carrying amount of investment properties as at 31.12.2017 does not significantly differ from their fair value, with the exception of book value of land reclassified from inventories in the amount of EUR 11,851 thousand, the fair value of which by expert opinion was EUR 27,410 thousand (31.12.2016: the carrying amount of investment properties did not significantly differ from their fair value). Management's estimate regarding the fair value of investment properties is based on the existing market value of the assets. The estimated amount for which the asset can be exchanged in a transaction between independent parties at the date of estimation is considered its market value. External experts were not involved in the estimation of the fair value of investment properties, with the exception of land reclassified from inventories. Market value estimates are mostly based on market transactions, with the exception of real estate that is estimated using discounted cash flow method. As at 31.12.2017, the carrying amount of investment property was EUR 15,719 thousand (31.12.2016: EUR 4,108 thousand) (Note 22).

NOTE 3 OPERATING SEGMENTS

in thousands of euros

The chief operating decision-maker, i.e. the Management Board of parent AS Merko Ehitus, monitors the business of the group by countries and operating segments.

Based on internal management information, the group's Management Board monitors activities by the following segments:
- Estonian construction service,
- other home markets construction service,
- real estate development.

Estonian construction service and other home markets construction service segments include all projects of the respective countries in general construction, civil engineering and road construction. Other operating areas (management services, supervision service, etc.) are insignificant to the group and they are recognised within the construction service segment. The real estate segment primarily consists of the group's own real estate development – construction and sale, to a lesser degree, it also includes real estate maintenance and leasing.
The amount of each cost item disclosed in segment reporting is a figure presented to the company's management for decision-making purposes regarding allocation of resources to segments and assessing the performance of the segment. Unallocated expenses and income after the profit of reporting segments are accounted in segment reporting using the same principles as in the financial statements and are not used for evaluation of the results of operating segments by the company's management.

The group presented the segment's results using the gross profit as per segment reporting of Estonian construction, other home markets construction and real estate development in previous reporting periods. Based on the resolution of the AS Merko Ehitus management board to monitor the revenue and the operating profit (-loss) as the main financial indicators in the segment reporting, the operating profit (-loss) is presented according to segments in this annual report. The comparative data for previous periods has been adjusted accordingly in 2017 consolidated annual report. In addition to the cost item of the segment, marketing and general expenes, other operating income and expenses and financial income and costs have also been assigned to the segment's operating profit in proportion to the segment's revenue.

The business result is assessed based on external revenue, operating profit and profit before tax of the business segment. The operating profit and profit before tax of the segment is composed of the income and expenditure related to the segment. Other income and expenses not related to the segments are attributable to the activities of holding companies and are monitored at group level.

In the segment reporting, all intra-segment income and expenses have been eliminated from the pre-tax profit of the segments and all unrealised internal profits have been eliminated from the segment assets.

Additional information on the segments is provided in the Business activities chapter of the Management report.

in thousands of euros

2017	Estonian construction service	Other home markets construction service	Real estate development	Total segments
Revenue	135,338	108,446	98,388	342,172
Inter-segment revenue	(125)	(55)	(24,394)	(24,574)
Revenue from clients	**135,213**	**108,391**	**73,994**	**317,598**
incl. client (Estonian state), whose revenue is at least 10% of consolidated revenue	42,681	-	-	42,681
Operating profit (-loss)	**5,853**	**1,795**	**13,760**	**21,408**
Segment pre-tax profit (loss)	**5,822**	**1,552**	**13,426**	**20,800**
incl. interest income from operating activities (Note 7)	18	-	1,654	1,672
depreciation (Note 4)	(1,873)	(48)	(271)	(2,192)
impairment of inventories (Notes 4, 17)	-	-	(2,360)	(2,360)
reversal of impairment of inventories (Notes 4, 17)	-	-	5,276	5,276
recognition of provisions (Notes 4, 28)	(1,095)	(1,305)	(365)	(2,765)
reversal of provisions (Note 4, 28)	191	-	-	191
profit (loss) from joint ventures (Note 19)	-	-	64	64
other finance income (costs) (Notes 9, 10)	(31)	9	(357)	(379)
incl. interest income	-	9	-	9
interest expenses	(18)	-	(341)	(359)
Segment assets 31.12.2017	**29,422**	**49,162**	**157,058**	**235,642**
incl. joint ventures (Note 19)	-	-	79	79

2016	Estonian construction service	Other home markets construction service	Real estate development	Total segments
Revenue	122,566	52,993	108,199	283,758
Inter-segment revenue	(191)	(262)	(31,335)	(31,788)
Revenue from clients	**122,375**	**52,731**	**76,864**	**251,970**
Operating profit (-loss)	**3,398**	**(1,341)**	**7,479**	**9,536**
Segment pre-tax profit (loss)	**3,349**	**(1,425)**	**7,322**	**9,246**
incl. interest income from operating activities (Note 7)	-	-	1,675	1,675
depreciation (Note 4)	(2,629)	(40)	(293)	(2,962)
impairment of inventories (Notes 4, 17)	-	-	(37)	(37)
recognition of provisions (Notes 4, 28)	(687)	(527)	(1,860)	(3,074)
reversal of provisions (Note 4, 28)	166	23	-	189
profit (loss) from joint ventures (Note 19)	-	-	163	163
other finance income (costs) (Notes 9, 10)	(35)	(3)	(280)	(318)
incl. interest income	-	-	1	1
interest expenses	(35)	(3)	(262)	(300)
Segment assets 31.12.2016	**32,636**	**12,137**	**158,128**	**202,901**
incl. joint ventures (Note 19)	-	-	434	434

In addition to the segment assets, as at 31.12.2017 the group holds assets in the amount of EUR 41,453 thousand (31.12.2016: EUR 34,939 thousand) that cannot be associated with a specific segment or the allocation of which to segments would be impracticable. The unallocated assets of the group comprise cash and cash equivalents, deposits, loans receivable excluding loans to joint ventures, tax prepayments, other receivables and an unallocated portion of property, plant and equipment.

RECONCILIATION OF THE PRE-TAX PROFIT OF SEGMENTS AND THE GROUP

	2017	2016
Pre-tax profit from reporting segments	**20,800**	**9,246**
Other operating profit (loss)	(1,869)	(1,817)
incl. recognition of provisions	(98)	(76)
finance income (costs)	(159)	(150)
incl. interest income	1	41
interest expenses	(147)	(178)
Total profit before tax	**18,772**	**7,279**

Other finance income and costs, not associated with any segment, includes financial income from bank deposits, profit (loss) from exchange rate changes, non-capitalized loan interest costs and other finance income and costs.
As the basis for the figure, that is allocated to segments based on revenue proportion, is the sum of group's unallocated costs, the interest income (expenses) in the sum of EUR -246 thousand (31.12.2016: EUR -128 thousand) has not been presented separately in the respective cost item.

REVENUE BY CLIENT LOCATION

in thousands of euros and percentage

	2017		2016	
Estonia	190,928	60%	172,656	68%
Latvia	79,914	25%	44,924	18%
Lithuania	34,629	11%	24,801	10%
Norway	12,104	4%	4,479	2%
Finland	23	0%	5,110	2%
Total	**317,598**	**100%**	**251,970**	**100%**

NON-CURRENT ASSETS (EXCEPT FOR FINANCIAL ASSETS AND DEFERRED INCOME TAX ASSETS) BY LOCATION OF ASSETS

in thousands of euros

	31.12.2017	31.12.2016
Estonia	13,367	17,054
Latvia	12,390	443
Lithuania	5	10
Norway	119	112
Total	**25,881**	**17,619**

NOTE 4 COST OF GOODS SOLD

in thousands of euros

	2017	2016
Construction services and properties purchased for resale	186,352	145,079
Materials	50,983	40,911
Staff costs	22,255	20,703
Construction mechanisms and transport	9,317	8,161
Design	4,544	2,987
Real estate management costs	265	221
Depreciation (Note 3)	2,192	2,962
Impairment of inventories (Notes 3, 17)	2,360	37
Reversal of impairment of inventories (Notes 3, 17)	(5,276)	-
Provisions (Notes 3, 28)	2,574	2,885
Other expenses	11,181	9,015
Total cost of goods sold	**286,747**	**232,961**

NOTE 5 MARKETING EXPENSES

in thousands of euros

	2017	2016
Staff costs	2,326	2,375
Advertising, sponsorship	337	335
Transport	208	196
Depreciation	48	67
Other expenses	296	308
Total marketing expenses	**3,215**	**3,281**

NOTE 6 GENERAL AND ADMINISTRATIVE EXPENSES

in thousands of euros

	2017	2016
Staff costs	7,358	6,510
Office expenses, communication services	657	592
Consulting, legal, auditing	680	623
Transport	364	322
Computer equipment and software	526	466
Depreciation	435	459
Provisions (Notes 3, 28)	98	76
Other expenses	1,171	1,028
Total general and administrative expenses	**11,289**	**10,076**

NOTE 7 OTHER OPERATING INCOME

in thousands of euros

	2017	2016
Interest income from operating activities	1,979	1,856
Profit from sale of non-current assets	571	444
Fines and penalties for delay received	133	22
Collection of doubtful receivables (Notes 15,35)	238	3
Other income	872	141
Total other operating income	**3,793**	**2,466**

NOTE 8 OTHER OPERATING EXPENSES

in thousands of euros

	2017	2016
Fines, penalties	61	6
Gifts, donations	252	246
Doubtful receivables expense (Notes 15, 35)	243	117
Other expenses	45	30
Total other operating expenses	**601**	**399**

NOTE 9 FINANCE INCOME

in thousands of euros

	2017	2016
Interest income (Note 3)	3	46
Other finance income	1	-
Total finance income	**4**	**46**

NOTE 10 FINANCE COSTS

in thousands of euros

	2017	2016
Interest expense (Notes 3, 26)	745	610
Foreign exchange losses	1	6
Other finance costs	103	33
Total finance costs	**849**	**649**

NOTE 11 CORPORATE INCOME TAX

in thousands of euros

The income tax on the group's profit before tax differs from the theoretical amount that would arise using the statutory tax rates applicable to profits of the consolidated entities for the following reasons:

2017	**Latvia**	**Lithuania**	**Other foreign countries**	**Estonia**	**Total**
Profit (loss) before tax	5,263	3,003	918	9,588	18,772
Tax rate applicable to profits	15%	15%	24%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(789)	(450)	(220)	-	(1,459)
Tax calculated on expenses not deductible for tax purposes	(647)	(990)	(11)	-	(1,648)
Tax effect of income not subject to tax	-	669	-	-	669
Tax losses of previous periods recognised in the reporting period	23	390	-	-	413
Tax losses not recognised in the reporting period	(71)	(42)	(2)	-	(115)
Income tax withheld on dividends	-	-	-	(880)	(880)
Total income tax expense	**(1,484)**	**(423)**	**(233)**	**(880)**	**(3,020)**
incl. income tax expense	(234)	(216)	(233)	(880)	(1,563)
deferred income tax expense (Note 21)	(1,250)	(207)	-	-	(1,457)

2016	**Latvia**	**Lithuania**	**Other foreign countries**	**Estonia**	**Total**
Profit (loss) before tax	1,033	1,372	93	4,781	7,279
Tax rate applicable to profits	15%	15%	25%	0%	
Tax calculated at domestic tax rates applicable to profits in the respective countries	(155)	(206)	(24)	-	(385)
Tax calculated on expenses not deductible for tax purposes	(49)	(129)	-	-	(178)
Tax effect of income not subject to tax	-	(168)	-	-	(168)
Tax losses of previous periods recognised in the reporting period	-	108	-	-	108
Tax losses not recognised in the reporting period	(81)	-	(5)	-	(86)
Income tax withheld on dividends	-	-	-	(566)	(566)
Total income tax expense	**(285)**	**(395)**	**(29)**	**(566)**	**(1,275)**
incl. income tax expense	(236)	(11)	(29)	(566)	(842)
deferred income tax expense (Note 21)	(49)	(384)	-	-	(433)

As at 31.12.2017, the parent company AS Merko Ehitus has EUR 67 thousand (31.12.2016: EUR 0 thousand) in dividends received from subsidiaries in previous periods and income from abroad, on which the income tax has been withheld.

As at 31.12.2017, it is possible to pay out dividends to shareholders from retained earnings in the amount of EUR 97,172 thousand (31.12.2016: EUR 91,255 thousand). Considering the taxed dividends received and income tax withheld on foreign income totalling EUR 17 thousand (31.12.2016: EUR 0 thousand), the corresponding income tax on dividends would amount to EUR 24,276 thousand (31.12.2016: EUR 22,813 thousand). For calculating the additional income tax on dividends, the income tax rate in force in 2017 was used, which is 20/80 of the amount paid as net dividends. The income tax related to disbursement of dividends is recognised as a liability and income tax expense upon the announcement of dividends.

NOTE 12 EARNINGS PER SHARE

Basic earnings per share for profit attributable to equity holders of the parent have been derived by dividing the net profit attributable to shareholders by the weighted average number of shares.

	2017	2016
Net profit attributable to shareholders *(in thousand EUR)*	14,694	6,122
Weighted average number of ordinary shares *(thousand pcs)*	17,700	17,700
Basic earnings per share *(in euros)*	**0.83**	**0.35**

In 2017 and 2016, the group did not have any potential ordinary shares to be issued; therefore the diluted earnings per share equal the basic earnings per share.

NOTE 13 DIVIDENDS PER SHARE

Dividends payable are recognised after the approval of profit allocation at the general meeting of shareholders. In accordance with the profit allocation proposal, dividends payable in parent company AS Merko Ehitus in 2018 will total EUR 17,700 thousand, i.e. EUR 1.00 per share. Taking into account the dividends already paid to the parent company and planned to be paid by foreign subsidiaries in the second quarter of 2018, the group will not incur income tax expenses arising in 2018 in Estonia in connection with disbursement of dividends.

In 2017, the parent company AS Merko Ehitus paid EUR 7,257 thousand in dividends, i.e. EUR 0.41 per share, incurring an income tax obligation of 20/80 of the amount disbursed, i.e. EUR 1,814 thousand, which was covered in part from income tax withheld on taxed dividends received from subsidiaries in previous periods. In Q2 2017, the group incurred an additional income tax expense of EUR 880 thousand related to disbursement of dividends.
In 2016 the parent company AS Merko Ehitus distributed dividends in the amount of EUR 9,027 thousand, i.e. EUR 0.51 per share. AS Merko Ehitus had to pay an additional income tax expense of EUR 566 thousand in Estonia related to disbursement of dividends.

NOTE 14 CASH AND CASH EQUIVALENTS

in thousands of euros

	31.12.2017	31.12.2016
Cash on hand	1	2
Bank accounts	39,174	33,291
Short-term bank deposits	35	251
Total cash and cash equivalents (Note 35)	**39,210**	**33,544**

As at 31.12.2017, the weighted average interest on short-term bank deposits was 5.35% (31.12.2016: 0.5%).

NOTE 15 TRADE AND OTHER RECEIVABLES

in thousands of euros

	31.12.2017	31.12.2016
Trade receivables (Note 35)		
Accounts receivable	36,768	31,735
Allowance for doubtful receivables	(103)	(265)
	36,665	**31,470**
Tax prepayments excluding corporate income tax		
Value added tax	733	3,318
Other taxes	2	-
	735	**3,318**
Accrued income form construction services (Notes 32, 35)	**17,780**	**4,606**
Other short-term receivables		
Short-term loans (Notes 16, 35)	10,590	1,560
Interest receivables (Note 35)	603	218
Other short-term receivables (Note 35)	636	347
	11,829	**2,125**
Prepayments for services		
Prepayments for construction services	8,075	3,155
Prepaid insurance	248	348
Other prepaid expenses	512	544
	8,835	**4,047**
Total trade and other receivables	**75,844**	**45,566**
incl. short-term loan receivables from related parties (Note 16)	9,000	-
other short-term receivables and prepayments to related parties (Note 33)	2,911	4,333

In 2017, the payment discipline of customers improved compared to last year. The share of overdue receivables decreased from 14.6% to 10.6% of total receivables, and as at the balance sheet date, the amount of overdue receivables was EUR 3,898 thousand (31.12.2016: 4,590 thousand). By 12 March 2018, overdue receivables had been collected in the amount of EUR 2,738 thousand. At the same time, in 2017, the share of receivables overdue for more than 180 days increased, which prolonged the average collection period of trade receivables to 40 days (2016: 37 days).

	2017	2016
Doubtful receivables at the beginning of the period	(265)	(326)
Reporting period doubtful receivables expenses (Note 8)	(114)	(108)
Reestablishment of receivables written off in previous years	(18)	(3)
Receivables written off during the year as uncollectible	56	169
Received doubtful receivables (Note 7)	238	3
Doubtful receivables at the end of the period	**(103)**	**(265)**

Additionally, in 2017, advance payments to suppliers were wrote down in the amount of EUR 129 thousand (2016: EUR 9 thousand), (Note 8). According to the management estimates, based on historical experience, there are sufficient reasons to conclude that the trade receivables reported in the financial statements will be collected from the buyers.

Accounts receivable in the amount of EUR 830 thousand have been secured by a collateral on the registered immovable located at Bokšto 14, Vilnius in the amount of EUR 1,500 thousand.

A more detailed overview of the Company's credit risk is provided in Note 35.

NOTE 16 LOANS GRANTED

in thousands of euros

	Joint ventures (Note 33)	**Unrelated legal entities**	**Total**
2017			
Loan balance at beginning of the year	3,952	1,560	5,512
Granted	6,371	4,000	10,371
Reclassification of interest receivable into loan	138	30	168
Decrease of loan receivable in connection with sale of share in joint venture	(1,461)	-	(1,461)
Loan balance at end of the year	**9,000**	**5,590**	**14,590**
incl. current portion (Notes 15, 35)	9,000	1,590	10,590
non-current portion 2...5 years (Notes 20, 35)	-	4,000	4,000
Average effective interest rate	6.2%	8.0%	
2016			
Loan balance at beginning of the year	3,888	1,500	5,388
Granted	536	10	546
Reclassification of interest receivable into loan	88	50	138
Collected	(560)	-	(560)
Loan balance at end of the year	**3,952**	**1,560**	**5,512**
incl. current portion (Notes 15, 35)	-	1,560	1,560
non-current portion 2...5 years (Notes 20, 35)	3,952	-	3,952
Average effective interest rate	6.7%	8.0%	

Issued loans reported as at the balance sheet date had not yet fallen due, with the exception of a loan receivable in a sum of EUR 1,590 thousand for which loan contract prolongation negotiations are ongoing.
As at 31.12.2017 the loans granted to unrelated legal entities in a sum of 5590 thousand euros are secured by mortgages on the registered immovable properties at Tatari st. 6a, Sepapaja 3/Suur-Sõjamäe 12a and Sepapaja 5 in Tallinn in the amount of EUR 7,900 thousand.

NOTE 17 INVENTORIES

in thousands of euros

	31.12.2017	**31.12.2016**
Materials	238	422
Work-in-progress	36,023	39,537
Finished goods	17,612	18,918
Goods for resale		
Registered immovables purchased for resale	63,613	63,150
Other goods purchased for resale	747	746
	64,360	**63,896**
Prepayments for inventories		
Prepayments for other inventories	188	591
Total inventories	**118,421**	**123,364**

As at 31.12.2017, the inventories of OÜ Unigate, OÜ Paekalda 2, OÜ Paekalda 3, OÜ Paekalda 7 and OÜ Paekalda 9 purchased in 2017 are presented in lines Work-in-progress and Registered immovables purchased for resale in the amount of EUR 6,415 thousand (Note 18).
The inventories pledged as collateral as at 31.12.2017 for loans total EUR 64,372 thousand (2016: EUR 44,870 thousand) (Note 30).

In 2017, inventories have been written down to their net realisable value by EUR 2,360 thousand (2016: EUR 37 thousand) and previously made write-downs have been reversed in the amount of EUR 5,276 thousand (2016: EUR 0 thousand) (Notes 2, 4, 18, 35), incl. EUR 660 thousand calculated proportionally to non-controlling interest (Note 18). The reversal of write-downs is based on the updated valuation tests performed by the management, which took into consideration the fact that the economic environment has improved considerably compared to the time the write-downs were made, which has also brought about a recovery in real estate sales prices, according to comparable transactions known to management.

	Carrying amount before write-down	Write-down	Reversal of write-down	Carrying amount after write-down
31.12.2017				
Finished goods	19,972	(2,360)	-	17,612
Registered immovables purchased for resale	58,337	-	5,276	63,613
Total	**78,309**	**(2,360)**	**5,276**	**81,225**
31.12.2016				
Finished goods	18,955	(37)	-	18,918
Total	**18,955**	**(37)**	**-**	**18,918**

NOTE 18 SHARES IN SUBSIDIARIES

	Ownership and voting rights %		Location	Area of operation
	31.12.2017	**31.12.2016**		
AS Merko Ehitus Eesti	100	100	Estonia, Tallinn	Construction
Tallinna Teede AS	100	100	Estonia, Tallinn	Road construction
AS Vooremaa Teed	-	100	Estonia, Jõgeva	Road construction
AS Merko Infra	100	100	Estonia, Tallinn	Construction
AS Gustaf	-	100	Estonia, Pärnu	Construction
AS Merko Tartu	100	100	Estonia, Tartu	Construction
OÜ Fort Ehitus	-	76	Estonia, Viimsi	Construction
OÜ Mineraal	100	100	Estonia, Tallinn	Mining
OÜ Heamaja	-	100	Estonia, Tallinn	Real estate
OÜ Rannamõisa Kinnisvara	-	100	Estonia, Tallinn	Real estate
Kivimäe 32 OÜ	100	-	Estonia, Tallinn	Real estate
UAB Merko Statyba	100	100	Lithuania, Vilnius	Construction
UAB Statinių priežiūra ir administravimas	100	100	Lithuania, Vilnius	Real estate
UAB Timana	100	-	Lithuania, Vilnius	Real estate
OÜ Merko Property	100	100	Estonia, Tallinn	Real estate
UAB Balsiu mokyklos SPV	100	100	Lithuania, Vilnius	Real estate
UAB Merko Bustas	100	100	Lithuania, Vilnius	Real estate
UAB MN Projektas	100	100	Lithuania, Vilnius	Real estate
UAB Jurininku aikštele	100	100	Lithuania, Vilnius	Real estate
UAB VPSP1	-	100	Lithuania, Vilnius	Real estate
UAB Timana	-	100	Lithuania, Vilnius	Real estate
UAB Rinktinės projektai	100	100	Lithuania, Vilnius	Real estate
OÜ Jõgeva Haldus	100	100	Estonia, Tallinn	Real estate
OÜ Metsailu	100	100	Estonia, Tallinn	Real estate
OÜ Kiviaia Kinnisvara	100	-	Estonia, Tallinn	Real estate
OÜ Tähelinna Kinnisvara	100	100	Estonia, Tallinn	Real estate
Väike-Paekalda OÜ	100	100	Estonia, Tallinn	Real estate
Suur-Paekalda OÜ	100	100	Estonia, Tallinn	Real estate
Paekalda 2 OÜ	100	-	Estonia, Tallinn	Real estate

	Ownership and voting rights %		Location	Area of operation
	31.12.2017	31.12.2016		
Paekalda 3 OÜ	100	-	Estonia, Tallinn	Real estate
Paekalda 7 OÜ	100	-	Estonia, Tallinn	Real estate
Paekalda 9 OÜ	100	-	Estonia, Tallinn	Real estate
OÜ Unigate	100	-	Estonia, Tallinn	Real estate
SIA Merko Investments	100	100	Latvia, Riga	Holding
OÜ Merko Investments	100	100	Estonia, Tallinn	Holding
SIA Merks	100	100	Latvia, Riga	Construction
SIA SK Viesturdarzs	100	100	Latvia, Riga	Real estate
SIA Merks Investicijas	100	100	Latvia, Riga	Real estate
SIA Industrialas Parks	100	100	Latvia, Riga	Real estate
SIA Elniko	-	100	Latvia, Riga	Real estate
SIA Ropažu Priedes	100	100	Latvia, Riga	Real estate
PS Merko-Merks	100	100	Latvia, Riga	Construction
SIA Zakusala Estates	75	75	Latvia, Riga	Real estate
PS Merks-Ostas celtnieks	65	65	Latvia, Riga	Construction
PS Merks Merko Infra	100	-	Latvia, Riga	Construction
Merko Finland Oy	100	100	Finland, Helsinki	Construction
Hartian Oy	75	75	Finland, Helsinki	Real estate
Lenko Stroi LLC	100	100	Russia, St. Petersburg	Construction
Merko Investments AS	100	100	Norway, Sofiemyr	Holding
Peritus Entreprenør AS	56	56	Norway, Sofiemyr	Construction

2017

On 8 November 2016, AS Merko Ehitus launched a process for restructuring its 100% subsidiary in Lithuania, UAB Merko Bustas. In accordance with the restructuring plan, UAB Merko Bustas's 100% subsidiary UAB VPSP1 merged with parent company UAB Merko Bustas. The restructuring was completed and the final merger entry in the Commercial Register made on 4 July 2017.

On 28 December 2016, AS Merko Ehitus's 100% subsidiary AS Merko Ehitus Eesti initiated a process to merge its fully owned subsidiaries AS Merko Tartu, AS Gustaf, OÜ Rannamõisa Kinnisvara and OÜ Heamaja, all engaged in real estate development, in order to have savings in administrative cost related to company management. The acquiring company was AS Merko Tartu. The companies being acquired merged into AS Merko Tartu and as a result of the merger the companies being acquired winded up without liquidation proceedings and AS Merko Tartu become the legal successor of the companies being acquired. As a result of the merger, AS Merko Ehitus Eesti will remain the sole shareholder in AS Merko Tartu, the acquiring company. The closing date of the merger was 1 January 2017 after which all transactions of the acquirees have been deemed to had been made on account of the acquirer. The final merger entry in the Commercial Register was made on 5 September 2017.

On 16 June 2017, AS Merko Ehitus launched a process for restructuring its 100% subsidiary in Latvia, SIA Merks. In accordance with the restructuring plan, SIA Merks's 100% subsidiary SIA Elniko merged with the parent company. The restructuring was completed and the final merger entry in the Commercial Register made on 16 November 2017.

On 25 July 2017, Tallinna Teede AS, part of Merko Ehitus group, and its 100% subsidiary, AS Vooremaa Teed signed a merger agreement with the intention to improve the internal efficiency. According to the merger agreement, the acquiring company was Tallinna Teede AS. Because of the merger, AS Vooremaa Teed winded up without liquidation proceedings. The merger date was 1st of August 2017, after which all AS Vooremaa Teed transactions deemed to be made on the account of Tallinna Teede AS. The final merger entry in the Commercial Register was made on 29 September 2017.

On 31 July 2017, AS Merko Ehitus entered into an agreement with Nordecon AS to acquire 50% shareholding and loan receivable in joint venture Unigate OÜ and 100% stakes in entities OÜ Paekalda 2, OÜ Paekalda 3, OÜ Paekalda 7 and OÜ Paekalda 9. As a result of the transaction, AS Merko Ehitus is a 100% owner of subsidiary Unigate OÜ. The acquisition cost was EUR 4534 thousand and the completion of transaction took place on 4th August 2017 after the payment of purchase price. The acquisition of the subsidiaries is recognized at the group level as acquisition of inventories and starting from the moment of acquisition is recorded under inventory entries Work-in-progress and Registered immovables purchased for resale. The difference of acquired book values and fair value of net assets in a sum of EUR 2,512 thousand has been reported in the group as purchase of inventory (Note 17). The purpose of the acquisition was to resolve the ownership of Paekalda development in Tallinn and to secure a long-term strategy for the development of apartments in Merko Ehitus group in Estonia.

On 1 November 2017, SIA Merks, a 100% subsidiary of AS Merko Ehitus, founded a 100% general partnership PS Merks Merko Infra for the fulfilment of the contract for the construction of the new Skrunda substation in Latvia.

On 16 November 2017, AS Merko Ehitus Eesti, part of Merko Ehitus group, acquired a share of Kivimäe 32 OÜ with an acquisition price of EUR 328 thousand, which represented 50% of its share capital, thereby becoming 100% owner of the company.

On 20 November 2017, AS Merko Ehitus supervisory board decided to start liquidation procedures of 100% owned subsidiary based in Russia, OOO Lenko Stroi. The liquidation of the company is planned to be completed in 2018.

On 30 November 2017, AS Merko Ehitus Eesti disposed of its 76% shareholding in OÜ Fort Ehitus to its co-owner. The impact of the sales transaction to consolidated figures was a profit of EUR 14 thousand, decrease in the balance of cash for EUR 7 thousand and an elimination of non-controlling interest of EUR 123 thousand.

According to the decision of the sole shareholder, demerger of OÜ Metsailu took place on 19 December 2017, in order to simplify the development project management. According to the demerger plan, OÜ Metsailu registered immovables, located on Kiviaia tee in Tallinn, were distributed to OÜ Kiviaia Kinnisvara.

In connection with the improvement of efficiency of the business operations and the structure of the Estonian companies of AS Merko Ehitus group, on 21 December 2017, AS Merko Ehitus and AS Merko Ehitus Eesti, 100% subsidiary of AS Merko Ehitus, entered into a real right contract to transfer the right of ownership on real estate development segment's registered immovables and shareholdings in private limited companies on 1 January 2018. These companies are (a) 100% subsidiaries of AS Merko Ehitus: OÜ Tähelinna Kinnisvara, OÜ Metsailu, OÜ Paekalda 2, OÜ Paekalda 3, OÜ Paekalda 7, OÜ Paekalda 9, OÜ Unigate, Suur-Paekalda OÜ, Väike-Paekalda OÜ; and (b) a 50% joint venture OÜ Kodusadam. As per a merger contract signed prior, on balance sheet date 1 January 2018, AS Merko Ehitus Eesti merged AS Merko Tartu and aforementioned received subsidiaries with itself, with the exception of OÜ Tähelinna Kinnisvara.

On 21 December 2017, a merger between AS Merko Infra and OÜ Mineraal, both belonging to AS Merko Ehitus group, was initiated. The acquiring company is AS Merko Infra. OÜ Mineraal will be acquired by AS Merko Infra and as a result of the merger, the company being acquired will wind up without liquidation proceedings and AS Merko Infra will become the legal successor of OÜ Mineraal. The merger date is 1st of January 2018, after which all transactions of the acquired company will be deemed to be made on the account of AS Merko Infra.

On 31 December 2017, as an intra-group transaction in Lithuania, UAB Merko Statyba, 100% subsidiary of AS Merko Ehitus, acquired a 100% ownership of a real estate development company UAB Timana from its sister company UAB Merko Bustas.

ACQUISITION OF SUBSIDIARIES

in thousands of euros

	OÜ Unigate	**Paekalda 2 OÜ**	**Paekalda 3 OÜ**	**Paekalda 7 OÜ**	**Paekalda 9 OÜ**
	Fair value	Fair value	Fair value	Fair value	Fair value
Cash	0	-	-	-	-
Inventories	5,934	157	103	107	114
Short-term liabilities	1,881	-	-		-
Net assets	4,053	157	103	107	114
Acquired ownership interest	50%	100%	100%	100%	100%
Net assets acquired	4,053	157	103	107	114
Acquisition cost	4,053	157	103	107	114
Subsidiary's cash and cash equivalent on acquisition	0	-	-	-	-
Paid on acquisition	(4,053)	(157)	(103)	(107)	(114)
Cash flow from acquisition of subsidiary	(4,053)	(157)	(103	(107)	(114)
Net loss for the period	(61)	-	-	-	-
Comprehensive loss for the period	(61)	-	-	-	-
incl. attributable to equity holders of the parent	(61)	-	-	-	-

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FINANCIAL INFORMATION REGARDING SIGNIFICANT SUBSIDIARY WITH A NON-CONROLLING INTEREST

in thousands of euros

	SIA Zakusala Estates	
Statement of financial position	**31.12.2017**	**31.12.2016**
Cash	230	441
Trade and other receivables	6	9
Inventories	17,657	14,988
Total short-term assets	17,893	15,438
Short-term liabilities	22	92
Net assets	17,871	15,346
Equity	17,871	15,346
Non-controlling interest %	25%	25%
Non-controlling interest	4,468	3,836
Statement of comprehensive income	**01.01-31.12.2017**	**01.01-31.12.2016**
Reversal of impairment of inventories	2,643	-
Other expenses	(1)	(2)
Land tax	(117)	(68)
Financial expenses	-	(1)
Net profit (loss) for the period	2,525	(71)
Comprehensive profit (loss) for the period	2,525	(71)
incl. attributable to equity holders of the parent	1,894	(53)
attributable to non-controlling interest	631	(18)
Cash flow statement	**01.01-31.12.2017**	**01.01-31.12.2016**
Operating profit	2,525	(70)
Change in receivables related to operating activities	3	(7)
Change in inventories	(2,669)	(104)
Change in payables related to operating activities	-	20
Total cash flow from operating activities	(141)	(161)
Proceeds from borrowings	-	70
Repayments of borrowings	(70)	-
Issue of share capital	-	430
Total cash flow from financing activities	(70)	500
Change in cash and cash equivalents	(211)	339
Cash and cash equivalents in the beginning of the period	441	102
Cash and cash equivalents at the end of the period	230	441

In 2017, a previously made write-down on SIA Zakusala Estates immovable in the sum of EUR 2,643 thousand was reversed, of which 660 thousand euros was calculated proportionally to non-controlling interest.

In 2016, a contribution was made to the share capital of SIA Zakusala Estates, as a result of which the non-controlling interest in the company increased by EUR 108 thousand.

As at 31 December 2017, the group's non-controlling interest in equity is EUR 4,567 thousand (31.12.2016: EUR 3,692 thousand), including ZIA Zakusala Estates non-controlling interest in the amount of EUR 4,468 thousand (31.12.2016: EUR 3,836 thousand). The other companies with a non-controlling interest – totalling at EUR 99 thousand (31.12.2016: EUR -144 thousand) – do not separately constitute a significant item for the group.

NOTE 19 INVESTMENTS IN JOINT VENTURES

	Ownership and voting rights %		Location	Area of operation
	31.12.2017	31.12.2016		
Joint ventures				
OÜ Unigate*	-	50	Estonia, Tallinn	Real estate
Poolkoksimäe Sulgemise OÜ**	50	50	Estonia, Tallinn	Construction
Kivimäe 32 OÜ***	-	50	Estonia, Tallinn	Real estate
Kodusadam OÜ	50	50	Estonia, Tallinn	Real estate

2017

* On 31 July 2017, AS Merko Ehitus entered into agreements with Nordecon AS to acquire 50% share and loan receivables in joint venture Unigate OÜ. As a result of the transaction, AS Merko Ehitus is a 100% owner of subsidiary Unigate OÜ (Note 18).
** On 17 March 2017, AS Merko Ehitus and AS Ehitusfirma Rand ja Tuulberg initiated a process to dissolve joint venture Poolkoksimäe Sulgemise OÜ, in which each joint owner had a 50% share. The liquidation of the company was completed and the deletion entry to the Commercial Register made on 26 January 2018.
*** On 16 November 2017, AS Merko Ehitus Eesti, part of AS Merko Ehitus group, acquired a 50% share in Kivimäe 32 OÜ, therefore becoming a 100% owner of that entity (Note 18).

2016

No transactions were concluded with the shares of joint ventures in 2016.

in thousands of euros

	Investment at 31.12.2016	Changes in 2017		Investment at 31.12.2017
		acquisition (sale)	profit (loss) on entities	
Joint ventures				
OÜ Unigate	160	(92)	(68)	-
Poolkoksimäe Sulgemise OÜ	0	-	(0)	-
Kivimäe 32 OÜ	269	(327)	58	-
Kodusadam OÜ	5	-	74	79
Total joint ventures	**434**	**(419)**	**64**	**79**

in thousands of euros

	Investment at 31.12.2015	Changes in 2016		Investment at 31.12.2016
		acquisition (sale)	profit (loss) on entities	
Joint ventures				
OÜ Unigate	279	-	(119)	160
Poolkoksimäe Sulgemise OÜ	0	-	(0)	0
Kivimäe 32 OÜ	0	-	269	269
Kodusadam OÜ	5	-	(0)	5
Total joint ventures	**284**	-	**150**	**434**

JOINT VENTURES
in thousands of euros

	Assets 31.12.	Liabilities 31.12		Equity 31.12.	Income	Expenses	Net profit (loss)
	Current assets	Current liabilities	Non-current liabilities				
2017							
OÜ Unigate	-	-	-	-	-	(136)	(136)
Poolkoksimäe Sulgemise OÜ	-	-	-	-	-	(0)	(0)
Kivimäe 32 OÜ	-	-	-	-	189	(68)	121
Kodusadam OÜ	25 284	25,125	-	159	3,653	(3,503)	150
Total	**25,284**	**25,125**	**-**	**159**	**3,842**	**(3,707)**	**135**
2016							
OÜ Unigate	3,747	-	3,427	320	-	(237)	(237)
Poolkoksimäe Sulgemise OÜ	0	-	-	0	41	(36)	5
Kivimäe 32 OÜ	614	80	-	534	3,853	(3,260)	593
Kodusadam OÜ	9,756	4,747	5,000	9	-	(1)	(1)
Total	**14,117**	**4,827**	**8,427**	**863**	**3,894**	**(3,534)**	**360**

In 2017, interest expenses for the following companies are recognised in the joint venture's expenses: OÜ Unigate EUR 136 thousand (2016: EUR 215 thousand), Kivimäe 32 OÜ EUR 0 thousand (2016: EUR 58 thousand).

In connection with the joint venture, the group has contractual obligations to finance, as needed, the joint ventures' activities with loans totalling EUR 9,000 thousand (31.12.2016: EUR 3,972 thousand), of which the group has paid EUR 9,000 thousand in total (31.12.2016: EUR 3,952 thousand). In addition, the group has an obligation to provide construction services in future periods in amount of EUR 18,083 thousand (31.12.2016: EUR 22,772 thousand).

NOTE 20 OTHER LONG-TERM LOANS AND RECEIVABLES

in thousands of euros

	31.12.2017	31.12.2016
Long-term loans (Notes 16, 35)	4,000	3,952
Long-term bank deposit (Note 35)	-	36
Long-term interest	-	261
Long-term trade receivables (Note 35) *	13,163	11,122
Total other long-term loans and receivables	**17,163**	**15,371**
incl. long-term loan receivables from related parties (Note 16, 33)	-	3,952
other long-term receivables and prepayments from related parties (Note 16, 33)	-	261

* incl. long-term receivables from buyer of Balsiu School in amount of EUR 10,580 thousand (31.12.2016: EUR 10,580 thousand).

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NOTE 21 DEFERRED INCOME TAX ASSETS AND LIABILITIES

in thousands of euros

Break-down of deferred income tax assets and liabilities in Latvian and Lithuanian subsidiaries:

31.12.2017	Latvia	Lithuania	Other foreign countries	Total
Deferred income tax liability				
effect of other payables	-	(1,259)	-	(1,259)
Deferred income tax assets				
incl. tax loss carryforwards	-	-	5	5
Total deferred income tax assets	**-**	**-**	**5**	**5**
Deferred income tax expense of the financial year (Note 11)	(1,250)*	(207)	-	(1,457)

* Elimination of deferred income tax assets in the sum of EUR 1,250 thousand is due to changes in the corporate income tax law in Latvia (Note 1.17).

31.12.2016	Latvia	Lithuania	Other foreign countries	Total
Deferred income tax liability				
effect of other payables	-	(1,122)	-	(1,122)
Deferred income tax assets				
incl. tax loss carryforwards	(49)	-	5	(44)
effect of carrying amount of property, plant and equipment	(12)	-	-	(12)
effect of stage of completion method	43	47	-	90
effect of write-down of receivables	32	17	-	49
effect of write-down of inventories	800	-	-	800
effect of provisions	-	6	-	6
other effects	436	-	-	436
Total deferred income tax assets	**1,250**	**70**	**5**	**1,325**
Deferred income tax expense of the financial year (Note 11)	(49)	(384)	-	(433)

NOTE 22 INVESTMENT PROPERTIES

in thousands of euros

	Land	Right of superficies	Buildings	Total
Cost at 31.12.2015	51	29	5,245	5,325
Accumulated depreciation 31.12.2015	-	(10)	(944)	(954)
Carrying amount at 31.12.2015	**51**	**19**	**4,301**	**4,371**
Depreciation	-	(1)	(262)	(263)
Carrying amount at 31.12.2016	**51**	**18**	**4,039**	**4,108**
Cost at 31.12.2016	51	29	5,245	5,325
Accumulated depreciation 31.12.2016	-	(11)	(1,206)	(1,217)
Carrying amount at 31.12.2016	**51**	**18**	**4,039**	**4,108**
Acquisition	-	-	7	7
Reclassification	11,851	-	-	11,851
Depreciation	-	(1)	(246)	(247)
Carrying amount at 31.12.2017	**11,902**	**17**	**3,800**	**15,719**
Cost at 31.12.2017	11,902	29	5,252	17,183
Accumulated depreciation 31.12.2017	-	(12)	(1,452)	(1,464)
Carrying amount at 31.12.2017	**11,902**	**17**	**3,800**	**15,719**

As at 31.12.2017, the carrying amounts of investment properties do not significantly differ from their fair values, with the exception of the reclassified land from the inventories, the fair value of which has been estimated by valuation expert at EUR 27,410 thousand (31.12.2016: the carrying amounts of investment properties did not significantly differ from their fair values). Fair values have mainly been estimated based on comparable transactions (Level 2), with the exception of investment property to the extent of EUR 1,905 thousand (31.12.2016: EUR 2,031 thousand) in carrying amount that has been measured using the discounted cash flow method. Fair value measurement was carried out using Level 3 inputs of the fair value hierarchy.

Investment properties have been acquired for the purpose of earning rental income and/or for capital appreciation. Buildings located on the plot of land have temporarily been leased out under the operating lease terms. Information about leased investment properties is disclosed in Note 25. Maintenance costs incurred and improvement expenses are immaterial.

In the fourth quarter of 2017, the land at Skanstes in Riga totalling EUR 11,851 thousand was reclassified from inventories to investment property for long-term holdings for the purpose of capital appreciation, as the group does not have plans to carry out development operations on the premises.

As at 31.12.2017, investment properties pledged as collateral for loans total EUR 15,333 thousand (31.12.2016: EUR 3,688 thousand) (Note 30). The Pärna avenue properties in Tartu, the court and police building in Jõgeva and land at Skanstes in Riga have been pledged as collateral to bank loans.

NOTE 23 PROPERTY, PLANT AND EQUIPMENT

in thousands of euros

	Land	Buildings	Machinery and equipment	Other fixtures	Construction in progress and prepayments	Total
Cost at 31.12.2015	824	5,725	18,910	5,141	56	30,656
Accumulated depreciation at 31.12.2015	-	(1,806)	(11,314)	(4,094)	-	(17,214)
Carrying amount at 31.12.2015	**824**	**3,919**	**7,596**	**1,047**	**56**	**13,442**
Acquisition	-	47	1,479	170	1,190	2,886
Acquired subsidiary's non-current assets	-	-	2	41	-	43
Disposals	(3)	(80)	(697)	(4)	-	(784)
Reclassification	-	-	144	-	(153)	(9)
Write-offs	-	-	(35)	(1)	-	(36)
Depreciation	-	(184)	(2,028)	(492)	-	(2,704)
Carrying amount at 31.12.2016	**821**	**3,702**	**6,461**	**761**	**1,093**	**12,838**
Cost at 31.12.2016	821	5,650	17,625	5,190	1,093	30,379
Accumulated depreciation at 31.12.2016	-	(1,948)	(11,164)	(4,429)	-	(17,541)
Carrying amount at 31.12.2016	**821**	**3,702**	**6,461**	**761**	**1,093**	**12,838**
Unrealised exchange rate differences	-	-	-	(4)	-	(4)
Acquisition	-	2	767	319	166	1,254
Disposals	(4)	(71)	(1,357)	(3)	-	(1,435)
Disposal in the course of business combination	(6)	-	(903)	-		(909)
Reclassification	-	-	724	225	(949)	-
Write-offs	-	-	(3)	(12)	-	(15)
Depreciation	-	(180)	(1,440)	(444)	-	(2,064)
Carrying amount at 31.12.2017	**811**	**3,453**	**4,249**	**842**	**310**	**9,665**
Cost at 31.12.2017	811	5,530	13,707	5,561	310	25,919
Accumulated depreciation at 31.12.2017	-	(2,077)	(9,458)	(4,719)	-	(16,254)
Carrying amount at 31.12.2017	**811**	**3,453**	**4,249**	**842**	**310**	**9,665**

Information on leased assets is provided in Note 25, and on lease payments in Note 26.

As at 31.12.2017, property, plant and equipment pledged as collateral for loans total EUR 3,384 thousand (31.12.2016: EUR 3,777 thousand) (Note 30). The group's most significant item of property, plant and equipment pledged as collateral to the loans is the Järvevana tee 9G property and the office building thereon.

NOTE 24 INTANGIBLE ASSETS

in thousands of euros

	Goodwill *	Software	Prepayments	Total
Cost at 31.12.2015	891	1,075	100	2,066
Accumulated amortisation and impairment at 31.12.2015	(267)	(920)	-	(1,187)
Carrying amount at 31.12.2015	**624**	**155**	**100**	**879**
Unrealised exchange rate differences	1	-	-	1
Acquisitions	-	17	174	191
Obtained in the course of business combination	78	-	-	78
Reclassification	-	70	(61)	9
Amortisation and impairment	(389)	(96)	-	(485)
Carrying amount at 31.12.2016	**314**	**146**	**213**	**673**
Cost at 31.12.2016	970	1,137	213	2,320
Accumulated amortisation and impairment at 31.12.2016	(656)	(991)	-	(1,647)
Carrying amount at 31.12.2016	**314**	**146**	**213**	**673**
Unrealised exchange rate differences	(5)	(2)	-	(7)
Acquisitions	-	128	54	182
Reclassification	-	223	(223)	-
Amortisation and impairment	(235)	(116)	-	(351)
Carrying amount at 31.12.2017	**74**	**379**	**44**	**497**
Cost at 31.12.2017	74	1,471	44	1,589
Accumulated amortisation and impairment at 31.12.2017	-	(1,092)	-	(1,092)
Carrying amount at 31.12.2017	**74**	**379**	**44**	**497**

* In connection with the disposal of the road maintenance field of activity from AS Vooremaa Teed, a 100% subsidiary of Tallinna Teede AS belonging to AS Merko Ehitus group, and the merger of the companies in Q3 2017, the goodwill of AS Vooremaa Teed has been impaired and written off the balance sheet.

NOTE 25 LEASED ASSETS

in thousands of euros

	31.12.2017	31.12.2016
Assets acquired under finance lease terms		
Machinery and equipment		
Cost	3,545	4,511
Accumulated depreciation	(2,585)	(2,411)
Carrying amount	960	2,100

Assets leased under non-cancellable operating lease terms	**2017**	**2016**
Land lease agreements		
Payments in the reporting period	2	2
Payments in subsequent periods:	13	13
Payable next year	2	2
Payable in 2…5 years	7	7
Payables after 5 years	4	4

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On the basis of cancellable lease agreements, operating lease payments totalling EUR 599 thousand were paid for vehicles in 2017 (2016: EUR 357 thousand). The Company does not intend to use a bargain purchase option for the assets leased under the operating lease terms in the reporting period.
Lease agreements does not set any limits to groups' dividend or financing policies. Rented assets have not been re-rented.

INVESTMENT PROPERTIES LEASED OUT UNDER NON-CANCELLABLE OPERATING LEASE TERMS

	31.12.2017	**31.12.2016**
Cost	5,320	5,297
Accumulated depreciation	(1,469)	(1,207)
Carrying amount	3,851	4,090

	2017	**2016**
Operating lease income received for investment properties (Note 22)	509	503
Future operating lease income:	1,446	1,979
Next year	512	485
In 2…5 years	927	1,491
Later than 5 years	7	3

NOTE 26 BORROWINGS

in thousands of euros

	Finance lease liabilities at present value	Loans from					Total borrowings (Note 35)
		banks	parent company (Note 33)	entities under common control (Note 33)	other entities	total	
2017							
Balance at beginning of the year	1,769	25,703	12,500	6,000	29	44,232	46,001
Received	68	59,541	-	-	2,110	61,651	61,719
Repaid	(818)	(34,880)	(12,500)	-	-	(47,380)	(48,198)
Sale to lessor	(156)	-	-	-	-	-	(156)
Loan liability related to the disposals of subsidiary	-	-	-	-	(7)	(7)	(7)
Reclassification of loan into other payables	-	22	-	-	(22)	-	-
Exchange rate	-	(3)	-	-	-	(3)	(3)
Loan balance at end of the year	**863**	**50,383**	**-**	**6,000**	**2,110**	**58,493**	**59,356**
incl. current portion	487	20,621	-	1,000	2,110	23,731	24,218
non-current portion 2…5 years	376	29,762	-	5,000	-	34,762	35,138
Accrued interest of reporting period	44	641	34	146	-	821	865
incl. capitalised interest cost	-	120	-	-	-	120	120
Interest rate range	1,6%-4,1%+3-6 month euribor	1,05%-2,3%+1-6 month euribor; 1,69%+ eonia	4,0%	2,65%+6 month euribor	0%		
Base currencies	EUR	EUR, NOK	EUR	EUR	EUR, NOK		
2016							
Balance at beginning of the year	2,704	19,403	-	8,000	1,078	28,481	31,185
Received	51	24,339	12,500	-	-	36,839	36,890
Loan liability related to the acquisition of subsidiary	-	-	-	-	25	25	25
Repaid	(855)	(18,039)	-	(2,000)	(768)	(20,807)	(21,662)
Sale to lessor	(131)	-	-	-	-	-	(131)
Reclassification of loan into other payables	-	-	-	-	(306)	(306)	(306)
Loan balance at end of the year	**1,769**	**25,703**	**12,500**	**6,000**	**29**	**44,232**	**46,001**
incl. current portion	1,282	7,696	12,500	-	7	20,203	21,485
non-current portion 2…5 years	487	18,007	-	6,000	22	24,029	24,516
Accrued interest of reporting period	49	472	25	177	27	701	750
incl. capitalised interest cost	-	140	-	-	-	140	140
Interest rate range	1,5%-4,1%+3-6 month euribor	1,3%-2,95%+1-6 month euribor	4,0%	2,65%+6 month euribor	4,2%		
Base currencies	EUR	EUR	EUR	EUR	EUR, NOK		

	2017	2016
Minimum future payments under finance lease	870	1,807
incl. current portion	492	1,312
non-current portion with the term of 2...5 years	378	495

Borrowings with floating interest rates related to EURIBOR are divided by the interest rate changes and the contractual repricing dates as follows:

	2017	2016
Finance lease liabilities		
1-5 months	180	401
6-12 months	572	1,090
Bank loans		
1-5 months	12,265	-
6-12 months	38,070	25,703
Loans from entities under common control		
6-12 months	6,000	6,000
Total	**57,087**	**33,194**

Borrowings with the contractual fixed interest rate are divided as follows:

	2017	2016
Finance lease liabilities	111	278
Loans from bank	48	-
Loan from parent company	-	12,500
Loans from other entities	2,110	29
Total	**2,269**	**12,807**

Although different risk factors were evident in global financial markets throughout the year, it was generally a relatively stable year. The risk margins on loans did not significantly change as compared to last year, because EURIBOR was stable and other risk margins have not changed significantly since the loans were taken. Therefore, we can state that the fair value of bank loans to a material extent equals their carrying amount. The fair value of loans is measured using the discounted cash flow method and on the basis of Level 3 inputs of the fair value hierarchy (Note 35).
Among the loans from entities under common control, there is a loan from Järvevana OÜ, the interest of which is 6-month EURIBOR + 2.65%.
Loan collaterals and pledged assets are presented in Note 30.

NOTE 27 PAYABLES AND PREPAYMENTS

in thousands of euros

	31.12.2017	31.12.2016
Trade payables (Note 35)	**35,356**	**25,035**
Payables to employees	**8,613**	**7,106**
Tax liabilities, except for corporate income tax		
value added tax	532	4,122
personal income tax	554	513
social security tax	958	993
unemployment insurance tax	53	55
contributions to mandatory funded pension	43	46
other taxes	160	122
	2,300	**5,851**
Prepayments for construction services (Notes 32, 35)	**13,749**	**8,943**
Other liabilities (Note 35)		
interest liabilities	2	21
other liabilities	594	508
	596	**529**
Prepayments received	**14,358**	**8,795**
Total payables and prepayments	**74,972**	**56,259**
incl. payables to related parties (Note 33)	17	38

NOTE 28 PROVISIONS

in thousands of euros

	Provision for warranty obligation for construction	Provision for onerous construction contracts	Provision for legal costs and claims filed (Note 35) *	Provision for costs of projects sold	Other provisions	Total provisions
2017						
Balance at beginning of the year	2,476	79	273	2,788	21	5,637
Recognised (Notes 3, 4, 6)	1,152	408	75	1,067	161	2,863
Used during the year	(736)	(263)	(228)	(2,455)	(52)	(3,734)
Reversed (Notes 3, 6)	(18)	-	-	(173)	-	(191)
Exchange rate	-	-	-	(6)	-	(6)
Balance at end of the year	**2,874**	**224**	**120**	**1,221**	**130**	**4,569**
incl. current portion	2,874	224	120	1,221	130	4,569
2016						
Balance at beginning of the year	2,378	392	100	2,120	23	5,013
Recognised (Notes 3, 4, 6)	936	55	173	1,973	22	3,159
Related to acquired subsidiary's provisions	5	-	-	42	-	47
Used during the year	(787)	(368)	-	(1,205)	(24)	(2,384)
Reversed (Notes 3, 6)	(56)	-	-	(142)	-	(198)
Balance at end of the year	**2,476**	**79**	**273**	**2,788**	**21**	**5,637**
incl. current portion	2,476	79	273	2,788	21	5,637

* Additional information is provided in subsection "Legal risk" in Note 35.

The basic principle for making provisions for warranty obligations are the historical trends in the statistical share of construction contract volumes. Historically, the amount of provision used has not varied significantly from the amount of provision recognised.

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The provisions for costs of projects sold are based on the total costs of projects as defined in business plans, which are constantly updated and realized pursuant to the work performed.

NOTE 29 OTHER LONG-TERM PAYABLES

in thousands of euros

	31.12.2017	31.12.2016
Trade payables (Note 35)	1,248	1,317
Other long-term payables (Note 35)	541	744
Total other long-term payables	**1,789**	**2,061**
incl. other long-term payables to related parties (Notes 33)	541	322

NOTE 30 LOAN COLLATERALS AND PLEDGED ASSETS

The group has entered into commercial pledge contracts to secure loans and other liabilities, set mortgages on assets and pledged shares of its subsidiaries:

in thousands of euros

Commercial pledges	31.12.2017	31.12.2016
Movable property	62,018	41,641
Term deposit	35	36
Financial assets *	12,643	12,719
Total	**74,696**	**54,396**

* The financial assets of UAB Balsiu mokyklos SPV, which OÜ Merko Property has pledged to secure the investment loan in the amount of EUR 5,311 thousand for the benefit of Luminor Bank AB (31.12.2016: EUR 5,665 thousand).

Mortgages	31.12.2017	31.12.2016
Inventories (Note 17)	64,372	44,870
Land and buildings (Note 23)	3,240	3,401
Other non-current assets (Note 23)	144	376
Investment properties (Note 22)	15,333	3,688
Total	**83,089**	**52,335**

Pledges of shares
In addition to the commercial pledge on financial assets, OÜ Merko Property has pledged the shares of its wholly-owned subsidiary UAB Balsiu mokyklos SPV for the benefit of Luminor Bank AB. An investment loan in the amount of EUR 5,311 thousand (31.12.2016: EUR 5,665 thousand) is secured by the pledge.

As at 31.12.2016, UAB Merko Bustas had pledged its shares of the (100%) subsidiary UAB MN Projektas to Swedbank AB. The pledge secured an investment loan with a EUR 1,900 thousand line of credit.

NOTE 31 SHARE CAPITAL

There were no changes in share capital during 2017 and 2016.

The Commercial Code of the Republic of Estonia specifies the following requirements for the share capital of the entities registered in Estonia:

- the minimum share capital of a public limited company shall be at least EUR 25 thousand;
- the net assets of a public limited company shall be at least one half of the Company's share capital but not less than EUR 25 thousand.

The size of share capital or its minimum and maximum limits are set out in the articles of association of a public limited company whereas the minimum share capital shall equal at least ¼ of maximum share capital.

According to the current articles of association of AS Merko Ehitus, the Company's share capital consists of 17,700 thousand registered ordinary shares without nominal value which have been fully paid for and without amending the articles of association of the public limited company, changes can be made to the Company's share capital within the range of EUR 6,000 – 24,000 thousand.

As at 31.12.2017 and 31.12.2016, the share of capital of AS Merko Ehitus was EUR 7,929 thousand and the consolidated net assets of AS Merko Ehitus were EUR 130,170 thousand (31.12.2016: EUR 122,790 thousand), therefore the Company's equity and share capital were in compliance on both balance sheet date with the requirements established in the Republic of Estonia. The calculated value of the share was 0.447966 euros.

NOTE 32 CONSTRUCTION CONTRACTS IN PROGRESS

in thousands of euros

	31.12.2017	31.12.2016
Costs incurred for construction contracts in progress and corresponding profit*	480,705	335,989
Progress billings submitted	(476,674)	(340,324)
Revenue recorded from construction services during the period**	241,442	173,218
Accrued income from construction services (Notes 15, 35)	17,780	4,606
Prepayments for construction services (Notes 27, 35)	(13,749)	(8,943)
Advance payments received for construction contract works	10,743	3,825

* Costs incurred for construction contracts in progress and corresponding profit have been presented for contracts in effect, including those entered into in 2017 and 2016.

** The difference in sales revenue from construction service with respect to the amount recognised in Note 3, EUR 2,162 thousand (2016: EUR 1,888 thousand) stems from sales revenue from other segments, including extraction of filler sand for road construction.

Accrued income from construction services are included in the statement of financial position line *Trade and other receivables*. Prepayments for construction services are included in the statement of financial position line *Trade and other payables*.

NOTE 33 RELATED PARTY TRANSACTIONS

In compiling the Annual Report, the following entities have been considered as related parties:

- parent company AS Riverito;
- shareholders of AS Riverito with significant influence over AS Merko Ehitus through AS Riverito;
- other shareholders with significant influence;
- other subsidiaries of AS Riverito or so-called sister companies, in this Note "Entities under common control";
- joint ventures;
- key members of the management (supervisory and management board), their close relatives and entities under their control or significant influence.

Significant influence is presumed to exist when the person has more than 20% of the voting power.

The parent of AS Merko Ehitus is AS Riverito. As at 31.12.2017 and 31.12.2016, AS Riverito owned 71,99% of the shares of AS Merko Ehitus. The ultimate controlling party of the group is Mr Toomas Annus.

GOODS AND SERVICES

in thousands of euros

	2017	2016
Provided services and goods sold		
Parent company	15	15
Joint ventures	15,763	7,471
Entities under common control	6,430	5,641
Members of the management	42	108
Other related parties	-	617
Total services provided and goods sold	**22,250**	**13,852**

	2017	2016
Interest income		
Joint ventures	435	280
Purchased services and goods		
Parent company	90	90
Joint ventures	-	20
Entities under common control	59	126
Total purchased services and goods	**149**	**236**
Interest expense		
Parent company	34	38
Entities under common control	146	177
Total interest expense	**180**	**215**

BALANCES WITH RELATED PARTIES
in thousands of euros

	31.12.2017	31.12.2016
Receivables from related parties		
Loans granted (Note 15, 16, 20)		
Joint ventures	9,000	3,952
Receivables and prepayments (Note 15)		
Parent company	4	4
Joint ventures	2,489	3,896
Entities under common control	418	433
Total receivables and prepayments	**2,911**	**4,333**
Other long-term receivables (Note 20)		
Joint ventures	-	261
Total receivables from related parties	**11,911**	**8,546**
Payables to related parties		
Short-term loans received (Note 26)		
Parent company	-	12,500
Entities under common control	1,000	-
Total short-term loans received	**1,000**	**12,500**
Payables and prepayments (Note 27)		
Parent company	9	9
Joint ventures	7	-
Entities under common control	1	29
Total payables and prepayments	**17**	**38**
Long-term loans received (Note 26)		
Entities under common control	6,000	6,000
Other long-term payables (Note 29)		
Other related parties	541	322
Total payables to related parties	**6,558**	**18,860**

With regard to receivables from related parties, no impairments were performed in either 2017 or 2016.

TRANSACTIONS INVOLVING RELATED PARTIES (ADDITIONAL INFORMATION)

On 14 December 2016, AS Merko Ehitus signed a short-term (due date 31 of January 2017) loan agreement in the amount of EUR 12,500 thousand with parent company AS Riverito, to partially finance the acquisition of Veerenni land plots (purchase price EUR 16,800 thousand). On 26 January 2017 the loan from AS Riverito was repaid before the due date and refinanced with long-term loans from different credit institutions.

REMUNERATION OF THE MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS

In 2017, the members of the Supervisory and Management Boards of AS Merko Ehitus and Management Boards of its significant subsidiaries were paid gross fees totalling EUR 2,355 thousand (2016: EUR 2,221 thousand).

TERMINATION BENEFITS OF MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARDS

Authorisation agreements have been entered into with the members of the Supervisory Board according to which no termination benefits are paid to them upon the termination of the contract. Upon premature removal or termination of authority of the members of the Supervisory and Management Boards, the group has the obligation to pay compensation totalling EUR 882 thousand (2016: EUR 716 thousand). In 2017, compensation was paid to the management board members in the amount of EUR 147 thousand (2016: EUR 65 thousand).

MEMBERS OF THE SUPERVISORY AND MANAGEMENT BOARD

Track record and photographs of the members of the Supervisory Board can be found in the management report and on AS Merko Ehitus website at group.merko.ee.

Shares held by members of the Supervisory Board of AS Merko Ehitus as at 31 December 2017

		NO. OF SHARES	% OF SHARES
Toomas Annus (AS Riverito)	Chairman of the Supervisory Board	8,322,914	47.02%
Indrek Neivelt (OÜ Trust IN)	Member of the Supervisory Board	31,635	0.18%
Teet Roopalu	Member of the Supervisory Board	-	-
		8,354,549	**47.20%**

Shares held by members of the Management Board of AS Merko Ehitus as at 31 December 2017

		NO. OF SHARES	% OF SHARES
Andres Trink	Chairman of the Management Board	600	0.00%
Tõnu Toomik (AS Riverito)	Member of the Management Board	1,607,185	9.08%
		1,607,785	**9.08%**

NOTE 34 CONTINGENT LIABILITIES

in thousands of euros

The group has purchased the following guarantees from financial institutions to guarantee the group's obligations to third parties. These amounts represent the maximum right of claim by third persons against the group in case the group is unable to meet its contractual obligations. Management estimates that additional expenses related to these guarantees are unlikely.

	31.12.2017	31.12.2016
Performance period's warranty to the customer	31,229	21,036
Tender warranty	2,201	767
Guarantee warranty period	18,197	20,470
Prepayment guarantee	16,249	4,411
Payment guarantee	31,019	30,500
Contracts of surety	4,215	3,902
Total contingent liabilities	**103,110**	**81,086**

The "Payment guarantee" entry as at 31.12.2017 and 31.12.2016 includes a payment guarantee for the benefit of a financial institution, issued within the framework of a contract for construction, in order to secure the customer's contractual payment obligations in the total amount of up to EUR 30,500 thousand. The realisation of the payment guarantee is not considered likely by the group. To secure the customer's contractual obligations, a first-ranking mortgage of EUR 36,600 thousand with the financing institution as the beneficiary has been established on the registered immovable property of the building to be constructed in the framework of the construction agreement. To secure the group's payment guarantee, a second-ranking mortgage of EUR 8,500 thousand with the group as the beneficiary has been established.

Performance period's warranty to the customer – warranty provider guarantees to the customer that the contractor's obligations arising from construction contract will be adequately completed.
Tender warranty – warranty provider guarantees to the customer arranging the tender process that the tenderer will sign a contract as per tender conditions.
Guarantee for warranty period – warranty provider guarantees to the customer that the construction defects discovered during the warranty period will be eliminated.
Prepayment guarantee – warranty provider guarantees to the customer that advances will be reimbursed, if contractor fails to deliver goods or services agreed.
Payment guarantee – guarantor guarantees repayments of the customer's/developer's loan.
Contracts of surety – the group guarantees the timely fulfillment of group member's liabilities towards a third party (e.g. providing services by a certain date in the agreed amount).

As at 31 December 2017 the group has recognised a provision (Note 28) with regards to the guarantee for warranty period which is based upon historical experience and contractual volumes.

Tax authorities have the right to review the group's tax records within 5 years after submitting the tax declaration and upon detecting errors, impose additional taxes, interest and fines. The group's management estimates that there are no circumstances which might lead the tax authorities to impose additional significant taxes on the group.

For legal risks, please refer to the respective paragraph of Note 35.

NOTE 35 RISK MANAGEMENT

FINANCIAL RISKS MANAGEMENT

In its daily activities, the group needs to consider various financial risks. The key risks include: market risk (incl. interest rate risk and foreign currency risk), credit risk, liquidity risk and equity risk. Based on the group's balance sheet structure and position in the market, none of these risks have a significant impact as at the date of preparation of the financial statements. The group's risk management is based on laws, regulations, requirements and regulations arising from International Financial Reporting Standards, as well as the group's internal regulations and good business practices. The group's finance department is responsible for management of financial risks.

1. CREDIT RISK

Credit risk relates to a potential damage which would occur if the parties to the contract are unable to fulfil their contractual obligations. For mitigating credit risk, the payment behaviour of clients is constantly monitored, their financial position is analysed and if necessary, third persons are engaged as a guarantor in transactions. Construction activities are partially financed by customer prepayments. As a rule, a precondition for receiving a prepayment is a bank guarantee for the prepayment submitted to the customer. Free cash is mostly held in bank account or term deposits at Swedbank, LHV, SEB, Luminor and OP Corporate Bank bank groups. Swedbank AS, AS LHV Pank, SEB Pank AS and Luminor Bank AS do not have separate ratings by Moody's. The parent company of Swedbank AS's Swedbank AB, the parent company of SEB Pank AS's Skandinaviska Enskilda Banken AB and OP Corporate Bank PLC all have a long-term rating Aa3 by Moody's. Luminor Bank is jointly owned by DNB Bank ASA (Moody's credit rating Aa2) and Nordea Bank AB (Moody's credit rating Aa3). The management estimates that the group is not exposed to significant credit risk.

FINANCIAL ASSETS EXPOSED TO CREDIT RISK
in thousands of euros

	Allocation by due dates		Carrying amount	Collateral
	1-12 months	2-5 years		
31.12.2017				
Cash and cash equivalents (Note 14)	39,210	-	39,210	-
Trade receivables (Notes 15, 20)	36,665	13,163	49,828	1,500
Accrued income from construction service (Notes 15, 32)	17,780	-	17,780	-
Loans granted (Notes 15, 16, 20)	10,590	4,000	14,590	5,590
Interest receivables (Notes 15, 20)	603	-	603	-
Other short-term receivables (Note 15)	636	-	636	-
Total	**105,484**	**17,163**	**122,647**	**7,090**

31.12.2016				
Cash and cash equivalents (Note 14)	33,544	-	33,544	-
Term deposits (Notes 20)	-	36	36	-
Trade receivables (Notes 15, 20)	31,470	11,122	42,592	1,500
Accrued income from construction service (Notes 15, 32)	4,606	-	4,606	-
Loans granted (Notes 15, 16, 20)	1,560	3,952	5,512	1,650
Interest receivables (Notes 15, 20)	218	261	479	-
Other short-term receivables (Note 15)	347	-	347	-
Total	**71,745**	**15,371**	**87,116**	**3,150**

The group's customers are primarily large local entities or public sector entities (as at 31.12.2017, the public sector proportion in accounts receivable amounted to 12.2% (as at 31.12.2016: 20.8%)) with well-known and sufficient creditworthiness.

TRADE RECEIVABLES BY DUE DATE

in thousands of euros

	31.12.2017		**31.12.2016**	
Not overdue	45,930	92.2%	38,002	89.2%
1-30 days overdue	2,146	4.3%	2,076	4.9%
31-60 days overdue	397	0.8%	1,384	3.2%
61-90 days overdue	271	0.5%	141	0.3%
91-120 days overdue	44	0.1%	152	0.4%
121-180 days overdue	22	0.1%	551	1.3%
More than 180 days overdue	1,018	2.0%	286	0.7%
Total trade receivables (Notes 15, 20)	**49,828**	**100%**	**42,592**	**100%**

** Trade receivables are presented in net amount, i.e. the sum of receivables also includes allowance for doubtful receivables from buyers.*

As at the balance sheet date, the amount of overdue short-term receivables was EUR 3,898 thousand (31.12.2016: EUR 4,590 thousand), of which EUR 2,738 thousand has been collected by 12 March 2018. In a year, the share of overdue short-term receivables in total receivables decreased from 10.8% to 7.8%. The group keeps running track of payment history for all customers separately for each receivable. According to management estimates, which are based on customers' historical payment behaviour and background assessment on the payment behaviour of new clients, the management estimates that there are sufficient reasons to conclude that the receivables reported in the financial statements will be paid off by the buyers. The receivables, which were not overdue at the balance sheet date, will be paid by due date. Trade receivables and receivables from customers of construction works under the stage of completion method have not been guaranteed with additional collateral as is customary in the industry.

As at balance sheet date, the loans granted to joint ventures, the economic activities of which the group has a good overview of, totalled EUR 9,000 thousand (31.12.2016: 3,952 thousand) and therefore, no additional collateral is required. As at 31.12.2017, loans granted to unrelated legal entities amounted to EUR 5,590 thousand (31.12.2016: 1,560 thousand), which in management's opinion is not exposed to material credit risk. As at the year-end, the management expects to collect these loans on time. Additional information on loan guarantees is given in Note 16.

2. MARKET RISK

INTEREST RISK

Interest risk arises from interest rate changes in the financial markets as a result of which it may be necessary to revalue the group's financial assets and take into consideration higher financing costs in the future. Most of the group's bank loans have floating interest rates based on either Euribor or the interbank rates of the countries of incorporation of the entities. In 2017, the share of interest-bearing liabilities in the group's capital structure increased slightly and management considers this share to be moderate (as at 31.12.2017, 21.4% and as at 31.12.2016, 19.3% of the balance sheet total) and effect of changes in the interest rate environment to be insignificant for the group's results over the next 12 months.

EFFECT OF CHANGES IN INTEREST RATE RISK ON FINANCE COSTS AND INCOME

As at 31.12.2017, the group's interest-bearing liabilities totalled EUR 59,356 thousand (31.12.2016: EUR 46,001 thousand), of which short-term loans and repayments of long-term liabilities in 2018 totalled EUR 24,218 thousand (31.12.2016: EUR 21,485 thousand) and long-term loans and finance lease liabilities totalled EUR 35,138 thousand (31.12.2016: EUR 24,519 thousand). As at 31.12.2017, the group's loans granted totalled EUR 14,590 thousand (31.12.2016: EUR 5,512 thousand), of which EUR 10,590 thousand were classified as short-term loans with repayments in 2018 (31.12.2016: EUR 1,560 thousand) and EUR 4,000 thousand as long-term loans (31.12.2016: EUR

3,952 thousand). Loan interest depended on interbank 1-12 month loan base interest in the entity's domicile and Euribor. As at 31.12.2017, the break-down of interest-bearing borrowings and loans granted was as follows:

	31.12.2017	31.12.2016
Fixed rate liabilities	2,269	12,809
Liabilities with floating rate interests 1-5 months	12,445	401
Liabilities with floating rate interests 6-12 months	44,642	32,791
Total interest-bearing borrowings	**59,356**	**46,001**
Fixed rate receivables	14,590	5,512

The management does not expect big changes in base interest rates, the market is stable and base interest rates remain low. Assuming that average EURIBOR is 10 pp higher over the next 12 months as compared to the beginning of the year and there is no change in the position of liabilities, interest expenses would increase by EUR 57 thousand (31.12.2016: EUR 33 thousand). All the loans granted have fixed interest rate and therefore a change in the reference rates would have no impact on the interest income.

In addition to risk arising from changes in Euribor, there is risk due to changes in the risk margin attributable to the changes in the economic environment related refinancing of liabilities. This is most directly manifested in a possible need to extend overdraft credit contracts. As at the year-end, group entities had entered in overdraft contracts with banks and other unrelated third parties in the total limit amount of EUR 17,478 thousand, of which EUR 8,000 thousand was withdrawn. In 2018, one contract in a total amount of EUR 4,000 thousand will expire.

FOREIGN EXCHANGE RISK

The group's economic activities are conducted mainly in the currencies of the countries of location of the companies: euros in Estonia, Latvia and Lithuania and krones in Norway. Transactions within the group are conducted in euros as a rule. To eliminate foreign currency risks, close track is kept of the proportions of the company's assets and liabilities held in different currencies and, when it comes to entering into long-term construction contacts, the euro is the preferred currency in the Baltics, and, in Norway, the krone. The bread-down of financial assets and liabilities in local currencies as at the balance sheet date is as follows:

	In EUR	In NOK
31.12.2017		
Assets	96.2%	3.8%
Liabilities	96.9%	3.1%
31.12.2016		
Assets	98.3%	1.7%
Liabilities	98.7%	1.3%

Considering the fact that the materials and services used in construction are generally from the local market or supplied from within the EU, the currency risk in the group is currently minimal.

3. LIQUIDITY RISK

The group's liquidity or solvency represents its ability to settle its liabilities to creditors on time. As at 31.12.2017, the group´s current ratio was 2.2 (31.12.2016: 2.9) and the quick ratio 1.1 (31.12.2016: 1.1). In addition to available current assets, and to ensure liquidity and better management of cash flows, the group has concluded overdraft agreements with banks. As at end of the year, the group entities had concluded overdraft contracts with banks and other unrelated third parties in the total amount of EUR 17,478 thousand, of which EUR 9,478 thousand was unused, (31.12.2016: EUR 11,198 thousand, of which EUR 8,198 thousand was unused). In addition to the overdraft facility, the Company has a current loan facility with the limit of EUR 3,500 thousand (31.12.2016: EUR 3,500 thousand) from AS Riverito, which was fully unused as at the end of current and previous financial years.

The management estimates that the group's capital structure – equity at 47.0% (31.12.2016: 51.6%) of the balance sheet total and a moderate proportion of interest bearing liabilities at 21.4% (31.12.2016: 19.3%) of the balance sheet total – ensures the group's trustworthiness for creditors. It also enables to prolong existing financial liabilities and raise additional working capital funds, if needed.

FINANCIAL ASSETS/LIABILITIES
in thousands of euros

	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
31.12.2017					
Assets					
Cash and overnight deposits (Note 14)	39,210	-	-	39,210	39,210
Trade receivables (Notes 15, 20)	31,039	5,626	13,163	49,828	49,828
Accrued income from construction services (Notes 15, 32)	17,780	-	-	17,780	17,780
Loans and interest (Notes 15, 16, 20)	11,193	-	4,000	15,193	15,193
Other short-term receivables (Note 15)	322	314	-	636	636
Total	**99,544**	**5,940**	**17,163**	**122,647**	**122,647**
Liabilities					
Trade payables (Notes 27, 29)	35,356	-	1,248	36,604	36,604
Prepayments for construction services (Notes 27, 32)	13,749	-	-	13,749	13,749
Loan and finance lease liabilities (Note 26) *	11,225	12,993	35,138	59,356	59,356
Other liabilities (Note 27, 29)	436	160	541	1,137	1,137
Financial guarantees	31,872	-	-	31,872	-
Total	**92,638**	**13,153**	**36,927**	**142,718**	**110,846**
Net assets / liabilities	**6,906**	**(7,213)**	**(19,764)**	**(20,071)**	**11,801**

	Allocation by due date			Total	Carrying amount
	1-3 months	4-12 months	2-5 years		
31.12.2016					
Assets					
Cash and overnight deposits (Note 14)	33,544	-	-	33,544	33,544
Term deposits (Notes 20)	-	-	36	36	36
Trade receivables (Notes 15, 20)	26,828	4,642	11,122	42,592	42,592
Accrued income from construction services (Notes 15, 32)	4,606	-	-	4,606	4,606
Loans and interest (Notes 15, 16, 20)	81	1,697	4,213	5,991	5,991
Other short-term receivables (Note 15)	117	230	-	347	347
Total	**65,176**	**6,569**	**15,371**	**87,116**	**87,116**
Liabilities					
Trade payables (Notes 27, 29)	22,332	2,703	1,317	26,352	26,352
Prepayments for construction services (Notes 27, 32)	8,943	-	-	8,943	8,943
Loan and finance lease liabilities (Note 26) *	20,067	1,418	24,516	46,001	46,001
Other liabilities (Note 27, 29)	236	293	744	1,273	1,273
Financial guarantees	32,465	-	-	32,465	-
Total	**84,043**	**4,414**	**26,577**	**115,034**	**82,569**
Net assets / liabilities	**(18,867)**	**2,155**	**(11,206)**	**(27,918)**	**4,547**

* The schedule of expected interest payments cannot be determined with reasonable accuracy. In line with the best practice of property development, the loan obligations to acquire land plots have been assumed with open-end maturities. The repayment of these loan obligations depends on the progress of related development projects and on the timing of cash flows generated from those projects after their completion. Consequently, the management is of opinion that even its best estimate of the timing of expected interest payments would not be sufficiently accurate for the users of these financial statements and this information has not been disclosed.

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4. FAIR VALUE ESTIMATION

According to the estimation of the group, the carrying values of financial assets at amortised cost (Notes 14, 15, 16, 20) and financial liabilities at amortised cost (Notes 26, 27, 29) in the consolidated balance sheet as at 31 December 2017 and 31 December 2016 do not vary significantly from their fair value.

The fair values of short-term receivables and loans granted and short-term payables and accounts payable to suppliers do not differ significantly from their value recognised in the statement of financial position, as their realisation takes place within 12 months or recognition took place during an interval proximate to the balance sheet date.

The Management Board estimates that the fair value of long-term receivables does not materially differ from their carrying amount because no material changes have occurred in risk margins of the borrowers. The fair value of receivables is measured using the discounted cash flow method in accordance with IFRS 7 on the basis of Level 3 inputs of the fair value hierarchy.

The fair value of trade receivables (31.12.2017: EUR 10,580 thousand; 31.12.2016: EUR 10,580 thousand) related to Balsiu School – other receivables and amounts receivable from invoices issued (including VAT) – equals their carrying amount, as the impact of discounting is not significant. The fair value of the mentioned receivables is equal to EUR 25,215 thousand using the effective interest rate of 0.31% (31 December 2016: EUR 26,586 thousand using the effective interest rate of 0.31%). As the amount receivable is due from the state institution, the interest rate used for the fair value calculation is a long-term borrowing rate at the end of the period applicable to the Republic of Lithuania (www.ecb.europa.eu/stats/financial_markets_and_interest_rates/long_term_interest_rates). Long-term receivables related to Balsiu School are valued on the basis of Level 2 inputs of the fair value hierarchy.

A significant part of the group's long-term payables have a floating interest rate, which changes according to fluctuations of the market interest rate. In the estimation of the management, the group's risk margins have not materially changed since the loans were obtained and the interest rates on the group's debt meet the market conditions. The fair value of long-term financial obligations is determined based on discounted future contractual cash flows using the market interest rate available to the group for the use of similar financial instruments (Level 3).

To provide an indication of the inputs used to determine fair value, the group has classified its financial instruments into three levels based on the requirements of accounting standards.

Level 1: Financial instruments valued at unadjusted prices on the stock market or other active regulated market. As at 31 December 2017 and 2016, the group did not have any Level 1 financial instruments.

Level 2: Financial instruments whose values are based on valuation methods based on observable inputs. This category includes e.g. financial instruments valued based on prices of identical instruments traded on an active regulated market or financial instruments which are revalued at regulated market price but have low liquidity on the stock market.

Level 3: Financial instruments where the valuation methods used for revaluation are based on non-observable inputs.

CAPITAL MANAGEMENT

The group considers borrowings and total equity as capital. As at 31.12.2017, the total equity attributable to equity owners of the parent was EUR 130,170 thousand (31.12.2016: EUR 122,790 thousand). The group's principle is to maintain a strong equity base for the purpose of retaining its trustworthiness among its shareholders, creditors and the market, and to ensure the group's sustainable development. Over the long term, the group's goal is to increase income for its shareholders and ensure its ability to pay dividends.

The group's equity is currently mainly tied up in the land plots portfolio invested in for the purpose of real estate development, which the group has realised according to the changes in the market primarily through its own developments. The group can additionally regulate the equity structure through dividends payable to shareholders or repayments of share capital.

The group considers it important to ensure an optimal capital structure. Therefore, it monitors that the group's equity to assets ratio is at least 40% (31.12.2017: 47.0%, 31.12.2016: 51.6%).

According to good market practice, the group uses the ratio of net debt to total capital to monitor its capital composition:

	31.12.2017	31.12.2016
Borrowings	59,356	46,001
Less: cash and cash equivalents and short-term deposits	(39,210)	(33,544)
Net debt	20,146	12,457
Total equity attributable to owners of the parent	130,170	122,790
Total net debt and equity attributable to equity owners of the parent	150,316	135,247
Share of net borrowings	13.4%	9.2%

The group's net debt at 31.12.2017 stood at EUR 20.1 million (31.12.2016: EUR 12.5 million).

MANAGEMENT OF OTHER RISKS

LEGAL RISK

Due to different interpretations of contracts, regulations and laws related to group's principal activities, there is a risk that some buyers, contractors or supervisory authorities evaluate the Company's activities from the perspective of laws or contracts from a different position and dispute the legitimacy of the Company's activities.

As at 31 December 2017, a provision has been set up at the group in the amount of EUR 120 thousand for covering potential claims and legal costs (31 December 2016: EUR 273 thousand), (Note 28).

An overview of the key legal disputes of group entities ended during 2017 and ongoing as of 31.12.2017 is presented below.

ESTONIA

Lawsuit against former employee

On 17 December 2014, AS Merko Infra filed a claim in Harju County Court against a former AS Merko Infra employee, Maksim Vihharev, seeking EUR 97 thousand in damages (EUR 84 thousand being the principal claim and EUR 13 thousand late interest) along with a petition to secure the action. The lawsuit relates to intentional damage caused by fictitious transactions concluded by Maksim Vihharev on behalf of AS Merko Infra while serving as electrical work project manager and purchase of items not necessary for contractual work. The potential positive outcome of this suit is not recognised in the group's financial reporting.

Appeal for the revocation of the order of the Minister of the Environment

Several court cases are ongoing in connection with Minister of the Environment regulation No 22 of 27 March 2015, which redrew the boundaries of species protection sites to exclude properties on Paekalda street owned by AS Merko Ehitus subsidiaries Suur-Paekalda OÜ and Väike-Paekalda OÜ.

On 2 February 2016, AS Merko Ehitus subsidiaries Suur-Paekalda OÜ and Väike-Paekalda OÜ filed a complaint in Tallinn Administrative Court for compensation of damage. The plaintiffs are seeking a ruling ordering that the state pay damages of approximately EUR 3.2 million to Suur-Paekalda OÜ (exact amount to be determined) and approximately EUR 1.6 million to Väike-Paekalda (exact amount to be determined) as well as late interest at the rate specified in subsection 113 (1) of the Law of Obligations Act starting from 2 February 2016 until due compliance with the demand for compensation. The claims consist of direct patrimonial damage (reduction in the value of immovable property and expenditures made on development activity) and claims for revenue foregone (failed development activity in 2005-2007). The possible positive impact of the claim submitted has not been recognized by the group in its financial statements.

LATVIA

Lawsuit against former employee

On 5 May 2015, SIA Merks filed suit in Riga District Court against former SIA Merks employee Rolands Mēnesis in a claim for the compensation of damage amounting to EUR 337 thousand. Previously, on 2 March 2015, SIA Merks had filed a petition to secure the action in the same amount, which was duly granted by the court. The object of the statement of claim is damage deliberately caused by project manager Rolands Mēnesis by entering into fictitious transactions on behalf of SIA Merks and purchase of items not necessary for contractual work. The court ruling is expected during the first half of 2018.
The possible effect of the potential positive outcome of this claim has not been taken into account in the group's financial reporting.

Starptautiskā lidosta "Rīga"

On 21 September 2017, SIA Merks has initiated court proceedings against VAS "Starptautiskā lidosta "Rīga"" (Riga International Airport). The basis of the court proceeding is a dispute with Riga International Airport on the terms and conditions of signing the final completion certificate of the new passenger terminal of Riga International Airport. SIA Merks seeks court decision requiring Riga International

Airport to sign the final completion certificate and thus entitling SIA Merks for payment of EUR 449 thousand (EUR 414 thousand being the principal claim and EUR 35 thousand late interest) for the works. The date of the first court hearing is scheduled on 16 May 2018. Due to the fact that Riga International Airport refuses to sign the final deed, SIA Merks will prepare an additional claim to the court to confirm that the works are fully and properly performed and should be duly accepted by Riga International Airport and, in addition to releasing the final payment also transfer the retention money for the warranty period guarantee in the amount of EUR 920 thousand. No additional provisions are recognised in relation to the potential outcome of this claim.

LITHUANIA

Vilniaus vandenys

On 18 May 2016, AS Merko Ehitus and UAB Merko Statyba, acting pursuant to the joint venture agreement, filed an action against UAB Vilniaus vandenys in the total amount of EUR 183 thousand, encompassing the acceptance of additional works and the compensation of direct expenses incurred, interest on unpaid sums and the extension of the contract term of the sewerage and wastewater pipeline project carried out in Avižieniai region (project "Extension of water supply and waste water networks in Avižieniai Subdistrict"). The plaintiffs maintain that due to the actions of UAB Vilniaus vandenys, both the construction period became longer and also additional works were carried out – works that the customer later refused to pay for. In the hearing on 2 February 2017, the plaintiffs asked the court to appoint a court expertise and by the court decision of 9 January 2018, the court expertise was appointed. The planned term of the court expertise is 3 months.

The potential positive outcome of this claim is not recognised in the group's financial reporting.

VALUE OF ASSETS

Although the economic environment has attained certain stability, the effect of the real estate market risk remained material for assessing the company's activities. In 2017, the group recognised EUR 2,838 thousand (2016: EUR 543 thousand) in impairment losses on assets and inventories, incl. impairment loss of EUR 2,360 thousand (2016: EUR 37 thousand) on finished goods, EUR 235 thousand (2016: EUR 389 thousand) in connection with the merger of AS Vooremaa Teed with AS Tallinna Teed the impairment on goodwill recognised under intangible assets, EUR 114 thousand (2016: EUR 108 thousand) on the write-off of doubtful and irrecoverable receivables and EUR 129 thousand loss from write-off of prepayments to suppliers (2016: EUR 9 thousand). In 2017, prior period impairment losses on inventories were reversed in the amount of EUR 5,276 thousand (2016: none) and receivables expensed in prior periods in the amount of EUR 238 thousand were collected (2016: EUR 3 thousand). See also Notes 15, 17 and 24 for further details.

NOTE 36 SUPPLEMENTARY DISCLOSURES ON THE PARENT COMPANY

The financial information of the parent comprises separate primary statements of the parent (income statement, statement of financial position, cash flow statement and statement of changes in equity), the disclosure of which is required by the Estonian Accounting Act. The primary financial statements of the parent have been prepared using the same accounting methods and measurement bases as those used for the preparation of the consolidated financial statements, except for subsidiaries, associates and joint ventures, which are reported at cost in the separate primary financial statements of the parent.

INCOME STATEMENT
in thousands of euros

	2017	**2016**
Revenue	16,431	14,262
Cost of goods sold	(13,075)	(12,505)
Gross profit	**3,356**	**1,757**
Marketing expenses	(80)	(86)
General and administrative expenses	(1,713)	(1,609)
Other operating income	1,010	506
Other operating expenses	(158)	(673)
Operating profit (loss)	**2,415**	**(105)**
Finance costs	(355)	(215)
Finance income from investments in subsidiaries	7,324	9,027
Profit before tax	**9,384**	**8,707**
Deferred income tax expense	(14)	-
Net profit for the year	**9,370**	**8,707**

STATEMENT OF FINANCIAL POSITION

in thousands of euros

	31.12.2017	31.12.2016
ASSETS		
Current assets		
Cash and cash equivalents	1,183	1,434
Receivables and prepayments	9,564	3,719
Inventories	25,730	36,080
	36,477	**41,233**
Non-current assets		
Investments in subsidiaries	136,111	131,382
Investments in joint ventures	5	764
Other long-term financial assets	3,599	6,149
Investment properties	17	18
Property, plant and equipment	44	80
Intangible assets	112	88
	139,888	**138,481**
TOTAL ASSETS	**176,365**	**179,714**
LIABILITIES		
Current liabilities		
Borrowings	12,004	16,652
Trade and other payables	15,133	13,781
Short-term provisions	27	1,176
	27,164	**31,609**
Non-current liabilities		
Long-term borrowings	5,007	6,024
	5,007	**6,024**
TOTAL LIABILITIES	**32,171**	**37,633**
EQUITY		
Share capital	7,929	7,929
Statutory reserve capital	793	793
Retained earnings	135,472	133,359
TOTAL EQUITY	**144,194**	**142,081**
TOTAL LIABILITIES AND EQUITY	**176,365**	**179,714**

STATEMENT OF CHANGES IN EQUITY

in thousands of euros

Parent	Share capital	Statutory reserve capital	Retained earnings	Total
Balance as at 31.12.2015	**7,929**	**1,200**	**133,272**	**142,401**
Net profit for financial year	-	-	8,707	8,707
Share capital reduction	-	(407)	407	-
Dividends	-	-	(9,027)	(9,027)
Balance as at 31.12.2016	**7,929**	**793**	**133,359**	**142,081**
Carrying amount of holdings under control or significant influence				(132,146)
Value of holdings under control or significant influence under the equity method				112,855
Adjusted unconsolidated equity 31.12.2016				**122,790**
Net profit for financial year	-	-	9,370	9,370
Dividends	-	-	(7,257)	(7,257)
Balance as at 31.12.2017	**7,929**	**793**	**135,472**	**144,194**
Carrying amount of holdings under control or significant influence				(136,116)
Value of holdings under control or significant influence under the equity method				122,092
Adjusted unconsolidated equity 31.12.2017				**130,170**

Adjusted unconsolidated equity is used as the basis for verifying compliance with equity requirements set forth in the Commercial Code.

CASH FLOW STATEMENT

in thousands of euros

	2017	2016
Cash flows from operating activities		
Operating profit (loss)	2,415	(105)
Adjustments:		
Depreciation and impairment charge	38	53
Profit (loss) from sale of non-current assets	-	(1)
Adjustment of revenue from construction contracts under stage of completion method	80	2
Interest income from business activities	(683)	(497)
Change in provisions	(1,010)	625
Change in trade and other receivables related to operating activities	(3,241)	296
Change in inventories	10,394	(19,683)
Change in trade and other payables related to operating activities	1,231	4,971
Interest received	531	175
Interest paid	(415)	(416)
Total cash flows from operating activities	**9,340**	**(14,580)**
Cash flows from investing activities		
Acquisition of subsidiaries	(2,743)	(502)
Investments in subsidiaries	(13,636)	(9,110)
Reduction of equity in subsidiary	12,417	1,605
Purchase of property, plant and equipment	(5)	(3)
Proceeds from sale of property, plant and equipment	-	6
Purchase of intangible assets	(38)	(51)
Interest received	4	43
Dividends received	7,324	9,027
Total cash flows from investing activities	**3,323**	**1,015**
Cash flows from financing activities		
Proceeds from borrowings	26,771	22,035
Loan repayments received	(32,409)	(7,712)
Finance lease principal payments	(19)	(30)
Dividends paid	(7,257)	(9,027)
Total cash flows from financing activities	**(12,914)**	**5,266**
Net increase/decrease in cash and cash equivalents	**(251)**	**(8,299)**
Cash and cash equivalents in the beginning of period	1,434	9,742
Effect of exchange rate changes	-	(9)
Cash and cash equivalents at end of the period	1,183	1,434

SIGNATURES OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD TO THE 2017 ANNUAL REPORT

The Management Board of AS Merko Ehitus has prepared the management report, the consolidated financial statements and the profit allocation proposal for 2017.

Andres Trink	Chairman of the Management board		27.03.2018
Tõnu Toomik	Member of the Management Board		27.03.2018

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

Toomas Annus	Chairman of the Supervisory Board		02.04.2018
Teet Roopalu	Member of the Supervisory Board		02.04.2018
Indrek Neivelt	Member of the Supervisory Board		02.04.2018

Independent auditor's report

To the Shareholders of AS Merko Ehitus

(Translation of the Estonian original)*

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS Merko Ehitus and its subsidiaries (together the Group) as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union. Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Group's consolidated financial statements comprise:

the consolidated statement of financial position as at 31 December 2017;

the consolidated statement of comprehensive income for the year then ended;

the consolidated cash flow statement for the year then ended;

the consolidated statement of changes in equity for the year then ended; and

the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

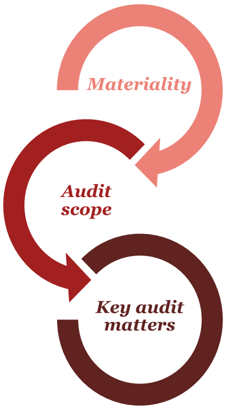
Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59^1 of the Auditors Activities Act of the Republic of Estonia.

Our audit approach

Overview



Materiality

Overall materiality for Group audit is EUR 3.1 million, which represents approximately 1% of consolidated total revenue.

Audit scope

A full scope audit was performed by us or, under our instructions, by PwC network firms or other auditors for Group entities covering 94% of the Group's revenues and 95% of the Group's assets. Selected audit procedures were performed on remaining balances to ensure we obtained sufficient audit evidence to express an opinion on the Group's financial statements as a whole.

Key audit matters

- Revenue recognition on construction contracts
- Valuation of inventory relating to property developments

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the management made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall group materiality	EUR 3,1 million
How we determined it	1% of total revenues
Rationale for the materiality benchmark applied	We have used revenue rather than profit as a basis of our materiality calculation, because revenue is a more stable benchmark that is used both internally by management as well as, we believe, externally by shareholders in evaluating the performance of the Group. The profit of the Group has fluctuated significantly in recent years, depending on the cycle of the construction and real estate market and on the timing of sales of large development projects.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	***How our audit addressed the key audit matters***
Revenue recognition on construction contracts *(*refer to Note 1 'Summary of significant accounting policies – subsections 1.20 'Revenue' and 1.21 'Unfinished construction contracts', and Note 3 'Operating Segments' for further details). In 2017 the Group has recognised revenue of EUR 317.6 million, EUR 243.6 million of which is related to construction services. The Group's revenues from construction services are generated from a large portfolio of contracts with different terms regarding service fee, use of subcontractors or partners and profit sharing. Revenue from construction contracts is recorded by reference to the stage of completion of contract. The stage of completion method requires the management to estimate the cost to complete the contract, as well as any possible adjustments to the contractual fee, at each measurement date. Accounting estimates have subjective nature and rely on many sources of information, both within the Group and external, about the expected outcome of a contract. The complexity resulting from both the large number of varying contractual terms and estimation uncertainties regarding the expected outcome of construction contracts could lead to errors that may become material, when aggregated. As such, revenue recognition on construction contracts requires significant time and resource to audit due to both its magnitude and complexity, and is therefore considered to be a key audit matter.	We audited revenue recognition on construction contracts through a combination of controls testing and substantive testing. We performed testing of the design, implementation and operating effectiveness of manual controls supporting identification of contractual terms, selection of suitable accounting policies and assessment of the stage of completion. We did not identify any exceptions that impacted our audit approach. The controls testing was supported by substantive audit procedures. We selected a sample of contracts and performed substantive procedures that included, but were not limited to: • reconciling the contract fee used in calculating the revenue based on the stage of completion to the contract; • reconciling incurred contract costs included in revenue calculation to accounting records and testing the proper allocation of costs to individual contracts; • testing correct periodisation of contract costs; • checking the formula used for calculation of revenue based on stage of completion; • investigating the estimates of margins during current and comparative periods applied for revenue calculation of the same contracts to identify potential management bias. We evaluated the correctness of disclosures in relation to the construction contracts. As a result of our work, we found no material exceptions.

Valuation of inventory relating to property developments (refer to Note 1 'Summary of significant accounting policies – subsection 1.11 'Inventories', Note 17 'Inventories' and Note 35 'Risk management' subsection 'value of assets' for further details).

As at 31 December 2017 the Group's balance sheet includes inventory in the amount of EUR 118.4 million, of which EUR 17.6 million were finished apartments, EUR 36.0 million unfinished apartments and EUR 63.6 million land purchased for development and resale (mostly with the aim of being developed as residential property).

Inventories are carried at the lower of cost and net realisable value.

With property prices, especially those of residential property, following the economic cycle and exhibiting substantial fluctuation over time, net realisable value of the inventory of finished and unfinished apartments and property for resale needs to be carefully monitored against the carrying amount. Should the net realisable value of a property fall below its carrying amount, a write-down to net realisable value is necessary. Determining the net realisable value of property requires estimates of the expected selling price and may require estimates of the cost to complete the development of the property.

Due to the magnitude and related estimation uncertainty, valuation of inventory of finished and unfinished apartments and land to be developed for sale is considered a key audit matter

We assessed the management's expertise to perform valuation of property. The management is experienced in property valuation and the outcomes of completed development projects have usually met the profitability estimates.

We evaluated the model prepared by the management for determining the net realisable value and identifying any necessary write-down. We validated that the valuation model is in accordance with IFRS requirements.

We performed testing of the inputs used in the valuation model. Our work targeted individual properties on our assessment of the risk, based on the location, carrying amount and any specific conditions related to a property. For inputs based on estimates, which include unit costs applicable for completing the construction and sales price, we assessed the reasonableness of the inputs by comparing them with historical data from completed projects and available market information such as construction price indexes. Where available, we compared the estimated sales prices with comparable market transactions.

It was evident from our work that sufficient attention had been paid to each property's individual characteristics including their construction quality, geographic location and relevant legal or contractual obligations.

We also read the disclosures provided in respect of net realisable value of inventory, including sensitivity analysis, and found them to comply with IFRS requirements.

We concluded that the assumptions used in the management's valuations were supportable in light of available property-specific and market evidence. As a result of our work, we noted no material exceptions.

How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises a number of subsidiaries that are further disclosed in Note 18. A full scope audit was performed by PwC Estonia or, under our instructions, by other PwC network firms for entities covering 92% of the Group's assets and 94% of the Group's revenues, and by an external independent audit firm covering 3% of the Group's assets and 0% of the Group's revenues. The remaining entities of the Group were immaterial, therefore we only performed selected audit procedures on these components relating to specified account balances or disclosures.

Where work was performed by component auditors from another PwC network firm or from an external independent audit firm, we determined the level of involvement we needed to have to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole. The nature, timing and extent of the work impacting the Group audit opinion is set and monitored in Estonia, with input from the teams outside Estonia at the risk assessment stage.

At the Group level we also audited the consolidation process. We also evaluated whether significant risk of material misstatement existed, using analytical procedures in relation to the aggregated financial information of the remaining entities not subject to audit or audit of specified account balances, including comparing their account balances to those present at the time of deciding the audit scope.

Other information

The Management Board is responsible for the other information contained in the Group's 2017 Consolidated Annual Report in addition to the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Management Board and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, the Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Appointment and period of our audit engagement

We were first appointed as auditors of AS Merko Ehitus, as a public interest entity, for the financial year ended 31 December 2008. Our appointment has been renewed by tenders and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for AS Merko Ehitus, as a public interest entity, of 10 years.

AS PricewaterhouseCoopers

Ago Vilu	Janno Hermanson
Certified auditor in charge, auditor's certificate no.325	Auditor's certificate no.570

27 March 2018

** 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

in euros

Total retained earnings as at 31.12.2017	**122,150,396**
incl. net profit for 2017	14,694,591

The Management Board proposes profit allocation as follows:

Dividends (EUR 1.00 per share)	17,700,000
Retained earnings after profit allocation	**104,450,396**

Andres Trink	Chairman of the Management Board	27.03.2018
Tõnu Toomik	Member of the Management Board	27.03.2018

OTHER NOTES TO THE ANNUAL REPORT

KEY FINANCIAL INDICATORS IN 2013-2017

CONSOLIDATED INCOME STATEMENT

in thousands of euros

	2017	2016	2015	2014	2013
Revenue	317,598	251,970	251,012	252,323	262,719
Cost of goods sold	(286,747)	(232,961)	(228,044)	(227,591)	(239,996)
Gross profit (loss)	**30,851**	**19,009**	**22,968**	**24,732**	**22,723**
% of revenue	*9.7%*	*7.5%*	*9.2%*	*9.8%*	*8.6%*
Marketing expenses	(3,215)	(3,281)	(3,230)	(3,190)	(3,041)
General and administrative expenses	(11,289)	(10,076)	(8,907)	(9,128)	(9,260)
Other operating income	3,793	2,466	1,943	1,901	2,264
Other operating expenses	(601)	(399)	(278)	(340)	(425)
Operating profit (loss)	**19,539**	**7,719**	**12,496**	**13,975**	**12,261**
% of revenue	*6.2%*	*3.1%*	*5.0%*	*5.5%*	*4.7%*
Finance income	4	46	120	143	84
Finance costs	(849)	(649)	(786)	(680)	(1,062)
Profit (loss) from associates and joint ventures	78	163	(138)	(130)	(138)
Profit (loss) before tax	**18,772**	**7,279**	**11,692**	**13,308**	**11,145**
% of revenue	*5.9%*	*2.9%*	*4.7%*	*5.3%*	*4.2%*
Corporate income tax expense	(3,020)	(1,275)	(1,857)	(1,055)	(791)
Net profit (loss) for the financial year	**15,752**	**6,004**	**9,835**	**12,253**	**10,354**
incl. attributable to equity holders of the parent	14,694	6,122	10,000	12,417	10,399
% of revenue	*4.6%*	*2.4%*	*4.0%*	*4.9%*	*4.0%*
Attributable to non-controlling interests	1,058	(118)	(165)	(164)	(45)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

in thousands of euros

	31.12.2017	31.12.2016	31.12.2015	31.12.2014	31.12.2013
ASSETS					
Current assets					
Cash and cash equivalents	39,210	33,544	39,905	51,583	46,633
Trade and other receivable	75,844	45,566	24,854	46,382	57,172
Prepaid corporate income tax	492	617	421	3	19
Inventories	118,421	123,364	109,090	117,638	87,451
	233,967	**203,091**	**174,270**	**215,606**	**191,275**
Non-current assets					
Investments in joint ventures	79	434	284	67	7,349
Other long-term loans and receivables	17,163	15,371	16,419	11,409	20,066
Deferred income tax assets	5	1,325	1,423	1,535	1,592
Investment properties	15,719	4,108	4,371	4,619	4,672
Property, plant and equipment	9,665	12,838	13,442	15,003	13,117
Intangible assets	497	673	879	1,011	1,167
	43,128	**34,749**	**36,818**	**33,644**	**47,963**
TOTAL ASSETS	**277,095**	**237,840**	**211,088**	**249,250**	**239,238**
LIABILITIES					
Current liabilities					
Borrowings	24,218	21,485	5,525	14,287	18,916
Payables and prepayments	74,972	56,259	43,266	71,122	72,162
Corporate income tax liability	413	278	711	352	62
Short-term provisions	4,569	5,637	5,013	6,239	5,906
	104,172	**83,659**	**54,515**	**92,000**	**97,046**
Non-current liabilities					
Long-term borrowings	35,138	24,516	25,660	23,359	16,469
Deferred income tax liability	1,259	1,122	788	738	505
Other long-term payables	1,789	2,061	1,159	1,671	2,162
	38,186	**27,699**	**27,607**	**25,768**	**19,136**
TOTAL LIABILITIES	**142,358**	**111,358**	**82,122**	**117,768**	**116,182**
EQUITY					
Non-controlling interests	4,567	3,692	3,268	4,455	1,193
Equity attributable to equity holders of the parent					
Share capital	7,929	7,929	7,929	12,000	12,000
Statutory reserve capital	793	793	1,200	1,200	1,200
Currency translation differences	(702)	(645)	(663)	(665)	(669)
Retained earnings	122,150	114,713	117,232	114,492	109,332
	130,170	**122,790**	**125,698**	**127,027**	**121,863**
TOTAL EQUITY	**134,737**	**126,482**	**128,966**	**131,482**	**123,056**
TOTAL LIABILITIES AND EQUITY	**277,095**	**237,840**	**211,088**	**249,250**	**239,238**

OTHER KEY FIGURES

attributable to equity holders of the parent

		2017	2016	2015	2014	2013
EBITDA	million EUR	22.2	11.2	15.5	16.4	15.1
EBITDA margin	%	7.0	4.4	6.2	6.5	5.7
General expense ratio	%	4.6	5.3	4.8	4.9	4.7
Staff costs ratio	%	10.1	11.7	12.2	11.9	11.8
Revenue per employee	thousand EUR	434	325	322	319	308
ROE	%	11.9	5.0	8.0	10.1	8.8
ROA	%	5.8	2.8	4.4	5.0	4.4
ROIC	%	11.4	5.1	7.9	8.8	8.0
Equity ratio	%	47.0	51.6	59.5	51.0	50.9
Debt ratio	%	21.4	19.3	14.8	15.1	14.8
Current ratio	times	2.2	2.9*	3.2	2.3	2.0
Quick ratio	times	1.1	1.1*	1.2	1.1	1.1
Accounts receivable turnover	days	40	37	39	56	58
Accounts payable turnover	days	40	38	39	39	43
Number of employees 31.12	people	757	797	791	765	860
Average number of employees	people	732	776	779	790	853
Secured order book	million EUR	344	270	247	179	214
New contracts signed	million EUR	335	202	247	170	254

** As at 31 December 2016, in the formula for calculating the current ratio and the quick ratio, the amount of current liabilities has been reduced by EUR 12.5 million as a result of refinancing of the short-term loan received from the parent company AS Riverito at the end of 2016 with long-term bank loans at the beginning of 2017. Additional information has been disclosed in Note 33 of the financial statements.*

SHARE-RELATED KEY FIGURES

attributable to equity holders of the parent

		2017	2016	2015	2014	2013
Earnings per share (EPS)	EUR	0.83	0.35	0.56	0.70	0.59
Equity per share	EUR	6.99	6.90	7.02	6.93	6.71
Dividend per share	EUR	1.00*	0.41	0.51	0.41	0.41
Dividend rate	%	120*	119	90	58	70
Dividend yield	%	11.4*	4.5	6.0	5.7	5.7
P/E ratio	times	10.61	26.17	15.01	10.18	12.25
P/B ratio	times	1.26	1.31	1.21	1.03	1.07
Share price trend						
Average	EUR	9.27	8.44	8.47	7.33	6.96
Highest	EUR	9.69	9.22	10.50	7.99	7.70
Lowest	EUR	8.75	7.60	7.06	6.70	5.71
Share price 31.12	EUR	8.81	9.05	8.48	7.14	7.20
Market value 31.12	million EUR	155.9	160.2	150.1	126.4	127.4
Share turnover trend						
Share turnover	million EUR	4.69	5.35	7.71	7.62	5.08
Transactions	pcs	2,203	2 312	2,829	1,699	2,183
Shares traded	million pcs	0.51	0.63	0.90	1.03	0.73
Ratio of shares traded	%	2.9	3.6	5.1	5.8	4.1
Number of shares	million pcs	17.70	17.70	17.70	17.70	17.70
Number of shareholders 31.12	pcs	2,040	1,813	1,624	1,423	1,425

** Pursuant to the Management Board's proposal regarding dividend payment.*

DEFINITIONS OF RATIOS

Gross profit margin (%)	=	Gross profit	Revenue
Operating profit margin (%)	=	Operating profit	Revenue
EBT margin (%)	=	Earnings before tax	Revenue
Net profit margin (%)	=	Net profit (attributable to equity holders of the parent)	Revenue
Return on equity, ROE (%)	=	Net profit (attributable to equity holders of the parent) of the current 4 quarters	Shareholders equity (average of the current 4 quarters)
Return on assets, ROA (%)	=	Net profit (attributable to equity holders of the parent) of the current 4 quarters	Total assets (average of the current 4 quarters)
Return on invested capital, ROIC (%)	=	(Profit before tax + interest expense - foreign exchange gain (loss) + other financial income) of the current 4 quarters	(Shareholders equity (average) + interest-bearing liabilities (average)) of the current 4 quarters
Equity ratio (%)	=	Shareholders equity	Total assets
Debt ratio (%)	=	Interest-bearing liabilities	Total assets
Current ratio	=	Current assets	Current liabilities
Quick ratio	=	Current assets - inventories	Current liabilities
Accounts receivable turnover (days)	=	Trade receivables of the current 4 quarters (average) x 365	Revenue of the current 4 quarters
Accounts payable turnover (days)	=	Payables to suppliers of the current 4 quarters (average) x 365	Cost of goods sold of the current 4 quarters
EBITDA (million EUR)	=	Operating profit + depreciation	
EBITDA margin (%)	=	Operating profit + depreciation	Revenue
General expense ratio (%)	=	Marketing expenses + General and administrative expenses	Revenue
Labour cost ratio (%)	=	Labour costs	Revenue
Revenue per employee (EUR)	=	Revenue	Number of employees (average)
Earnings per share, EPS (EUR)	=	Net profit (attributable to equity holders of the parent)	Number of shares
Equity/share (EUR)	=	Shareholders equity (average of the current 4 quarters)	Number of shares
Dividend per share (EUR)	=	Payable dividends	Number of shares
Dividend rate (%)	=	Payable dividends x 100	Net profit (attributable to equity holders of the parent)
Dividend yield (%)	=	Dividends payable per share	Share price 31.12
P/E	=	Share price 31.12	Earnings per share of the current 4 quarters
P/B	=	Share price 31.12	Equity per share (average of the current 4 quarters)
Market capitalisation	=	Share price 31.12 x Number of shares	
Ratio of shares traded	=	Number of shares traded during the year	Number of shares in total
Injury rate (per 100 employees)	=	Total number of injuries/accidents excluding minor (first-aid level) injuries/accidents x 200 000	Total number of working hours per year
Occupational diseases rate(per 100 employees)	=	Total number of occupational illnesses x 200 000	Total number of working hours per year
Lost days rate (per 100 employees)	=	Total number of lost days due to occupational illnesses/injuries/accidents x 200 000	Total number of working hours per year
Absentee rate per year	=	Total number of absentee days	Calculated number of total working days per year

REVENUE BREAK-DOWN OF THE PARENT PRESENTED ACCORDING TO THE ESTONIAN CLASSIFICATIONS OF ECONOMIC ACTIVITIES

Revenue break-down of the parent of AS Merko Ehitus for the year 2017 is presented according to Estonian Classifications of Economic Activities (EMTAK 2008), as required under the Commercial Code § 4 p.6:

in thousands of euros

EMTAK code		2017	2016
	Rendering of construction services		
4221	construction of utility projects for fluids	58	-
	Real estate activities		
6810	sales of own real estate	16,261	14,187
6820	renting and operating of own or leased real estate	112	75
		16,431	**14,262**
	Total revenue	**16,431**	**14,262**

SUSTAINABLE DEVELOPMENT REPORT

SUSTAINABILITY REPORTING PRINCIPLES

The Annual Report of Merko Ehitus group is prepared based on the international integrated reporting framework and the Global Reporting Initiative (GRI) "G4 Sustainability Reporting Guidelines". The purpose of the Annual Report is to provide a clear overview and description of how Merko Ehitus creates additional value to its customers, shareholders and other stakeholders, while highlighting the key factors of the value chain process. The Annual Report does not focus only on past events, but is more focused, through integrated reporting, on the horizon ahead. We aim to give the reader a better overview of the strategy, long-term objectives and sustainability of AS Merko Ehitus group as a whole.

Key economic, social responsibility and environmental aspects have been presented by using the integrated reporting principle, in the different sections and notes to the annual report.

For the above reasons, Merko Ehitus does not prepare a separate sustainability or social responsibility report. The last report on the above subjects was prepared for 2015. This section of the Annual Report provides a more detailed overview of the sustainability and social responsibility principles of Merko Ehitus group in accordance with the GRI G4 instructions. In preparing the report, Merko Ehitus has focused on the key subjects of the group companies, depending on the specifics of their business.

Further information on the internationally integrated reporting framework and GRI G4 can be acquired on websites www.integratedreporting.org and www.globalreporting.org.

STAKEHOLDERS

The Merko Ehitus group has mapped its primary stakeholder groups: Merko group employees, shareholders and investors, customers for construction service and apartment buyers, local government units and public organisations, cooperation partners, subcontractors and suppliers and the public. Stakeholders are mapped and selected based on the standpoint of both the company and the stakeholder, taking into account cooperation between the parties and the impact of the company on the stakeholder.

The primary principles for disclosure of information at Merko are continuity, neutrality, transparency, integrity and fairness and preventive approach. Various channels have taken shape for communicating with different stakeholders:

Employees	Everyday cooperation and communication with the company's colleagues and managers at various levels, annual performance reviews, company's website, Intranet and newsletter, company information days and other events, in-house trainings and social media.
Shareholders and investors	Stock market system and press releases, website section aimed at investors, investor meetings, materials and events.
Customers and apartment buyers	Everyday cooperation and communication in the course of the construction process, feedback from customers and satisfaction surveys, company's website, public communication. Additional communication channels for apartment buyers: apartment development project website and sales materials, sales director and, in the case of some projects, sales office, customer days, model apartment, social media, satisfaction surveys.
Partners in cooperation, subcontractors and suppliers	Everyday cooperation and communication in the course of the construction process, meetings and events, public communication.
Local governments and public organisations	Meetings, public communication.
Broader public	Social responsibility and support and cooperation projects, cooperation with different organisations, public communication, social media.

GRI CONTENT INDEX

General disclosures		Page	
STRATEGY AND ANALYSIS			
G4-1	CEO's statement	p. 6	
ORGANISATIONAL PROFILE			
G4-3	Name of the organisation	p. 2	
G4-4	Products, services and trademarks	p. 4	
G4-5	Location of organisation's headquarters	p. 2	
G4-6	Number of countries and location of operations	p. 4, 20, 73-75, 81-86	
G4-7	Nature of ownership and legal form	p. 4, 49-57	
G4-8	Markets served	p. 4, 18-19, 45-47, 73-75	
G4-9	Scale of reporting organisation	p. 4, 34, 45-47, 73-75	
G4-10	Basic information on employees	p. 34	
G4-11	Percentage of employees covered by collective bargaining agreements		Merko Ehitus group doesn't have general collective bargaining agreements, it complies with company-specific agreements in line with local legislation.
G4-12	Supply chain description		Merko Ehitus group companies use suppliers and subcontractors extensively in its operations in all of the countries it operates in. The materials used in construction come from an extensive network of suppliers located mainly in Europe, particularly in the group's current operating countries. Merko Ehitus group companies mainly act as general contractors hence the large extent of the workforce used in construction, with the exception of project management, comes from the subcontractor network. Subcontractors and their workforce are largely from the group's operating countries.
G4-13	Significant changes during the reporting period	p. 13-15, 45-47, 81-86	
G4-14	Addressing the precautionary approach in environmental issues	p. 32-33, 38-39	
G4-15	Voluntary charters and other initiatives		No significant commitments to voluntary charters and other initiatives.
G4-16	Memberships in associations		Merko Ehitus group companies are members in the following associations and organisations: Estonian Chamber of Commerce and Industry Estonian Association of Construction Entrepreneurs Estonian Waterworks Association Estonia Concrete Association Estonian Association of Electrical Enterprises Estonian Society for Electrical Power Engineering Estonian Asphalt Pavement Association Latvian Chamber of Commerce and Industry Latvian Partnership of Building Contractors Latvian National Real Estate Developers Alliance Latvian Construction Industry Digitalization Association Latvian Association of Civil Engineers Skanste Development Agency Lithuanian Builders Association
MATERIAL ASPECTS AND BOUNDARIES			
G4-17	Coverage of the report		The report covers all of the Merko Ehitus group's functions, unless otherwise mentioned.
STAKEHOLDER ENGAGEMENT			
G4-24	List of stakeholders	p. 125	
G4-25	Identification and selection of stakeholders	p. 125	
G4-26	Approach to stakeholder engagement	p. 125	
REPORT PROFILE			

G4-28	Reporting period	p. 2	The reporting period is the calendar year, January 1, 2017 – December 31, 2017
G4-29	Date of most recent previous report		The most recent previous integrated annual report was published on April 03, 2017.
G4-30	Reporting cycle		The report is published annually.
G4-31	Contact point	p. 2	Priit Roosimägi, Head of Group Finance Unit
G4-32	GRI Content Index	p. 126-130	
G4-33	External assurance		The GRI report has not been assured by a third party.
GOVERNANCE			
G4-34	Governance structure	p. 49-54	
ETHICS AND INTEGRITY			
G4-56	Organisation's values, principles, standards, norms of behaviour and codes of ethics	p. 7, 37-39	In addition to Merko Ehitus values, mission and vision, our operations are guided by management and business principles. These are included in the orientation of new personnel and also highlighted in various events and materials for personnel.
ECONOMIC RESPONSIBILITY			
Economic Performance			
G4-DMA	Management approach		Merko Ehitus group operations have an important economic impact on the surrounding society and the company's key stakeholders. Group employs a significant number of personnel and creates business for suppliers and subcontractors. Merko Ehitus business operations are long-term in nature, which is also reflected in the group's co-operation with stakeholders where possible, and stakeholders' economic stability.
G4-EC1	Direct economic value generated and distributed		See below

Direct economic value generated and distributed for stakeholders 2017 (2016)

Customers Revenue EUR 317.6 million (252.0)	**Suppliers** Materials and goods, EUR 60.3 million (49.1) External services EUR 186.4 million (145.1)	**Employees** 757 employees (797) Labour costs EUR 29.6 million (29.6)
	Investors Dividends EUR 7.3 million (9.0)	**Public sector** Corporate income tax expense EUR 3.0 million (1.3)

Merko Ehitus group approach to taxes
Group is committed to being a responsible taxpayer in all of its operating countries. It complies with local and international tax regulations, practices and interpretations, as well as requirements concerning tax returns and other documentation. Merko Ehitus group applies the market price principle pursuant to the OECD Transfer Pricing Guidelines and local transfer pricing regulations in the group's internal business transactions.

PAID* TAXES BY COUNTRIES
in thousands of euros

	2017	2016
Estonia	22,321	18,936
Latvia	4,108	2,976
Lithuania	2,382	1,138
Norway	649	632
Total	**29,460**	**23,682**

** Actually paid and not calculated tax amounts.*

PAID* TAXES BY TAX TYPES
in thousands of euros

	2017	2016
Value added tax	13,978	8,463
Taxes on employee wages and fringe benefits	12,563	12,893
Other taxes	1,667	898
Corporate income tax	1,252	1,428
Total	**29,460**	**23,682**

** Actually paid and not calculated tax amounts.*

Market presence			
G4-EC6	Proportion of management hired from the local community at significant locations of operation	p. 50-53	The management of the group takes place on a national basis, where managers are generally local and national citizens.
Indirect economic impacts			
G4-EC7	Infrastructure investments and services	p. 22, 39	
G4-EC8	Significant indirect economic impacts	p. 22, 23, 38, 39	
Procurement practices			
G4-EC9	Proportion of spending on local suppliers at significant locations of operation	p. 4, 75	The materials and services used in construction are generally from the local market or supplied from within the EU.
ENVIRONMENTAL RESPONSIBILITY			
Materials			
G4-DMA	Management approach		Operations in the construction business involve substantial use of construction materials. As such, the efficiency of the use of construction materials is also a significant cost issue that is given a lot of attention from that perspective in particular. Every construction project is unique, which makes it difficult to develop an unambiguous measure of material efficiency that would accurately reflect its true level. For this reason, material efficiency is monitored and managed on a project-specific basis. In addition to project-specific analysis, Merko Ehitus engages in more general development of design management and technical calculation practices from the perspective of material efficiency, focusing on aspects such as the optimisation of building structures and the selection of materials.
Energy			
G4-DMA	Management approach		Construction management is not particularly energy-intensive. Due to the project-intensive nature of Merko Ehitus group business, energy consumption can vary significantly from one period to the next. The company focuses on the energy-efficiency of its own operations particularly at the project and unit level by developing various energy-efficient working methods and replacing its vehicles and equipment as energy efficiency improves.
G4-EN3	Energy consumption within the organisation	p. 33, 38-39	AS Merko Ehitus group construction companies have been awarded environmental management system certificate ISO 14001. In addition, pursuant to EED 2012/27/EU, large companies have the obligation to regularly conduct an energy audit. In the Republic of Estonia, this obligation is governed by the Energy Sector Organisation Act, which entered into force in 2016 Merko's regular energy audits have been properly submitted and declared to be in conformity with requirements.
G4-EN4	Energy consumption outside of the organisation	p. 39	The energy consumption of AS Merko Ehitus outside the organisation is of local nature and complies with the principles of construction management – objects requiring more labour are mostly located closer to the place of residence of the workers, while the project management of smaller objects which are located farther from the main office is often led from the main office, thus reducing energy consumption, fuel consumption and CO_2 emissions. Buildings are designed in conformity with Regulation No. 55 of the Minister of Economic Affairs and Communications, which ensures the energy needed for the low heating of buildings. In the choice of building materials, we strive to reuse waste and materials located/produced in the local vicinity. The use of such options is largely project-based
Waste			
G4-DMA	Management approach		Significant amounts of waste are generated in the construction business. A particularly large volume of waste is generated when a construction site has existing buildings/facilities that are demolished to make way for new construction. Like materials and energy, the reutilisation of waste, reducing waste volume and recycling waste are cost-efficiency issues for Merko Ehitus group, and as such they are managed and developed on a project-specific and unit-specific basis. As a rule, Merko Ehitus group's construction sites sort the construction waste they generate and focus is placed on reducing the volume of waste. Waste that can be reutilised as material is reused depending on the local availability of reuse methods.

Compliance			
G4-DMA	Management approach		The risk of significant environmental damage is quite small in group's business operations, although local damage may be significant in cases such as fuel leaks. Merko's construction sites have established practices for avoiding and managing such risks. In addition to the prevention of actual environmental damage, Merko Ehitus group companies take also special protection measures in its construction projects to avoid negative impacts from construction on endangered species, for example. The assessment is very project-specific in these situations.
G4-EN29	Significant fines and sanctions for non-compliance with environmental regulations		No significant fines and sanctions for non-compliance with environmental regulations during the period.
SOCIAL RESPONSIBILITY			
LABOUR PRACTICES AND DECENT WORK			
Employment			
G4-LA1	Total number and rates new employee hires and employee turnover	p. 34	
G4-LA2	Benefits provided to full time employees	p. 37	
Occupational Health and Safety			
G4-DMA	Management approach		Occupational health and safety is one of the key responsibility aspects related to Merko Ehitus group's personnel, and it also creates the foundation for an employment relationship that is good in other respects as well. As the risk of occupational accidents is always present in construction business, the group places significant focus on the development of occupational safety. Over a period of several years, the company has created a very systematic approach to ensure occupational safety in particular, including personnel training, the development of operating methods, management engagement, as well as continuous reporting and monitoring.
G4-LA6	Rates of injury, fatalities and absenteeism	p. 35-36	
G4-CRE6	Coverage of internationally recognised health and safety management system	p. 33, 35-36	
Training and Education			
G4-DMA	Management approach		One of the material factors in the value creation in Merko Ehitus business operations is personnel competence and its development. Regular and high-quality performance and development discussions create a strong foundation for competence development at the group. They are used to monitor the development of personnel and provide encouragement at the individual level. The response to competence development needs includes coaching programmes aimed at all personnel groups, training, seminars and other development methods.
G4-LA10	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	p. 36-37	
G4-LA11	Employees receiving regular performance and career development reviews	p. 35	
Labour practices Grievance Mechanisms			
G4-LA16	Number of grievances about labour practices filed, addressed, and resolved through	p. 35	
SOCIETY			
Local Communities			
G4-SO1	Percentage of operations with implemented local community engagement, impact assessments, and development programs	p. 9-10, 39-41, 125	

G4-SO2	Operations with significant actual and potential negative impacts on local communities	p. 39-41, 125	
Anti-corruption			
G4-DMA	Management approach		Group does not tolerate any form of corruption. Group's core values include ethical business practices, which are an important success factor in the long run. Merko Code of Ethics is complied with throughout the group companies. There is a general communication channel set up for anonymously reporting suspicions of illegal activity in the various languages spoken in group's operating countries.
G4-SO4	Communication and training on anti-corruption policies and procedures	p. 37-38	Merko continuously provides training and orientation to its personnel on the prevention of corruption and other illegal operating practices. The content and scope of the training depends partly on the role of the persons concerned.
G4-SO5	Confirmed incidents of corruption and actions taken		There were no confirmed incidents of corruption in 2017. In addition to the prevention of corruption, Merko Ehitus group has a principle of investigating all suspected cases of misconduct and deciding on further action based on the results of the investigation.
Political contributions			
G4-SO6	Contributions to political parties and related institutions		Merko Ehitus group does not support any politicians, political parties or other political institutions.
PRODUCT RESPONSIBILITY			
Customer satisfaction			
G4-PR5	Results of surveys measuring customer satisfaction	p. 27, 29	