elering

GENERATING OPPORTUNITIES

Annual Report **2011**

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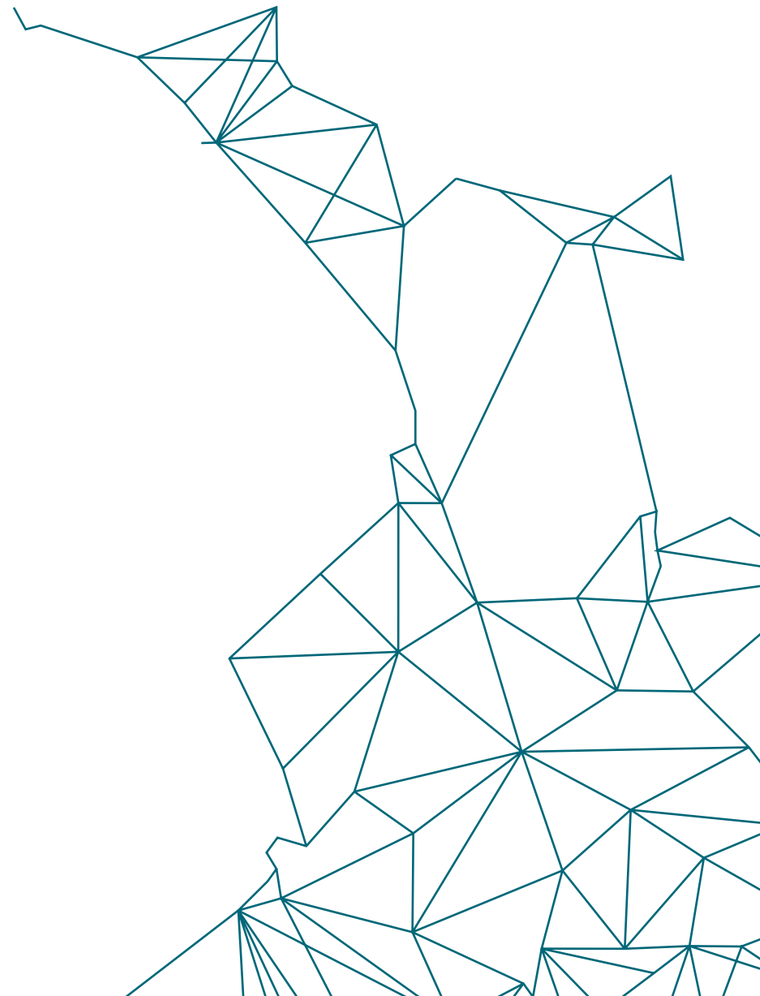


Management Report of Elering's Annual Report

Taavi Veskimägi
Chairman of the Management Board

Statement by the Chairman of the Management Board

Elering has become the competence centre of the Estonian energy sector

Availability of electricity at any time is vitally important to the modern society. Since Elering is the company responsible for supplying the Estonian consumers with electricity, our entire activity is subject to higher expectations and attention.

As of the end of 2011 Elering had been operating as a separate system administrator independent from other market participants for about two years. This has meant close cooperation with the Estonian state as the owner of the company aimed at designating strategic choices of the Estonian energy sector and ensuring competition and equal treatment in the electricity market. In addition to that, this period of time saw the making of major and important investment decisions aimed at improving security of supply and more effective functioning of the electricity market. These two years showed that separating the electricity system operator and the main network owner was the right choice – we are developing and managing the Estonian electricity system based on the public interest. This is the policy and direction of entire Europe, which has successfully started in 2009 with the so-called Third Energy Package.

We can be successful in our everyday work aimed at development of the electricity network and the electricity market only if we engage as much competence as possible in our activities, and share it with our partners, general public and interest groups. This doesn't only mean application of high standards to our personnel policy, but also continuous cooperation with all the institutions and organisations that contribute to the Estonian energy sector. In 2011 we launched our energy sector competence centre, in which we engage the experts through the Advisory Council for Electricity Market and Advisory Council for Developing the Estonian Electricity Network that regularly work together.

We also closely cooperate with supranational partners within the framework of the European Union Energy and Climate Policy in the same open manner. A number of events of global significance happened in the previous year, making work of the system administrators who manage and develop the electricity systems throughout the entire Europe more challenging than ever before. The nuclear disaster that happened at Fukushima put safety of the nuclear energy under question, and the resulting decision by Germany to close a number of nuclear plants meant that the risks of the lack of security of supply and production capacity increased as in Germany, so in its neighbouring states.

The expiry of the Kyoto protocol in 2012 highlighted the issue of sustainability of the EU's Climate Policy. The International Durban Climate Change Conference demonstrated that most states support the move towards legally binding agreements concerning restrictions on greenhouse gas emissions. As the result of the Conference the Kyoto protocol was extended, which means that even some big economies will have to start reducing greenhouse gas emissions for the first time. The same goal is established by the European Commission's Energy Roadmap 2050, which shows the EU's strong determination to continue with the ambitious policy aimed at reduction of CO2 emissions. We must be able to take these principles into consideration already now, as we plan management of the energy sector.

One of the cornerstones of ensuring security of the electricity supply is the functioning of the free electricity market. The vision of the EU's energy sector to unite the electricity markets into one competitive and effectively functioning market serves the interests of the both producers and consumers – the effectively functioning electricity market increases competition, brings more balanced price levels, and creates opportunities for electricity trade in a much larger market. In the light of that it feels good to mention that Nord Pool Spot electricity exchange was successfully launched in Estonia, and that both reliability of the marketplace and volumes of trade increased in 2011. The next important milestone on the way towards better development of the market is its full opening for all Estonian consumers from the beginning of 2013.

The first step towards real competition in the Northern Baltic region is ensuring strong electricity connections; and investments into the cross-border connections constitute a significant part of Elering's investment activities. The passing year clearly demonstrated how powerful interstate connections serve the interests of the producers and consumers. The second undersea cable between Finland and Sweden FennoSkan 2 that was put into operation in the middle of November, created a better access to the Scandinavian hydroelectricity for our consumers, which contributed to the fact that the open market electricity price for home consumers in December was basically the same as the price of the regulated market. Also, we put a cornerstone to the second Estonia-Finland connection EstLink 2, which means that in a few years there will be even fewer obstacles to the access to electricity of the Nordic States.

In 2011 we also successfully progressed with other Elering's large-scale investments. We started construction of the emergency reserve power plant which will considerably increase security of electricity supply. At the same time we started with the first stage of constructing of the Tartu-Viljandi-Sindi high voltage line and concluded the cooperation contract with county governments to construct the high voltage line between Harku-Lihula-Sindi. Completion of those lines will considerably improve Estonia's security of supply and will create preconditions for connection of additional high capacities to the network. This is an important stage of the long-term process as the result of which the Baltic States will be connected to the Central-European frequency bands and desynchronised from Russia.

A large contribution to development of the infrastructure will hopefully come from the energy infrastructure modernisation package amounting to 9.1 billion euros, that was approved by the European Commission at the end of 2011. Elering sees the creation of the third connection between Estonia and Latvia as one of the possible projects that can be executed within the framework of the package. The co-financing would speed up building of new connections and integration of the Northern Baltic electricity markets, reducing the pressure to increase transmission tariffs. The third Estonia-Latvia connection together with the realisation of other projects concerning the plan for integration of the regional electricity markets of the Baltic area (BEMIP), such as EstLink 2, Lithuania-Poland and Lithuania-Sweden connections, would create strong preconditions for more effective integration of the Baltic States into other European electricity networks and markets.

Last year the foundation for another important direction of the Estonian energy sector was laid under the leadership of Elering – liberalisation of the gas market. In cooperation with Pöyry Management Consulting (UK) Ltd company Elering prepared the report on development of the gas market in Estonia, which is the first thorough analysis of the Estonian gas market. The conclusion of the report was that development of the gas market should result in security of supply, emergence of the effective gas market and more correct price of gas in Estonia. In the light of that and based on our experience as the independent electricity system administrator we consider that it would be right to focus on creation of the independent natural gas transmission network operator and the effective market, as well as ensuring complete security of supply.

Next year we will continue moving towards those goals – through rational investment decisions, development of the electricity market and systems, gathering and sharing competence related to the energy field, and reasonable and economical management. The A3 rating with a stable outlook given to Elering by Moody's rating agency further strengthens confidence in our reliability and independence, as well as in attainability of our goals.

Enjoy your reading!

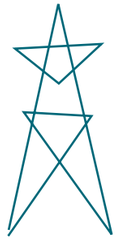
Taavi Veskimägi
Chairman of the Management Board

Brief overview of Elering

Elering is an electricity system operator that manages the Estonian electricity system in real time and is responsible for its functioning. Our goal is to ensure supply of high quality electricity to our customers at all times. For this purpose we are creating conditions for functioning of electricity market and building cross-border interconnections.

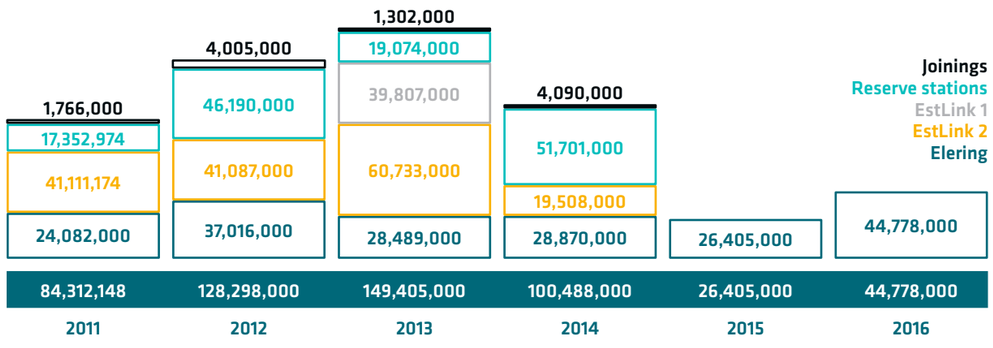
150
substations

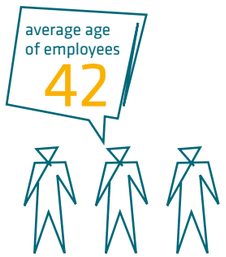
Cross-border interconnections with Finland, Latvia and Russia



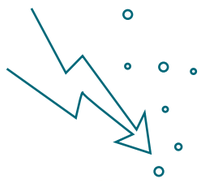
5,252
km of high-voltage overhead and cable lines

Distribution of Elering's investments 2011-2016 (EUR)





146
employees



350
MW of capacity of EstLink 1 cable connection between Estonia and Finland

VISION 2020
Elering's vision is to create wider and more efficient options for energy supply for both energy consumers and suppliers.

MISSION 2020
Elering's mission is to ensure the security of the electricity supply to Estonian consumers at any given time.

Our values are:
RESPONSIBILITY – EQUALITY – DEDICATION

Responsibility, which includes both our obligation to supply the Estonian people with electricity, and development and management of the Estonian electricity system.

Equality, which we follow as during creation of electricity market conditions, so during everyday communication with all participants of the energy market.

Dedication characterises our entire activity which is aimed at development of the company and at achievement of goals assigned to us by the state.

Financial figures (MEUR)

	2011	2010	2009	2008/09*	2007/08*
Revenue	**94**	89	76	82	76
Operating profit	**29**	21	20	25	24
Income tax	**0**	0	8	0	0
Net profit	**21**	14	5	18	17
Equity	**190**	160	141	176	158
Assets	**486**	419	368	355	335
EBITDA	**50**	44	40	44	44
Investments	**78**	27	31	39	14
Dividends	**0**	0	31	0	0

Financial ratios

ROE	**11.7%**	9.0%	6.2%	10.5%	11.0%
Equity/Assets	**39%**	38%	38%	49%	47%
Net borrowings/EBITDA	**4.0**	3.3	4.7	3.1	3.3

** Financial year from April until March*

Net borrowings = interest-bearing liabilities – cash and deposits
EBITDA = operating profit + depreciation

$$ROE = \frac{\text{Net profit}}{\text{Average equity}}$$

Key indicators of the Estonian electricity system

Electricity balance (GWh)

	2011	*2010*	*Change %*
Electricity output in Estonia	**11,387**	**11,321**	**1%**
Electricity output directed to Elering's network	11,179	11,126	0%
Output of renewable energy in Estonia	1,159	867	34%
Electricity output directed to network from cross-border lines	**1,499**	**1,729**	**-13%**
· incl. electricity output directed to network from Finland	460	233	97%
· incl. electricity output directed to network from Latvia and Russia	1,039	1,496	-31%
Total electricity output directed to network	**12,886**	**13,050**	**-1%**
Electricity consumption in Estonia	**7,824**	**8,006**	**-2%**
Elering's domestic transmissionservice for consumption	7,261	7,431	-2%
Elering's network losses	356	381	-7%
Electricity transmission to cross-border lines	**5,062**	**5,044**	**0%**
· incl. electricity transmission to Finland	1,734	2,065	-16%
· incl. electricity transmission to Latvia and Russia	3,328	2,979	12%
Total electricity output transmitted through network	**12,886**	**13,050**	**-1%**
Balance	**3,563**	**3,315**	**7%**

Decrease in electricity consumption in 2011 was caused by winter period during the year's first and last quarters, which were warmer than average. Therefore consumption of electricity in 2011 fell back to the level of year 2006.

Cross-border electricity trade (GWh)

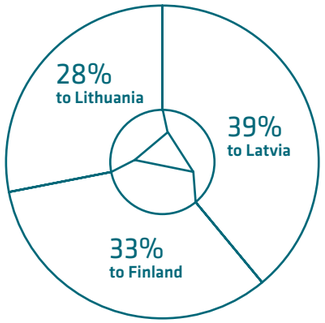
	2011	*2010*	*Change %*
Total imports	**1,627**	**1,338**	**22%**
incl. trade between Estonian-Latvian border*	1,126	1,082	4%
incl. trade between Estonia and Finland	501	256	96%
incl. imports through electricity exchange	1,053	533	98%
incl. imports based on bilateral agreements	574	805	-29%
Total exports	**5,172**	**4,663**	**11%**
incl. trade between Estonian-Latvian border*	3,475	2,672	30%
incl. trade between Estonia and Finland	1,697	1,992	-15%
incl. exports through electricity exchange	3,769	2,249	68%
incl. exports based on bilateral agreements	1,403	2,414	-42%
Balance	**3,545**	**3,325**	**7%**

* *Export and import volumes at Estonian-Latvian border comprise supplies of electricity trade of Estonia-Latvia and Estonia-Lithuania. Cross-border electricity trade balance does not include system imbalance and cross-border regulation of supplies. Cross-border electricity trade balance comprises Balance providers` deliveries and delieveries stated by the power exchange operator.*

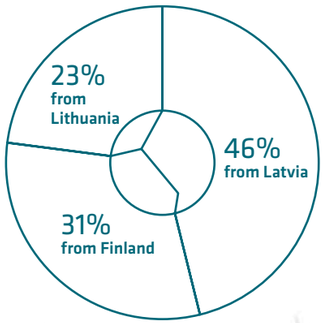
Electricity balance of the Nordic States from the summer period of 2011 has been characterised by increase in electricity production caused by the rise of levels in hydro-reservoirs, which in turn stimulated import of electricity from Finland to Estonia – in 2011 the amount of electricity imported from Finland was approximately two times bigger that in 2010.

In 2011 energy trade export to Latvia and Lithuania increased approximately one third.

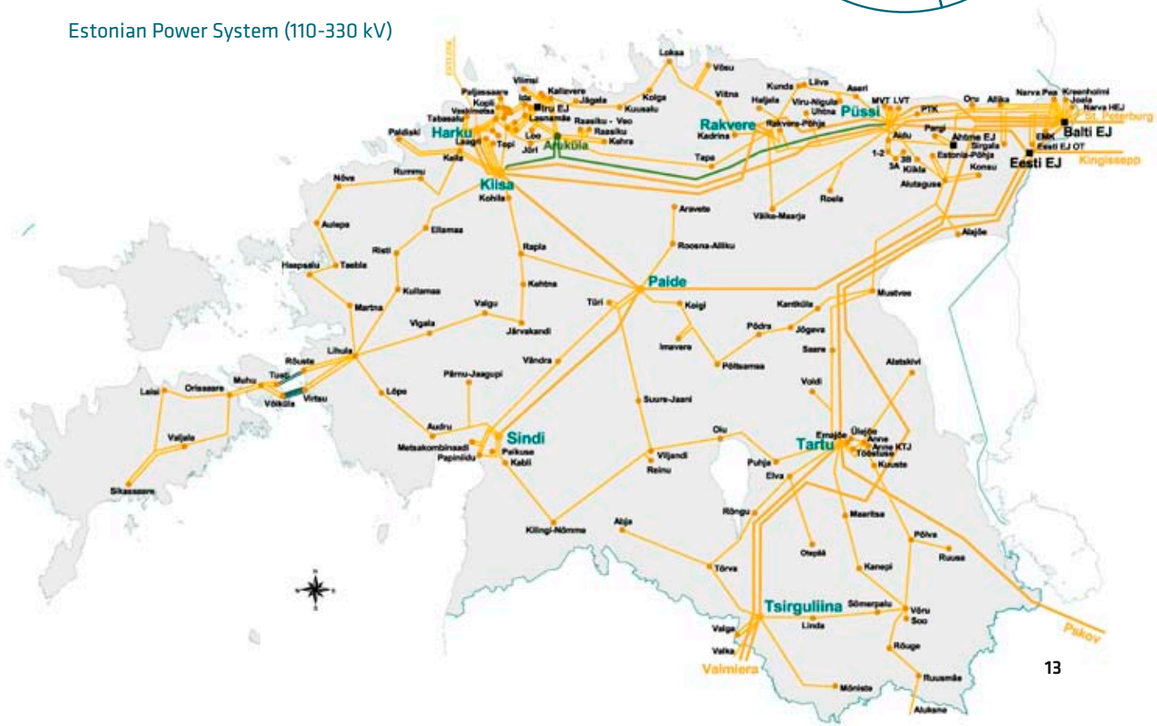
Export in 2011

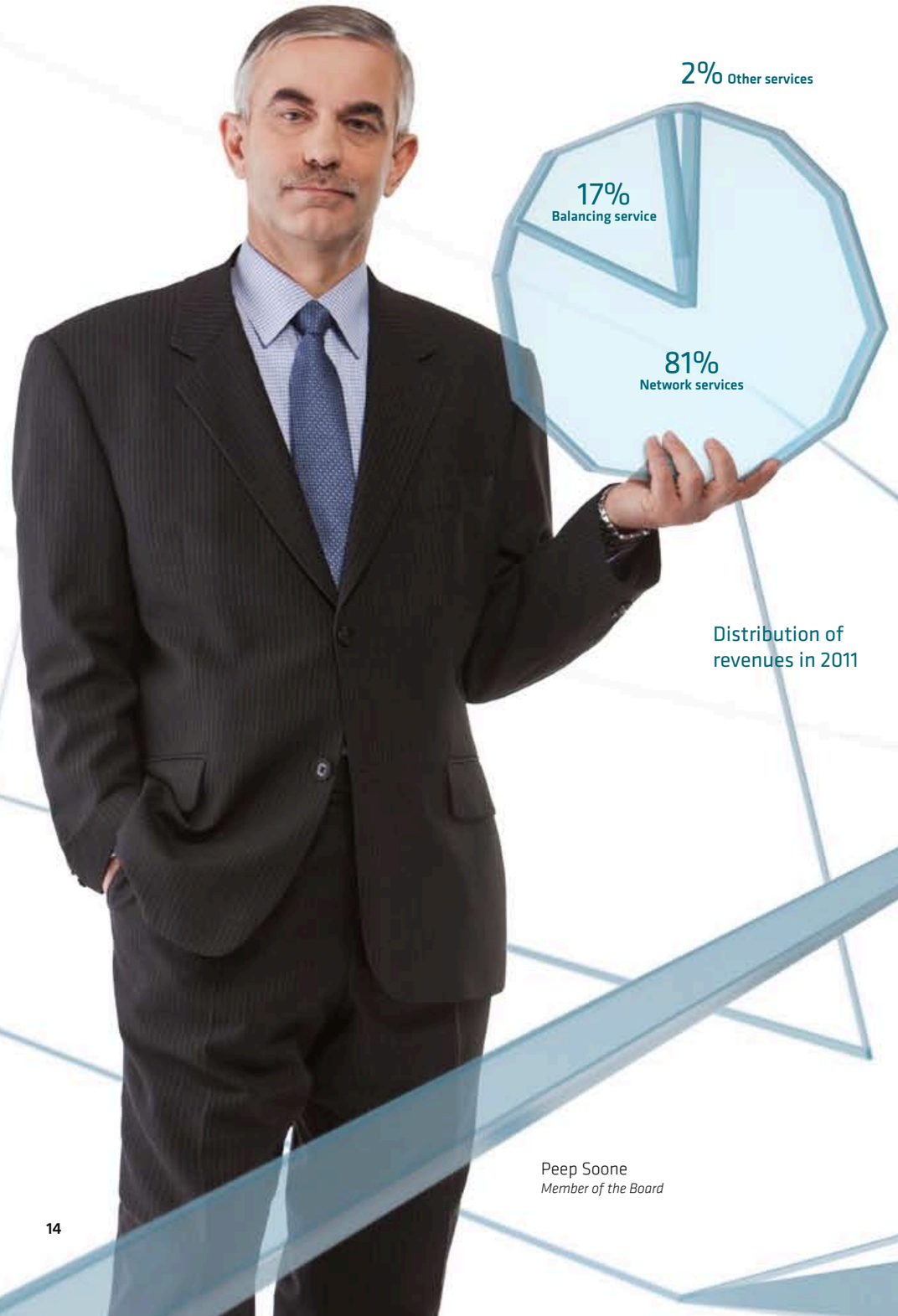


Import in 2011



Estonian Power System (110-330 kV)





Distribution of revenues in 2011

Peep Soone
Member of the Board

Summary of the Financial Year

We base the financial management of our company on the principle of conservatism, which allows us to ensure financing of large-scale investment programs and to achieve reasonable return on investment for the owner - the Republic of Estonia.

Macroeconomic environment

Changes in electricity consumption to a large extent depend on climate and, in a situation where the prices of energy grow, increasingly on possibilities for energy saving, as well as on general macroeconomic environment.

In the previous year there was a growth in the EU's economy as a whole. The European Commission estimates that the overall growth of the EU's economy in 2011 will constitute 1.5% and in the years 2012 and 2013 – 0.5% and 1.3% respectively. According to preliminary estimates of Statistics Estonia, in 2011 Estonia's economic growth reached 7.5%. For the years 2012-2015 Ministry of Finances estimates that Estonia's economic growth will constitute 3-3.5%. Therefore, despite the changing external environment, Estonia's prospects for the forthcoming years are good.

7.5%
Estonia's economic growth in 2011

In 2011 Estonia's financial and economic position received positive estimates from different rating agencies, which again proves reliability of Estonia's financial and economic policy and stability of the country's investment environment. In December 2011 Moody's rating agency confirmed that Estonia's state rating remained at a high A1 level, having stayed close to this position since the end of 2002. This rating is two degrees higher than Elering's long-term issuer rating of A3. According to the agency, the main factors that contributed to Estonia maintaining this rating were adoption of euro in difficult economic conditions, exceptionally low level of debt carried by the state and stable high budget discipline which was followed even during recession period. Standard & Poor's raised Estonia's state rating to AA- level in August 2011 and in January of this year it confirmed this rating again. The agency estimates the rating's perspectives as negative, with the main risk being the possibility that the economy of Europe and the Eurozone may weaken.

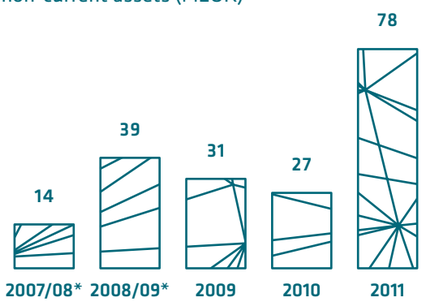
Investments and financing

For Estonia and Elering the start of 2011 marked with the adoption of euro. The transition turned out to be successful as technically so essentially, all systems functioned smoothly and without malfunctions from the first days of January. The adoption of euro contributed to strengthening of Elering's financial reliability in the eyes of international investors.

For Elering the year 2011 also marked the beginning of an intensive investment period. While historically Elering's investments on average amounted to around 30 million euros a year, the previous year gave a start to a four-year period during which the average amount of investments constitutes around 100 million euros a year. One of Elering's most important achievements was improvement of the company's financial reliability in 2011 for the purpose of acquiring additional capital for larger investments.

100 million euros – average amount of investments per year

Investments into non-current assets (MEUR)

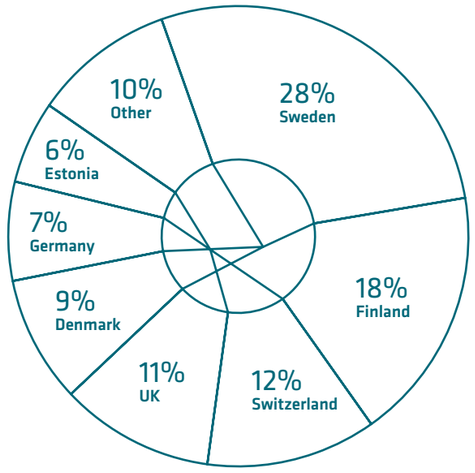


** Financial year from April until March*

The most suitable form of acquisition of long-term borrowing capital was the Eurobond market. The international rating agency Moody's gave Elering a long-term issuer credit rating A3/Stable, which demonstrated to potential investors the high credit value of the company. The bonds were quoted on the London Stock Exchange to demonstrate the open and transparent nature of the company's activities, as well as its equal treatment of all investors. The issue of bonds was successful despite a difficult situation in financial markets caused by the problems of Greece. The issue was oversubscribed 1.45 times and the volume amounted to 225 million euros. There were 52 investors from fourteen countries.

At the beginning of summer 2011 Elering successfully issued Eurobonds

Geographic distribution of Eurobond investors



At the beginning of summer of 2011 Elering successfully issued Eurobonds. The bonds were used for refinancing a syndicate loan amounting to 187 million euros. Initially the loan was due to be repaid in December 2012, which would be right in the middle of the company's intensive investment period. Taking into consideration the problems emerging in the global financial markets, it was necessary to exclude the situation where borrowing capital had to be found quickly under potentially unfavourable conditions of the market.

In 2011 the Republic of Estonia as Elering's owner increased the share capital of the company by 9.89 million euros, by the issue of new common shares. The purpose of increasing the share capital was to strengthen Elering's balance sheet in the light of the forthcoming investments and loans taken for their financing. As a result of issue of the shares Elering's new share capital amounts to 149.89 million euros, which, according to the estimate of the management is sufficient for the entire five-year investment period.

Results of operations

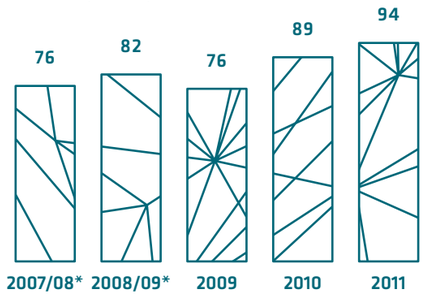
In 2011 Elering's revenue was 94.4 million euros (in 2010 – 90 million euros). The main part of it came from the sale of network services – 76.9 million euros (in 2010 – 70.7 million euros), which constituted 81% of the total income. Elering provided network services to the power plants, distribution network operators and large consumers. The main reason for increased revenue was the correction of network fees, which was done taking into account investments into the regulated assets.

Although the year 2011 was successful for Estonia's economy as a whole, transmission of electricity for domestic consumption decreased by 2%. The main reason for that was exceptionally warm weather in the heating period, during which due to the Estonian climate the consumption of electricity for heating and lighting is at its highest. During all those months of 2011 the average air temperature was higher than the year before.

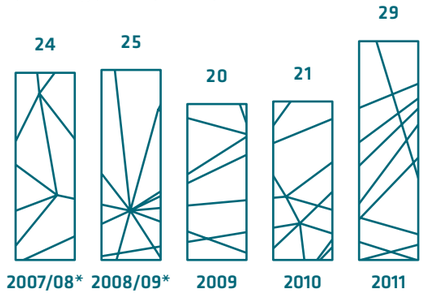
The second-largest group contributing to the revenue was the balancing service – 15.6 million euros (in 2010 – 15.8 million euros). The operating expenses totally amounted to 65.8 million euros (in 2010 – 68.2 million euros) and operating profit constituted 28.6 million euros (in 2010 – 20.8 million euros). Net finance expenses totally amounted to 8.1 million euros (in 2010 – 7.2 million euros) and the net profit was at a record high – 20.5 million euros (in 2010 – 13.5 million euros).

By the end of the year Elering's assets amounted to 486.3 million euros (by the end of 2010 – 419.4 million euros), having increased by 66.9 million euros mainly due to investments into non-current assets. As for liabilities, a 3-year syndicate loan was refinanced with 7-year bonds. The equity increased by 30.4 million euros, out of which the increase of share capital constituted 9.9 million euros, and the annual net profit constituted 20.5 million euros. The balance sheet at the end of the year is characterised by strong capitalisation and good liquidity, which creates good preconditions for carrying out investments in the forthcoming years.

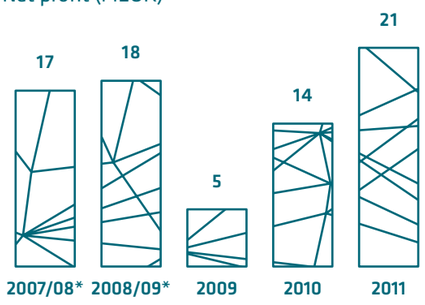
Revenue (MEUR)



Operating profit (MEUR)



Net profit (MEUR)



** Financial year from April until March*

Kalle Kilk
Member of the Board

Development of the electricity network in 2011

It is important to secure electricity supply as today, so in the future. Therefore, Elering makes all decisions related to development of the electricity network carefully considering the long-term perspective and making investments into the network's reliability and development of connections.

The year 2011 saw a rapid growth of the monetary amounts of Elering's investments compared to the previous years. During that year approximately 78 million euros was invested, while the average amount of investments in the previous years was around 30 million euros.

Ca 78 million euros were invested during a year

Eight large investment objects are finalised

In the previous year building of 8 large electricity network investment objects was completed. Four of them were related to connection of the customers, three were related to renewal of Elering's electricity network and one was related to increase in transmission capacity of the grid. Although only tried and true technical solutions are used during building of electricity network, we are still aiming at reducing the costs and simplifying technical solutions by applying minor changes. This in turn helps us to make the electricity network more reliable.

The most innovative object of 2011 was the renovated Loksa substation, where instead of a regular 110 kV switchyard with circuitbrakers and disconnectors a compact Compass switchgear was installed. Such type of switchgear requires less space and time for installation, less material during construction and fewer subsequent operational expenses. At the same time measuring transformers with SF6 insulation were installed at a few substations. Such transformers have a number of advantages over transformers filled with oil, mainly due to the possibility of unidentified leaks in the latter transformers that may cause dangerous malfunctions. We also used innovative tube towers during building of Tartu-Sindi power line, which are installed faster and are more looting-resistant than lattice towers.

Smaller grid renovation work included improvements of overhead transmission lines that help to reduce the number of power outages. Partial renovation of the lines included 100 km of lines with replaced worn shielding wires, 130 km of lines with replaced insulators and 180 km of lines with installed bird barriers on towers for prevention of accumulation of dirt and appearance of flashovers on insulation.

In the previous year we made a great step ahead with large-scale investments

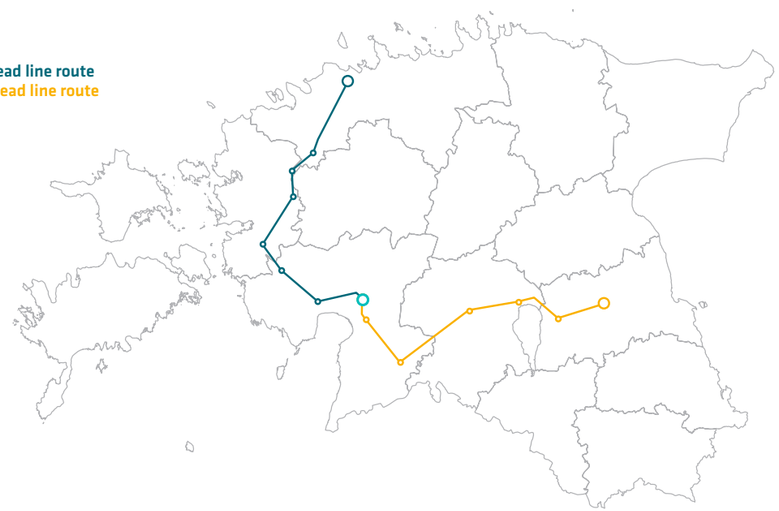
In addition to numerous completed investments in 2011 we prepared a foundation for building of further facilities and carried on working on the objects construction of which had already started.

Construction of the emergency reserve power plant
With respect to one of Elering's largest investments – the emergency reserve power plant – in 2011 we completed preparation work, organised tender for building and signed a building contract amounting to around 130 million euros with Wärtsilä Finland Oy. According to the survey ordered by Elering, the best place for construction of the power plant is the area of the 330 kV Kiisa substation.

The plant will be built in two stages – the first unit will be put into operation in spring of 2013, and the second one – in autumn of 2014. The purpose of the emergency reserve plant is to secure supply of electricity to the customers in case of unforeseen emergency incidents in the power system. The plant will not produce electricity on a daily basis and will not participate in the electricity market. The plant will be started only if it will be necessary to ensure supply of electricity to the customers in case of outages of interconnections or production units. Capacity of the new plant amounts to one sixth of maximum load in Estonia, which means that in case of an emergency it would be able to satisfy a large part of Tallinn's electricity consumption needs in winter. The plant can be run on light fuel oil and natural gas, and the storage tank for liquid fuels that is being built at the spot will ensure sufficient availability of fuel even in the most extreme circumstances.

Second cable connection EstLink 2 between Estonia and Finland
With respect to the second major investment which is the direct current cable connection EstLink 2 between Estonia and Finland, just before the end of the start of 2011 most of design work was completed as the first step of execution of the signed building contract. Nexans cable factory started to make the 145 km long undersea cable, and carried out a number of cable type tests with a cable test piece in order to ensure that it meets all the respective requirements. Cable installation work is planned for 2012. Civil works have already been started and the project corner stone has been laid at converter platforms, one of which is located in Estonia in Püssi and the other in Finland in Anttila. The converter substations will be ready by the end of 2013 and following the designated testing period the entire direct current connection will start to operate in the electricity market at the beginning of 2014. EstLink 2 will triple connection capacity of electricity systems between Estonia and the Nordic States, and it will play an important role in securing electricity supply to consumers and in functioning of the electricity market in Estonia.

Harku-Lihula-Sindi overhead line route
Tartu-Viljandi-Sindi overhead line route



New high voltage line connecting Tartu, Viljandi and Sindi
Construction of the new 330 kV high voltage line stretching from Tartu through Viljandi to Sindi went according to the plans, and the first 28 km-long part of the line from Tartu to Puhja was completed and put into operation in August. In addition to that most of the work on the part of line from Puhja to Oiu substation was completed. In addition to the impact of the environment, building of the high voltage lines is often hindered by failure to come to agreement with land owners. Nevertheless, so far the given investment object has been executed according to the desired speed despite numerous disagreements with the land owners, which at times even resulted in legal disputes. After the new line from Tartu to Sindi will be ready, we plan to continue building the line from Sindi to Tallinn.

Building of Harku – Lihula – Sindi high voltage line
In order to build a new 330 kV Harku – Lihula – Sindi line, on 12 October 2011 Elering concluded a co-operation agreement with county governors of Harju, Lääne and Pärnu counties for planning location of a line route going through three counties. According to the agreement, the parties will be co-operating in the course of preparation of thematic plans "Specification of Location of Harku-Lihula-Sindi 330/110 kV overhead line route" that specify plans of the given counties, as well as in the course of strategic assessment of environmental impact related to the respective line route. Completion of the high voltage line will improve stability of electricity supply in the entire continental part of Estonia, especially in its Western part and the Tallinn area. Completion of the line will make it possible for new environmentally-friendly electricity producers to connect to the network, which will disperse production of energy within Estonia. The new electricity connection is also important for development of the electricity market between the Baltic States and Central Europe with Scandinavia. We plan to announce the tender for building in 2016, and the line should be commissioned in 2019.

Renovation of substation of Eesti Power Plant
One of the current projects that are most important for Estonian energy industry is the renovation of the substation of Eesti Power Plant. This substation has been serving as the network connection point of the largest local power plant, and as one of the transit centres of vital importance for security of electricity supply in Estonia. By developing the main network we do try to reduce the importance of such individual centres, however it will undoubtedly continue to play an important role in the future already given the mere fact that new additional units of the oil shale power plant are being built at Eesti Power Plant, which will also be connected to the renovated substation in a few years. As a part of the renovation in 2011 we organised the tender, concluded the contract and started building work with the aim to complete by 2013 one connection point for Eesti Power Plant's oil shale unit and one connection point for gas turbine for burning char gas that is generated as one of side products of production of shale oil.

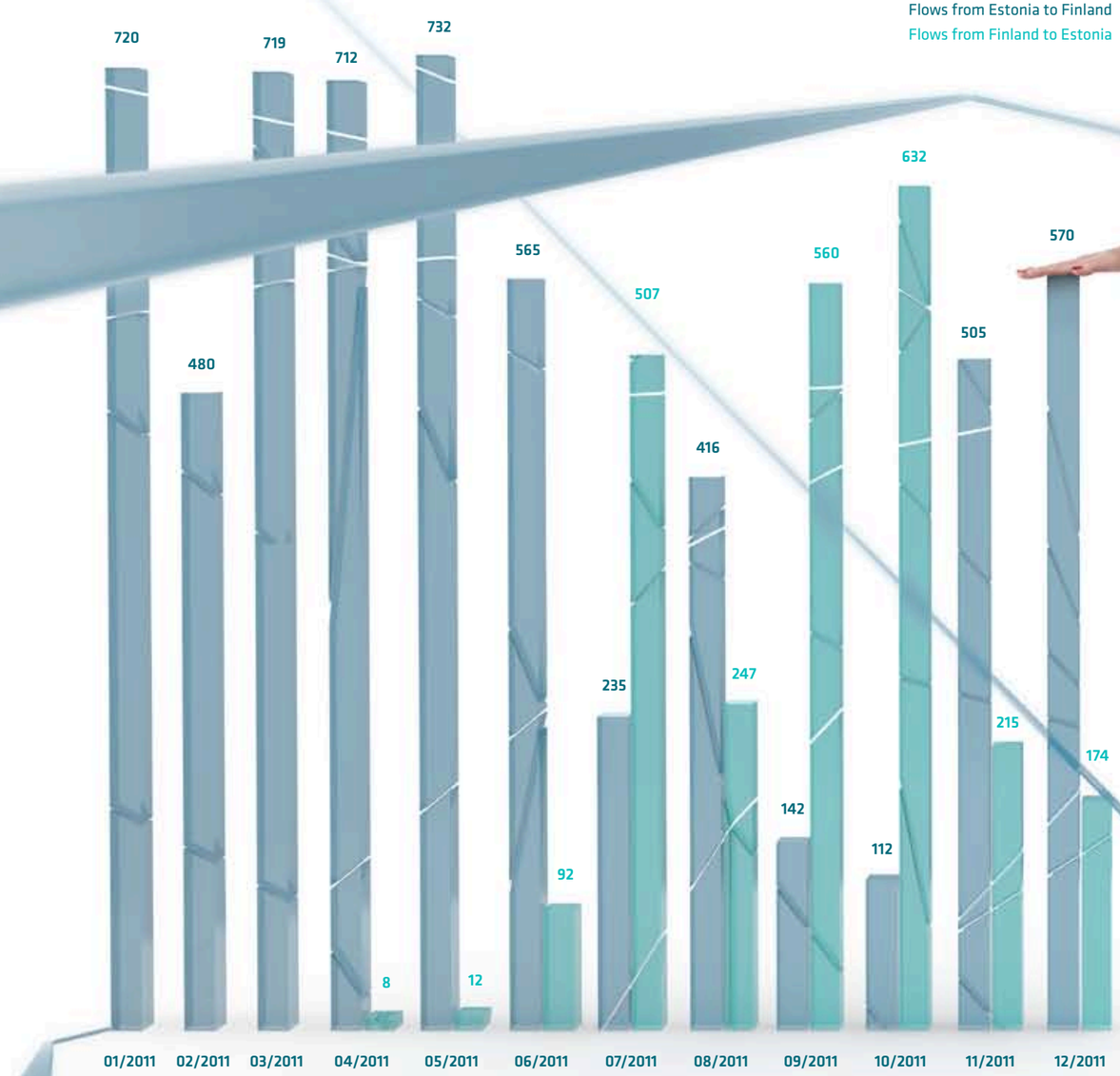
Reliability of the electricity network is constantly monitored

In addition to activities related to development of the network, it is also important to the customer receiving network services that reliability of the available network is maintained at a good level. With this respect the year 2011 was a year of learning and revising the learnt. For example, as a result of active building in towns, Elering's cable lines got damaged, which lead to power supply interruptions and monetary damages. In addition to that, in 2011 electricity lines were damaged more often than normally by thunders and storms. This was the reason why in 2011 the expenses on unscheduled and emergency maintenance work were higher than usual.

Elering pays a lot of attention to maintenance of line routes and removal of the trees from lines' protection area that may fall on the lines.
The widht of protection area for power lines is fixed by a decree however in reality the line corridors are often narrower than the protection area. In 2011 we removed approximately 230 ha of forest in order to widen the space of line corridors. As a result of that the part of the line corridors with the voltage of 330 kV where the lines are protected from the trees that may fall on them from the protection area was extended by approximately 100 km. Cleaned protection area of 110 kV lines was extended by approximately 30 km. Nevertheless, there are still quite many places where it was not possible to widen the route to the width of a protection area. With this respect it is very important to maintain effective communication with the land owners, without whose agreement it is not possible to widen the routes.

Elering pays a lot of attention to maintenance of line routes

Developments of the electricity market in 2011



Ingrid Arus
Head of Electricity Markets Department

We believe that one cornerstone needed for securing electricity supply is functioning of the open electricity market. Consumers must have an opportunity and freedom to choose electricity seller, and producers must have an access to the regional electricity market.

While the main event of 2010 was partial opening of Estonian electricity market and start of the electricity exchange, then in 2011 the main activities were aimed in two directions – regional development and preparations for opening the Estonian electricity market fully in the beginning of 2013. Better access to data and transparency, developing energy trade policy with third countries, expansion of power exchange to Latvia and Lithuania, and the Data Warehouse can be named as the main highlights of 2011.

Nord Pool Spot Estonia price area in 2011

During the first full year of functioning of the Nordic powerexchange NPS Estonia price area, increase in trading activity took place and the total volume traded amounted to 10.4 TWh. The previous trading year demonstrated that reliability of the market place increased continuously and the way price was formed on power exchange clearly indicated the fact that well-connected regional electricity market creates opportunities for consumers and producers.

Trading activity increased during the first full year of functioning of the NPS Estonia price area

Through the year the price was influenced by low level of consumption in both in the Nordic States and Baltic States, as well as by high filling rate of hydro-reservoirs in Nordics. Bottlenecks, or lack of sufficient transmission capacities first occurred in the first half of the year between Estonia and Finland, but Estonian price area was also influenced by overloads on the border between Estonia and Latvia during the summer.

NPS Estonia 2011

Share of electricity bought from the electricity exchange for domestic consumption	33.2%
Eligible consumers	201
Traders on electricity exchange in the Estonia area (incl. Latvia and Lithuania) Elspot / Elbas	19/5
Volumes of electricity bouht in NPS Estonia price area	4.59 TWh
Volumes of electricity sold in NPS Estonia price area	5.79 TWh
Electricity bought for domestic consumption	2.56 TWh
Congestion income earned by EstLink 1 cable owners	19.58 MEUR

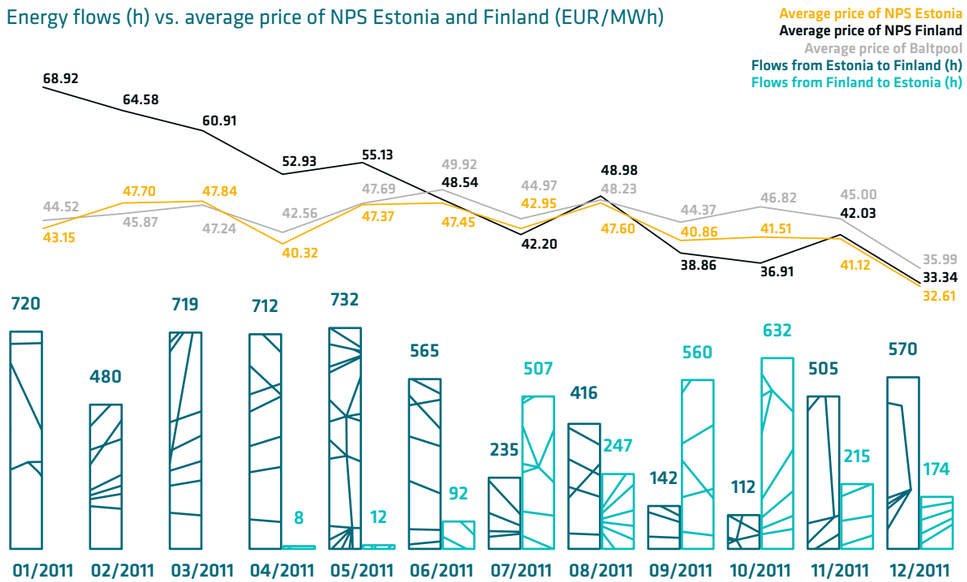
Price comparison of different areas

2011 (EUR/MWh)	*Average price*	*Max. daily price*	*Min. daily price*	*Average price in 2010**
NPS System	47.15	92.13	1.45	53.06
NPS Estonia	43.37	90.96	1.60	46.31
NPS Finland	49.44	150.05	0.36	56.64
Baltpool	45.26	7.10	0.08	46.42

** Due to the fact that the electricity exchange opened in Estonia in April 2010, NPS Estonia comprises 9 months` average price.*

The factors and prices were the main reasons behind energy flows between Finland and Estonia. The following chart shows energy flows compared to the average electricity prices in Estonia, Finland and Lithuania.

Energy flows (h) vs. average price of NPS Estonia and Finland (EUR/MWh)



Development of the electricity market

Elering adopted peak-load reserve principles
In 2011 Elering implemented a few measures aimed at minimising the number of situations when the demand and supply curves in the NPS Estonia price area don't intersect. At the end of July Elering started placing bids into SESAM, the Nordic power exchange Nord Pool Spot's platform for day-ahead electricity purchases and sales, in order to reduce the risk for market participants in the Estonian price area of imbalance and of maximum prices (price peaks).

Bids are submitted on a daily basis in a separate bidding portfolio. Principles for the use of the bids are similar to the principles for the so called peak-load reserve, which are currently applied by Finland and Sweden. Nord Pool Spot who is the power exchange operator has the right to increase the bids for sale by 50 MWh at the agreed price of 203 EUR/MWh in order to avoid imbalance that may emerge on Estonian-Latvian border. Application of this mechanism may be necessary during summer period when the risk of emergence of imbalance in theoretically the highest.

Third countries` border
For Estonia it is very important to work out common principles on energy import from third countries. Common rules could become effective for all third countries outside the European Economic Area, which would first and foremost concern the Baltic States and Finland. Such principles should first and foremost ensure fulfilment of the requirements of the EU Third Energy Package by the system administrators of the member states – separation of activities, distribution of obligations and rights, etc.

For Estonia common principles on energy import from third countries are important

During application of the principles it is important to guarantee equal treatment of market participants – irrespective of the fact whether the market participant is located within or outside the European Union. Today's conditions differ with respect to environmental requirements and fuel price regulation, lower safety requirements are applied to the use of nuclear energy, and a number of other requirements are different from those effective in the EU market. Due to differentrules applicable in EU and Russia the electricity production in Russia is significantly cheaper than in the EU member states, which does not guarantee fair competition.

In 2011 an expert working group was formed for the purpose of development of rules for technical cooperation between Russia and ENTSO-E, the organisation representing the main network operators of the EU member states. The main goal of the expert group is to develop solutions for technical cooperation between the EU and the third states which would take into consideration procedures and operating principles of different markets.

Substantial discussions of this issue will start this year; however it is the ENTSO-E's firm position that representatives from Belarus should also be involved in the expert group.

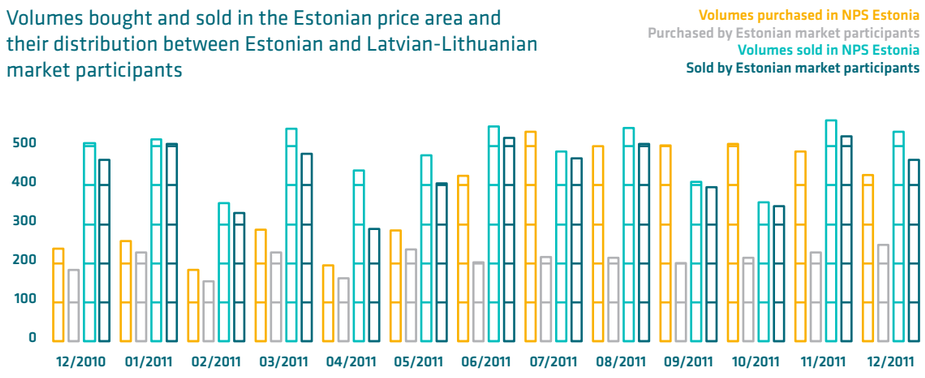
During the previous year there were no changes in trading rules and it is now important to move towards development of harmonised regional principles. One of the possibilities for harmonisation of the rules is expansion of the Nord Pool Sport electricity exchange to Latvia and Lithuania.

Expansion of the NPS electricity exchange to Latvia and Lithuania
Expansion of the NPS to Latvia and Lithuania has become a critical issue. Opening NPS price areas in these states could significantly contribute to market transparency, and common electricity trade principles would be effective in the whole region. It was expected that the decision to expand to Latvia and Lithuania would be made already in the middle of 2011, but unfortunately the decision was delayed. Main reasons behind the delay were certification procedure of Latvia's transmission system operator and the decision which would confirm the actual separation from Latvenergo. In Lithuania the opening of the NPS price area was delayed due to adoption of amendments to the legislation which should designate the electricity exchange operator in order to start the NPS price area.

Opening NPS price areas in Latvia and Lithuania could contribute to market transparency

Although there is no NPS in Latvia and Lithuania, market participants in their systems can participate in Estonian price area via auctions applied to Estonian and Latvian border. Their supplies are guaranteed by the system operators of Latvia and Lithuania – the respective supply guarantee agreement was signed with Litgrid, and there is a plan to sign a similar agreement with the Latvian system operator, Augstspriegumals Tikls. In 2012 analysis of the trade principles applied to Estonian-Latvian border will continue with the goal to ensure market transparency and equal allocation of rights and obligations of the market participants.

Volumes bought and sold in the Estonian price area and their distribution between Estonian and Latvian-Lithuanian market participants



All important data accessible in real time

The goal of liberalisation of the European electricity market is to create a market that is open to fair competition, providing more choice for the consumer. In order to ensure that, it is necessary to first and foremost create conditions for equal treatment of all market participants and to provide access to the data that is needed to make any decisions, alsoto ensure effective operation.

Elering contributes to easy and user-friendly access to the data

In 2011 we made a significant quality leap in increasing transparency of functioning of the electricity system and the electricity market. We started a new website with aim to offer market participants all necessary information in prompt, transparent, user-friendly and easily downloadable form.

Regulation (EC) No 714/2009 of the European Parliament and of the Council establishes conditions for publishing data for all EU member states, which are completely fulfilled by Elering through its website, (which also performs other functions).

The published data includes both planned and actual transmission capacities, used transmission capacity, production and consumption.

In addition to that also frequency, price and volumes of balancing energy, energy from renewable sources and a lot of other data is publi-shed, which is very important for both long-term and short-term planning in the electricity market.

In addition to our website we have also made the data related to the electricity market available on Nord Pool Spot platform, where interested parties can find market prices, transmission capacities and outages of generationand transmission lines in all price areas. At the same time we participate in the Nordic Map project, where together with Finnish, Swedish, Danish and Norwegeian system operators all operational information concerning consumption, production (separately for each type of fuel), capacity flows and prices as minutely updates is provided and updated every minute.

Elering is a member of European Network Trans-mission System Operator for Electricity, where a pan-European

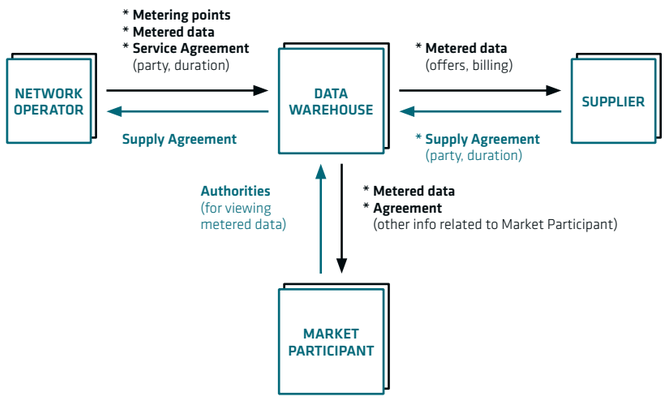
platform for publishing data is being jointly developed. Since European electricity markets continue integration and more opportunities appear for trade activities in markets with other states, it is important to give all participants in the European market access to respective data of all systems.

Data warehouse – a tool for effective functioning of the market

Estonia's electricity market will become open for all consumers starting from 1 January 2013. Equal treatment of electricity suppliers and effective data exchange between market participants are very important in order to secure effectively functioning market. This can be ensured only through development of equal access to the data and harmonised principles.

In order to provide effectively functioning data exchange which is necessary, the data exchange platform together with respective principles and rules is being developed under leadership and responsibility of Elering. With respect to data exchange, the main responsibilities lie on those who are responsible for measuring volumes of electricity – network operators and owners of direct lines; at the same time responsibilities related to balance management lie on sellers, balance providers and system operators. In 2011 all market participants and network operators agreed to participate in the data warehouse project and to undertake necessary developments. In 2012 respective activities and development of the system will continue in order to ensure equal and justified access to the data starting from the late autumn of 2012.

Simplified data warehouse diagram



The data warehouse is an information system that ensures the following possibilities:

This is a place where a network operator forwards measurement data of the measurement points on hourly basis and through which the data becomes available for all eligible market participants;

- The system helps market participants to undergo procedure for changing the supplier:
  - the system doesn't allow one customer to simultaneously conclude more than one contract
  - the system provides information concerning change of the supplier to all network operators and other eligible market participants
- The data warehouse is the place where the market participant administrates authorisation/ rights necessary to receive the data related to him and to submit personal bids.

Operation of the Estonian electricity system in real time

Elering's competent activities in the Estonian electricity system that concern planning its entire operation and managing the electricity system in real time guarantee to Estonian consumers high quality electricity supply at all times, which has a direct and important impact on everyday lives of all Estonian people.

In order to plan reliable operation of the electricity system it is necessary to first and foremost draw up a specific schedule for operation of the electricity system in real time – the programme of activities must include analysis of possibility to undertake planned outages of different network components and power plants, impact of possible emergencies, impact of production of the wind parks, changes in consumption, considerations concerning transmission capacities of cross-border lines and capacity of transit flows. Due to development of the electricity market and the field of energy from renewable sources, in particular increase in the share of wind parks, preparation of such analyses has become more difficult, which requires application of new technical solutions for planning and operation of the electricity system. In 2011 Elering started developing the load forecast system and the service for forecast of production of wind power plants. These developments are planned to be incorporated into the working process in 2012.

In order for the electricity system to work it is necessary to keep voltage, frequency and power flow levels of the entire system within the allowed limits. In addition, it is necessary to use sufficient volume of reserve electricity production capacities in order to handle unexpected changes in production or consumption.

Emergency electricity generation reserves were used 17 times

In 2011 we used reserve capacities for balancing deviations of the Estonian electricity system, which were caused by changes in production and consumption. In Estonia and its neighbouring states emergency electricity generation reserves were used 17 times for resolving situations arising from technical emergency and near-emergency incidents. The most problematic place was the cross-section between Estonian and Latvian cross-border lines, where in the summer of 2011 overloads were repeatedly identified and in order to ensure reliable operation of the electricity network Estonian and Latvian system operators had to jointly activate reserve capacities in order to return the power flows of those electricity transmission lines within the allowed limits. Overloads were mainly caused by big deficit of the Latvian and Lithuanian electricity systems and unfavourable distribution of generation in electricity systems of the BRELL states. Since there are reasons to expect that in 2012 the Latvian and Lithuanian electricity systems will also remain in deficit, it is very likely that in the summer of 2012 there will be tension concerning transmission flows between Estonia and Latvia.

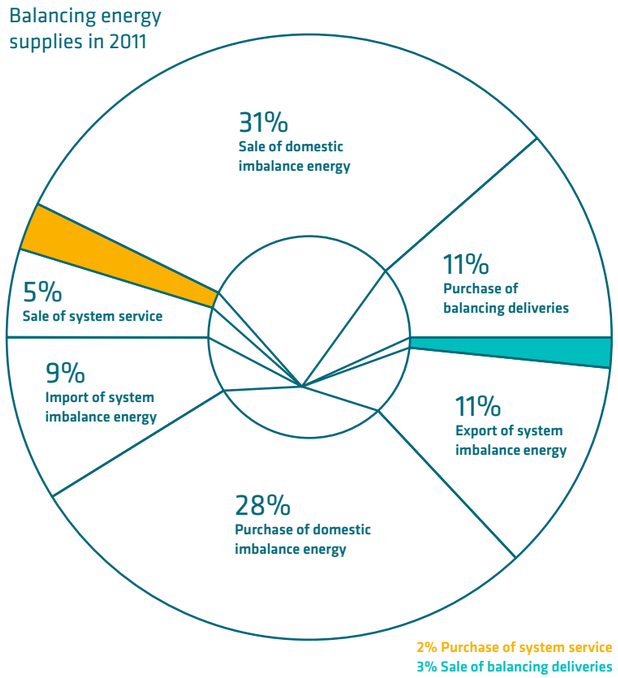
Märt Allika
Head of Power System Control Centre

Maximum consumption in Estonia	1,517 MW	23.02.2011 09:45-09:50
Minimum consumption in Estonia	440 MW	24.06.2011 04:55-05:00
Average load in Estonia in 2011	902 MW	
Maximum net generation in Estonia	1,973 MW	06.01.2011 16:50-16:55
Minimum net generation in Estonia	526 MW	17.07.2011 03:00-03:25
Average net generation in Estonia in 2011	1,308 MW	

Balance service supplies

As a whole, in the year 2011 there was more surplus than deficit of imbalancing energy in the Estonian electricity system – export of imbalancing energy constituted 81 GWh and import of imbalancing energy from Latvia constituted 63 GWh. In order to secure Estonia's capacity balance Elering purchased a total of 82 GWh of upward regulation of supplies and emergency reserves and sold 19 GWh of downward regulation of supplies. In addition to that Elering sold system services amounting to 33 GWh and purchased system services amounting to 11 GWh. Regulations of system services include regulations applied to other system operators and aimed at resolution of situations arising from technical accidents or near-accidents that may happen in the system. In 2011 supplies of system services were five times higher compared to supplies of system services in 2010, which was due to the overloads at the crossing between Estonian and Latvian cross-border lines in the summer of 2011 and the increased regulations provided to operators of the neighbouring systems as system services. The regulations made with respect to the system services are not shown as a part of the price of balancing energy.

Balancing energy supplies in 2011



Domestically Elering sold a total of 201 GWh of imbalancing energy and purchased a total of 224 GWh of imbalancing energy. The sales and purchases of domestic imbalancing energy include the imbalancing energy volumes of the balance providers, transmission network losses of imbalancing energy and imbalancing energy resulting from interruptions of the EstLink 1 cable.

Prices of imbalancing energy

In 2011 the highest sales price of imbalance energy in Estonia was 131.75 €/MWh, which was caused by high price of high upward regulation of supplies in June.

The lowest purchase price of imbalance energy in 2011 was 0 €/MWh, as at one hour in September the downward regulation was sold for price of zero.

	Unit	*Average price*	*MAX price*	*MIN price*
Prices of imbalance energy in 2011				
Sales price of imbalance energy	€/MWh	47.43	131.75	7.64
Purchase price of imbalance energy	€/MWh	42.95	95.81	0.00
Prices of imbalance energy in 2010				
Sales price of imbalance energy	€/MWh	47.87	485.85	16.40
Purchase price of imbalance energy	€/MWh	44.69	334.00	2.00

Elering as a competence centre

Elering's energy competence centre demonstrates our emphasis on educational, scientific and development activities related to the field of energy, and active participation in directing development of the Estonian energy sector and resolving key problems.

Elering and society

Elering plays an important role in functioning and development of Estonian society – we are responsible for stable functioning of the electricity system and for availability of quality electricity. Therefore, in order for us to reach our goals it is vitally important to follow the principles of environmental sustainability, honest and responsible business activities and to put emphasis on development of Estonia by way of enriching our knowledge and promoting education. These principles are the basis for Elering's everyday work and achievement of its goals, which lets us continue to be an open, competent and reliable partner as for our customers, employees and business partners, so for the whole society.

The previous year was very significant for the Estonian energy sector – foundation was set for numerous large investments into development of the electricity network and improvement of its reliability, such as EstLink 2, and we started preparations for opening of the electricity market for all electricity consumers in 2013, and exploration of gas market development perspectives. With participation and under the leadership of our experts, a number of key issues of the Estonian energy sector became the subjects of public discussions and thorough cooperation with Tallinn University of Technology was started with the aim of advancing knowledge in the field of energy. Therefore, there is no doubt that we can call the year 2011 as the year that turned Elering into a competence centre.

Cooperation with Tallinn University of Technology was started in the field of energy

Honest, responsible and reliable operation is important for every company and the society as a whole in order to achieve the goals. Elering also follows these principles in its everyday work and in the course of achievement of its business goals. Elering is 100% owned by Estonian State, which means great responsibility as towards the citizens, customers and business partners, so towards our employees. Our management, business activities and communication with the target groups have always been based on the principles of professionalism, openness and ethic.

In order to ensure better organisation of our work we have united the best knowledge and expectations of our partners, owner and customers. Advisory Councils that were created to work together with Elering and continued to do so in the previous year are the direct result of that. Under the leadership of Elering the Advisory Council for Electricity Market and Advisory Council for Developing the Estonian Electricity Network function simultaneously and include the ministries' officials, representatives of market participants and independent experts. The goal of the Councils is to find the best solutions for key energy sector issues and future challenges concerning Elering and Estonia as a whole through cooperation with all the partners.

In 2011 the Advisory Council for Electricity Market gathered three times. The main topics that were discussed were regional market development opportunities and NPS expansion, as well as opening of the electricity market. The main topic of the Advisory Council for Developing the Estonian Electricity Network was dedicated to development plans of Europe and the Baltic Region. The next forthcoming years will bring important events for the Estonian energy sector – opening of the electricity market for all consumers, decisions concerning gas market development, etc., which means that data exchange, centralisation of competence and involvement of all the participants have a very significant importance.

Equal treatment of all the market participants

Since Elering is an independent system administrator, one of the main principles of our activity that follows from the legislation is the principle of equal treatment of all the market participants. We provide to all our customers – whether they are electricity producers, distribution networks, large consumers connected to the main network of balance administrators – services of equal quality and identical information.

We value opinions and knowledge of social groups, media and wider public in the field of energy, and that's why we try to participate in public debates and share our competence and knowledge. As the energy competence centre we have been the leading speaker in numerous important topics related to the field of energy – the impact of EU energy and climate policy on Estonia, gas market development, etc. For instance, in the previous year Elering supported organisation of the series of seminars dedicated to explanation of opening of the electricity market, and took the floor in a number of different thematic conferences and seminars.

Updated website provides all the important data related to the electricity system

In 2011 Elering updated its website, which is now a centre for all the important data related to the Estonian electricity system. The new application allows using the website for real-time monitoring of movement of electricity between the systems, loads of energy, connections between the states. In the future Elering will continue to raise awareness of Estonian public concerning energy-related issues – by thoroughly explaining and introducing important subjects to the public through media, its website and various events, and in cooperation with educational establishments.

By following the abovementioned principles and completing the started activities, in the forthcoming years we want to remain being an open, competent, responsible and reliable partner as for our customers, employees and partners, so for the whole society.

Research and development activities

In the previous year numerous analyses and research activities related to the field of energy were carried out under the leadership of Elering, which helped to resolve the key issues of the Estonian energy sector and open numerous discussions concerning choices and opportunities of the field of energy.

In 2011 Elering started with a series of publications

In 2011 Elering started with a series of publications, the first issue of which is the report on security of supply of the Estonian electricity system that is prepared annually. The report was prepared on the basis of Elering's know-how concerning modelling of the electricity market and networks. Elering also continued to develop the Balmorel market model. The second issue of the series of publications was the first in-depth publication dealing with the Estonian natural gas market – the plan for the Estonian gas market development that was drawn up upon Elering's order, in which Pöyry Management Consulting presented analysis of the possibilities for improvement of functioning of Estonian gas market. This document was the basis for further steps taken in the course of planning of development of the given field.

In 2011 Elering launched the data exchange platform project, which, as the electricity market opens in 2013, will create equal conditions for access to the data necessary for effective functioning of the market for all the market participants.

As a part of the intelligent network (the so-called *smart grid*) programme, Elering launched a consumption management project within the framework of which it will start to draw consumption patterns of the large electricity consumers and offer respective solutions. On the basis of the received results and knowledge it is possible to assess payback of the consumption management and the scope of its application (MW) in Estonia (i.e. reducing peak loads and increasing regulation capacities). The results of the research allow ensuring effective planning and functioning of the electricity system and of the electricity market.

In order to increase effectiveness of the electricity system management in 2011 Elering purchased the load forecasting system – a complete solution for short-term (up to 14 days in advance) forecasting of load of the electric system. At the same time Elering prepared tender for forecasting service for wind power plants – a solution for forecasting production of wind power plants 0-72 hours in advance. Those software solutions will contribute to fulfilment of the main functions concerning planning and management of administration of the electricity system (including planning and managing reserve capacities, network transmission capacity, interruptions of electrical equipment, voltage charts and network losses), therefore serving Elering as important tools for ensuring functioning and secured supplies of the Estonian electricity system.

In December 2011 Elering and Tallinn University of Technology signed a joint statement of intents, the aim of which is advancing scientific and development activities in the field of energy, training of energy specialists and raising general awareness in Estonian society. As a direct result of that we have launched our internship program and have taken part in research and analyses of the field of energy. In the future our cooperation should ensure that Estonia will have more energy experts with a better knowledge of the given field and a wider outlook.

Over the following years we want to continue working on the projects that we started in 2011:

- carry our social and economical analysis of long-term scenarios of the energy market;
- offer solutions for management of electricity consumption;
- explore Estonia's potential of using natural gas;
- complete data exchange platform that will ensure better communication between electricity consumers and sellers;
- organise open days for high-school students;
- continue granting Elering's scholarship;
- support arrangement of international conferences.

Sustainable and environmentally clean operation

Elering carries out its everyday activities in a responsible manner, based on the principle of preservation of healthy and clean environment. We feel responsibility for the impact on the environment that results from our activities, and we do everything in order for our main activities to support the principles of sustainable and environmentally clean operation.

We have approved and follow the principles of environmental responsibility, such as fulfilment of the environmental requirements established by the legislation, application of environmentally sustainable technologies and avoiding pollution of the environment and generation of waste. Not only we believe that following these principles is important for Elering, but we also take them into consideration when choosing partners and subcontractors.

Ensuring electricity supply in Estonia is inevitably related to the surrounding natural environment, due to which Elering's investments and main business activities as the electricity system administrator and developer go hand in hand with our surrounding environment. In this respect the principle of assessment of environmental impact is of a great importance, and we follow it in the course of preparation of investment concerning development of our infrastructure and construction. In 2011 we ordered and performed assessment of environmental impact with respect to building of the Tartu-Viljandi-Sindi line and EstLink 2.

Development of networks and building of lines for securing electricity supply concern many Estonian land owners. In order to complete such building work in the most sustainable way, Elering concluded agreements with representatives of counties that will be affected by building of the new line. This way, for example, the aim of the agreement for building of Harku-Lihula-Sindi route that got signed by the county governors was to find joint solutions which would allow minimum impact on the environment and on the people's ability to exercise rights to their land.

In addition to that, Elering's workers themselves have also contributed to preservation of the natural environment – in May of 2011 a large number of Elering employees went to the woods of Lääne-Virumaa and Haljala to plant trees there. Approximately 2700 fir seedlings were planted within one day, and the income received from planting the forest was granted to an animal shelter.

We planted ca 2700 fir seedlings

We have accepted the obligation to follow the above-mentioned principles and initiatives of environmental responsibility in all our activities in the following years. We plan to participate more actively than ever in improving environment of the communities which were affected by Elering's investments.

European Union climate and environmental policy and renewable energy in Estonia

Estonia is a member of the European Union (EU) and a participant of the EU's internal market, which also means responsibility and obligation to follow the union's climate and environmental policy and create preconditions for Estonia to join the European market.

The EU's energy policy is founded, on the one hand, on protection of the environment and reduction of the use of fossil energy sources, and on the other hand, on securing supply of energy in a situation where a large part of it (ca 60% of raw liquid fuels and ca 30% of natural gas) is imported from outside of the EU. Therefore, serious attention is directed at the risks that arise from the climate change from the one hand, and at the dangers related to stability of supplies of fuels, rising prices and world-wide competition for fossil resources on the other hand. As it is known, the main bases of the EU energy policy are established by the Lisbon Treaty, which defines as priorities: the functioning of the internal energy market; security of energy supply; energy efficiency; energy saving; the use of renewable sources of energy; integration and interconnection of energy networks.

The most impressive expression of the EU energy policy are the so-called 20/20/20 targets for the year 2020, which stand for reduction of emission of greenhouse gasses and increasing energy efficiency and the share of energy from renewable sources by 2020.

EU's Energy Roadmap 2050

In 2011 one of the decisions having the biggest impact on the energy sector was the approval by the European Commission of the Energy Roadmap 2050. The document establishes long-term goals for the energy sector, the most important of which is reduction of greenhouse gas emission by 80-95% below 1990 levels. In addition to that the EU energy policy for the future is defined by the European Energy Strategy 2020 adopted in 2010.

Energy infrastructure modernisation package of 9.1 billion euro

From the point of view of realisation of the energy policy one should certainly note the importance of the energy infrastructure modernisation package amounting to 9.1 billion euro, approved by the European Commission at the end of 2011, that will help to achieve the targets related to climate and energy. The money provided to the energy sector within the framework of the package is aimed at development of the pan-European infrastructure and can be used only for projects involving at least two states. The financing can be obtained in the form of bonds, grants and loan guarantees. This is the first time when the EU co-finances large-scale energy investments form its regular budget.

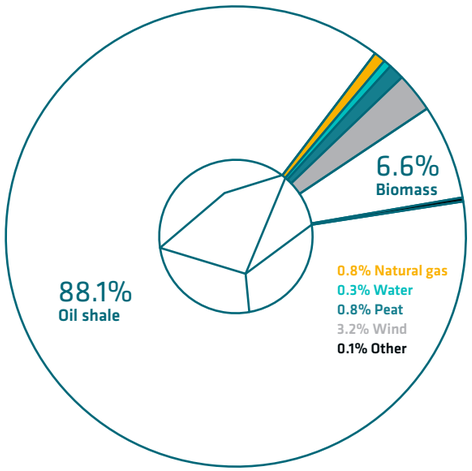
Third connection between Estonia and Latvia will be co-financed by the EU

Elering sees creation of the third connection between Estonia and Latvia as one of the possible projects that can be co-financed by the EU. The co-financing could speed up building of new connections and integration of the Northern-Baltic electricity markets, reducing the pressure to increase transmission tariffs. The third Estonia-Latvia connection together with the realisation of other projects concerning the plan for connecting other Baltic regional areas with Europe (BEMIP), such as EstLink 2, Lithuania-Poland and Lithuania-Sweden connection, would create strong preconditions for more effective integration of the Baltic State into other European electricity networks and markets.

Renewable Energy in Estonia

Today position of Estonia with respect to the energy security looks good as almost entire electricity production is based on domestic primary energy resources such as oil shale, biofuels (mainly wood), peat and wind energy.

Production per type of fuel in 2011



At the same time in the light of the targets for 2020 set by the EU climate and energy policy it is apparent that CO_2-rich oil shale as a source of electricity production will not be competitive in the future markets compared to electricity production methods based on renewable sources of energy and containing less CO_2 (mainly natural gas). It can be expected that in the longer perspective the alternate ways for securing electricity supply in Estonia are either restructuring domestic electricity production, or importing electricity. Elering will play an important role with respect to both such alternatives, as building interstate connections and developing the electricity market, so connecting new power plants to the electricity system. In order to achieve the targets set by the EU's requirements concerning renewable energy, Estonia needs to ensure that the share of renewable energy will account for 25% of the final consumption of energy including 10% of fuels used in transport. In order to fulfil the assumed obligations, Estonia has established grant schemes with a view to increase investments in production of electricity from renewable energy sources and in efficient combined production of heat and power which ensures primary energy savings through efficient combined production process.

Elering's role in supporting renewable energy and electricity produced by an efficient combined production mode is to be the payer of grants and the collector of service fees to be paid to finance the grants. This means that Elering acts as a paying agency collecting the renewable energy fee from its consumers and then using it to give renewable energy grants to the electricity producers in accordance with the conditions and limits established by the law. The renewable energy fee is payable by all final consumers of electricity in Estonia in accordance with the volume of the network service that they consumed. In 2012 the renewable energy fee is 0.97 cents per 1 kWh.

According to the development plan of the electricity sector until 2018 renewable electricity is expected to account for 5.1% of gross consumption according to the target for 2010. The share of electricity produced in combined heat and power plants should be at least 20% in 2020 according to the target.

The share of renewable energy in total consumption increased to 13%

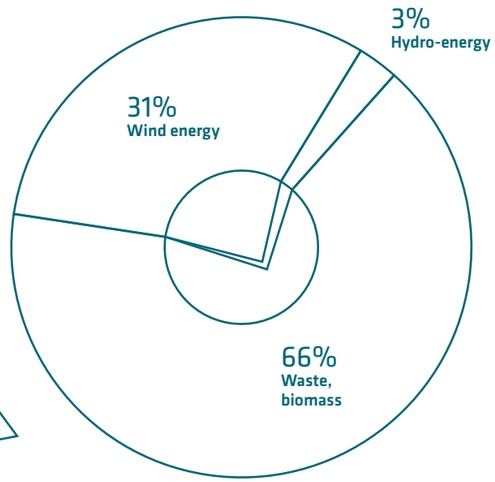
In 2011 production on renewable energy in Estonia accounted for around 13% of electricity consumption (together with self-consumption of power plants), which is 3.2% more than the year before. This shows that Estonia has got very close to achievement of the final target to increase the share of electricity produced from renewable sources to 15-20% of the total electricity consumption by 2020.

Ca 35% more renewable energy was produced compared to 2010

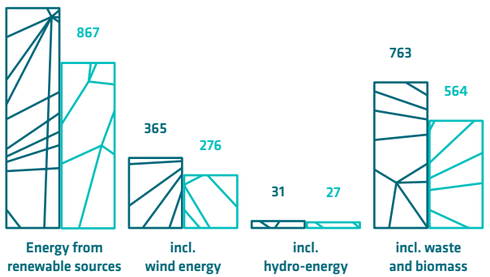
These figures were reached first and foremost due to increase of electricity produced as from biomass and biogas, so from wind energy. In 2011 renewable energy comprised electricity produced from waste and biomass (66%), wind energy (31%) and hydro-energy (3%).

Energy from renewable sources (TWh)	*2011*	*2010*	*Change*
Total energy from renewable sources	1.16	0.87	33%
incl. wind energy	0.37	0.28	32%
incl. hydro-energy	0.03	0.03	0%
incl. biomass and biogas	0.76	0.56	36%

Distribution of energy from renewable sources in 2011



Volumes of energy produced from renewable sources (GWh)



The volumes of renewable energy that received grants also increased by approximately 40%, which meant that the amount of paid grants reached 57.2 million euros. Increase in the volumes of energy that received grants was caused first and foremost by the increase in volumes of electricity produced from wind energy and biomass. The biggest new producers who received grants were Pärnu Fortum Termest combined production plant that was put into operation at the end of 2010, as well as Virtsu III and Vanaküla wind parks. At the same time Narva Power Plants received bigger grants for production of electricity from biomass.

Good corporate governance

Elering is dedicated to complying with good corporate governance practices and wish to make continuous improvement in that area. We consider this as a prerequisite for achieving our strategic objectives and designing our organisational culture.

We confirm as the principles for our activities, that:

- the company's risk management and control system are functioning and efficient;
- the company's financial reporting and annual report are based on a functioning system of risk management and internal control.

Elering publishes its good corporate governance report on website www.elering.ee.

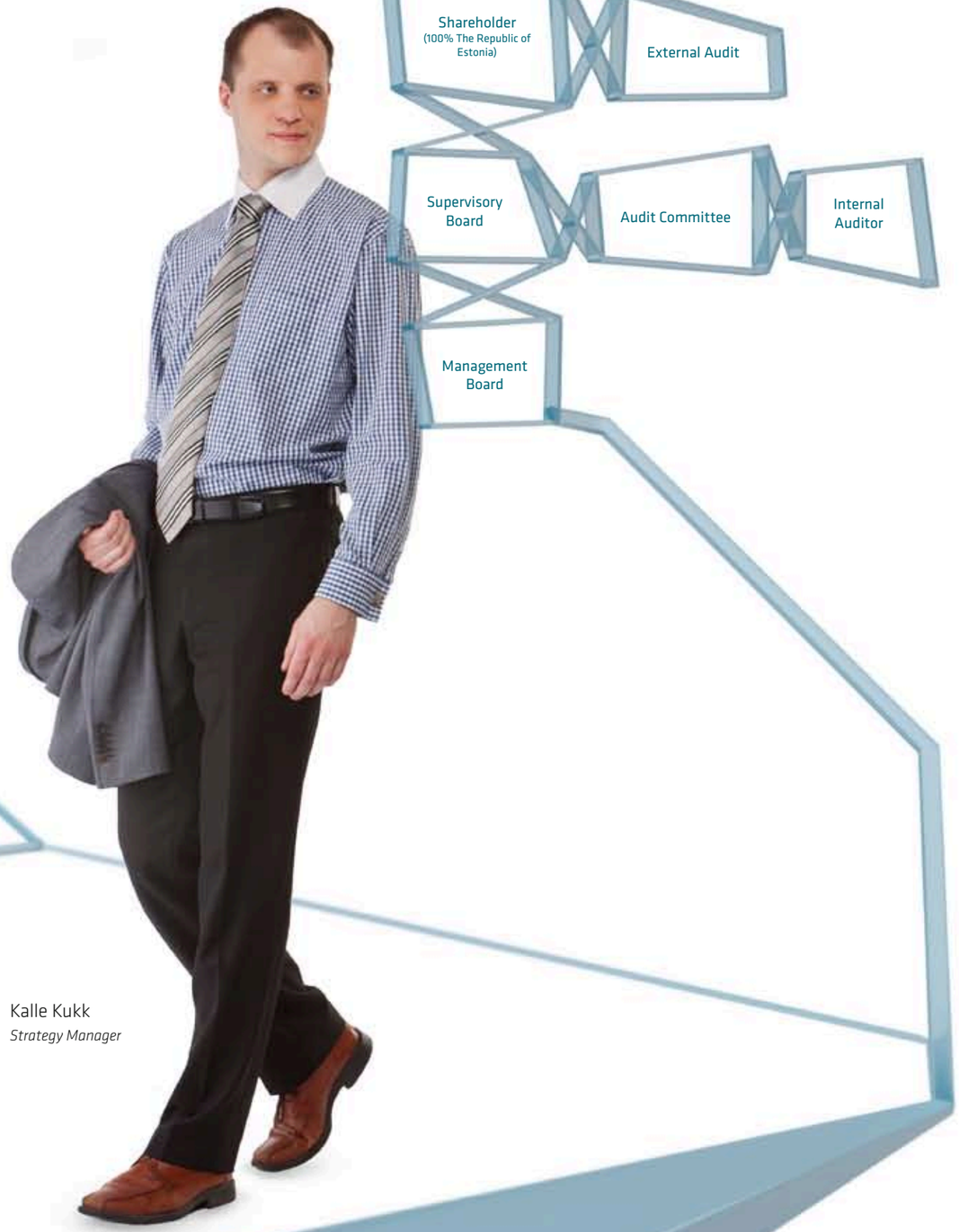
Management

The directing bodies of Elering are responsible for developing the company as a whole.

Organogram
Elering is a company that fully belongs to the state, which is represented at the general meeting by the Minister of Economic Affairs and Communications. Competence of the company's owner includes: to amend the articles of association; to increase and decrease share capital; to elect and remove members of the Supervisory Board; to elect auditors; to designate a special audit; to approve the annual report and allocate profit; to decide on merger, division, transformation and/or dissolution of the company.

In the company, the owner's interests are guaranteed by members of the Supervisory Board (representatives of the Ministry of Finance and the Ministry of Economic Affairs and Communications). The Supervisory Board gives the Management Board instructions for organising the management of the company and exercises supervision over the activities of the company's Management Board. The Supervisory Board determines, regularly reviews and assesses the company's strategy, general action plan, principles of risk management and annual budget.

The Supervisory Board comprises three to five members. The number of the members of the Supervisory Board is decided and the members are elected by the owners. In 2011 the Supervisory Board of Elering has five members. The articles of association set out restrictions on the selection of members of the Supervisory Board, members of the Supervisory Board are elected and removed by the owner, i.e. the Minister of Economic Affairs and Communications. Fees of the members of



Kalle Kukk
Strategy Manager

the Supervisory Board are determined by a directive of the Minister of Economic Affairs and Communications.

Members of the Supervisory Board

- **Lauri Tammiste**, Chairman of the Supervisory Board, Head of the Energy Department, Ministry of Economic Affairs and Communications (until 15.12.2011)
- **Ando Leppiman**, Chairman of the Supervisory Board, Head of the Energy Department, Ministry of Economic Affairs and Communications (from 15.12.2011)
- **Heiki Tammoja**, Director of Electrical Power Engineering Institute, Tallinn University of Technology
- **Thomas Auväärt**, Head of the Financial Markets Department, Ministry of Finance
- **Jüri Raatma**, Adviser of the Ministry of Economic Affairs and Communications
- **Aivar Sõerd**, Member of Riigikogu

The Audit Committee, established by a resolution of the Supervisory Board, is responsible for exercising supervision over risk management, internal control and financial reporting. The Audit Committee is an advisory body of the Supervisory Board in the area of accounting, audit, risk management, internal control and audit, exercise of supervision and preparation of the budget, legality of activities.

The Audit Committee comprises five members. Members of the Audit Committee are elected and removed by a decision of the Supervisory Board. Members of the Audit Committee are elected for a term of three years. Members of the Audit Committee elect from among themselves the chairman to organise the activities of the Audit Committee. The members of the Supervisory Board are paid an additional fee for participation in the Audit Committee.

The Chairman of the Audit Committee in 2011 was Thomas Auväärt. Members of the Audit Committee were Lauri Tammiste/Ando Leppiman, Heiki Tammoja, Jüri Raatma and Aivar Sõerd.

The Management Board of Elering has complete freedom of decision and everyday management decisions are made independently, without interference by the owner and the Supervisory Board. The Management Board needs the consent of the Supervisory Board for transactions and operations that are beyond the everyday economic activities of the company. The Management Board ensures that the members of the Supervisory Board have sufficient information of the company's economic condition as well as more important matters related to the economic activities, and informs the Supervisory Board of the more important matters of the economic activities as necessary.

The Management Board comprises three members. Members of the Management Board are elected by the Supervisory Board for a term of five years. The Chairman of the Management Board organises the work of the Management Board as well as the everyday management and economic activities of the company. The person authorised by the Supervisory Board concludes contracts with the members of the Management Board which set out the rights and obligations of the Management Board with regard to the company in a greater detail.

A member of the Management Board may be paid a fee only on the basis of a contract of management board member concluded with him or her. A member of the Management Board may be also paid an additional fee based on his or her performance in the amount of up to four months' fee. Bonuses may be paid on the basis of the annual results or any other grounds based on a resolution of the Supervisory Board. Fees of the members of the Supervisory Board are fixed and provided in a management board member contract. Elering has not established any long-term bonus systems. A member of the Management Board may be paid severance compensation only upon removal at the initiative of the Supervisory Board before expiry of the term of his or her authorities in the amount of up to three months' fees.

Members of the Management Board

- **Taavi Veskimägi**, Chairman of the Management Board
- **Peep Soone**, Member of the Management Board
- **Kalle Kilk**, Member of the Management Board

In order to ensure independence, a declaration of interests of members of the Management Board is submitted to the Ministry of Economic Affairs and Communications. Transactions concluded with related parties are also declared upon approval and audit of the annual report.

Employees

Elering as an employer is characterised by low labour turnover and long length of service of its employees. In the financial year 2011, the average number of employees in Elering was 146, of whom 74% were men and 26% women. As of the end of the year, the average age of employees was 42. The labour turnover in 2011 was 6%.

Reproduction and development of employees are of critical importance for ensuring continuous success of the company. We collaborate with several institutions of higher education and offer the selected students a thorough practical training programme. Of the employees, 80% have higher education and many employees combine work with education. As of the end of 2011, approx. 20% of Elering's staff simultaneously studied for a degree in higher education institutions. In collaboration with Tallinn University of Technology, we organise energy-related in-service training courses to our engineering and technical staff.

The age composition of the staff is a cross-section of different generations. The strength of the company lies in equal representation of different generations in the staff. Senior specialists with their experience of several years and young people with their recently acquired academic education complement each other. We elect and recognise our best employees with the annual title "Person of a year".

Risk management and internal control system

The Management Board is responsible for the functioning of the internal control system of the company. To ensure the functioning of the internal control system, the position of an internal auditor will be created on the basis of the articles of association or the internal auditor service will be outsourced to an audit company. The Management Board has concluded a contract with AS PricewaterhouseCoopers for outsourcing the internal auditor service. In 2011 the company drew up a description of the internal regulations. All the regulations of the high level, for example rules, will be drawn up or updated during 2012.

Risk management objectives in Elering are:

- to manage and describe the risk management processes in the company;
- to define the roles and responsibilities of the parties to the risk management process;
- to ensure that all risks are identifiable, assessable and they can be responded to;
- to help the managers to understand and manage risks in a better way.

The principles of risk management policy in Elering must ensure that:

- the culture, processes and structure of the company encourage the fulfilment of the company's strategic objectives and at the same also the identification, management, monitoring and, if possible, the hedge of risks;
- the monitoring and management of the company's risks and the internal control system are based on the internationally recognised "Enterprise Risk Management (ERM) Model" developed by the Committee of Sponsoring Organisations of the Treadway Commission (COSO), a voluntary organisation that promotes good corporate governance;
- all relevant legislation, standards, regulations and contractual obligations as well as requirements and expectations arising from society have been taken into account upon management of the company's risks;
- we are continuously improving the risk management activities in the company.

Disclosure of information

The company's website presents a separate list of data that is subject to disclosure by Elering on the basis of the legislature. The website presents annual reports, financial results, operating information, main activities, structure, strategy, news and notices as well as other information that is necessary for investors and the public at large. The website is also available in English. The information on website www.elering.ee (incl. news and notices) is continuously updated.

Launching natural gas business line

Elering is responsible for a wider security of energy supply in Estonia. Therefore, it is Elering's responsibility as an independent system administrator operating on the basis of public interest, to create preconditions for emergence of more effective competition in the Estonian energy market and to create foundation for development of a functioning gas market.

Over the recent years natural gas has started to attract more serious attention everywhere in the world. Technological development that made natural gas play increasingly big role in the energy sector can be named as the main reason for that. Increased production of shale gas, changes in corridors for supply of liquefied gas and substitution of liquid fuels with natural gas are just some examples. At the same time Europe has become increasingly concerned about security of natural gas supplies.

This fundamental change for Elering, as a result of which it shifted the focus from security of electricity supply to wider security of energy supply in Estonia, happened in 2010, when by a decision of the Government of Republic, the company was obligated to develop gas-related competence in Elering in addition to its electricity-related competence. The most valuable result of Elering's involvement in the gas market development process is creation in Estonia of an alternative competence centre, which, being an independent system administrator, is impartial towards all the market participants and which acts on the basis of interests of the public.

In 2011 intensive activities aimed at development of the gas market took place under the leadership of Elering. In order to carefully explore the current situation and the required actions, in May 2011 Elering, on the basis of results of the tender, contracted Pöyry Management Consulting (UK) Ltd company to perform analysis of the pros and cons related to liberalisation of the gas market, and to prepare the plan of required further actions. In the course of preparation of the document various target group and stakeholders, ministries and other state agencies, as well as different market participants including Eesti Gaas were consulted.

This analysis is the first thorough and complete study of development of the gas market published in Estonia, which creates a foundation for further actions. The main conclusion of the report stated that in order to develop the domestic gas market and achieve competitive environment, a package of activities must be implemented in Estonia, one of the most important of which is separation of ownership of the natural gas transmission network from import and sale of gas. In 2011 the Ministry of Economic Affairs and Communications prepared amendments to the Natural Gas Act, which were approved by the Estonian Government, and according to which the transmission network should be a separate and independent system administrator should be crated by the end of 2014.

Another important action according to the report was development of the natural gas infrastructure, so that alternative suppliers could enter the market. In 2011 Elering in cooperation with Port of Tallinn started preparation of the project for building a regional liquefied natural gas (LNG) terminal in Port of Muuga. According to the initial plans the first stage of the LNG terminal will be put into operation in 2015.

Realisation of all the activities stated in the gas market development report is a precondition for creation of the regional gas market and effective competition as well as reduction of sphere of influence of a dominating market participant in the local value chain of gas business. Creation of an alternative gas sector competence is also of an equal importance. These steps should significantly increase not only security of gas supply, but also security of energy supply of Estonia as a whole.

Perspectives of use of natural gas as the primary fuel in Estonia are designated by the state development plan for the energy sector. In 2012 Elering wants to contribute to updating this document. We are waiting for a public debate on the matter, in the course of which future directions for natural gas in Estonia could be designated.

Annual Report for the Financial Year

Statement of Financial Position

in thousands of euros	*Note*	*31/12/2011*	*31/12/2010*
ASSETS			
Current assets			
Cash and cash equivalents	6	23,550	40,064
Deposits at banks with maturities of over 3 months	7	30,000	0
Trade and other receivables	8	18,671	21,868
Total current assets		**72,221**	**61,932**
Non-current assets			
Property, plant and equipment	9	410,434	354,361
Intangible assets	10	3,723	3,100
Total non-current assets		**414,157**	**357,461**
TOTAL ASSETS		**486,378**	**419,393**
LIABILITIES			
Current liabilities			
Trade and other payables	12	35,348	36,341
Total current liabilities		**35,348**	**36,341**
Non-current liabilities			
Borrowings	11	221,639	185,695
Deferred income	13	24,077	22,330
Government grants	13	15,045	15,149
Total non-current liabilities		**260,761**	**223,174**
TOTAL LIABILITIES		**296,109**	**259,515**
EQUITY			
Share capital	14	149,890	140,000
Statutory reserve capital	14	3,490	2,814
Retained earnings	14	36,889	17,064
TOTAL EQUITY		**190,269**	**159,878**
TOTAL LIABILITIES AND EQUITY		**486,378**	**419,393**

The notes on pages 52 to 81 are an integral part of these financial statements.

Statement of Comprehensive Income

in thousands of euros	*Note*	*2011*	*2010*
Revenue	15	94,156	88,865
Other income	16	247	86
Goods, raw materials and services	17	-37,339	-37,756
Other operating expenses	18	-3,177	-2,943
Staff costs	19	-3,949	-3,804
Depreciation and amortisation	9, 10	-21,245	-23,639
Other expenses	20	-126	-41
Operating profit		**28,567**	**20,767**
Finance income	21	661	86
Finance costs	21	-8,727	-7,335
Profit before income tax		**20,501**	**13,518**
Profit for the year		**20,501**	**13,518**
Total comprehensive income for the year		**20,501**	**13,518**

The notes on pages 52 to 81 are an integral part of these financial statements.

Cash Flow Statement

in thousands of euros	*Note*	*1/1/2011-31/12/2011*	*1/1/2010-31/12/2010*
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before income tax		20,501	13,518
Adjustments for:			
· Profit from sale of property, plant and equipment	16	-22	-61
· Depreciation, amortisation and impairment	1.9	21,244	23,639
· Expending government grants	13	-105	0
· Interest expenses	21	8,724	7,329
· Interest income		-661	-85
Changes in working capital:			
· Changes in receivables and prepayments related to operating activities	8	3,293	-8,728
· Changes in liabilities and prepayments related to operating activities	12	-10,985	16,370
Changes in deferred income from connection and other service fees	13	1,747	182
Cash generated from operations		**43,737**	**52,164**
Interest paid	21	-6,056	-5,592
Interest received		640	68
NET CASH USED IN OPERATING ACTIVITIES		**38,323**	**46,640**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property, plant and equipment, and intangible assets	9.10	-69,225	-26,101
Net change in deposits with maturities of over 3 months	7	-30,000	0
Foreign grants to acquire non-current assets	13	0	15,149
Proceeds from sale of property, plant and equipment		60	323
NET CASH USED IN INVESTING ACTIVITIES		**-99,165**	**-10,629**
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayment of short-term borrowings	11	0	-130,801
Net change in overdraft	11	0	-56,834
Long-term bank loans received	11	0	185,902
Bank loans repaid	11	-187,000	0
Bonds issued	11	221,438	0
Contribution to share capital	14	9,890	5,786
NET CASH USED IN FINANCING ACTIVITIES		**44,328**	**4,053**
Net increase/decrease in cash and cash equivalents		**-16,514**	**40,064**
Cash and cash equivalents at the beginning of the year	6	**40,064**	**0**
Cash and cash equivalents at the end of the year	6	**23,550**	**40,064**

The notes on pages 52 to 81 are an integral part of these financial statements.

Statement of Changes in Equity

in thousands of euros	*Share capital*	*Statutory reserve capital*	*Retained earnings*	*Total*
Balance as of 1.1.2010	**134,214**	**2,814**	**3,545**	**140,573**
Contribution to share capital	5,786	0	0	5,786
Comprehensive income for financial year	0	0	13,519	13,519
Balance as of 31.12.2010	**140,000**	**2,814**	**17,064**	**159,878**
Contribution to share capital	9,890	0	0	9,890
Comprehensive income for financial year	0	0	20,501	20,501
Transfers to statutory reserve capital	0	676	-676	0
Balance as of 31.12.2011	**149,890**	**3,490**	**36,889**	**190,269**

More detailed information on share capital and other equity items is set out in Note 14.

The notes on pages 52 to 81 are an integral part of these financial statements.

Notes to the Financial Statements

Note 1

ELERING AS AND ITS OPERATIONS

The financial statements of Elering AS (the "Company") for the year ended 31 December 2011 have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

On 25.02.2011 the sole shareholder of the Company made the resolution to transform Elering OÜ into a public limited company. The transformation was completed on 08.04.2011.

The Company is domiciled in the Republic of Estonia. The Company's registered address is Kadaka tee 42, 12915 Tallinn, Estonia. The Company's principal business activity is electricity transmission within the Republic of Estonia. The economic activities of the Company are regulated by the Estonian and EU legislation. The Estonian Competition Board monitors the Company's network activities and provision of balancing service, and approves network tariffs and standard terms of respective contracts.

From 27.01.2010, the sole shareholder of the Company is the Republic of Estonia, until then, the Company's immediate parent company was Eesti Energia AS whose sole shareholder is the Republic of Estonia.

The Management Board approved these financial statements on 30.03.2012. Pursuant to the Commercial Code of the Republic of Estonia, the annual report shall be presented for approval to the Company's Supervisory Board and the General Meeting of Shareholders.

Note 2

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Bases of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union under the historical cost convention. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Functional and presentation currency
On 1 January Estonia joined the Eurozone and adopted euro as its currency, which replaced the Estonian kroon. As a result of this from 2011 the Company's functional currency is euro and all amounts in financial statements are presented in thousands of euros. Comparative data concerning the previous periods is converted into euros at the exchange rate of 15.6466 EEK/EUR, which was previously applied as the fixed exchange rate

Foreign currency translation
Foreign currency transactions are translated into the functional currency using the exchange rates of the European Central Bank (2010: Bank of Estonia) prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates are recognised in the income statement.

Financial assets
The purchases and sales of financial assets are recognised on the trade date – the date on which the Company commits to purchase or sell a certain financial asset. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Depending on the purpose for which financial assets were acquired as well as management's intentions, financial assets are classified into the following categories at initial recognition according to IAS 39:

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

On 31 December 2011 (as well as 31 December 2010), the Company had no other classes of financial assets than those classified under the category of 'loans and receivables'. As of balance sheet date the Company had no derivative instruments.

Loans and receivables
Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Company intends to sell in the near term. Financial assets that are not recognised at fair value through profit or loss are initially recognised at fair value to which transaction costs are added. After initial recognition, loans and receivables are accounted for at amortised cost using the effective interest rate method unless the payment date falls within 30 days.

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The criteria that the Company uses to determine that there is objective evidence of an impairment loss include: significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and a breach of contract, such as a default or delinquency in payments for more than 90 days.

The amount of the loss is the difference between the carrying amount and the present value of estimated future cash flows discounted at the 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 impairment loss is recognised in the income statement.

Uncollectible loans and receivables are written off against the related allowance account.

The Company recognises the following financial assets in the category of 'loans and receivables': "Cash and cash equivalents", "Deposits at banks with maturities of over 3 months" and "Trade and other receivables".

Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

Prepayments
Prepayments are carried at cost less a provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which itself will be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Company has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Company. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying amount of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Property, plant and equipment
Property, plant and equipment is property, plant and equipment that are used in business activities and the useful life of which exceeds one year. Property, plant and equipment is recognised in statements of financial position as carrying amount which constitutes historical cost less any accumulated depreciation and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Other than the purchase price, cost of the acquired property, plant and equipment includes transportation and installation expenses, as well as other expenses directly related to acquisition and putting such assets into operation. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only if they meet respective property, plant and equipment criteria. The carrying amount of the replaced part is derecognised. All other repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred.

If property, plant and equipment consist of components with significantly different useful lives, the components are recognised as separate items of property, plant and equipment.

Land is not depreciated. Depreciation of other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives in years
Buildings	25-40
Facilities – electricity transmission lines	30-60
Other facilities	10-30
Machinery and equipment - electricity transmission equipment	7-25
Other property, plant and equipment	3-20

The residual value of an asset is the estimated amount that the Company would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, on each balance sheet date.

On each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. An impairment loss recognised for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals and write-offs determined by comparing proceeds with the carrying amount are recognised in profit or loss.

Intangible assets
An intangible asset is initially recognised at its cost, comprising its purchase price, any directly attributable expenditure on preparing the asset for its intended use and borrowing costs that relate to assets that take a substantial period of time to get ready for use. After initial recognition, an intangible asset is carried at its acquisition cost less any accumulated amortisation and impairment losses.

Acquired software licences are capitalised on the basis of the costs incurred to acquire and bring them to use.

Personal right of use. Payments made for rights of superficies and servitudes meeting the criteria for recognition as intangible assets are recognised as intangible assets. The costs related to rights of use of land are depreciated according to the contract period, not exceeding 100 years.

Intangible assets are amortised using the straight-line method over their useful lives:

	Useful lives in years
Software licences	3-5 years
Personal rights of use	50-100 years

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less costs to sell.

Impairment of non-financial assets
Land and assets that are subject to depreciation/amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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 value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment loss are reviewed for possible reversal of impairment on each reporting date.

Leases
Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made or received under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Financial liabilities
Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. The Company has financial liabilities only in the category of 'other financial liabilities'.

Other financial liabilities are initially recognised at fair value, net of transaction costs incurred and are subsequently carried at amortised cost. The amortised cost of current liabilities normally equals their nominal value; therefore current liabilities are stated in the balance sheet in their redemption value. Non-current liabilities are subsequently carried at amortised cost. The difference between the amortised cost and the redemption value is recognised as interest expense in the income statement over the period of the borrowings using the effective interest rate method. The borrowing costs associated with the assets meeting respective requirements are capitalised as cost of the assets.

A financial liability is classified as current when it is due within 12 months after the balance sheet date or the Company does not have an unconditional right to defer the payment for longer than 12 months after the balance sheet date. Borrowings with a due date of 12 months or less after the balance sheet date that are refinanced into non-current borrowings after the balance sheet date but before the approval of the annual report, are classified as current. Borrowings that the lender has the right to recall due to the violation of terms specified in the contract if such right is established by the balance sheet date are also classified as current liabilities.

Offsetting
Financial assets and liabilities are offset and the net amount is reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Provisions and contingent liabilities
Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Company has a present legal or constructive obligation as a result of past events and, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Other possible or present obligations arising from past events but whose settlement is not probable or the amount of which cannot be measured with sufficient reliability are disclosed as contingent liabilities in the notes to the financial statements.

Development costs
Development costs are costs that are incurred in applying research findings for the development of specific new products or processes. Development costs are capitalised if all of the criteria for recognition specified in IAS 38 have been met. Capitalised development costs are amortised over the period during which the products are expected to be used. Expenses related to research carried out for collecting new scientific or technical information and training costs are not capitalised.

Share capital
Share capital is classified as equity. The Company does not have any preference shares. Incremental costs directly attributable to the issue of new shares are recognised as a reduction of equity. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Dividends
Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the note Events after the Balance Sheet Date.

Statutory reserve capital
Statutory reserve capital is formed to comply with the requirements of the Commercial Code. Reserve capital is formed from annual net profit allocations. During each financial year, at least one-twentieth of the net profit shall be 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.

Revenue recognition
Revenue is measured at the fair value of the consideration received or receivable, net of VAT and discounts.

Revenue from sales of goods is recognised at the point of transfer of risks and rewards of ownership of the goods, normally when the goods are shipped.

Sales of services are recognised in the accounting period in which the services are rendered, by reference to stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. The sales of network services and balancing energy fall into this category.

- Recognition of connection fees. When connecting to the electricity network, the clients must pay a connection fee based on the actual costs of infrastructure to be built in order to connect to the network. The revenue from connection fees is deferred and recognised as income evenly over the estimated customer relationship period. The amortisation period of connection fees is 20 years. Deferred connection fees are carried in the balance sheet as long-term deferred income.

- Interest income. Interest income is recognised on a time-proportion basis using the effective interest method.

Recognition of government grants
Government grants are recognised at fair value when there is a reasonable assurance that the Company will comply with all the conditions attached to government grants and that the grant will be received. The government grants are recognised in profit or loss on a systematic basis over the periods in which the Company expenses the related costs for which the grants are intended to compensate.

Government grants are presented in the statement of financial position using the gross method, according to which the government grant is recognised at its cost, and if the government grant is received in the form of a transfer of a non-monetary asset, it is recognised at its fair value. The amount of the government grant received for the purpose of acquisition of assets is recognised as deferred income from government grants. The acquired asset is depreciated and the grant is credited to income over the estimated useful life of the asset.

Subsidies to electricity producers
The law obliges the Company to participate in supporting mechanism for eligible electricity producers (first and foremost power plants using renewable sources of energy). The Company collects subsidies from consumers and distribution network operators and pays it out to to those electricity producers who meet the criteria.

In accordance with current principles, the Company prepares an estimate of the amount of subsidies for the following calendar year, based on estimates on the amount of electricity produced by these producers, and the amount of network services to be provided to the end users in Estonia. The Company uses these estimates to determine the charge of subsidy for the following calendar year per kWh (kilowatt-hour) of network services, taking into account any difference between estimated and actual amounts of subsidies paid during the previous period (November through October).

The customers are charged according to the estimated charge per kWh. Due to the different reasons the actual amounts paid out and received as subsidies always differ from the estimated amounts. Over or under collected subsidies are shown in the balance sheet as either Trade and other payables (in case of surplus) or Trade and other receivables (in case of deficit). These balances are taken into account when determining the charge for the next period as described above. Collecting and paying of subsidies has no impact on the comprehensive income of the Company. See also Notes 8 and 12.

Employee benefits
Wages, salaries, contributions to the state pension, paid annual leave, sick leave and bonuses, along with social and unemployment taxes are recognised in the income statement in the year in which the associated services are rendered by the employees of the Company. Any amounts unpaid by the balance sheet date are recognised as a liability.

If during the reporting period, an employee has provided services for which payment of compensation is to be expected, the Company will recognise a liability (accrued expense) in the amount of forecasted compensation, from which all amounts already paid will be deducted.

Income tax
According to the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. From 1 January 2008, the tax rate on the net dividends paid out of retained earnings is 21/79. The corporate income tax arising from the payment of dividends is recognised as a liability and an income tax expense in the period in which dividends are declared, regardless of the period for which the dividends are paid or the actual payment date. An income tax liability is due on the 10th day of the month following the payment of dividends.

Due to the nature of the taxation system, the companies registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise. A contingent income tax liability which would arise upon the payment of dividends is not recognised in the balance sheet. The maximum income tax liability which would accompany the distribution of Company's retained earnings is disclosed in the notes to the financial statements.

Value added tax
Output value added tax related to sales is payable to tax authorities at the earlier of (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis.

Other taxes in Estonia
The following taxes had an effect on the Company's expenses.

Tax	*Tax rate*
Social security tax	33% of the paid payroll to employees and fringe benefits
Unemployment insurance tax	Until 31.05.2009: 0.3%, until 31.07.2009: 1%, from 01.08.2009: 1.4% of the payroll paid to employees,
Fringe benefit income tax	21/79 of fringe benefits paid to employees
Land tax	1-2.5% on taxable value of land per annum
Excise tax on electricity	Until 28.02.2010: 3.20 euros per MWh of electricity, from 01.03.2010: 4.47 euros per MWh of electricity
Corporate income tax on non-business related expenses	21/79 on non-business related expenses

Note 3

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Company makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Revenue recognition (connection fees)
The Company recognises all connection and other service fees (Note 13) as income over the estimated customer relationship period as the entity has a constructive obligation to provide a supply of electricity to the end customer and to meet certain performance standards regarding availability of supply, the Company also has an ongoing obligation to maintain the connection. Thus a new connection has no standalone value without ongoing access to the network.

The customer relationship period is 20 years based on management's estimate. In the reporting period, income from connection and other service fees totalled 1,222 thousand euros (2010: 1,147 thousand euros). If the estimated customer relationship period were increased by 25%, the annual income from connection fees would decrease by 244 thousand euros (2010: 229 thousand euros).

Useful lives of property, plant and equipment
The estimated useful lives of items of property, plant and equipment (Note 8) are based on management's estimates regarding the period during which the asset will be used. The estimation of economic lives is based on historical experience and takes into consideration production capacity and physical condition of the assets. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. In the reporting period, depreciation amounted to 20,934 thousand euros (2010: 19,651 thousand euros). If depreciation rates were increased/decreased by 20%, the depreciation charge for the year would increase/decrease by 4,187 thousand euros (2010: 3 930 thousand euros).

Note 4

NEW ACCOUNTING PRONOUNCEMENTS

Adoption of new or revised standards and interpretations
The new standards, amendments to published standards and interpretations that became effective for the Company from 1 January 2011 had no effect on the financial statements and have no importance with respect to the Company's business activity.

New or revised standards and interpretations
New or revised standards or interpretations that have not yet become effective are not expected to have significant effect on the Company.

Note 5

FINANCIAL RISK MANAGEMENT

The risk management function is performed at the Company in accordance with internationally approved Enterprise Risk Management Mode methodology, which has been developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The Company's risks are assessed in four categories: strategic, operational, financial and external risks. Financial risk comprises market risk (including currency risk, interest rate risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then to ensure that exposure to risks stays within these limits. Risk management is monitored at the Management Board level and the results are reported to the Supervisory Board. The Company's liquidity, interest rate and currency risks are managed at the Company's Finance Department.

The following table provides reconciliation of classes of financial assets and financial liabilities of the Company in accordance with the measurement categories of IAS 39:

Financial assets

Loans and receivables:

in thousands of euros	*31/12/2011*	*31/12/2010*
Cash and cash equivalents (Note 6)	23,550	40,064
Deposits at banks with maturities of over 3 months (Note 7)	30,000	0
Trade and other receivables (Note 8)	17,085	21,553
Total financial assets	**70,635**	**61,617**

Other financial liabilities

Muud finantskohustused:

in thousands of euros	*31/12/2011*	*31/12/2010*
Trade and other payables (Note 12)	34,401	35,690
Borrowings (Note 11)	221,639	185,695
Total financial liabilities	**256,040**	**221,385**

Credit risk

The Company takes on exposure to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Exposure to credit risk arises as a result of the Company's sales on credit terms and other transactions with counterparties giving rise to financial assets. In accordance with the Company's risk management principles, the Company's short-term available cash resources can be deposited in the following domestic financial instruments: overnight deposits at credit institutions, term deposits at credit institutions. The following principles are followed when depositing short-term available cash resources: ensuring of liquidity, capital preservation, revenue generation.

The Company's assets exposed to credit risk as of balance sheet days were as follows:

in thousands of euros	*31/12/2011*	*31/12/2010*
Cash and cash equivalents (Note 6)	23,550	40,064
Deposits at banks with maturities of over 3 months (Note 7)	30,000	0
Trade and other receivables (Note 8)	17,085	21,553
Total exposure of assets to credit risk in the statement of financial position	**70,635**	**61,617**

The Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties or groups of counterparties or by applying additional instruments for credit risk management. The participants in the tender for building investment objects must meet requirements concerning amount of equity and provide bank guarantees the amount of which depends on the value of the contract. The Company established criteria for holding financial assets at credit institutions. According to the given criteria maximum permitted limits depend on the credit rating and equity of the credit institution. Limits on the level of credit risk are approved regularly by management. Such risks are monitored on an ongoing basis and they are subject to a biannual review.

The Company's Accounting Department reviews ageing analysis of outstanding trade receivables and follows up on past due balances each week. The results are reported to the CFO of the Company. The Company has identified circumstances under which the collection of debt is passed over to a collection agency. Information about credit risk is disclosed in Note 8.

Credit risk concentration
The Company is exposed to concentrations of credit risk. Management monitors and discloses concentrations of credit risk by reports, which list exposures to counterparty with aggregated balances in excess of 5% of the Company's equity. On 31.12.2011, the Company had 1 counterparty (distribution network operator) (31.12.2010: 1 counterparty) with an aggregated receivables balance of 13,614 thousand euros (31.12.2010: 15,808 thousand euros) or 83% of the gross amount of trade and other receivables (31.12.2010: 73%;).

Market risk

The Company is exposed to market risk. Market risk arises from open positions in (a) foreign currencies and (b) interest bearing assets and liabilities. Management sets limits on the value of exposed positions that may be accepted, which is monitored on a daily basis. However, the use of this approach does not completely prevent losses outside of these limits, but limits their maximum amounts.

Sensitivities to market risks shown below are based on a change in one factor while holding all other factors constant. In practice, this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in interest rate and changes in foreign currency rates.

Currency risk
Currency risk is the risk that in the future fair value of financial instruments of cash flow will fluctuate due to chances of currency rates. As most of the Company's transactions and balances are denominated in euros, the Company is not exposed to significant currency risk. The Company established separate limits for open currency positions depending on the currency and duration. Open position with duration over one month cannot exceed the amount of one million euros in any currency.

Transactions in other currencies are insignificant; there were no financial instruments denominated in other currencies as of 31.12.2011 and 01.01.2010.

Interest rate risk
As of 31 December 2011 long-term bonds constituted 100% of the Company's long-term borrowing liabilities carried at amortised cost. Long-term bonds were issued on 12.07.2011 with maturity of seven years and the nominal value of 225 million euros. Bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year. Before 13.07.2011 the Company had a loan from a bank syndicate. Euro was the currency and the interest rate on the loan was Euribor + 300 basis points. Pursuant to the loan agreement, the Company had the right to choose between 3-month and 6-month Euribor for each following interest period. Euribor was fixed one day prior to the beginning of the new interest period: the Company's management decided whether to fix the interest rate for three or six months, depending on which option was expected to be more favourable. The Company's interest-bearing financial assets are overnight deposits and term deposits. The rate for overnight deposits is being fixed once a day and term deposits have a fixed interest rate for the whole term of the deposit.

Floating interest financial instruments (until 13.07.2011: loan) expose the Company to cash flow interest rate risk, i.e. the risk that increase in market interest rates will cause increase in the Company's interest expense. At the same time, in case of short-term deposits, change in market interest rates has effect on the Company's interest income arising from investment of available resources into new deposits. The Company established the minimum limit for fixed interest-bearing liabilities at 60% of all liabilities. Fixed interest financial instruments create fair value interest rate risk. Since the Company does not recognise interest-bearing financial instruments at fair value, change in market interest rates does not have effect on balance value of available assets or liabilities, nor interest income or expense arising from them.

The table below summarises the Company's exposure to interest rate risks in 2011 and 2010. The table presents the aggregated amounts of the Company's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing and maturity dates.

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*Above 5 years*	*Total*
31.12.2011				
Cash and cash equivalents (Note 6)	23,550	0	0	**23,550**
Deposits at banks with maturities of over 3 months (Note 7)	0	30,000	0	**30,000**
Long-term bonds	0	0	-221,639	**-221,639**
Net interest sensitivity gap on 31.12.2011	**23,550**	**30,000**	**-221,639**	**-168,089**

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*Total*
31.12.2010			
Cash and cash equivalents (Note 6)	40,064	0	**40,064**
Long-term borrowings (Note 11)	-185,695	0	**-185,695**
Net interest sensitivity gap at 31.12.2010	**-145,631**	**0**	**-145,631**

The Company did not have other financial instruments exposed to risk of change in interest rate.

If in 2011, interest rates had been 10 basis points lower (in 2010: 10 basis points) or 100 basis point higher (in 2010: 100 basis points) with all other variables held constant, profit for the year would have been 222 thousand euros (2010: 186 thousand euros) higher or 2,216 thousand euros (2010: 1,857 thousand euros) lower, mainly as a result of a lower/higher interest expense on variable interest liabilities.

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company is exposed to daily calls on its available cash resources. Liquidity risk is managed by the Finance Department of the Company. The Company's objective is to obtain a stable funding base primarily consisting of amounts due to banks and bonds. The liquidity position is monitored and regular liquidity stress testing under a variety of scenarios covering both normal and more severe market conditions is performed by the Finance Department.

The table below shows liabilities on 31.12.2011 and 31.12.2010 by their remaining contractual maturity. The amounts disclosed in the maturity table are contractual undiscounted cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing on the reporting date. Foreign currency payments are translated using the spot exchange rate at the balance sheet date.

The maturity analysis of financial liabilities on 31.12.2011 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Over 5 years*	*Total*
Liabilities*					
Trade and other payables (Note 12)	29,436	61	0	0	**29,497**
Borrowings (Note 11)	0	10,406	36,151	251,344	**297,901**
Total future payments	**29,436**	**10,467**	**36,151**	**251,344**	**327,398**

** including interest expenses*

The maturity analysis of financial liabilities on 31.12.2010 is as follows:

in thousands of euros	*On demand and less than 1 month*	*From 1 to 12 months*	*From 12 months to 5 years*	*Total*
Liabilities*				
Trade and other payables (Note 12)	33,954	0	0	**33,954**
Bank and parent company overdrafts (Note 11)	9	0	0	**9**
Borrowings (Note 11)	1,727	7,576	193,201	**202,504**
Total future payments	**35,690**	**7,576**	**193,201**	**236,467**

** including interest expenses*

For ensuring liquidity and better management of cash flows, the Company has concluded an overdraft contract amounting to 20,000 thousand euros and holds its money in liquid bank deposits. As of the financial year the Company's total available cash resources (cash and cash equivalents, as well as deposits with maturities of over 3 months) amounted to 53,550 thousand euros. See further information in Notes 6 and 7.

In addition, as of 31.12.2011 the Company had undrawn borrowing facilities amounting to 100,000 thousand euros. As of 31.12.2010 the Company had overdraft contracts with banks amounting to 20,000 thousand euros. See further information in Note 11. The Company was granted irrecoverable financial help amounting to 50,000 thousand euros from the European Union for building of EstLink 2 electricity interconnector between Estonia and Finland, of which 15,000 thousand euros were transferred in 2010. The Company is eligible to receive the remaining part over 2012-2014 in accordance with completion of the project stages.

Capital Management

The Company's main goal in capital risk management is to ensure the Company's sustainability of operations in order to generate return for its shareholders and provide a sense of security to creditors and thereby, preserve an optimal capital structure and lower the cost of capital. In order to preserve or improve the capital structure, the Company can regulate the dividends payable to the shareholders, buy back shares from shareholders, issue new shares or bonds and take new loans.

According to the widespread industry practice, the Company uses the equity to asset ratio for monitoring the Company's capital structure, arrived at by dividing total equity by total assets as of the balance sheet date. Starting from 2011 the Company's goal has been to preserve the ratio of equity to assets at 35-45%. Before 2011 the goal was maintaining the ratio of 35-55%.

The equity to asset ratio was 39% as of 31.12.2011 and 38% as of 31.12.2010.

in thousands of euros	*31/12/2011*	*31/12/2010*
Equity	190,269	159,878
Total assets	486,303	419,393
Equity to asset ratio	**39%**	**38%**

Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best expressed by an active quoted market price.

Estimated fair values of financial instruments have been determined by the Company using available market information, where it exists, and appropriate valuation methodologies. Judgement is also required to interpret market data to determine the fair value.

Financial assets carried at amortised cost
Carrying amounts of trade and other financial receivables approximate their fair values.

Liabilities carried at amortised cost
Carrying amounts of trade and other payables approximate their fair values.

The estimated fair value of non-current borrowings with a fixed interest rate is determined using valuation techniques, based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Management estimates that the fair values of borrowings as of 31.12.2011 and 31.12.2010 do not significantly differ from their carrying amount because the risk margins have not changed. The only liabilities as of 31.12.2011 were bonds the market value of which without the accrued interest was 227,624 thousand euros (nominal value 225,000 thousand euros).
The only liability as of 31.12.2010 was the non-tradable syndicate loan which was refinanced on 13.07.2011 with the help of bonds with similar interest.

Note 6

CASH AND CASH EQUIVALENTS

in thousands of euros	*31/12/2011*	*31/12/2010*
Bank accounts	465	17,695
Short-term deposits	23,085	22,369
Total cash and cash equivalents	**23,550**	**40,064**

Bank accounts and deposits

in thousands of euros	*31/12/2011*	*31/12/2010*
Deposits at banks:		
with Moody's credit rating of Aa3	0	22,378
with Moody's credit rating of Aa2	10,000	7,090
with Moody's credit rating of A1	11,148	0
with no Moody's credit rating*	2,402	10,596
Total deposits at banks	**23,550**	**40,064**

* *Two banks without credit rating at which the Company holds its money are Estonia-based subsidiaries of international banks with Moody's credit ratings of A1 and A2.*

Note 7

DEPOSITS AT BANKS WITH MATURITIES OF OVER 3 MONTHS

in thousands of euros	*31/12/2011*	*31/12/2010*
Deposits at banks with maturities of over 3 months	30,000	0
Total deposits at banks with maturities of over 3 months	**30,000**	**0**

Deposits at banks with maturities of over 3 months

in thousands of euros	*31/12/2011*
with Moody's credit rating of Aa2	4,000
with Moody's credit rating of A1	18,000
with no Moody's credit rating *	8,000
Total deposits at banks with maturities of over 3 months	**30,000**

* *Two banks without credit rating at which the Company holds its money are Estonia-based subsidiaries of international banks with Moody's credit rating of A1 and A2.*

During the financial year effective interest rates of deposits with maturities of over 3 months amounted to 1.4-1.88%. During the financial year deposit maturities amounted to 122-188 days.

Note 8

TRADE AND OTHER RECEIVABLES

in thousands of euros	*31/12/2011*	*31/12/2010*
Trade receivables		
Accounts receivable	16,386	21,535
· incl: trade receivables from related parties (Note 23)	14,412	17,473
Other receivables	699	18
· incl: subsidies due to electricity producers (Note 2 and 12)	587	0
· incl: interest receivable	112	18
· incl: allowance for doubtful receivables	-12	-24
Total financial assets within trade and other receivables	**17,085**	**21,553**
Tax receivables	1,438	253
· incl: VAT recoverable	1,435	248
Prepayments	148	62
Total trade and other receivables	**18,671**	**21,868**

Analysis by credit quality of trade receivables is as follows:

in thousands of euros	*31/12/2011*	*31/12/2010*
Accounts receivable not yet due		
· Related parties excluding distribution networks	798	1,466
· Related parties: distribution networks	13,614	15,808
· Non-related distribution networks	1,027	1,309
· Other clients	911	2,921
Total accounts receivable not yet due	**16,350**	**21,504**
Accounts receivable past due but not classified as doubtful (IAS 39)		
· 1 to 90 days overdue	36	31
Total accounts receivable past due but not classified as doubtful	**36**	**31**
Accounts receivable classified as doubtful		
· over 90 days overdue	12	23
Total accounts receivable classified as doubtful	**12**	**23**
Total accounts receivable past due	**48**	**54**
Total trade receivables	**16,386**	**21,535**

Note 9

PROPERTY, PLANT AND EQUIPMENT

in thousands of euros	*Land*	*Buildings*	*Facilities*	*Machinery and equipment*	*Other*	*Construction in progress*	*Total*
Property, plant and equipment on 01.01.2010							
Cost at 01.01.2010	3,716	16,272	232,868	184,339	49	0	437,244
Accumulated depreciation	0	-2,577	-57,946	-44,591	-9	0	-105,123
Carrying amount on 01.01.2010	**3,716**	**13,695**	**174,923**	**139,748**	**39**	**0**	**332,121**
Construction in progress	0	0	0	0	0	20,299	20,299
Prepayments	126	0	0	0	0	0	126
Total property, plant and equipment on 01.01.2010	**3,842**	**13,695**	**174,923**	**139,748**	**39**	**20,299**	**352,546**
Movements 1.1.2010-31.12.2010							
Additions	532	0	0	57	0	24,098	24,687
Reclassified from construction in progress	0	745	7,491	19,675	0	-27,911	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	982	982
Disposals in carrying amount	-1	0	0	-261	0	0	-262
Depreciation charge	0	-483	-9,380	-9,776	-12	0	-19,651
Impairment charge	0	0	-3,581	-58	0	-301	-3,940
Total movements 1.1.2010-31.12.2010	**531**	**262**	**-5,470**	**9,637**	**-12**	**-3,132**	**1,816**
Cost at 31.12.2010	4,247	16,835	235,498	201,518	49	0	458,147
Accumulated depreciation	0	-2,878	-66,046	-52,134	-21	0	-121,079
Carrying amount on 31.12.2010	**4,247**	**13,957**	**169,452**	**149,384**	**28**	**0**	**337,068**
Construction in progress	0	0	0	0	0	17,167	17,167
Prepayments	126	0	0	0	0	0	126
Total property, plant and equipment on 31.12.2010	**4,373**	**13,957**	**169,452**	**149,384**	**28**	**17,167**	**354,361**
Movements 1.01.2011-31.12.2011							
Additions	592	0	0	64	5	74,703	75,364
Reclassified from construction in progress	0	537	1,593	15,492	0	-17,622	0
Capitalised borrowing costs (Note 21)	0	0	0	0	0	1,868	1,868
Disposals in carrying amount	0	0	0	-37	0	0	-37
Prepayments	-126	0	0	0	0	0	-126
Depreciation charge	0	-485	-9,794	-10,643	-12	0	-20,934
Impairment charge	0	0	-31	-31	0	0	-62
Total movements 1.01.2011-31.12.2011	**466**	**52**	**-8,232**	**4,845**	**-7**	**58,949**	**56,073**
Property, plant and equipment on 31.12.2011							
Cost on 31.12.2011	4,839	17,326	236,957	216,322	54	0	475,498
Accumulated depreciation	0	-3,317	-75,737	-62,093	-33	0	-141,180
Carrying amount on 31.12.2011	**4,839**	**14,009**	**161,220**	**154,229**	**21**	**0**	**334,318**
Construction in progress	0	0	0	0	0	76,116	76,116
TOTAL PROPERTY, PLANT AND EQUIPMENT ON 31.12.2011	**4,839**	**14,009**	**161,220**	**154,229**	**21**	**76,116**	**410,434**

Construction in progress mainly consists of construction of substations and electricity transmission lines. Upon completion, cost of these assets is recognised as cost of buildings, machinery and equipment and facilities.

Additions to construction in progress during financial year include capitalised borrowing costs of 1,868 thousand euros (2010: 982 thousand euros). The capitalisation rate was 5.2% (2010:4.4%).

In 2010, the Company launched preparations for the construction of the second connection between Estonia and Finland (EstLink 2), including thorough renovation of the current lines for the purpose of increasing their throughput capacity. As a result of the activities mentioned above, some of the obsolete assets related to the lines were written down (2010: EUR 2,744 thousand, 2009: EUR 0) and the lines were renovated.

See further information on operating lease of property, plant and equipment in Note 22.

Note 10

INTANGIBLE ASSETS

in thousands of euros	*Acquired software and licenses*	*Right of use of land*	*Total*
Intangible assets on 01.01.2010			
Cost at 1.1.2010	40	1,027	1,067
Accumulated amortisation	-16	-33	-49
Carrying amount on 1.1.2010	**24**	**994**	**1,018**
Intangible assets not yet available for use	963	0	963
Total intangible assets on 1.1.2010	**987**	**994**	**1,981**
Movements 1.1.2010-31.12.2010:			
Additions	945	168	1,113
Capitalised borrowing costs (Note 21)	54	0	54
Amortisation charge	-36	-12	-48
Total movements 1.1.2010-31. 12.2010	**963**	**156**	**1,119**
Intangible assets on 31.12.2010			
Cost at 31.12.2010	215	1,195	1,410
Accumulated amortisation	-52	-45	-97
Carrying amount on 31.12.2010	**163**	**1,150**	**1,313**
Intangible assets not yet available for use	1,787	0	1,787
Total intangible assets on 31.12.2010	**1,950**	**1,150**	**3,100**
Movements 1.01.2011-31.12.2011			
Additions	794	15	809
Capitalised borrowing costs (Note 21)	63	0	63
Amortisation charge	-237	-12	-249
Total movements 1.01.2011-31.12.2011	**620**	**3**	**623**

in thousands of euros	*Acquired software and licenses*	*Right of use of land*	*Total*
Intangible assets on 31.12.2011			
Cost at 31.12.2011	2,631	1,210	3,841
Accumulated amortisation	-289	-57	-346
Carrying amount 31.12.2011	**2,342**	**1,153**	**3,495**
Intangible assets not yet available for use	228	0	228
TOTAL INTANGIBLE ASSETS ON 31.12.2011	**2,570**	**1,153**	**3,723**

Note 11

BORROWINGS

in thousands of euros	*31/12/2011*	*31/12/2010*
Long-term borrowings		
Long-term bank loan	0	185,695
Issued bonds	221,639	0
Total long-term borrowings	**221,639**	**185,695**

The Company's borrowings are denominated in currencies as follows:

in thousands of euros	*31/12/2011*	*31/12/2010*
Borrowings denominated in euros	221,639	185,695
Total borrowings	**221,639**	**185,695**

The average interest on borrowings was 5.1% in 2011 (2010: 4.28%).

The Company has used the following types of facilities for financing purposes:

Until 13.07.2011 that Company had a syndicated loan in the amount of 187 million euros. The currency was euro and the interest rate was Euribor + 3.00%. According to the loan agreement the Company had the right to choose between 3-month and 6-month Euribor for each following interest period. Euribor was fixed one day prior to the beginning of the new interest period: the Company's management decided whether to fix the interest rate for three or six months, depending on which option was expected to be more favourable. On 12.07.2011 the Company issued Eurobonds with maturity of seven years and the nominal value of 225 million euros, used for refinancing the above mentioned syndicate loan. Bonds' coupon is fixed at 4.625% p.a. and interest payments are made once a year. The initial offering price formed 98.812% of the nominal value and the arrangement expenses were 479 thousand euros.

Until 08.01.2010 the Company had a loan agreement with Eesti Energia AS. In 2010 the interest rate was 4.88%. The Company refinanced the loan on 08.01.2010 with syndicated loan.

As of 31.12.2011 and 31.12.2010, the Company had undrawn loan facilities in the total amount of 100,000 thousand euros as of 31.12.2011 (31.12.2010: 100,000 thousand euros). The right to take out a portion of the loan granted by the European Investment Bank (75,000 thousand euros) or the full amount of it is effective during 36 months from the signing of the contract on 18.11.2010. In accordance with the contract entered into with Nordic Investment Bank on 20.10.2010, either a portion or the full amount of the loan (25,000 thousand euros) can be taken during the period of 8.07.2011-31.12.2014. For both contracts, the interest rate will be agreed prior to taking out each portion.

Overdraft

From 8.01.2010 to 13.07.2011 the Company had at its disposal four overdraft contracts totally amounting to 20 million euros, all with floating interest rates based on Euribor. On 13.07.2011 the given contracts were terminated and a new overdraft contract was concluded with the limit of 20 million euros with the floating interest rate based on Euribor.

During the period of 1.01.2010-8.01.2010 and in 2009, the Company used the overdraft obtained from its then parent Eesti Energia AS. The interest rate was 4.88% (2009: 4.81%). On the date of taking out the syndicated loan referred to in the previous section, the total amount of the overdraft was paid back to Eesti Energia AS and the respective overdraft contract was terminated.

As of 31.12.2011 and 31.12.2010 the Company did not use overdraft.

Note 12

TRADE AND OTHER PAYABLES

in thousands of euros	*31/12/2011*	*31/12/2010*
Trade payables	20,067	16,311
· Incl: trade payables to related parties (Note 23)	12,586	8,111
Payables for purchased property, plant and equipment and intangible assets	9,305	2,481
· Incl: payables to related parties (Note 23)	1	3
Subsidies due to electricity producers (Notes 2 and 8)	0	15,084
Accrued interest	4,904	1,737
Other payables	125	77
· Incl: payables to related parties (Note 23)	57	32
Total financial liabilities within trade and other payables excl accrued interest	**29,497**	**33,953**
Total financial liabilities within trade and other payables	**34,401**	**35,690**
Taxes payable:	**387**	**417**
Social security tax	169	186
Personal income tax	91	108
Unemployment insurance tax	18	20
Contributions to mandatory funded pension	6	5
Corporate income tax and income tax on fringe benefits	4	3
Excise tax	99	95

in thousands of euros	*31/12/2011*	*31/12/2010*
Accrued expenses - employee benefits:	**426**	**223**
Wages and salaries	184	0
Bonuses	90	50
Holiday pay	90	116
Social security and unemployment insurance tax	62	57
Other payables	**134**	**11**
Total trade and other payables	**35,348**	**36,341**

Note 13

DEFERRED INCOME FROM CONNECTION AND GOVERNMENT GRANTS

Income from connection and other service fees

in thousands of euros	
Deferred income from connection and other service fees on 1.1.2010	**22,148**
Movements 1.1.2010-31.12.2010:	
Connection and other service fees received	1,329
Connection and other service fees recognised as revenue	-1,147
Deferred income from connection and other service fees on 31.12.2010	**22,330**
Movements 1.01.2011-31.12.2011:	
Connection and other service fees received	2,969
Connection and other service fees recognised as revenue (Note 15)	-1,222
Deferred income from connection and other service fees on 31.12 2011	**24,077**

Income from government grants

in thousands of euros	
Prepayments related to government grants on 31.12.2010	**15,149**
Movements 1.01.2011-31.12.2011:	
Subsidies used	-98
Government grants recognised as revenue (Note 16)	-6
Prepayments related to government grants on 31.12.2011	**15,045**
· incl. long-term prepayments	15,045

Note 14

EQUITY

The Company's share capital consists of 149,890 shares with the nominal value of 1,000 thousand euros (31.12.2010: one share with the nominal value of 140,000 thousand euros). The shares have been paid for in full.

In 2011, with the resolution of the sole shareholder, the share capital was increased by 9,890 thousand euros, with issue of 9,890 new common shares. The new shares were paid for in September 2011.

In 2010, with the resolution of the sole shareholder, the share capital was increased by 5,786 thousand euros. The payment for the increase in the nominal value of the share was made in December 2010.

No dividends were paid in the financial years 2011 and 2010.

As of 31.12.2011 the Company's statutory reserve capital totalled 3,490 thousand euros (31.12.2010: 2,814 thousand euros). As at 31.12.2011 the Company has the obligation to additionally transfer 1,025 thousand euros (31.12.2010: 676 thousand euros) to reserve capital.

The retained earnings of the Company as of 31.12.2011 amounted to 36,889 thousand euros (31.12.2010: 17,063 thousand euros). The income tax applicable to the net profit distributable as dividends is 21/79 from 1 January 2008. As of 31.12.2011 it would be possible to distribute 28,333 thousand euros as net dividends (31.12.2010: 12,946 thousand euros) and the corresponding income tax would amount to 7,531 thousand euros (31.12.2010: 3,441 thousand euros).

Note 15

REVENUE

Analysis of revenue by activity

in thousands of euros	*2011*	*2010*
Sales of balancing and control electricity		
Balancing electricity	15,314	15,708
Control service	260	125
Total Sales of balancing and control electricity	**15,574**	**15,833**
Sales of network services		
Transmission fees	73,031	67,239
Revenue from connection fees (Note 13)	1,222	1,147
Other network services*	2,681	2,339
Total sales of network services	**76,934**	**70,725**

Analysis of revenue by activity

Sales of other goods and services		
Lease of transmission equipment (Note 22)	820	820
Sales of scrap metal	91	706
Sales of other services	697	778
• Incl. lease of buildings (Note 22)	317	411
Other goods	40	3
Total sales of other goods and services	**1,648**	**2,307**
Total revenue	**94,156**	**88,865**

Analysis of revenue by geographical location of customers

in thousands of euros	*2011*	*2010*
Estonia	91,284	86,983
Latvia	2,282	1,247
Russia	364	380
Lithuania	61	238
Finland	165	17
Total revenue	**94,156**	**88,865**

Note 16

OTHER INCOME

in thousands of euros	*2011*	*2010*
Fines, penalties and compensations received	114	20
Profit on disposal of property, plant and equipment	22	61
Foreign grants for operating expenses	105	0
Government grants related to acquisition of property, plant and equipment	6	0
Other income	0	5
Total other income	**247**	**86**

Note 17

GOODS, RAW MATERIALS AND SERVICES

in thousands of euros	*2011*	*2010*
Electricity purchased to provide the balancing service		
Purchase of balancing electricity	9,570	9,531
Purchase of power regulation service	5,602	5,893
Total electricity purchased to provide the balancing service	**15,172**	**15,424**

in thousands of euros	*2011*	*2010*
System services		
Purchased electricity reserves	5,012	4,298
Reactive energy	283	162
Total system services expenses	**5,295**	**4,460**
Electricity to compensate for network losses		
Electricity from non-renewable sources	10,438	11,397
Total electricity to compensate for network losses	**10,438**	**11,397**
Maintenance and repair works		
On facilities and equipment related to core activities	4,362	4,357
On production buildings and sites	670	729
Disassembly works and waste processing	56	130
Other expenses	153	197
Total maintenance and repair works	**5,241**	**5,413**
Other expenses		
Operative switching and dispatching management expenses	601	576
Other expenses	592	485
Total other expenses	**1,193**	**1,062**
Total goods, raw materials and services	**37,339**	**37,756**

Note 18

OTHER OPERATING EXPENSES

in thousands of euros	*2011*	*2010*
Transportation and tools	97	79
Security, insurance and occupational safety	167	276
Office expenses	495	413
Research and consulting	509	394
Telecommunication	936	899
Information technology	365	432
Training and other operating expenses	608	450
Total other operating expenses	**3,177**	**2,943**

Note 19

STAFF COSTS

in thousands of euros	*2011*	*2010*
Basic salaries, additional remuneration, bonuses, vacation pay	2,804	2,723
Other benefits	0	15
Termination benefits	18	12
Other remuneration	118	81
Total remuneration to employees	**2,940**	**2,831**
Social security tax	972	938
Unemployment insurance tax	37	35
Total staff costs	**3,949**	**3,804**
• Including compensations to the members of the Management and Supervisory Board		
Salaries, additional remuneration bonuses, vacation pay	205	201
Fringe benefits	29	18
Social security tax	77	72
Total compensations to the members of the Management and Supervisory Boards	**311**	**291**

The average monthly pay was 1,706 euros (2010: 1,681 euros).

Termination benefits
The members of the Management Board receive compensation for premature termination of their employment contracts, such compensation amounts up to the three months' salary.

Note 20

OTHER EXPENSES

in thousands of euros	*2011*	*2010*
Non-business related expenses	44	28
Fines, penalties and compensations paid	24	0
Income tax from expenses not related to business	1	5
Other	57	8
Total other expenses	**126**	**41**

Note 21

FINANCE INCOME AND COSTS

in thousands of euros	*2011*	*2010*
Finance income		
Interest income	661	85
Foreign exchange gains	0	1
Total finance income	**661**	**86**
Finance costs		
Interest expenses	-10,655	-8,364
Foreign exchange losses	-3	-6
Total finance costs	**-10,658**	**-8,370**
Capitalised finance costs (Notes 9 and 10)	1,931	1,035
Total finance income and costs recognised in the statement of comprehensive income	**-8,727**	**-7,335**
Net finance income (costs)	**-8,066**	**-7,249**

Note 22

OPERATING LEASE

Company as a lessor

Operating lease revenue

in thousands of euros	*2011*	*2010*
Buildings	317	411
Transmission equipment	820	820
Total operating lease revenue (Note 15)	**1,137**	**1,231**

Transmission equipment
The Company has an operating lease contract under which the free fibres of the fibre-optic cable fixed to the line masts are leased out. This cable also acts as a lightning protection cord for the lines and the fibres are used by the Company for its technical communication. The free fibres have been leased out to Televõrgu AS. The lease contract contains a restriction under which the Company cannot give its transmission equipment out for use by other companies operating in the telecommunications field. The contract is effective until 31.03.2025. Annual lease payments variy depending on the length of fibres leased out during the year.

Information about assets (facilities) leased out under operating leases

in thousands of euros	*31/12/2011*	*31/12/2010*
Cost	5,961	5,795
Accumulated depreciation at the end of period	-2,601	-2,171
Carrying amount	**3,360**	**3,624**

Depreciation charge

in thousands of euros	*2011*	*2010*
Depreciation charge	429	365

Estimated future lease payments under operating leases

in thousands of euros	*31/12/2011*	*31/12/2010*
Not later than 1 year	840	820
Later than 1 year and not later than 5 years	3,360	3,278
Later than 5 years	6,930	7,581
Total future minimum lease payments	**11,130**	**11,679**

Company as a lessee

Operating lease expenses

in thousands of euros	*2011*	*2010*
Buildings	36	36
Transport equipment	64	56
Other machinery and equipment	60	94
Total operating lease expenses	**160**	**186**

All operating leases where the Company is a lessee can be terminated upon short notice.

Note 23

BALANCES AND TRANSACTIONS WITH RELATED PARTIES

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form:

(I) Republic of Estonia and the entities under its control or significant influence
(II) Management and Supervisory Boards

(III) Close relatives of the persons described above and the entities under their control or significant influence
(IV) Until 27.01.2010 parent company and other entities in the consolidation group of the parent company (i.e. fellow subsidiaries)

The outstanding balances with related parties were as follows:

in thousands of euros	*31/12/2011*	*31/12/2010*
Trade receivables		
Companies controlled or significantly influenced by the State	14,412	17,473
Total trade receivables	**14,412**	**17,473**
· incl. from network operators	13,775	16,006
Trade payables and other liabilities		
Companies controlled or significantly influenced by the State	12,644	8,146
Total trade payables and other liabilities	**12,644**	**8,146**

Income and expense items with related parties were as follows:

in thousands of euros	*Related party*	*2011*	*2010*
Revenue from sale of goods and services	Parent company*	0	501
	Fellow subsidiaries *	0	8,388
	Companies controlled or significantly influenced by the State	81,994	69,676
Total revenue from sale of goods and services		**81,994**	**78,565**
Purchase of goods and services	Parent company*	0	347
	Fellow subsidiaries*	0	1,889
	Companies controlled or significantly influenced by the State	23,693	13,734
Total purchase of goods and services		**23,693**	**15,970**
Interest expenses	Parent company*	0	178
Incl. Capitalised borrowing costs (Note 21)		0	-19
Expenditures on non-current assets	Parent company*	0	24
	Fellow subsidiaries *	0	135
	Companies controlled or significantly influenced by the State	1,302	59
Total expenditures on non-current assets		**1,302**	**218**

* *the Company was part of Eesti Energia Group until 27.01.2010. The sales to related parties in 2010 also include the transactions with the entities of Eesti Energia Group concluded in January 2010.*

Transactions with companies, in which the members of the Supervisory and Management Boards as well as their close relatives have significant influence

in thousands of euros	*2011*	*2010*
Purchases of services	0	1

Key management personnel compensations are disclosed in Note 19.

Note 24

CONTINGENCIES AND COMMITMENTS

Network development obligations
Under the Electricity Market Act, the network operator must develop the network within its service area in a way that ensures the continued provision of network services in accordance with the set requirements.

Capital expenditure commitments
On 31.12.2011, the Company has contractual capital expenditure commitments in respect of property, plant and equipment totalling 294,226 thousand euros (31.12.2010: 231,264 thousand euros). The largest of them are the contracts for the construction of the second undersea electricity cable EstLink 2 between Estonia and Finland in 2011-2014. The contribution of the Company is 126,406 thousand euros and expenditure on emergency reserve power plant is 113,591 thousand euros in 2011-2014.

Tax legislation
The tax authorities have the right to verify the Company's tax records up to 6 years from the time of submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The Company's management estimates that there are not any circumstances which may lead the tax authorities to impose additional significant taxes on the Company.

INDEPENDENT AUDITOR'S REPORT

(Translation of the Estonian original)*

Report on the Financial Statements

To the Shareholder of Elering AS

We have audited the accompanying financial statements of Elering AS (the Company), which comprise the statement of financial position as of 31 December 2011 and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation, and true and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

AS PricewaterhouseCoopers, Pärnu mnt 15, 10141 Tallinn, Estonia; Audit Company's Registration No.6
T: +372 614 1800, F: +372 614 1900, www.pwc.ee

Report on the Legal and Regulatory Requirements

During the audit we have not noted any material inconsistencies between the accompanying financial statements and the regulatory requirements as set out in Electricity Market Act and legislation established on the basis thereof.

AS PricewaterhouseCoopers

Ago Vilu
Auditor's Certificate No.325

30 March 2012

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

PROFIT ALLOCATION PROPOSAL

The retained earnings of Elering AS as of 31.12.2011 were 36,888,763 euros.

Management Board of Elering AS proposes to the sole shareholder
to allocate the retained earnings as follows:

Statutory legal reserve	1,025,052 euros
Retained earnings	35,863,711 euros

SIGNATURES OF THE MANAGEMENT TO THE 2011 ANNUAL REPORT

The signing of Elering AS 2011 Annual Report on 30.03.2012.

Taavi Veskimägi
Chairman of the Management Board

Kalle Kilk
Member of the Management Board

Peep Soone
Member of the Management Board

THE REVENUE OF ELERING AS ACCORDING TO EMTAK 2008

The revenue of Elering AS is divided by the main areas of activities as follows:

EMTAK area of activity*	*2011*	*2010*
35121 Transmission of electricity – transmission through the transmission network	77,314	70,725
35141 Trade of electricity (balancing electricity)	15,574	15,833
77399 Renting and leasing of other machinery, equipment and tangible goods n.e.c.	820	820
47770 Retail sale of other second-hand goods	131	709
68201 Renting and operating of own or leased real estate	317	406

** EMTAK – classification of Estonian economic activities*

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