GILDTOP100

The most valuable
Estonian companies

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Photo: GILD Bankers

Dear Readers

It is amazing how much Estonian businesses are worth. Would you have believed that the total value of the 100 biggest Estonian companies amounts to almost EUR 350 billion? What is the price of the most valuable Estonian business in your opinion? GILD Bankers is happy to be the first to offer answers to these questions based on methods of widespread use in the world.

Several rankings of companies have been prepared in Estonia. Although methods differ, the hitherto published rankings mainly use relative assessment where the results of a business are compared with its earlier results.

The GILD Top 100 was prepared on totally different grounds. We attempted to assess the monetary value of the businesses. The main objective of any business is neither to increase its turnover nor even to improve its profitability. The actual objective of a commercial enterprise is to earn profit for its owners, to improve the equity value of the business. The GILD TOP 100 shows which businesses have managed best in this task and where the corporate wealth of Estonian enterprise lies. It ranks businesses according to the estimated value of their equity as of 01.01.2007, with the assumption that they were publicly traded on the Tallinn Stock Exchange at that moment.

Determining of the price of businesses based on public information is not at all an easy task. In its daily work GILD Bankers comes into contact with many companies which have made it into the ranking. Therefore, we would be able to calculate a more precise value, but for obvious reasons, we used no confidential information. We still believe that we reached the price that was fair and appropriate at the beginning of 2007. Value assessment, to a certain extent, is always subjective. I therefore recommend readers examine the description of the GILD TOP 100 methodology.

This year, we decided with our cooperation partners to give four awards based on the rankings – of course to the most valuable business - Hansabank, to Tallink as the most valuable business controlled by Estonian capital, to Eesti Energia for having the biggest potential to become a public company, and to Viru Keemia Grupp as the biggest surprise in the opinion of those who prepared the list. But all 100 businesses in the list are still winners. We congratulate you all!

Value is directed towards the future, and it shows the ability of a company to successfully manage during changing business cycles. In the interests of the welfare of each business, the state, and the society, more attention must be paid to increasing the value of the business. Today's trends show that the bigger Estonian companies become, the more likely they are to attempt to find the most favourable tax and business environment for their activities. If we want the most valuable businesses, regardless of the nationality of their capital, to establish themselves here, we have to create an attractive business climate also for the biggest and most ambitious.

GILD Bankers would like to thank all its cooperation partners and everyone who assisted in compiling the rankings of valuable Estonian companies.

I hope this report will enable you to hit on even more valuable and inspiring ideas.

Yours,
RAIN TAMM
Managing Partner
GILD Bankers

Photo: GILD Bankers

How was the GILDTOP100 compiled?

ALAR VOITKA
GILD Bankers' Senior Associate

The GILD TOP 100 ranks Estonian companies according to the estimated value of their equity as of 01.01.2007, based on the assumption the companies traded on the Tallinn Stock Exchange at that moment. In Estonia, the GILD Top 100 is the first serious attempt to identify and value the biggest businesses. Similar surveys have been prepared before, e.g. The Financial Times' "Top 150 Non-Public Companies."

Prior to viewing the results of the ranking, one must know three things:

First, this is not company takeover value, or in other words, there is no reason to presume, that if you come to an investment bank with an idea to sell the business or purchase a competitor, the purchase price will be close to the value indicated in the ranking.

Second, our assessment of the market capitalisation of the business does not take into consideration the size of the business and its probable liquidity on the secondary market. Both these aspects have their impact on the actual exchange price of the business.

Third, we have not adjusted the value judgements with the impact of any business-specific risks, e.g. the competence of the management, dependence on major suppliers or customers, cooperation between principal owners, and other such circumstances. The value judgements have been stated on the assumption that the business is a going concern.

Criteria

The list of the one hundred biggest companies in Estonia was based on profit-making organisations registered in the Commercial Register. The companies assessed included inter alia, publicly traded companies, state enterprises and joint undertakings. Branches of foreign companies (e.g. Nordea) and organisations that are not directly profit-oriented (e.g. RMK - State Forest Management Centre) were omitted. Furthermore, holding companies (e.g. Hansa Assets, US Invest, Pambos Holdings, etc.) were also excluded.

As the objective was to rank businesses according to the estimated market value of their equity, we assessed the parent company as a rule in case of groups. Therefore you find Merko Group, not Merko Ehitus, and Hansabank, not Hansa Liising Eesti, among the one hundred biggest companies. An exception was made where the estimated market value of any subsidiary (controlled company) turned out to be bigger separately than the market value of the group as a whole. In such cases, the parent company (controlling company) was left out and the subsidiaries run separately for the ranking. NG Investeeringud is an example here, as Tallinna Kaubamaja left NG Investeeringud (hardly) behind in market value. Therefore you find both Tallinna Kaubamaja and Liviko in the GILD Top 100 ranking instead of NG Investeeringud.

Assessment methods

Businesses may be assessed using various methods, which vary from each other both in principle, accuracy as well as the information required for their use. Taking into consideration the scope of the work and the intention of GILD Bankers to give as impartial and objective assessment to the market value of the business as possible, we chose to use the comparative assessment method. It is important to point out here that GILD Bankers used only public information for the assessment of the market value of the businesses.

In the case of comparative assessments, the judgement of the value of the business is based on the values of other businesses already assessed by the market. As we were assessing the business' equity value or the market capitalisation, GILD Bankers formed a suitable comparison group for each business or sector, and we chose for it public companies listed on various world stock exchanges operating in similar areas of activity, with as similar growth potential, risk profile and profitability. Comparison groups were formed for companies operating in several essential areas of activity. We preferred European businesses, but in the case of need we also included US and/or Asian businesses in the comparison groups. We did not prepare any special comparison groups for the companies listed on the Tallinn Stock Exchange at the end of 2006, as their exchange value at the end of the year was known.

For the businesses in the comparison group, their year-end value multiple were calculated (the exchange value of the comparison business at the end of the year divided by its financial indicators for 2006, e.g. turnover, profit or equity). The median values of the comparison group multiple were in turn applied to the financial results of the business assessed, and through this the equity value of the business was derived. Here we point out that the financial data of the businesses assessed had to be adjusted first in almost all cases in order to eliminate the impact of any income and expenditure of nonrecurring nature, e.g. exchange rate gains, gains from the sale or write-ups of non-current assets, etc.

In the case of comparative assessments, the judgement of the value of the business is based on the values of other businesses already assessed by the market.

As a rule we assessed the value of the business based on either the earnings before interest, taxes, depreciation and amortization (EBITDA) or the earnings before interest and taxes (EBIT), but in certain cases we also used the turnover or book value of equity multiples.

Results

The assessment results are in the GILD Top 100 ranking. The results reflect the valuation of similar businesses on foreign stock exchanges at the beginning of 2007. Taking into consideration the peculiarities of Estonia, primarily its stronger growth potential and more favourable tax environment, we can say that the estimations here are, with certain exceptions, rather conservative, and when new businesses are listed, a little higher valuation levels could be expected. In principle, GILD Bankers abstained from any subjective upward adjustment of the median values of the comparison group. In the same way we abstained from any downward adjustment of the multiple of Eesti Raudtee and other such businesses, in light of the events and new information received this year.

The net debt position of the business had significant impact on equity value, and to a smaller extent, also the existence or absence of minority shareholdings. Figuratively speaking, if we have two otherwise identical businesses, the one with a higher debt burden is much less valuable from the point of view of its owner. GILD Bankers assessed both the debt burden of the business as well as its cash and other interest bearing claims in their nominal value, although we had strong doubts in case of certain businesses when examining their intragroup loans with compound interest about that the market would evaluate with a strong discount such tricks made for avoiding taxes associated with dividends.

In conlusion, I would like to stress that this first estimate is based on only public information, which will hopefully help to start a discussion about the development of businesses from the aspect of increasing their value and the opportunities of promoting it.

I would like to thank everyone who participated in this project and gave their contribution to the GILD Top 100.

GILDTOP100

The most valuable
Estonian companies

Rank	Company	Sector	Value (millions EEK)	Turnover for 2006 (millions EEK)	Net profit for 2006 (millions EEK)	Principal owners
1	Hansapank, AS	financial sector	89 065	N/A	5062	Swedbank AB 100%
2	Eesti Energia, AS	utilities sector	24 713	7299	3229	Republic of Estonia 100%
3	SEB Eesti Ühispank, AS	financial sector	21 367	N/A	1375	Skandinaviska Enskilda Banken (SEB) 100%
4	Eesti Telekom, AS	telecommunications	18 132	5768	1309	TeliaSonera AB 53,7%; Republic of Estonia 27,2%
5	Tallink Grupp, AS *(period 01.12.2005–30.11.2006)*	transport	13 464	8316	1537	Infortar AS 38,9%; ING Luxembourg S.A. 9,6%; Citibank Hong Kong (CIFC) 7,8%
6	Olympic Entertainment Group, AS	entertainment	10 488	1659	389	OÜ HansaAssets 51,7%; OÜ Hendaya Invest 27,8%
7	Tallinna Sadam, AS	transport	6 385	1178	595	Republic of Estonia 100%
8	Tele2 Eesti, AS	telecommunications	6 326	1682	463	Tele2 Holding AS 51,99%; Beleggingsmaatschappij Belmus B.V. 47,99%
9	Sampo Pank, AS	financial sector	6 016		333	Danske Bank 100%
10	Tallinna Kaubamaja, AS	trade	5 850	4239	275	NG Investeeringud AS 67%; ING Luxembourg A.A. 8,9%
11	Merko Grupp, AS	construction	5 798	3592	476	Toomas Annus 65,3%
12	BLRT Grupp, AS	metal industry	5 728	3495	399	Fjodor Berman 37,5%
13	Elisa Andmesideteenused, AS (Elisa Eesti, AS) *at the end of 2006 acquired Elisa Mobiilsideteenused AS*	telecommunications	5 310	240	103	Elisa OYJ 100%
14	Tallinna Vesi, AS	utilities sector	4697	693	248	United Utilities (Tallinn) B.V. 35,3%; Tallinna linn 34,7%

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1

Photos: Vallo Kruuser, Ingmar Muusikus, Priit Simson/Eesti Päevaleht, Ardo Kaljuvee/Eesti Päevaleht


2


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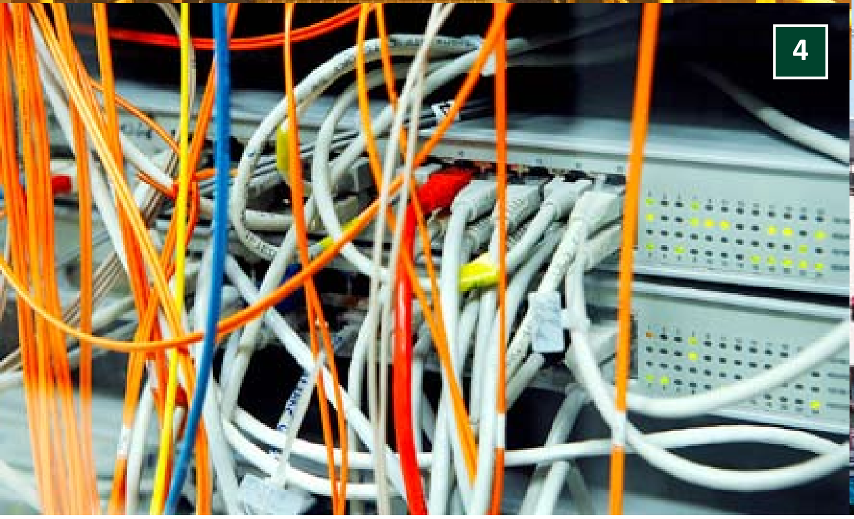
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Special nominations

※ Based on the results of the ranking GILD Bankers, Eesti Ekspress, Tallinn Stock Exchange and Estonian Confederation of Employers decided to award some special nominations.

※ We accentuated separately those businesses with the highest value, which have proven that it is possible to successfully grow and expand even without selling the controlling interest to foreign investors. Estonian Employers' Confederation award for the most valuable Estonian company controlled by Estonian private capital was given to Tallink.

※ Tallinn Stock Exchange awarded Eesti Energia for having biggest potential to become a public company. The stock exchange TOP 3 formed of the biggest companies, which shares are not publicly traded today on any stock exchange, neither directly nor through their parent companies. At the same time these companies already regularly disclose information about their economic activities and their important management decisions. They would be interesting for investors even with regard to their size and reputation.

※ Eesti Ekspress awarded Viru Keemia Grupp as the biggest surprise in the list. Regardless of the relatively little public attention, Viru Keemia Grupp is an industrial undertaking actively expanding and investing in the environmental and product development activities, which market value has already increased up to at least 2.8 billion kroons by today.

I The Estonian business with the highest value

1. Hansapank
2. Eesti Energia
3. SEB Eesti Ühispank

II The business with the highest value controlled by Estonian private capital

1. Tallink
2. Olympic Entertainment Group
3. Tallinna Kaubamaja

III The Most Likely IPO Candidate

1. Eesti Energia
2. Tallinna Sadam
3. BLRT Grupp

IV The biggest surprisor

Viru Keemia Grupp

Rank	Company	Sector	Value (millions EEK)	Turnover for 2006 (millions EEK)	Net profit for 2006 (millions EEK)	Principal owners
15	Transgroup Invest, AS	transport	4220	11 755	365	Sergei Glinka 50%; Maksim Liksutov 50%
16	Eesti Raudtee, AS	transport	3669	1821	249	BRS 66%, Republic of Estonia 34% (Republic of Estonia 100%)
17	Kunda Nordic Tsement, AS	production of building materials	2839	824	264	HeidelbergCement Sweden AB 75%
18	Viru Keemia Grupp, AS	chemical industry	2796	1504	299	Tristen Trade OÜ 38,9%; Alvekor OÜ 25,5%
19	Falck Baltics, AS (G4S Baltics, AS)	security services	2721	1560	172	Group 4 Falck International AS 55%; US Securities Holding OÜ 26,87%
20	Pro Kapital Grupp, AS *data for 2005*	real estate	2689	2686	-85	Lion Ventura-Trustee-Servicos 39%
21	Ühendatud Kapital, AS	real estate	2586	439	509	Expert Capital S.A. 100%
22	Eesti Ehitus, AS	construction	2543	2504	175	AS Nordecon 66,2%
23	Silberauto, AS	trade	2503	4008	184	Väino Kaldoja 100%
24	If Eesti Kindlustus, AS	financial sector	2430	N/A	215	If P&C Insurance Holding Ltd
25	PTA Grupp AS (Silvano Fashion Grupp, AS)	trade	2333	423	45	SIA Alta Capital Partners 73,9%
26	Rakvere Lihakombinaat, AS	food industry	2287	1699	181	HK Ruokatalo OY 100%

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Photos Rauno Volmar/EPL

Rank	Company	Sector	Value (millions EEK)	Turnover for 2006 (millions EEK)	Net profit for 2006 (millions EEK)	Principal owners
27	Baltika, AS	trade	2159	899	87	OÜ BMIG 20,8%; management board members in total 27,8%
28	A. Le Coq, AS	food industry	2145	962	146	A. Le Coq Group AS 100% (Olvi Oyj)
29	Rimi Eesti Food, AS	trade	1923	5408	46	Rimi Baltic AB 100%
30	General DataComm International, OÜ	trade	1892	824	135	General Datacomm OOO 100%
31	Magnum, AS	trade	1847	2169	104	Kadux B.V. 51,1%
32	Saku Õlletehase AS	food industry	1702	770	118	Baltic Beverages Holding AB 75%
33	Toyota Baltic, AS *(period 01.04.2006–31.03.2007)*	trade	1702	3382	116	Toyota Motor Finland Oy 100%
34	Tallinna Lennujaam, AS	transport	1601	331	95	Republic of Estonia 100%
35	Eurodek Tallinn, OÜ	transport	1592	615	113	Blanin Holding Ltd. 100%
36	maxit Estonia, AS	production of building materials	1552	669	148	maxit Oy Ab 100%
37	Ekspress Grupp, AS	media	1552	931	92	Hans Luik 65,2%; OÜ HHL Rühm 34,8%
38	Trigon Capital, AS	financial sector	1536	N/A	121	Joakim J. Helenius 55,7%, Thominvest Oy 28,5%
39	Balti Investeeringute Grupi Pank, AS	financial sector	1522	N/A	174	Parvel Pruunsild 50%; Vahur Voll 50%
40	Arco Vara, AS	real estate	1518	484	208	Toletum OÜ 66,7%, HM Investeeringud OÜ 33,3%
41	Stockmann, AS	trade	1502	1245	127	Stockmann Oyj Abp 100%
42	Famar-Desi, AS (Famar-Desi Grupp AS)	trade	1494	1744	103	AS Desintegraator 50%; AS Famar-Kauba 50%

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43	Hotell Viru, AS	real estate	1443	4	26	Pontos Oy 90%
44	Skanska EMV, AS	construction	1418	1910	126	Skanska Oy 100%
45	Mecro, AS	trade	1386	1789	97	Ando Aron 75%, Mart Lajal 25%
46	Ergo Kindlustuse AS	financial sector	1370	821	121	ERGO International AG 100%
47	Pakterminal, AS	transport	1362	388	147	Trans-Kullo AS 50%; Tankmaatschappij Dipping B.V. 50%
48	Eesti Krediidipank, AS	financial sector	1286	N/A	79	JSC Latvian Business Bank 65,7%; Valentina Otsason 15,7%
49	Henkel Makroflex, AS	production of building materials	1260	942	112	BANK Austria Creditanstalt AG Clients 100%
50	Lavesta, AS	trade	1187	3303	141	Roseglen Corporation Limited 100%
51	ABB, AS	production of electrical equipment	1185	1376	59	ABB Norden Holding AB
52	Cramo Estonia, AS	construction equipment rental	1178	279	92	Cramo Oyj 100%
53	EKE Invest, AS	real estate	1119	277	79	Harju KEK AS 27%, Uuemõisa Invest OÜ 20%
54	Transiidikeskuse AS	transport	1117	390	155	Trans Investment Group AS 80,4%
55	Riigi Kinnisvara AS	real estate	1108	188	43	Republic of Estonia 100%
56	Harju Elekter, AS	production of electrical equipment	1091	622	47	Harju KEK AS 30,1%; ING Luxembourg S.A. 10%
57	Lennuliiklus-teeninduse AS	transport	1083	209	72	Republic of Estonia 100%
58	DBT, AS	transport	1083	311	68	Transiidikeskus AS 45%; CAPCO Holdings Limited 45%
59	Technomar & Adrem, AS	timber industry	1064	475	94	Igor Izraeljan 90%
60	Elke Grupi AS	trade	1059	1627	72	Urmas Sepp/ Peeter Kangur/ Riho Sepp 26,3%; Vello Väinsalu 20%
61	Eesti Meedia, AS	media	1 058	12	63	Schibsted ASA 100%

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Rank	Company	Sector	Value (millions EEK)	Turnover for 2006 (millions EEK)	Net profit for 2006 (millions EEK)	Principal owners
62	E-Betoonelement, AS	production of building materials	1056	651	101	Consolis OY AB 100%
63	Norma, AS	production of car parts	1055	1047	86	Autoliv AB 51%
64	ES Sadolin AS	chemical industry	1044	785	64	Akzo Nobel Coatings OY 90%
65	Ramirent, AS	construction equipment rental	1042	236	83	Ramirent Europe OY 100%
66	Eesti Gaas, AS	utilities sector	1020	1630	56	OAO Gazprom 37,%; E.ON Ruhrgas International AG 33,6%; Fortum Heat and Gas OY 17,7%
67	Neste Eesti AS	trade	985	2273	96	Neste Oil Oyj 100%
68	Harju KEK, AS	trade	982	622	64	Lembit Kirsme 20,7%, Endel Palla 10%
69	Konesko, AS	production of electrical equipment	970	673	69	Mart-Järvo Hirtentreu 46%
70	Krimelte, OÜ	production of building materials	969	756	79	Britech International LTD 49%
71	Rocca al Mare Kaubanduskeskus, AS	real estate	956	81	53	Citycon Estonia OÜ
72	Nordea Finance Estonia, AS	financial sector	938	N/A	63	Nordea Finance Finland Ltd
73	Eesti Statoil, AS	trade	937	2572	78	Statoil ASA 100%
74	Seesam Rahvusvaheline Kindlustuse AS	financial sector	930	N/A	83	OKO Bank Plc. 100%
75	Järvakandi Klaas, AS	glass industry	926	483	73	OI Finnsh Holdings Oy 100%
76	Sokotel, AS	hotels	926	302	65	Suomen Osuuskauppojen Keskuskunta 100%
77	Liviko, AS	food industry	920	504	48	OÜ NG Investeeringud 100%
78	Nitrofert, AS	chemical industry	916	834	37	Balmat Holding Limited (Küpros) 100%
79	Espak, AS	trade	913	839	58	Arvi Liivik 22,7%; Maris Johannes 22,7%
80	Amserv Grupi AS	trade	907	1882	62	R.R. Varad OÜ 49,9%, Raivo Kütt 25%, Raivo Aavisto 25%

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81	Prisma Peremarket, AS	trade	903	1516	52	Suomen Osuuskauppojen Keskuskunta 100%
82	Teede REV-2, AS (TREV-2 Grupp, AS)	construction	901	1126	58	TREV Capital AS 67%
83	Starman, AS	telecommunications	899	235	44	Royalton Capital Investors 33,4%; OÜ Constock 19,1%; OÜ Com Holding 17,8%
84	Mainor, AS	real estate	867	241	170	AS Maskello 26,4%; Thominvest OY 13,1%; Ülo Pärnits 11,7%
85	TTP, AS	real estate	852	468	205	Tiit Aava 80%
86	Skinest Grupp, AS	trade	844	638	104	Oleg Ossinovski 100%
87	Stora Enso Timber, AS	timber industry	840	1799	-117	Stora Enso Timber Oy Ltd. 100%
88	Ehitus Service, OÜ	trade	825	805	52	Askembla Growth Fund 58%
89	Levadia Group, OÜ	metal industry	819	1592	167	Viktor Levada 90%
90	Wendre, AS	textile industry	809	688	60	Trading House Scandinavia AB 100%
91	RDS Hotelli AS	hotels	799	184	58	Pontos Development Ltd. 46,7%; Finnish Fund for Industrial Cooperation Ltd. 25,9%
92	Talter, AS	construction	795	784	49	Lemminkäinen Oyj 99,4%
93	Leibur, AS	food industry	776	293	41	Vaasan & Vaasan Oy
94	T.R. Tamme Auto, OÜ	chemical industry	766	378	104	Toomas Tamm 60%; Raivo Tamm 40%
95	Rudus Eesti, AS	production of building materials	759	543	73	Rudus AB OY 100%
96	Eesti AGA, AS	chemical industry	758	190	64	OY AGA Ab 100%
97	Tartu Maja Betoontooted, AS	production of building materials	756	443	75	AS Merko Ehitus 25%; AS Skanska EMV 25%; AS YIT Ehitus 25%; Jaan Luts 12,5%; Vallot Mangus 12,5%
98	Manutent, OÜ	real estate	754	303	78	Harustemos OÜ 50%
99	Kolle, AS	production of building materials	753	753	119	Kai Konstruktor AS 70,2%
100	E.O.S., AS	transport	750	767	268	Intercross Investments AB 48,6%

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The most valuable business in Estonia is Swedish-owned Hansabank. The bank's "price" exceeds 89 billion EEK.

A Definite Leader

SULEV VEDLER
Eesti Ekspress

Hansabank for the Swedes represents both fortune and misfortune.

The investment in Estonia is becoming increasingly more important for our Western neighbors: the percentage of Hansabank's loans in the total loan burden of Swedbank Group was 16% in the second quarter this year, its share in net profit was 32% and its contribution to profit increase was as much as 92%.

"The profit trend has been especially strong in the Baltic States," said Swedbank's Chairman of the Board Jan Liden when presenting the results for the first half-year.

During the past year, Hansabank's net profit increased nine times faster than that of the parent bank.

The Banker, a British specialist magazine, has awarded Hansabank the Best Bank in Estonia title for seven consecutive years. That is greater superiority than what Michael Schumacher enjoyed in his time in the F1 series.

As of summer 2007, Hansabank was the market leader in all three Baltic States in terms of deposits as well as lending. The bank came a close second to the SEB Group in the Lithuanian lending market.

The Swedes took over Hansabank in the spring two years ago. The bank's market value then was 67 billion EEK. An analysis by GILD Bankers estimates Hansabank's value (as of the end of the year) to be more than 89 billion EEK. In a year and a half, the bank's value increased by approximately one third.

At the same time, due to a price decrease of their shares on the Stockholm stock exchange, the owners of Swedbank have lost more than 55 billion EEK in the last seven months and Hansabank is largely to blame. Investors are afraid of overheating of the Baltic economy and the resulting backlashes.

THE MASTER ARRIVES: Swedbank's manager Jan Liden in Tallinn during Hansabank's takeover in the spring of 2005.

So it is that Hansabank's hitherto exhilarated expansion will find itself under scrutiny since the Swedes are planning to separate the subsidiary Russian bank from Tallinn and place it under Stockholm's leadership.

Falling Share Prices

On 15 February, Swedbank's shares on the Stockholm stock exchange reached their highest point ever – 282 SEK per share. This record can largely be attributed to Hansabank's outstanding economic results and extensive plans of expansion to Russia, including entering the retail market planned for the current year.

However, there were other opinions spreading in the market. In the winter and spring, an analyst from the influential ratings agency Standard & Poor's visited Tallinn and, after the visit, recommended to "definitely sell" Swedbank's shares since, even in the best-case scenario, they could lose as much as one-tenth of their current price in a year.

In June, Hansabank painfully burned its fingers in Russia. The local central bank restricted Hansabank's activities for three months in a number of important areas due to the bank's Russian branch's breach of rules in the fight against money laundering. The bank did not put up a fight as it had indeed committed the aforementioned sin.

In the summer, talk of the "coming back to earth" of the Baltic economies gained momentum. The main question no longer was whether a return to earth would happen but rather how bumpy the landing would be.

In the beginning of August, Fitch Ratings still confirmed Hansabank's ratings on the same level as before. When the mess that started in the US housing market hit the world's capital markets in a tsunami-like fashion, numerical proof emerged

Hansabank got things right from the start and it did not have a burden to carry from the Soviet times.

of the shrinking economic growth in this region. While Estonian gross domestic product in the first quarter increased 9.8%, second-quarter growth slowed to 7.6%.

In the beginning of October, Swedbank shares on the Stockholm stock exchange cost 216 SEK, 23% less compared to its highest price in winter.

The Big Question: How should Growth Continue?

In the Business Plan 2008 conference in the middle of September, Hansabank Estonia's director general Priit Põldoja said that the local banks are still doing "extremely well. For the second year in a row, all of the banks are showing off record profits and enormous growth."

At the same time, Põldoja extended a warning that "luck-based" economic growth is drawing to a close and the next growth will be much more difficult to achieve than the previous one. In terms of banks, "their profit ceiling was reached in the third quarter of 2007. That's my personal prognosis," the banker estimated.

Põldoja explained how the banking business had been very easy thus far. International parent banks provided free money, which was loaned out in increasing amounts while low interest rates promoted the lending.

The picture has changed now. Interest rates are going up. Loan amounts are not growing at their former speed. When the latest economic results were published, Põldoja told Eesti Ekspress that people were taking smaller loans than before in the home loans market. "As compared to the same period last year, the number of new clients had decreased by 13% in the first half-year. At the same time, more loan agreements were signed than a year ago," he said.

Banks are facing the question of how to proceed. It is as difficult to lure clients away from the competitors as it is to win new clients. "Are there any new products we could bring to the local market? It is increasingly more difficult to achieve easy growth," Põldoja said at the abovementioned conference and noted that Hansabank is contemplating fund product sales to Scandinavia.

"We have far greater challenges ahead of us than those that we were accustomed to facing in the past few years," Põldoja concluded.

The Good Old and the Good New Swedish Times

Estonians have used the expression "the good old Swedish times" for centuries now. The expression refers in general to the period of 1629–1699 when a large part of the country was under the rule of the king's court in Stockholm.

Swedish power settled here after the Livonian War when the Russian forces had looted this part of Europe's once blooming and fruitful granary.

More specifically, "the good old Swedish times" refer to the period from when Sweden's King Karl XI gained the throne to the great famine in 1680. The Swedes confiscated manor estates from the Germans, freed the Estonians from servitude and established peasants' schools. This noted a quintessential change in the Estonian way of thinking.

The last decade in Estonia can be described as "the good new Swedish times." This is due to Swedish capital that helped Estonian economy to re-bloom after the terrible decades-long Soviet period.

According to statistics from the Bank of Estonia, Swedish direct investments in the country amount to 65 billion EEK which constitute 40% of all direct investment in Estonia.

An especially important role here is played by Swedbank, which is a collective farm-like formation that was established by merging agricultural credit unions and savings funds and that used to carry a name difficult to pronounce for foreigners – FöreningsSparbanken.

While minister Axel Oxenstiern in the 17th century, i.e. "the good old times," wanted to make the Estonian-Russian border town Narva the second capital of the Swedish empire, Tallinn today essentially holds a similar position in the Swedbank structure.

In the summer, the banking giant Citigroup estimated that more than 80% of Swedbank's pre-tax profit growth in 2006-2009 should come from Hansabank.

The Secret of Hansabank's Success

Swedbank appeared in Estonia in the summer of 1996. Naturally, one of the first things the Swedes asked for was an audience with Hansabank.

By that time, Hansabank had become the leader of the banking market in Estonia. Its success due to the fact that Hansabank got everything right from the start. Unlike Hoiupank (Savings Bank), Sotsiaalpank (Social Bank) and many others, it did not have a burden to carry from the Soviet times.

Manager Jüri Mõis first travelled to Finland and Sweden to study the banks there. A revolutionary step in Estonian banking was the employment of tellers. In other banks, clients were served by accountants and there was a lot of paperwork. Hansabank, however, took its accounting online.

Initially, Hansabank dealt mostly with cash operations and currency exchange. One of the first cash collectors of the bank was future-CEO Indrek Neivelt who carried the money in a gym bag.

When it started out, Hansabank was not an independent institution but a branch of the Tartu Commercial Bank. Witnessing the disarray at the bank in Tartu, Jüri Mõis realized that there must be a joint accounting for rubles and foreign cur-

Who does Hansabank Work for?

Swedbank's major shareholders as of 30 June 2007

Foundations of Swedish savings banks	21.5 %
Swedish savings banks	8.3 %
Franklin-Templeton funds	2.6 %
SPP/SHB funds	2.5 %
Swedbank profit-sharing funds	2.2 %
Swedbank Robur funds	2.5 %
Fourth Swedish National Pension Fund	2.7 %
AMF Pension	1.6 %
AFA Insurance	2.6 %
SEB funds	1.5 %
Other investors	26.2 %
Other Swedish institutions	14.8 %
Swedish private persons	11.0 %

Hansabank vs. Swedbank: Net Profit Growth Trends

	Swedbank		Hansapank	
year	*net profit**	*growth*	*net profit**	*growth*
2002	4152 mln SEK	-20 %	1874 mln EEK	11 %
2003	6343 mln SEK	53 %	2049 mln EEK	9 %
2004	9157 mln SEK	44 %	3012 mln EEK	47 %
2005	11 879 mln SEK	30 %	3784 mln EEK	26 %
2006	10 880 mln SEK	-8 %	5062 mln EEK	34 %

**the share distributed to shareholders (excluding minority holding)*
Sources: income statements of Swedbank and Hansabank

The Baltic States Become an Increasing Source of Profit for Swedes

	Swedbank		Baltic banking operations		Baltic profit share
	net profit	*growth*	*net profit**	*growth*	
2005 III Q	4120 mln SEK	28%	628 mln SEK	18 %	15%
2005 IV Q	2604 mln SEK	-37%	547 mln SEK	-13 %	21%
2006 I Q	2304 mln SEK	-12%	597 mln SEK	9 %	26%
2006 II Q	2854 mln SEK	24%	561 mln SEK	-6 %	20%
2006 III Q	2935 mln SEK	3%	856 mln SEK	53%	29%
2006 IV Q	2959 mln SEK	1%	925 mln SEK	8%	31%
2007 I Q	2956 mln SEK	0%	995 mln SEK	8%	34%
2007 II Q	3144 mln SEK	6%	1180 mln SEK	19%	38%

**the share distributed to Swedbank*
Sources: Swedbank's interim reports, facts about Swedbank

Photo: Pille-Riin Pregel/EPL

rency. A bank should be small rather than too large to handle. He hired his wife Tiina Mõis as head accountant.

When Tartu Commercial Bank, Balti Ühispank and Põhja-Eesti Aktsiapank (North-Estonian Bank) collapsed, large numbers of clients switched to Hansabank.

In the autumn 1990, founding member of the bank Rain Lõhmus put on paper his vision of how to establish a commercial bank. His idea was to set up a bank with a limited number of offices that would later cover towns outside Tallinn. As part of a four- or five-year plan, Lõhmus wanted Hansabank to be among the two or three top banks. By its fourth year of operation, Hansabank was Estonia's largest bank.

In the 1990s, Hansabank was the first to offer home loans and sell its shares in Western countries. The issue of securities was organised by the

IN THE LEADING POSITION ON BOTH SIDES OF THE SEA: Hansabank's Director General Erkki Raasuke is also a member of Swedbank's executive management.

Finnish-British investment banker Joakim Helenius, who, Estonian foreign intelligence thought, did not exist! Helenius later moved to Tallinn. His investment bank Trigon, with its 2.1 billion EEK, occupies the 29th place in the Top 100 Most Valuable Businesses in Estonia.

Swedish Manoeuvres

Initially, Swedbank invested in the now-defunct Hoiupank rather than Hansabank. However, the Swedes bought their holding in Hoiupank from Hansabank. The transaction earned the latter approximately 100 million EEK in extraordinary profit. Swedbank was proud to announce they were the first Swedish bank to invest in Estonia.

"Swedbank is a very serious investor, and being the owner of Swedbank would make any bank in the world proud," said Hoiupank's manager Olari Taal.

As it happened later, however, "the Svenssons" and the Estonian leaders of Hoiupank had a great disagreement since Taal & Co. themselves desired to become Hoiupank's majority owners. To their dismay, they discovered that the Swedes were secretly negotiating an increased holding.

The Hoiubankers fell out with the Swedes. "The management of Hoiupank does not believe that Swedbank becoming a strategic investor would benefit Hoiupank or Hoiupank's other shareholders," they declared.

The declaration did not do the trick. Swedbank bought one fifth of Hoiupank.

Buying into Hansabank

In the summer of 1998, Hansabank took over Hoiupank. The Swedes were rather pleased. Through this transaction, they gained quite a large seven percent share package.

Hansabank was hungry for capital and was on the lookout for a strategic partner. The founders of Hansabank, lead by Hannes Tamjärv, had their eyes foremost on SEB, another Swedish bank. Hansabankers liked SEB because the bank was entrepreneur-friendly and shared a business philosophy with Hansabank. The president of SEB's Council Jacob Wallenberg was bedazzled by the Baltic States, noting that when he was in the Swedish navy, "everything beyond the Baltic Sea was hostile territory."

All this made Swedbank anxious as SEB was its great rival. Lars-Olof Ödlund, the Swedbank representative in Hansabank's supervisory board, advised Tamjärv and Mõis to take their time in finding a partner. At the same time, the representative sent an alarm to Swedbank headquarters.

Swedbank began to buy Hansabank's shares in bulk without informing the leaders or bigger shareholders of its actions.

In the middle of August, Swedbank announced that its holding in Hansabank had grown to ten per cent. The holding reached 20% two weeks later.

Ödlund assured the press that Swedbank had no intentions to further increase its share. A few days later Swedbank's holding increased to 25%. Ödlund beat around the bush: "I was talking about an approximate 20% holding and 25 is approximately 20..."

SEB awoke. A price war erupted between the Swedish banks. In the end, Hansabankers set the Swedes against each other in a bid. Swedbank emerged as the winner and gained almost half the bank.

Swedbank had holdings in Norwegian and Finnish banks, as well. These holdings stood around 20-25 percent, leading Tamjärv to believe that the Swedes would also sell part of Hansabank. That did not happen. Swedbank's share kept growing.

It was strongly suggested to manager Jüri Mõis that he resign, since the bidding he organised cost the Swedes an approximate extra billion EEK in buying Hansabank.

Taking Over Hansabank

The Swedes named Indrek Neivelt as the new chief. Neivelt was assisted by chairman of the supervisory board Anders Sahlen who told the Swedes not to hit the brakes and let the Baltic boys do their jobs. The Swedes, tended to think the good way is the Swedish way.

In 2001, Hansabank privatized the Lithuanian rural credit bank, making Hansabank a cross-Baltic business. Estonians were happy since the price of Hansabank's shares on the stock exchange rocketed upwards.

The bank adopted a more human face. The bank's logo exchanged its grey Hansa cog for a people-friendly and colourful one. In its official version, the "Hansa cog" refers to the bank's vitality, direction toward creation of new values. "Orange is a vivid, positive and vital colour, which symbolises" the bank's "openness, readiness for challenges, innovation and dynamism. Sea green is calm and balanced, expressing the traditional nature of the financial sector and the bank's reliability."

In 2004, Swedbank amended its strategy on conquering foreign markets. Its new principle was to completely buy up partners whenever possible.

In 2004, Swedbank amended its strategy on conquering foreign markets. Its new principle was to concentrate on universal banking and completely buy up partners whenever possible. The Swedes announced their intention to buy Hansabank as a whole but this met strong resistance. Hearing the takeover price, Hansabank's founding member Heldur Meerits lashed out: "It seems that some people at Swedbank were drunk while writing in their offer that this is an amazing opportunity to cash our shares."

The Swedes offered to buy each share for 11 EUR while the corresponding trading price on the stock market was 11.8 EUR. Resistance from Estonians was strong enough to force the Swedes to increase their offer up to 13.5 EUR; only then could they successfully carry out their plan.

One of the key figures in the resistance Indrek Neivelt left the bank and is now working in Russia. The Tallinn stock exchange experienced a temporary collapse as the market value of stock exchange shares decreased more than threefold after Hansabank exited the stock exchange.

Baltic States Conquered, On to Russia!

After the total takeover by Swedbank, the financial scheme at Hansabank underwent a material change. Hansabankers no longer had to venture to international capital markets, the money flowed directly from the parent company. This gave impetus to the loan boom that was underway in Estonia.

Three to four years ago, Hansabank endeavoured to implement a so-called responsible loan policy but dug its own hole. Studies did show an increase in client satisfaction, yet it seemed to people other banks were being more generous. This led the head of retail banking Andres Liinat to resign and loan conditions were relaxed.

Hansabank's share in Swedbank's profit grew rapidly as did the importance of local employees. Currently, two out of nine members in Swedbank's management are Hansabank employees: Erkki Raasuke who followed Neivelt as Hansabank's manager and Giedrius Dusevicius, chief of the Lithuanian branch.

After Latvia and Lithuania were conquered, it became quite clear that the Baltic States alone would not suffice if large-scale growth was desired. Three years ago, Hansabank acquired a pocket bank in Moscow. Hansabank's leader Indrek Neivelt then told Eesti Ekspress that it was pointless to avoid Russia: "When you have a neighbour, you have two choices: you either communicate with them or build a high fence. The thing with high fences, however, is that eventually they will fall down or will be climbed over."

He was not expecting fast growth from the project in Moscow: "If we wanted, in four to five years, we could become a big Russian bank with a small business in the Baltic States, but this would also imply taking great risk. We're going to proceed slowly and firmly, with both feet on the ground."

A Painful Slap from Moscow

Neivelt emphasised: "In Russia, it is crucial to be neutral and not a member of an economic group."

Last year, Hansabank ran into difficulties with the Russian Tax Board in relation to the bank's leasing activities.

The Swedes then decided to trash Hansabank's name in Russia and adopt a Svedbank trademark as a clean slate. This would refer to trustworthy and neutral Swedish capital and would help to avoid any reference to the "fascist" Baltic States.

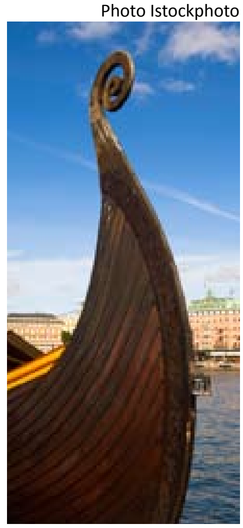
In a similar manner, Hansabank was presented as a Swedish bank when entering the Lithuanian market. In Lithuania, Estonians had a much worse reputation than the Swedes. But the bank still failed in Russia. In June, the local central bank strongly curtailed Hansabank's activities in Russia for three months. Among other things, they prohibited the opening of new accounts for clients and the acceptance of new deposits.

The reason lay in disregarding money laundering related requirements. Unlike Estonia, money laundering in Russia represents a major problem and the local banking supervision takes the issue very seriously.

New Objective: Long-term Deposits

In September, Hansabank's subsidiary regained its operating rights in Russia. Its name, however, was changed to Svedbank.

Photo Istockphoto



Just before this story was published, Hansabank announced that Swedbank is planning to relocate the branch in Russia under Swedbank's leadership.

The Swedes' latest expansion in the Eastern market – the purchase for 735 million USD (if results are good, 250 million USD will be added within the next three years) of TAS-Kommerzbank which belonged to the former head of the Ukrainian central bank Sergiy Tigipko – was no longer operated from Tallinn.

This created suspicions that, at some point, the Swedish might separate the Russian branch from Hansabank, as when SEB once told Eesti Ühispank that their playground was limited to Estonia alone. Do all the gymnastics you please in your little frog pond!

Immediately prior to the publication of this story, Hansabank indeed announced that Swedbank is planning to relocate the branch in Russia under Swedbank's leadership by the end of the current year.

And so the quintessential question arises: How will Hansabank continue its development? A nice growth will continue in the Baltic States, yet there are restrictions to further development.

Last summer Priit Põldoja spoke at a conference organised by UBS in Vienna. His presentation was titled: "Long-term Deposits: a New Growth Opportunity for Baltic Banks." Põldoja declared that the volume of Hansabank's funds in March last year totalled 622 million EUR. The respective figure next year could be as high as 1,350 million EUR. An increasing part in the bank's growing profit is formed by investment management.

"Funds, life insurance and pension are just banking products," Põldoja said and advised banks to transform themselves into sales organizations. Funds, insurance companies and banks should increase cooperation: starting from integrated IT systems and ending with unified brandings.

At the Goldman Sachs seminar in Portugal, Swedbank's financial manager Mikael Inglander said that the principal means of saving in the Baltic States is demand deposit. However, pension reform is underway and experience from developing markets shows that people will start saving seriously only when GDP per capita has reached the 8,000-10,000 EUR level. "Due to low incomes, saving is fairly underdeveloped," Inglander noted and added: "It still represents one of the keys to growth in the near future."

Photo GILD Bankers

First Night-Frosts in Businesses Mergers

LAURI ISOTAMM
GILD Bankers Partner

The number and volume of business mergers and acquisitions (M&A) has been on a continuous growing track in the world since 2003. Last year, M&A activity exceeded the previous year, beating the record in 2000 in both number and volume of transactions – the total value of relevant transactions was 3.2 trillion USD.

In 2006, transaction volume reached 3.8 trillion USD, growing an approximate 38% in a single year (data from Thomson Financial). These results have triggered a discussion among entrepreneurs, investment bankers and economic analysts on whether the above-described growth is sustainable and how long favourable conditions will last. The third quarter this year demonstrated that the current situation cannot continue for long. Although this year will almost certainly be a new M&A record year, there has been a sudden decline in global activity.

In the past few years, there have been more transactions and transactions in greater volume than ever before (see chart). Nine out of the ten historically largest M&A transactions were made from March 2006 onwards. The justified question arises of whether we are dealing with a bubble similar to the dot-com boom at the turn of the century.

Fortunately, there are few common features with the boom seven years ago – there are no dominating economic sectors in mergers and acquisitions; also, what is being "sold" is actual results rather than the future potential of businesses which was typical for the Internet business bubble.

Nine out of the ten historically largest M&A transactions were made from March 2006 onwards.

Mergers and acquisitions are related to the financing cycle. Most transactions are carried out during conditions of higher liquidity and greater economic activity. In the conditions of high liquidity, many transactions in recent years have been made with mostly borrowed money (exceeding the Earnings Before Interest, Tax and Depreciation (EBITDA) by 8.5-9 times). At the same time, the value of businesses is estimated to be very high.

The United States has traditionally been the most active M&A area. In 2007, Europe caught up with America and passed the US in the first half of the year in number of transactions (data from Thomson Financial). Europe's increasing importance is also signalled by the London Stock Exchange stepping to the foreground as the preferred quotation place for foreign businesses.

Instability in Financial Markets Curbed M&A Activity

Although results are still excellent for businesses, and balances in general are strong, it is evident the M&A market cannot grow forever. Results from the third quarter in 2007 give grounds for caution and the prognosis of an end to the cycle. Direction towards caution for the M&A sector mainly comes from what is happening on the world's financial markets.

Events of the past few months that started in the US real estate market have, by now, developed into a more general credit crisis and caused the financial markets to fear for further development of the world's economy. Difficulties that a number of low quality sub-prime mortgage issuing businesses were experiencing in the US have caused worry in financial markets about the influence of the abovementioned on banks and funds throughout the world, which led to the crisis in credit markets, thus paralysing the M&A market, as well. Sources of cheap loans dried out quickly, making the thus-far popular high-leverage transactions expensive or impossible.

Central banks in different countries are still trying to alleviate the situation and maintain liquidity of markets. The US Federal Reserve's decision in September brought excellent news for money markets – the prime rate was lowered by 0.5 percentage points to prevent a major economic setback. Liquidity that for a while was drying up is on a growth track once again.

Analysts are convinced that 2007 as a whole will present the best M&A year of all time. At the same time, the global environment today has become unclear and it is believed that trends have taken a new turn.

Trends in the Baltic States

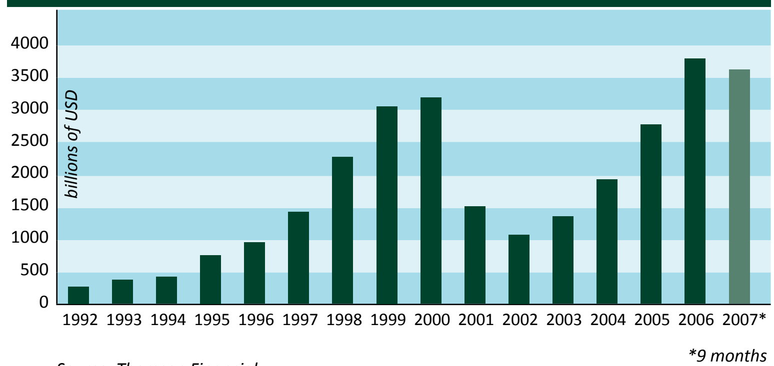
In the beginning of the 1990s, greater emphasis in the Baltic States was on selling transactions. During that period, foreign investors from both the North and West were entering the ownership circle of Estonian businesses. Businesses were restructured, refinanced and privatised.

After the crisis and collapse of the stock exchange in Russia, a trend was established that has peaked in the past few years. The local business landscape has been characterized by consolidations, numerous mergers and acquisitions, the rise of strategic investors and low activity of the stock exchange. Joining the European Union has noticeably increased the number of capital raising transactions.

The mergers and acquisitions market in the Baltic States is at a stage where domestic buyers (Eesti Ehitus, Hansabuss, Ekspress Grupp) are increasing in importance. They are not only acquiring local businesses but are expanding beyond the Baltic region, as well. Most of the attention is turned to East (the Ukraine, Belarus, and, more generally, the former CIS), yet transactions are carried out with Western companies, as well. The number of transactions where one party is a public company (Tallinna Kaubamaja, Kalev, Ekspress Grupp) is also growing.

The world's economic events and trends also influence, although with a minor delay, the small Baltic economies and the M&A market in the Baltic States. Similarly to global developments, more transactions have been completed in the first nine months of 2007 in the Baltic region than in the same period in 2006. The Baltic environment at the moment favours M&A transactions wherefore mergers and acquisitions have become an important alternative to organic growth in expansion strategies of businesses.

Global M&A transactions



Source: Thomson Financial

The mergers and acquisitions market in the Baltic States is in a stage where domestic buyers are increasing in importance.

The close connection of the Baltic economic environment to the rest of the world is characteristically demonstrated by events surrounding the sale of OMX, the parent company of stock exchanges in Nordic countries and the Baltic region. NASDAQ in the US, the Dubai stock exchange, as well as the national investment company in Qatar have shown their interest in OMX.

Private equity investors, i.e. financial investors who represent principal competition for domestic strategic buyers, are gaining increasingly important roles in the Baltic region as in the rest of the world.

When traditionally in the Baltic region private equity investors exit the investment, selling their holding to a strategic buyer, there is an increasing number of transactions where one private equity investor sells to another.

An indication of a development in the market is the emergence of new types of transactions. Thus, the first dual-track investments have been carried out in the Baltic States. An apt example here is the sale, organized by GILD Bankers in the beginning of 2007, of 48% of the shares of the Lithuanian company AB Levuo. Two sales methods were used simultaneously – the so-called dual-track process. An initial public offering (IPO) as well as a private placement was prepared at the same time. The parallel utilization of the two selling methods enabled a higher price, as this approach created a positive competition between the market and investors participating in the private placement.

Advisors for M&A transactions are becoming increasingly independent since it benefits the transaction to have a consulting financial institution that is unconnected to the company through lending or trading in shares.

The M&A landscape in the Baltic States in the coming years depends on international trends, yet, in the long-term perspective, the M&A market can be expected to be active.

Photos Ingmar Muusikus

Juhan Parts: We Need Greater Ambition!

Minister of Economic Affairs and Communications Juhan Parts invites public enterprises to adopt greater objectives and encourages entrepreneurs to explore the world more.

SULEV VEDLER
Eesti Ekspress

Minister, do you sometimes feel like the owner or at least the representative of the owner of large businesses?
The economy today represents what is going on in the world. Most companies owned by the state today are not companies in global competition. The state no longer has shoe factories, leather producers, tourist homes, etc.

The harbour and railroad might, in their specific areas, be in certain competition, yet Estonian Air Navigation Services (Lennuliiklusteenindus AS) is a very specific monopoly.

The state still owns a few highly valuable businesses in Estonia. GILD TOP 100 contains six public enterprises: Eesti Energia AS (Estonia's energy concern), AS Tallinna Sadam (Port of Tallinn), Eesti Raudtee (Estonian Railways), Riigi Kinnisvara AS (State-owned real estate), Tallinn Airport and Es-

tonian Air Navigation Services. Which of these is doing especially well?
Everything which is happening around businesses is changing.

Where there are no short-term problems, more ambition is needed. In Tallinn Airport, for example.

Are you saying the airport needs to do better as it is falling behind Riga airport?
No, not necessarily.

If we're looking for excuses, there are more than a million people living in Riga. There are no other excuses. The Baltic military district was in Riga, as well. The Baltic provinces were governed from Riga.

We most certainly have to develop our airport further with greater ambition! We have to start utilizing the Ämari airfield!

Has something been done already in terms of Ämari?
A number of things have been discussed. We have to bring military, civilian and trade issues together. I'm sure Tallinn Airport is the best initiator in this respect. We need initiators in Estonia.

Our transport operators seem to be head over heels in love with Russian oil, yet it would benefit them to straighten their backs and see what is happening in the world! There are all kinds of advisors, talking about our God-given special geographical location. In terms of aviation, though, we are at an optimal distance from New York as well as Beijing.

As well as Helsinki.
Yes, but I think Tallinn and Helsinki are not in competition. We should be cooperating, instead.

The head of Finnair once told me the same thing: Helsinki is at a great location for the Chinese, enabling a convenient connection to Western Europe.

If the world's population increases from 6.8 billion to 8 billion in the next 20 years, the growth will not happen in Western Europe but rather in Asia and Africa. Asia for us is quite convenient in terms of connections.

In terms of aviation we are at an optimal distance from New York as well as Beijing.

But you shouldn't think I'm a dreamer. I like realistic ambitions. Fantasizing will not get you far.

Which public enterprise is doing the worst?
There is nothing tragic happening with any of the public enterprises.

The situation is the most complicated in the transit sector.

When the Bronze Night [riots in Tallinn in April, 2007] happened, did anyone foresee a great economic backlash? The transit business and tourism were significantly harmed.
Did anyone account for the collapse of the Soviet Union? That as a result of the collapse of the Soviet Union the war in Iraq would begin?

Life in the world is not a chemistry lab and we cannot calculate security policy issues on a business level alone. Your question is a security policy related one. The Pro Patria and Res Publica Union has stood behind the consistent policy that when Estonia becomes strong we can be friends with Russia.

The most valuable public enterprise is Eesti Energia AS. Is it feasible that you might take it to the stock exchange one day?
That's not impossible. It might happen should we require additional capital for investment. It is in Estonia's strategic interest to obtain more producers. Power production is a business. If there are deficits there, why isn't more electricity being produced? They just keep manufacturing 10–50 mW windmills that will be erected in little private forests obtained in various land trade deals. That is immoral. Should the Estonian economy collapse for no other reason it will do so thanks to stealing and pinching behind each others' backs. This kind of a business culture must be rooted out!

From where will Eesti Energia get electricity in the future? The future seems quite uncertain.
It is not uncertain. Eesti Energia's future is no more uncertain than it is for any other business. You can say the future for Tallinna Kaubamaja AS is uncertain – what should they sell: these shoes, those

jackets? Maybe they should start selling more groceries?

This is no longer the Russian times where everything seemed eternal and you didn't have to make any changes in business.

In the case of Eesti Energia, you should look at it in a similar manner: where to produce; to whom to sell; what does the owner want?

The strategic assignment here is to generate an electricity market in the region. Eesti Energia here is similar to the Scouts Battalion [a unit in the Estonian Army] in that it possesses a certain security dimension, a dimension of competitiveness of the Estonian economy, as well as an entrepreneurial dimension.

Eesti Energia obtains electricity from various sources: oil shale, bio-energy, nuclear energy, wind energy.

Will Estonia face a price shock? In the open market, Eesti Energia is keeping its eye on the Nordic countries where, for a long time, the price of electricity was twice as high as that in Estonia. In the next five to six years, Estonia will reach the same level.

Speaking of a price shock, groceries in Estonia are already more expensive than in Germany. It is cheaper to purchase consumer goods in Germany, let alone the US. The initial fee you pay when sitting in a cab is the highest among European capital cities – I might be exaggerating, I haven't taken a cab in all of the capitals but... The fee in most capitals is 2-2.5 euros, in London it is 2 pounds, Tulika taxis in Estonia ask for 45 EEK.

What Estonian entrepreneurs have done – randomly increased their prices – represents a unique cataclysm of the Estonian economy.

But a price shock? I'm not sure where the [electricity] market price is heading. We cannot base the price on the 45 €/mWh price level at the Nordic stock exchanges.

The electricity security hysterics, blown out of proportion by the Kremlin, have created the notion that the price of electricity can only go up. But it doesn't have to. The producer price for nuclear electricity is 15 €/mWh, the selling price in the market, on the other hand, is 45 €/mWh. The producer price is three times smaller.

I wouldn't say that the emergence of an electricity market here would necessarily indicate the current electricity price level in the Nordic countries.

"ONE MAN BAND": General shareholder meetings for two Top 10 businesses – Eesti Energia AS and AS Tallinna Sadam – take place in the person of Juhan Parts because the state has placed these shares under the jurisdiction of the Minister of Economic Affairs.

Still, that's where the electricity price is heading. Crude oil prices change either way from time to time, gas prices in Estonia, however, have not increased above 15 EEK per litre. These matters cannot be looked at on a one-to-one basis like that.

The electricity price today is what it is and we have to make sure there won't be any ill-considered price increases. We have quite an efficient inspectorate for these purposes.

Something good happened while Juhan Parts was the prime minister...
That's the first time I'm hearing about that. As far as I know, everything went downhill – that's what I read in Eesti Ekspress... [Eesti Ekspress is an Estonian weekly for which the interviewer, Sulev Vedler, writes. –ed.]

...the good I mentioned actually went downhill, as well. I'm referring to inflation. When Estonia joined the European Union, the prices did not go up as much as they are going up now. Did you ask entrepreneurs to hold back price increases?
Nothing like that happened. When the referendum was held, one of the main issues was a price increase to the European level.

In terms of the price increase – today, you can buy a pair of shoes here at the same price as in an expensive store on Fifth Avenue in New York – I don't suspect a cartel, but whether or not there is competition is a big question mark...

The open labour market has had the greatest effect on the economy. Construction workers and bus drivers are leaving. Feel free to work! Prices and salaries are increasing in Estonia. So in order to pay higher salaries, entrepreneurs have no choice but to increase prices. They are unable to invest in new technologies and new products.

Back then we more or less met the euro criteria, as well.

We had a realistic plan on our desk for Estonia joining the European Union on January 1, 2007. When the coalition collapsed in April 2005, we had put together a budget strategy laying out things we could have done before the next elections. We [with Minister of Finance Taavi Veskimägi] calculated tens of millions of kroons, trying to reduce our expenses. Despite the number of problems we wanted to resolve, concerning education, for example.

Then, however, the new coalition was formed and they concluded an agreement where the pension explosion took the central place. After that, out of nowhere, the real estate boom started.

At some point – in the autumn 2005, I think – I asked Prime Minister Ansip about his government's great ideal. Conversion to the euro, he said. That was a clear answer...

No one anticipated a bubble.

Selling Hansabank to Swedbank was most certainly harmful to Estonian economy.

Allan Martinson recently said that hundreds of people in Estonia are working for Playtech and Skype, yet the profit is taken abroad. At the same time, our enterprises do not have to pay income tax and the prime minister is preaching an excellent investment environment in Estonia. How attractive are we really?
Discussions on whether we will follow the example of Ireland or Portugal lead nowhere. Vahur Kersna once produced an excellent program on how Estonia will switch to IME [*Isemajandav Eesti - Estonia's economic autonomy*]; we should ask him for the date and time when the country will switch to a knowledge-based economy.

We have a number of young men in various forms who can conjure up money. Selling Hansabank to Swedbank was most certainly harmful to the Estonian economy. We surrendered the [company's] potential.

What should we do, Minister, they're asking me! Khrushchev could say: Now we are going to grow corn. In Estonia, things should be initiated at a lower level.

We should be discussing our economic potential and ways to boost it.

We have to clean up the public media space! We should keep the yellow press; Eesti Ekspress should keep on writing and making jokes. But we need a debate in the public media space and not just one or two opinion articles.

We also have to boost what is already there in the rest of the world, whether it be technology, knowledge or inviting the right people over.

Our macroeconomic framework is highly competitive. We have to find an appropriate league for us in terms of attractiveness. We are extremely pleased when Kaia Kanepi climbs a step up in the WTA's ranking. We do not publish continuous editorials, complaining she's not the first. We are not complaining when Margit Rüütli and Maret Ani climb upward a little. We're happy about that as well! In economy, what counts is an increased average prosperity – that's when we are going to feel happy as a nation.

What Affects Eesti Energia

Unlike many other enterprises, Eesti Energia's well-being depends on air temperature, domestic policies of neighbouring countries, decisions from Brussels and even the US-Iran conflict.

SULEV VEDLER
Eesti Ekspress

Eesti Energia is not only the Estonian state's most valuable business but also the most capable by its name. "Energy" derives from the Greek word energeia – activity – and has the meaning of working stock, ability to work, vigour.

Eesti Energia today is a company with great ambition whose business interests reach from Nordic countries to the oil fields in the Middle East. The notion of "it's all easy for Eesti Energia: they're a monopoly and increasing electricity prices will solve all their problems" is a widespread viewpoint in Estonia.

Actually, a number of factors that people never think about or are not aware of at all affect Eesti Energia's activity. Some of these factors are discussed below.

WEATHER IN ESTONIA. Eesti Energia gives serious consideration to weather conditions. "Next to macroeconomic developments, air temperature is the major factor that influences Eesti Energia's

TO THE NORTH! Eesti Energia's Chairman of the Board Sandor Liive at the construction site of a Finnish nuclear plant.

Photo Rene Suurkaev/Eesti Päevaleht

economic results the most," the company notes in its reports and describes the average temperature fluctuation to the accuracy of one tenth of a degree.

Domestic households and institutions-businesses consume more electricity and heat when it is cold. Therefore, most of Eesti Energia's turnover is obtained in the second half of the economic year.

Fluctuation of the year's average temperature by one degree affects electricity consumption by up to 150 GWh a year (considering prices in the domestic market, this amounts to more than six million EEK). For example, in the 2006/2007 economic year, the average temperature was 1.9 degrees higher than the year before. The company estimates this to have reduced electricity sales by up to 220 GWh.

WEATHER IN NORDIC COUNTRIES. In January 2007, operation of the sub-marine electricity cable Estlink between Estonia and Finland was launched. This signalled the start of energy trade between the Baltic States and Nordic countries.

Eesti Energia highly anticipated the entry into the Nordic market. The local electricity market is 90 percent closed. The market will be gradually opened by 2013. The Nordic electricity market, however, is free. Prices there develop based on the offer and demand relationship. Last summer, the company announced that the base energy prices in the Nordic market were in the 50-60 €/mWh bracket. In Estonia's closed market, electricity cost 26 €/mWh only. A great opportunity to earn from the price difference lies ahead.

In the first six months of the sub-marine cable, Eesti Energia sold 686 GWh of electric power to Finland.

However, the business was significantly affected by the weather. The beginning of the Nordic winter last year was warm and rainy, and at the turn of the year 2006/2007 the prices of base energy moved to a level lower than the average, staying in the 23-41 €/mWh range. The average price that developed in 2006 was 48.6 €/mWh.

Prices kept falling. In the second quarter, trading in the Nordic stock exchange remained in a 16-27 €/mWh range due to warmer than average weather with a lot of precipitation (and near-zero price of emission quotas). The average price developed at 22.5 €/mWh which was almost twice as low as the previous year's price and was even below the relevant price in Estonia.

Photo Rene Suurkaev/Eesti Päevaleht

In the first six months of the sub-marine cable, Eesti Energia sold 686 GWh of electric power to Finland.

In a recent interview with Eesti Ekspress, the CEO Sandor Liive said: "Sometimes in the summer, the market price of electricity in the Nordic countries is 20 €/mWh. During the peak time in the winter, the price will increase as high as 80 €/mWh. It's hard to see electricity prices going down in the free market in the next decades, as inputs are becoming more expensive, environmental conditions are becoming harsher, and as consumption increases, new ways of production have to be created."

"BLACK" ELECTRICITY FROM RUSSIA. Before, the Finns called Estonian electricity "black" when power plants in Narva were polluting from far across the bay. The situation has changed a lot. "Black" electricity is coming from Russia, where environmental protection-related restrictions and taxes are not applicable.

This automatically makes Russian power production cheaper than that in Estonia.

Thus, the biggest question linked to the opening of the Baltic market is Russia. Will our Eastern neighbour's electricity with its "black" competitive advantage be freely allowed in the market, or will restrictions be imposed?

GAZPROM PRICE LIST. Eesti Energia is known as a vigorous user of oil shale. It also is a large consumer of Russian natural gas. The gas is used by the Eesti Energia-owned Iru power plant, which heats the Lasnamägi area of Tallinn and the town of Maardu.

In the last heating period, Gazprom suddenly raised gas prices, which caused the Iru plant's selling price to skyrocket. Tallinna Küte, the Estonian district heating company belonging to the to the international energy concern Dalkia International, reacted by initiating its own boiler plants for use and Iru was forced to bring its boilers to a stop.

ELECTRICITY LOSSES. In March 2004, Eesti Energia reported the distribution network's losses decreased from 19.5% to 11.1% in the preceding five years, reaching their lowest level ever. The volume of saved energy amounted up to 630 GWh, which is equals the electricity consumption of both the business and private consumers in the whole Tartu area in a full year!

In the past financial year, the entire system's electricity losses decreased to 10.6% and those of the distribution network to 8.3%.

Power networks took 63% of investments in the past financial year.

SITUATION IN THE MIDDLE EAST. During the first Republic of Estonia (Eesti Wabariik, 1918 – 1940), the Ida-Virumaa region was referred to as the "local oil fields" since oil shale was used to produce oil rather than electricity.

In oil production, 70% of energy contained in oil shale is used, while electricity production utilizes approximately 40%.

Two year ago, previous views on the profitability of oil production were revitalized as crude oil prices went sky high, dragging along oil shale prices which move alongside crude oil prices.

Eesti Energia's management turned increasingly more attention to oil. Overviews of crude oil prices and factors that affect it appeared in reports. The situation in the Middle East was discussed, and it was even mentioned that the nuclear program in Iran is causing instability (which, naturally, increased crude oil and oil prices).

The company decided to form a subsidiary independent from the oil plant and to build a new plant which was to take the oil production volumes from 130,000 tons to 500,000 tons in the next four to five years.

Crude oil and shale prices dropped in the first quarter of the current financial year. When in 2005 Eesti Energia earned a 75 million EEK return in oil production, in 2006 the profit was a mere 17 million.

They have great plans, however. Eesti Energia has started to investigate oil production opportunities in Russia, the Ukraine and the Middle East, as well. The matter has been taken the furthest in Jordan where Eesti Energia's subsidiary was granted authorization to study almost one-third (300 million tons) of the reserves in the El Lajjun oil shale deposit.

STATE GREED IN COLLECTING DIVIDENDS. In 2004 the net profit for Eesti Energia amounted to 671 million EEK. The state collected 97 million EEK in dividends.

In 2005, Eesti Energia received 2.1 billion EEK in net profit. The state collected 500 million in dividends.

Eesti Energia's net profit of 2006 was 2.6 billion EEK. The state collected a billion in dividends.

Eesti Energia has become a good milk cow for politicians. Recently, however, Sandor Liive extended a warning that the situation might be changing shortly: "In five and a half years, Estonian electricity will be at least twice the price it is now. It might also happen that the now-shining Eesti Energia will be financially weak by then and the state will have to revitalize its equity capital with considerable amounts."

When the Minister of Economic Affairs came up with the plan to dissolve Eesti Energia, the relevant ratings agency immediately showed the company's long-term credit rating estimate as negative.

POLITICIANS' DISSOLUTION PLANS. The European Union forbids electricity production and distribution to be in the hands of a single company alone. Eesti Energia performed a simple trick to meet the requirement: it formed separate companies from its network. OÜ Põhivõrk, (National Grid, transmission of electricity) commenced operations in April 2004 and OÜ Jaotusvõrk (Distribution Network, distribution of electricity) in July of the same year. Both companies still belong to the Eesti Energia group, yet, to quote a popular local acronym, Legally It's All Correct (JOKK – Juriidiliselt on Kõik Korrektne).

The then Minister of Economic Affairs Meelis Atonen still thought that had not been enough. He gave a sensational interview to Eesti Ekspress, announcing his intentions to divide Eesti Energia into smaller businesses, with the shares of the newly-formed, smaller companies held by the Ministry rather than Eesti Energia. "When there's competition in the energy business and network companies can choose which producer they will buy from, in the long run, prices will not increase as quickly as in the case of one monopoly-like enterprise," the Minister said.

Atonen's plans, however, did not get far, as most of the Minister's efforts were directed toward the fight with the "ferry king" Vjatšeslav Leedo [shareholder of Saaremaa Shipping Company].

This past September, a new threat emerged. The Energy Commissioner with the European Commission Andris Piebalgs proposed that the energy market in the European Union be liberalized. Piebalgs is of the opinion that in order to ensure fairer competition, energy distribution and production should be separated. This could lead to the separation of the National Grid from Eesti Energia. Another option would be the formation of an independent system operator.

At the same time, Sandor Liive told Eesti Ekspress: "Lithuania divided its system into smaller parts. A nuclear plant feasibility study showed them to be the economically weakest partner."

OPINION OF RATING AGENCIES. Eesti Energia needs a good credit rating in order to receive large remunerative loans from international financial markets.

Photo Vallo Kruuser

LITHUANIANS' RADIOACTIVE JEWEL: The Ignalina nuclear plant in all its "glory."

In March 2004, the company was boasting the best credit rating among Eastern European energy companies.

However, at the same time, the Minister of Economic Affairs Meelis Atonen came out with the plan to disassemble Eesti Energia. Standard & Poor's (S&P) immediately showed the company's long-term credit rating estimate as negative. There was a risk the company's credit quality could weaken significantly as a result of restructuring and disassembly.

Sandor Liive's (then still the financial director) reaction was not good. "Businesses cut into pieces are either taken over or go bankrupt," he said.

In July 2005, Moody's raised Eesti Energia's credit rating to the A1 level and Standard & Poor's removed its negative estimate.

Eesti Energia thereafter announced: "The improvement of our credit rating decreased the average interest rate for debt obligations by one basis point."

This August, Standard & Poor's warned Eesti Energia that it was at risk of a negative rating once again. This was in connection to Eesti Energia's possible investment in the new nuclear plant in Ignalina, Lithuania, the total cost of which could exceed 60 billion EEK.

WATER LEVELS IN LATVIA. Latvia is one of the most important export countries for Eesti Energia. Latvians do buy electricity from Estonia, yet generally only when water levels in the Daugava River are low and their own hydro plants are unable to work at full capacity.

In deluge periods for the Daugava, it is extremely difficult to compete with the cheap Latvian hydro energy.

LATVIAN DOMESTIC POLICY. In August 2000, the Latvian Seim (parliament) stopped the privatization process of the national energy company Latvenergo. The referendum, planned by left wing politicians, that would have banned privatisation of power plants practically forever, however, was cancelled. This move derailed the secretly long-planned merger process of Eesti Energia and Latvenergo. The businessmen involved found it more reasonable to withdraw the merger plan.

Still, it is not entirely impossible that things may change in the future. Latvians are afraid of disassembling Latvenergo, yet they could be invited to become shareholders in Eesti Energia. The same applies to Lithuanian electricity companies.

LITHUANIAN DOMESTIC POLICY. Four years ago, Eesti Energia participated in the privatisation of the Lithuanian power transmission system. Rumor has it that Lithuanians had promised to sell the system to the giant German group E.On. Germans were confident they would easily win the bidding, yet the Estonian offer proved better.

Lithuanians found themselves in a tight position, as Prime Minister Algirdas Brazauskas had allegedly given promises to the Germans that could not be taken back. In the end, the Prime Minister decided to revoke the privatisation.

Estonia and Lithuania then became allies. The reason for this lay in the fact that, in 2009 Lithuania will be obligated to close down the nuclear plant in Ignalina where most of its electricity is produced.

In December 2004, Lithuania closed its first reactor with 1300 mW capacity. Eesti Energia was quick to declare that "in the medium- to long-term perspective, this event will increase the competitiveness of Estonian electricity in the Baltic electricity market."

This past February, the Baltic prime ministers issued a joint declaration, announcing the construction of a new nuclear power plant in Ignalina. A month later, the heads of Lietuvos Energija, Eesti Energia and Latvenergo signed a common intentions protocol to start analysing the feasibility and profitability of building the nuclear plant.

Then the wiggling started. Although holdings were supposed to be equal and actions carried out jointly, Lithuania announced suddenly that it had invited Poland to join in. Next, the Lithuanian parliament adopted a nuclear power plant building act, allowing a new nuclear power plant to be built

Eesti Energia's economic indicators					
financial year	*2002/2003*	*2003/2004*	*2004/2005*	*2005/2006*	*2006/2007*
Electricity sales GWh	6931	7675	7983	8002	7818
Incl. export GWh	1562	1973	2036	1766	1208
Thermal energy sales GWh	2361	2168	1977	1981	1822
Domestic power transmission system losses	15,6%	13,9%	12,5%	12,1%	10,6%
Sales revenue mln EEK	5721	5901	6176	7086	7535
Net profit mln EEK	646	516	671	2119	2635
Assets at the end of the year mln EEK	18 541	19 481	20 617	23 420	26 084
Debt obligations at the end of the year mln EEK	4313	4611	4834	5403	5351
Rate of return of invested capital	6,1%	4,9%	5,6%	14,3%	16,1%
Average number of employees	9768	9754	9542	8983	8576

Source: Eesti Energia's annual report

in Lithuania to replace the plant being closed in Ignalina. According to the act, Lithuania's holding in the nuclear plant project would be 34%. The three remaining countries therefore were to receive 22%, one and a half times less than Lithuania.

FINNISH DOMESTIC POLICY. Eesti Energia's Chairman of the Board Sandor Liive and Prime Minister Andrus Ansip have repeatedly expressed Eesti Energia's wish to participate in the building of the sixth nuclear reactor in Finland.

Finland will choose the shareholders of the sixth reactor in 2008 and the parliament is scheduled to approve the construction project in 2009. Building of the sixth reactor should be completed in 2016–2018.

In a recent interview with Eesti Ekspress, Sandor Liive said: “We don't need to own a nuclear plant, but we are in need of nuclear energy. Thus, the Finnish nuclear plant presents a good opportunity for us to have nuclear energy for utilization purposes in the future. It's not impossible that the new reactor in Finland will be finished before [the new plant in] Ignalina.”

In addition, a new Estonian-Finnish sub-marine cable is being planned.

ESTONIAN DOMESTIC POLICY. In 2000 Mart Laar's government wanted to merge the plants in Narva to form a company with NRG Energy, hoping the US would provide a ticket to NATO in return. It was a close shave for the company: Gunnar Okk and other members of the board were willing to give up their jobs so as to make sure the transaction never occurred.

Later, the management of the company hoped the state would take Eesti Energia to the stock exchange. Such plans have always been cancelled. Even after the last elections, Prime Minister Andrus Ansip assured Eesti Ekspress that “we are not planning to privatise any important infrastructure companies, not even by taking them to the stock exchange.” If investing in a nuclear plant or plants is going to occur, taking the enterprises to the stock exchange might be a way of obtaining capital.

Latvians are afraid of disassembling Latvenergo, yet they could be invited to become shareholders of Eesti Energia. The same applies to Lithuanian electricity companies.

During the last election cycle, Eesti Energia was pulled into the so-called K-oil affair. Prior to local elections, Minister of Economic Affairs Edgar Savisaar asked Eesti Energia's management not to sell oil shale oil at its market price but rather at a price affordable for the consumer. Oil prices had almost doubled in bidding, and nearly 80,000 people experienced a noticeable increase in heating prices. When Eesti Energia declared that Savisaar's request was contrary to European Union regulations, the minister recommended, coincidentally, that employment contracts of the heads of the company not be renewed and, as characteristic of a market economy, a competition be held. The affair terminated in Gunnar Okk leaving the company.

Liive, the new head, is finding himself under pressure, as well. For example, prior to the spring elections, the Estonian Green Party demanded that the plan for the nuclear plant be dropped and wind energy plants be promoted instead. The underlying reasons are not hard to find: the Green Party was financed by wind energy supporters.

CO_2 RELATED DECISIONS FROM BRUSSELS. 90% of Eesti Energia's electricity production is based on oil shale. This represents a great risk since producing competitive electricity from oil shale presumes a free CO_2 quota.

The matter of emission quotas appeared in Eesti Energia's quarterly reports in the spring of 2005. The company announced that it was allocated free emission permits for 46.7 million tons of CO2 by the Estonian government.

At the end of the year, the company picked the first ripe fruits, selling some of the unused pollution quotas “due to lower than expected electricity sales and investments directed at environment protection.” This gave Eesti Energia a profit of 341 million EEK.

Thereafter, big business began. In the past two years, the company earned 2.7 billion EEK, i.e. most of its profit, selling quotas.

This January, however, Eesti Ekspress reported that Eesti Energia would face a big decrease in profit as quota prices dropped, and the European Union plans to allocate fewer quotas to Estonia.

It might happen that Eesti Energia will have to purchase quotas in the future, instead. This will add to the price of oil shale electricity and the company’s competitiveness will suffer.

ENVIRONMENTAL POLICY. Eesti Energia is the largest miner, water-consumer and polluter in Estonia. Due to environmental requirements, the company will be unable to utilize old boilers at Narva power plants from 2016 onwards.

A few years ago, Eesti Energia prepared its most important investment plan to date, related to the renovation of two energy blocks in Narva. The new boilers will be equipped with fluid bed technology, which will reduce fuel expenses by one fifth and will enable noticeably fewer hazardous compounds to be emitted in the environment.

Currently, it is being discussed whether to renovate the old boilers or build a brand new plant.

Even with the most up-to-date technologies, the production of one mWh of electricity from oil shale releases a ton of CO_2. With lignite, the corresponding indicator is 800 kg, with gas 400 kg, and zero with electricity windmills.

The confusion surrounding the quota system and environmental requirements constitutes the principal reason behind the company’s plans to invest in nuclear plants, electricity windmills and green energy projects.

NATIONAL PRICE CONTROL. The Estonian electricity market is a closed market, and Eesti Energia must obtain authorization from the state in order to increase prices. In November 2004, the Estonian Energy Market Inspectorate approved the current tariffs, which enabled the Distribution network to have a 7.4%- and the National Grid a 6.9% rate of return on regulated assets. The Inspectorate also approved the regulatory networks’ plan to invest an average of 1.1 billion EEK per year.

The tariffs took effect in March 2005. Eesti Energia then announced its financial position was improving.

Photo Ingmar Muusikus

Although Eesti Energia is extremely large, it can be seriously wounded by the loss of a key person.

This past September, the company applied for another price increase. The price for a closed market customer would increase by an average of 16%. With the addition of renewable energy aids and the electricity excise duty, the increase would be 23%.

The question is whether the regulator will approve the application or conform to political pressure. Reactions to the price increase news were not favorable, including that of Prime Minister Ansip, because the state had not calculated for a price increase of this extent.

MANAGEMENT’S AMBITIONS. When Sandor Liive took the helm, the company started to function with a new rhythm. Liive wants to turn Eesti Energia into a national pride and joy.

The company’s objective is to sell electricity to two million clients by 2015.

This would indicate a fourfold increase, as Eesti Energia currently approximately 480,000 home clients and 22,000 business clients. Couple these numbers with the fact that Estonia’s population is decreasing.

But there is a logical reason behind the ambition. The company earns 90% of its profit domestically. Should Eesti Energia be unable to expand its activity and grow abroad, its activity will diminish after competition emerges, since in Estonia Eesti Energia can only lose market share and profit.

Eesti Energia has invested a total of 13.9 billion EEK in the past five years, but that will not suffice. Sandor Liive is certain Eesti Energia must continue investing in electricity production, or it will soon be out of electricity to sell to its clients.

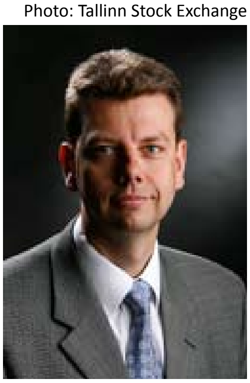
GOOD PEOPLE. Last year, Eesti Energia employed an average of 8,576 people. That is 407 fewer employees than the year before and 1,192 fewer employees than five years ago.

The company is actually suffering from a serious lack of staff. It is proving difficult to employ competent engineers and enterprising people. The company, in addition, requires a new breed of specialists since electricity- oil sales, the quota-businesses, etc., are all in demand of personnel.

One more thing. Although Eesti Energia is extremely large, it can be seriously wounded by the loss of some key persons. For example, the operation of the oil plant in Narva, they say, largely depends on the work of one engineer, Aleksander Kaidalov.

Publicly Traded Companies are the Most Valuable

Photo: Tallinn Stock Exchange



ANDRUS ALBER
Chairman of the Board of the Tallinn Stock Exchange

Endeavouring to characterize a company that investors would like to see on the stock exchange, the following key words can be listed: reliable, well-known, profitable, transparent. A business possessing these traits holds value in the eyes of investors.

Most of the companies currently listed on the Tallinn Stock Exchange can also be found among the GILD TOP 100 Estonian enterprises. Furthermore, there are only three companies among the ten most valuable businesses that are not connected to the Tallinn Stock Exchange. Two owner-companies of the mentioned three are listed on foreign stock exchanges. The shares or bonds of all other relevant businesses have been or still are listed on the stock exchange in Tallinn.

The Stock Exchange as a Premier League for Businesses

Being listed on the stock exchange is an additional sign of quality for a business. This foremost owes to the fact that publicly traded companies have to comply with certain information disclosure requirements, their financial reporting must be transparent and they must have permanent investor relations. All of the aforementioned lend added reliability to businesses, as well.

Listed companies will also certainly be better known. Top managers of businesses that entered the stock exchange recently have mentioned notably increased media coverage and interest in the newly-listed companies.

Stock exchanges and capital markets, more generally, serve the purpose of providing an alternative to lending. An increased loan burden at a time when credit institutions have become more conservative in giving out loans and interest rates increased several percentage points in just a few years can be more expensive than organizing a public issue of shares. In addition, having tidied up its accounting, management and implemented other requirements to publicly traded companies, an enterprise's proneness to risk will be likely to go down in the eyes of lenders, as well making it cheaper for listed companies to obtain loans.

New Businesses Welcome on the Stock Exchange

I saw an advertisement for donorship in Ireland once, saying there are two types of people: those who have already donated blood and those who are planning to do so. The 100 most valuable businesses in Estonia, I believe, also fall in two groups: those that are on the stock exchange already and those that are planning to be listed in the future.

Estonia is an attractive destination country for investments – a continuous inflow of foreign investment and large reinvested capital flows in the balance of payments indicate that investment in this region is still profitable.

In addition to foreign investors, local investors in Estonia are becoming more active, as well: trading activity in the Estonian securities market has notably increased as compared to 2006, and 30 000 new securities accounts were opened in 2006-2007, most of them by private individuals.

Shares of new companies, including those of public companies, would offer additional savings and investment opportunities. Since 2005, Estonian investors (excluding banks) have obtained minority holdings in foreign companies in the total value of more than 11 billion EEK. This should provide a good indication of the amount of money held by Estonian residents and businesses that is available for investment in shares. Issues of securities held in Tallinn in the past few years have cer-

Market value of companies listed on the Tallinn Stock Exchange, mln €

year	*value*
1996	430,08
1997	918,90
1998	442,76
1999	1785,07
2000	1931,86
2001	1665,50
2002	2308,75
2003	3004,99
2004	4563,57
2005	2962,80
2006	4521,90
2007 I half year	5229,40

Source: Tallinn Stock Exchange

tainly provided reprieve, yet the oversubscription of IPOs is a clear indication of demand exceeding offer.

Eesti Energia as a Stock Exchange Hope

Eesti Energia, holding the second position in the TOP 100, is the only business in the top 10 whose shares have never been traded on the Tallinn Stock Exchange. Despite the fact that it's not publicly traded, Eesti Energia is big, well-known, and pays continuous high dividends to its owner (the state). What is more important – the company publishes information on its activities and management principles on a constant basis. Thus, it seems to be a perfect candidate to enter the Tallinn Stock Exchange. Nevertheless, the state, thus far, has been reluctant to take the company public, and there are a number of myths and stereotypes related to state-owned companies entering the stock exchange.

Some claim that when a business is taken to the stock exchange, the state loses control over its activities, especially if it is an infrastructure company. At the same time, it is forgotten that the state has a multitude of regulative levers for implementing its will, should it wish to do so. And if the state holds on to a 60-70% holding, it will also keep a strong ownership status. There are a number of infrastructure companies on European stock exchanges that the state has turned into publicly traded companies: Energias De Portugal, British Gas, SNTC, Deutsche Post AG, Macquarie Airports, Österreichische Post AG etc., not to mention many telecommunications businesses. Our own domestic stock exchange contains Eesti Telekom and Tallinna Vesi.

Another favoured argument against taking state-owned businesses to the stock exchange claims that when listed on the exchange, a business starts to desire profit, and other interests important for the state will be forsaken. We should remember here, however, that the state itself in the past few years has taken out billions of EEKs in dividends from public companies, including Eesti Energia and the Port of Tallinn. Furthermore, a number of state-owned businesses have taken loans from banks and issued bonds in the international market. All these transactions already presuppose profitability of a company and base its activity on business logic rather than social policy alone.

The State Needs No Additional Funds?

A central argument against taking state-owned businesses to the stock exchange has always been the government's non-existent debt level and extensive reserves. Indeed, it is much more complicated to explain the need to reduce holdings in state-owned businesses to a government with the lowest debt in the European Union as compared to governments groaning under their debt burden.

Yet, when introducing a state-owned company to the stock exchange, the state doesn't necessarily have to sell its holding but instead can provide the opportunity to involve all the money collected from the issue of shares in the company's further development. Involvement of additional equity capital would be a reasonable alternative to new loans in the case of Eesti Energia's possible investments in nuclear plants or distribution networks, modernization of Eesti Post in connection to the postal market opening up, or the financing of Tallinn Airport's expansion plans, for example. In addition, the state can earn macroeconomic profit in a wider sense thus allowing Estonia's foreign debt, which has grown quickly to practically equal the country's GDP, to be stabilized.

At the same time, the government's reserves are not overly large considering the size and growth of Estonian economy. The national Stabilization Reserve Fund has grown by several billion EEK in its absolute amount in the past few years. Comparing this reserve amount in relation to the state budget or goods import, it is evident that the relative amount of reserves has decreased noticeably.

Can we rest peacefully, knowing the Stabilization Reserve Fund created to alleviate economic problems is smaller than the total of one month's expenses in the state budget or is capable of covering goods import for only 12 days?

Interest Remains in Estonian Companies and Market

Nearly every week, Estonia hosts delegations from foreign banks in Europe and beyond. All of them share a common interest – Estonia (and the Baltic region more generally) is developing fast and capital market volumes are reaching a level where they are considering investment in our securities market. After IPOs in recent years, share market capitalization has reached its level prior to Hansabank leaving the market and liquidity has improved. Every new issue of shares improves the situation further, i.e. the more publicly traded companies we have, the faster the addition of foreign investors and foreign brokers in the market.

Organizing an IPO is a time-consuming process and requires extensive preparation. Still, I believe, we will see quite a few new publicly traded companies in the next TOP 100 Most Valuable Businesses as compared to today.

The 100 most valuable businesses in Estonia, I believe, fall in two groups: those that are on the stock exchange already and those that are planning to be listed in the future.

Listing makes the company more attractive and reliable

Photo GILD Bankers

HEIKKI KÄLLU
GILD Bankers' Partner

IPO (Initial Public Offering) refers to an initial issue of securities which, in essence, means that the relevant business becomes a publicly traded company. During an IPO, either new shares are issued to investors and the company's capital increases, or shareholders sell their existing shares. In the case of the latter, capital is not involved in the business, but existing shareholders either reduce their holding or give it up entirely. Often, a combination of both is used.

An IPO allows for involvement of additional capital and provides existing shareholders with liquidity. Being listed on the stock exchange enables full or partial payment for acquired businesses by shares owned rather than the business' own funds or through bank loans.

This is of particular interest to businesses expanding quickly by way of acquisition, especially when the market values highly the owners' shares.

It is also important to increase public awareness of a company, especially for retail brands. Being well known brings a reduced risk in the eyes of creditors, which brings down the price of debt capital. Stock market companies also gain the additional advantage of motivating their employees with stock options.

The Way to the Stock Exchange

A total of 22,000 securities accounts in Estonia contain shares of public companies. IPOs in recent years have added a number of new companies, like Starman, Tallink Grupp, Ekspress Grupp and Arco Vara, to the stock exchange, thus signalling increasing activity on the exchange. There has been a significant shift in the mindset of Estonian entrepreneurs – entering the stock exchange today is viewed as a plausible alternative to the involvement of capital. A few years back, the central focus lay in selling the company or involving an investment fund in the circle of owners. The general economic environment has provided support for the timing of IPOs, as well. A growth phase in the economy is the best time for IPOs, and many businesses have taken advantage of this window of opportunity.

When a company has decided to enter the stock exchange, the first step is the shareholders' decision to initiate the procedure of listing securities. Then, listing particulars are registered with the financial supervision authority in the relevant country and approval is gained from the authority. A public offer prospectus will include the company's financial information, a thorough overview of the company's activity as well as information on its owners thus far – all of the information required by investors to make a decision. Finally, a listing application is submitted with the relevant country's stock exchange. The preparatory work takes four to six months.

The European Union has implemented a single passport system which enables a public offering of shares in other EU states with a relatively small amount of additional work and expenses.

When the financial supervisory authority in a European Union member state has registered a public issue of securities, offering a similar issue of securities in another member state can be applied for quite quickly and at a rather low cost. In the case of Estonia, our interest here mainly lies in the Baltic or Nordic region yet, in exceptional cases, further markets could be looked at as well. Tallink, Olympic Entertainment Group, Arco Vara and City Service, for example, have taken advantage of this opportunity.

Components of an Enterprise's Stock Exchange Suitability

Whether or not a business is suited for the stock exchange will be ascertained in a thorough analysis so that the issue of securities will be successful from the perspective of the enterprise planning the IPO and so that future shareholders will be satisfied with their investment. Shares that are actively traded and have growth potential provide verification that turning the enterprise into a publicly-traded business was justified. Prior to the issue of securities, the reasons as to why an investor would be interested in purchasing the relevant enterprise's shares must be thought through, i.e. an equity story for the company has to be compiled.

Equity Story

An equity story must be factual, plausible, logical, and in conjunction with the planned IPO's nature—as well as easy to sell. Should the story claim the company is developing and growing rapidly, yet new capital will not be involved in the IPO, and existing shareholders will sell their holdings instead, it will not appear trustworthy to investors.

There may still be good reason for the aforementioned– the selling shareholder, for example, could be an investment fund that wants to exit its investment, etc. In such an event, the equity story has to state this clearly and provide good reasons. A good statement of grounds highlights the principal factors affecting the company's future perspective and connects these to important developments in the relevant field of trade or to the country's/region's macro trends. An equity story must position

Evaluation of Three Estonian IPOs

Photo: Ingmar Muusikus

Water samples in the laboratory of Tallinna Vesi.

TALLINNA VESI. The company's shares are positioned as offering a combination of stability and growth. Infrastructure companies have a stable cash flow, and long-term rate agreements ensure certain growth, making it easy to estimate the cash flow for Tallinna Vesi. The company's growth potential lies in expanding its activities in rural municipalities neighbouring Tallinn.

The company pays good dividends when viewed in the larger context of the Tallinn Stock Exchange.

The rate of return of the enterprise in the first six months was close to 50%. In assessing this it should be considered that it was the first IPO in Estonia since 1999 and, Tallinna Vesi was the first listed water company in Central and Eastern Europe. Lack of similar prior cases caused foreign investors to behave with excessive caution.

Photo: Marko Mumm / Eesti Päevaleht

Tallink Shuttle on its virgin voyage, april 2007.

TALLINK GROUP. The company's shares are clearly positioned as growth shares. The relevant equity story is extremely strong considering the region – a dominating position in a shipping lane (Tallinn-Helsinki) with traffic among the heaviest in Europe, the most modern fleet, and better financial results compared to the competition.

Weak results for the shares in the first six months (approximately –30%) are the result of a mistake in pricing and structuring (some of the existing shareholders had no sales restrictions) the transaction price (IPO price) was too high.

Photo: Marko Mumm / Eesti Päevaleht

CEO of AS Arco Vara Aare Tammemäe in June 2007, prior to the company's IPO.

ARCO VARA. The company's shares are positioned as growth shares, however, the IPO was conducted too late and the attitude towards real estate in the Baltic region of local investors and foreign investors familiar with the region had become negative, which also manifested in investors' lukewarm interest in the relevant issue of securities.

Quite a few investors from the US took part in the issue of securities, probably because of an extremely long-term vision for the Estonian real estate market. The rate of return on the enterprise's shares in the first three months (approximately –30%) clearly indicates negative changes in the macro environment.

the company for the investor – whether they are buying growth shares or dividend shares, whether the relevant sector of the economy is stable or cyclical, whether or not the company operates in a sector of the economy that is materially regulated by the state, etc.

Corporate governance

The next essential area is the quality of management of a business and the guarantee of shareholder rights, i.e. corporate governance. This is a wide-encompassing concept, which on one hand, refers to ensuring that the company's management does not steal from shareholders, and on the other, must ensure a major shareholder will not completely override minority owners.

The quality of management is a central subject matter not only in Central and Eastern Europe but in the entire world. Enron, Parmalat, Tyco and a number of other companies around the world provide examples of bad, even criminal, management of a business.

Management of a Business

This relates to business management quality. Investors presume the management of a business aspiring to enter the stock exchange to be able enough to implement the company's future objectives, i.e. realize the equity story and, in addition, guarantee the day-to-day administration of the enterprise at a professional level. As the management has to present the business to investors and sell the relevant equity story in IPO road shows, in addition to professional business administration skills, the management must be convincing and have excellent stage skills.

Size of a Business

Although the minimum market value requirement of the stock exchange allows relatively small companies to trade on the exchange, due to practical considerations, a company's market value after issue of securities should be no less than 50 million EUR, i.e. 800 million EEK.

Expenses constitute a significant factor: the organization of a public issue of securities is rather expensive, whereas certain expenses (attorney fees, due diligence and the above-mentioned road show-related expenses etc.) are not directly linked to the volume of issue of securities. Therefore, the expenses of a small issue of securities can prove to be perceptually very high. In addition, target investors to whom the issue of securities will be sold must be considered. If the issue of securities is planned for international sale, it should be remembered that small businesses are not attractive to international investors. Some investors even have restrictions in terms of minimum market value or the average expected daily turnover of a share.

Some investors have restrictions in terms of minimum market value or the average expected daily turnover of a share.

Successful Issue of Securities

An issue of securities has great potential to be successful if two of the main success factors are in place: a good equity story and the right price level. The price level will develop during the gathering of IPO purchase applications and the price bracket will be set by an advisor in cooperation with the enterprise. The final price will be determined by demand of institutional investors.

Prior to the beginning of an IPO, the advisor will carry out an evaluation of the company, the price bracket will be coordinated with the company, and normally there will be a pre-marketing session, during which the price bracket will be tested on international investors and adjusted in accordance to their feedback.

During an IPO, the organizer collects subscription applications from institutional investors. In the application, investors note how many shares they want to subscribe and at which price (the price remaining in the aforementioned price bracket). After the end of the subscription period, the organizer prepares an overview of the demand and suggests a final price to the enterprise. Setting the final price is, in large part, up to a gut feeling; the objective is to set as high a price as possible, at the same time making sure quality investors will be ready to purchase at the set level. The normal price behaviour for shares six months following the IPO in developed markets is +15 to +25%, in the Baltic region +20 to +35%.

Bo Magnusson: SEB Expects a Soft Landing in Estonia

President of the Council of SEB Eesti Ühispank Bo Magnusson says the owners of SEB expect a soft landing for the Estonian economy. Nevertheless, there are no guarantees.

TOIVO TÄNAVSUU
Eesti Ekspress

Is SEB satisfied with its investment in Estonia in 1998? That's when you bought Eesti Ühispank.
Naturally we're very happy with the developments thus far. For us, Estonia is not just business or a mere investment; Estonia is as important a home market for SEB, as are Sweden, Germany, Latvia, Lithuania, the Ukraine, etc. We're happy with how the bank is growing, how satisfied the customers are, and how we have been able to employ our competence and experience in Estonia.

There is a lot of talk in Estonia at the moment of a soft landing or a painful crash of the economy. How critical, according to SEB estimates, is the situation in Estonia at the moment?
Our main scenario predicts a soft landing; at the same time, it depends on a controlled slowing down of credit expansion and the government's financial policy. Thus we are paying great attention to macroeconomic developments in Estonia and other Baltic sates.

How do economic changes in Estonia affect SEB Eesti Ühispank's business?
We have set long-term objectives for ourselves. We have a high-quality client portfolio, and we are not overly focused on the real estate sector alone. We adopted this direction in the beginning of 2006, and we have always been among the most conservative banks in Estonia in terms of real estate.

At the same time, we are a valued partner among real estate developers, which is attested to by our recent award from Euromoney. This demonstrates that we can offer a quality service in complex sectors and are able to adjust quickly to changes in the economy.

The owner authorises SEB Eesti Ühispank to do business only in Estonia alone. This, in its turn, curbs the bank's growth opportunities as the Estonian banking market is well developed and clients are conservatively not prone to switch banks.

I see a great long-term growth potential for SEB in Estonia. The economy is continuing to grow and we have a lot more to offer to our customers.

15 years ago no one even dared to dream of the kind of development in banking that we have achieved in Estonia. Estonian enterprises are developing and becoming increasingly more internation-

Photo Marko Mumm/Eesti Päevaleht

SEB Eesti Ühispank: rapid growth

	assets in total	*net profit*	*equity capital cost benefit*
2002	21 486 mln EEK	379 mln EEK	16,6%
2003	25 580 mln EEK	544 mln EEK	19,8%
2004	34 733 mln EEK	743 mln EEK	21,1%
2005	49 839 mln EEK	924 mln EEK	21,9%
2006	70 951 mln EEK	1375 mln EEK	25,6%

Source: SEB Eesti Ühispank's annual report

al. This gives us the opportunity to provide them with more rounded financial services. SEB is the largest business bank in Northern Europe and that gives our Baltic clients a number of advantages.

In terms of private individuals, saving is just starting to gain momentum in Estonia and is growing extremely fast. We're seeing great potential for life insurance, asset management, funds and other saving products. SEB has 150 years of experience in saving, and we can offer our customers some of the most developed saving products in the banking sector.

Recently, Mart Altvee left SEB Eesti Ühispank's management due to insufficient freedom and the Matrix Management system in use.

Altvee claimed not to be the suitable leader for a Matrix organization. He started as the leader of the bank prior to the implementation of the system.

SEB Eesti Ühispank's voice is quite loud in the group today as Estonians are participating in a number of working groups and committees vital for the group.

I consider the Matrix system the basis for SEB's success, as the system enables us to offer all of our products and services in all markets and through that create synergy. For example, we brought various novel savings products from Sweden to Estonia and took some more complicated e-services to Sweden in return.

THE POWER IS 100% SWEDISH: Under Bo Magnusson's leadership, SEB Eesti Ühispank will become SEB Pank.

How important is SEB Eesti Ühispank's role in SEB group's economic results?

The Estonian unit forms approximately six per cent of SEB group's results. This indicator has grown a lot since 1998 and will continue to do so.

As a Swede, what have you noticed that is characteristic to the banking habits of Estonians?

Estonians take the lead in e-banking utilization. In addition, there is a continuing increase of interest in more complex savings products such as saving through life insurance, for example. Our business clients are demanding more complex product solutions, as well.

SEB Eesti Ühispank is the number two bank in the local market. Are you happy with that?

To have the biggest market share is not an objective in itself for us and neither is the growth of market share. Our main objective is the happiest customer base and greatest profitability in all of our countries of operation. So, quality rather than quantity first.

Alternative Market – Protest-spelling Challenge for Investors

Photo: Tallinn Stock Exchange

KALLE VIKS
Market Services Managing Director of the Tallinn Stock Exchange

ALTERNATIVE (noun) – colloquial for another way, choice
ALTERNATIVE (adjective) – colloquial for outside the mainstream, different from the usual or conventional (art, fashion, music etc.)

How many of us understand alternative art, listen to alternative music or wear alternative fashion? A minority, probably, since alternative as a form of protest and differentiation from the mainstream is unconventional and can carry certain dangers. At the same time, multitude of alternatives makes our world-view so much richer.

Similar to alternative cultural phenomena, dissidence and protests stand behind the creation of an alternative market – protests against the many continuously stricter rules in the securities market. Protests against rules that make the bringing together of enterprises and investors is increasingly more expensive and complex.

One of the main reasons behind the emergence of the first alternative market (the London AIM—Alternative Investment Market) more than ten years ago, was the desire to create an easier alternative for all market participants. The idea proved successful – with a backdrop of increasingly burdensome regulations, the setting up of alternative markets spread across Europe in 2005. Thus, the London AIM hosts trading shares of 1,687 businesses and OMX's First North (Nordic region) the shares of 117 companies.

As a result of developments in the securities market and changes in the regulative environment, the realistic option of launching of an alternative market in Estonia is now beginning to emerge. Currently, the Riigikogu [Parliament] is deliberating amendments to the Securities Market Act required to launch an alternative market and, as early as within the current year, the Tallinn Stock Exchange, a member of the OMX group, is scheduled to open an Estonian First North alternative market. The alternative market is foremost directed at growth enterprises and knowledgeable investors and is a long-awaited event for a number of interested parties.

What are Investors Interested in?

Public discussion thus far has emphasized central reasons as to why businesses should show interest in the alternative market, yet investor motives have not been dissected much. From the perspective of investors, one of the most important reasons behind setting up an alternative market is the increase in the number of publicly traded companies. According to data from the Estonian Central Register for Securities, there are approximately 5,100 public limited companies and 90,000 real investors in Estonia; the shares of only 18 businesses, however, are traded on the Tallinn Stock Exchange.

This is a disproportionately small number – the choice of local investment projects is not nearly big enough for investors who believe in the continued success of Estonian businesses and an alternative market can significantly alleviate the situation.

Through an alternative market meant for growth enterprises, investors can also contribute to the development of Estonian businesses complementing this way the state structures active in business promotion. Alternative markets provide small investors with the opportunity to participate in small- and medium-sized growth enterprises and allow financial investors to supplement their portfolios with more risky products.

Is there enough available money in Estonia for businesses in the alternative market? I believe lack of the means of investment will not be an obstacle in the near future – a company's story, however, will become increasingly more important. If the leaders of businesses can comprehensibly determine companies' developmental objectives, believe in those goals, and move the business forward, investors who will support them will be there. The presence of money in the market is also indicated by the fact that the seven companies that entered the Tallinn Stock Exchange since 2005 have gained more than one billion EEK from retail investors. Money awaits good ideas.

Well-done Homework can Compensate for Additional Risks

Shares of businesses in the alternative market bring along a number of risks that investors must account for. One of the main risk factors is the uniqueness of companies expected in the market – the relevant enterprises are likely in their aggressive growth phases and are not widely known. Risks are also increased by lower requirements set by the companies – minimum requirements for business activity history, equity capital amount, the free float of shares are not applicable, and expectations as to reporting and continuous disclosure of information are lower.

Lower requirements and greater risks bring along an increased expected rate of return on investment. As a rule, shares of companies in the alternative market are slightly under -priced, yet the probability of not achieving this rate of return increases, as well. Failure risk for growth enterprises is fairly high. Largely due to heightened risks, the volatility of businesses and share prices in the alternative market is increased. Investing in the alternative market requires investors to be highly skilled in assessment and dispersion of risk.

The alternative market provides knowledgeable investors with the opportunity to diversify their investment portfolios, adding more risky elements.

The investors' task is to find future pearls among growth enterprises – businesses whose management and future perspectives have the greatest potential. This requires intense analysis of enterprises and being up-to-date on the situation in different economic sectors. Due to these reasons, the alternative market is unsuited for new investors and investors with low risk-tolerance. Yet for experienced and knowledgeable investors it offers a rewarding opportunity to diversify their portfolio, adding to it more risky elements.

Alternative Market – the Wild West?

Due to decreased requirements, investor protection in the alternative market as an unregulated market is weaker, and therefore investment in the market presupposes more knowledge and experience from the investor than stock exchange investments. At the same time, the alternative market is a much safer and more attractive investment location for investors when compared to the current securities market outside of the stock exchange (unlisted shares) where no information disclosure-related requirements exist at all.

The alternative market does not refer to chaos and anarchy. Similar to the regulated market, so as to ensure elementary investor protection and due trading and information disclosure, the alternative market is monitored as well. Limited monitoring is implemented by alternative market contractual advisors who monitor the activities of advised companies on a continuous basis and provide support in improving their practices.

My conviction is that the alternative market is foremost suitable for experienced investors who want to take reasonable additional risks and who no longer necessarily require maximum investor protection provided by strict rules. Stricter rules are mostly guided by the desire to protect investors – often from their own ignorance.

Should alternative markets, initially launched as a form of protest, gain popularity across Europe and more investors be involved, investor protection by way of amplitude of additional requirements might prove to be necessary for this trading venue, as well. This could lead to stricter regulation of alternative markets, more forceful investor protection, and the move closer to mainstream. Expenses for market participants could increase and the protest wave could rise once again...

Increasing Value with Alternative Investment

KIMMO IRPOLA
GILD Bankers' Partner

How much a business can increase its value largely depends on the company's current development phase.

The percentage of private equity-type alternative investments is rapidly growing in the financial markets around the world. Similar to a number of other widespread terms in the financial vocabulary, the term "private equity investor" does not have a good equivalent in Estonian. These kind of investors can be called long-term investors who, as a rule, acquire holdings in businesses that are just starting up or are in the middle of their development and are not listed on the stock exchange. Private equity investors are generally (but not always) active investors who, so as to increase the value of the company as well as their investment, participate in the strategic management of the business.

What is the Best Timing for Alternative Investments?

Private equity or risk capital provides an alternative solution in specific situations. Specific situations may include a rapid growth phase of the business, conflict between existing shareholders, restructuring of the company's balance sheet, acquisition of the company, or different types of purchase transactions. As opposed to a strategic investor whose objective in entering a business is the expansion of his main business, the central goal of a private equity investor is a profitable realization of his investment. Typically, such investors will exit the business in six to seven years.

When a business is growing fast, it is in need of financing that will exceed its own cash flow. In such an event, an alternative financial investment can offer a junior loan, convertible bond or an opportunity to invest directly into equity capital. Even if the company is able to take advantage of a general bank loan, a private equity holding will help in strengthening the company's capitalization.

The more risk capital is involved, the greater the involvement of risk capitalists in the company's business activities. As a result of an investment, private equity investors will participate as a board member, development of strategy, introduction of management practices, acquisition transactions, management formation and, finally, the process of exiting the company.

Photo: GILD Bankers

Financial investors have developed into the principal competition for domestic strategic buyers.

Alternative Investment Trends in the Baltic States

In 2006, risk capital investments made up 0.002% of the GDP in the Baltic States while the average in the European Union was 0.325%. Still, only a small number of risk capitalists operate in the Baltic region. Foreign investors mainly look at bigger transactions in the Baltic markets; Mid Europa Partners, for example, recently purchased the leading mobile network in Lithuania, BITE GSM. The same has occurred with a number of Internet environments. The majority of local funds' risk capital investments remain in the one to five million EUR bracket.

Financial investors have developed into the principal competition for domestic strategic buyers. Traditionally when private equity investors in the Baltic region have exited the investment, they sell their holding to a strategic buyer. Nowadays, the number of transactions where one private equity investor sells to another or the company is taken to the stock Exchange is increasing.

The number of transactions where one of the parties is a public enterprise is also growing. Relevant examples include Tallink and Tallinna Kaubamaja, both of which have, at different times, gained support from private equity investors. The recent purchase of AS Kalev by Alta Capital is a good example of how a private equity investor can consolidate a sector.

Recently, alternative investments have been directed at larger businesses, since the percentage of acquisitions among these enterprises is the highest. Financing the setting-up of businesses is left entirely up to business angels or investors with an outstanding risk tolerance. In addition, the rate of return for alternative investments has increased as with the development of financial markets the opportunities for investors to exit the investment have increased as well.

Falck Trademark to Remain on Tow Trucks

Interview with Peeter Tohver, manager of Estonian branch of G4S Baltics, ranked 19th in GILD TOP 100.

Photo: Tiit Blaat

TOIVO TÄNAVSUU
Eesti Ekspress

Why is it so important to launch an expensive name change process and turn the Estonian Falck into G4S?
Actually, it was not that important. We are a part of a major international group. Group4Falck and Securior merged in 2004. The decision regarding the change of name was made in the group headquarters in London in early 2006.

We did not have any choice. The companies of the group were granted one year for the transfer to the new trademark. We were the last ones to make that transfer, since to date we have managed very well with Falck. We chose a smooth transfer which is much cheaper than an overnight change.

What is the cost of the name change?
Fortunately, we do not have to invest large funds into the campaign – the appearance of our vehicles and personnel and diverse tasks that we undertake are the carriers of our trademark.

We will make the final transfer to the new name within one year, and it will cost approximately 10 million EEK. By the autumn of the next year you should not see the name of Falck anywhere, though this cannot be confirmed 100%. For instance, stickers of ESS, the predecessor of Falck, can still be seen on some buildings.

We will make the final transfer to the new name within one year and it will cost approximately 10 million EEK.

Will the content be changed along with the name?
There are all kinds of stories circulating about us, that we deal with everything starting from birth and ending with death. This is actually not the case. As to the content, we want to underline that we are a proper security company that is engaged in everything that entails – starting with manned guards and ending with home-guarding and the transport of cash. We have combined other services under the trademark of Ühisteenused, for instance cooperation with the cities on parking and public transport ticket inspection.

The head of G4S Group, Nick Buckles has said that success is ensured by co-operation with government and has referred, for instance, to the fact that G4S protects nuclear structures in the US. Cooperation with local government is important also in the case of G4S Estonia. This is one success factor. Mainly, success has been brought about by the fact that we have been able to offer good service to our clients, regardless of whether the client is a state, city, private individual or a business. Whether we guard the Pentagon, the European Parliament or the home of Mr. Jüri Mets – all of these clients are important for us.

G4S holds 49% of the security market in Estonia. You have almost 40,000 clients. Can you still spare enough personal attention to all of them?
I very much want that our service quality will not deteriorate. We have made every effort in order to offer the best service.

I have to admit that we have not always been successful. It is really the logic that the smaller the company the easier it is to offer personalised services to the clients. But our advantage is a large stock of skills and knowledge.

What will become of the Falck trademark in Estonia?
The trademark will remain on the Estonian market – like elsewhere in Northern Europe-- and

Photo: G4S

WELL-KNOWN CONTENT, NEW COLOURS: Peeter Tohver underlines that G4S is the trademark of a security company. Ühisteenused takes care of other tasks.

will be used by a company providing car servicing and towing aid now operating under the name of Rosqvist. This company is not connected with our Group.

So that instead of security vehicles, Falck tow trucks will be roaming the streets?

Yes, indeed this will be a bit funny in the beginning, but one will get used to it. Only the security services of the Group 4 Falck group joined Securior, the rest, i.e. rescue services, were not joined with Securior. Our task is to make the G4S trademark as good as possible.

What are the new and innovative security solutions that G4S will surprise us with in the coming years in Estonia?

That is an issue under our constant attention. But it is a pleasure to admit that innovativeness is, in all cases, at a high level in Estonia. Wifi solutions, cordless home-guarding, innovations in cash transport and ATMs – these are all on the top level here. It is the same with mobile payments and parking control.

As much as the world is able to invent secure solutions, as much as will we introduce these into use.

In the future, IP-based (internet protocol-based) guarding will become the keyword in home and business guarding.

Do you expect to see a substantial increase in the size of the Estonian G4S workforce?

Staff numbers will not increase. The quality of manned guarding will be improved, since the economy will experience a small decline – or rather the growth will decelerate. As a result, the size of the workforce entering the market will increase a bit. We also intend to start replacing manned guarding with video solutions and other innovative solutions that we can offer.

Like a flea and an elephant

The Flea	*The Elephant*
G4S Estonia (formerly Falck Eesti)	**Group 4 Securior**
Together with her sister companies in Latvia and Lithuania, G4S Estonia belongs to G4S Baltics Group (a company registered in Estonia), of which 65% belongs to Group 4 Securior and 35% to the company U.S. Invest, owned by Estonian businessman Urmas Sõõrumaa.	A giant created by the merging of two large companies – Group 4 Falck and Securior. Listed on London and Copenhagen stock exchanges.
Annual sales 0.95 billion EEK.	Annual sales 108 billion EEK.
3,900 employees, almost 40,000 clients.	Over 500,000 employees. Strong expansion in emerging markets, e.g. India, where security guards are recruited by the tens of thousands.
Leader in the Estonian security market. Market share in Estonia 49%, which leaves them only one step from the Group's goal in each Baltic country: a market share of 50% in 3 to 4 years. Completely dominates the next competitor – Securitas –the latter having only 8% of the market. Guarding services comprise 35%, alarm services 27% and the common services (public transport inspection, parking control, etc.) 8% of sales. Also enjoys an absolute monopoly in the market of cash transport (only in Estonia).	The second largest provider of security services in the world (soon to become the first). Share in the global security market 7%, losing to Securitas (market share 8%) while outpacing Tyco (5%). Controls 12% of the international market of manned security services (Securitas 14%) and 2% of the market of security systems (Securitas 3%, Tyco 24%). Holds 12% of the market for cash services in the world, on the same level with Securitas.

Photo: Toomas Tuul

ESTONIAN OIL FIELDS: Viru Keemia Grupp's production base in Ida-Viru county.

VKG Majority Owner Priit Piilmann: We Need Extra Brains

Viru Keemia Grupp (VKG), a company mainly focused on the production of shale oil, starts to produce fine chemicals that can be sold on the international market.

TOIVO TÄNAVSUU
Eesti Ekspress

Estonian oil shale, mainly "shovelled into the stove" by Eesti Energia, and from which millions of tons of oil has been produced, finds its future, for example, in the resins of car tyres or brown hair colouring.

Today, rapid chemical development is underway in Kohtla-Järve. The price of a ton of oil is less than the price of a kilogram of fine chemicals on the international market – that is the appeal to VKG.

"One has to admit that this is by far not a simple business," says Priit Piilmann, one of the owners of VKG. "This area takes considerably more money and time than was initially planned. While these can be found, another factor seriously lacking is brains," he says.

VKG must rely on chemists who have worked in the company for decades, since the development of oil shale chemistry cannot be purchased by way of consultations. The difference between VKG and world-famous chemistry and cosmetics firms such as BASF or Henkel lies in the fact that while the bigger firms have thousands of scientists, big labs and large budgets, the VKG develops chemicals almost manually in Kohtla-Järve through the method of trial and error. Still, remarkable results have been achieved in this way– such as 2-methyl-resorcin.

The annual demand for 2-methyl-resorcin amounts to 50-60 tons worldwide. VKG is able to cover that 1.5 times. Kohtla-Järve is the only factory in the world where 2-methyl-resorcin is produced from oil shale. Competitors are located in China and in the US, but they are producing the chemical from oil, and their production process is much more expensive.

Photo: Vallo Kruuser

The function of resins is diverse. VKG is waiting for the day when chemicals from Kohtla-Järve will reach the tyres of a major tyre manufacturer like Bridgestone. But similar chemicals are contained in dyes, furniture, drinking bottles, sand moulds for production of engine parts, model aircraft, as well as anabolic steroids for athletes. In other words – chemicals are everywhere.

VKG tries to make the best of oil shale in a number of ways, so that it translates into a most-expensive product with the smallest amount of residues.

Chemicals top the value chain in oil shale processing. Currently, two projects are underway in Kohtla-Järve. First, a new oil factory will process fine oil shale and material which has until now been processing waste. This will raise the annual oil production of VKG from 1.65 million to 2.45 million tons.

Second, a cement factory will untilize a major part of the residues of mining and oil production.

According to Piilmann, Eesti Energia may be likened to one who "shovels oil shale into the stove." "This may seem bad, but Eesti Energia is not free in its choices. Its first task is to supply Estonia with electricity and 'shovelling oil shale into the stove' is unfortunately the only option," he says. Eesti Energia is also engaged in the production of oil and chemicals and reduction of residues.

MAJORITY OWNER: At the initiative of Priit Piilmann, the Kiviter plant, once in bankruptcy, has now become one of the most valuable undertakings in Estonia.

In recent years, VKG has invested approximately 20 million EEK in development work related to chemicals with the help of Enterprise Estonia (EAS). This year, EAS named VKG's projects as "industrial undertaking of the year."

Until VKG breaks into the top of the international chemical industry, its profit is derived from oil sales. Shale oil is an energy product with a price which has soared on the international market in recent years.

VKG produces oil, as well as purchases it from the Narva Oil Factory of Eesti Energia. Oil is delivered by small tankers to Western European ports through Sillamäe Port. In the Western European ports it is mixed with other oil products, mainly heavy fuel oil where it becomes fuel for ships.

While Estonian shale oil is often considered a product hostile to the environment, the understanding in Western Europe is just the opposite, according to Piilmann. "Our oil helps to reduce the sulphur content of heavy fuel oil and reduces fuel consumption. And therefore it is an environmentally friendly product."

Since the market price of oil is related to the price of heavy fuel oil, and due to the volatility of the market, VKG also uses futures transactions for hedging risks.

Piilmann sees VKG's future growth in the production of fine chemicals and the launching of a new oil factory. The plan to establish an oil production facility in the Slantsy mining area of Russia has not been completely buried, either. Although today it seems that the mining permit was snatched from in front of the noses of the Estonians by the local oligarch Viktor Vekselberg. Each year VKG sells to Russia – Moscow and Tchelyabinsk electrode factories – approximately 15,000 tons of coke.

VKG is an influential group in Ida-Viru county. Besides the oil and chemical industries, the company is also part of the electricity grid, heat production and water system of the region. VKG also provides transportation and construction services.

Although according to the estimates of GILD Bankers, the value of Neste Estonia exceeds the value of Estonian Statoil by 50 million EEK. Neste has earned more profit for its owners in recent years, and the sales of Statoil are higher. And, of course, hamburgers and hot dogs are available only in Statoil.

Two Great Ones – Neste Estonia and Estonian Statoil

Photo: Ingmar Muusikus

	AS Neste Eesti, Director General Indrek Kaju:
Value in GILD's TOP100	985 million EEK
Slogan	"Smart filling stations"
Sales 2006	2.27 billion EEK
Share of fuel in the total business sales of 2006	98%
Number of service stations	By the end of the year 41 automatic filling stations
Will the number of filling stations increase?	"In case we build two or three stations each year, in five years Neste will have ten to fifteen stations more."
Staff	41
Store	None. "In 2000, we made a decision to limit our focus in the Baltic states to only the retail sale of fuels. We have successfully implemented that strategy. Borrowing a comparison from athletics, we prefer to be a sprinter, competing in 100 metre race with decathlonists."
Carwash business	None. "We have left the business, but nine Jazz carwashes provide services to Neste's clients in Tallinn, Tartu and Keila."
Management	Indrek Kaju's superior is Ingmar Dahlblom who, at the moment, is responsible for the Neste's retail sales outside Finland. Dahlblom's superior is the head of the Retail Sales Division of Neste Oil.
Owner	Neste Oil Corporation OY (Finland)
Share in the sales of the owner group	1.1 %
What next?	"A revolution in the world of car fuels during the next three to five years is unlikely. Fuel merchants must start to add a bio-component into petrol and diesel fuel. Neste has every potential to be a successful retailer in five years. Retail sales do not bring in super profits, but on the other hand, there is no risk that the market will just collapse."

Photos: Ingmar Muusikus

Photo Veiko Tõkman / Äripäev

	AS Eesti Statoil, Director General Helle Kirs-Toiger:
Value in GILD's TOP100	937 million EEK
Slogan	"A place under the sun"
Sales 2006	2.57 billion EEK
Share of fuel in the total business sales of 2006	Ca. 80 %
Number of service stations	46 service stations, 5 automatic filling stations
Will the number of filling stations increase?	"With our estimated 30% market share, we are the leaders in the retail market of engine fuels. We want to continue in that position, and we have a network of service stations sufficient for that aim."
Staff	651
Store	"Store and services account for more than one-fifth of the sales. The goal of the selection of foodstuffs in our stores is to offer the client a quick and refreshing break. The product group FoodToGo (food and beverages for instant consumption), comprises one-third of store sales, includes hot meals, sandwiches, salads, pastries, hot drinks etc."
Carwash business	The number of sold car washes increased by 29% in 2006.
Management	Estonian Statoil, the retail units of the Baltic countries, plus Poland, Russia and Scandinavia are subordinated to the head of Statoil Energy & Retail Europe, who is stationed in Oslo. He, in turn is subordinated to the head of the Manufacturing & Marketing unit of the Group, who in turn is subordinated to the President of the Group.
Owner	StatoilHydro ASA (Norway)
Share in the sales of the owner group	0.3 %
What next?	"We do not plan to introduce any principal changes in Statoil's full-service concept – we will continue with the retail sale of engine fuels, store goods and services. The coming years will see an important increase in the topicality of biofuels and the accompanying changes in the product line of engine fuels. The store concept of Statoil is being updated now. In the future, we hope to offer our corporate clients quicker and more convenient filling and paying options."