








JOINT STOCK COMPANY
«LATVIJAS GĀZE» ANNUAL REPORT

2005

SCHEME OF THE BALTIC GAS PIPELINES

Legend:

-  Existing gas transmission pipelines
-  Prospective and under-construction gas transmission pipelines
-  International gas measurement stations
-  Existing underground gas storage facilities
-  Prospective underground gas storage facilities

THE COMPANY IN THE YEAR 2005

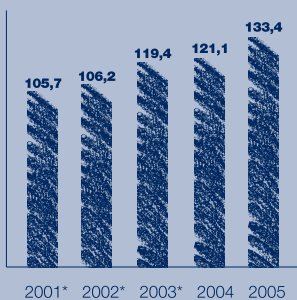
The main purpose of the activities of the Joint Stock Company "Latvijas Gāze" was to ensure stable and uninterrupted supplies and sales of natural gas in Latvia, as well as supplies to Estonia and Western region of Russia during the winter season by means of developing and modernising gas supply systems and related services.

MAIN AREAS OF THE COMPANY'S OPERATION:

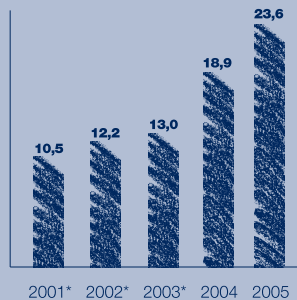
- natural gas purchasing, storage, transportation, distribution and sales;
- export and import operations with natural gas;
- natural gas metering and quality control.



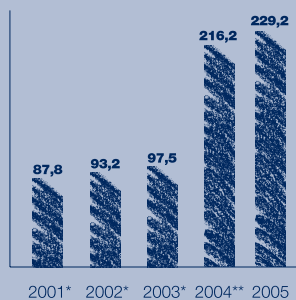
Net turnover (million LVL)



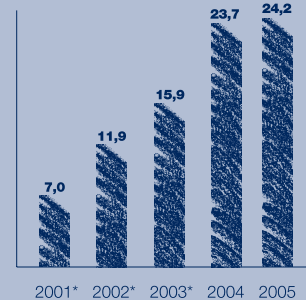
Net profit (million LVL)



Equity (million LVL)



Investments (million LVL)



* Concern of the JSC "Latvijas Gāze"

** Equity after revaluation of fixed assets

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THE COUNCIL REPORT

The year 2005 surprised the world with a rapid increase of prices of oil products that also affected the environment of entrepreneurship and the results of economic activity of the JSC "Latvijas Gāze" (hereinafter – the Company). Working in the conditions of competition, the Company has retained its position in the fuel market and provided increase of natural gas sales both in terms of volume and cash.

In long term, the investment policy implemented by the Company is directed at raising the operation safety of the system of gas supply, providing for the stability of gas delivery, expanding the gas pipe network and creating new connections. It has ensured growth of the number of users for several thousands annually, especially in the household sector, gradually increasing the proportion of this group of users in the total amount of gas realization.

The cooperation with the public administration authorities and the Public Utility Commission has given the Company an opportunity to react operatively to the changes of gas purchase prices, thus providing for sufficient liquidity for the implementation of stable policy of dividends and great investment projects. In comparison with the year 2004, the net profit of the Company has increased for 25.3% and reached the highest level so far – Ls 23.6 million (EUR 33.6 million). A part of the profit is connected with execution of the judgment of the Court of Stockholm and applies to the economic activity of previous periods.

In the reporting period, much attention was paid to the issue of incorporating the requirements of the EU Gas Directive into the Energy Law. The workgroup created by the Council and the Board of the Company achieved acceptance of a special law which stipulated that special sections of the Energy Law concerning the liberalization of natural gas market take effect on January 1, 2010.

In 2005, the Council received regular reports of the Board about activity as well as economic and financial standing of the Company. The Council controlled the work of the Board in all major directions and saw to that the Company acted according to the laws, Articles of Association of the Company and the resolutions of the Shareholders' Meetings, checked and accepted the budget submitted by the Company and made proposals on improvement of the Company's work.

In 2005, the Council repeatedly reviewed and approved the amendments to the contracts with the natural gas suppliers JSC "Gazprom" and LLC "Itera Latvija" which provided not only for the changes of marketable gas prices in connection with the growth of prices of oil products, but also specified the terms of the contract in accordance with the internationally accepted norms.

Last year, the Council discussed and approved the investment program of the Company for 2006 – 2010 the purpose of which is to raise the safety and stability of gas supply. The main directions of the program are as follows:

- improvement of safety and development of Inčukalna underground gas storage facility;
- modernization and diagnostics of the system of gas transmission pipelines and completion of the program of modernizing all gas regulation stations;
- modernization of the distribution system of natural gas, completion of modernization of all gas regulation points, perfection of available information technologies and introduction of new technologies;
- building new gas pipes and improvement of customer service.

In 2005, the Council also examined and approved amendments to the regulations of the Council and the Board of the Company due to changes in the Articles of Association in accordance with the requirements of the Commercial Law.

The audit of the Company's annual report of 2005 was performed by the international auditing firm "PricewaterhouseCoopers Ltd" in accordance with the legislation of Latvia and International Accounting Standards. The Council has received the auditor's reports in which it is declared that the Company's balance sheet, the profit and loss account and the cash flow statement in all significant aspects reflect the financial standing of the Company as of December 31, 2005. The Council has examined the report of the Board concerning the activity of the Company in the reporting year, research and development, financial risk management and proposals on distribution of profit of the year 2005, and they have been accepted.

The Council of the Company acknowledges successful performance of the Board and the personnel in 2005 and wishes success and development in the future.



THE COUNCIL

The Council of the Company is elected for three years by the General Meeting of Shareholders of the JSC "Latvijas Gāze". In 2005, membership of the Council was as follows:

Chairman of the Council:

Kiril Seleznev – representing the share of OAO "Gazprom" in the Company

Deputy Chairmen of the Council:

Juris Savickis – representing the share of LLC "Itera Latvija" in the Company;

Stephan Kamphues – representing the share of "E.ON. Ruhrgas International AG" in the Company.

Members of the Council:

Eike Benke – representing the share of "E.ON. Ruhrgas International AG" in the Company;

Matthias Keuchel – representing the share of "E.ON. Ruhrgas International AG" in the Company;

Yelena Karpel – representing the share of OAO "Gazprom" in the Company;

Vlada Rusakova – representing the share of OAO "Gazprom" in the Company;

Reiner Lehmann – representing the share of "E.ON. Ruhrgas International AG" in the Company;

Uwe Fip – representing the share of "E.ON. Ruhrgas International AG" in the Company;

Igor Nazarov – representing the share of LLC "Itera Latvija" in the Company;

Alexander Krasnenkov – representing the share of OAO "Gazprom" in the Company.

Council Chairman: Kiril Seleznev



ALEKSANDRS MIHEJEVS
Member of the Board

ADRIANS DĀVIS
Chairman of the Board

ANDA ULPE
Member of the Board

THE BOARD OF THE JSC “LATVIJAS GĀZE”

FRANKS ZĪBERTS
Member of the Board



GINTS FREIBERGS
Member of the Board





SHARES AND SHAREHOLDERS

In 2005, quotation of the shares of the JSC "Latvijas Gāze" was continued in the Official List of Riga Stock Exchange (RSE) and the Official List of Baltic Stock Exchange. At the end of 2005, the capitalization value of the Company reached LVL 383.44 million (EUR 545.59 million). Compared to 2004, it has grown by LVL 124.1 million (EUR 176.58 million). By capitalization value, the shares of the JSC "Latvijas Gāze" are the number one among the securities quoted in RSE and the number four among those quoted in Baltic Stock Exchange.

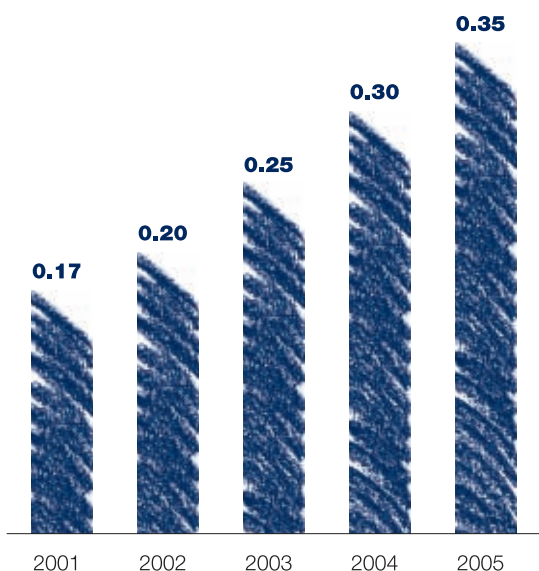
The price per Company share during 2005 fluctuated between LVL 6.15 and LVL 9.9 (EUR 8.75 and EUR 14.09) and stopped at LVL 9.61 (EUR 13.67) at the end of the reporting year. Compared to the beginning of the year, it had grown by 55%. During the reporting year, turnover of the shares of the JSC "Latvijas Gāze" reached 63 360 shares for LVL 486 242 (EUR 691 860).

The equity capital of the Company is LVL 39.9 million, divided into as many voting shares with the face value of LVL 1 (EUR 1.42). In the repor-

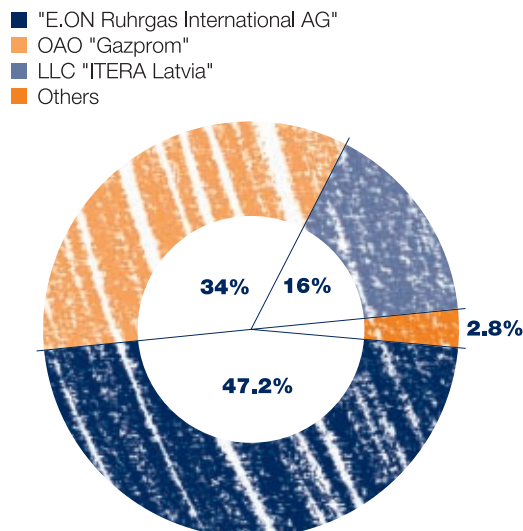
ting year, the structure of shareholders of the JSC "Latvijas Gāze" was changed. One of the shareholders of the Company – LLC "Itera Latvija" – sold 9% or 3 591 700 shares of the Company to another shareholder OAO "Gazprom". After this transaction the structure of the main shareholders of the JSC "Latvijas Gāze" is as follows: "E.ON Ruhrgas International AG" owns 47.2%, OAO "Gazprom" – 34%, LLC "Itera Latvija" – 16% of the shares of the JSC "Latvijas Gāze". The rest of the shares are owned by minority shareholders, including employees of the Company.

On May 19, 2006, the Council of the Company approved the draft for distribution of the profit gained in 2005, determining that LVL 0.35 (EUR 0.498) per share or LVL 13.97 million (EUR 19.87 million) in total (62.2% of the profit of the JSC "Latvijas Gāze" in 2005) has to be paid in dividends. Compared to the year 2004, the dividend payable per share has grown by LVL 0.05. The amount of dividends has grown every year since 1999, when the shareholders of the Company received LVL 0.12 per share. Moreover, the market value of the shares also tends to grow year by year.

Dividends per share (LVL)



Structure of shareholders of the JSC "Latvijas Gāze" (%)



NATURAL GAS IN THE ENERGY MARKET OF LATVIA

The fuel for the needs of the heat supply market of Latvia is mostly imported – natural gas, liquefied petroleum gas, petroleum products and coal. Wood and peat, in their turn, are local energy resources used to ensure heat supply in Latvia.

Latvia, compared to many other countries of the European Union, still has a centralized heat supply system. As the result, it is possible to provide heat supply to both private and commercial consumers without building a complicated gas supply system in urban environments, thus enabling to provide for observance of higher requirements of ecological protection in densely populated territories.

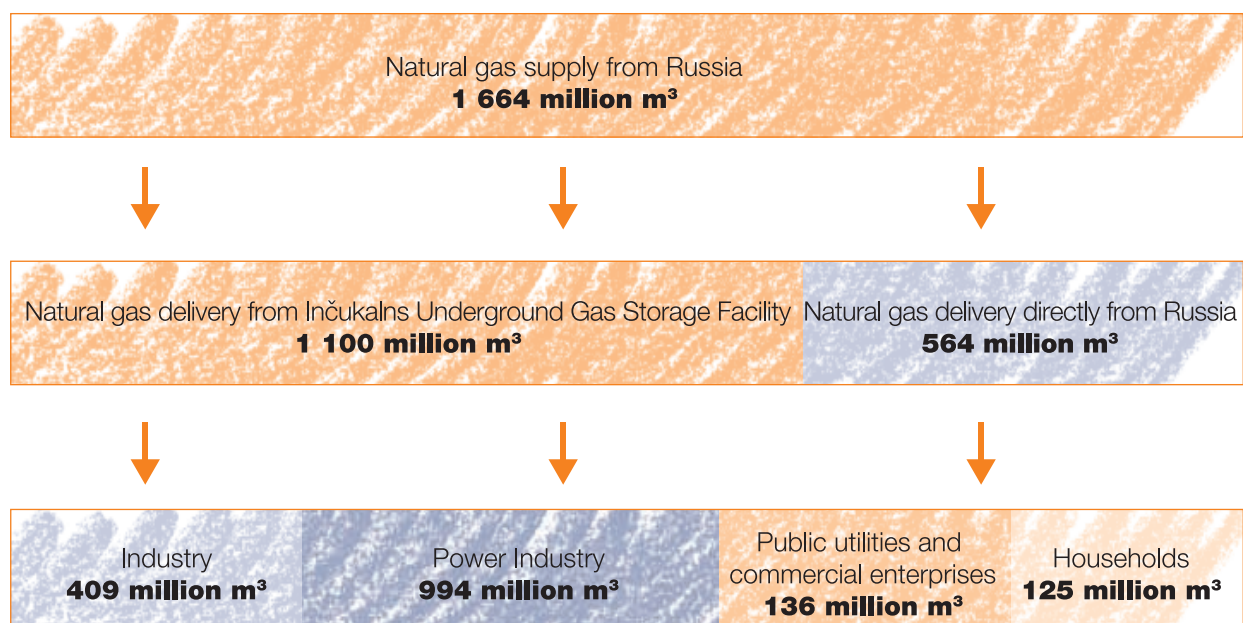
Natural gas is still the main fuel in the electricity generation process in thermal power stations. Cogeneration

stations of small and medium capacity, where natural gas is used as fuel, also continue their development.

Already since 2000, natural gas safely retains the first place in the primary energy market, outpacing wood and petroleum products. The closest alternative fuel to natural gas is heavy fuel oil that is easily replaceable in steam-shops, thermal power stations and industry. However, the growth of heavy fuel oil prices in recent years and the competitive price of natural gas has made this fuel, which is ecologically one of the most harmful, unclaimed in the market. In 2005, the share of heavy fuel oil in the primary fuel market of Latvia was only 1.7%.

Because of similar reasons, popularity of natural gas grows in the sector of individual houses where more

Structure of natural gas consumption in 2005



and more customers choose natural gas as the most favourable, convenient and ecologically the purest fuel. As the demand is growing, the JSC “Latvijas Gāze” actively and continuously implements many gasification projects for private sector customers, building new gas supply systems and planning projects for several years in advance. Besides, order of gasification projects from the private sector is growing rapidly despite the high costs of implementation. It is mostly caused by construction of new private house villages and broad crediting facilities enabling private customers to obtain financing for gas supply system for their houses.

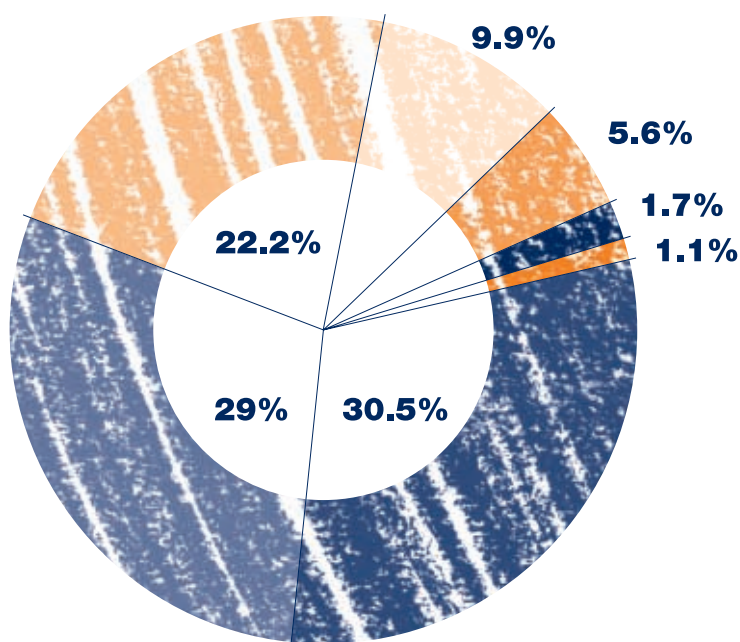
Although in May 2005 Public Utilities Commission, after long discussions and thorough evaluation of justification and possible consequences, agreed to the proposal of the JSC “Latvijas Gāze” to increase the sales tariffs of natural gas, they are still among the lowest in the European Union. Thus it can be surely anticipated that also in the upcoming years natural gas will retain its lea-

ding role in the fuel market of Latvia both because of ecological reasons and relatively low costs. It is also possible that implementation of so many gasification projects both by building new gas pipelines and making local gas supply networks will enable increase of the total amount of natural gas consumption in the country.

Globally gas prices are significantly influenced by oil and heavy fuel oil prices which have considerably grown during the recent years. Therefore, considering the global trends, the JSC “Latvijas Gāze” will be forced to review regularly the gas tariffs for consumers in Latvia also in the future. In 2006 gas prices are certainly being affected by oil and heavy fuel oil prices. Furthermore, the contract signed between the JSC “Latvijas Gāze” and the Russian gas company “Gazprom” states that the supply prices grow by 14–20% this year, depending on the heavy fuel oil prices, and that the price increase is expected next year, too.

Balance of primary energy resources in 2005

- Natural gas
- Wood
- Oil products for transportation
- Electric energy
- Other oil products
- Heavy fuel oil
- Others





DEVELOPMENT OF THE COMPANY

In 2005, the Company kept paying attention to further expansion of natural gas distribution system and connection of new users to the existing gas supply system. In the reporting year, the JSC “Latvijas Gāze” invested LVL 10.7 million (EUR 15.2 million) for installation of new gas transmission pipelines, and 250.2 kilometres of distribution pipelines were put into operation, including 20 kilometres of service lines and gas transmission pipeline Preiļi – Rēzekne, 46.5 kilometres in length. This is the longest and most complicated object built since establishment of the JSC “Latvijas Gāze”. The total costs of this project were LVL 6 million. With building new gas pipelines in the reporting year, the total length of natural gas pipelines on December 31, 2005 was 5620.1 kilometres, including gas transmission pipelines – 1280.7 kilometres and distribution pipelines – 4339.4 kilometres. The number of individual customers using gas for heating grew by 4.2 thousand in 2005 and at the end of the year reached 35 thousand users. The total number of natural gas users (including industrial consumers) was almost 433.9 thousand at the end of the reporting year. In 2005, the JSC “Latvijas Gāze” sold 1664.2 million cubic metres of natural gas to users in total.

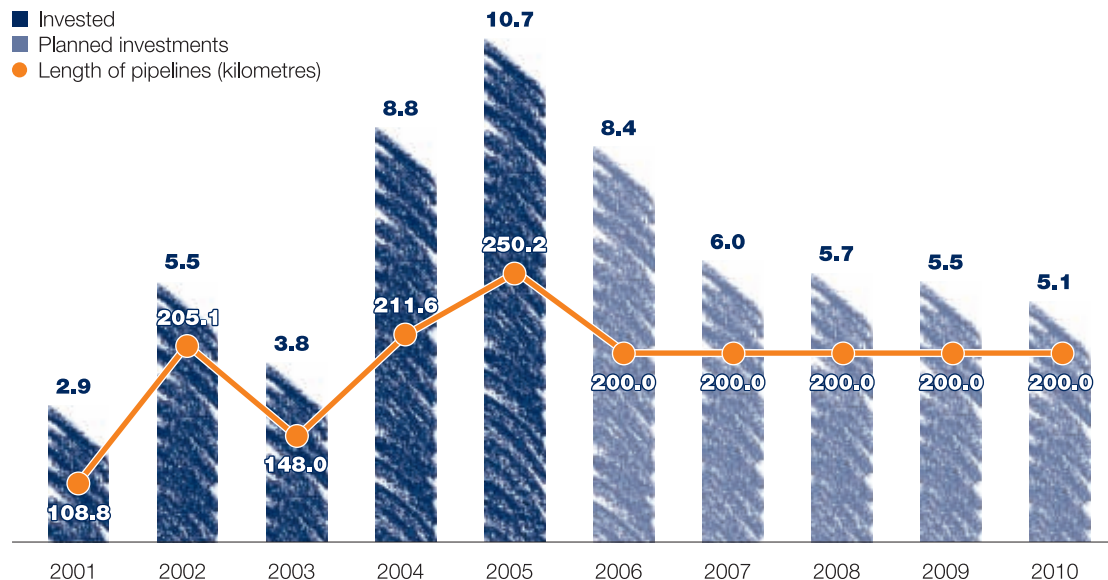
In 2005, the Company invested LVL 24.2 million (EUR 34.4 million) in total for modernization of the existing gas supply system and creation of new capital assets. 40.7% of the total investment was used for modernization of Inčukalns Underground Gas Storage Facility (UGS), 17.9% – for development of the system of gas transmission pipelines, 41.4% – for development of the distribution system and attraction of new cus-

tomers. The most significant projects completed in 2005 were reconstruction of the methanol house in Inčukalns UGS, construction of the gas transmission pipeline Preiļi – Rēzekne, modernization of four gas regulation stations and construction of the gas regulation station “Rēzekne”, inspection of the gas transmission pipelines Pskov – Riga and Vireši – Tallinn with the intelligent pig. In order to implement more effective and operative exchange of information between the JSC “Latvijas Gāze” and its customers in Latvia, in the summer of 2005 the Contact Centre (CC) of the Company started working. It provides three types of services – payment facilities for consumed natural gas, as well as service and connection. The CC gives possibility for customers and collaboration partners to receive high-level servicing and informative support by means of all most frequently used communication channels. The CC is one of the most modern operator centres of such type in Latvia, established using the common international practice of the field and its positive examples.

Establishment of the CC in its initial stage includes several tasks:

- integration of the customer service channels – joint telephone number and e-mail, using which it is possible to solve issues of customers;
- reduction of the number of the primary contact stations, solving most issues telephonically;
- increasing the standards of customer service;
- unified examination of customer complaints and suggestions;
- more flexible working hours of service.

Construction of new gas pipelines and development of the system of distribution pipelines (million LVL)



INČUKALNS UNDERGROUND GAS STORAGE FACILITY

For a long time already, the Inčukalns Underground Gas Storage Facility (UGS) of the JSC "Latvijas Gāze" has been a strategically important link in the Baltic and Russian North-West region. During the heating season, the natural gas pumped into the Inčukalns UGS is supplied to consumers not only in Latvia, but also in the North-western part of Russia. The basic mission of the Inčukalns UGS is equalization of seasonal fluctuations of gas supply to the Baltic and Russian North-West region. In the period of increased gas consumption (winter), the gas storage facility supplies consumers with gas, while in the period of low consumption (summer), gas is pumped into the Inčukalns UGS.

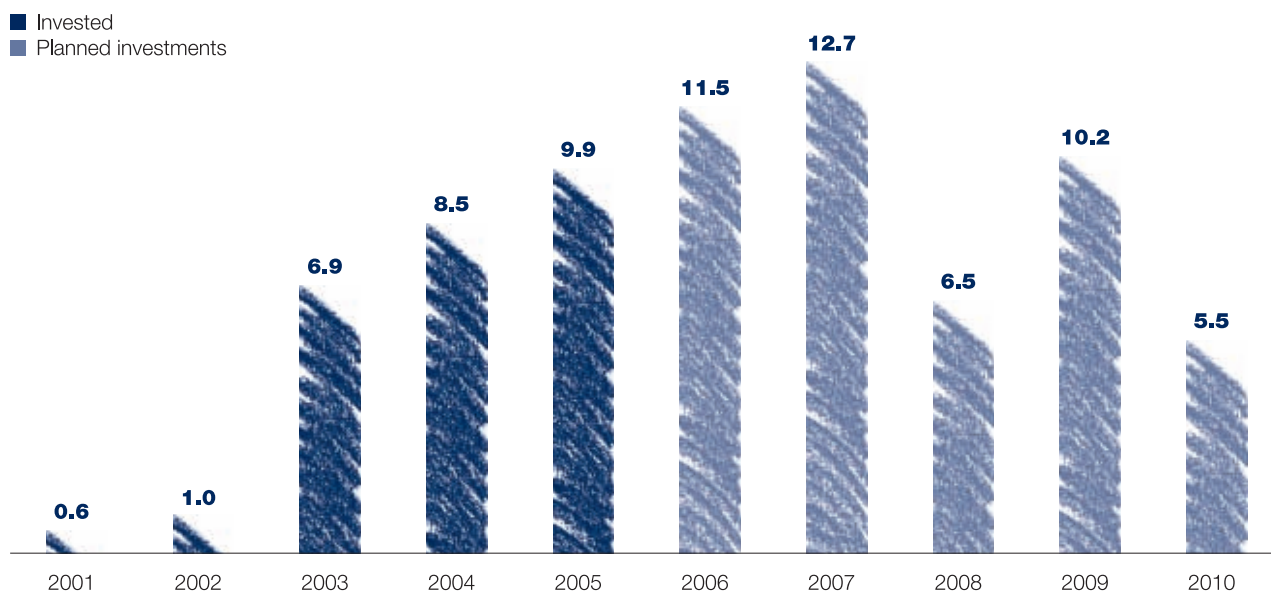
As one of the main tasks, the JSC "Latvijas Gāze" has set forth increase of integrity of Inčukalns UGS in the common gas supply complex of the Baltic States, Russia and Europe. With the demand for fuel still increasing, the Inčukalns UGS, which already now is one of the largest underground gas storage facilities in Europe, can be even more enlarged. In the common European balance of fuel, the proportion of natural gas is increasing. Thus, the role of natural gas storage facili-

ties in the gas supply system also is increasing significantly, and Latvia has an advantageous position on this score because the capacity of potential gas storage facilities is several ten milliards of cubic metres.

In 2005, the Inčukalns UGS reached again the largest amount of natural gas storage in its history. The total amount with buffer gas after completing the injection process in the reporting year reached 4.46 milliard cubic metres, including the amount of active natural gas – 2.31 milliard cubic metres.

One of the main priorities of the JSC "Latvijas Gāze" in the field of investments in the upcoming years is modernization of the Inčukalns UGS. Investments in improvement of technologies render not only an economical effect, but also make the process of natural gas storage safer and environmentally friendlier. The main purpose of modernization of the Inčukalns UGS is to improve operation safety of surface and underground equipment, provide for continuity of operation of the gas storage facility in compliance with the scheduled power.

Investment in modernization of the Inčukalns UGS (million LVL)



Also in 2005, the JSC «Latvijas Gāze» continued the modernization projects of the Inčukalns UGS, for implementation of which LVL 9.86 million have been invested.

In 2005, modernization of the compressor plant (CP) No. 1 of the Inčukalns UGS was continued. It operated from 1968 till 1996. When performing the technically economical examination of the station in 1999, a decision was made to demount and replace the equipment of the station. Beginning with 2002, systematic modernization has been performed, and it is due to be implemented in three stages. In the first stage, reserve power for operation of the CP 2 was made by installing one gas pumping unit consisting of a turbine «Solar Turbines» and a compressor «Dresser». Part of the works was done already in 2004. In the reporting year, assembly of inlet manifold and outlet manifold was implemented, whereas assembly of gas pumping unit, measuring unit, gas preparation unit, masts of light and lightning conductors, systems of cable sewerage and drainage, and foundation was commenced. In 2006 – connection works of all technological units, assembly of exhaust field and connective pipeline, connecting to the existing technological pipelines, all works of electric installation, assembly of technical and impulse gas unit, pressing of whole system, filling of all technological system with soil, and the works of run-up adjustment.

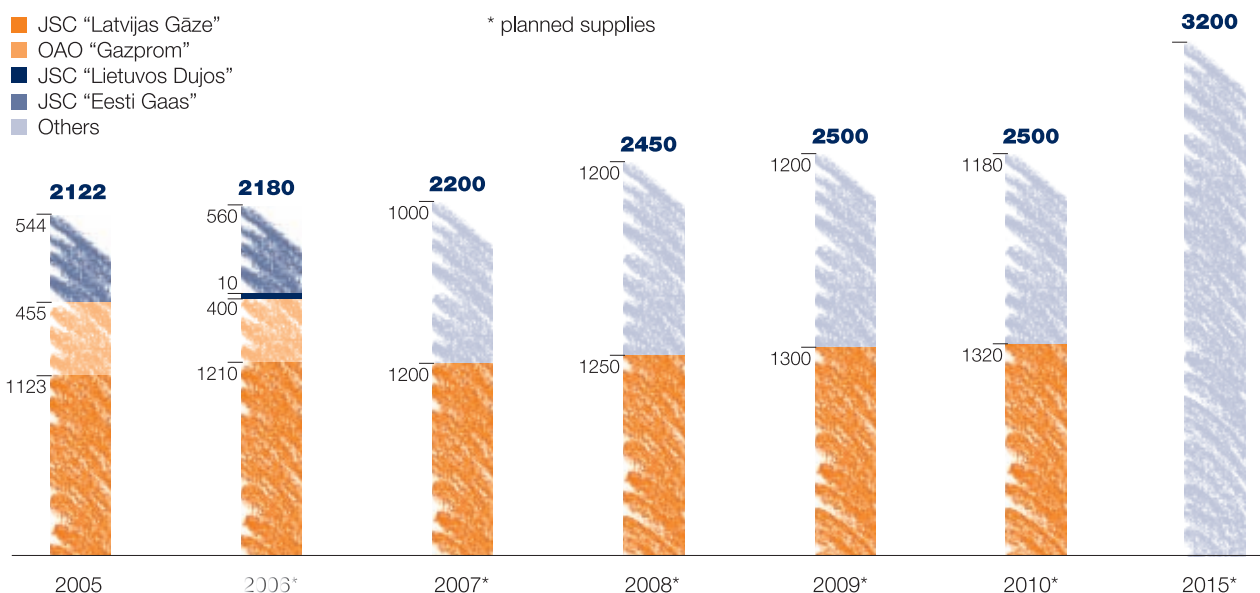
In order to provide for complete compliance with the European standard, a decision was made to construct a new methanol storage building in Inčukalns UGS. Designing of the object was commenced in 2004, and

construction – in 2005. Within the project, in the gas distribution point (GDP 2), formation of a new methanol storage building and methanol pumping station was implemented, in the GDP 3 – a new methanol storage building and methanol pumping station, in the GDP 1 – partial purchase of equipment of the methanol supply system (pumps, containers). The planned amount of work was done by October of the reporting year, thus the total consumption of methanol during the gas withdrawal season 2005/2006 was by 30% less than in the previous withdrawal season.

In the reporting year, renovation of the engineering building (CP 2) of the Inčukalns UGS was performed. Also in 2005, implementation of the project of electric supply reconstruction was commenced, and it continued in 2006. The total costs of implementation are planned LVL 1.6 million. In 2005, reconstruction of the electric supply system of the GDP 2 and the GDP 3 was carried out, yet reconstruction of the electric supply system of the central warehouse is due to be completed in June 2006.

In 2005, reconstruction project of the electrochemical protection system of the Inčukalns UGS was worked out by the Ukrainian company «Vnipitransgaz». In addition, a survey of technological communications of the Inčukalns UGS on scale 1:10 000 was carried out. In 2006, it is planned to implement the tender procedure and sign a contract concerning rights to perform the construction works. In the reporting year, a number of other reconstruction works of the Inčukalns UGS was implemented, part of which are continued in 2006.

Supplies from the Inčukalns UGS (million m³)





ENVIRONMENTAL MANAGEMENT OF THE COMPANY

Attention of the society is more and more often turned to exploring and tackling problems of environment management. It is caused by human actions, as the result of which irreversible processes gradually proceed in the environment. In near future, they can cause global climate changes connected with large ecological risks in many places. So, in order to ensure sustainable development of companies in the current period, each of them begins to pay attention to tackling environmental problems in everyday work. The JSC "Latvijas Gāze" is no exception in this regard and spends part of investments to ensure and maintain such operation by which not only environmental influence related to the Company's activities is ascertained and diminished, but also continuous:

- exploration and observation of the requirements of environmental legislation;
 - involvement of the personnel in tackling environment-related issues;
 - identification and evaluation of the most significant environmental aspects;
 - effective communication;
 - safe risk management
- is provided.

A large step in effective implementation of the above-mentioned events in the Company was introduction of the Environment Management System (EMS) in the natural gas storage system at the beginning of 2005 when "Bureau Veritas Quality International", representing the international classification company "Bureau Veritas" issued a certificate to the operation site Inčukalns Underground Gas Storage Facility, approving its compliance with the requirements of the standard ISO 14001:1996. At the beginning of 2006, "Bureau Veritas Quality International" already approved compliance of operation of the object

with the requirements of ISO 14001:2004 standard, which was a step towards new improvements of environmental quality indices.

Introduction of the EMS in the Company was commenced with the gas storage system because the Inčukalns UGS is a significant object not only for the energy and national economy of Latvia and Baltic region. It is also a complicated technological object that ensures natural gas storage of up to 4.4 milliard cubic metres, both injecting gas into the storage facility and withdrawing from it. Safe and environment-friendly operation of the Inčukalns UGS is one of the constant priorities of the JSC "Latvijas Gāze" and, in order to ensure safe, environment-friendly and stable operation of the storage facility, JSC "Latvijas Gāze" intends to invest LVL 54 million for development of the Inčukalns UGS up to 2010. The main tasks planned to be accomplished in the natural gas storage system are reconstruction of the compressor plant No.1, the methanol feed system, the technological equipment of bores and gas collection points, as well as modernization of the existing technological process control system.

Environment protection standards are observed by the Company not only in the Inčukalns UGS, but also in the natural gas transmission and distribution systems because the common gas supply system in Latvia consists of:

- the natural gas storage system,
- the natural gas transmission system,
- the natural gas distribution system.

Introduction of the EMS in the whole Company could be the next step in ensuring its sustainable development, the guidelines of which are currently being explored and analysed by the Company.



“GAS TRANSMISSION”

The operation unit “Gāzes transports” is a structural unit of the JSC “Latvijas Gāze” which performs the functions of natural gas transmission system operator – ensures operation of the system as well as its technical maintenance and development. The natural gas transmission system is formed by gas transmission pipelines (GTP), commercial international gas measuring station (GMS), gas regulation station (GRS), anticorrosive equipment for electrochemical protection (ECP) of underground pipelines, communication and remote line, as well as SCADA system.

“Gāzes transports” provides for natural gas supply to the distribution system as demanded by the natural gas distribution system operator, and for natural gas feed for injection into Inčukalns underground gas storage facility according to the technical capacity of the system, reception of natural gas from foreign countries and transmission to foreign countries. It also provides for gas pressure adjustment in the natural gas transmission system, gas purification, odorization, commercial recording of the gas received and given for sale and its input into the natural gas distribution system in compliance with the requirements of state standards.

At the end of 2005, the assets of “Gāzes transports” included 1280.9 km of gas transmission pipelines with branches (by almost 40 km more than in the previous year), 48 GRS (1 more than the year before) with commercial records points and gas odorization equipment,

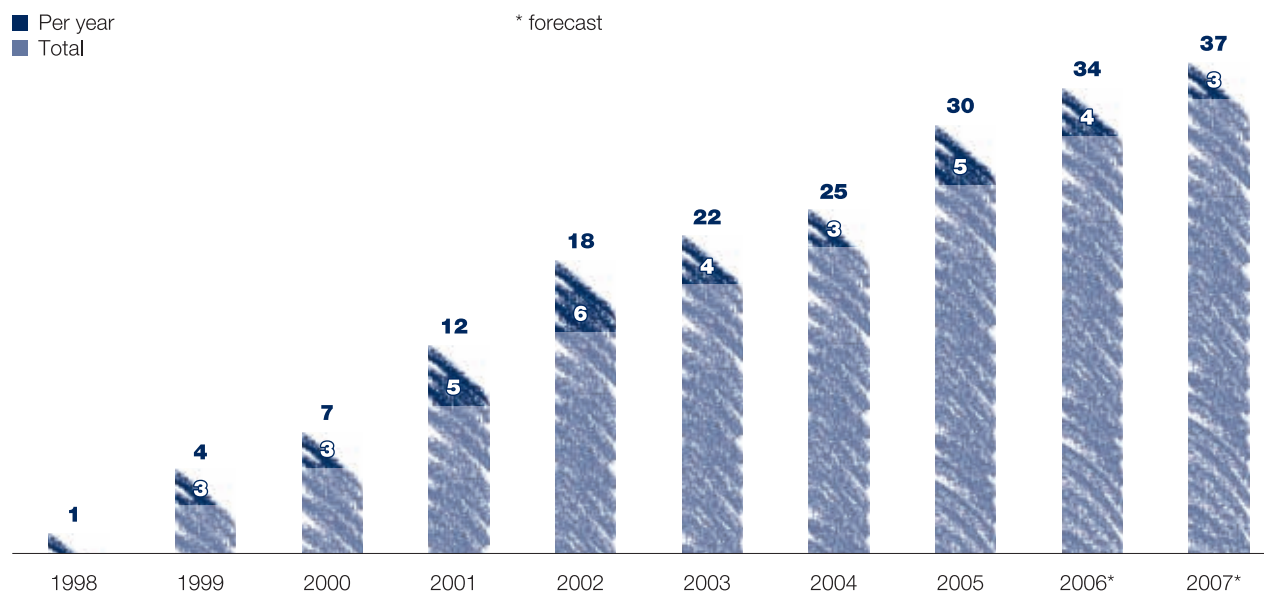
international GMS “Korneti” for recording gas received from Russia and transmitted to Russia, 4 automotive gas filling compressor stations (AGFCS), 103 ECP (1 more than the year before) devices for protecting pipelines against corrosion, systems of communication telemechanics and SCADA for ensuring uninterrupted connection with all objects of gas transmission pipelines, structural units of the Company and countries related to GTP.

The purposes of the operation unit “Gāzes transports” are to ensure uninterrupted gas transmission within its working area along the pipelines of gas transmission system in compliance with the conditions of the licence and to develop the gas transmission system observing the gasification perspectives, plans, technical policy and commercial interests of the JSC “Latvijas Gāze”. The technical policy of “Gāzes transports” is pointed towards improvement of system safety, including continuity of gas supply and fail-safe operation of the system.

In the year 2005, the Company continued the modernization of gas supply system, commenced in previous years, as a result of which conformity to the unified gas supply rules of Europe, where the main requirements are safety and ecology, was ensured.

In the reporting year, the JSC “Latvijas Gāze” continued the modernization of the gas supply system kept by the Company, commenced in previous years. In 2005, individual courses of pipeline system were prepared for

Modernized gas regulation stations (number)



internal diagnosing of technical condition with a special intelligent pig. This work included projection and construction of pig launcher and receiver, change of individual taps, installation of markers in the GTP route every 2 km to ensure attraction of defects. For this purpose LVL 730 000 (EUR 1 038 702) were spent in total.

Also in the reporting year, the JSC «Latvijas Gāze» carried out internal diagnostics of individual courses of pipelines and the related complex of actions (pipe purification, examination of the results of diagnostics, analysis, choice of repair technologies). Resurrection, investigation, evaluation and repair of the diagnosed defects was performed.

In the reporting year, the Company equipped line taps with modern electro- or hydro- pneumatic leads, joining them to the SCADA system in order to provide for their remote control from the central control desk. In 2005, LVL 286 thousand (EUR 406.9 thousand) were spent for this purpose within the capital investment programme (CIP).

Additional LVL 94 thousand (EUR 133.7 thousand) were spent for ensuring electrochemical protection of pipelines. 12 cathodic protection stations (CPS) were reconstructed and modernized. Projects were worked out for reconstruction of six CPS and two drainage protection stations (DPS), which is due to be carried out in 2006. Also the ECP devices were connected to the newly created SCADA sub-system, which allows receiving data concerning their operation parameters.

In 2005, JSC «Latvijas Gāze» continued reconstruction of GRS. Four stations were reconstructed, projects were worked out for reconstruction of five stations, and their technological equipment was purchased. In 2005, preparation works were commenced on designing a span-new GRS «Rīga-3» and development of the reconstruction project of GRS «Rīga-1». For these purposes, LVL 733 thou-

sand (EUR 1 042.9 thousand) were spent in the reporting year within CIP.

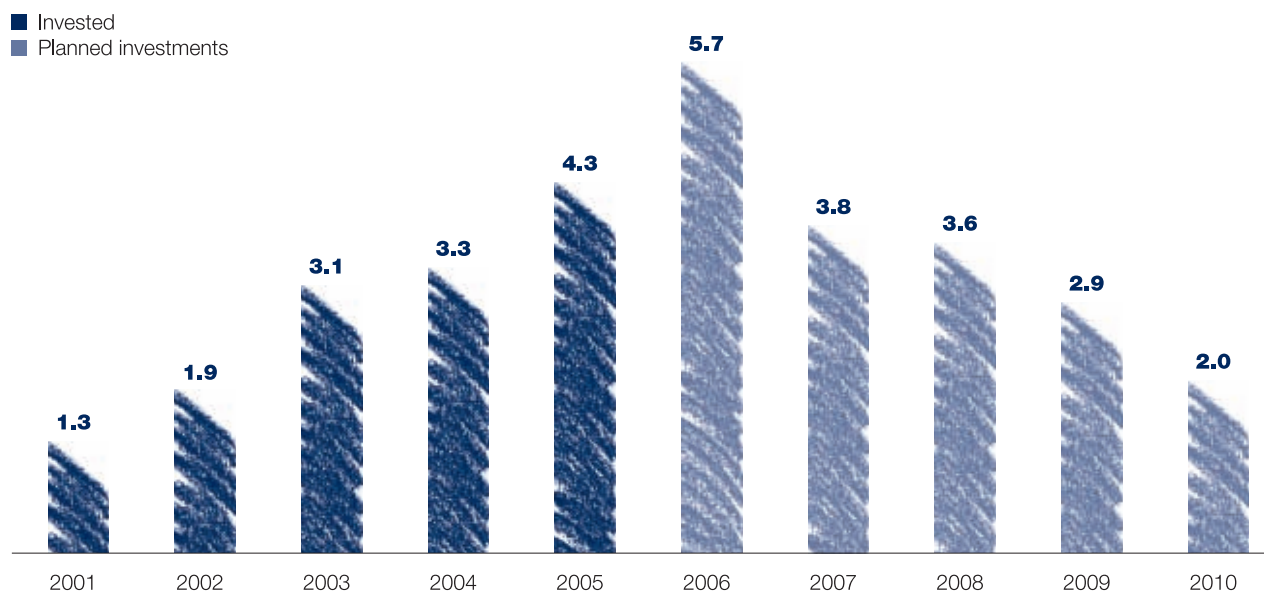
LVL 95 thousand (EUR 135.17 thousand) have been spent on connecting two GRS to parallel GTP to increase the safety of uninterrupted gas supply. Also in 2005, the Company implemented arrangement of operation documentation specified in the laws of the Republic of Latvia, the Cabinet of Ministers regulations, State Standards and other legislative acts. For all GTP, passports of the new type were worked out, inspected, registered in State Labour Inspectorate, and operation licences were received. Analogical work was done with GRS, as well as the necessary work instructions were remade.

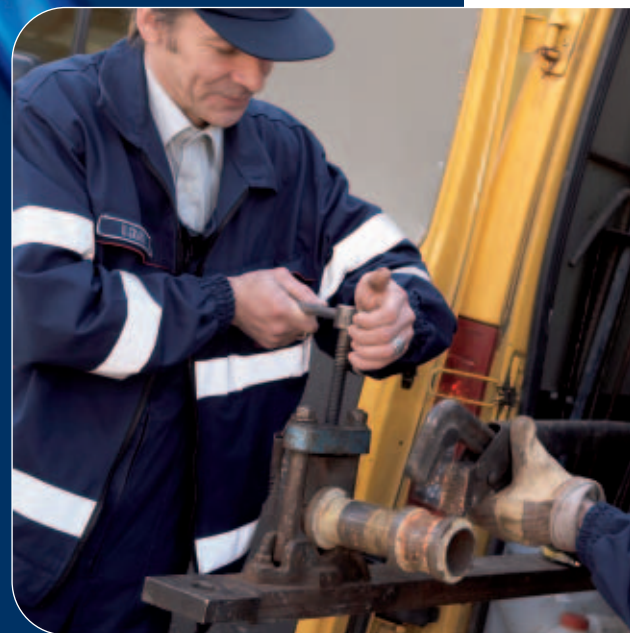
In 2005, the JSC «Latvijas Gāze» completed construction of GTP «Preiļi – Rēzekne» with total length of 46.5 km, and construction of GRS «Rēzekne» which ensured natural gas feed for Rēzekne at the beginning of heating season of 2005. When building this pipe, after completing the construction works and installation, internal diagnostics of the pipe was carried out for the first time in Latvia.

In the reporting year, the Company commenced elaboration of an improved version of the present SCADA system. SCADA development was commenced in 1995 and it was introduced in 2000. The improved version envisages replacement of system peripherals for new factory-built ones, as well as production of new software. Specialists of the Company plan to complete these works in 2006.

The new modernization projects in the gas supply system, carried out and launched in 2005, will noticeably increase the safety of GTP system, provide for gas supply continuity important for consumers, as well as decrease penetration of polluting substances into environment and allow identification and reduction of possible crash risks to the utmost.

Investment in modernization of gas transmission pipeline system (million LVL)





PERSONNEL

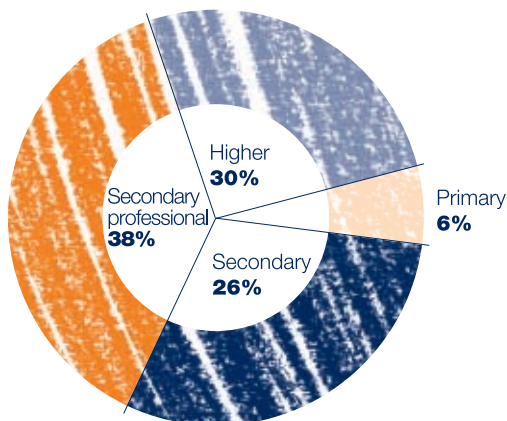
The employees of the JSC “Latvijas Gāze” are one of the main Company assets. That is why the management of the Company pays special attention to raising motivation of the employees and providing high-level working conditions. At the end of 2005, the JSC “Latvijas Gāze” employed 1323 persons, which is by 39 employees more than in the preceding year. The growth of the number of employees was related to measures of strengthening safety of gas supply, increase of the amount of work and establishment of a new structural unit – the Contact Centre that deals with informative customer service.

The Company can boast a particularly stable staff and relatively small staff turnover – 64% of the employees have worked for the JSC “Latvijas Gāze” for more than ten years, which proves that staff policy is successfully chosen. 90% of the employees are over 30 years of age, 13% are older than 60 years. On the other hand, 10% of the employees of the JSC “Latvijas Gāze” are under 30, which is a good indicator, considering the necessity of retaining professionalism of personnel, duly thinking about development of the

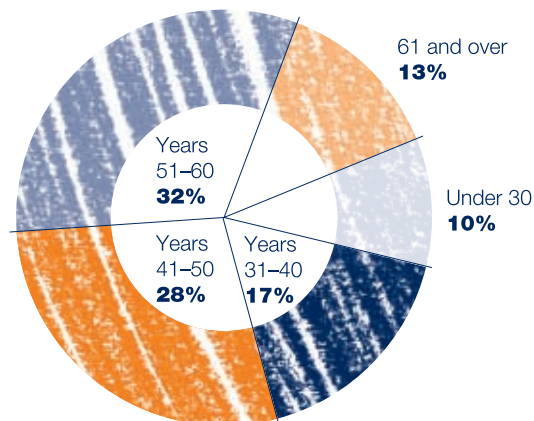
Company and involving new specialists. One third of the employees have higher education while 64% have secondary or secondary professional education. It must be added that the number of employees with higher education is growing with every year. The Company pays much attention to raising the educational level of the employees; therefore in 2005 the JSC “Latvijas Gāze” continued to stimulate staff training, both by paying for studies at universities and organizing special training courses. Two scholarship holders of the Company are studying at I. M. Gubkin’s Russian State Oil and Gas University, one of them began studies in 2005. The Company also continues to support studies of its employees at Russian State Oil and Gas University. In general, 11 graduates of this university worked in the JSC “Latvijas Gāze” at the end of 2005, and 8 of them are scholarship holders of the Company. At the Training Centre of the Company, 801 employees of the Company and 2955 employees of other organizations were taught during the reporting year. 24 thematic seminars were held, attended by 465 people in total. The Training Centre teaches and certifies designers of gas supply



Description of education level of the JSC “Latvijas Gāze” personnel (%)



Description of the JSC “Latvijas Gāze” personnel across age groups (%)



systems, specialists of assemblage, building supervision and operation of all specialities, provides training and certification for persons in charge of hazardous equipment and maintenance personnel, as well as teaches other professional skills.

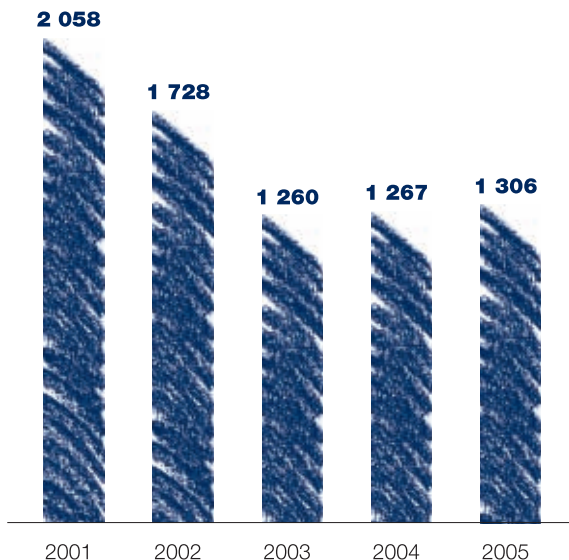
For obtaining academic education in universities of Latvia, setting studies in the speciality of gas technologies as the priority, the JSC "Latvijas Gāze" has awarded allowances to 23 employees of the Company for paying tuition fees of the academic year 2005/2006, compulsory social payments and personal income tax. To think duly about alternation of generations at the JSC "Latvijas Gāze" and to provide for involving new specialists, the Company cooperates with Riga Technical University and Latvian Educational Foundation. Qualification of the personnel is raised in various seminars and at establishments of professional education in Latvia and abroad.

Late in the year 2005, at the conference of employees' representatives of the JSC "Latvijas Gāze", the Collective Agreement for 2006 and 2007 was approved. In the agreement, social guarantees granted by the employer to the employees of the Company, are

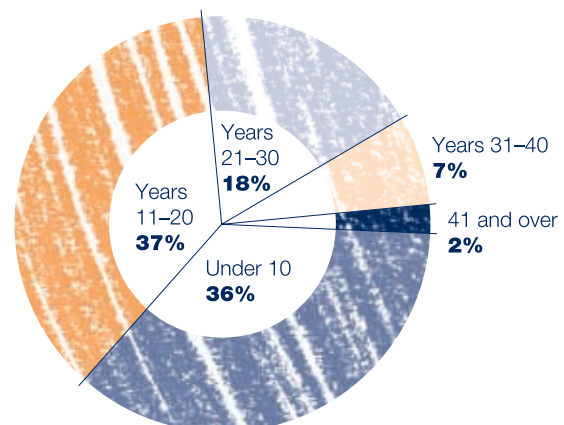
supplemented and updated. In order to strengthen motivation of the employees, the JSC "Latvijas Gāze" provides for health and accident insurance of the personnel as well as pays for the employees in the pension fund. Early in the year 2006, Free Trade Union Confederation of Latvia dignified the best collaboration partners in the event of nomination of social partnership "Collaboration Partner 2005". In the category of private enterprises, the JSC "Latvijas Gāze" among other companies was declared as the best collaboration partners. In order to fortify mutual cooperation of the employees and stimulate sportive and other activities, the Company regularly organizes both common sporting events and attendance of various cultural events involving families of the employees as well. The Company has its own ice hockey and basketball teams.

In 2005, the JSC "Latvijas Gāze" joined Latvian Association of Personnel Management, which has been established in order to increase popularity of personnel management in Latvia, raise the competence of specialists of personnel management and the prestige of this job in the labour market, as well as to show the positive influence of efficient personnel management on the work of the company.

Average number of the employees at the JSC "Latvijas Gāze"



Description of the JSC "Latvijas Gāze" personnel as to length of service (%)



INTERNATIONAL CO-OPERATION

In the year 2005, the JSC "Latvijas Gāze" continued closest co-operation with the specialists of the Company's shareholders – Russian gas company "Gazprom" and German gas company "E.ON Ruhrgas International" AG. The co-operation was implemented in several directions, including matters regarding postponement of natural gas market liberalization in Latvia and preparing arguments for motivating its necessity, modernization of Inčukalns Underground Gas Storage Facility, operation safety advancement and extension, preparation and discussion of draft regulations of the Council and the Board of the Joint Stock Company "Latvijas Gāze", as well as about optimisation of sales work in the Company.

In the reporting year, the specialists of the Company also continued everyday co-operation with shareholders, operatively preparing various kinds of information, mainly economical and financial, on demand of the specialists of Company's shareholders.

During the reporting year, the JSC "Latvijas Gāze" continued its especially successful co-operation with the energy company "E.ON Hanse". The main directions of co-operation were policy of technical development of gas supply industry, issues of operation of gas transport and division systems, policy of natural gas sale, work with consumers, etc. Also in 2005, specialists of the JSC "Latvijas Gāze" continued exchange of experience with experts of Lithuanian gas company "Lietuvos Dujos" and Estonian gas supplier "Eesti Gaas" in the field of emergency service, as well as in issues of operation, technology, personnel management and finances.

Specialists of the JSC "Latvijas Gāze" participated in the events and seminars organized by "International Gas Union" (IGU). In the reporting year, the special edition of IGU, which was published worldwide, comprised information about the JSC "Latvijas Gāze" and possibilities of creating new underground gas storage facilities in the territory of Latvia. A report about Inčukalns Underground Gas Storage Facility and possibilities of developing other potential gas storage facilities in Latvia was prepared by specialists of the JSC "Latvijas Gāze" and read at the World Gas Conference in Amsterdam.

The JSC "Latvijas Gāze" is also a member of the international organization "Gas Transmission Europe" (GTE). From participation in this organization the Company obtains experience in the issues of gas market liberalization, opportunity to receive documents and projects worked out by GTE members about issues concerning gas transport and storage and – considering that this organization successfully collaborates with the European Community (EC) – access to the EC draft documents in various stages of preparation. In the reporting year, employees of the Company took part in the annual con-

ference of this organization, gaining invaluable experience in various issues related to gas supply as well as meeting and sharing experience with colleagues from gas supply companies of other countries.

In collaboration with DVGW (Deutscher Verein des Gas und Wasserfaches), valuable information for solution of standardization and technical issues of gas supply as well as for establishing Latvian national standards in compliance with the requirements of the European Union norms.

In 2005, the JSC "Latvijas Gāze" continued collaboration with Gas Center of European Economical Commission of the United Nations. In November 2005, the Company organized a seminar in Riga about principles of making gas prices and tariffs. The seminar was attended by representatives from companies "Gazprom", "Centrica", "Gasunie" and other well-known European gas companies that are members of DVGW.

The JSC "Latvijas Gāze" is also a member of several other international organizations, for instance, World Energy Congress (WEC) and Nordic Gas Association. In 2005, the Company continued collaboration with these organizations, and employees of the Company participated in the events organized by them – workgroup meetings, seminars and conferences.

In the reporting year, the leading employees and specialists of the JSC "Latvijas Gāze" spoke at several conferences, informing the participants about the most significant activities of the Company, projects and other important matters, as well as visited several foreign gas companies for exchange of experience.

In order to get acquainted with the latest trends in the field of information technologies (IT) and telecommunications, the leading IT specialists of the JSC "Latvijas Gāze" participated in several international IT forums and exhibitions. Thus, for instance, employees of the Company took part in the energy conference "Introduction of SCADA System" and the world's largest information technologies and telecommunications fair "CeBIT". In order to get acquainted with new technologies and exchange experience in matters of energoaudit, experts of the Company attended seminars in Germany. Also significant for obtaining experience was participation of the Company's employees at the conference "Extraction of natural gas" in Russia. Informatively substantial and useful was also participation of the specialists of "Latvijas Gāze" in the conferences "Distribution Europe 2005" and "Gas Infrastructure Europe", taking place in Germany, as well as at the scientifically applied conference "50 years since the beginning of underground gas storage works in Russia".



JSC “LATVIJAS GĀZE” FOR SOCIETY

Support programmes in sport, culture and social sphere, implemented by the JSC “Latvijas Gāze”, have become a tradition. The programmes are implemented in three directions, cooperating with different public organizations – Latvian Olympic Committee, Latvian Culture Foundation and Latvian Children Foundation. Thus, the most effective use of the funds allotted by the Company is found in each of the mentioned directions.

SOCIAL SPHERE

Unfortunately, social sphere in Latvia is still one of the most painful issues. That is why also in 2005 the JSC “Latvijas Gāze” provided significant support not only for covering medical expenses of seriously ill children, but also for orphanages and care improvement programmes for children with mental disadvantages. JSC “Latvijas Gāze” realizes that it is important not only to support the struggle against consequences of various disasters, but also to speak duly about their causes. That is why in the reporting year, with financial support of the JSC “Latvijas Gāze” the special hero Gāzēns told children about various safety issues in “Radioteātris” (‘Radio Theatre’), a programme by “Radio Latvia”. More-over, the Company financed publishing of various educational games and books and their delivery to schools. Representatives of the Company also visited schools and informed children about various safety issues. The management and shareholders of the Company also realize their responsibility and duty towards next generations on the environmental level. Therefore in the reporting year, in order to preserve the nature of Latvia and to stimulate maintenance of the unique landscapes and fauna in the future, the Company allotted funds also for various projects of nature protection, including maintenance of the nature park of Lake Engure and the project of the foundation of the Gauja National Park “Protection and management of wild animals”.

SPORT

JSC “Latvijas Gāze” is one of long-term contributors of Latvian Olympic Committee, thus this co-operation has become a stable tradition. At the same time, the Company does not reject its aid in implementation of various other sportive activities. Thus, for instance, in 2005, the JSC “Latvijas Gāze” supported training process and participation in European and World Championships of beach volleyball players Aleksandrs Samoilovs and Mārtiņš Plaviņš. They became the World champions among juniors U-21 and the European champions U-23. Traditionally, the Company is the main sponsor of Latvian National men’s basketball team. At the same time, the Company also gives invaluable support for sportive activities of the youth in order to retain the traditions of sport in Latvia and to stimulate more active involvement into sports of the rising generation.



CULTURE

The cultural tradition of Latvia has rich and widely known history. Unfortunately, nowadays culture misses financing because it is not possible to satisfy all the needs from the state budget funds. That is why the JSC “Latvijas Gāze” is among those companies who try to support various cultural activities, realizing that culture confines itself not only to huge and loud events, but also to everyday occurrences. Already for the second year, the JSC “Latvijas Gāze” is the main sponsor of Latvian National Opera. The management of the Company supported financing of cultural events of different levels. Thus, for instance, in the reporting year, the JSC “Latvijas Gāze” financially supported the first Summer Festival of the Daile Theatre in Stāmeriena, participation of the youth dancing group of Bulduri Horticultural High School in “European days” in Germany and other sonorous and also less known culture events. International Opera Music Festival of Sigulda has already become a tradition, and it is also supported by JSC “Latvijas Gāze”.

EDUCATION AND SCIENCE

Support for the society cannot be imagined without assistance to education and science, which nowadays, because of various reasons, in a sense have become stepchildren. That is why the JSC “Latvijas Gāze” considered financing of various projects of this field possible and even necessary also in 2005. The Company notably supported publishing of various educational materials in the field of professional education. Thus, for instance, in 2005, the Company supported publishing of the book “Siltuma, gāzes un ūdens inženiersistēmu automatizācijas pamati” (‘The Basics of Automation of Heat, Gas and Water Engineering Systems’) which is intended for bachelor and master students of the study courses “Heat, Gas and Water Technology” and “Energetics and Electrical Engineering” of Riga Technical University (RTU). Publishing of the book “Mazā kliniskā traumatoloģija un ortopēdija” (‘Small Clinical Accident Surgery and Orthopaedics’) was also sponsored. Moreover, the JSC “Latvijas Gāze” rendered support for payment of scholarships within the earmarked programme of Latvian Educational Foundation “For Education, Science and Culture” in gas technology specialities for the academic year 2005/2006, as well as for Annual Awards to scientists and creative practitioners in heart cardiology, gas and heat engineering and related branches of chemical technology. In order to prepare qualified specialists of engineering technologies in Latvia, the JSC “Latvijas Gāze” donated a new computer classroom to the Institute of Heat, Gas and Water Technologies of Construction Faculty of RTU. A course “A Happy Latvian in a Rich Country” on learning Latvian folk traditions for a teacher camp was organized with the support of the Company. The Company has contributed not only to purchase of various teaching aids for individual schools, but also to repairs of premises of educational institutions and purchase of equipment.



THE COMPANY'S SUMMARISED ANNUAL ACCOUNTS

Report of the Board

1. Performance of the Company in the reporting year

In the year 2005, the Joint Stock Company "Latvijas Gāze" (hereinafter the Company) retained its position in the fuel market. In the reporting year the Company devoted major attention to the fulfilment of the Investment program and to increase of safety of gas supply network operation, as well as to supply natural gas to the consumers in the amounts and quality as specified in the contracts.

In the reporting period 1 664,44 mio nm³ of natural gas have been delivered to the consumers. In comparison to the year 2004, the volume of natural gas sales has increased by 2,7%. The increase was ensured by gasification of Rēzekne city and new connections in accordance with investment contracts.

The financial results of the Company were influenced by rapid increase of price of oil products in the World. In order to hasten the adjustment of gas price towards the price of oil products in Rotterdam market, amendments to the natural gas supply agreement became effective as of January 1, 2005, according to which the purchase price of natural gas was determined by a formula taking into account the actual heavy fuel oil quotation. The formula anticipated gradual increase of the price up to 60% during three years at heavy fuel oil quotation 200 USD/t. Since the actual heavy fuel oil quotation during 2005 significantly exceeded the highest quotation specified in the agreement, in December 2005 new amendments to the natural gas supply agreement were signed, removing the heavy fuel oil quotation ceiling specified in the agreement as of January 1, 2006.

On the basis of the changes of the gas purchase price, at the beginning of 2005 the Company submitted to the Public Utilities Commission (hereinafter PUC) a proposal for natural gas tariffs which provided for a gradual increase in natural

gas transmission, storage, distribution and sales service as well as natural gas end-user tariffs as of the middle of 2005 through 2007. Natural gas service and end-user sales tariffs approved by PUC instruction No. 132 of June 8, 2005 "On JSC "Latvijas Gāze" natural gas tariffs" became effective as of July 1, 2005 and August 1, 2005 depending on the users' consumption group. Compared to the existing tariffs, the increase of tariffs constituted 9,7%–17,0% depending on the consumption volume.

The total revenues from natural gas sales and other core business activities amounted to Ls 133,4 mio (EUR 189,8 mio) in 2005, expenses (excl. administration) – Ls 110,3 mio (EUR 157 mio), and gross profit from core business activities was Ls 23,1 mio (EUR 32,8 mio). The tariff increase provided additional revenues of Ls 6,1 mio (EUR 8,7 mio). Core business ensured to the Company net profit of approximately Ls 15,3 mio (EUR 21,8 mio). Net profitability (less the results of legal proceeding described below) in 2005 reached 11,5% and was behind the level reached in 2004 by 4,1%. In comparison with the year 2004, the net profit of the Company grew by 25,3% or Ls 4,8 mio (EUR 6,8 mio) and reached Ls 23,6 mio (EUR 33,6 mio). 36,4% of the total net profit was received in relation with Stockholm Court judgement.

Pursuant to an earlier arbitral award rendered by a Swedish arbitration tribunal and pursuant to a final judgement during the reporting period by the Svea Court of Appeal in Stockholm, Sweden, the Company received compensation for damages and interest payments from the State for a total amount of Ls 8,5 mio (EUR 12,1 mio). The above-mentioned arbitral tribunal rendered an arbitral award favourable to the Company on June 19, 2003 in proceedings subject to UNCITRAL arbitration based on a claim against the Republic of Latvia for breach of the Share Sales and Purchase Agreement. According to the arbitral award, the Republic of Latvia was under an obligation to compensate the Company for damages of Ls 6,9 mio (EUR 9,8 mio) plus interest payments. On September 19, 2003, the Republic of



Latvia lodged an appeal to the Swedish Svea Court of Appeal to annul the arbitral award of June 19, 2003 and to reimburse it for all expenses related to the appeal. According to the ruling by the Swedish Svea Court of Appeal dated May 4, 2005 the arbitral award concerning the UNCITRAL arbitration case is in effect, the court ruling being final and non-appealable. In 2005 the Company booked to income the provisions made during previous periods of Ls 1,4 mio (EUR 2 mio) which were formed to finance the other parties' claimed litigation expenses in case of an unfavourable outcome in the court. As a result of the judgement by Svea Court of Appeal, net profit for the Company increased by Ls 8,6 mio (EUR 12,2 mio), Ls 8,3 mio (EUR 11,8 mio) of which are related to lost profits in previous periods starting from 2001.

In 2005, a great attention was paid by the Company to further natural gas distribution system expansion and connection of new users to the existing system of gas supply. As of January 1, 2006 the total length of natural gas pipeline was 5 620,1 km including 1 280,7 km of transmission pipelines and 4 339,4 km of distribution pipelines. During the reporting year, gas pipelines by Ls 10,7 mio (EUR 15,2 mio) were put into operation – 250,2 km of distribution lines, including 20 km of house connections, and 46,5 km of gas transmission line Preiļi-Rēzekne.

The number of individual users consuming gas for heating grew by 4,2 thousand users during 2005 and reached 35 thousand by the end of the year. The total number of gas users approached 433,9 thousand.

In 2005, operational unit "Incukalna UGS" (hereinafter IUGS) achieved the highest ever operation indicators in the history of the facility. In the reporting period, 1,95 billion nm³ of natural gas was injected into the storage and the total gas volume in the storage reached 4,46 billion nm³ including active gas volume – 2,32 billion nm³.

Revaluation of fixed assets as at 31.12.2005 received for gratis and concretized transmission pipelines' lengths and their replacement values during digital survey in the reporting year increased the value of assets. The value of the Company's assets increased by approx. Ls 1,7 mio (~ EUR 2,4 mio).

During the year 2005, the Company invested Ls 24,2 mio (EUR 34,4 mio) in the modernisation of the existing gas supply system and formation of new fixed assets. 40,7% of total investments were used for IUGS modernisation, 17,9% for development of gas transmission grid, but 41,4% for development of distribution system and for attraction of new consumers. The most significant projects concluded during 2005 were reconstruction of IUGS methanol facility, construction of gas transmission line

Preiļi-Rēzekne, modernisation of four gas regulation stations and construction of Rēzekne GRS, inspection of gas transmission pipelines Pskov-Rīga and Viesī-Tallinn with intellectual pig.

2. Research and development activities

To ensure uninterrupted gas supply to the consumers and safe exploitation of gas supply system in long-term, the Company has developed "Activity plan for safety increase of gas supply system of the Joint Stock Company "Latvijas Gāze" from the year 2006 to 2010". The activity plan has been prepared based on assessments by Russian companies "Gazobezopasnostk" and "Lenttransgaz", "VNIGAS" institute, "Giprospecgaz", German companies "Pipeline Engineering GmbH", "Untergrundspeicher und Geotechnologie – Systeme GmbH", "E.ON Engineering GmbH", "E.ON Ruhrgas International AG" and other collaboration partners about equipment's technical condition and modernization possibilities. Activity plan provides for investments in safety increase for total amount of Ls 73,8 mio (EUR 105 mio).

The activity plan contains mainly projects, the execution of which is necessary in order to increase the safety of system operation, gasification of new objects, and increase of gas supply stability in the whole region covering seasonal consumption fluctuations with gas supplies from IUGS to Estonia and Western part of Russia, as well as to Lithuania in further perspective.

The largest investments in IUGS are provided for installation of new compressor, modernisation of bore-wells and gas collection stations. In transmission pipeline system – for the completion of diagnostics and elimination of faults, replacement of line valves, modernisation of GRS Rīga-1 and GRS TEC-2.

3. Management of financial risks

The activities of the Company are exposed to several financial risks, including credit risk and foreign currency exchange rate. Management of the Company strives to minimize possible negative effects of financial risks on the Company's financial position.

Until the reporting year, the Company was exposed to the risk of foreign currency exchange rate fluctuations because the gas purchase price was set for in the USD, but sales tariffs in Lats. As of January 2005, the gas purchase price is set for in USD, but subsequently converted to EUR. Settlements for the supplied gas take place in EUR.

Since the exchange rate of the Lat is pegged to Euro as of January 1, 2005, fluctuations of Ls/EUR exchange rate are limited and no significant influence on financial results for next periods is anticipated. Changes of gas purchase prices in USD depending on heavy fuel oil quotation is

covered by natural gas sales tariffs approved by PUC, which also cover EUR/USD exchange rate fluctuation up to a certain level. The risk of foreign currency exchange rate fluctuation, connected with the debts to the suppliers, is managed by keeping considerable cash funds in deposits of the respective currencies.

Cash funds and receivables are the main financial assets exposed to the credit risk. The Company's cash funds and cash equivalents are kept with the largest financial institutions of Latvia. Receivables are shown at their initial value net of provisions for bad and doubtful debts. The Company is exposed to the concentration of the credit risk because considerable net turnover share refers to a limited number of customers. Four of the Company's consumers form up to 43% of the sales (in 2004 – 45%), the debt of one of these debtors on December 31, 2005 was 19,9% (in 2004 – 18%) of the total receivables. The individual total debt of the rest of the debtors in the end of the reporting year does not exceed 7% (in 2004 – 9%).

4. Post balance sheet events

Since the last day of the reporting year till the day of signing the report by the Board, there have been no significant or extraordinary circumstances that would have a material effect on the financial results and the financial position of the Company.

On the basis of the oil market trends and the rapid price increase of oil products, as of January 1, 2006 the amendments to the natural gas supply agreement became effective, removing the peg of natural gas price to the heavy fuel oil quotation ceiling to 200 USD/t, thus fixing the highest gas purchase price.

In December 2005, the Company submitted to the PUC the natural gas tariff project for 2006. According to PUC resolution of March 22, 2006 No.73 "On natural gas tariffs in 2006", tariffs that will become effective as of May 1, 2006 were approved. The new tariffs are pegged to heavy fuel oil quotation in the stock exchange and will cover the increase in gas purchase expenses. Service tariffs were not amended.

5. Distribution of profit of 2005 proposed by the Board

	2005 Ls	2005 EUR
Current year's profit	23 640 926	33 638 006
Profit share not available for distribution (unrealized deferred income tax income in connection with the revaluation of fixed assets)	(1 182 713)	(1 682 849)
Profit available for distribution	22 458 213	31 955 157
Profit distribution proposed:		
Calculated dividends to shareholders (62,2%)	13 965 000	19 879 405
Dividend per share (Ls/1 share)	0,35	0,498
Reserves provided for in the Company's Charter	8 493 213	12 075 752

Several members of the Company's Council and Board own shares and hold managerial positions in several companies registered in the Register of Enterprises of the Republic of Latvia. Except as disclosed in the financial statements, the Company did not have material transactions with those companies during the reporting year.

Information on the shareholdings by the members of the Company's Council and Board in the Company is available from the Company's Board.

6. Future perspective

On the basis of investments made during the previous years and the reporting year in safety increase of the system operation, expansion of gas supply network, attraction of new clients, recovery of receivables, as well as the situation in the fuel market in Latvia, the Board of the Company believes that the Company will continue successful development also in 2006 and will have a stable place in the fuel market.

Chairman of Board



A. Dāvis

Board meeting minutes Nr. 11 (2006)

Riga, May 3, 2006

Profit and loss account for the year ended December 31, 2005

	2005 Ls	2004 Ls	2005 EUR	2004 EUR
1. Net sales	133 385 522	121 119 444	189 790 499	172 337 443
2. Cost of sales	(110 318 091)	(93 963 191)	(156 968 502)	(133 697 575)
3. Gross profit	23 067 431	27 156 253	32 821 997	38 639 868
5. Administrative expenses	(5 733 215)	(5 624 859)	(8 157 630)	(8 003 453)
6. Other operating income	7 777 520	789 374	11 066 414	1 123 178
7. Other operating expenses	(1 069 376)	(1 006 222)	(1 521 586)	(1 431 725)
10. Interest and similar income	4 684 414	1 855 076	6 665 320	2 639 535
11. Revaluation of long term financial investments and short term securities	1 028	145	1 463	206
12. Interest and similar expenses	(49 108)	(14 391)	(69 874)	(20 476)
13. Provisions for bad and doubtful debtors, net	(355 321)	(188 644)	(505 576)	(268 416)
14. Provisions for obsolete and slow moving inventories, net	(71 438)	(37 497)	(101 647)	(53 354)
16. Profit before taxes	28 251 935	22 929 235	40 198 881	32 625 363
17. Corporate income tax for the reporting year	(3 697 363)	(3 390 929)	(5 260 874)	(4 824 857)
18. Deferred income tax	372 425	498 932	529 913	709 916
19. Other taxes	(1 286 071)	(1 163 354)	(1 829 914)	(1 655 304)
20. Current year's profit	23 640 926	18 873 884	33 638 006	26 855 118
Unrealised deferred tax gain related to fixed assets revaluation	(1 182 713)	(1 079 127)	(1 682 849)	(1 535 459)
Profit available for distribution	22 458 213	17 794 757	31 955 157	25 319 659

Balance sheet as at December 31, 2005 (1)

	31.12.2005. Ls	31.12.2004. Ls	31.12.2005. EUR	31.12.2004. EUR
Assets				
Long-term investments				
I. Intangible assets:				
1. Research and development	414 382	249 339	589 611	354 777
2. Concessions, patents, licences, trademarks and similar rights	1 161 904	1 206 378	1 653 241	1 716 521
5. Advance payments for intangible assets	252 540	69 002	359 332	98 181
Total intangible assets	1 828 826	1 524 719	2 602 184	2 169 479
II. Fixed assets:				
1. Land, buildings, constructions and gas transmission system	167 130 927	159 476 104	237 805 885	226 914 053
3. Equipment and machinery	21 351 082	20 180 678	30 379 853	28 714 518
4. Other fixed assets	1 270 662	1 222 471	1 807 989	1 739 420
5. Advances for fixed assets and fixed assets under construction	24 155 641	19 589 786	34 370 381	27 873 754
Total fixed assets	213 908 312	200 469 039	304 364 108	285 241 745
III. Long-term financial investments:				
3. Investment in associated companies	80	80	114	114
5. Other securities and investments	3 714	9 086	5 285	12 928
9. Long-term trade debtors	216 160	201 618	307 568	286 877
Total long-term financial investments	219 954	210 784	312 967	299 919
Total long-term investments	215 957 092	202 204 542	307 279 259	287 711 143
Current assets				
I. Inventories:				
1. Raw materials and consumables	43 602 436	27 393 977	62 040 676	38 978 118
5. Advances for goods receivable	14 424	63 278	20 524	90 036
Total inventories	43 616 860	27 457 255	62 061 200	39 068 154
II. Debtors:				
1. Trade debtors	13 020 442	9 830 518	18 526 420	13 987 567
4. Other debtors	1 611 941	1 007 223	2 293 586	1 433 149
7. Deferred expenses	358 093	272 918	509 520	388 327
Total debtors	14 990 476	11 110 659	21 329 526	15 809 043
III. Short-term financial investments:				
5. Other securities and investments	24 121	24 577	34 321	34 970
9. Term deposits	-	8 000 000	-	11 382 974
Total short-term financial investments	24 121	8 024 577	34 321	11 417 944
IV. Cash and bank:	23 867 656	12 201 531	33 960 615	17 361 215
Total current assets	82 499 113	58 794 022	117 385 662	83 656 356
Total assets	298 456 205	260 998 564	424 664 921	371 367 499

Balance sheet as at December 31, 2005 (2)

	31.12.2005. Ls	31.12.2004. Ls	31.12.2005. EUR	31.12.2004. EUR
Liabilities				
Shareholders' funds:				
1. Share capital	39 900 000	39 900 000	56 772 585	56 772 585
2. Share premium	14 320 210	14 320 210	20 375 823	20 375 823
3. Long-term investments revaluation reserve	119 007 653	117 673 829	169 332 635	167 434 774
5. Reserves				
c) statutory reserve	29 135 700	23 310 942	41 456 366	33 168 482
d) other reserves	2 091 647	2 091 647	2 976 146	2 976 146
6. Retained earnings				
a) previous years' retained earnings	1 079 126	-	1 535 458	-
b) current year's retained profit	23 640 926	18 873 884	33 638 007	26 855 118
Total shareholders' funds	229 175 262	216 170 512	326 087 020	307 582 928
Provisions				
3. Other provisions	-	1 386 000	-	1 972 100
Total provisions	-	1 386 000	-	1 972 100
Creditors:				
Long-term creditors:				
3. Borrowings from credit institutions	17 735	46 296	25 235	65 873
12. Deferred income	6 675 392	4 500 330	9 498 227	6 403 393
15. Deferred tax liability	19 896 526	20 033 571	28 310 206	28 505 204
Total long-term creditors:	26 589 653	24 580 197	37 833 668	34 974 470
Short-term creditors:				
3. Borrowings from credit institutions	35 470	30 864	50 469	43 916
5. Advances received	3 015 972	1 791 248	4 291 342	2 548 716
6. Trade creditors	24 744 413	2 141 619	35 208 128	3 047 248
9. Accounts payable to related companies	7 593 588	9 040 277	10 804 702	12 863 155
10. Taxes and social insurance	2 891 109	3 376 520	4 113 677	4 804 355
11. Other creditors	1 759 537	231 006	2 503 595	328 692
12. Deferred income	244 122	162 548	347 354	231 285
15. Accrued liabilities	2 407 079	2 087 773	3 424 966	2 970 634
Total short-term creditors:	42 691 290	18 861 855	60 744 233	26 838 001
Total creditors:	69 280 943	43 442 052	98 577 901	61 812 471
Total liabilities and shareholders' funds	298 456 205	260 998 564	424 664 921	371 367 499

Statement of changes in equity for the year ended December 31, 2005

	Share capital	Share premium	Long-term investments revaluation reserve	Other reserves*	Statutory reserve	Retained earnings	Total
	Ls	Ls	Ls	Ls	Ls	Ls	Ls
Balance as at 31.12.2003.	39 900 000	14 320 210	7 877 665	2 091 647	20 264 394	13 021 548	97 475 464
Dividends	-	-	-	-	-	(9 975 000)	(9 975 000)
Transferred to reserves	-	-	-	-	3 046 548	(3 046 548)	-
Revaluation of fixed assets	-	-	129 305 143	-	-	-	129 305 143
Deferred tax liability arising on the revaluation of fixed assets	-	-	(19 395 772)	-	-	-	(19 395 772)
Disposal of revalued fixed assets	-	-	(133 185)	-	-	-	(133 185)
Deferred tax on disposal of revalued fixed assets	-	-	19 978	-	-	-	19 978
Profit for the year	-	-	-	-	-	18 873 884	18 873 884
Balance as at 31.12.2004.	39 900 000	14 320 210	117 673 829	2 091 647	23 310 942	18 873 884	216 170 512
Dividends	-	-	-	-	-	(11 970 000)	(11 970 000)
Transferred to reserves	-	-	-	-	5 824 758	(5 824 758)	-
Revaluation of fixed assets	-	-	1 679 902	-	-	-	1 679 902
Deferred tax liability arising on the revaluation of fixed assets	-	-	(251 985)	-	-	-	(251 985)
Disposal of revalued fixed assets	-	-	(110 698)	-	-	-	(110 698)
Deferred tax on disposal of revalued fixed assets	-	-	16 605	-	-	-	16 605
Profit for the year	-	-	-	-	-	23 640 926	23 640 926
Balance as at 31.12.2005.	39 900 000	14 320 210	119 007 653	2 091 647	29 135 700	24 720 052	229 175 262

	Share capital	Share premium	Long-term investments revaluation reserve	Other reserves*	Statutory reserve	Retained earnings	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Balance as at 31.12.2003.	56 772 585	20 375 823	11 208 907	2 976 146	28 833 635	18 527 994	138 695 090
Dividends	-	-	-	-	-	(14 193 146)	(14 193 146)
Transferred to reserves	-	-	-	-	4 334 847	(4 334 847)	-
Revaluation of fixed assets	-	-	183 984 643	-	-	-	183 984 643
Deferred tax liability arising on the revaluation of fixed assets	-	-	(27 597 697)	-	-	-	(27 597 697)
Disposal of revalued fixed assets	-	-	(189 505)	-	-	-	(189 505)
Deferred tax on disposal of revalued fixed assets	-	-	28 426	-	-	-	28 426
Profit for the year	-	-	-	-	-	26 855 118	26 855 118
Balance as at 31.12.2004.	56 772 585	20 375 823	167 434 774	2 976 146	33 168 482	26 855 119	307 582 929
Dividends	-	-	-	-	-	(17 031 776)	(17 031 776)
Transferred to reserves	-	-	-	-	8 287 884	(8 287 884)	-
Revaluation of fixed assets	-	-	2 390 285	-	-	-	2 390 285
Deferred tax liability arising on the revaluation of fixed assets	-	-	(358 542)	-	-	-	(358 542)
Disposal of revalued fixed assets	-	-	(157 509)	-	-	-	(157 509)
Deferred tax on disposal of revalued fixed assets	-	-	23 627	-	-	-	23 627
Profit for the year	-	-	-	-	-	33 638 006	33 638 006
Balance as at 31.12.2005.	56 772 585	20 375 823	169 332 635	2 976 146	41 456 366	35 173 465	326 087 020

* These reserves were made before registration of the Company in Commercial Register in the amount of 5% from annual profit. Since neither the Commercial Law, nor Company Charter require the creation of such reserves, shareholders will make decision on utilisation of reserves.

Changes in Statutory reserves can only be made with shareholders' approval. Revaluation reserve and share premium cannot be distributed to shareholders.

Cash flow statement for the year ended December 31, 2005

	2005 Ls	2004 Ls	2005 EUR	2004 EUR
I. Cash flow from operating activities				
1. Profit before taxes	28 251 935	22 929 235	40 198 881	32 625 363
Adjustments for:				
- fixed asset depreciation and write-down of intangible assets	11 820 057	10 364 456	16 818 426	14 747 292
- change in provisions for inventories	71 438	37 497	101 647	53 353
- change in provisions for long-term financial investments	(1 028)	(145)	(1 463)	(206)
- change in accrued expenses for bonuses for reporting year's financial results	400 830	350 592	570 330	498 848
- change in accrued unused annual leave expenses	(81 524)	202 297	(115 998)	287 843
- change in other provisions	(1 386 000)	716 000	(1 972 100)	1 018 776
- interest and similar income	(4 684 414)	(1 855 076)	(6 665 320)	(2 639 535)
- interest and similar expense	49 108	14 391	69 874	20 476
- (profit) / loss on sale of fixed assets	(14 720)	16 514	(20 945)	23 497
Adjustments for:				
Trade debtors increase	(3 271 271)	(148 688)	(4 654 599)	(211 565)
Inventories increase	(16 097 026)	(21 028 017)	(22 904 005)	(29 920 173)
Trade creditors' increase	21 156 105	5 354 621	30 102 425	7 618 940
Other debtors' (increase) / decrease	(689 893)	337 690	(981 629)	480 489
Other creditors' increase	4 894 850	474 100	6 964 745	674 584
3. Gross cash flows from operating activities	40 418 447	17 765 467	57 510 269	25 277 982
Interest expense	(49 108)	(14 391)	(69 874)	(20 476)
Interest income	4 751 219	1 855 076	6 760 376	2 639 535
Corporate income tax paid	(5 256 781)	(1 507 678)	(7 479 726)	(2 145 233)
6. Net cash flows from operating activities	39 863 777	18 098 474	56 721 045	25 751 808
II. Cash flows from investing activities				
Acquisition of fixed assets and intangible assets	(24 226 995)	(23 662 814)	(34 471 908)	(33 669 151)
Proceeds from sale of investments	6 400	-	9 106	-
Proceeds from sale of fixed assets	16 898	15 203	24 044	21 632
Net decrease / (increase) of other investments in term deposits over 90 days	8 000 000	(8 000 000)	11 382 974	(11 382 974)
9. Net cash flows from investing activities	(16 203 697)	(31 647 611)	(23 055 784)	(45 030 493)
III. Cash flow from financing activities				
Repayment of borrowings	(23 955)	(36 097)	(34 085)	(51 361)
Dividends paid	(11 970 000)	(9 975 000)	(17 031 776)	(14 193 146)
7. Net cash flow from financing activities	(11 993 955)	(10 011 097)	(17 065 861)	(14 244 507)
Net increase / (decrease) in cash and cash equivalents	11 666 125	(23 560 234)	16 599 400	(33 523 192)
Cash and cash equivalents at the beginning of the reporting year	12 201 531	35 761 765	17 361 215	50 884 407
Cash and cash equivalents at the end of the reporting year	23 867 656	12 201 531	33 960 615	17 361 215

Notes

Accounting policies

(a) General principles

Annual accounts are prepared in accordance with the laws of the Republic of Latvia "On Accounting" and "On Annual Accounts of the Companies" and with mandatory Latvian accounting standards. In preparation of these annual accounts following Latvian accounting standards (LAS) are applied: LAS No 1 "Framework of preparation of financial statements", LAS No 2 "Cash flow statement", LAS No 3 "Events after the balance sheet date", LAS No 4 "Change in accounting policies, changes in accounting estimates and prior period errors" and LAS No 5 "Long-term contracts".

The profit and loss account is prepared in accordance with turnover method.

Cash flow statement is prepared using indirect cash flow method.

The accounting policies used by the Company are consistent with those used in the previous accounting period. According to LAS No 2 "Cash flow statement" the reclassification of deposits with original term over 90 days and related interest income is made. Also according to the changes in the law "On the Annual Accounts of Companies" reclassification of deferred tax liabilities from accruals to long term creditors and of accrued expenses for unused annual leave, bonuses and other accrued liabilities to accrued expenses. In financial statements for 2005, the comparative figures for 2004 have been classified in accordance with the principles of 2005 and they are comparable.

(b) Net sales and income recognition

Income is recognised upon delivery of gas or performance of services, net of value added tax and discounts. Interest income and penalties income is recognised on an accruals basis unless its collectibility is in doubt.

The income from residents and enterprises contribution to financing of construction works of gas pipelines is accounted for as deferred income and recognised in the profit and loss account over the expected useful life of constructed fixed assets of 30 to 40 years.

(c) Foreign currency translation

The Company maintains its accounts in Latvian Lats. All transactions denominated in foreign currencies are converted to Lats at the exchange rate set by the Bank of Latvia prevailing on the day on which the transactions took place. Monetary assets and liabilities denominated in foreign currencies are translated in Lats in accordance with the official Bank of Latvia exchange rate for the last day of the

reporting period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

	31.12.2005. Ls	31.12.2004. Ls
1 USD	0,593	0,516
1 EUR	0,702804	0,703

Euro annual accounts are prepared using account closing balances in Ls at the last day of reporting period, performing conversion to EUR by using the official fixed EUR/Ls rate set by the Bank of Latvia from January 1, 2005 (1 EUR = Ls 0,702804). The management of the Company believes that this exchange rate is the most suitable for conversion and the effect of the application to the comparative information of actual exchange rates (as at December 31, 2004 of 1 EUR = Ls 0,7030 for the balance sheet and average rates of 2004 of 1 EUR = Ls 0,6681 for the income statement) is not material for presentation in the financial statements.

(d) Intangible assets

Intangible assets are recorded at historic cost net of accumulated amortisation. Amortisation is calculated on a straight-line basis to write down each intangible asset to its estimated residual value over its estimated useful life. Generally, intangible assets are amortised over a period of 5 years.

(e) Fixed assets

Fixed assets are recorded at historic cost or revalued amount net of accumulated depreciation and impairment charge.

Increase in value arising on revaluation is shown in equity under "Long-term investments revaluation reserve". Decrease that offsets a previous increase of the same asset's value recognised in the said reserve is charged against that reserve; any further decrease is charged to the current year's profit and loss account.

Depreciation is calculated on a straight-line basis to write down each fixed asset to its estimated residual value over its estimated useful life using following rates set by management:

	% per annum
Buildings	0,6 –1
Gas transmission system	2–2,5
Machinery and equipment	5–20
Furniture and fittings	10 –20
Computers and equipment	30

Depreciation is not calculated for land and buffer gas.

Company capitalises fixed assets with cost exceeding Ls 50 and useful life exceeding 1 year.

Direct charges related to the particular fixed asset under construction are capitalised, during the period of time that is required to complete and prepare the asset for its intended use, as part of the cost of the asset.

Where the carrying amount of a fixed asset exceeds its estimated recoverable amount, it is written down immediately to its recoverable amount and the impairment loss is recognised as an expense in the profit and loss account or off-set against the revaluation reserve if the fixed asset is carried at revalued amount. Recoverable amount is the higher of the fair value less costs to sell and the value in use of the related fixed asset.

Subsequent costs are included in the asset's carrying amount or recognised as separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. Such costs are depreciated over the remaining useful life of the related asset. Capitalising the cost of mounted spare parts, the carrying value of the part replaced is written off to the profit and loss account.

Repairs and maintenance are charged to the profit and loss account during the period in which they are incurred.

Gains or losses on disposals are determined by comparing carrying amount with proceeds and gains from related asset's revaluation reserve write-off and are charged to the profit and loss account during the period in which they are incurred.

(f) Inventories

Natural gas cost is determined by the first-in first-out (FIFO) method. Materials', spare parts', gas meters' and other inventories' cost is determined by the weighted average method. The cost of natural gas comprises cost of gas purchased. Direct labour, other direct costs and related production overheads are recognised on an accruals basis and charged to the profit and loss account in the period when incurred.

Inventories are recorded at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and selling expenses. When the net realisable value of inventories is lower than its cost, provisions are created to reduce the value of inventories to its net realisable value.

(g) Account receivables

Accounts receivable are recorded in the balance sheet at their amortised cost less provisions made to cover anticipated loss on bad and doubtful accounts receivable. Provi-

sions for bad and doubtful accounts receivable are established when there is an objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of provisions for bad and doubtful accounts receivable is the difference between the amortised cost and the recoverable amount.

(h) Other long-term investments

Other long-term investments are disclosed at the cost less provisions created to cover losses on other than temporary diminution of value of investments. Assessment of investments is made each year based on latest available financial information.

(i) Borrowings

Borrowings are recognised initially at the proceeds received net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account.

(j) Taxes

Corporate income tax for the reporting period is included in the annual accounts based on the management's calculations prepared in accordance with Latvian Republic tax legislation.

Deferred tax is provided for using liability method on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the annual accounts. The deferred tax is calculated based on currently enacted tax rates that are expected to apply when the temporary differences reverse. The principal temporary differences arise from different fixed assets depreciation rates, accrued unused annual leave and bonus expenses and accrued expenses for bad and doubtful debts where the management is of the opinion that they will meet the criteria stated in Article 9 of the law "On Corporate Income Tax".

Increase in deferred tax liability that results from revaluation of fixed assets is charged to equity as deduction from respective increase in 'Long-term investments revaluation reserve'. Decrease in deferred tax liability that results from depreciation of revalued fixed assets is charged to the profit and loss account and the respective unrealised tax gain is shown in the notes to the annual accounts.

(k) Accrued unused annual leave expenses and accrued liabilities

Accrued liabilities are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Amount of accrued unused annual leave expenses is determined by multiplying the average daily wage of employees for the last six months of the reporting year by the amount of accrued but unused annual leave at the end of the reporting year.

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, balances of current account with banks and short-term deposits, which can be easily converted to cash and are not subject of significant change in value.

(m) Related parties

Related parties are defined as Company's major shareholders, which have a significant influence, members of the Council and members of the Board of Directors, their close relatives and companies in which they have a significant influence or control.

(n) Profit available for distribution

On revaluation of fixed assets additional temporary difference arises between fixed asset values for financial and tax purposes. According to Accounting policies section (j) the respective increase in deferred tax liability is attributed to the 'Long-term investments revaluation reserve'. Decrease in deferred tax liability that results from depreciation of revalued fixed assets is charged to the profit and loss account as tax income.

In order to comply with the law of the Republic of Latvia "On the Annual Accounts of Companies" Section 29 article 4, the said income cannot be distributed. Therefore, the profit available for distribution is calculated as net difference between net profit and unrealised deferred tax income related to fixed asset revaluation and is shown separately in profit and loss account.

Translation from Latvian

AUDITORS' REPORT TO THE SHAREHOLDERS OF JSC "LATVIJAS GĀZE"

We have audited the financial statements of JSC "Latvijas Gāze" for 2005 from which the summarized financial statements were derived, in accordance with International Standards on Auditing issued by International Federation of Accountants. In our report dated 19 May 2006 we expressed an unqualified opinion on the financial statements from which the summarized financial statements were derived.

In our opinion, the accompanying summarized financial statements on pages 28 to 36 are consistent, in all material respects, with the financial statements from which they were derived.

For better understanding of the JSC "Latvijas Gāze" financial position and the results of its operations for the year and of the scope of our audit, the summarized financial statements should be read in conjunction with the financial statements from which the summarized financial statements were derived and our audit report thereon.

PricewaterhouseCoopers SIA
Audit company licence No. 5



Juris Lapshe
Certified auditor
Certificate No. 116
Member of the Board

9 June 2006
Rīga

