



JSC Latvijas Gāze

*Annual  
Report  
2008*

## The Company in 2008

In 2008 the main goal of the Joint Stock Company *Latvijas Gāze* was to provide stable and uninterrupted gas supply and sales in Latvia, but in the winter period – also to Estonia, Northwestern region of Russia and by developing and modernizing the gas supply system and its related services.

## The basic areas of activity of the Company are:

- natural gas purchase, storage, transmission, distribution and sales;
- import operations with natural gas;
- natural gas quantity accounting and quality control;
- operation of the gas supply system, including ensuring its safety and system development.

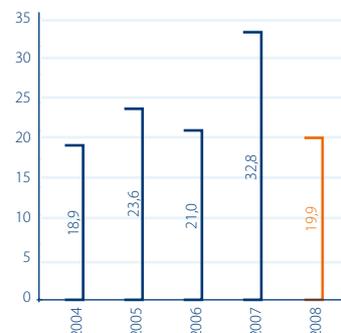
### Investment (LVL million)



### Equity (LVL million)



### Net profit (LVL million)



### Net turnover (LVL million)



# *Content*

Council Report / 6
Council / 8
Board / 9
Shares and Shareholders / 10
Natural Gas in the Energy Market of Latvia / 12
Development / 15
Inčukalns Underground Gas Storage Facility / 18
Gas Transmission / 20
Personnel / 22
International Co-operation / 24
To the Society / 26
Environmental Policy / 28
Summarised Annual Accounts / 30
Auditors' Report / 41



The year 2008 will go  
down in history as  
the year of changes  
and challenges

---

# Council Report



Kirill Seleznev

2008 will go in the history of the world as a year of significant changes and challenges. If at the beginning of the year both in Latvia and many other countries a rapid growth was still in progress and the prices of oil products reached record-high levels, the second half of the year, with the credit crisis deepening, saw a significant slowdown of the economic development and with the decrease in demand the oil prices went down as well. At the end of the year, a recession began in Latvia. Thus, the budget revenue decreased, and the government had to raise several taxes and approach the International Monetary Fund, the European Commission and other donors for help.

During the last year, the gas purchase prices in Latvia kept rising. However, with a corresponding rise of the natural gas tariffs and prices for the end users, preconditions for the Company's successful operation during the difficult and changeable circumstances were created. The Company's priority in this period did not change, still being the provision of continuous and secure natural gas supply to its consumers, the attraction of new customers by expanding the current natural gas supply networks and the provision of the services of natural gas storage for consumers in other countries.

During the year 2008, the JSC *Latvijas Gāze* sold 1.63 billion m<sup>3</sup> of natural gas, and its turnover reached 351 million LVL (499.4

million EUR). The Company spent 22.8 million LVL (32.4 million EUR) on measures of further modernization, customer attraction and security improvement. The key projects implemented are the reconstruction of the gas collection point and the wells at the Inčukalns UGS and the diagnostics of the gas transmission pipelines. For the attraction of new customers, 148.3 km of gas distribution pipelines were built.

In 2008, the Council during its meetings heard out and discussed the reports prepared by the Board in order to inform the Council on the Company's operation under the fickle circumstances. The Council gave to the Board instructions and recommendations for improving the Company's operation, repeatedly reviewed and approved changes in agreements with the natural gas suppliers OJSC *Gazprom* and LLC *ITERA Latvija*, including changes that envisage the extension of the period of validity of the previously concluded gas supply agreements till 2030. Thus, the consumers are guaranteed natural gas supplies for a long period and investments in sustainable development of the natural gas system are ensured. The Council members attended the major operation units of the Company and got acquainted in presence with the course of implementation of several modernization programmes.

Last year the Council members S. Kamphues and R. Lehmann discontinued their work at the Council, and new members –



A. Saul and H. Watzka – were elected instead of them. The Council expresses gratitude and acknowledgment to S. Kamphues and R. Lehmann for the great work and contribution to the development of the Company and wishes success to the new Council members A. Saul and H. Watzka.

The Council has got acquainted with the Corporate governance report prepared by the Board concerning the previous year in compliance with the “Corporate governance principles and suggestions on their observance” issued by the JSC NASDAQ OMX Riga and considers that the Board has done serious work in order for the Company to observe the recommended corporate governance principles in its operation. The Council follows these principles, too.

During the reporting period, the Council regularly received the Board reports on activity and the economic and financial standing of the Company. The Council has supervised the Board’s work in all main areas and controlled its compliance with laws, the Articles of Association of the Company and the resolutions of the Shareholders’ meeting, verified and accepted the budget submitted by the Board, as well as given its proposals for improving the Company’s work.

The Annual Report 2008 was audited by the international auditor company *Price-waterhouseCoopers* LLC. The Council has

received the auditor’s reports where it is stated that the financial statements give a true and fair view of the financial position of the JCS *Latvijas Gāze* as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with the Annual Accounts Act of the Republic of Latvia. The Council has reviewed and accepted the Board report on activity of the Company in the reporting year, the measures of research and development, the financial risk management, as well as the proposals regarding distribution of the profit of 2008.

The Council of the Company commends the Board and the employees for their good operation and performance in 2008 and wishes success and development also in future.

Chairman of the Council:  
**Kirill Seleznev**

# Council

The composition of the Council of the JSC *Latvijas Gāze* in the year 2008 was as follows:

Chairman of the Council:

**Kirill Seleznev,**  
represents the share  
of the OJSC *Gazprom*

Deputy Chairmen of the Council:

**Juris Savickis,**  
represents the share  
of the LLC *ITERA Latvija*

**Stephan Kamphues,**  
represents the share  
of *E.ON Ruhrgas International AG*  
(till 25th July 2008)

**Achim Saul,**  
represents the share  
of *E.ON Ruhrgas International AG*  
(from 25th July 2008)

Members of the Council:

**Eike Benke,**  
represents the share  
of *E.ON Ruhrgas International AG*

**Reiner Lehmann,**  
represents the share  
of *E.ON Ruhrgas International AG*  
(till 25th July 2008)

**Heinz Watzka,**  
represents the share  
of *E.ON Ruhrgas International AG*  
(from 25th July 2008)

**Uwe Fip,**  
represents the share  
of *E.ON Ruhrgas International AG*

**Marcus Anton Soehrich,**  
represents the share  
of *E.ON Ruhrgas International AG*

**Yelena Karpel,**  
represents the share  
of the OJSC *Gazprom*

**Vlada Rusakova,**  
represents the share  
of the OJSC *Gazprom*

**Aleksandr Krasnenkov,**  
represents the share  
of the OJSC *Gazprom*

**Igor Nazarov,**  
represents the share  
of the LLC *ITERA Latvija*

# Board



Adrians Dāvis



Aleksandr Mihejev



Joerg Tumat



Gints Freibergs



Anda Ulpe

The Board of the Company is elected for three years by the Meeting of Shareholders of the JSC *Latvijas Gāze*.

The composition of the Board of the JSC *Latvijas Gāze* in the year 2008 was as follows:

**Adrians Dāvis**  
Chairman of the Board

**Aleksandr Mihejev**  
Member of the Board,  
Deputy Chairman of the Board

**Joerg Tumat**  
Member of the Board,  
Deputy Chairman of the Board

**Anda Ulpe**  
Member of the Board

**Gints Freibergs**  
Member of the Board

# Shares and Shareholders

## Shares and shareholders of the JSC *Latvijas Gāze*

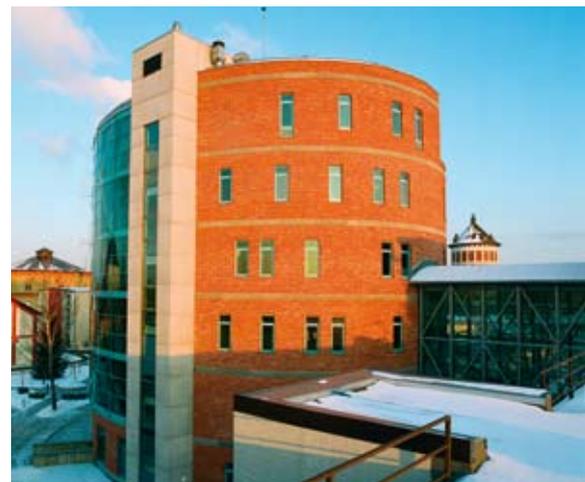
The intensive teamwork of the JSC *Latvijas Gāze* has helped the company to overcome the issues related to the international economic crisis, continue to operate with profit and successfully quote its shares at the Riga Stock Exchange (now – *NASDAQ OMX Riga*) and the Baltic Stock Exchange.

## Structure of shareholders

*E.ON Ruhrgas International AG* (Germany) – 47.2%; *OJSC Gazprom* (Russia) – 34%; *LLC ITERA Latvija* – 16% and others (including employees of the JSC *Latvijas Gāze*) – 2.8%

The price of one share with voting rights – 1 LVL (1.42 EUR).

In the reporting period, the structure of shareholders of the JSC *Latvijas Gāze* did not change. Since February 15, 1999, the shares of the Company are quoted at the Riga Stock Exchange, and their trade code as from August 1, 2004 is GZE1R. Before July 31, 2008, these shares were quoted in the Official list of the Riga Stock Exchange and the Joint List of the Baltic Stock Exchange. In compliance with the resolution of the Board of the JSC *Riga Stock Exchange*, dated June 25, 2008, on the basis of the insufficient amount of quotable shares of the JSC *Latvijas Gāze* available in free public trading, as from August 1, 2008 the shares



of the Company were moved to the Second list of the Baltic Stock Exchange and the Riga Stock Exchange.

## JSC *Latvijas Gāze* in figures

Capitalization value of the JSC *Latvijas Gāze* at the end of 2008 – 181.5 million LVL (258.3 million EUR).

Capitalization value of the JSC *Latvijas Gāze* at the end of 2007 – 284.1 million LVL (404.3 million EUR).

It should be admitted that over the reporting period the capitalization value of the JSC *Latvijas Gāze* fell by 102.6 million LVL (146 million EUR).

The considerable drop was not caused by worsening of the Company's operation, but the global financial crisis, as well as the negative mood in financial markets over the world, including the Baltics. The review of the capitalization value indicates that at the end of 2008 the shares of the JSC *Latvijas Gāze* took second place in the list of securities quoted at the *NASDAQ OMX Riga* (as they also did in 2007) and the seventh place in the list of shares quoted at the Baltic Stock Exchange (eleventh in 2007).

During the reporting year, the price of one share of the JSC *Latvijas Gāze* fluctuated within the range of 3.62 to 8.20 LVL (5.15 to 11.67 EUR), reaching 4.55 LVL (6.47 EUR) at the end of the reporting year, which is



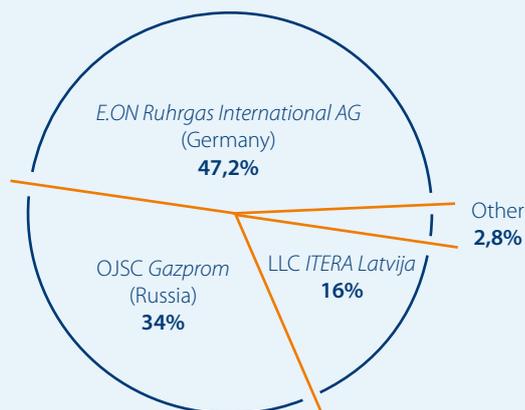
by 36.1% less than at the end of 2007. Over the reporting year, the turnover of the Company's shares reached 46 565 shares, which is by 108 260 shares less than in 2007. The stock capital of the JSC *Latvijas Gāze* at the end of the reporting year had not changed – 39.9 million LVL (56.8 million EUR).

### Distribution of profit

The project of distribution of the profit 2008, prepared by the Board of the JSC *Latvijas Gāze*, envisages paying 0.38 LVL (0.54 EUR) per one share in dividends, which results in a total of 15.16 million LVL (21.57 million EUR) or 76.1% of the Company's profit in 2008. In comparison to 2007, the amount of dividends to be paid per one share has decreased by LVL 0.12 or 24%.

### Shareholder structure of JSC *Latvijas Gāze* (%)

December 31, 2008



### JSC *Latvijas Gāze* dividend per share (LVL/share)



# Natural Gas in the Energy Market of Latvia

## Energy balance

The total energy consumption in 2008 remained at the level of previous years despite high energy prices and the economic crisis. Although energy efficiency measures continued in the country both in the district heat production and transmission, and individually in houses, the total natural gas consumption was at the level of the previous year as the number of customers of the JSC *Latvijas Gāze* kept growing. Also in the overall state energy balance, natural gas retained its leading position with 30% of the total consumption.

The structure of natural gas consumption by industries has not considerably changed. The main consumers of natural gas are the energy industry – district heat supply and electricity production companies. Individual heating of households take up about a tenth of the total consumption.

## Price changes

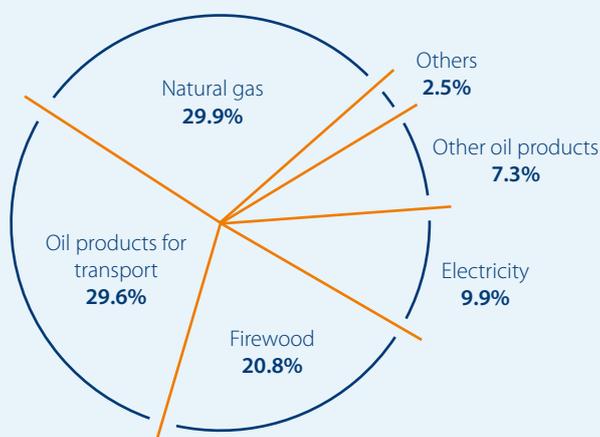
At the beginning of 2008, new natural gas calculation contracts were signed with the suppliers OJSC *Gazprom* and LLC *ITERA Latvija*. This marked the end of a period that started at the beginning of the millennium – the price of natural gas delivered to Latvia reached the price in the market of the European Union. However, the natural gas prices to the end users

grew much more rapidly than the leveling difference. It should be emphasized that the share of increase, which concerns the differences between the base supply prices in Latvia and the European Union, was rather negligible already in 2007. The main reason was the increase of oil prices over two years, as in Latvia the price of the imported natural gas, like in Europe in general, is linked to the prices of heavy fuel oil and diesel fuel.

As recently as in January 2007 the price of one barrel of oil was around 50 USD, but in summer 2008 it exceeded 150 USD for the first time in history. The same happened to heavy fuel oil, to which the natural gas

price is pegged in Latvia. The heavy fuel oil index at FOB ARA in January 2007 was 240 dollars per ton, but in July 2008 it had already jumped to 760 dollars per ton, and a similar trend applied to other oil products. The price tripled, and that made gas and other energy resources more expensive throughout Europe. In Latvia, the payments for natural gas for the end users in 2008 rose by up to 80%. In the second half of 2008 the oil market saw a rapid fall, and, for instance, from July to December the monthly price of heavy fuel oil decreased 3.5 times and, considering the maximum and minimum price, such a drop had never occurred before.

Energy balance in 2008 (%)



However, this did not enable the Company to decrease the natural gas tariffs considerably yet in 2008, as the prices of natural gas supply from Russia and the natural gas tariffs in Latvia are calculated depending on the average prices of oil products of the previous nine months, thus the steep drop of the natural gas tariffs is expected in 2009. It should be emphasized that the correlation between the prices of oil, its products and natural gas is not literal – the end price of natural gas is also affected by currency relations, operator's costs and other factors. At the end of 2008, the natural gas purchase costs were about 80% of the end price for consumers and 20% were the operator's costs, which is a less changeable portion.

### Events that will influence the future

In 2008, the system of calculation of the purchase price and the end tariffs was changed, extending the heavy fuel oil and diesel fuel quotation period from six to nine months. These changes will make the price more predictable, and the rapid changes in the oil market will be more gradual in the natural gas market. This will enable all parts of the chain – suppliers, the JSC *Latvijas Gāze* and customers – to plan their expenses and investments more precisely.

In 2008, the JSC *Latvijas Gāze* started working at the long-term natural gas supply

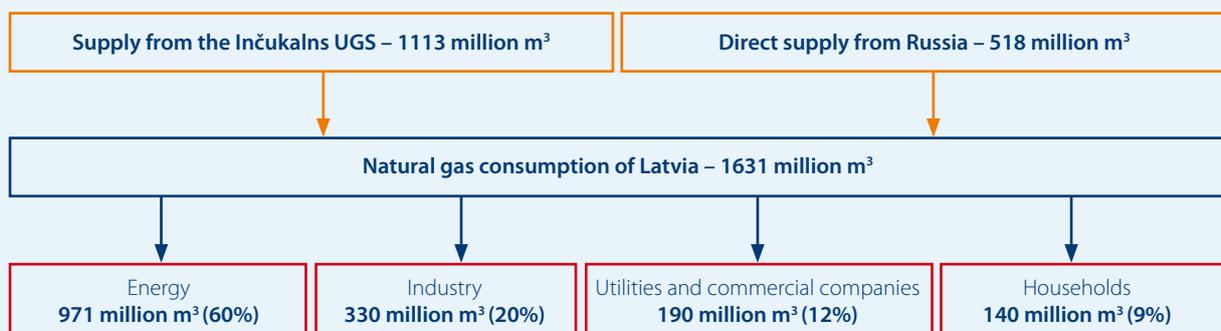
agreements with the OJSC *Gazprom* and the LLC *ITERA Latvija*. The agreements were concluded at the beginning of 2009, and they are valid until 2030. The agreements guarantee the volumes of natural gas necessary for Latvia and a price competitive with other main energy resources. This will give additional incentive and security to companies wishing to make long-term investments in production facilities or other areas of entrepreneurship where natural gas is consumed.

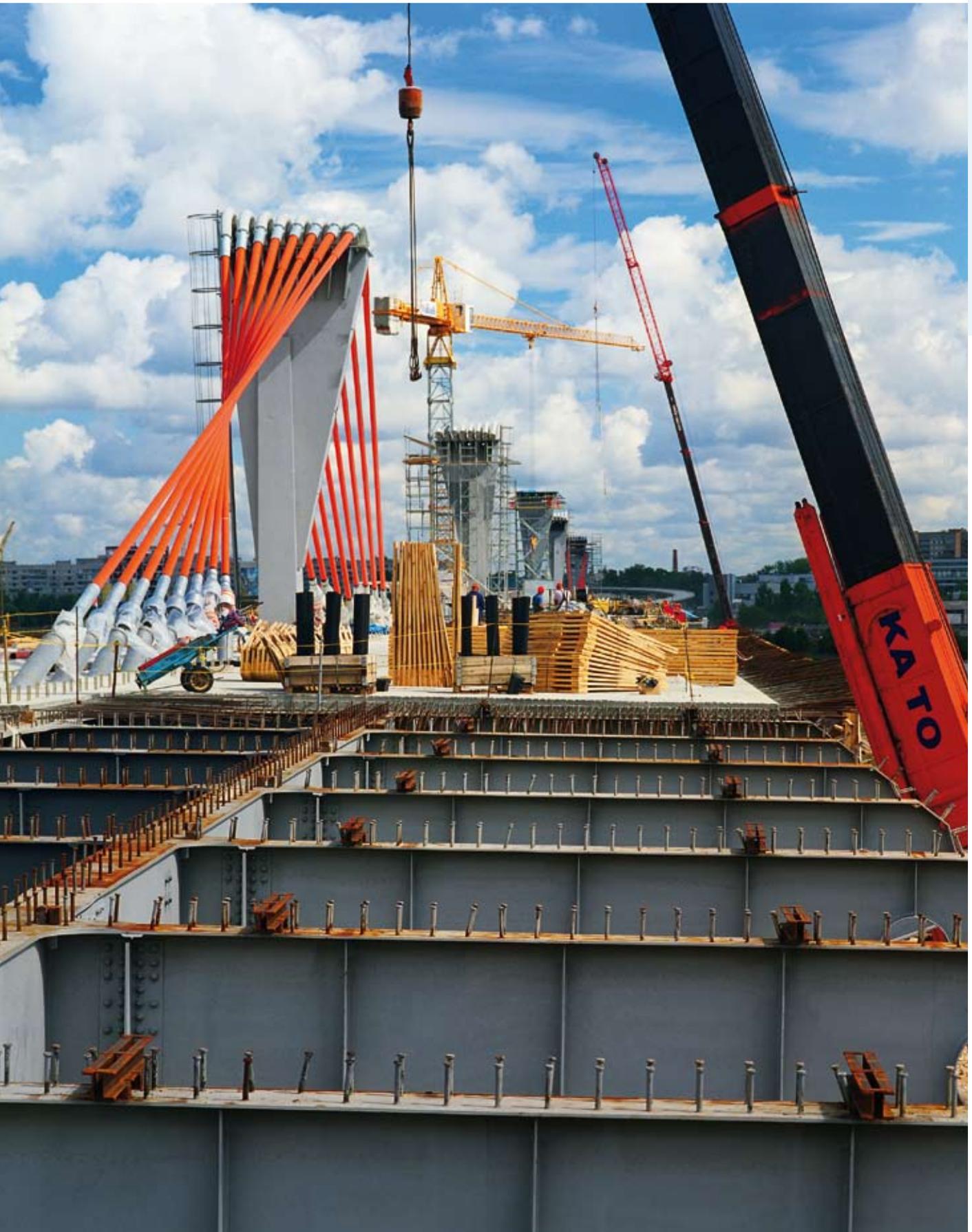
The year 2008 can be described by the uncertainty of the state policy as concerns the development of energy production in Latvia. With the closure of the Ignalina NPS in 2009, the Baltic States are predicted to face problems with energy supply already in mid-term. In 2008, there was passed a political decision to prepare and announce a tender on the construction of a 400 MW coal power station in Liepāja. It is yet to take place, however. Back in 2007, Latvia in co-operation with Lithuania, Estonia and Poland started working at the project of construction of a joint NPS in Lithuania, but this has not yielded any concrete agreements either. In 2009, however, the reconstruction of the 2nd Thermal Power Plant of Riga was completed, installing a new 420 MW power unit to be fuelled by natural gas. There are still active discussions in the society and among experts regarding the further solution of self-provision of electricity, and the possible variants include various directions

of development of NPS, a coal station in Kurzeme, a natural gas station in Riga, a terminal of liquefied natural gas and a station in Riga, as well as the use of renewable energy resources.

In 2009, under the influence of the economic crisis, a decrease in the consumption of energy resources in Latvia is anticipated, as well as the overall ability of consumers to pay for energy in the coming years is doubted. However, with the drop of the oil prices, the natural gas price for consumers in the heating season 2009-2010 is predicted to be 30% lower than in the previous heating season, which will improve the ability of customers to settle accounts for energy in both direct natural gas supplies and indirectly through district heating services. The competitiveness of natural gas in the market will be retained because of the linkage to the prices of the main alternative energy resources in Latvia. Both the society and the companies of energy supply expect more activity from the government in ensuring co-financing mechanisms for the improvement of the energy efficiency of buildings. In Latvia, the potential of the reduction of heat energy consumption in households is estimated within the range of 40% to 50%. The improvement of energy efficiency would enable households to reduce the costs for heat supply, which is the main source of consumption of energy resources in Latvia, as well as avoid inexpedient consumption of energy resources.

### Natural gas flow in 2008





# Development

Historically, the JSC *Latvijas Gāze* has prided itself on a reasoned investment and development programme, the main purpose of which is to create a secure and stable natural gas supply system in Latvia. In this respect, the year 2008 was significant with the implementation of three large-scale projects – the construction of gas pipelines below the Dienvidu bridge, the replacement of compressors at the Inčukalns Underground Gas Storage Facility (UGS) and the enabling of gas supply to the new power unit of the Thermal Power Plant TEC-2.

## Gas pipelines of the Dienvidu Bridge – a unique solution in Europe

The Daugava is a historic and exuberant river for Latvia. However, it has always been a problem for the natural gas supply system in the capital city. The gas transmission pipeline enters Riga on the right side of the Daugava. So far natural gas was transmitted across the river by a pipeline below the Akmens bridge. An alternative solution of transporting gas across the Daugava was necessary. Designing of the gas pipeline was launched parallel to the construction of the Dienvidu bridge. Building of the gas pipeline inside the bridge became a unique solution of engineering and technology, the design and implementation of which was entrusted to the

ZRF LLC *Rumba* following the results of a tender. It was decided to place the gas pipeline in two rows – symmetrically on the either side of the bridge. In the final version, the gas pipelines were designed in the beam consoles at the sides of the bridge span. In order to “thread” the pipelines, there were holes left in the consoles. During the complicated process of assembly, the pipelines were slid along these holes. Envisaging that under the influence of temperature and mechanical load the bridge and thus the gas pipeline would be displaced, causing damage, it was necessary to install glide props, and the vertical sections of the pipe, that are connected with the underground branch-offs on the banks, had to ensure amortization of movement of the gas pipeline.

This large-scale project was successfully implemented and cost 1.6 million LVL (2.3 million EUR).

## Modernization of the Inčukalns UGS and new connection to the Thermal Power Plant TEC-2

In August 2008, the construction of two large natural gas infrastructure units of national importance was completed – a new compressor was installed at the Inčukalns UGS to ensure the injection of gas received from Russia into the facility securely, economically and without loss, and a connection to the new gas-fired power unit of the TEC-2 of Latvenergo has been built. It should be noted that the new branch-offs enable the TEC-2 to use natural gas at an amount equal to 1/3 of the total natural gas consumption of Latvia.

The construction of the connection started back in October 2006. A gas pipeline at the length of 4 km and 800 mm in diameter was built, and currently it is the largest pipeline in Latvia (the former largest gas transmission pipeline in Latvia was 700 mm in diameter). Furthermore, a new gas regulation station was built in Stopiņi District. In the case of necessity, the improved infrastructure will be sufficient for operating an additional TEC-2 power unit, which might be built in the future. The connection costs are 5 million LVL (7.1 million EUR).

The gas regulation station, for its part, will not only serve the needs of the TEC-2, but the entire Riga, since in parallel to the TEC-2 connection there is also a loop of gas pipeline being built around Riga, which will considerably improve the security of gas supply and provide for the development of Riga, Riga District and the surrounding territories.

## The year 2008 – 2834 new customers and improvements in the Old Riga

Last year, continuing the customer attraction programme of the JSC *Latvijas Gāze* and performing notable marketing activities, the JSC *Latvijas Gāze* attracted 2834 new customers – 193 industrial consumers, 366 commercial customers and 2275 individual customers. For the attraction of 2029 customers, JSC *Latvijas Gāze* made investments in the amount of almost 5 million LVL (7.1 million EUR), building gas distribution pipelines at the length of 126 kilometres.

With the natural gas demand increasing in the Old Riga, the JSC *Latvijas Gāze* performed complicated underground works – built the subterranean gas regulation point so much needed for the Old Riga. This was done in order for the natural gas system to be stable, secure and unnoticeable in the historic part of the city.

## Customer service centres

In order to provide the customers with quality and efficient service, the JSC *Latvijas Gāze* established customer service centres in Riga, Jūrmala and Daugavpils already a few years ago. In 2008, the number of visitors of the customer service centres considerably grew. 50086 customers or potential customers addressed the customer service centres with a variety of service-, finance-, modernization- and security-related questions. Specialists at the Contact Centre of the JSC *Latvijas Gāze* provided answers by telephone to approximately 175.6 thousand customers.



The new branch-offs let the Thermal Power Plant TEC-2 use one third of all natural gas consumed in Latvia



# Inčukalns Underground Gas Storage Facility



The Inčukalns Underground Gas Storage Facility (Inčukalns UGS) is a strategic unit of the gas supply system both for the Baltic and the Russian Northwest region. During the heating season, natural gas from the storage facility is supplied to consumers not only in Latvia, but also in the neighbouring countries Estonia and Russia. One of the main objectives of the JSC *Latvijas Gāze* is still the improvement of integrity of the Inčukalns UGS in the overall gas supply complex of the Baltic States, Russia and Europe. Considering the tendency of increased global use of fuel, the presence of gas storage facilities and the use of their potential becomes increasingly important. The Inčukalns UGS is one of the largest underground gas storage facilities in Europe, thus – a key asset of Latvia as a country of the European Union.

## Inčukalns UGS in figures

The volume of gas injected into the Inčukalns UGS in 2008 – 1.92 billion m<sup>3</sup>.

The total volume of gas at the storage facility in the reporting year – 4.47 billion m<sup>3</sup>.

In 2008, the JSC *Latvijas Gāze* invested 22.8 million LVL (32.4 million EUR) in the modernization of the gas supply system and the creation of new fixed assets. 10% of the total investment was spent on the improvement of operation security and the modernization of equipment at the Inčukalns UGS.

## Modernization

The main purpose of the modernization of the Inčukalns UGS was to improve the operation security of the underground and surface equipment, as well as to ensure the continuity of operation of the gas storage facility corresponding to the planned capacities. The investment in the improvement of technologies not only yielded an economic effect, but also made the process of natural gas storage more secure and environment-friendly. During the reporting year, no gas incidents or pipeline depressurization were encountered.

- In 2008, the modernization of the gas collection station GSP-1 was completed. The implementation of this project, including the design, took 4 years, and the total costs reached 11.4 million LVL (16.2 million EUR). On June 30, 2008, with a state transfer protocol the GSP-1 was put into operation.

- The reconstruction of the underground wells in the gas-carrying area, commenced in the previous year, was continued. During the reporting year, colon heads and fountain fittings were purchased and assembled in four wells, and pump compressor pipes were drawn down in one well. The equipment of the underground part of wells is due for installation by the end of 2009.

- In co-operation with the Russian company *Gazpromenergodagnostika*, the technical condition of 23 wells was examined, and it was found out that 6 wells urgently needed



a capital repair. The results of the diagnostics will be taken into account when adjusting the programme of well reconstruction. In co-operation with the same company, a new project on the development of methods of diagnosing the technical condition of technological communications was also started in the reporting year.

- The reconstruction of the gas drying unit at KC-1 was started. The technical regulations were worked out, and a tender was organized regarding the development of the detail design. The equipment draft project and the technical specifications for manufacturing have been drawn up, and a tender has been announced regarding the supply of this equipment. The total costs of the project are planned in the amount of 9.5 million LVL (13.5 million EUR), and the project is due for completion by the end of 2011.

- As from October 1, 2008, the company standard LV US 40003000642 – 23 – 2008 “The operation security rules of underground gas storage facility system” was introduced, and the creation of a database of landowners was commenced.

### 40th anniversary of the Inčukalns UGS

On August 9, 2008, it became 40 years since the first natural gas injection at the Inčukalns UGS. Celebrating this anniversary, an event was organized with the par-

ticipation of veterans and employees of the Inčukalns UGS. Within the framework of the event, a scientific technical meeting took place, with the participants sharing their work experience and discussing the issues of further development of the storage facility. The meeting was also attended by the invited guests - representa-

tives of institutes of the Russian companies *Gazprom*, *VNIIGAZ* and *Giprospetsgaz*. As part of the anniversary events, a special informatively historic material “The History of the Creation and Operation of the Inčukalns Underground Gas Storage Facility (1968 – 2008)” was prepared and published.

**Natural gas deliveries from Inčukalns UGS (million m<sup>3</sup>)**



# Gas Transmission

The functions of natural gas transmission system operator are performed by a structural unit of the JSC *Latvijas Gāze* – the operation unit *Gas Transport*. Its mission is to ensure the system functionality, as well as the technical operation and development.

The natural gas transmission system consists of gas transmission pipelines (hereinafter – GTP), the commercial international gas metering station, gas regulation stations (hereinafter – GRS), underground pipeline electric-chemical protection anti-corrosion equipment, communication and remote control lines, as well as the SCADA system.

The technical policy of the JSC *Latvijas Gāze* is directed towards the preservation and improvement of system security, which includes the continuity of natural gas supply and the system operation without failure.

## Reconstruction of gas regulation stations

Within the framework of the GRS modernization and reconstruction programme, another stage was implemented in the reporting year – the reconstruction of the GRS *Koknese* and *Vecbecri* and the assembly of technological equipment at the GRS *Ziemeļi* was completed, spending 1.72 million LVL (2.45 million EUR). This program-

me was started back in 1998, and currently 95% or 45 existing GRSs comply with the technical and ecological requirements of nowadays. The automation level of the GRSs provides for full control of the equipment operation from the central console of the Dispatcher Department of the JSC *Latvijas Gāze* via the SCADA system hardware. After the reconstruction, the capacity of the GRS *Ziemeļi* has almost doubled – up to 150 000 m<sup>3</sup> per hour. At the beginning of the reporting year, the reconstruction of the GRS *Rudbārži* and *Dzirkstele* was also completed.

In 2009, it is planned to complete the GRS reconstruction programme (GRS *Lutriņi* and *Zirņi*).

Assembly of the reduction unit of the gas pipeline Rīga-Daugavpils and tapping of an additional line valve on Rīga-Panevežis.

In order to ensure the security of the gas transmission system, the operation unit *Gas Transport* improves the GTP network by implementing a variety of measures, including the construction of a new line valve unit on the GTP Rīga-Panevežis.

According to the detail design of the GTP Rīga-Panevežis, there was no line valve unit envisaged on the 11.8 km section of the gas pipeline. Considering that the start of the GTP Rīga-Daugavpils is connected in this section, during repairs with gas discharge into atmosphere and in the event of possible crashes it is necessary to



disconnect the whole gas pipeline Rīga-Daugavpils. As a result of internal diagnostics, dangerous defects, which restrict the maximum allowed pressure of the whole pipeline, were found on the GTP Rīga-Daugavpils.

In order to improve the security level of GTP operation, the reporting period saw the assembly of the reduction unit on the gas pipeline Rīga-Daugavpils together with the tapping of an additional line valve on the gas pipeline Rīga-Panevežis. The costs of the project were 0.317 million LVL (0.452 million EUR).

The main function of the reduction unit of the gas pipeline Rīga-Daugavpils is to lower the operating pressure to the maximum allowed level automatically.

## Measures for preparing the internal diagnostics of GTPs

In order to allow for the performance of internal diagnostics, the operation unit *Gas Transport* has to build cleaning intelligent pig launcher and receiver units, replace the outdated GTP line valves with valves with sufficient internal throughput to allow for the movement of pigs through gas pipelines.

In the reporting year, within the framework of preparation for diagnostics, the gas pipeline Iecava-Liepāja was completed the construction of a unified pig launcher-re-



ceiver unit and a pig receiver unit, the replacement of two line valves, and this was done without interrupting the gas transmission by using a piece of equipment that allows for hot tapping. There were gas equipment and materials purchased, with a tender announced. A contract was signed with the winner on the construction of a pig launcher unit in 2009. Altogether for these purposes 1.37 million LVL (1.95 million EUR) were spent.

On the 1st line of the GTP Rīga-Inčukalna UGS, for its part, the assembly of a pig launcher unit and the replacement of two line valve units are completed. On the 2nd line, a pig launcher unit was built and a line valve unit was replaced. The assembly of a unified pig receiver unit on the 1st and the 2nd line are in progress, and five line valve units have been replaced. The total funds spent amount to 1.62 million LVL (2.3 million EUR).

There was gas equipment and materials purchased for the GTP Rīga-Panevėžis. A tender was announced, and a contract was signed with the winner on the construction of a pig receiver unit on the GTP Rīga-Panevėžis in 2009.

## GTP diagnostics

In order to ensure untroubled operation of the system, the internal diagnostics of GTP pipes and due aversion of the found

damage has been set as priority. The internal diagnostics of pipes is carried out with the purpose to determine the maximum permissible operating pressures on the GTPs in order to be able to maintain a higher pressure in the future when the volume of gas to be transmitted might grow. Despite the considerable expenses, the diagnostics completed so far confirm their necessity and usefulness. By the end of the reporting period, the JSC *Latvijas Gāze* had completed diagnostics to gas pipelines at the length of 51% of the total length of GTPs.

## GTP inspection and repairs

Taking into account the summary of the results of internal diagnostics and corresponding to the degree of dangerousness of the found defects, the maximum permissible pressure of the particular pipeline is restricted. After the inspection of the defects and the analysis of their dangerousness, the operation unit "Gas Transport" together with the involved state control institutions draw up a programme of inspection and repairs of the damaged gas pipelines. Under this programme, the maximum permissible pressure of the gas pipeline is restored and marked by the representative of the state control institutions in the operation passports of the gas pipeline. After the completion of the aforementioned, the independent inspectorate

LLC *Inspecta* submitted to the JSC *Latvijas Gāze* the opinion on the maximum permissible operating pressure.

In the reporting year, the external insulation at the length of 2685 m was replaced in various sections of gas pipelines. A section of 180 m in length was repaired and replaced pipes. A valve unit of a 171.39 km branch-off was tapped and assembled with the damages of welded joints and eliminated without interrupting gas transmission. A 72 km section of a gas pipeline was replaced due to having been found defective, as well as a pipeline of 381 m was replaced the external insulation. Altogether, 0.574 million LVL (0.817 million EUR) were spent for these purposes.

Also during the reporting year, other modernization works, commenced earlier, were continued, including the reconstruction of eight cathodic protection stations and the projects of reconstruction for other nine stations. Moreover, power supply lines and power branch-offs to the GTP line valves were installed, and the old branch-offs were modernized by replacing them with new ones manufactured in the European Union.

# Personnel



## Personnel of the JSC *Latvijas Gāze*

Take my factories, but leave my people, and I will build the factories again – this phrase was once said by Henry Ford, and he was certainly right. The performance of any company directly depends on the employees, their skills, ability and responsibility. Although the organizational structure of the JSC *Latvijas Gāze* did not change in 2008, there were regular changes made in the staff list due to the production needs – changes in the amount of work, setting new priorities and the necessity to improve the work organization.

In order to improve the ability of the employees of the JSC *Latvijas Gāze* to communicate with foreign partners, the English language courses were organized at the Company in the second half of the year 2008. More than 40 executives and specialists of the JSC *Latvijas Gāze* in four groups learned English. The courses of English are continued in 2009.

### The structure of employees

1398 – number of employees at the JSC *Latvijas Gāze* at the end of the reporting period.

157 – number of employees engaged over the period from January 1 thru December 31, 2008.

115 – number of employees having resigned from the JSC *Latvijas Gāze* over the period from January 1 thru December 31, 2008.

The overall ratio of staff turnover has indicated a negative tendency over the recent years – with each year it has grown. In 2008, the complicated economic situation also influenced the labour market, therefore the turnover of employees at the Company considerably decreased, which is a positive trend. The ratio of personnel stability in 2008 indicated a stable working environment. On the negative side, the turnover of new employees still exceeded the 10% norm ratio.

Every year the JSC *Latvijas Gāze* takes part in the salary research by the LLC *Fontes* in order to obtain information on the level of salaries in Latvia and the salary competitiveness at the JSC *Latvijas Gāze*.

The administration and shareholders of the Company have paid much attention to the development of the personnel. The education and professional development of employees was ensured by promoting the obtention of academic education, as well as via various programmes, the acquaintance of international experience, participation in various conferences, courses and seminars. For the obtention of academic education at Latvian higher education establishments, with gas technology studies as the priority, the JSC *Latvijas Gāze* has granted financial support to cover the study fee for the academic year of 2008/2009. In 2008, two scholarship holders studied at the *Oil and Gas Russian State University* named after I. M. Gubkin; three other employees of the Company continued postgraduate studies at the same university. Currently, the JSC *Latvijas Gāze* employs 11 graduates of the aforementioned university, 9 of them being scholarship holders.

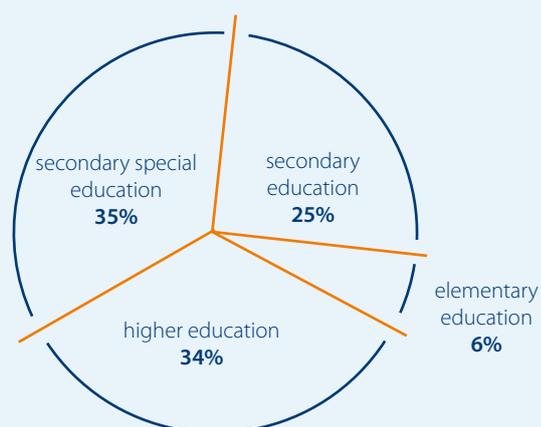
Meanwhile, 2693 persons were trained at the various programmes of the Training Centre of the JSC *Latvijas Gāze*. 943 of them were employees of the Company, and 1696 – employees of other organizations. The tendency observed over the last 7 to 8 years – the decrease in the number



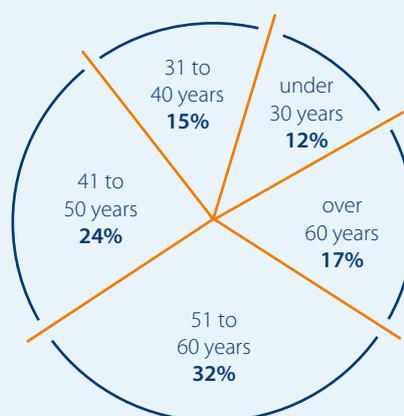
of participants – stems from the fact that steam houses are now equipped with the automatic control, therefore it is not necessary to instruct operators anymore.

It has to be admitted that half of the employees of the JSC *Latvijas Gāze* are older than 50 years of age, which suggests of the aging of personnel. This tendency also stems from the overall aging of the population of Latvia and the outflow of new people for other countries of the European Union. At the end of 2008, there were 198 employees of pension age at the JSC *Latvijas Gāze* (in 2007 – 172), i. e., 14.2% of the total staff (in 2007 – 12.7%). In order to stimulate the alternation of generations, the JSC *Latvijas Gāze*, in compliance with the Collective Agreement, pays to retiring employees a single remuneration in the amount of one to four average salaries depending of the length of service in the gas industry.

### The structure of employees' education



### The age structure of employees



# International Co-operation

The JSC *Latvijas Gāze* not only expands its activity in the local market, but also promotes its brand abroad. In 2008, the Company both took part in international events and involved foreign companies in its own projects. Representatives of the JSC *Latvijas Gāze* participated in the business forum of the Baltic Sea countries, in an international seminar on the management and technical issues of the natural gas system, optimized its membership in international organizations and took the floor in several significant conferences, etc.

## Council of the Baltic Sea States

At the beginning of June, the business forum of the Baltic Sea countries took place in Riga together with the meeting of the Council of the Baltic Sea States. Executives of the JSC *Latvijas Gāze* were among the participants of the forum. It should be noted that this is the main forum of the region and it featured seven Prime Ministers, the Energy Commissioner of the European Union Andris Piebalgs, the Deputy Chairman of the OJSC *Gazprom* V. Golubev and others.

The first day of the forum was dedicated to energy issues. The key topics discussed were secure energy supply and the creation of new connections, the development of energy prices and the possibilities of replacing the fossil fuel with alternative energy resources.

## Co-operation in performance of works

In 2008, the closest co-operation was still with the specialists of the shareholders of the JSC *Latvijas Gāze* – OJSC *Gazprom* and *E.ON Ruhrgas*. The main areas of co-operation with OJSC *Gazprom* and its subordinate units were the further modernization of the Inčukalna UGS, the improvement and extension of operation security, the creation of a gas dynamic three-dimensional model at the Inčukalna UGS, the pigging of gas pipelines etc.

## Training

- Within the framework of a co-operation agreement, employees of the JSC *Latvijas Gāze* met and visited the German colleagues, mostly from *E.ON Ruhrgas AG* and other structural units of *E.ON*, dealing with issues related to the operation of emergency services, natural gas filling stations, natural gas marketing, sales, the operation of the billing and contact centre, problems of metering at the gas accounting stations, the construction of pipelines with trenchless methods, the pressure regulator, the maintenance and repair of safety valves etc.
- 22 employees of the unit *Gas Transport* of the JSC *Latvijas Gāze* visited Germany for exchange of experience. During the trip they became acquainted with the company *E.ON Hanse*, heard lectures on the structure of the

German gas industry and gas pipeline system, the structure and duties of the Technical Department of *E.ON Hanse*, the operation of the gas emergency service, the creation of gas connections and the technique of connection drilling etc. They also saw the gas metering and regulation station and became acquainted with the latest technical equipment used by *E.ON Hanse* in gas pipeline construction and repairing.

## Participation in international organizations

In 2008, the JSC *Latvijas Gāze* continued to optimize its membership in international organizations and participated in activities of the International Gas Union, DVGW (Deutsche Vereinigung des Gas- und Wasserfaches), the World Energy Congress, Baltic Gas and the Inter-Republic Association for Applied and Scientific-Technical Gas Co-operation.

The executives and specialists of the JSC *Latvijas Gāze* also reported at several conferences, informing the participants on the key activities and projects of the Company and other important issues, as well as visited numerous foreign gas companies.

## Seminar in Bīriņi

In order to raise the qualification of the employees of the JSC *Latvijas Gāze* and ensure the possibility to work with the latest technologies, in September 2008, more than 40 representatives of the Company participated in a seminar on managerial and technical issues of the natural gas system, held in Bīriņi and organized by the international company *E.ON Ruhrgas International AG*. Eight high-qualified specialists from Germany educated the employees. The participants of the seminar heard reports on the legislative documents of DVGW, the ensuring of quality, the reduction of construction expenses and project management in Hungary, gas pipeline insulation materials, the regulation of energy companies in Germany, as well as learned more about the German gas supply system and the modern technologies of energy saving. During the training, the participants received answers to many questions that had been unclear so far.



**Baltic gas supply system**

-  Operating transmission pipelines
-  Currently under construction and prospective transmission pipelines
-  Interstate gas measurement stations
-  Operating underground gas storages
-  Prospective underground gas storages

# To the Society

Despite the considerable changes in the economic life of the world, Latvia and the Company JSC *Latvijas Gāze* has still found a possibility to financially support various charity projects, thus enabling events that would not take place without additional financial investments. Of course, to take care for the emergence of new ideas in the energy supply area, the priority of the Company has always been the development of education and science. At the same time, notable support in 2008 was rendered to a variety of culture, sports, history, environment protection and charity events in order to continue purposefully the socially responsible policy developed over several years.

## Culture

The JSC *Latvijas Gāze* is honoured to be one of the main supporters of events important for the country's cultural life for a long time already, and the same was true for 2008 as well. The contribution to the concert *My Song for Latvia*, dedicated to the 90th anniversary of the Republic of Latvia and organized by the Latvian Radio, the Latvian Television and the Latvian National Theatre should be mentioned as the most significant and symbolic one. The concert featured the best popular and classical music performers of Latvia. Apart from that, as a tradition, the JSC *Latvijas Gāze* supported the Latvian National Opera, as well as contributed to classical music



events, including the IX International Festival of Bach's Chamber Music, the 9th Annual Winter Music Festival *Winterfest* and the pupils' festive concert *You Are Latvia* in the Latvian National Opera. Also noteworthy is the support for the preservation of national cultural heritage in opera and ballet, the strengthening and development of Latvian national opera, operetta, ballet and music culture in Latvia and abroad, as well as for ensuring the accessibility of the global achievements in opera, ballet and music culture.

However, music has not been the only area of culture covered by the support of the JSC *Latvijas Gāze*. The Company also sponsored the Latvian championships of Latin American dances, the summer festival of the Daile Theatre, the creation of the documentary *Brāji Kokari* and the month of German culture *Olvācija*, etc.

## Sports

Healthy body has healthy spirit – that refers to the attitude of the JSC *Latvijas Gāze* towards the kinds of sport that develop in Latvia and the athletes who strive to succeed. Athletes of bobsleigh, volleyball, basketball, ice hockey, tennis, motor sports, as well as weightlifters and power athletes could all rely on the support of the JSC *Latvijas Gāze*. Traditionally, the Company was one of the main sponsors of the Latvian Olympic Committee, thus en-



sureing the participation of our athletes in international competitions, among which one should certainly emphasize the summer Olympic Games in Beijing last year. Understanding the necessity to promote the sportive achievements of Latvia in a long term, the JSC *Latvijas Gāze* supported not only the well-known athletes who promote Latvia worldwide, but also young talents who work on their development and future success. For such purposes, support was rendered to the ice-hockey club *Pērkons* for training and to the boy's and girls' basketball teams of the Riga Secondary School No. 49 for participation in the world basketball championship of schools in Turkey, etc.

### Environmental protection

The JSC *Latvijas Gāze* also felt responsible to take care for environmental protection projects. Every year large amounts of money were invested in the security of gas pipelines and activities in this area were supported. Last year the JSC *Latvijas Gāze* sponsored the foundation of the nature park of Lake Engure in order to facilitate environmental education, tourism infrastructure development and the preservation of the culture-historical heritage in the nature park of Lake Engure. The foundation *Daugava Union* also received support in order to create recreational areas on the banks of the River Daugava.

### Education and science

Understanding the necessity to support efforts that are directed towards the development of the Latvian economy in future at the time when the Government has failed to allocate funds for science and its development, the JSC *Latvijas Gāze* supported the projects that might contribute to the Latvian economics, especially the events of education and science that took place in the field of natural sciences, mainly physics and chemistry.

Long and successful is the Company's cooperation with the Riga Technical University. In order to facilitate the elaboration and development of prospective projects, the University's Development Fund was supported. Scholarships were granted to students of gas technology, as well as both aspiring and already well-known Latvian scientists. In this context it should be mentioned that already since 2003 there is a tradition to present the life contribution awards of the target programme "For Education, Science and Culture" of JSC *Latvijas Gāze*, the Latvian Academy of Sciences and the Latvian Education Fund. It is a prize for promising performance in the gas, heat engineering and chemistry technology, as well as cardiology. Indeed, the JSC *Latvijas Gāze* has contributed notably for Latvia to have its own high-ranked specialists in the future – gas technologists, engineers, doctors, etc.

### Charity

The JSC *Latvijas Gāze* still dedicates annually a certain amount of funding to various charity or social projects. Again, attention is paid to prospective events in the area of education. For instance, within the framework of the foundation *Ziedot*, indigent children were sponsored school supplies enrolling in the 1st form. However, it was not the only way in which the JSC *Latvijas Gāze* helped children for their future. A certain amount of money was shifted for the implementation of the goals set forth in the Statute of the Independent children ombud of the organization *Save the Children* and the preparation of a report to the UN regarding the condition of children in the country. The association *For the Disabled Children in Latvia*, on its part, was granted funds for implementing the Project *Summer Rehabilitation and Recreation Seminar 2009*.

Within the framework of various social projects the JSC *Latvijas Gāze* supports events related to art and religious processes. The most important to mention are completion of the reconstruction of the heating unit for the Orthodox Church of the Saint True-hearted Sergio of Valmiera, as well as creation of the bronze sculpture *The Children and Our Future* by Māris Abiļevs.

# Environmental Policy

Both for the JSC *Latvijas Gāze* and the country, the year 2008 was remarkable with uncertainty as concerns the greenhouse gas (GG) emission allowances granted by the European Union. For the period of 2008 to 2012, there is still about 20% of the total amount of GG emission allowances necessary for the needs of national economy missing. Companies involved in the GG emission allowance trading scheme have to purchase these allowances in the international market, thus reducing their competitiveness both in the internal and external market.

Due to the lack of GG allowances the following issues became topical at the beginning of 2008:

- on the validity of the amount of GG allowances requested to the Ministry of Environment of the Republic of Latvia for the companies' production needs;
- on the country's development priorities at the level of industries.

## Search for solutions

In the process of seeking a solution, the importance of the environmental policy increased and so did the amount of work to be done in the area of external communication, which in 2008 showed in various ways.

- An independent energy audit of the Inčukalns Underground Gas Storage Facility (Inčukalns UGS) has been carried out.

Such a step was taken in order to obtain the expert opinion to prove to the Department of Climate and Renewable Energy Resources of the Ministry of Environment of the Republic of Latvia the validity of the amount of GG emission allowances requested for production needs in 2008-2012 at the operation unit of the JSC *Latvijas Gāze* Inčukalns UGS.

- Detailed information regarding equipment in use and the main indicators of its operation (for the period from 2000) has been prepared and submitted to the Ministry of Environment of the Republic of Latvia.

- Additional information regarding the necessity of receiving greenhouse gas emission allowances for 2008-2012 has been prepared and provided to the Ministry of Environment of the Republic of Latvia. This information includes data on the internal distribution of the spent GG emission allowances among the pieces of equipment in operation by the JSC *Latvijas Gāze* in 2007.

- The second stage of verification of the GG emitted by the Inčukalns UGS was carried out in co-operation with the independent certification institution LLC *BUREAU VERITAS LATVIA*. The result confirmed that the JSC *Latvijas Gāze* operates in compliance with the international requirements that are binding to all companies involved in the GG emission allowance trading scheme.

- Information has been prepared for the Ministry of Environment explaining in detail the amount of GG emission allowances needed for industrial needs of the Inčukalns UGS for the period from 2008 thru 2012, with an emphasis to issues related to the new piece of technological equipment – turbine motor compressor SOLAR MARSS 100S – involved in the production process in 2008.

## Results

With the resolution No.3 of the Ministry of Environment issued at the end of 2008 the JSC *Latvijas Gāze* was awarded 239 735 GG emission allowances for the natural gas flaring equipment of the Inčukalns UGS for the period from 2008 thru 2012.

## External communications

In order to ensure a positive solution to the problems related to the GG allowances, a variety of additional measures in the area of external communications have been taken.

- Action plans for the reduction of natural gas losses and the ensuring of environmental protection for 2009 in the sections of natural gas transmission, storage and distribution have been prepared.

- In co-operation with the LLC *Zaļā Josta*, the management of packaging materials has been continued.

- Close co-operation with the Ministry of Environment and the Office of the UN Development Programme in Latvia in the management of equipment containing polychlorinated biphenyl (PHB) has been maintained and implemented. As a result of successful collaboration over several years, by attracting the funds of the European Union, in 2008 the JSC *Latvijas Gāze* collected all the PHB-containing equipment and utilized it in an environment-friendly way.

- An application of the JSC *Latvijas Gāze* for opening a personal account in the International Register of GG emission units has been prepared and submitted to the Latvian Environment, Geology and Meteorology Agency.

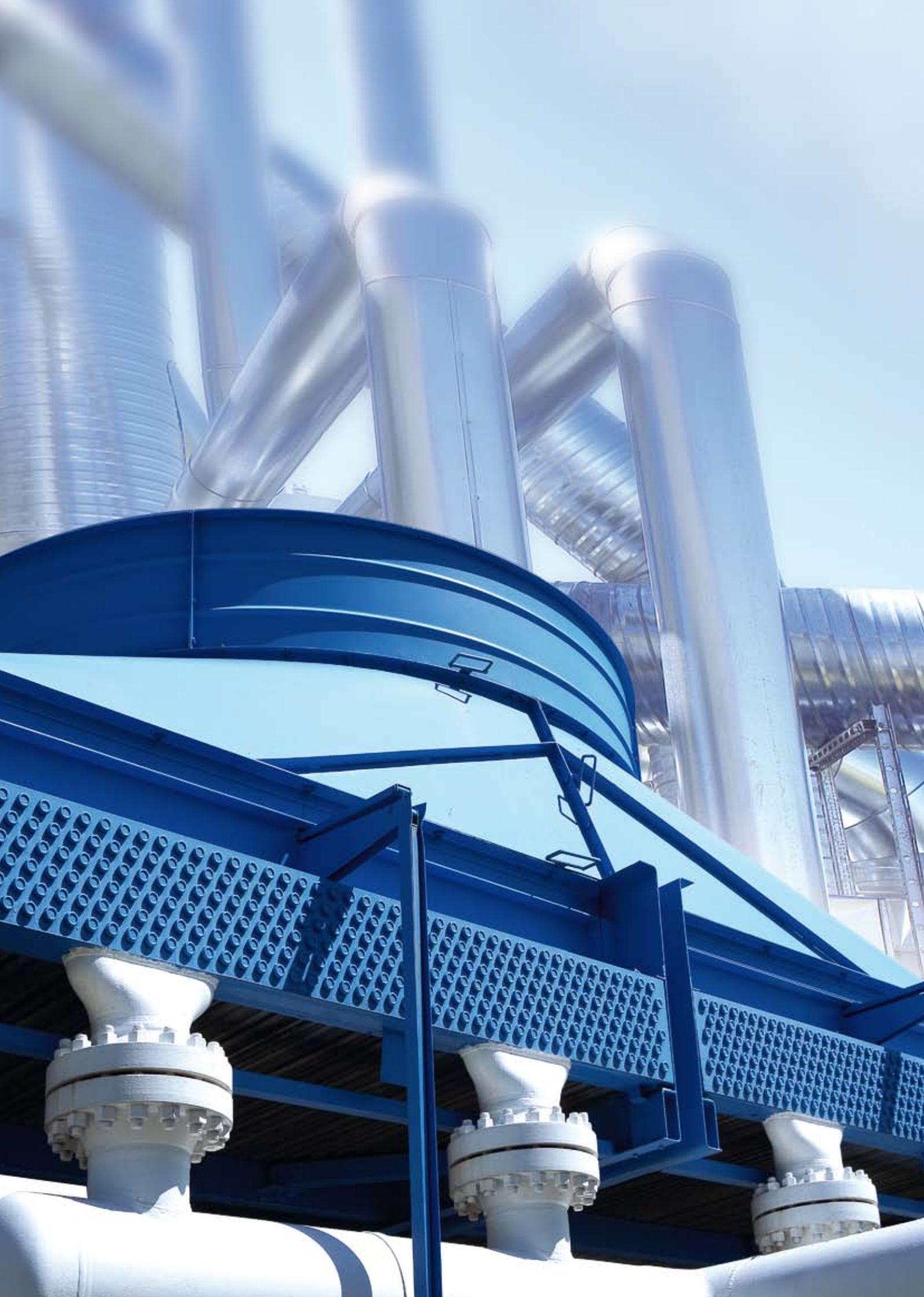
## Internal communications

Several measures of internal communications were also taken in 2008.

- Regular monitoring of the amount of emissions of natural gas and natural gas combustion products in the environment from the overall natural gas supply system was carried out.

- Applications for executing pollutionary activities were worked out and the required certificates were received (mostly in relation to the reconstruction of the gas regulation stations of the natural gas transmission system).

- In relation to the reconstruction of the Inčukalns UGS, the conditions of certification of pollutionary activity of B-category were amended.



# The Company's summarised annual accounts

## Board report

### 1. The operation of the Company in the reporting year

The Joint Stock Company *Latvijas Gāze* (hereinafter – the Company) is an energy supply company that is active in natural gas transmission, storage, distribution and sale. In 1997, the Energy Supply Regulation Council of the Republic of Latvia issued to the Company exclusive licences for the provision of regulated public services by February 10, 2017, and on January 31, 2007, the Council of the Public Utility Commission (hereinafter – the PUC) – a licence for natural gas sales by February 10, 2012. According to the Energy Law, the Company is a natural gas system operator that, avoiding overload capacities, ensures continuous and secure natural gas supply to consumers in Latvia.

During the reporting year, 1 631 million m<sup>3</sup> of natural gas were supplied to natural gas users. In comparison to 2007, natural gas sales in m<sup>3</sup> have decreased by 2.5%. The decrease of consumption stems from the relatively high air temperature in the 1st and 4th quarter of 2008 and the record-high quotation of oil products at exchanges, as a result of which the natural gas sales end tariffs considerably increased, making for more economical use of resources and a decrease of demand, which was further reinforced by the global financial crisis and the rapid economic recession in the second half of 2008.

The situation of recent years in the global market of oil products as well as the desire of the natural gas suppliers to gradually approximate the natural gas supply prices for the Republic of Latvia to the level of the European

countries caused a rapid rise of the natural gas prices. As from January 1, 2005, the formula of the natural gas purchase prices was linked to the actual heavy fuel oil quotation – up to 200 USD/t. In 2006, the ceiling of natural gas prices was lifted, while in 2007 the price formula was changed resulting in the natural gas purchase price being raised by more than 50% at the heavy fuel oil quotation of 300 USD/t. The last stage of the price increase was implemented in 2008 when the natural gas price was pegged to the heavy fuel oil and gasoil quotation and the natural gas purchase prices reached the level of European countries. During the year 2008, the natural gas purchase price grew more than twice compared to 2007. The changes in the price formula increased the natural gas purchase price in 2008 by approximately 16%, while the rest of the increase was related to the rise of the oil prices. Further on, the changes in the natural gas purchase price will depend on the fluctuations of the oil product prices at the exchange and the supply flow of the consumed gas (directly through pipelines or from the Inčukalna UGS).

The average natural gas sales tariff rose by 52.1% during the year 2008, while the purchase costs of natural gas sold – by 82.9%. At the beginning of 2008, the users were supplied the gas that had been bought in 2007 for the needs of 2008 for the price of 2007. The increase of natural gas sales end tariffs in 2008 was contributed to by the levelling of natural gas purchase prices with the EU countries and the record-high prices of oil products in the summer and autumn of 2008. By October 1, 2008, natural gas was sold to consumers for the natural gas sales end tariffs approved with the resolution No.83 of the

PUC Council dated March 28, 2007 "On the natural gas supply tariffs of the Joint Stock Company *Latvijas Gāze*" in compliance with the conditions of the resolution No. 555 of the PUC Council dated November 23, 2007 "On the discriminative natural gas sales tariff and actual heavy fuel oil quotation".

On the basis of the changes in gas purchase prices, in April 2008 the Company submitted to the PUC a tariff project, which envisaged a rise of the tariffs of natural gas transmission, storage, distribution and sales, as well as the differential natural gas sales end tariffs as from July 1, 2008. The tariffs had been calculated in compliance with the methods of public utility tariff calculations approved by the PUC Council in February 2008. When evaluating the submitted project, the PUC took into account the Company's profit of 2007 and postponed the enactment of the new tariffs by two months. On July 24, 2008, the PUC passed a resolution on increasing the natural gas tariffs. In compliance with the resolution No.247 of the PUC Council "On the natural gas supply tariffs of the Joint Stock Company *Latvijas Gāze*, as from October 1, 2008 the new differential natural gas sales end tariffs took effect. These tariffs consist of two parts: the fixed regulated service tariffs and the natural gas sales price, which changes with a step of 5 LVL/thousand m<sup>3</sup> depending on the actual natural gas purchase costs. For users with the annual natural gas consumption over 25 thousand m<sup>3</sup>, the tariffs are changed monthly, while for users with the annual natural gas consumption up to 25 thousand m<sup>3</sup> who settle accounts by the levelled consumption - once in six months.

The total income from natural gas sales and other services of basic activities in 2008 reached 351 million LVL (499.4 million EUR), the expenses (excluding administrative costs) – 320 million LVL (455.4 million EUR), and the gross profit – 31 million LVL (44.1 million EUR). In comparison to the year 2007, the Company's net profit fell by 39.3% or 12.9 million LVL (18.3 million EUR), amounting to 19.9 million LVL (28.4 million EUR). The net profitability of basic activities in 2008 was 5.7%, whereas in 2007 it was 13.7%.

During the season of 2008, 1.92 billion m<sup>3</sup> of natural gas were injected into the Inčukalns UGS, with the total gas volume at the storage facility reaching 4.47 billion m<sup>3</sup>.

In 2008, the Company invested 22.8 million LVL (32.4 million EUR) in the modernization of the gas supply system and the creation of new fixed assets. 40% of the total investment was spent for the modernization on

the gas transmission pipeline system, 10% – on the improvement of operation safety and the modernization of equipment at the Inčukalns UGS, while 36% – on the expansion of the distribution networks and the renewal of fixed assets. 2.9 thousand new users were connected to the gas supply system. The total number of gas-enabled units at the end of the year reached 441.6 thousand.

During the reporting period, the modernization of the gas collection point GCP-1 at the Inčukalns UGS was completed. The total costs of the unit are 11.4 million LVL (16.2 million EUR). The reconstruction of the underground wells in the gas-carrying area is still in progress. The equipment of the underground part of the wells is due to be installed by the Company itself in 2009. In cooperation with the LLC *Gazpromenergodagnostika*, examination of the technical condition has been carried out in 23 wells. The reconstruction of the gas drying unit at the CS-1 has been commenced, with the total costs of the project planned around 9.5 million LVL (13.5 million EUR), and is due for completion by the end of 2011. The reconstruction of the gas regulation stations (GRS) – *Koknese* and *Vecbebrei* and the assembly of technological equipment at the GRS *Ziemeļi* is completed. The aversion of the damage found in the diagnostics of the gas transmission pipelines, as well as the construction of a pig launcher and a pig receiver for the gas pipelines Riga – Inčukalns UGS, Iecava – Liepāja and Riga – Panevėžis is still in progress. 5.1 million LVL (EUR 7.3 million) have been spent for the construction of gas distribution pipelines in 2008. The major projects were the construction of a gas pipeline over the Daugava below the Dienvidu Bridge in Riga and along the Riga bypass road. During the year 2008, 148.3 km of gas distribution pipelines have been put into operation, and the SCADA system, which controls the operation of the gas regulation points (GRP), has been connected to 28 GRPs (in 2007 – 45 GRPs). The introduction of an automated commercial accounting telemetric system (ARM) has been commenced. The new system will allow for improving and modernizing the natural gas accounting control system.

## 2. Research and development activities

In order to ensure uninterrupted gas supply to users and secure operation of the gas supply system in a long term, the Company has developed the "Plan of measures for the improvement of operation security of the gas supply system of the Joint Stock Company *Lat-*

*vijas Gāze* 2006-2010". It has been prepared on the basis of the opinions by the Russian companies *Gazobezopasnostj* and *Lentransgaz*, the institutes *VNIIGAS* and *Giprospecgaz*, as well as the German companies *Pipeline Engineering GmbH*, *Untergrundspeicher und Geotechnologie – Systeme GmbH*, *E.ON Engineering GmbH*, *E.ON Ruhrgas International AG* and other partners regarding the technical condition and modernization possibilities of equipment.

The plan envisages investments in security improvement at the total amount of LVL 73.8 million (EUR 105 million). This basically includes projects to be implemented in order to improve the security of system operation, to provide gas supply to new units and to improve the stability of gas supply in the whole region, covering the seasonal consumption fluctuations with gas supplies from the Inčukalns UGS to Estonia and the Western part of Russia, as well as in further perspective – to Lithuania.

In 2008, the Company commissioned the OJSC *Giprospecgaz* with an evaluation and feasibility study of development of the gas transmission pipelines system of Latvia. Independent experts evaluated the possibility of transmitting 2.6 billion m<sup>3</sup> of gas along the existing pipelines to prospective consumers till 2020 in the directions of Mažeikiai and Daugavpils, as well as assessed the looping of the gas transmission pipelines Izborsk – Inčukalns UGS and Riga – Daugavpils with the new gas pipeline Alūksne – Gulbene – Rēzekne.

## 3. Financial risk management

The operation of the Company is subject to various financial risks, including credit risks, foreign currency risk and interest rate fluctuation risks. The administration of the Company tries to minimize the negative impact of potential financial risks on the financial standing of the Company.

The Company is not directly subject to the risk of fluctuation of foreign currency rates as the gas purchase price is set in USD and afterwards recalculated in EUR, whereas the gas sales tariffs are set in LVL. Settlements for the supplied gas are made in EUR. As since January 1, 2005 the lat rate is pegged to the euro rate, the fluctuations of the LVL/EUR rate are limited and are not expected to have a significant influence on further financial results. The changes in gas purchase prices in USD depending on the quotation of oil products are covered by the PUC-approved natural gas sales tariffs, which to a certain extent cover

the fluctuations of both the LVL/EUR and the EUR/USD rate. The risk of fluctuations of foreign currency rates related to debts to suppliers is under control by keeping a significant share of financial resources in deposits of the respective currency.

The borrowings of the Company have a variable interest rate.

The financial resources exposed to credit risk are mostly funds as well as customer debts. The Company is subject to considerable concentration of credit risk as a large share of the net turnover concerns a limited number of customers. Four of the Company's customers comprise up to 48.6% (in 2007 – 47%) of sales, one of these receivables was 17.2% (in 2007 – 20.7%) as of December 31, 2008, the second and the third largest receivables were 7.2% and 6.3% respectively (in 2007 – 8.7% and 6.8%) of the total amount of receivables. The Company has introduced and observes a credit policy that envisages selling goods on credit only to customers with a good credit history, controlling the amount of credit set for each customer.

Customers' debts are shown at their recoverable value. The Company's partners in money transactions are local financial institutions with appropriate credit history.

The Company implements cautious liquidity risk management, ensuring the availability of appropriate credit resources in order to settle liabilities when they fall due.

#### 4. Post balance sheet events

The most significant event after the end of the reporting year was the signing of the amendments to the natural gas supply agree-

ments with the OJSC *Gazprom* and LLC *ITERA Latvija* on natural gas supply to the Republic of Latvia till 2030. The former edition of the agreements stipulated the volumes of gas supply by 2015.

In order to protect the interests of consumers and set fixed differential end tariffs of natural gas in the heating season of 2008/2009, the PUC Council on January 28, 2009 passed the resolution No. 24 "On the procedure of application of the resolution No.247". According to this resolution, the Company had to apply to users with the annual natural gas consumption over 25 thousand m3 the natural gas sales price of 210 LVL/thousand m3 in February, March and April 2009 and include the deviation of total costs occurring due to differences between the applied and actual natural gas sales prices of each month in the calculation of the natural gas sales price.

#### 5. Profit distribution as suggested by the Board

Profit of the reporting year	LVL 19 928 226	EUR 28 355 311
Share of profit not available for distribution (income of deferred tax not realized due to the revaluation of fixed assets)	LVL (1 770 008)	EUR (2 518 494)
Share of profit available for distribution	LVL 18 158 218	EUR 25 836 817
Suggested profit distribution:		
• dividends to participants (76.1%)	LVL 15 162 000	EUR 21 573 582
• dividends per one share (LVL / 1 share)	LVL 0,38	EUR 0,541

Reserves stipulated in the Articles of Association

LVL 2 996 218    EUR 4 263 235

Some members of the Council and the Board of the Company own shares and interests at several companies registered in the Register of Enterprises of the Republic of Latvia and perform managerial functions. During the reporting year, the Company has not carried out large-scale transactions (except for those mentioned in the financial accounts) with these companies.

Information on the Company's shares owned by the members of the Board and the Council is available at the Board of the Company.

#### 6. Perspective

On the basis of the investments made over the recent years in the improvement of the system operation security, the expansion of the gas pipeline network and the attraction of new customers as well as having regard of the situation in the fuel market of Latvia, the Board of the Company considers that in 2009 the Company will continue its successful development and take a stable place in the fuel supply market.



Chairman of the Board

A. Dāvis

Board meeting minutes No. 17 (2009)  
Riga, April 29, 2009

## Profit and loss account for the year ended December 31, 2008

	2008 LVL	2007 LVL	2008 EUR	2007 EUR
1 Net sales	351 004 620	239 440 515	499 434 579	340 693 159
2 Cost of sales	(320 027 733)	(195 532 509)	(455 358 440)	(278 217 695)
<b>3 Gross profit</b>	<b>30 976 887</b>	<b>43 908 006</b>	<b>44 076 139</b>	<b>62 475 464</b>
5 Administrative expenses	(7 517 856)	(7 238 653)	(10 696 945)	(10 299 675)
6 Other operating income	2 339 440	2 326 442	3 328 723	3 310 229
7 Other operating expenses	(1 525 871)	(1 874 195)	(2 171 119)	(2 666 739)
10 Interest and similar income	1 861 260	1 138 801	2 648 334	1 620 368
11 Revaluation of long term financial investments and short term securities	261	384	371	546
12 Interest and similar expenses	(435 982)	(558 067)	(620 347)	(794 058)
13 Provisions for bad and doubtful debtors, net	(2 106 835)	172 415	(2 997 756)	245 324
14 Provisions for obsolete and slow moving inventories, net	(93 025)	6 042	(132 362)	8 597
<b>16 Profit before taxes</b>	<b>23 498 279</b>	<b>37 881 175</b>	<b>33 435 038</b>	<b>53 900 056</b>
17 Corporate income tax for the reporting year	(4 177 756)	(5 973 221)	(5 944 411)	(8 499 128)
18 Deferred income tax	757 706	1 067 765	1 078 119	1 519 293
19 Other taxes	(150 003)	(156 733)	(213 435)	(223 011)
<b>20 Current year's profit</b>	<b>19 928 226</b>	<b>32 818 986</b>	<b>28 355 311</b>	<b>46 697 210</b>
Unrealised deferred tax gain related to fixed assets revaluation	(1 770 008)	(1 741 185)	(2 518 494)	(2 477 483)
<b>Profit available for distribution</b>	<b>18 158 218</b>	<b>31 077 801</b>	<b>25 836 817</b>	<b>44 219 727</b>

## Balance sheet as at December 31, 2008

	31.12.2008. LVL	31.12.2007. LVL	31.12.2008. EUR	31.12.2007. EUR
<b>ASSETS</b>				
<b>Long-term investments</b>				
<b>I. Intangible assets:</b>				
1. Research and development	32 452	78 337	46 174	111 462
2. Concessions, patents, licences, trademarks and similar rights	2 188 698	1 620 892	3 114 238	2 306 323
5. Advance payments for intangible assets	81 569	203 595	116 062	289 689
<b>Total intangible assets:</b>	<b>2 302 719</b>	<b>1 902 824</b>	<b>3 276 474</b>	<b>2 707 474</b>
<b>II. Fixed assets:</b>				
1. Land, buildings, constructions and gas transmission system	264 981 500	255 258 865	377 034 707	363 200 644
3. Equipment and machinery	44 408 779	36 413 047	63 188 002	51 811 101
4. Other fixed assets	4 658 746	4 390 522	6 628 796	6 247 149
5. Advances for fixed assets and fixed assets under construction	5 970 558	21 621 346	8 495 339	30 764 404
<b>Total fixed assets:</b>	<b>320 019 583</b>	<b>317 683 780</b>	<b>455 346 844</b>	<b>452 023 298</b>
<b>V. Long-term financial investments:</b>				
3. Investment in associated companies	80	80	114	114
5. Other securities and investments	5 937	5 676	8 447	8 077
9. Trade debtors	5 090	4 433	7 242	6 308
<b>Total long-term financial investments:</b>	<b>11 107</b>	<b>10 189</b>	<b>15 803</b>	<b>14 499</b>
<b>Total long-term investments:</b>	<b>322 333 409</b>	<b>319 596 793</b>	<b>458 639 121</b>	<b>454 745 271</b>
<b>Current assets</b>				
<b>I. Inventories:</b>				
1. Raw materials and consumables	115 680 757	85 359 145	164 598 887	121 455 121
5. Advances for goods receivable	2 476	209 239	3 523	297 720
<b>Total inventories:</b>	<b>115 683 233</b>	<b>85 568 384</b>	<b>164 602 410</b>	<b>121 752 841</b>
<b>III. Debtors:</b>				
1. Trade debtors	39 298 457	24 620 661	55 916 667	35 032 044
3. Receivables from affiliated companies	243 826	155 261	346 933	220 917
4. Other debtors	4 445 007	920 220	6 324 677	1 309 354
7. Deferred expenses	382 433	456 930	544 154	650 152
<b>Total debtors:</b>	<b>44 369 723</b>	<b>26 153 072</b>	<b>63 132 431</b>	<b>37 212 467</b>
<b>IV. Short-term financial investments:</b>				
5. Other securities and investments	15 281	17 809	21 743	25 340
<b>Total short-term financial investments:</b>	<b>15 281</b>	<b>17 809</b>	<b>21 743</b>	<b>25 340</b>
<b>V. Cash and bank:</b>	<b>6 446 083</b>	<b>44 304 704</b>	<b>9 171 950</b>	<b>63 039 914</b>
<b>Total current assets:</b>	<b>166 514 320</b>	<b>156 043 969</b>	<b>236 928 534</b>	<b>222 030 562</b>
<b>Total assets</b>	<b>488 847 729</b>	<b>475 640 762</b>	<b>695 567 655</b>	<b>676 775 833</b>

## Balance sheet as at December 31, 2008

	31.12.2008. LVL	31.12.2007. LVL	31.12.2008. EUR	31.12.2007. EUR
<b>LIABILITIES</b>				
<b>Shareholders' funds:</b>				
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	186 917 922	187 441 623	265 960 242	266 705 402
5. Reserves				
c) statutory reserve	58 710 159	47 582 358	83 537 030	67 703 596
6. Retained earnings				
a) previous years' retained earnings	5 178 481	3 437 296	7 368 314	4 890 831
b) current year's retained profit	19 928 226	32 818 986	28 355 311	46 697 210
<b>Total shareholders' funds:</b>	<b>324 954 998</b>	<b>325 500 473</b>	<b>462 369 305</b>	<b>463 145 447</b>
<b>Creditors:</b>				
<b>Long-term creditors:</b>				
12. Deferred income	13 459 780	11 429 762	19 151 542	16 263 086
15. Accruals for post employment benefits and other employee benefits	4 672 646	2 500 000	6 648 577	3 557 180
15. Deferred tax liability	29 915 358	30 538 257	42 565 719	43 452 024
<b>Total long-term creditors:</b>	<b>48 047 784</b>	<b>44 468 019</b>	<b>68 365 838</b>	<b>63 272 290</b>
<b>Short-term creditors:</b>				
3. Borrowings from credit institutions	1 787 886	20 029 914	2 543 933	28 500 000
5. Advances received	5 376 924	5 475 474	7 650 674	7 790 898
6. Trade creditors	78 315 274	62 848 711	111 432 596	89 425 660
8. Accounts payable to related companies	7 744 443	53 251	11 019 350	75 769
10. Taxes and state compulsory social insurance contributions	8 572 974	7 589 341	12 198 242	10 798 659
11. Other creditors	4 348 923	3 449 052	6 187 959	4 907 559
12. Deferred income	3 673 803	432 942	5 227 351	616 021
15. Accrued liabilities	6 024 720	5 793 585	8 572 407	8 243 530
<b>Total short-term creditors:</b>	<b>115 844 947</b>	<b>105 672 270</b>	<b>164 832 512</b>	<b>150 358 096</b>
<b>Total creditors:</b>	<b>163 892 731</b>	<b>150 140 289</b>	<b>233 198 350</b>	<b>213 630 386</b>
<b>Total liabilities and shareholders' funds:</b>	<b>488 847 729</b>	<b>475 640 762</b>	<b>695 567 655</b>	<b>676 775 833</b>

## Statement of changes in equity for the year ended December 31, 2008

	Share capital LVL	Share premium LVL	Long-term investments revaluation reserve LVL	Statutory reserve LVL	Retained earnings LVL	Total LVL
<b>Balance as at 31.12.2006.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>119 122 188</b>	<b>39 720 559</b>	<b>23 269 095</b>	<b>236 332 052</b>
Dividends	-	-	-	-	(11 970 000)	(11 970 000)
Transferred to reserves	-	-	-	7 861 799	(7 861 799)	-
Revaluation of fixed assets	-	-	81 019 796	-	-	81 019 796
Deferred tax liability arising on the revaluation of fixed assets	-	-	(12 152 969)	-	-	(12 152 969)
Disposal of revalued fixed assets	-	-	(643 990)	-	-	(643 990)
Deferred tax on disposal of revalued fixed assets	-	-	96 598	-	-	96 598
Profit for the year	-	-	-	-	32 818 986	32 818 986
<b>Balance as at 31.12.2007.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>187 441 623</b>	<b>47 582 358</b>	<b>36 256 282</b>	<b>325 500 473</b>
Dividends	-	-	-	-	(19 950 000)	(19 950 000)
Transferred to reserves	-	-	-	11 127 801	(11 127 801)	-
Revaluation of fixed assets	-	-	1 501 617	-	-	1 501 617
Deferred tax liability arising on the revaluation of fixed assets	-	-	(225 243)	-	-	(225 243)
Disposal of revalued fixed assets	-	-	(1 890 511)	-	-	(1 890 511)
Deferred tax on disposal of revalued fixed assets	-	-	90 436	-	-	90 436
Profit for the year	-	-	-	-	19 928 226	19 928 226
<b>Balance as at 31.12.2008.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>186 917 922</b>	<b>58 710 159</b>	<b>25 106 707*</b>	<b>324 954 998</b>
	EUR	EUR	EUR	EUR	EUR	EUR
<b>Balance as at 31.12.2006.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>169 495 603</b>	<b>56 517 264</b>	<b>33 108 939</b>	<b>336 270 214</b>
Dividends	-	-	-	-	(17 031 776)	(17 031 776)
Transferred to reserves	-	-	-	11 186 332	(11 186 332)	-
Revaluation of fixed assets	-	-	115 280 784	-	-	115 280 784
Deferred tax liability arising on the revaluation of fixed assets	-	-	(17 292 117)	-	-	(17 292 117)
Disposal of revalued fixed assets	-	-	(916 315)	-	-	(916 315)
Deferred tax on disposal of revalued fixed assets	-	-	137 447	-	-	137 447
Profit for the year	-	-	-	-	46 697 210	46 697 210
<b>Balance as at 31.12.2007.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>266 705 402</b>	<b>67 703 596</b>	<b>51 588 041</b>	<b>463 145 447</b>
Dividends	-	-	-	-	(28 386 293)	(28 386 293)
Transferred to reserves	-	-	-	15 833 434	(15 833 434)	-
Revaluation of fixed assets	-	-	2 136 608	-	-	2 136 608
Deferred tax liability arising on the revaluation of fixed assets	-	-	(320 492)	-	-	(320 492)
Disposal of revalued fixed assets	-	-	(2 689 955)	-	-	(2 689 955)
Deferred tax on disposal of revalued fixed assets	-	-	128 679	-	-	128 679
Profit for the year	-	-	-	-	28 355 311	28 355 311
<b>Balance as at 31.12.2008.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>265 960 242</b>	<b>83 537 030</b>	<b>35 723 625*</b>	<b>462 369 305</b>

\* The retained earnings brought forward include accumulated revaluation reserve of disposed fixed assets of LVL 62 325 (EUR 88 680). 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, 2008

	2008 LVL	2007 LVL	2008 EUR	2007 EUR
<b>I Cash flows from operating activities</b>				
<b>1. Profit before taxes</b>	<b>23 498 279</b>	<b>37 881 175</b>	<b>33 435 038</b>	<b>53 900 056</b>
Adjustments for:				
- fixed asset depreciation and write-down of intangible assets	19 311 381	18 488 470	27 477 619	26 306 722
- difference between the actual and forecasted purchase cost of natural gas and income from participation charge	2 657 242	(373 163)	3 780 915	(530 963)
- change in provisions for inventories	93 025	(6 042)	132 362	(8 597)
- change in provisions for long-term financial investments	(261)	(384)	(371)	(546)
- change in accrued expenses for bonuses for reporting year's financial results	(96 000)	3 017 300	(136 594)	4 293 233
- change in accrued unused annual leave expenses	206 196	145 060	293 390	206 401
- change in other provisions	120 939	(248 689)	172 081	(353 852)
- changes in accruals for post employment benefits and other employee benefits	2 172 646	2 500 000	3 091 397	3 557 180
- interest and similar income	(1 861 260)	(1 138 801)	(2 648 334)	(1 620 368)
- interest and similar expense	435 982	558 067	620 347	794 058
- (profit) / loss on sale of fixed assets	(538 426)	44 773	(766 111)	63 706
<b>Adjustments for:</b>				
Trade debtors increase	(14 767 019)	(10 732 552)	(21 011 576)	(15 271 046)
Inventories increase	(29 332 051)	(15 000 845)	(41 735 749)	(21 344 279)
Trade creditors' increase	23 157 755	7 933 090	32 950 517	11 287 770
Other debtors' (increase) / decrease	(2 329 777)	974 686	(3 314 974)	1 386 853
Other creditors' increase	7 485 744	6 080 028	10 651 254	8 651 100
<b>3. Cash generated from operations</b>	<b>30 214 395</b>	<b>50 122 173</b>	<b>42 991 211</b>	<b>71 317 428</b>
Interest paid	(150 569)	(475 694)	(214 240)	(676 852)
Interest received	2 366 000	879 318	3 366 515	1 251 157
Corporate income tax paid	(9 443 867)	(3 445 795)	(13 437 412)	(4 902 925)
<b>6. Net cash flows generated from operations</b>	<b>22 985 959</b>	<b>47 080 002</b>	<b>32 706 074</b>	<b>66 988 808</b>
<b>II. Cash flows from investing activities</b>				
Acquisition of fixed assets and intangible assets	(22 772 950)	(29 053 278)	(32 402 989)	(41 339 090)
Proceeds from sale of fixed assets	120 398	59 670	171 311	84 903
Decrease of other investments in term deposits over 90 days, net	-	7 126 414	-	10 139 974
<b>9. Net cash used in investing activities</b>	<b>(22 652 552)</b>	<b>(21 867 194)</b>	<b>(32 231 678)</b>	<b>(31 114 213)</b>
<b>III. Cash flows from financing activities</b>				
Repayment of borrowings	(20 029 914)	(15 791)	(28 500 000)	(22 469)
Received loans	1 787 886	20 029 914	2 543 933	28 500 000
Dividends paid	(19 950 000)	(11 970 000)	(28 386 293)	(17 031 776)
<b>7. Net cash (used in) / generated from financing activities</b>	<b>(38 192 028)</b>	<b>8 044 123</b>	<b>(54 342 360)</b>	<b>11 445 755</b>
<b>Net (decrease) / increase in cash and cash equivalents</b>	<b>(37 858 621)</b>	<b>33 256 931</b>	<b>(53 867 964)</b>	<b>47 320 350</b>
Cash and cash equivalents at the beginning of the reporting year	44 304 704	11 047 773	63 039 914	15 719 564
<b>Cash and cash equivalents at the end of the reporting year</b>	<b>6 446 083</b>	<b>44 304 704</b>	<b>9 171 950</b>	<b>63 039 914</b>

## Notes

### Accounting policies

#### (a) Information on the Company

The legal address of the Joint Stock Company *Latvijas Gāze* is Aristīda Briāna street 6, Riga, LV-1001, Latvia. The Company is registered in Commercial Register with common registration number 4000 300 0642. The Company's main shareholders are *E.ON Ruhrgas International AG* (47.23%), *OJSC Gazprom* (34.0%) and *LLC Itera Latvija* (16.0%). The Board of the Company consists of *Adriāns Dāvis* (Chairman of the Board), *Aleksandrs Mihejevs* (Александр Михеев) (Member of the Board, Deputy Chairman of the Board), *Jörg Tumat* (Member of the Board, Deputy Chairman of the Board), *Anda Ulpe* (Member of the Board) and *Gints Freibergs* (Member of the Board). The Company's auditor is the certified audit company *SIA PricewaterhouseCoopers* and responsible certified auditor *Olga Bukovska*.

#### (b) Financial statements preparation basis

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", LAS No 5 "Long-term contracts", LAS No 6 "Revenue", LAS No 7 "Property, plant and equipment", LAS No 8 "Provisions, contingent

liabilities and contingent assets" and LAS No 9 "Investment property". LAS No 9 becomes effective for the reporting periods starting in 2008. The implementation of this standard did not leave an effect on the financial statements of the Company.

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, except for accounting policy (c), regarding recognition of income from penalties. Management of the Company believes that the change of this policy did not have material impact on the financial position of the Company.

*Recent instability in the global and Latvian financial markets and economies*

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and elsewhere, including Latvia. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

Management is unable to reliably estimate the effects on the Company's financial position of any further deterioration in the liquidity of the financial markets and the increased

volatility in the currency and equity markets as well as the economic downturn in Latvia. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company's business in the current circumstances.

*Impact on liquidity:*

The volume of wholesale financing has significantly reduced recently. Such circumstances may affect the ability of the Company to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

*Impact on asset valuation:*

Debtors of the Company may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for customers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. The management have based their assumptions about recoverable amounts of the assets on the available information, however it is not possible to determine reliably the effect of the economic downturn in its entirety.

### (c) Net sales and income recognition

Sales are recognised upon delivery of gas or performance of services. Net sales represent the total of goods and services sold during the year net of discounts, value added tax and the difference between the actual and forecasted purchase cost of natural gas, which is used for determination of applicable natural gas selling price for the following month. Applicable natural gas selling price is calculated based on latest available data. The exchange rate for EUR/USD set by ECB in the last day of the previous month, actual gross calorific value as well as planned volume of received and delivered gas are used in the calculation. Actual purchase costs of natural gas are calculated based on methodology approved by the the Public Utility Commission (PUC's) Council, taking into account the exchange rate of EUR/USD at the last day of the month when gas is delivered, actual gross calorific value as well as actual volume of gas received from suppliers.

Accrual of interest income is ceased, if it's recoverability is uncertain. Based on prudence principle, penalties, including fines for late payments for gas, are recognised when received. (2007: Penalties income was recog-

nised as it accrues unless its collectability 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.

### (d) 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.

	31.12.2008. LVL	31.12.2007. LVL
1 USD	0.495	0.484
1 EUR	0.702804	0.702804

Euro financial statements are prepared using account closing balances in LVL at the last day of the reporting period, performing conversion to EUR by using the official fixed EUR/LVL rate set by the Bank of Latvia 1 EUR = LVL 0.702804.

### (e) 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.

### (f) 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	1 – 3
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, advances for fixed assets and assets under construction.

The Company capitalises fixed assets with cost exceeding LVL 150 (EUR 213) 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.

## (g) Inventories

The cost of natural gas in Inčukalna UGS and in gas transmission pipelines is determined separately using the first-in first-out (FIFO) method based on total natural gas movement. 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.

## (h) Accounts receivable

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. Provisions 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.

## (i) 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.

## (j) 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.

## (k) 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 and intangible asset amortisation rates, accrued unused annual leave and bonus expenses, accruals for post employment and other benefits and provisions 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". The deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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.

## (l) 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.

The Company provides defined benefits upon retirement and in the period of employment for employees whose employment conditions meet defined criteria according to

the Employment contract. Amount of benefit liability is calculated based on current salary level and number of employees, which are entitled or may become entitled to receive those payments, as well as based on actuarial assumptions. Once a year an independent actuary evaluates these liabilities. Expected benefit expenses are accrued during the employment period.

Liabilities for the employee benefits are presented in the balance sheet at their present value. Employee benefit liabilities are calculated for each year using Projected Unit Credit method. Both actuary defined and publicly available assumptions are used in calculations regarding changes in demographic and financial variables.

## (m) 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.

## (n) 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.

## (o) 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 (k) 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 "Annual Accounts Act" of the Republic of Latvia 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.

**PricewaterhouseCoopers SIA**

K. Valdemara Street 19  
Riga, LV-1010  
Latvia  
Telephone +371 6709 4400  
Facsimile +371 6783 0055  
pwc.riga@lv.pwc.com

## Independent Auditors' Report

Translation from Latvian original \*

### To the Shareholders of JSC Latvijas Gāze Report on the Summarised Financial Statements

The accompanying summarised financial statements have been derived from the financial statements of JSC Latvijas Gāze (the Company) for the year ended 31 December 2008, which are prepared in accordance with the Annual Accounts Act of the Republic of Latvia. These summarised financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on whether these summarised financial statements are consistent, in all material respects, with the financial statements from which they were derived.

We have audited the financial statements of the Company in accordance with International Standards on Auditing. In our report dated 29 April 2009 we expressed an unqualified opinion on the financial statements of the Company for the year ended 31 December 2008 from which the summarised financial statements were derived.

In our opinion, the accompanying summarised financial statements are consistent, in all material respects, with the financial statements from which they were derived.

For a better understanding of the Company's financial position and the results of its operations for the year and of the scope of our audit, the summarised financial statements should be read in conjunction with the financial statements from which the summarised financial statements were derived and our audit report thereon.

PricewaterhouseCoopers SIA  
Certified audit company  
Licence No. 5



Juris Lapshe  
Member of the Board



Olga Bukovska  
Certified auditor in charge  
Certificate No. 170

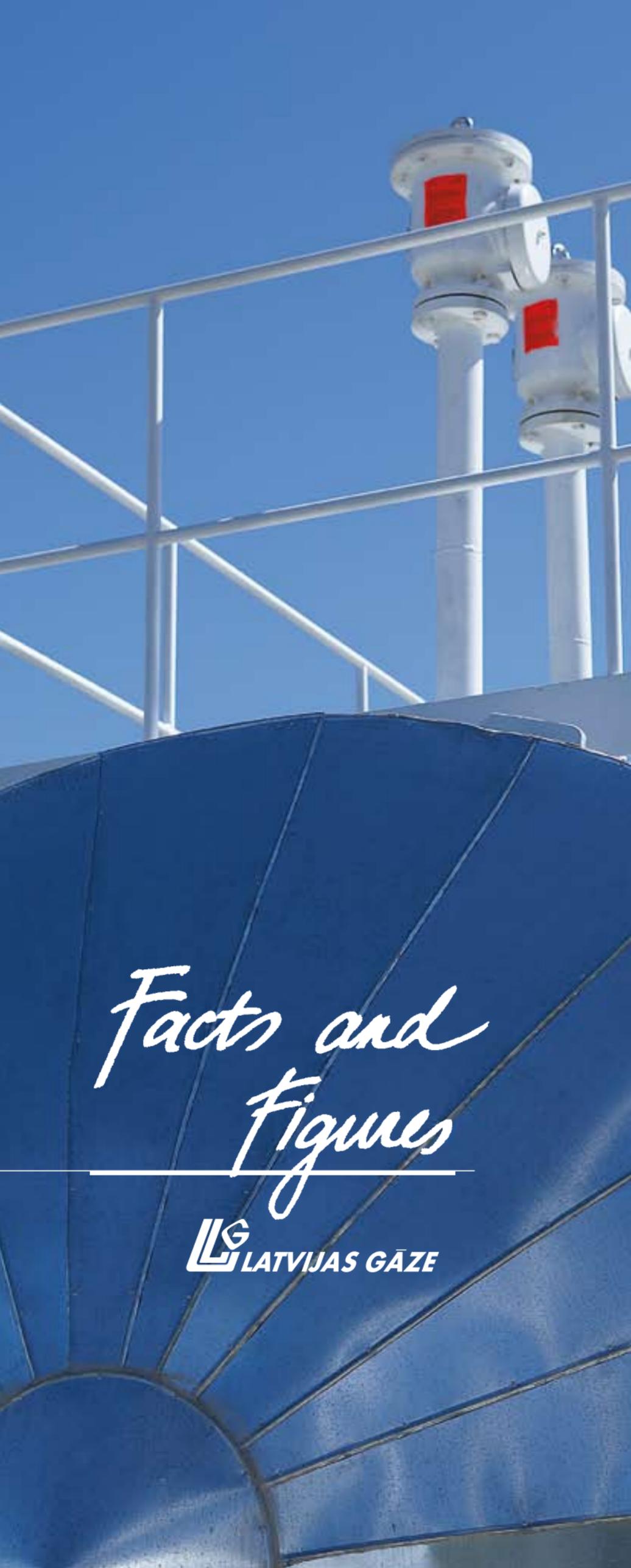
Riga, Latvia  
15 June 2009

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

Publication prepared by JSC *Latvijas Gāze*  
Public Relations Department

Design and printing: LLC *Artekoms*





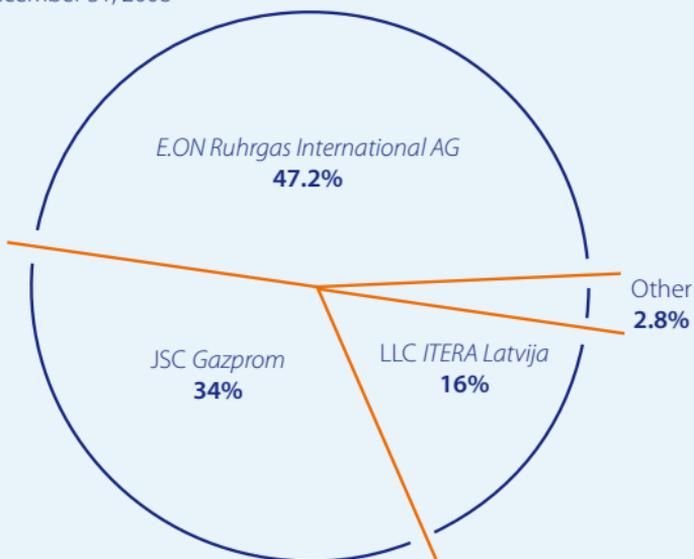
*Facts and  
Figures*

---

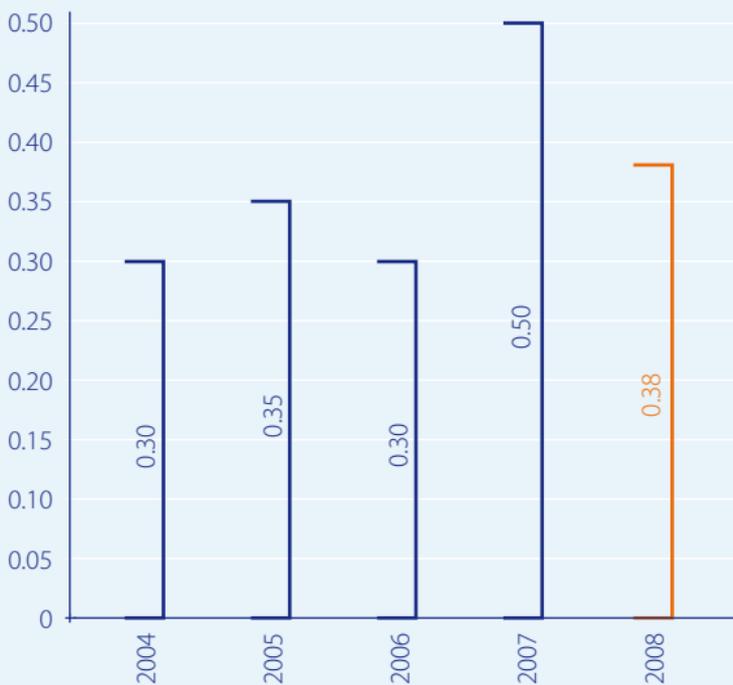
**LG** LATVIJAS GĀZE

## Shareholder structure of JSC Latvijas Gāze (%)

December 31, 2008



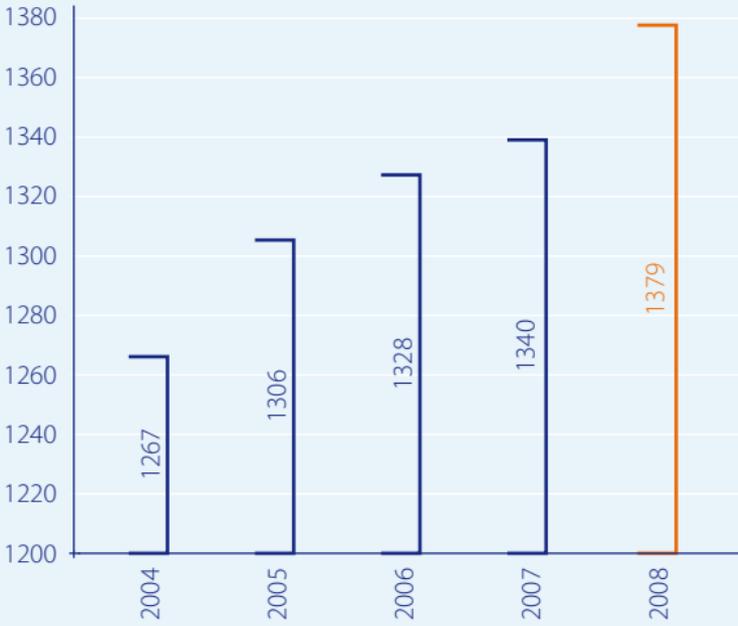
## JSC Latvijas Gāze dividend per share (LVL/ share)



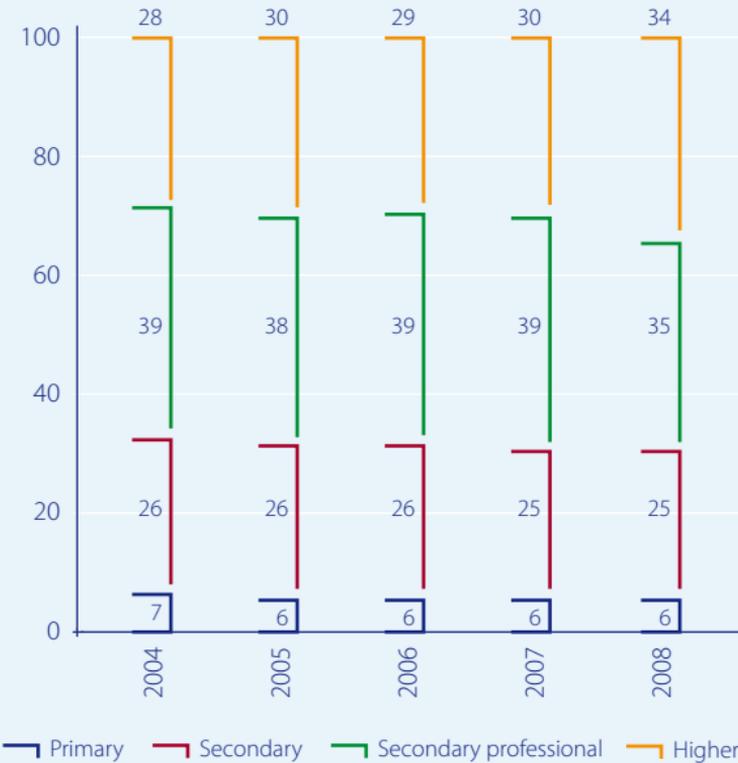
## Trade statistics of JSC Latvijas Gāze shares

Price (LVL)	2004	2005	2006	2007	2008
First	5.51	6.2	9.95	10.35	7.25
Maximum	6.6	9.9	11.13	11.25	8.20
Minimum	5.4	6.15	9.27	7.05	3.62
Average	5.85	7.67	10.22	10.34	6.77
Price of last transaction	6.5	9.61	10.32	7.12	4.55
Change (%)	18.18	47.85	7.39	-31.01	-36.1
Turnover (shares)	181 611	63 360	128 844	154 825	46 565
Turnover (LVL million)	1.06	0.49	1.32	1.6	0.315
Capitalization at the end of the period (LVL million)	259.35	383.44	411.77	284.09	181.545

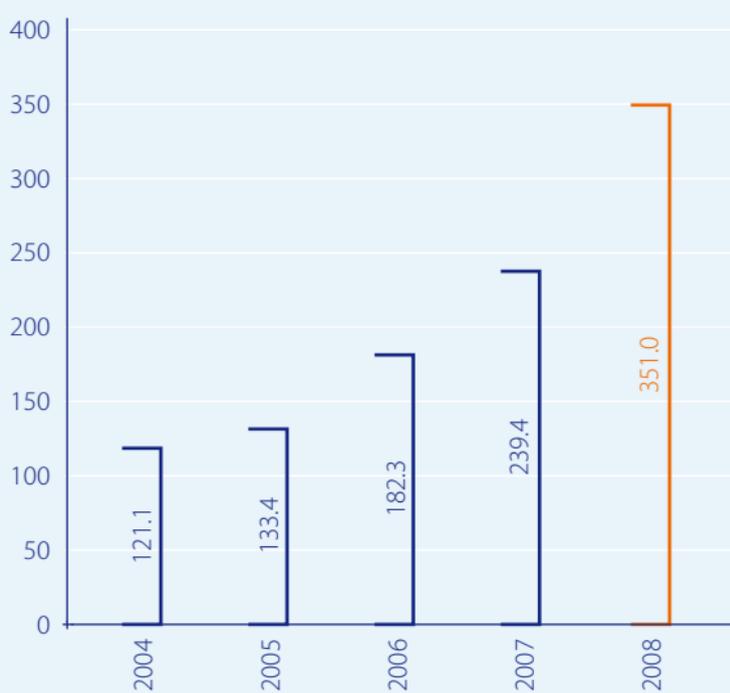
### Average number of JSC Latvijas Gāze employees



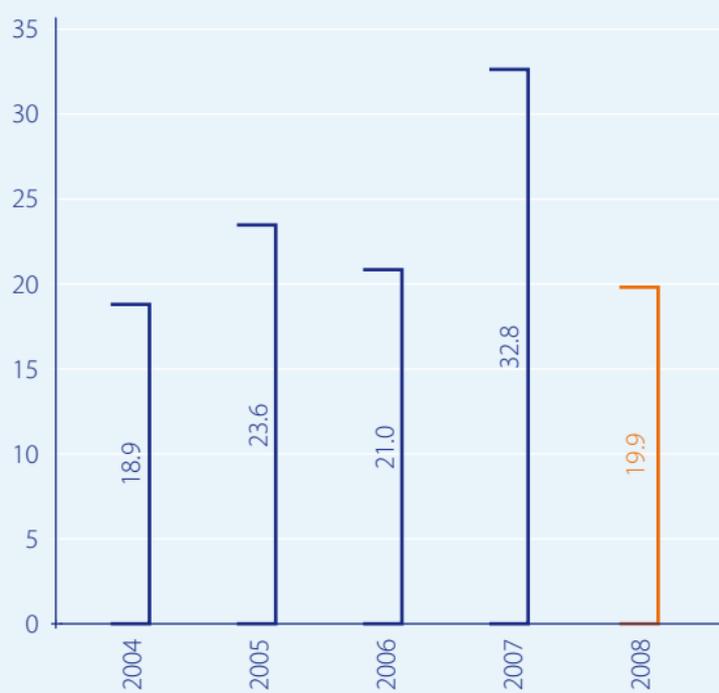
### Education profile of JSC Latvijas Gāze employees (%)



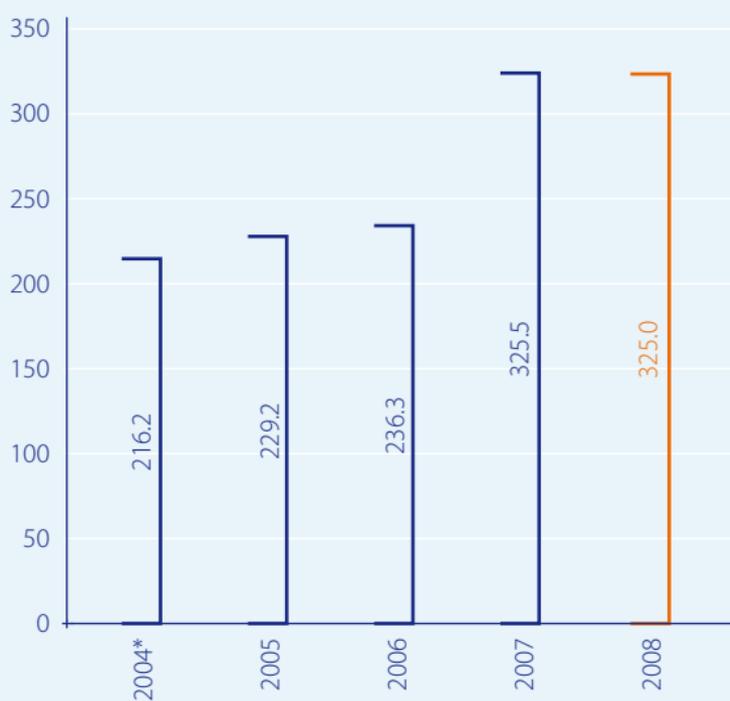
### Net turnover (LVL million)



### Net profit (LVL million)

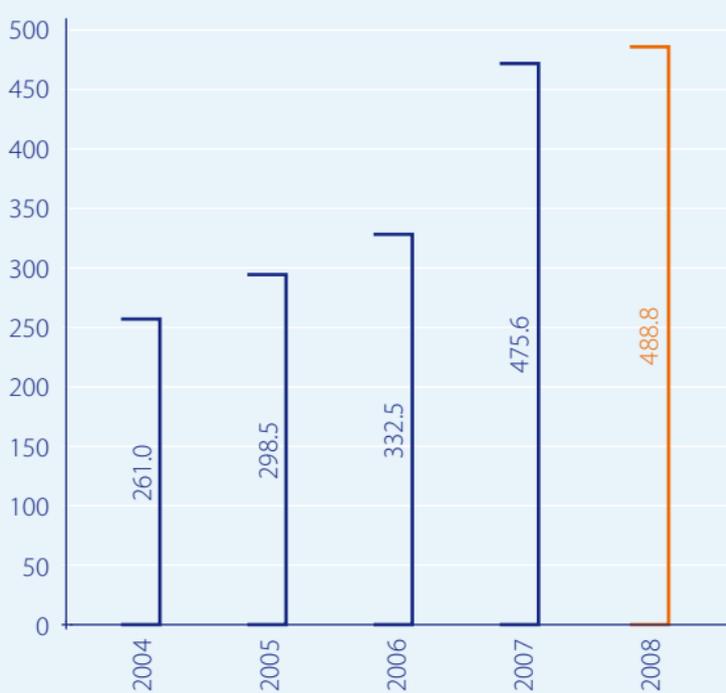


## Equity (LVL million)



\* Equity after revaluation of fixed assets

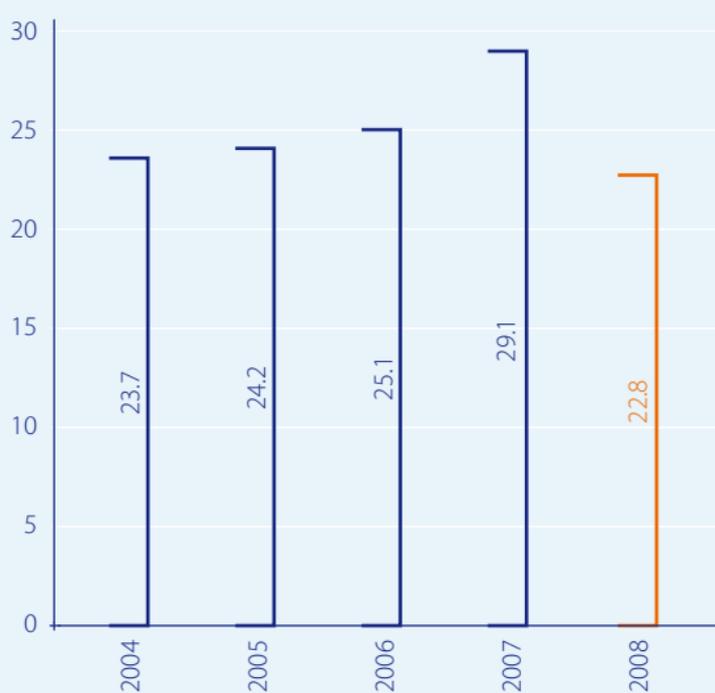
## Assets (LVL million)



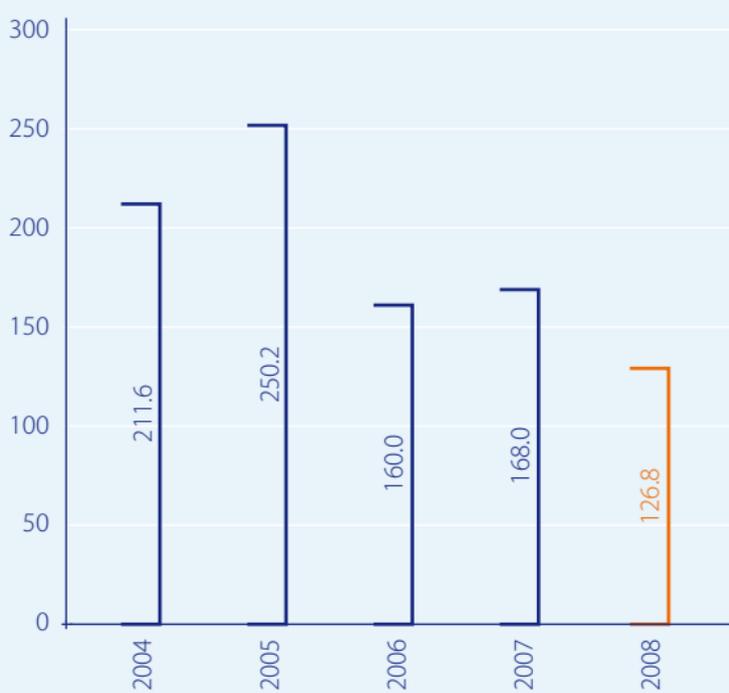
## Main financial indices (%)



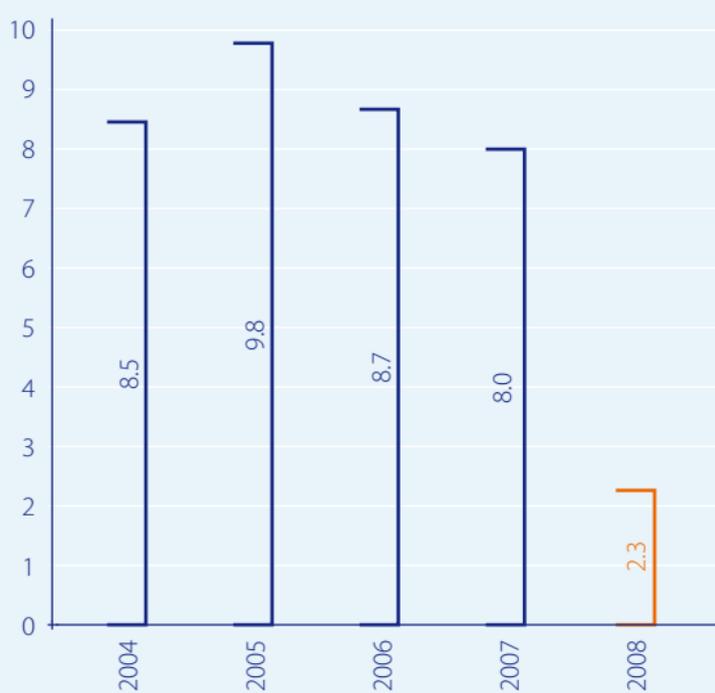
## Investment (LVL million)



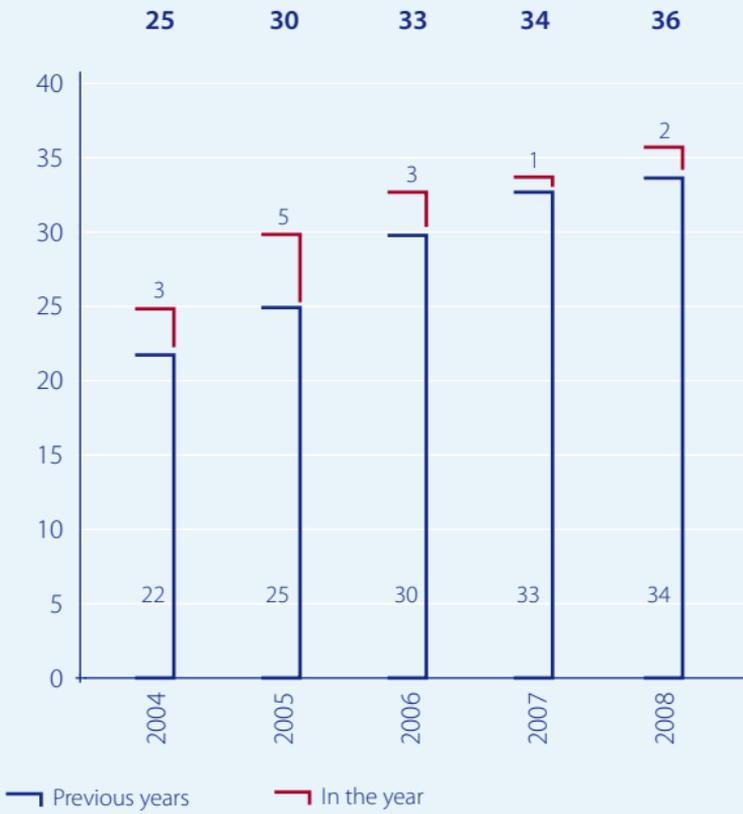
## Construction of new gas pipelines (km)



## Investment in modernization of Inčukalns UGS (LVL million)



## Modernization of gas regulation stations (quantity)



## Primary energy resources balance of Latvia (%)

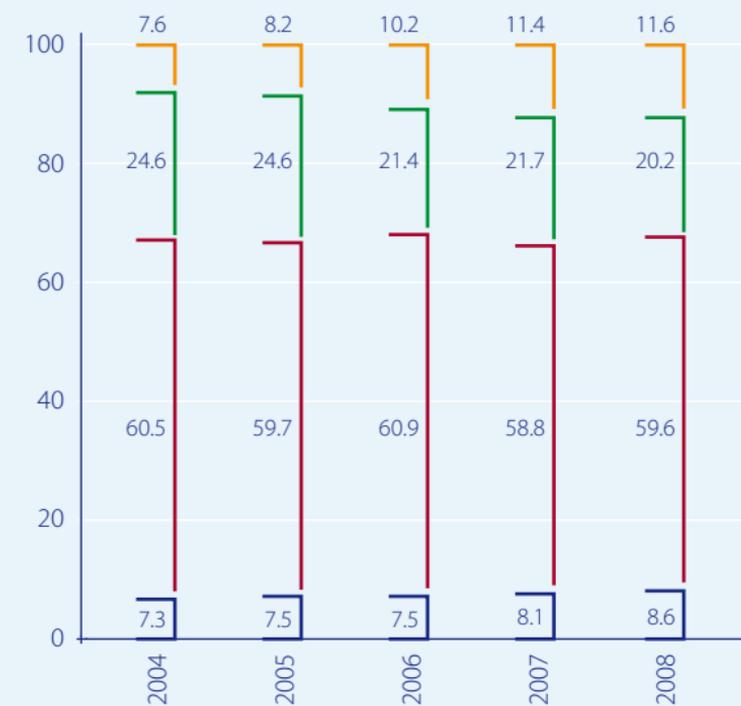


\* Operative information.  
Source: Central Statistical Bureau of LR, JSC Latvijas Gāze

## Volume of natural gas sales (million m<sup>3</sup>)



## Natural gas sales in Latvia by industries (%)



▬ Residential customers   
 ▬ Power industry   
 ▬ Industry  
▬ Municipal and commercial enterprises

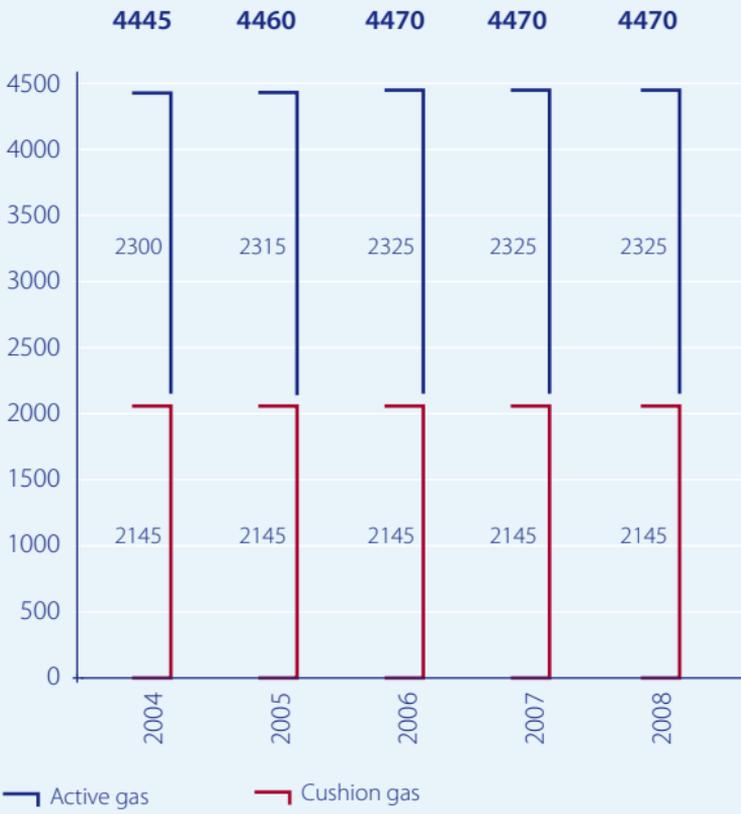
## Number of customers (thousands)



## Natural gas deliveries from Inčukalns UGS (million m<sup>3</sup>)



### Gas volume in Inčukalns UGS (million m<sup>3</sup>)



### Company-owned gas transmission and distribution pipelines (km)

