

# **AS LATVIJAS BALZAMS**

## **FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**Translation from the original in Latvian**

**AS LATVIJAS BALZAMS**  
**ANNUAL ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2005**

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**THE MANAGEMENT**

Names and positions of Council members	Alexander Kovalev – Chairman of the Council
	Pjotr Aven – Member of the Council
	Vitolds Kokars – Member of the Council Director for quality control of AS Latvijas balzams
	Yury Shefler – Member of the Council
	Alexey Oliynik – Member of the Council
Names and positions of Board members	Juris Gulbis – Member of the Council
	Rolands Gulbis – Chairman of the Board General director of AS Latvijas balzams
	Alexander Yernev – Member of the Board Chief engineer of AS Latvijas balzams
	Egils Dzerelis – Member of the Board Director of logistics of AS Latvijas balzams
	Sergey Limarenko – Member of the Board Chief of internal security department of AS Latvijas balzams
	Valizhan Abidov – Member of the Board

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**MANAGEMENT'S REPORT**

**Type of operations**

The Company was incorporated in 1900; however the current name of the Company was established in 1970. The Company is a producer of a wide range of alcoholic drinks. At present AS Latvijas balzams produces more than 120 different types of drinks. Shares of the Company are listed in the second list of Riga Stock Exchange.

**Performance of the Company during the reporting year**

AS Latvijas balzams is the largest producer of alcoholic drinks in Latvia and also one of the largest state taxpayers. During the last year the Company paid 31.7 million lats to the State budget, including 24.2 million lats for excise tax.

The turnover of the Company was 51.1 million Lats, the profit for the reporting year was 2.4 million Lats. The total amount of investment in property, plant and equipment exceeded 3.9 million Lats. Profit for the reporting year was influenced by increase of advertising and marketing expenses, which is explained by activities in the Baltics market and by entering into new export markets. Sale of number of trade marks has positively influenced financial results of the company.

Average number of employees in 2005 was 726 with an average monthly gross salary of 404 Lats.

**Distribution of profit proposed by the Board**

The Board proposes to distribute the part of the profit for year 2005 in dividends, proposing to pay 0.024 Lats per share. The management of the Company proposes to transfer remaining part of current profit to retained earnings.

**Future prospects**

One of the priorities for the year 2006 of AS Latvijas balzams will be promotion of export sales. At the same time, the Company plans to keep its leading position in the local market.

**The Management**

There were no changes in the composition of the Management in 2005. For list of the Management please see page 3.

**Responsibility of the Management about financial statements**

The Management is responsible for the preparation of the financial statements in accordance with International Financial Reporting Standards as adopted for the issue in the Europe Union (EU) and International Financial Reporting Standards (IFRS). The financial statements give a true and fair view of the financial position of the Company at the end of the reporting year, and the results of its operations and cash flow for the year then ended.

The Management confirms that the 2005 financial statements on pages 8 to 32 have been prepared using prudent and reasonable judgements and estimates. The accounting policies applied have been consistent except for the presentation of revenues as disclosed in the financial statements. The Management confirms that the financial statements have been prepared on going concern basis.

The Management is responsible for accounting records and for safeguarding the Company's assets and preventing and detecting of fraud and other irregularities in the Company. It is also responsible for operating the Company in compliance with the legislation of the Republic of Latvia.



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**MANAGEMENT'S REPORT (continued)**

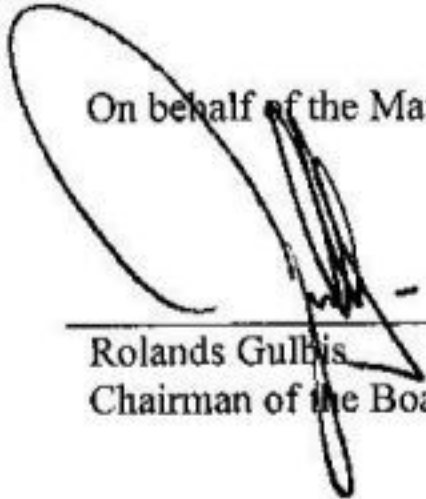
**Significant post balance sheet events**

During the period between the last day of the financial year and the date of signing of this report there have been no significant events that would have a material effect on the year-end results.

**Auditors**

The audit of the financial statements included on pages 8 to 32 was performed by the audit firm PricewaterhouseCoopers SIA in accordance with International Standards on Auditing.

On behalf of the Management of AS Latvijas balzams:

  
\_\_\_\_\_  
Rolands Gulbis  
Chairman of the Board

Riga, 10 April 2006

## AUDITORS' REPORT

### **To the shareholders of AS Latvijas balzams**

1. We have audited the financial statements of AS Latvijas balzams for the year ended 31 December 2005 set out on pages 8 to 32. The audited financial statements include the balance sheet as of 31 December 2005, related income statement, statement of changes in equity and cash flow statement for the year then ended and note disclosure. These financial statements are the responsibility of AS Latvijas balzams management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. Except as discussed in paragraph 3, we conducted our audit in accordance with International Standards on Auditing issued by International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We read the management report set out on pages 4 to 5 and did not identify material inconsistencies with the audited financial statements. We believe that our audit provides a reasonable basis for our opinion.
3. The Company's accounting policy is to account for buildings at revalued amounts less subsequent depreciation. The Company performed a revaluation in 2005 and accounted for the revaluation effect of Ls 5,000,766 as of 1 September 2005. The previous revaluation was performed on 1 January 1998. International Accounting Standard 16, *Property, Plant and Equipment*, provides that the revaluations should be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Considering the general increase in real estate prices in the Latvian market over recent years, as well as the result of the revaluation performed as of 1 September 2005, we consider that the fair value of the buildings had changed materially between 1998 and 31 December 2004. Accordingly, we consider that the carrying amount of buildings of Ls 6,361 thousand as of 31 December 2004 was materially lower than their fair value and, consequently, the depreciation charge for 2005 has been understated. The financial statements for 2005 do not disclose the fact of existence of the above described material error as required by International Accounting Standard 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. In the absence of valuation of buildings as at 31 December 2004 we qualified our audit report on the financial statements for the year ended 31 December 2004 and we were not able to satisfy ourselves as to the depreciation charge for the year ended 31 December 2005.

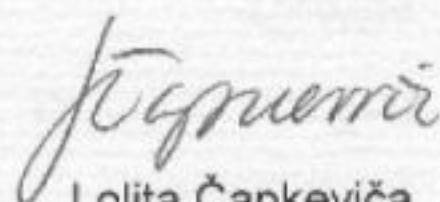


4. In our opinion, except for the effects on the financial statements of the matter referred to in paragraph 3, the financial statements give a true and fair view of the financial position of AS Latvijas balzams as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.
5. In addition, in our opinion, except for the effects on the financial statements of the matter referred to in paragraph 3, the financial statements give a true and fair view of the financial position of AS Latvijas balzams as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers SIA  
Audit company licence No. 5



Juris Lapshe  
Member of the Board



Lolita Čapkeviča  
Certified auditor  
Certificate No. 120

10 April 2006

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	Notes	2005 Ls	2004 Ls
Revenue	4	51,147,347	37,346,967
Cost of sales	5	(41,060,157)	(30,067,329)
<b>Gross profit</b>		<b>10,087,190</b>	<b>7,279,638</b>
Selling expenses	6	(3,842,796)	(3,270,159)
Administrative expenses	7	(4,085,767)	(2,870,107)
Other income	8	1,719,984	435,631
Other expenses	9	(379,141)	(154,548)
<b>Operating profit</b>		<b>3,499,470</b>	<b>1,420,455</b>
Finance income	11	144,675	159,062
Finance costs	11	(654,125)	(673,830)
<b>Profit before income tax</b>		<b>2,990,020</b>	<b>905,687</b>
Income tax expense	12	(612,344)	(198,854)
<b>Profit for the year</b>		<b>2,377,676</b>	<b>706,833</b>
<b>Earnings per share (expressed in santims per share)</b>			
– Basic	13	31.72	9.43
– Diluted	13	31.72	9.43

The Notes on pages 12 to 32 are an integral part of these financial statements.

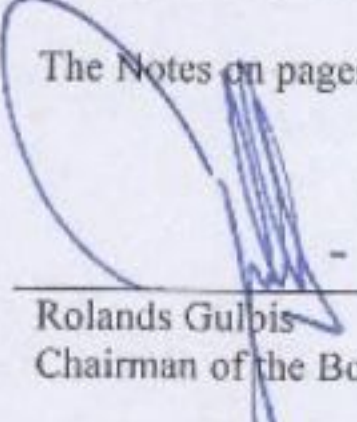


**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**BALANCE SHEET AS AT 31 DECEMBER 2005**

	Notes	31.12.2005 Ls	31.12.2004 Ls
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	15	20,122,993	12,913,594
Intangible assets	14	116,786	328,966
		<b>20,239,779</b>	<b>13,242,560</b>
<b>Current assets</b>			
Inventories	16	12,243,986	10,779,533
Trade receivables	17	11,127,988	7,403,423
Receivables from related parties	28(g)	5,076,483	4,834,696
Loans to related parties	28(h)	3,031,063	-
Other current assets	18	511,734	462,264
Current income tax		-	292,440
Cash and cash equivalents	19	906,186	897,664
		<b>32,897,440</b>	<b>24,670,020</b>
<b>Total assets</b>		<b>53,137,219</b>	<b>37,912,580</b>
<b>Equity</b>			
Share capital	20	7,496,900	7,496,900
Share premium		61,767	61,767
Revaluation reserve		5,334,638	984,878
Other reserves		1,249,047	1,249,047
Merger reserve		(11,101,905)	(11,101,905)
Retained earnings		18,265,462	15,886,958
<b>Total equity</b>		<b>21,305,909</b>	<b>14,577,645</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Deferred tax liability	12(c)	1,336,030	577,421
Borrowings	21	8,931,808	10,376,540
		<b>10,267,838</b>	<b>10,953,961</b>
<b>Current liabilities</b>			
Borrowings	21	4,752,897	2,242,497
Trade payables		5,914,006	3,483,034
Payables to related parties	28(e)	535,997	656,204
Current income tax		467,960	-
Other payables	22	9,892,612	5,999,239
		<b>21,563,472</b>	<b>12,380,974</b>
<b>Total liabilities</b>		<b>31,831,310</b>	<b>23,334,935</b>
<b>Total equity and liabilities</b>		<b>53,137,219</b>	<b>37,912,580</b>

The Notes on pages 12 to 32 are an integral part of these financial statements.

  
 Rolands Gulbis  
 Chairman of the Board

10 April 2006



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**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2005**

	Share capital Ls	Share premium Ls	Revaluation reserve * Ls	Other reserves** Ls	Merger reserve *** Ls	Retained earnings Ls	Total Ls
Balance at 1 January 2004	7,496,900	61,767	984,878	1,249,047	(11,101,905)	15,180,125	13,870,812
Profit for the year	-	-	-	-	-	706,833	706,833
<b>Balance as at 31 December 2004</b>	<b>7,496,900</b>	<b>61,767</b>	<b>984,878</b>	<b>1,249,047</b>	<b>(11,101,905)</b>	<b>15,886,958</b>	<b>14,577,645</b>
Balance at 1 January 2005	7,496,900	61,767	984,878	1,249,047	(11,101,905)	15,886,958	14,577,645
Disposal of revalued property, plant and equipment	-	-	(828)	-	-	828	-
Property, plant and equipment revaluation	-	-	5,118,193	-	-	-	5,118,193
Change in deferred tax liability as a result of revaluation of property, plant and equipment (see Note 12)	-	-	(767,605)	-	-	-	(767,605)
Profit for the year	-	-	-	-	-	2,377,676	2,377,676
<b>Balance as at 31 December 2005</b>	<b>7,496,900</b>	<b>61,767</b>	<b>5,334,638</b>	<b>1,249,047</b>	<b>(11,101,905)</b>	<b>18,265,462</b>	<b>21,305,909</b>

\* As at 31 December 2005 the deferred tax charged to equity is Ls 941,407 (31.12.2004 – Ls 173,802).

\*\* Other reserves were made before the required re-registration of the Company in the Commercial Register in the amount of 5% from annual profit in accordance with Latvian legal requirements. Since neither the Commercial Law, nor Statutes of the Company now require the creation of such reserves, shareholders will make decision on transfer of reserves to retained earnings.

\*\*\* The merger reserve arose as a result of merger of the Company with its subsidiary in 2000. The Company chooses to account for the merger in accordance with pooling of interests method. The merger reserve represents the excess of the pre-merger carrying amount of the investment in the subsidiary over the carrying amount of net assets absorbed by the Company as a result of the merger.

The Notes on pages 12 to 32 are an integral part of these financial statements.

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**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2005**

	Notes	2005 Ls	2004 Ls
<b>Cash flows from operating activities</b>			
Cash generated from operations	23	6,826,387	839,114
Interest paid		(588,829)	(716,352)
Income tax paid		(151,810)	(397,213)
<b>Net cash generated from / (used in) operating activities</b>		<b>6,085,748</b>	<b>(274,451)</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	15	(3,287,490)	(1,541,825)
Proceeds from sale of property, plant and equipment		15,865	6,631
Loans granted	28(h)	(3,031,063)	-
Loans repayment received		22,000	-
<b>Net cash used in investing activities</b>		<b>(6,280,688)</b>	<b>(1,535,194)</b>
<b>Cash flows from financing activities</b>			
Proceed from borrowings		2,714,150	4,070,729
Repayment of borrowings		(2,510,688)	(1,536,250)
<b>Net cash generated from financing activities</b>		<b>203,462</b>	<b>2,534,479</b>
<b>Net increase in cash and cash equivalents</b>		<b>8,522</b>	<b>724,834</b>
Cash and cash equivalents at beginning of the year		897,664	172,830
<b>Cash and cash equivalents at end of the year</b>	19	<b>906,186</b>	<b>897,664</b>

The Notes on pages 12 to 32 are an integral part of these financial statements.



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS**

**1 GENERAL INFORMATION**

The Company is regarded as producer of a wide range of alcoholic drinks. At present AS Latvijas balzams produces more than 120 different types of drinks. The largest shareholder of the Company, who owns 88.05% of the shares of the Company, is S.P.I. Distilleries B.V., which is incorporated in Netherlands.

AS Latvijas balzams is joint stock company incorporated and domiciled in Latvia. The Company is incorporated in 1900; however the current name of the Company was created in 1970. The address of its registered office is A. Čaka iela 160, Rīga, LV-1012, Republic of Latvia. Shares of the Company are listed in the Riga Stock Exchange second list.

These financial statements have been approved for issue by the Management on 10 April 2006 and signed on its behalf by the Chairman of the Board Rolands Gulbis.

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

**(a) Basis of preparation**

The financial statements of AS Latvijas balsams have been prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union (EU) and International Financial Reporting Standards (IFRS). All International Financial Reporting Standards issued by IASB and effective at the time of preparing these financial statements have been adopted for use in the EU through the endorsement procedure established by the European Commission, with the exception of the International Accounting Standard IAS 39 "Financial Instruments: Recognition and Measurement". Following the Accounting Regulatory Committee decision of October 2004, the Commission adopted the Regulation 2086/2004 requiring the use of IAS 39, minus certain provisions on the full fair value option and portfolio hedging of core deposits, by all listed companies from 1 January 2005.

Since the Company has not elected to follow the fair value option in IAS 39 and is not affected by the provisions regarding portfolio hedging that are not required by the EU-endorsed version of IAS 39, the accompanying financial statements comply with both International Financial Reporting Standards as adopted for use in the European Union and International Financial Reporting Standards.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of property, plant and equipment as disclosed in Note (f).

The preparation of the financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies.

IFRS requires that in preparing the financial statements, management of the Company make estimates and assumptions that affect the reported amounts of assets and liabilities and required disclosure at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The areas involving a higher degree of judgement are revaluation of property, plant and equipment, determination of frequency of revaluations, the management assumptions and estimates in determination of useful lives of property, plant and equipment, recoverable amount of accounts receivable and inventories as described in respective notes. The management determines fair value of property, plant and equipment based on valuations performed by independent certified valuers in accordance with real estate valuation standards.

In 2005, the Company adopted all new and revised IFRS issued up to and including 31 March 2004. The comparatives figures have been amended as required, in accordance with the requirements of the following relevant standards:

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**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(a) Basis of preparation (continued)**

IAS 1 (revised 2003)	Presentation of Financial Statements
IAS 2 (revised 2003)	Inventories
IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003)	Events after the Balance Sheet Date
IAS 16 (revised 2003)	Property, Plant and Equipment
IAS 17 (revised 2003)	Leases
IAS 21 (revised 2003)	The Effects of Changes in Foreign Exchange Rates
IAS 24 (revised 2003)	Related Party Disclosures
IAS 27 (revised 2003)	Consolidated and Separate Financial Statements
IAS 31 (revised 2003)	Interests in Joint Ventures
IAS 32 (revised 2003)	Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003)	Earnings per Share
IAS 36 (revised 2004)	Impairment of Assets
IAS 38 (revised 2004)	Intangible assets
IAS 39 (revised 2003)	Financial Instruments: Recognition and Measurement
IAS 40 (revised 2003)	Investment property
IFRS 2 (issued 2004)	Share based payments
IFRS 3 (issued 2004)	Business Combinations
IFRS 5 (issued 2004)	Non-current Assets held for Sale and Discontinued Operations

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 24, 27, 31, 32, 33, 39 and 40 (all revised 2003), IAS 36, 38 (all revised 2004) and IFRS 2, 3, 5 (all issued 2004) resulted in no material changes to the Company's accounting policies or disclosures and presentation in the financial statements.

New accounting standards, amendments and IFRIC interpretations have been published that are mandatory for accounting periods beginning on or after 1 January 2006 or later periods. These accounting standards, amendments and IFRIC interpretations have not yet been endorsed by EU. As the Company has not adopted these accounting standards, amendments and IFRIC interpretations, there is no difference between International Financial Reporting Standards as adopted for use in the European Union and International Financial Reporting Standards. New accounting standards, amendments and IFRIC interpretations are as follows:

*IAS 19(Amendment), Employee benefits (effective from 1 January 2006)*

This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. The amendments to the standard will not affect the Company's financial statements.

*IAS 21 (Amendment), Net investment in foreign operation (effective from 1 January 2006)*

This standard is not relevant to the Company's operations.

*IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006)*

This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value and subsequently measured at the higher of: (a) the unamortised balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date. This amendment is not relevant to the Company.



NOTES TO THE FINANCIAL STATEMENTS (continued)

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Basis of preparation (continued)

*IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)*

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Company assessed the impact of IFRS 7 and the amendments to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1. The Company will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

*IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)*

The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the financial statements, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect income statement. This amendment is not relevant to the Company as the Company does not have intragroup transactions that would qualify as hedged item in the financial statements for 2005 or 2004.

*IAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006)*

This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment should not have a significant impact on the classification of financial instruments. The amendment is not relevant to the Company's financial statements.

*IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards (effective from 1 January 2006)*

These amendments are not relevant to the Company, as the Company is not a first-time adopter of IFRS.

*IFRS 6, Exploration and Evaluation of Mineral Resources (effective from 1 January 2006)*

This standard is not relevant to the Company's operations.

*IFRIC 4, Determining whether an Arrangement Contains a Lease (effective from 1 January 2006)*

IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether; (a) fulfillment of the arrangement is dependant on the use of a specific asset or assets, and (b) the arrangement conveys a right to use the asset.

The interpretation will not affect the Company's financial statements.

*IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)*

The Company does not have interests in decommissioning, restoration and environmental rehabilitation funds. This interpretation will not affect the Company's financial statements.

*IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)*

This interpretation is not relevant to the Company's operations.

*IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007)*

This interpretation is not relevant to the Company's operations.



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**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(a) Basis of preparation (continued)**

*IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007)*

The interpretation clarifies that the accounting standard IFRS 2 *Share-based Payment* applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. This interpretation will not affect the Company's financial statements.

*IFRIC 9, Reassessment of Embedded Derivatives (effective for periods beginning on or after 1 June 2006)*

This interpretation is not relevant to the Company's operations.

**(b) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

**(c) Revenue recognition**

The Company's main operation is the production and sale of alcoholic drinks. Revenue represents the total of goods and services sold during the year net of discounts, value added tax and excise tax. In previous year revenue included excise tax. As the result of the change of the presentation of revenue figure the total effect on the comparative information is decrease of revenue and cost of sales by Ls 23,772,579, no impact on net profit or equity.

Income from sales of goods in Latvia is recognised when the customer has accepted the goods. Income from the sales of goods outside Latvia is recognised in accordance with the goods delivery terms. Income from penalties is recognised at the moment of receipt. Sales of services are recognised in the accounting period in which the services are rendered.

**(d) Foreign currency translation**

*(a) Functional and presentation currency*

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ('the functional currency'). The financial statements are presented in Latvian Lats (Ls), which is the Company's functional and presentation currency.

*(b) Transactions and balances*

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

The exchange rates of the principal foreign currencies applied by the Company at the balance sheet dates:

	31.12.2005	31.12.2004
	Ls	Ls
USD 1	0.593	0.516
EUR 1	0.702804	0.703

**(e) Property, plant and equipment**

Buildings and structures are shown at fair value, based on periodic valuations by external independent valuers, less subsequent depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset. All other property, plant and equipment is stated at historical cost less accumulated depreciation. Historic costs includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a 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. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(e) Property, plant and equipment (continued)**

Increases in the carrying amount arising on revaluation of buildings and structures are credited to "Revaluation reserve" in shareholders' equity. Decreases that offset previous increases of the same asset (net of deferred tax) are charged against that reserve directly in equity; all other decreases are charged to the income statement. The revaluation surplus is transferred directly to retained earnings when the surplus is recognised on retirement or disposal of the asset.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	<b>Years</b>
Buildings	10-71
Production equipment	2-25
Other equipment and machinery	2-25

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The decrease is reflected as the expenses in the income statement or recognised in reserves, in case the asset was previously re-valued.

Costs of borrowing to finance assets under construction and other direct charges related to the particular asset under construction are capitalised, during the time that is required to complete and prepare the asset for its intended use, as part of the cost of the asset. Capitalisation of the borrowing costs is suspended during extended periods in which active developments are interrupted.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement. When revalued assets are sold, the amounts included in "Revaluation reserve" are transferred to retained earnings.

**(f) Intangible assets**

Intangible assets primarily consist of licences and patents. Intangible assets are stated at historical cost less accumulated amortisation. Amortisation commences when the assets are available for use. Intangible assets are amortised using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

	<b>Years</b>
Intangible assets	3-5

An intangible asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

**(g) Inventories**

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. When the net realisable value of inventories is lower than their cost, provisions are created to reduce the value of inventories to their net realisable value.

**(h) Impairment of non-financial assets**

All the Company's non-financial assets have a finite useful life and are subject to amortisation or depreciation. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(i) Loans and receivables**

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of loans and receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the loans and receivables are impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

**(j) Share capital and dividend authorised**

Ordinary shares are classified as equity.

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

**(k) Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

**(l) Income tax**

Income tax is assessed for the period in accordance with Latvian tax legislation. The tax rate stated by Latvian tax legislation is 15 percent.

**(m) Deferred income tax**

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability settled.

The principal temporary differences arise from different property, plant and equipment depreciation rates, as well as provisions for slow-moving inventory, accruals for unused annual leave and accruals for bonuses. Deferred income tax asset is recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss, it is not accounted for.

**(n) Accruals for unused annual leave**

Amount of accrual is determined by multiplying the average wage per one day of employees in the last six months of reporting year by the number of unused holidays at the end of the reporting year.

**(o) Provisions**

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are measured at the present value of the best estimate of the expenditure required to settle the present obligation at the balance sheet date.



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(p) Pension obligations**

The Company pays social security contributions to the state Social Security Fund (the Fund) on behalf of its employees based on the defined contribution plan in accordance with the local legal requirements. A defined contribution plan is a plan under which the Company pays fixed contributions into the Fund and will have no legal or constructive obligations to pay further contributions if the Fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior period. The social security contributions are recognised as an expense on an accrual basis and are included within staff costs.

**(q) Operating leases – the Company as a lessee**

Lease in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any financial incentives received from the lessor) are charged to the profit and loss account on a straight-line basis over the period of the lease.

**(r) Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand and deposits held at call with banks.

**(s) Related parties**

Related parties are defined as the Company's major shareholders, members of the Board and the Council, their close relatives and companies in which they have a significant influence or control. Related parties are also all companies controlled by the ultimate controlling party or companies where the ultimate controlling party has significant influence.

**(t) Earnings per share**

Earnings per share is determined by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of participating shares outstanding during the reporting year.

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**3 SEGMENT INFORMATION**

**(a) Primary reporting format – business segments**

The only operational activity of the Company is production of alcoholic drinks. At present AS Latvijas balzams produces more than 120 different types of drinks. Substantially all the Company's production is alcoholic drinks, and therefore the Company has only one reportable business segment. The primary statements and notes presented in these financial statements represent the primary format of segment reporting.

**(b) Secondary reporting format – geographical segments**

The Company operates in Latvia and it sells drinks in the local market, as well as in foreign markets.

The operations of the Company can be divided into three major segments, which are sales in Latvia, sales to overseas markets through S.P.I group companies and unallocated sales, which mainly represent export sales to unrelated parties. The distribution of the revenues between these segments is as follows:

	2005 Ls	2004 Ls
Latvia	26,181,491	21,119,922
Overseas markets through S.P.I group companies	20,152,461	12,124,279
Unallocated	4,813,395	4,102,766
	<u>51,147,347</u>	<u>37,346,967</u>

Considering that the Company is located in Latvia and the production facility is only in Latvia, it is not possible to divide assets and capital expenditures among the segments.

**4 REVENUE**

Local sales	26,181,491	21,119,922
Export sales	24,953,419	16,217,804
Other sales (spirit, raw materials)	12,437	9,241
	<u>51,147,347</u>	<u>37,346,967</u>

**5 COST OF SALES**

Variable costs	37,504,962	26,794,701
<i>Materials</i>	33,869,177	24,230,813
<i>Goods bought</i>	383,262	134,399
<i>Salary expenses</i>	1,499,486	1,153,813
<i>Social insurance</i>	360,394	277,258
<i>Electricity</i>	364,715	321,960
<i>Natural resources tax</i>	532,056	456,753
<i>Impairment of receivables and inventory, and other accruals</i>	251,090	67,878
<i>Other expenses</i>	244,782	151,827
Fixed costs	3,555,195	3,272,628
<i>Depreciation and amortisation</i>	1,421,600	1,511,247
<i>Salary expenses</i>	731,050	659,602
<i>Social insurance</i>	173,215	157,706
<i>Repair expenses</i>	840,819	598,196
<i>Insurance</i>	61,806	71,085
<i>Laboratory expenses</i>	34,806	31,961
<i>Other expenses</i>	291,899	242,831
	<u>41,060,157</u>	<u>30,067,329</u>

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**6 SELLING EXPENSES**

	2005 Ls	2004 Ls
Salary expenses	830,481	710,606
Social insurance	199,588	170,919
Depreciation and amortisation	145,848	119,617
Advertising	1,706,470	1,509,626
Transportation cost	665,557	557,139
Warehouse maintenance	55,970	48,544
Other expenses	238,882	153,708
	<u>3,842,796</u>	<u>3,270,159</u>

**7 ADMINISTRATIVE EXPENSES**

Salary expenses	798,332	718,278
Social insurance	145,143	131,917
Communication and postal expenses	212,655	172,912
Office expenses	93,166	100,971
Professional fees	191,593	239,902
IT maintenance	297,202	365,896
Representations	89,856	81,260
Security	198,859	172,794
Management services	1,026,654	224,497
Transportation	105,345	130,882
Business trip	82,990	48,225
Personnel education and training	10,498	31,955
Depreciation	242,571	200,673
Real estate tax	138,493	96,140
Financial help, sponsorship	101,906	42,991
Healthcare, health insurance	54,079	48,724
Accruals for unused annual leave	68,149	25,521
Trade union, cultural and other expenses	201,020	16,734
Other expenses	27,256	19,835
	<u>4,085,767</u>	<u>2,870,107</u>

**8 OTHER INCOME**

Proceeds from sale of inventory	32,578	8,633
Proceeds from sale of materials	74,317	53,283
Sales of brand names	1,155,000	-
Services rendered	308,423	306,014
Difference from purchase of certificates	10,089	-
Net gain on disposal of property, plant and equipment	-	3,347
Other income	139,577	64,354
	<u>1,719,984</u>	<u>435,631</u>

**9 OTHER EXPENSES**

Net loss on disposal of property, plant and equipment	99,083	-
Fines and penalties	3,512	1,042
Loss on revaluation of property, plant and equipment	117,428	-
Other expenses	159,118	153,506
	<u>379,141</u>	<u>154,548</u>



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**10 EXPENSES BY NATURE**

	2005 Ls	2004 Ls
Materials	33,869,177	24,230,813
Employee benefit expenses	4,737,689	3,980,099
Depreciation and amortisation	1,810,019	1,831,537
Advertising	1,706,470	1,509,626
Management services	1,026,654	224,497
Repair expenses	840,819	598,196
Net increase of provisions	251,090	67,878
Transportation costs	665,557	557,139
Natural resource tax	532,056	456,753
IT maintenance	297,202	365,896
Real estate tax	138,493	96,140
Other expenses	3,492,635	2,443,569
	<u>49,367,861</u>	<u>36,362,143</u>

**11 FINANCE INCOME / COSTS**

Net gain from exchange rate fluctuations	-	126,972
Interest income	6,829	17,219
Income from penalties	137,846	14,871
<b>Finance income</b>	<u>144,675</u>	<u>159,062</u>
Interest on long-term loans	(551,010)	(553,816)
Interest on credit line	-	(120,014)
Net loss from exchange rate fluctuations	(103,115)	-
<b>Finance costs</b>	<u>(654,125)</u>	<u>(673,830)</u>

**12 INCOME TAX EXPENSE**

**(a) Components of income tax**

Deferred tax	(8,996)	92,511
Current income tax	621,340	106,343
	<u>612,344</u>	<u>198,854</u>

**(b) Reconciliation of accounting profit to tax charges**

Corporate income tax differs from the theoretically calculated tax amount that would arise applying the 15% rate stipulated by the law to profit before taxation:

<b>Profit before income tax</b>	<u>2,990,020</u>	<u>905,687</u>
Theoretically calculated tax at a tax rate of 15%	448,503	135,853
Expenses not deductible for tax purposes	223,681	92,013
Non-taxable income	(510)	(2,427)
Tax discount for donations	(59,877)	(26,585)
Adjustment for deviations from statutory accounts	547	-
<b>Tax charge</b>	<u>612,344</u>	<u>198,854</u>

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**12 INCOME TAX EXPENSE (continued)**

**(c) Deferred income tax liability**

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

	31.12.2005 Ls	31.12.2004 Ls
Deferred tax assets:		
- Deferred tax asset to be recovered within 12 months	(8,448)	(863,160)
	(8,448)	(863,160)
Deferred tax liabilities:		
- Deferred tax liability to be recovered after more than 12 months	1,344,478	1,440,581
	1,344,478	1,440,581
<b>Net deferred income tax liability</b>	<b>1,336,030</b>	<b>577,421</b>

The movement on the deferred income tax account is as follows:

	2005 Ls	2004 Ls
Beginning of the year	577,421	484,910
Deferred tax charged to revaluation reserve	767,605	-
Income statement charge	(8,996)	92,511
<b>End of the year</b>	<b>1,336,030</b>	<b>577,421</b>

The movement of deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

	Accelerated tax depreciation Ls	Accruals for unused annual leave Ls	Accruals for bonuses Ls	Provisions for slow moving stock Ls	Total Ls
At 1 January 2004	611,105	(28,582)	(11,076)	(86,537)	484,910
Charged / (credited) to income statement	65,157	(3,829)	8,826	22,357	92,511
At 31 December 2004	676,262	(32,411)	(2,250)	(64,180)	577,421
Charged / (credited) to income statement	(3,286)	(10,222)	2,198	2,314	(8,996)
Charged to equity	767,605	-	-	-	767,605
At 31 December 2005	1,440,581	(42,633)	(52)	(61,866)	1,336,030

**13 EARNINGS PER SHARE (EXPRESSED IN SANTIMS PER SHARE)**

The Company has no dilutive potential shares therefore diluted earnings per share are equal to basic earnings per share.

Earnings per share are calculated by dividing the profit for the reporting year with the average number of shares in issue during the reporting year.

	2005	2004
Profit attributable to equity holders of the Company, Ls	2,377,676	706,833
Weighted average number of shares in issue during the reporting year	7,496,900	7,496,900
<b>Earnings per share (in santims)</b>	<b>31.72</b>	<b>9.43</b>



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**14 INTANGIBLE ASSETS**

	<b>Licenses, patents</b>
	<b>Ls</b>
<b>At 1 January 2004</b>	
Cost	1,160,952
Accumulated amortisation	(605,375)
<b>Net book amount</b>	<u><b>555,577</b></u>
 <b>Year ended 31 December 2004</b>	
Opening net book amount	555,577
Additions	1,194
Amortisation charge	(227,805)
<b>Closing net book amount</b>	<u><b>328,966</b></u>
 <b>At 31 December 2004</b>	
Cost	1,162,146
Accumulated amortisation	(833,180)
<b>Net book amount</b>	<u><b>328,966</b></u>
 <b>Year ended 31 December 2005</b>	
Opening net book amount	328,966
Additions	314
Amortisation charge	(212,494)
<b>Closing net book amount</b>	<u><b>116,786</b></u>
 <b>At 31 December 2005</b>	
Cost	1,162,460
Accumulated amortisation	(1,045,674)
<b>Net book amount</b>	<u><b>116,786</b></u>

All intangible assets of AS Latvijas balzams are pledged in accordance with terms of Mortgage and Commercial pledge agreements as security for loans from the credit institutions (see Note 21).

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**15 PROPERTY, PLANT AND EQUIPMENT**

	Land and buildings Ls	Equipment and machinery Ls	Other assets Ls	Assets under construction Ls	Advances for assets Ls	Total Ls
<b>At 1 January 2004</b>						
Cost or valuation	8,613,804	11,030,086	2,381,305	404,242	57,743	22,487,180
Accumulated depreciation	(1,168,188)	(6,542,906)	(1,796,107)	-	-	(9,507,201)
<b>Net book amount</b>	<b>7,445,616</b>	<b>4,487,180</b>	<b>585,198</b>	<b>404,242</b>	<b>57,743</b>	<b>12,979,979</b>
<b>Year ended 31 December 2004</b>						
Opening net book amount	7,445,616	4,487,180	585,198	404,242	57,743	12,979,979
Additions	-	-	-	-	1,540,631	1,540,631
Disposals	-	-	(3,284)	-	-	(3,284)
Reclassified from advance payments	245,764	84,738	601,199	243,037	(1,174,738)	-
Reclassification	-	208,466	168,260	(376,726)	-	-
Depreciation charge	(226,616)	(1,074,472)	(302,644)	-	-	(1,603,732)
<b>Closing net book amount</b>	<b>7,464,764</b>	<b>3,705,912</b>	<b>1,048,729</b>	<b>270,553</b>	<b>423,636</b>	<b>12,913,594</b>
<b>At 31 December 2004</b>						
Cost or valuation	8,859,568	11,160,801	3,087,810	270,553	423,636	23,802,368
Accumulated depreciation	(1,394,804)	(7,454,889)	(2,039,081)	-	-	(10,888,774)
<b>Net book amount</b>	<b>7,464,764</b>	<b>3,705,912</b>	<b>1,048,729</b>	<b>270,553</b>	<b>423,636</b>	<b>12,913,594</b>
<b>Year ended 31 December 2005</b>						
Opening net book amount	7,464,764	3,705,912	1,048,729	270,553	423,636	12,913,594
Additions	-	-	114,339	42,931	3,764,664	3,921,934
Disposals	(112,094)	(2,773)	(909)	-	-	(115,776)
Reclassified from advance payments	278,460	215,422	195,419	2,879,405	(3,568,706)	-
Reclassification	-	122,967	6,754	(129,721)	-	-
Revaluation surplus, net	5,000,766	-	-	-	-	5,000,766
Depreciation charge	(406,955)	(884,940)	(305,630)	-	-	(1,597,525)
<b>Closing net book amount</b>	<b>12,224,941</b>	<b>3,156,588</b>	<b>1,058,702</b>	<b>3,063,168</b>	<b>619,594</b>	<b>20,122,993</b>
<b>At 31 December 2005</b>						
Cost or valuation	12,481,642	11,352,060	3,316,434	3,063,168	619,594	30,832,898
Accumulated depreciation	(256,701)	(8,195,472)	(2,257,732)	-	-	(10,709,905)
<b>Net book amount</b>	<b>12,224,941</b>	<b>3,156,588</b>	<b>1,058,702</b>	<b>3,063,168</b>	<b>619,594</b>	<b>20,122,993</b>



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS** (continued)

**15 PROPERTY, PLANT AND EQUIPMENT** (continued)

The Company performed revaluation of buildings on 1 September 2005, when the revaluation was performed by independent valuers AS BDO Invest Rīga using the replacement cost method. As at 31 December 2005 total revaluation surplus represents Ls 6,276,045 (31.12.2004: Ls 1,158,680). The revaluation surplus net of applicable deferred tax was credited to "Revaluation reserve" in shareholders' equity.

If revalued buildings were stated on the historical cost basis, the carrying amount of these buildings as at 31 December 2005 would be Ls 6,323 thousand (2004: Ls 1,315 thousand). The carrying amount of the revalued buildings as at 31 December 2005 is Ls 11,011 thousand (2004: Ls 1,982 thousand).

All property, plant and equipment of AS Latvijas balzams are pledged in accordance with terms of Mortgage and Commercial pledge agreements as security for loans from the credit institutions (see Note 21).

Borrowing expenses in amount of Ls 42,931 were capitalized during 2005 (no borrowing expenses were capitalized in 2004).

**16 INVENTORIES**

	31.12.2005	31.12.2004
	Ls	Ls
Raw materials and consumables	5,841,165	5,208,922
Inventory in transit	377,077	142,861
Finished goods and goods for sale	2,898,711	2,924,804
Excise tax stamps	2,389,665	1,876,219
Work-in-progress	737,368	626,727
	<u>12,243,986</u>	<u>10,779,533</u>

During 2005 provisions for impairment of inventory were decreased by Ls 15,427. The amount of decreased provisions has been included in "Cost of sales" in the income statement. The provisions for impairment as at 31 December 2005 amounted to Ls 524,411 (31.12.2004: Ls 539,838).

All inventories of AS Latvijas balzams are pledged in accordance with terms of Mortgage and Commercial pledge agreements as security for loans from the credit institutions (see Note 21).

**17 TRADE RECEIVABLES**

Trade debtors	13,448,418	9,694,335
Provisions for impairment of trade debts	(2,320,430)	(2,290,912)
	<u>11,127,988</u>	<u>7,403,423</u>

**18 OTHER CURRENT ASSETS**

VAT accepted	94,757	20,597
Loans to the management of the Company	-	22,000
Insurance	83,045	69,806
Other deferred expenses	22,307	14,405
Receivables for raw materials	134,422	150,027
Receivables for services	139,064	79,384
Other debtors	38,139	106,045
	<u>511,734</u>	<u>462,264</u>

**19 CASH AND CASH EQUIVALENTS**

Cash in hand	46,656	47,158
Cash at bank	859,530	850,506
	<u>906,186</u>	<u>897,664</u>

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**20 SHARE CAPITAL**

	31.12.2005 Ls	31.12.2004 Ls
Registered share capital	<u>7,496,900</u>	<u>7,496,900</u>

As at 31 December 2005 the total authorised and fully paid share capital consists of 7,496,900 (31.12.2004: 7,496,900) ordinary shares. Nominal value of one share is Ls 1 (31.12.2004: Ls 1).

Bank borrowings (see Note 21) are secured by a pledge of all shares owned by the Company's largest shareholder, S.P.I. Distilleries B.V., and any other shares that S.P.I. Distilleries B.V. may acquire in the future.

**21 BORROWINGS**

AS SEB Latvijas Unibanka	3,718,603	5,070,267
AS Hansabanka	<u>5,213,205</u>	<u>5,306,273</u>
<b>Non-current borrowings</b>	<b>8,931,808</b>	<b>10,376,540</b>
AS SEB Latvijas Unibanka	680,000	680,000
AS Hansabanka	741,250	645,000
Credit line	2,991,647	717,497
SIA Bravo (for further details see Note 28(f))	<u>340,000</u>	<u>200,000</u>
<b>Current borrowings</b>	<b>4,752,897</b>	<b>2,242,497</b>
<b>Total borrowings</b>	<b><u>13,684,705</u></b>	<b><u>12,619,037</u></b>

The carrying amount of borrowings does not materially differ from their fair value.

On 30 April 2004 the Company signed long-term loan agreement with AS Hansabanka and AS SEB Latvijas Unibanka for USD 12,500,000, which represents Ls 6,912,500, translated at the exchange rate set by the Bank of Latvia as at 30 April 2004, and Ls 6,800,000 respectively. Interest rate constitutes 6 months LIBOR plus 1.6% for the part of the loan in USD and 3 months RIGIBOR plus 1.6% for the part of the loan in lats.

As at 31 December 2005 the Company's liability to AS Hansabanka for received loan is USD 10,062,500, which represents Ls 5,967,063, translated at the exchange rate set by the Bank of Latvia as at 31 December 2005.

As at 30 April 2004 the Company signed credit line agreement with AS Hansabanka and AS SEB Latvijas Unibanka for Ls 2,675,000 and Ls 2,800,000 respectively. Interest rate is 3 months RIGIBOR plus 1.6%. As at 20 May 2005 the Company signed amendments to the credit line agreement with AS Hansabanka and AS SEB Latvijas Unibanka for Ls 4,058,000 and Ls 4,025,000 respectively. Fixed interest rate part was decreased to 0.95%. The credit line is repayable in one year.

As at 31 December 2005 the Company has unutilised credit line in amount of Ls 5,091,353.

The effective interest rates at the balance sheet date were as follows:

	31.12.2005	31.12.2004
Borrowings	4.272% - 6%	3.946% - 6.003%
Credit line	4.983%	6.137%

The exposure of the total principal amount of borrowings to interest rate changes and the periods in which the borrowings reprice are as follows:

	31.12.2005 Ls	31.12.2004 Ls
6 months or less	13,344,705	12,419,037
6 - 12 months	<u>340,000</u>	<u>200,000</u>
	<b><u>13,684,705</u></b>	<b><u>12,619,037</u></b>



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**21 BORROWINGS (continued)**

The loan principals have to be repaid by 30 April 2009. According to the loan agreement with AS Hansabanka and AS SEB Latvijas Unibanka the Company has a right to prolong the repayment of the loan until 30 April 2015.

Maturity of the total borrowings is as follows:

	31.12.2005 Ls	31.12.2004 Ls
Payable in 1 year	4,752,897	2,242,497
Payable between 2 and 5 years	8,931,808	10,376,540
	<u>13,684,705</u>	<u>12,619,037</u>

The loans are secured by the mortgage of (i) all real estate owned by AS Latvijas balzams and (ii) commercial pledge of all Company's assets on the date of pledging and all assets that might be acquired in the future, and (iii) all shares owned by the Company's largest shareholder, S.P.I. Distilleries B.V., and any other shares that S.P.I. Distilleries B.V. may acquire in the future. Carrying value of the pledged assets of the Company as at 31 December 2005 is Ls 53,137,219.

**22 OTHER PAYABLES**

	31.12.2005 Ls	31.12.2004 Ls
Excise tax *	7,456,713	4,411,475
Value added tax	1,210,201	738,270
Social insurance	110,374	94,719
Personal income tax	81,411	75,583
Natural resources tax	48,456	37,990
Real estate tax	27,649	5,296
Salaries	193,979	161,826
Prior years' unpaid dividends	5,235	5,235
Accruals for unused annual leave	284,219	216,070
Other accrued liabilities	472,000	235,000
Other creditors	2,375	17,775
	<u>9,892,612</u>	<u>5,999,239</u>

\* Includes deferred excise tax in amount of Ls 2,535,805 (31.12.2004: Ls 2,739,150) calculated in accordance with Latvian legislation after joining the European Union.

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**23 CASH GENERATED FROM OPERATIONS**

	2005 Ls	2004 Ls
Profit before corporate income tax	2,990,020	905,687
<u>Corrections:</u>		
- depreciation and amortization (Notes 14 and 15)	1,810,019	1,831,537
- increase / (decrease) of provisions for impairment of inventory	221,573	(149,046)
- loss / (gain) on foreign currency exchange rate fluctuation	856,501	(445,000)
- interest expenses (Note 11)	551,010	673,830
- loss / (gain) from disposal of property, plant and equipment and revaluation	217,339	(3,347)
- write off of borrowing costs	5,705	-
<u>Change in working capital</u>		
- debtors	(4,042,481)	(2,479,699)
- inventory	(1,449,026)	(2,695,490)
- creditors	5,665,727	3,200,642
	<u>6,826,387</u>	<u>839,114</u>

**24 AVERAGE NUMBER OF EMPLOYEES**

	2005	2004
Average number of employees during the reporting year:	<u>726</u>	<u>674</u>

**25 PERSONNEL EXPENSES**

	2005 Ls	2004 Ls
Salaries and social insurance for production staff	2,764,146	2,248,379
Salaries and social insurance for distribution staff	1,030,069	881,525
Salaries and social insurance for administration staff	943,475	850,195
<b>Total*</b>	<u>4,737,690</u>	<u>3,980,099</u>
including:		
the Board members' and management remuneration		
- salary expenses	437,124	402,275
- social insurance	55,000	56,379
the Council remuneration		
- salary expenses	-	402
- social insurance	-	97

According to the shareholders' decision, the Board and the Council members do not receive additional remuneration for fulfilment of their duties.

\* Includes social insurance of Ls 878,340 (2004 - Ls 737,799).

During the reporting year, no loans were issued to members of the Council, the Board and the Management staff.



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**26 ISSUED GUARANTEES AND PLEDGES**

The Company issued guarantee to AS Parekss banka regarding credit line issued to SIA Bravo in amount of Ls 3,000,000. The repayment term for this credit line is 25 January 2008.

In 2005 the Company issued guarantee to AS Parekss banka regarding employee of S.P.I. Spirits Ltd. for the total amount of USD 100,000.

**27 CAPITAL COMMITMENTS**

During year 2004 the Company signed and during year 2005 implemented amendments in the agreements regarding construction works. The capital commitments as at 31 December 2005 were Ls 2,098 thousand (31.12.2004: Ls 667 thousand).

The Company is leasing trade marks from S.P.I. group. The amount of the royalties depends on the amount of the produced drinks subject to royalty payments. According to the management estimates the royalty payments during 2006 will be approximately Ls 739 thousand (31.12.2004: Ls 390 thousand).

**28 TRANSACTIONS WITH RELATED PARTIES**

The largest shareholder of the Company, who owns 88.05% of shares of the Company, is S.P.I. Distilleries B.V., which is registered in Netherlands. The ultimate parent company is S.P.I. Group SA, which is registered in Switzerland and its majority shareholder is Mr. Shefler.

During year 2005 the Company had purchase and sale transactions with the following related companies which are direct or indirect subsidiaries of SPI Group SA: S.P.I. Spirits Ltd. (Cyprus), Spirits Product International IP B.V., Spirits International GmbH (Germany), Torgovy dom SPI-TRADE, CJSC Sojuzplodimport, Tambovskoje spirtovoje predpriyatije Talvis, S.P.I. Worldwide Trade Ltd., Torgovi Dom Rosvestalko, Spirits International N.V. (Netherlands), UAB Baltijos alkoholiniai produktai, SPI-RVVC OAO (Russia) and SIA Bravo.

**(a) sale of goods**

	2005 Ls	2004 Ls
S.P.I. Spirits Ltd.	20,167,165	12,296,059
Torgovi Dom Rosvestalko	966,002	554,161
Torgovy dom SPI-TRADE	4,336	-
SPI-RVVC OAO	16,145	-
SIA Bravo	65,693	145,591
S.P.I. Worldwide Trade Ltd.	70,280	-
	<u>21,289,621</u>	<u>12,995,811</u>

**(b) services rendered**

S.P.I. Spirits Ltd.	241,901	215,167
SIA Bravo	5,619	8,960
Spirits Product International IP B.V.	1,859	8,870
Spirits International N.V.	1,155,949	-
UAB Baltijos alkoholiniai produktai	2,117	-
CJSC Sojuzplodimport	-	2,887
Tambovskoje spirtovoje predpriyatije Talvis	-	1,277
SPI-RVVC OAO	-	999
Torgovy dom SPI-TRADE	-	621
	<u>1,407,445</u>	<u>238,781</u>

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**28 TRANSACTIONS WITH RELATED PARTIES (continued)**

**(c) purchase of goods**

	2005 Ls	2004 Ls
SPI-RVVC OAO	5,292,055	4,701,739
S.P.I. Spirits Ltd.	77,206	171,917
Spirits International GmbH	10,366	162,858
CJSC Sojuzplodimport	56,491	-
Tambovskoje spirtovoje predprijetije Talvis	1,500,999	87,222
SIA Bravo	18,705	1,998
	<u>6,955,822</u>	<u>5,125,734</u>

**(d) services received**

Spirits Product International IP B.V.	387,190	299,119
S.P.I. Spirits Ltd.	806,597	322
UAB Baltijos alkoholiniai produktai	25,500	35,944
	<u>1,219,287</u>	<u>335,385</u>

**(e) accounts payable to related parties**

	31.12.2005 Ls	31.12.2004 Ls
SPI-RVVC OAO	58,024	478,678
SIA Bravo	16,848	2,027
Spirits Product International IP B.V.	283,580	68,999
S.P.I. Spirits Ltd.	177,545	54,610
Tambovskoje spirtovoje predprijetije Talvis	-	51,890
	<u>535,997</u>	<u>656,204</u>

Payables are payable in cash and are not secured by a pledge or otherwise.

**(f) loans from related parties**

<u>340,000</u>	<u>200,000</u>
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On 29 November 2005 the Company signed short-term agreement with Bravo SIA regarding loan in amount of Ls 340,000. The repayment term is 31 December 2006. Interest rate is 6% per annum.

Loans are payable in cash and are not secured by a pledge or otherwise.

**(g) accounts receivable from related parties**

S.P.I. Spirits Ltd.	4,561,410	4,579,085
Torgovi Dom Rosvestalko	383,972	236,576
Spirits Product International IP B.V.	10,808	8,730
SIA Bravo	36,988	3,825
CJSC Sojuzplodimport	3,239	3,240
Tambovskoje spirtovoje predprijetije Talvis	-	1,414
SPI-RVVC OAO	1,129	1,129
Torgovy dom SPI-TRADE	5,485	697
Spirits International NV	1,054	-
UAB Baltijos Alkoholiniai Produktai **	2,118	-
S.P.I Worldwide Trade Ltd.	70,280	-
	<u>5,076,483</u>	<u>4,834,696</u>

Accounts receivable are payable in cash and are not secured by a pledge or otherwise.

No bad and doubtful debts due from related parties in 2005 and 2004.



**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**28 TRANSACTIONS WITH RELATED PARTIES (continued)**

**(h) loans to related parties**

	31.12.2005	31.12.2004
	Ls	Ls
S.P.I. Spirits Ltd. *	2,965,000	-
UAB Baltijos Alkoholiniai Produktai **	66,063	-
	<u>3,031,063</u>	<u>-</u>

\* Includes loan issued to S.P.I Spirits Ltd. in amount of USD 5,000,000, which represents Ls 2,965,000, translated at the exchange rate set by the Bank of Latvia as at 31 December 2005. Maturity term is 28 December 2006. Interest rate is LIBOR plus 1.5%.

\*\* On 3 December 2005 the Company signed loan agreement with UAB Baltijos Alkoholiniai Produktai for loan in amount of EUR 107 thousand with fixed interest rate 4.5% per annum. Maturity term is 31 December 2006. Until 31 December 2005 the Company issued EUR 94,000 which represents Ls 66,063, translated at the exchange rate set by the Bank of Latvia as at 31 December 2005.

Loans are payable in cash and are not secured by a pledge or otherwise.

No bad and doubtful debts due from related parties in 2005 and 2004.

**(i) issued guarantees**

The Company issued guarantee to AS Parekss banka regarding credit line issued to SIA Bravo in amount of Ls 3,000,000. The repayment term for this credit line is 25 January 2008.

**(j) royalty payments**

The Company is leasing trade marks from S.P.I. group. The amount of the royalties depends on the amount of the produced drinks subject to royalty payments. Royalty payments are included in total services received (Note 28f). According to the management estimates the royalty payments during 2006 will be approximately Ls 739 thousand (31.12.2004: Ls 390 thousand).

**29 FINANCIAL RISK MANAGEMENT**

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

**(a) Credit risk**

Financial assets which potentially subject the Company to concentration of credit risk consist principally of cash, trade receivables and issued loans. The Company has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. Customer debts are reported at their recoverable value. The partners of the Company in money transactions are local and foreign financial institutions with adequate credit history.

**(b) Foreign exchange risk**

The Company is exposed to foreign exchange risk arising from various currency exposures primarily because the majority of raw materials are purchased in EUR and USD, but a significant part of goods are sold in local market and exported to the markets dominated by US dollar. As of 1 January 2005 the Lat exchange rate has been tied to EUR, therefore the Lat/EUR exchange rate fluctuation possibilities are limited, and any substantial influence of this exchange rate on future financial results is not foreseen. In order to decrease influence of US dollar over the operations of the Company, part of the financing received from credit institutions is denominated in US dollars.

**AS LATVIJAS BALZAMS**  
**FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**29 FINANCIAL RISK MANAGEMENT (continued)**

**(c) Interest rate risk**

The Company is exposed to changes in interest rates, as largest portion of liabilities is interest bearing liabilities having floating interest rates. The Company continues to monitor the market in general, but at present do not consider it cost efficient to enter into any long-term interest rate swaps to limit the risk of increase in interest cost.

**(d) Liquidity risk**

The Company pursues a prudent liquidity risk management maintaining sufficient credit resources that allow to settle liabilities when they fall due. As at 31 December 2005 the Company's current assets exceeded its current liabilities by Ls 11.3 million. Additionally during 2005 the Company increased credit line facility by Ls 2,608 thousand amounting to Ls 8,083 thousand. Unutilised portion of credit line as at 31 December 2005 is Ls 5,091 thousand.

**(e) Fair value**

There are no material differences between the carrying amounts of financial assets and liabilities and their fair values. During the year, the Company did not use any derivative financial instruments.

**30 CONTINGENT LIABILITIES**

The Company is involved in litigation with SIA Aroma Floris's, which handed in the claim on compensation of losses in amount of Ls 36,346. In case of unfavourable court decision the Company can appeal the court decision. Since the management of the Company considers that the claim is invalid no provisions are recognised.

**31 SUBSEQUENT EVENTS**

On 16 March 2006 the Company has established 100% subsidiary undertaking SIA Meierovica 35, which will be involved in management and maintenance of real estate. The subsidiary's share capital is Ls 4,409,000, consisting of 4,409 shares with nominal value of Ls 1,000 each. Investment in subsidiary undertaking was partially financed by investment of the real estate owned by the Company. The carrying amount of the invested real estate as of 31 December 2005 is Ls 2,937,129, which according to the management estimates is equal to its fair value.

There are no subsequent events since the last date of the reporting year, which would have a significant effect on the financial position of the Company as at 31 December 2005.