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Joint Stock Company "Latvijas Gāze"
Annual Report 2006

Our planet, the Earth, is wonderful! Everything is correlated here. Thousands of fine ties link us to the mighty nature - to clouds in the sky, to water in rivers and seas, to birds high in the sky, to fish in the oceans, to flowers in the meadows, to big animals and small bugs.

People, animals and trees breathe the same air and live on the resources of the Earth. But only the human being - each and every one of us - is responsible for the future of the Earth. With our choice of energy resources we can impact the natural balance of things.

Natural gas is an environmentally friendly kind of fuel. Its use does not turn our planet into a desert.

Natural gas is the beginning of a better energy and cleaner environment in Latvia.



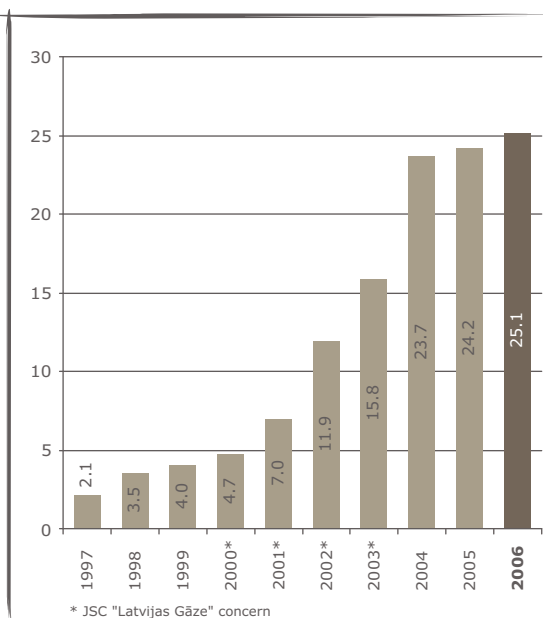
THE COMPANY IN 2006

In 2006 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 Lithuania by developing and modernizing the gas supply system and its related services.

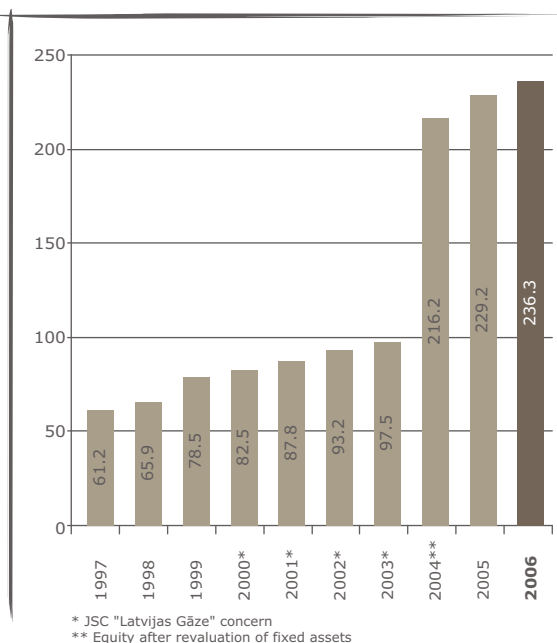
The basic areas of activity of the company are:

- 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.

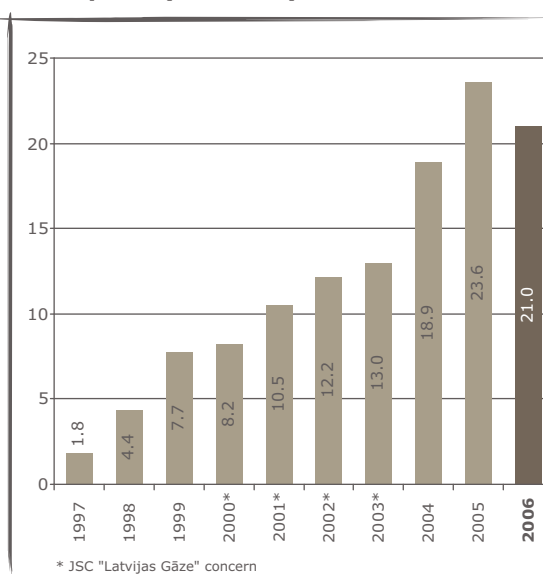
Investment (million Ls)



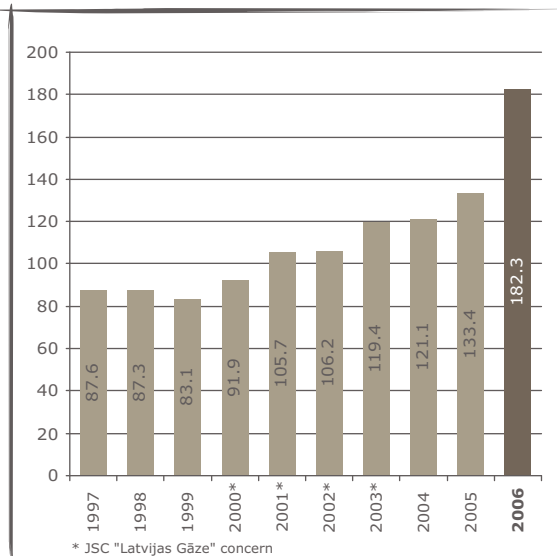
Equity (million Ls)



Net profit (million Ls)



Net turnover (million Ls)





A. Dāvis Chairman of the Board

Dear ladies and gentlemen!

The centuries-long effort of scientists to create the mythical "perpetuum mobile" confirms that energy is the source of survival of the civilization. Gas as a source of energy has an important role in Latvia already for 145 years. In 1862, the first gas factory started working in Riga, extracting gas from coal processing. Exactly 100 years later – in 1962 – the gas industry in Latvia experienced radical changes. 45 years ago, the gas transmission pipeline Dashav (Ukraine) – Riga was built, thus the gas industry learned the possibilities of natural gas and provision of gas supply services to the country rapidly began.

The political changes bringing about Latvia's independence were critical to the state economy. At the beginning of the 1990s, the situation of gas industry was as insecure as the situation of the state economy in general. The outdated gas supply infrastructure did not meet the requirements of the modern times, the gas purchase price increased and exceeded the gas sale price due to fluctuations of the currency market. Along with the liquidation of USSR companies, "Latvijas Gāze" lost its major consumers. For several years, "Latvijas Gāze", while suffering losses, credited companies that were unable to sell their products and pay for the supplied gas. It was also necessary to provide heating companies with

gas, since people could not be left without heating in winter. Enormous debts arose, suppliers threatened to cut off gas supplies. Loans of the Bank of Latvia and the World Bank did not solve the problems but only postponed the company's insolvency and a national-scale crisis.

In 1994, the state company "Latvijas Gāze" was turned into a joint stock company and included on the list of objects to be privatized. In compliance with the privatization regulations, in 1997 two investors were attracted to the company as shareholders: a gas supplier – the Russian Open Joint Stock Company "Gazprom" and a strategic investor – the German consortium of energy companies "Ruhrgas AG" and "PreussenElektra AG" (now the united company "E.ON Ruhrgas International AG"). In 1999, the LLC "ITERA Latvija" also became a shareholder of the company. In 2002, in a public offer the last 3% of the state-owned shares were sold and the process of privatization of the company was completed.

In 2007, it is the tenth anniversary since the privatization of the company "Latvijas Gāze" was commenced. Before privatization it was impossible to predict how effective this instrument would be in development of the company, but now it is clear that



owing to privatization "Latvijas Gāze" has transformed in a new quality. The reason of success is obvious – the shareholders of JSC "Latvijas Gāze" are not financial groups, but professional gas companies with broad experience in energy supply. Shareholders' foresight and insight ensured huge investment in the development of the company without expectations of immediate return. The company "Latvijas Gāze" received the necessary financial, technical, economic and legal help on all issues. Employees of the company could participate in conferences and seminars; and their professional growth was rapid. Before privatization, investment in the development of the company was small, but in these ten years, with the amount of investment increasing annually, 122 million lats (EUR 173.6 million) have been invested in the safety of the "Latvijas Gāze" system and company modernization and development. In the next year, it is planned to invest another 32 million lats (EUR 45.5 million).

From a horizontally integrated company "Latvijas Gāze" has changed into a vertically integrated structure, the cash flow and the number of personnel have been optimized, unified financial accounting and management has been established, operational costs have been reduced. Significant investments still are made to ensure the system safety and natural gas supply stability, as well as in

the development of information technologies. The market is constantly being extended by building of new gas pipelines, and the position of natural gas in the market of primary energy resources has noticeably increased. Also, considerable resources are devoted to elaborate strategic development plans for gas supply.

Latvia has enormous potential provided by the nature – ten non-reclaimed underground gas storage facilities capable of storing up to 50 billion m³ of active natural gas. Building of the Dobele and other underground gas storage facilities and connection thereof to the Baltic Sea gas pipeline "Nord Stream" would enable partial stabilization of gas supplies to the consumers of the European Union countries. However, it is clear that the implementation of a project of such scale is possible only with the collaboration between the European Union countries, including Latvia, and Russia. The company "Latvijas Gāze" is ready to work in order to implement these major plans the purpose of which is – to increase the welfare of the country!

Chairman of the Board

A. Dāvis

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Kiril Seleznev Chairman of the Council

THE COUNCIL REPORT

In 2006, oil product prices continued to increase in the world. The economic development of Latvia, in turn, was significantly affected by the high inflation, which remained very high for the second year in a row, reaching 7%. Although the growing domestic demand is considered to be the cause of inflation, it is also noticeably influenced by price equalization (including prices of energy resources) with the "old" EU countries. These factors and the parliamentary elections in autumn had a significant impact on the business environment and the results of economic activity of the Joint Stock Company "Latvijas Gāze" (hereinafter – the Company). Working in competitive conditions the Company has been capable of maintaining its position in the fuel market and has ensured an increase in the amount of natural gas sold despite the unusually high air temperature in the second half of the year.

The Company has managed to react quickly to the changes in the gas purchase price, and in collaboration with the state administration institutions and the Public Utility Commission it has achieved an increase of the natural gas tariffs and prices for consumers. Thus, preconditions have been created for sufficient liquidity of the Company, stable dividend policy and implementation of

voluminous investment projects have been ensured. The net profit of the Company in 2006 reached Ls 21.0 million (EUR 29.9 million) and the net profitability of basic activity – 11.5%, corresponding to the level of 2005.

In 2006, "Latvijas Gāze" continued its work on improving the safety of the gas supply system in compliance with the updated action plan for 2006-2010, which has been discussed and supported by the Company's Council.

The main directions of the plan are as follows:

- improvement and development of the operational safety of the Inčukalns Underground Gas Storage Facility;
- modernization and diagnostics of the system of gas transmission pipelines and elimination of the defects found as the result of diagnostics;
- completion of the modernization programme of all gas regulation stations;
- modernization of the natural gas distribution system, improvement of the available information technologies and introduction of new technologies;
- construction of new gas pipelines and improvement of customer service.

In 2006, the Council reviewed and approved changes in the contracts with natural gas suppliers OJSC "Gazprom" and LLC "ITERA Latvija" that provided not only for price changes of gas to be sold in correspondence with the oil product price increase, but also updated the terms of the contract in compliance with the internationally accepted norms.

The Council has become acquainted with the Corporate Governance Report for the past year, prepared by the Board. For the first time, the report was prepared in compliance with the "Principles of Corporate Governance and Recommendations on Their Implementation", issued by the JSC Riga Stock Exchange. The Council considers that the Board has accomplished a significant task to enable the Company to observe in its operation the recommended principles of corporate governance. The Council follows the same principles in its work.

In 2006, the Council received regular Board reports on the operation, the economic and financial situation of the Company. The Council supervised the operation of the Board in all the main directions and ensured that the Company operates in compliance with the laws, the Articles of Association of the Company and the resolutions of the Shareholders' meeting, verified and accepted submitted Company's budget, as well as made proposals for the improvement of the Company's operation.

In 2006, the term of office expired for both the Council and the Board of the "Latvijas Gāze". E. Benke, U. Fip, S. Kamphues, Y. Karpel, A. Krasnenkov, R. Lehmann, I. Nazarov, J. Savickis, K. Seleznev and V. Rusakova were re-elected as members of the Council of the Company. M. Soehrich was elected as the new member of the Council, but

M. Keuchel left his post. K. Seleznev was elected as the Chairman of the Council, but S. Kamphues and J. Savickis – as Deputy Chairmen.

In the Company Board A. Dāvis, G. Freibergs, A. Mihejev and A. Ulpe were re-elected. J. Tumat was elected as the new member, but F. Siebert left his post. A. Dāvis was re-elected as the Chairman of the Board, and J. Tumat and A. Mihejev – as Deputy Chairmen. The Council expresses its gratitude and acknowledgement to M. Keuchel and F. Siebert for their great work and contribution to the development of the Company and sincerely wishes great success in the new job.

The audit of the 2006 Annual Accounts of the Company was carried out by the International Audit Company LLC "PricewaterhouseCoopers". The Council has received the auditor's reports which confirm that the financial statements give a true and fair view of the financial position of the JSC "Latvijas Gāze" as of 31 December 2006, as well as its financial results and cash flows in 2006 in compliance with the Annual Accounts Act of the Republic of Latvia. The Council has reviewed and approved the Board Report regarding the activity of the Company in the reporting year, the research and development activities, financial risk management, as well as proposals for the distribution of profit of 2006.

The Council of the Company acknowledges the successful performance of its Board and employees in 2006 and wishes success and growth in the future as well.



Chairman of the Council

K. Seleznev

THE COUNCIL OF JSC "LATVIJAS GĀZE"

The Council of the Company is elected for three years by the General Meeting of Shareholders of the JSC "Latvijas Gāze". In 2006, membership of the Council of the JSC "Latvijas Gāze" was as follows:



Marcus A. Soehrich

Member of the Council,
representing the share
of "E.ON Ruhrgas International AG"
in the Company
(from 27.07.2006)

Uwe Fip

Member of the Council,
representing the share
of "E.ON Ruhrgas International AG"
in the Company

Stephan Kamphues

Deputy Chairman of the Council,
representing the share
of "E.ON Ruhrgas International AG"
in the Company

Reiner Lehmann

Member of the Council,
representing the share
of "E.ON Ruhrgas International AG"
in the Company

Vlada Rusakova

Member of the Council,
representing the share
of OJSC "Gazprom"
in the Company

Eike Benke - Member of the Council,
representing the share of "E.ON Ruhrgas International AG" in the Company



Kiril Seleznev

Chairman of the Council,
representing the share
of OJSC "Gazprom"
in the Company

Yelena Karpel

Member of the Council,
representing the share
of OJSC "Gazprom"
in the Company

Juris Savickis

Deputy Chairman of the Council,
representing the share
of LLC "ITERA Latvija"
in the Company

Igor Nazarov

Member of the Council,
representing the share
of LLC "ITERA Latvija"
in the Company

Aleksandr Krasnenkov

Member of the Council,
representing the share
of OJSC "Gazprom"
in the Company

Matthias Keuchel - Member of the Council,
represented the share of "E.ON Ruhrgas International AG" in the Company (till 26.07.2006)

THE BOARD OF THE JCS "LATVIJAS GĀZE"

The Board of the Company is elected for three years
by the General Meeting of Shareholders of the JSC "Latvijas Gāze".
In 2006, membership of the Board of the JSC "Latvijas Gāze" was as follows:



GINTS FREIBERGS

Member of the Board

ALEKSANDR MIHEJEV

Member of the Board,
Deputy Chairman of the Board

Frank Siebert

Member of the Board (till 15.08.2006), Deputy Chairman of the Board (till 15.08.2006)



ADRIANS DĀVIS
Chairman of the Board

ANDA ULPE
Member of the Board

JOERG TUMAT
Member of the Board (from 16.08.2006),
Deputy Chairman of the Board (from 16.08.2006)

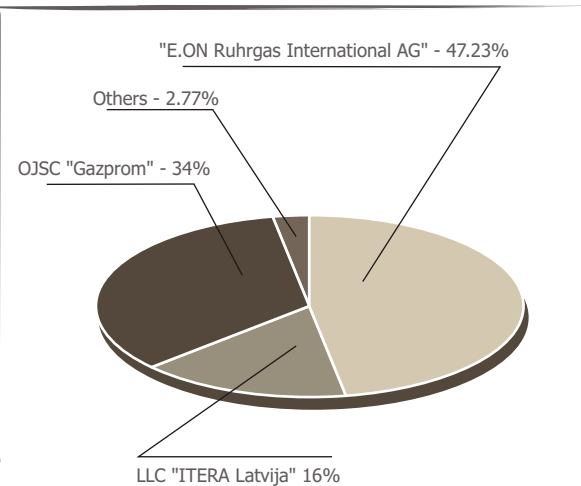
SHAREHOLDERS AND SHARES

In 2006, quotation of the JSC "Latvijas Gāze" shares in the Official List of the Riga Stock Exchange (RSE) and the Official List of the Baltic Stock Exchange (BSE) continued. The capitalization value of the company at the end of 2006 reached Ls 411.77 million (EUR 585.9 million), which was by Ls 28.3 million (EUR 40.27 million) more than at the end of 2005. In terms of capitalization value at the end of the reporting year, the shares of the JSC "Latvijas Gāze" took the first place among securities quoted at RSE and the fifth place among those quoted at BSE. In comparison to the end of 2000, the capitalization value of the JSC "Latvijas Gāze" shares at the end of the reporting year had increased almost four times. At the end of 2006, RSE introduced a new family of Baltic indices, two of which included the JSC "Latvijas Gāze" – OMX Baltic and OMX Baltic Energy.

In the reporting year, the price of one share of the JSC "Latvijas Gāze" fluctuated from Ls 9.27 to Ls 11.13 (EUR 13.19 to EUR 15.84) and reached Ls 10.32 (EUR 14.68) at the end of the reporting year, which is by 7.39% more than at the end of 2005. During the reporting year, the JSC "Latvijas Gāze" share turnover at RSE reached 128 844 shares at the value of Ls 1 316 154 (EUR 1 872 718). The share price at RSE has constantly grown since 2000, thereby confirming the stability and reliability of the JSC "Latvijas Gāze" to its shareholders. At the end of 2006, the price of one share of the JSC "Latvijas Gāze" at RSE had increased three times in comparison to 2000.

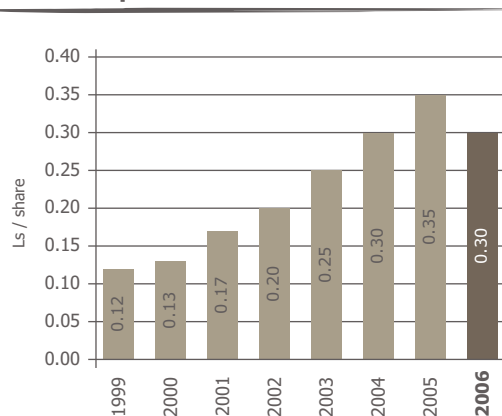
The equity capital of the company at the end of the reporting year had not changed and remained Ls 39.9 million (EUR 56.8 million), which divides into as many shares with voting rights with the nominal value of Ls 1 (EUR 1.42). In the reporting year, the shareholder structure of the JSC "Latvijas Gāze" has also remained unchanged. At the end of 2006, there were three main shareholders of the JSC "Latvijas Gāze": the German company "E.ON Ruhrgas International AG" (47.23% of shares), Russian OJSC "Gazprom" (34%) and LLC "ITERA Latvija" (16%). The remaining shares belonged to minor shareholders, including the employees of the JSC "Latvijas Gāze".

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



On May 31, 2007, the Council of the JSC "Latvijas Gāze" approved a draft profit distribution, which envisages paying out Ls 0.30 (EUR 0.427) per share or Ls 11.97 million (EUR 17.03 million) in total, which is 57% of the company's profit in 2006. In comparison to 2005, the amount of dividends planned to be paid out for one share has decreased by LVL 0.05, but it should be noted that the JSC "Latvijas Gāze" pays dividends to its shareholders regularly every year since 1999 and, overall, the amount of dividends paid out tends to grow.

Dividends paid



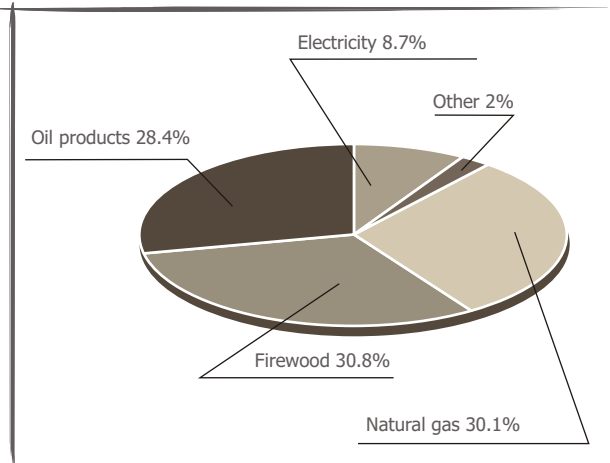
NATURAL GAS IN THE ENERGY RESOURCE MARKET OF LATVIA

The energy resource balance of Latvia did not change in the reporting year, and it consisted of imported natural gas, liquefied oil gas, various oil products and coal, as well as local fuel resources – firewood and peat. All these types of fuel are used for meeting the heat supply needs of Latvia.

In 2006, natural gas in the energy balance of Latvia takes the second place for the first time since 2000, lagging slightly behind firewood, yet still remaining one of the three most popular types of fuel in Latvia. It once again proves the benefits of natural gas as economic and ecologically clean fuel. In the reporting year, natural gas was the second cheapest fuel after coal. Of the total amount of natural gas consumed in Latvia, 61.4% were used for production of heating energy for district heating systems and electrical energy in thermal power stations, amounting to 73% of the fuel consumed for production of electrical and heating energy.

21% of the total amount of natural gas consumed were used by industry, whereas the rest – in other sectors; this includes also consumption by residential customers, which was 8% of the total amount of natural gas. Besides, it is characteristic that the popularity of natural gas as fuel increases every year. Consequently, in the reporting year the JSC "Latvijas Gāze" continued to implement many projects of provision of gas supply for private sector customers by both constructing new gas supply systems in new areas and elaborating and approving projects of

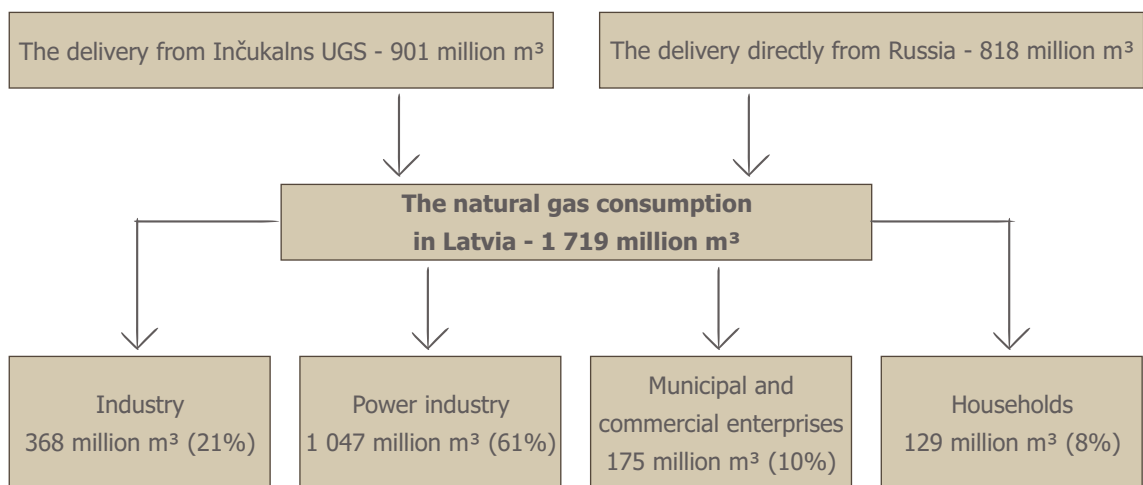
Energy balance in 2006 (%)



provision of gas supply to be implemented in future. At the same time, natural gas consumption kept increasing in almost all consumer groups, and a similar tendency is anticipated in 2007 as well.

Although, in reaction to the rapid price increase for oil and heavy fuel oil in the global market, the price of natural gas tends to increase every year, it still remains one of the cheapest fuel, therefore one can surely anticipate an increase in the popularity and the sale amount of natural gas in the coming years, especially taking into account several important factors: ecological considerations, the low prices, as well as the convenience and efficiency of supply and consumption.


Structure of natural gas consumption in 2006





m³

One can drive 12.5 km
with 1 m³ of natural gas
(compact class, 2.0l engine)

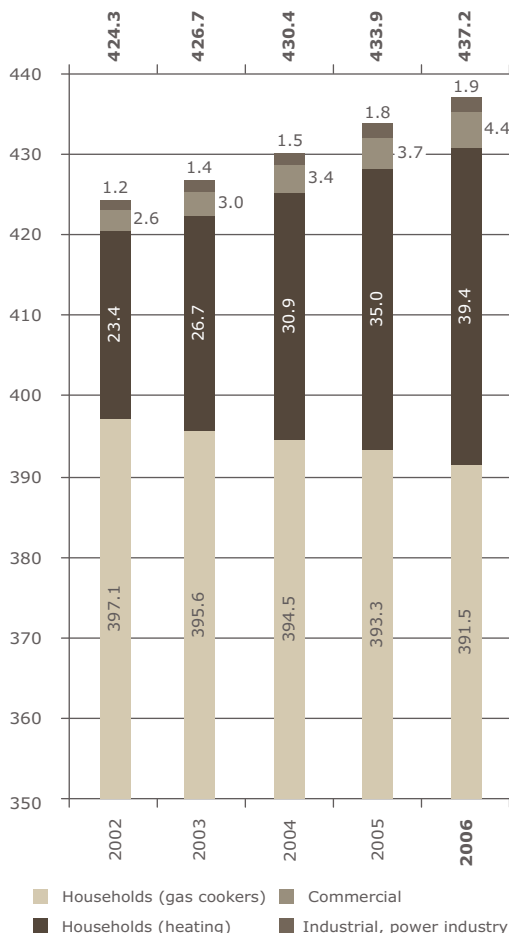
A close-up photograph of several vibrant green leaves, likely from a plant like a bamboo or reed. The leaves are covered in numerous small, clear water droplets that catch the light, giving the scene a fresh and dewy appearance. The background is softly blurred, emphasizing the texture and color of the leaves in the foreground.

Natural gas arises in a natural way,
the organic matter disintegrating deep in the underground.
The main component of natural gas (97.6%) is methane (CH_4).

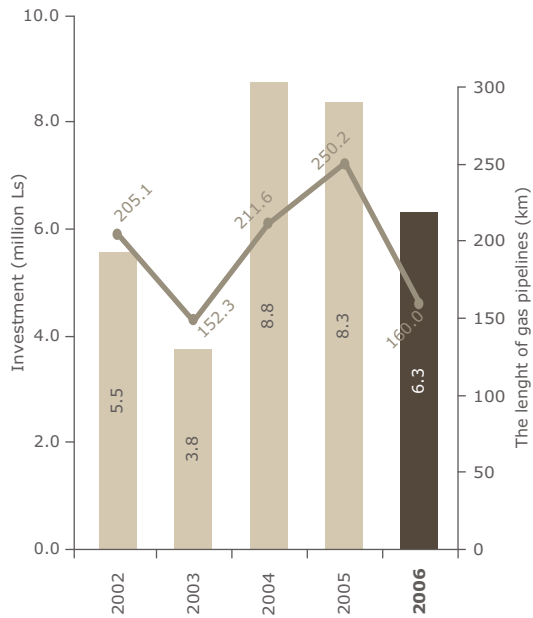
DEVELOPMENT OF THE COMPANY

In the reporting year, the JSC "Latvijas Gāze" devoted much attention to further expansion of the natural gas distribution system and connection of new users to the existing gas supply system. In 2006, gas distribution pipelines for the total value of Ls 4.9 million (EUR 6.96 million) were put into operation. Their total length is 160 kilometres. With the construction of the new gas pipelines the total length of the natural gas pipelines of the JSC "Latvijas Gāze" on January 1, 2007 reached 5872.3 kilometres, including the gas transmission pipelines – 1281.06 kilometres, and the gas distribution pipelines – 4591.25 kilometres. In 2006, the number of individual consumers using gas for heating increased by 4.3 thousand. At the end of the reporting year, the number of such users reached 39.4 thousand, and the total number of natural gas users approached 437.2 thousand.

Number of customers (thous.)



Construction of new gas pipelines and development of the system of gas distribution pipelines



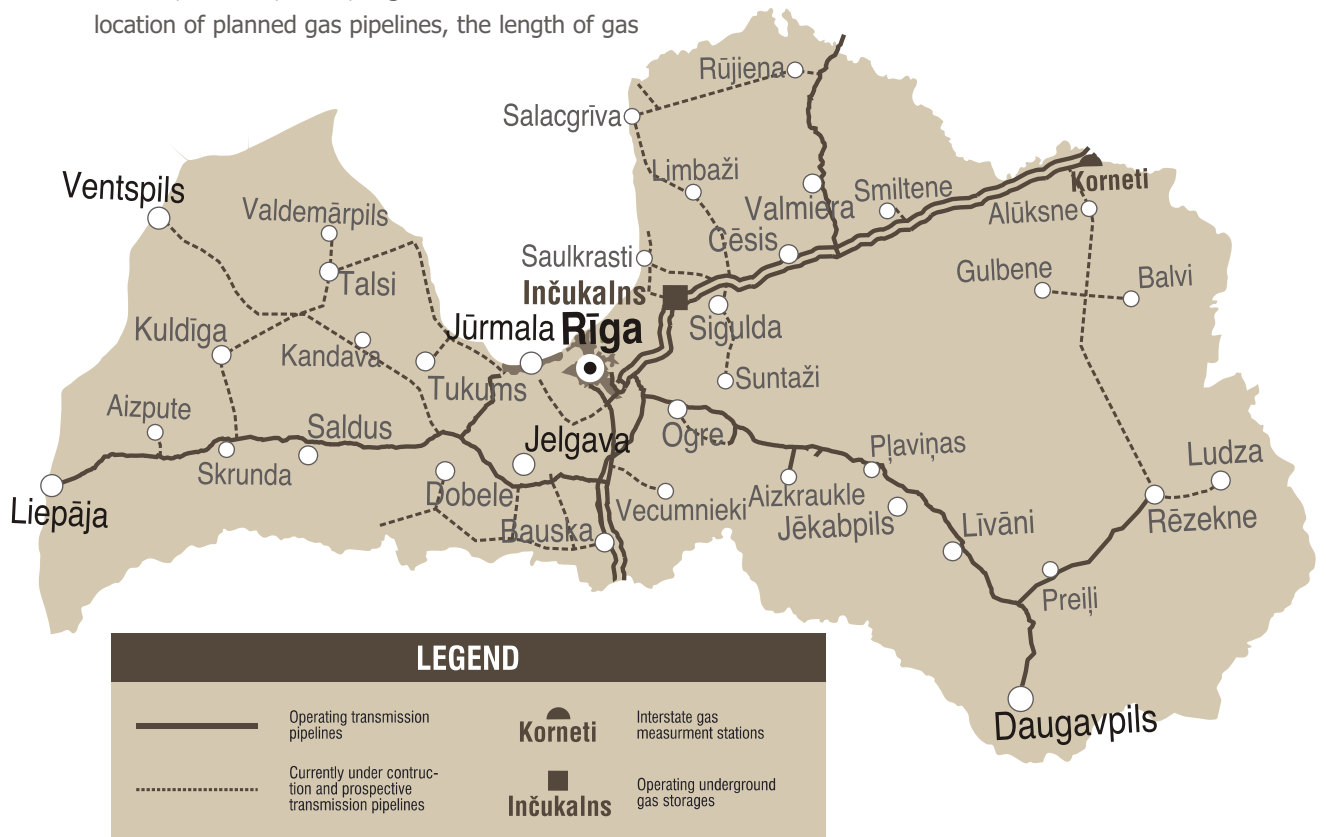
In 2006, the Contact Centre of the JSC "Latvijas Gāze", established in 2005, successfully continued its development. Improving the efficiency of operation of this structural unit, as of July 1, 2006 a short three-digit telephone number 155 with equal tariff for the outgoing calls for all landline subscribers was introduced. Due to this factor, the number of calls from the regions of the country has significantly increased and at the end of the reporting year it reached 14% of the total number of calls received by the Contact Centre. Overall, in 2006, the Contact Centre received more than 160 thousand telephone calls and sent almost four thousand letters and faxes. These indices confirm that the decision, made by the specialists of the JSC "Latvijas Gāze" in the previous years, regarding the establishment of a unified structural unit for co-ordinated customer service has been fully justified, and the JSC "Latvijas Gāze" is acting as a modern company.

In 2006, the construction of one of the most complex engineering structures was commenced - the natural gas pipeline on the TEC-2 with the maximum gas consumption equal to the amount consumed by 1/3 of the entire Latvia.



In the reporting period, the designs for the gas supply to the territories of the Riga district municipalities were elaborated. Proposals were drawn up regarding the prospective directions of the development of gas supply in Latvia: the prospective provision of gas supply to Tukums, Smiltene, Alūksne, Gulbene, Ludza, Engure and Saulkrasti. The location of planned gas pipelines, the length of gas

pipelines to be built and the approximate construction costs were evaluated. The principal scheme of gas supply to the Engure parish and Tukums was approved. On the basis of the technical and economic calculations, the possible investments of the company were ascertained.



INČUKALNS UNDERGROUND GAS STORAGE FACILITY

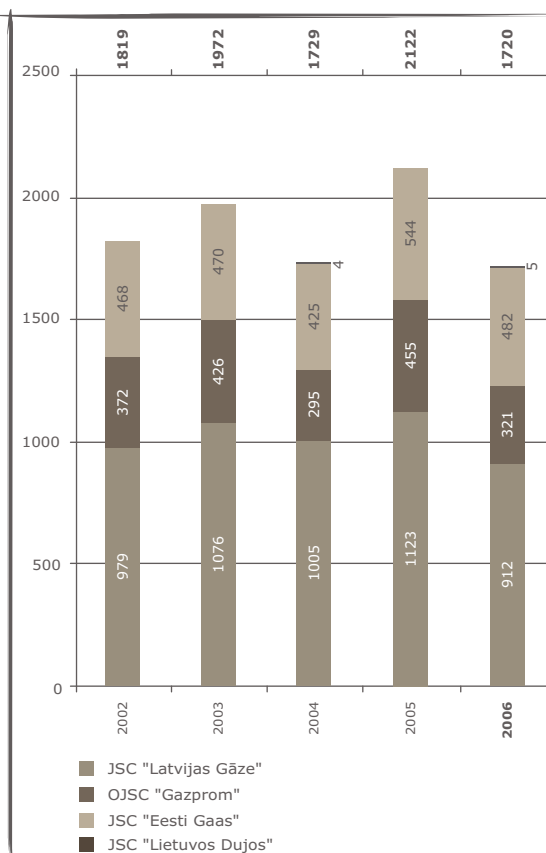


Inčukalns Underground Gas Storage Facility (hereinafter – Inčukalns UGS) – a structural unit of the JSC "Latvijas Gāze" – is a strategic unit of the gas supply system of the Baltic and Northwestern region of Russia, as during the heating season natural gas from the storage facility is supplied to consumers not only in Latvia, but also in Estonia and Russia. "Latvijas Gāze" has set closer intergration of the Inčukalns UGS into the common Baltic, Russian and European gas supply network as one of its main tasks. With the demand for fuel increasing, it is possible to expand the Inčukalns UGS, thereby augmenting its capacity and importance. Since the proportion of natural gas in the common European fuel balance is constantly increasing, importance of gas storage facilities grows, and Latvia finds itself in an especially beneficial situation because the capacity of its potential gas storage facilities is tens of billions cubic metres.

The Inčukalns UGS is not only a significant object of the JSC "Latvijas Gāze" – it is also important for the country in general, because a considerable amount of natural gas is stored in the facility – the Inčukalns UGS is one of the largest underground gas storage facilities in Europe, thus it is a national asset of Latvia as a member of the European Union.

The JSC "Latvijas Gāze" has a comprehensive

Natural gas deliveries from Inčukalns UGS (million m³)



approach to its primary activity – entrepreneurship is developed and balanced vis-à-vis concern for environment and safety. In order to accomplish this the company annually invests considerable financial resources in technology modernization, as well as promotes the awareness of each employee of the issues of environmental protection.

In the reporting year, the Inčukalns UGS reached the highest storage amount of natural gas in its history. The total amount of natural gas including blanket gas after stoppage of the injection process reached 4.47 billion cubic metres, including current gas – 2.325 billion cubic metres. In January 2006, record-high parameters of withdrawal, both monthly and daily, were reached – 24.7 million cubic metres of natural gas per day.

In the coming years, the JSC "Latvijas Gāze" has set modernization of the Inčukalns UGS as an investment priority. Work towards this priority had been started earlier and was continued in 2006 as well, spending 8.7 million lats in total for this purpose. Improvement of technologies provides not only economic effect, but also makes natural gas storage safer and more environmentally friendly. The main purpose of modernization is to improve the operation safety of above-ground and underground equipment, as well as to ensure uninterrupted operation of the gas storage facility in accordance with the planned capacities.

In order to ensure energy supply stability, the reconstruction of power supply equipment and installation of overvoltage system, commenced in 2005, was continued. In June 2006, this project was successfully completed, and currently the Inčukalns UGS receives power from the SJSC "Latvenergo" via two independent lead-ins. As a result of the implementation of this project, the 10 kV-voltage level has been excluded, and currently power is supplied to the Inčukalns UGS according to the traditional 20-0.4 kV scheme. All consumers of electricity are provided with uninterrupted power supply (diesel generators), including the gas production building, which is provided with a backup electro capacity of approximately 70%.

In the reporting year, specialists of the Inčukalns UGS, in collaboration with the Russian company "VNIIGAZ", elaborated a new well modernization programme, which differs from the previous programme in that each planned well is examined individually and not divided into groups as it has

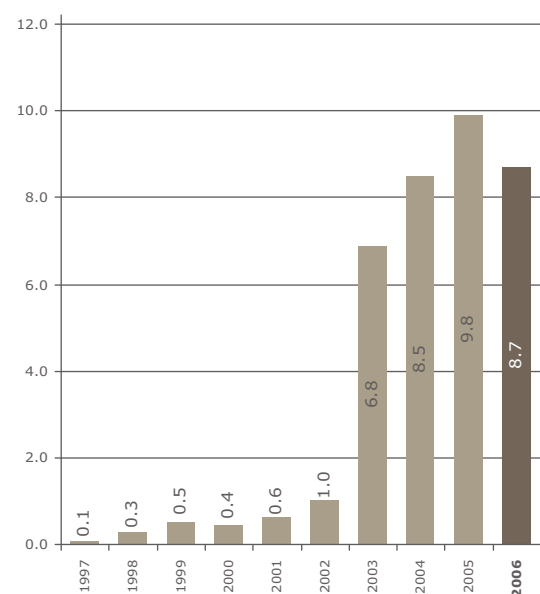
been done so far.

In 2006, specialists of the JSC "Latvijas Gāze" continued the reconstruction of the compressor shop No.1 (KC-1) and the instalment of the new turbine-type compressor that was commenced in previous years. All construction assembly works were completed, whereas in 2007 the programming of the automatic control system will have to be completed and the launching system adjusted. It is planned that KC-1 will start operating in June 2007. Also in 2006, capital repair of the compressor No.3 of the gas production shop KC-2 was continued.

In the reporting year, specialists of JSC "Latvijas Gāze" performed preliminary works for the reconstruction of the gas collection point No.1 and concluded contracts for supply of technological equipment, as well as for construction assembly. The planned works are expected to be commenced after the end of the gas extraction season of 2006-2007.

In 2006, a contract was concluded for a digital three-dimensional survey of the Inčukalns UGS communications and the implementation of this project was begun. It is planned to be completed in 2007. As the result, the Inčukalns UGS will receive a map of all communications of the storage facility (scale: 1:500) with depths of the communication lode. Currently, the digitalization of the geological archive of the Inčukalns UGS has also been started, including the digitalization of the neutron gamma carottage diagrams.

Investment in the Inčukalns UGS (million Ls)



m³



One can cook 200 pancakes,
utilizing 1 m³ of natural gas.

As a fuel natural gas has the least emission of carbon dioxide (CO₂). After the combustion of natural gas, there is no solid residue.



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

"Gāzes transports" provides for natural gas supply to the distribution system as requested by the natural gas distribution system operator, and for natural gas feed for injection into the Inčukalns UGS according to the technical capacity of the system, as well as the receipt of natural gas from abroad and transmission to foreign countries. It also provides for gas pressure adjustment in the natural gas transmission system, gas purification, odorization, commercial accounting of the gas received and put for sale and its input into the natural gas distribution system in compliance with the state standards.

The purpose of the operation unit "Gāzes transports" is to ensure uninterrupted natural gas transmission through the pipelines of the gas transmission system within its operation zone in compliance with the licence conditions and to develop the gas transmission system, observing the future perspectives, plans, technical strategy and commercial interests of the JSC "Latvijas Gāze". The policy of the JSC "Latvijas Gāze" is aimed at the maintenance and improvement of the system safety. It also includes continuity of gas supply and fail-safe operation of the system.

In 2006, the JSC "Latvijas Gāze" built no new GTP or their branches, therefore at the end of the reporting year, as in 2005, there were 1280.06 km of gas transmission pipelines and 48 GRS with commercial accounting units, gas odorization and warming equipment and diesel electric generators in the balance of "Gāzes transports". In addition, at the

end of 2006, the balance of "Gāzes transports" included the international GMS "Korneti", intended for commercial accounting of gas received from Russia and supplied to Russia, four automobile gas refill compressor stations (AGRCS), 103 ECP devices for pipeline protection against corrosion, as well as a communications, telemechanics and SCADA system for provision of uninterrupted stream of communication and technological information with all objects of GTP, structural units of the company and with countries related to GTP.

In the reporting year, the JSC "Latvijas Gāze" continued the modernization of the gas supply system that was commenced in previous years, replacing the old, morally and physically outdated GRS with modern, safe and environmentally-friendly ones. Also, in the course of modernization, replacement of ECP devices, their connection to the SCADA system was implemented, as well as a new transmission system SCADA was established in compliance with modern requirements, which consists of new factory-built peripherals and development of new software. In 2006, while implementing the modernization plan, part of line and branch taps of GTP were equipped with new modern electric and hydro-pneumatic actuators, which were connected to the SCADA system in order to ensure remote control from the central dispatcher console.

Within the framework of the GRS reconstruction programme, the reconstruction of three GRS was completed in the reporting year, spending Ls 182.8 thousand (EUR 260.1 thousand) in total. The reconstruction of GRS "Rīga-1" was commenced. Also the development of a project for GRS "Rīga-3", intended for gas supply to the new cogeneration block of Rīga TEC-2, and the GTP branch to GRS "Rīga-3" began in the reporting year.

Two factors are important for safe operation of GTP: high technical standards and keeping maximum operating pressure calculated by experts and approved by the Cabinet of Ministers. The most objective survey of the technical condition of gas

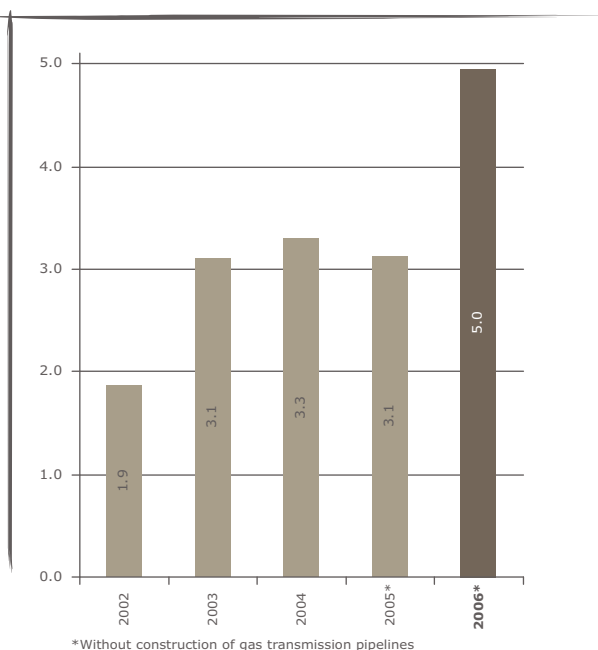
transmission pipelines is provided by their internal diagnostics with special "intelligent" pigs. After they are let through the pipeline, the obtained electronic information is deciphered and analyzed. On the basis of the obtained data, a final report and a list of defects are prepared, and permissible operating pressure is determined until defects are eliminated. In order to carry out this process, a several preliminary actions are necessary, including the designing of pig launchers and receivers as well as the replacement of specific tap units when the construction of taps prevents passability of the pigs. In total, Ls 545.5 thousand (EUR 776.2 thousand) were spent for this purpose.

In 2006, internal diagnostics of the GTP Izborsk – Inčukalns UGS was performed, letting six cleaning plungers, one profile gauge and two defectoscopes through the pipeline. The obtained data have been submitted for deciphering and processing. The length of the GTP Izborsk – Inčukalns UGS section in the territory of Latvia is 161.32 km, and the cost of its diagnostics was Ls 75.4 thousand (EUR 107.28 thousand), whereas the total cost of diagnostics of the section in the territory of Latvia once the report has been received will be Ls 107.7 thousand (EUR 153.24 thousand). In 2006, specialists of the JSC "Latvijas Gāze" made remarkable efforts in order to eliminate the defects found during diagnostics of the GTP Vireši – Tallinn, Pskov – Riga, Riga – Daugavpils in previous years. Simultaneously with the elimination of the defects found in the pipelines, significant work has been done in modernizing and improving the system, in particular new electric or hydro actuators have been installed on line taps, as well as diesel power stations have been purchased and installed on strategically most important objects in order to avoid interruptions of power supply. Considering the anticipated increase of natural gas consumption, it is necessary to provide for safe usage of the maximum operating pressure of gas (up to 55 bar) in GTP. For this purpose, the preparation of pipelines for internal diagnostics (replacement of taps, construction of pig launchers and receivers and

access roads to them) and the diagnostics of the remaining transmission pipelines have to be intensified. Therefore, in 2007 the following tasks should be listed as priorities: elimination of the defects found in diagnostics of the GTP Izborsk – Inčukalns UGS in order to receive permission to operate this pipeline with the operating pressure up to 55 bar, commissioning of the GRS "Riga-3" and preparation of the gas transmission pipelines Inčukalns UGS – Riga-1, Inčukalns UGS – Riga-2 and Iecava – Liepāja for diagnostics.

In 2006, the AGRCS "Daugavpils" was reconstructed, and the construction and installation works were completed. In 2007, operation of this station and dismantling of the old station will begin after the certification of technological equipment and pre-operation adjustment. In 2006, a total of Ls 190.0 thousand (EUR 270.3 thousand) have been invested in the reconstruction of the AGRCS "Daugavpils". Together with the technological equipment purchased in 2005, the total costs amount to Ls 395.8 thousand (EUR 563.2 thousand).

Investments in the GTP modernization (million Ls)



Every year the JSC "Latvijas Gāze" focuses on the studying and solution of environmental management issues. The basis of the company's environmental policy is the interaction of the methodical measures taken by the company and state institutions in order to reduce the environmental impact. The development and implementation are directly related to the priorities of the JSC "Latvijas Gāze" specified in the general strategic development plan. The development of a sustainable, environmentally friendly company in the modern world cannot be attained without the following preconditions:

- utilisation of the latest technological achievements;
- involvement of well-educated, active, interested and professional employees;
- understanding and support of the society;
- comprehensive analysis and assessment of industrial risks and development of preventive measures;
- compliance with the normative acts.

The JSC "Latvijas Gāze" is aware of these preconditions and bears responsibility toward the society in the following areas:

- technical and technological development of the energy supply system;
- natural gas supply safety and efficient use of energy resources;
- continuous improvement of the professional skills of the employees;
- study, assessment and reduction of the environmental impact caused by economic activity;
- notification of the society and care for safety;
- compliance with the normative acts;
- ensurance of appropriate action in emergency situations.

Following a globally approbated scheme of how to reduce the environmental impact of major enterprises, the company introduces an environmental management system, which not only allows making the environmental policy and the environmentally friendly production process even more transparent, but also facilitates better operation of the responsible services and coordination of information exchange both inside and outside the company.

The system that covers all three operation segments of the JSC "Latvijas Gāze" – natural gas storage, transmission and distribution, has been partially introduced. It operates successfully in the Inčukalns UGS, where it was introduced because, firstly, the Inčukalns UGS is a complex unit in terms of both technical engineering and technology; secondly, it is a unit of strategic importance; and thirdly, the operation of the storage facility results in a wide range of emissions. The environmental management system of the Inčukalns UGS ensures that this significant and complex unit neither harms the environment nor imperils the health and safety of the people living nearby. The environmental management system is a way to keep closer ties among the specialists of the company, the state and municipal institutions as well as the society.

Within the framework of the system, it is also necessary to provide qualitative and correct information to the society enabling it to understand not only the financial issues of the company, but also the technical aspects and the related risks. Correct and well-founded information on natural gas management helps to refute unfounded statements on potential dangerousness of some units of the gas supply infrastructure more effectively.

For several years now, considerable modernization is being carried out at the Inčukalns UGS, whereas in the natural gas transmission system it is planned to diagnose all transmission pipelines and eliminate defects by 2010. Currently, the modernization of the gas regulation stations has been completed, but the distribution system was fully modernized several years ago. The entire new infrastructure is being built in compliance with the best European practice and the highest requirements. All modernization is aimed towards the reduction of environmental and financial risks and the improvement of supply stability. They fully comply with the company's strategic plans of technological development and are highly appreciated in the environmental context.

The achievements of the JSC "Latvijas Gāze" in environmental management have been approved by ISO:14001, awarded to the Inčukalns UGS. It confirms that the company's environmental management policy is sustainable and responsible.

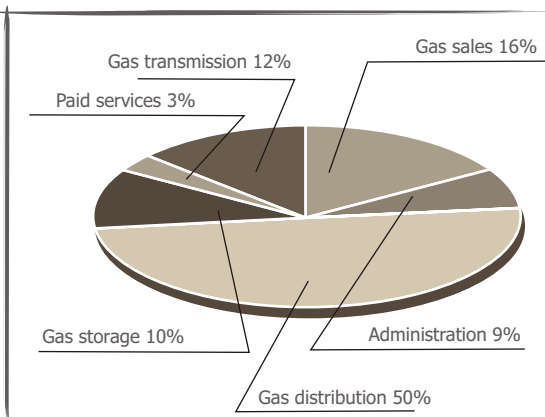
PERSONNEL

Recognizing that people and their skills are the greatest values, the goal of the JSC "Latvijas Gāze" in personnel administration is to create such an environment of management that provides for efficient development of employees' potential and its utilisation to achieve the company goals. The management of the JSC "Latvijas Gāze" believes that successful operation of the company depends on loyal, skilled and motivated employees.

The purpose of the company's personnel policy is to motivate its employees not only with the basic salary and bonuses, but also with good working conditions, positive assessment of work, manager's responsibility for employees, development and career opportunities, healthy and safe work environment, as well as positive relations among employees.

At the end of 2006, JSC "Latvijas Gāze" had 1348 employees, which is by 25 employees more than at the end of 2005.

Distribution of employees by the areas of activity of the JSC "Latvijas Gāze" (%)



At the end of the reporting period, 29% of the employees of the JSC "Latvijas Gāze" had higher education, 39% - secondary vocational education, 26% - secondary education, 6% - primary education. The management and the shareholders of the company devote much attention to personnel development. Education and training are provided by promoting the acquirement of an academic education, as well as through various programmes, trainings, acquisition of international experience, participation in various conferences, courses and seminars.


In 2006, specifying studies in the field of gas technologies as the priority, 44 employees were granted allowances to cover study fees, the compulsory social contributions and the individual income tax. In the reporting year, five employees graduated from academic studies that were sponsored by the "Latvijas Gāze". The company sponsored the post-graduate studies of three employees at the graduate school of the I. M. Gubkin Russian State University of Oil and Gas and granted allowances to cover taxes. "Latvijas Gāze" also sponsored the post-graduate studies of one employee at the graduate school of the "VNIIGAZ" Scientific Research Institute of Natural Gas and Gas Technologies. At the end of the reporting year, 11 graduates of the I. M. Gubkin Russian State University of Oil and Gas worked for the JSC "Latvijas Gāze", eight of whom are the company scholarship holders. Also, in 2006, employees of the JSC "Latvijas Gāze" and other organizations were trained at its Training Centre which carries out the instruction and certification of designers of gas supply systems, specialists of assembly, construction supervision and all specialities of operation, the instruction and certification of persons responsible for dangerous equipment and maintenance staff. In the reporting year, 15 topical seminars were organized at the Training Centre, with 357 employees participating in total.

Recognizing human health and life as a priority, the management of the company set a target to create a safe work environment as well as to ensure the social protection of its employees. In 2006, the JSC "Latvijas Gāze" paid for the health, life and accident insurance of its employees. For four years the company has been making payments also into a private pension fund. Considering that people highly appreciate the time spent together with family, the annual festival of gas employees took place also in 2006. The employees with their families participated in various sporting competitions and cultural events. Interested in a healthy way of living of its employees, the JSC "Latvijas Gāze" opened a new gym. It is located in a gas reservoir building, which, as an architectural monument of local significance, is included in the list of the state protected cultural monuments.



m³

One can have 32 light bulbs
of 100w switched on for
1 hour with 1 m³
of natural gas.

A close-up photograph of a bumblebee on a yellow flower. The bee is positioned in the lower-left quadrant, facing towards the center. The flower's petals are bright yellow and slightly blurred, while the center of the flower shows the intricate structure of the stamens. The background is a solid, vibrant green, which makes the yellow and the bee stand out. The lighting is soft, highlighting the texture of the bee's fur and the delicate structure of the flower.

No transport is used in the transportation of natural gas - it is delivered to customers via pipelines.



In the field of international co-operation, the year 2006 for the Joint Stock Company "Latvijas Gāze" was as dynamic as the previous one – with a range of events and projects that are important and significant for successful further development of the company.

In the reporting year, the leading employees and specialists of the Company made reports in numerous international conferences, informing the participants on the most significant activities, projects and other important issues of the Joint Stock Company "Latvijas Gāze", as well as visited several foreign gas companies. Information was also exchanged with specialists from the Russian companies "Lentransgaz" and "Specneftegaz" on issues of operation and diagnostics of gas transmission pipelines.

In 2006, specialists of the JSC "Latvijas Gāze" participated in one of the most important international events of the gas industry – the regular World Gas Conference and Exhibition in Amsterdam. This significant event takes place once in three years and is organized by the International Gas Union. Both the conference and the exhibition always call together several thousand specialists of the gas industry from all over the world. In the conference

and exhibition of 2006, the leading employees and a large group of specialists of the JSC "Latvijas Gāze" took an active part. Participation in the event provided a unique opportunity to become acquainted with the latest development trends and scientific achievements of the gas industry. The company's specialists will be able to use the information obtained during the conference in their everyday work. It is important to note that the report on the role of gas storage facilities in the improvement of gas supply safety, jointly prepared by the experts of the JSC "Latvijas Gāze", the Energy Institute of the Science Academy of Latvia and the Construction Faculty of Riga Technical University, was included in the agenda of the working group of gas storage facilities on the first day of the conference and attracted great interest of the audience.

Conference participants showed even greater interest in the joint exhibition booth of the Baltic gas companies "Eesti Gaas", "Latvijas Gāze" and "Lietuvos Dujos". Among other booths, it stood out with its original layout and provided information not only on natural gas usage but also on the economic development and culture of the Baltic States. Although the conference and the exhibition is a specific event of the industry, such approach in

arranging the booth stimulated the participants of the exhibition to linger longer at the booth of the Baltic gas companies.

Also in the reporting year the JSC "Latvijas Gāze" continued close co-operation with specialists from its major shareholders – the Russian company "Gazprom" and the German company "E.ON Ruhrgas International AG" –, focusing mostly on the modernization, expansion and improvement of operational safety of the Inčukalns UGS. Within the framework of co-operation, issues of optimization of the gas sales process, application of gas technologies, hydraulic calculations of gas networks etc. were dealt with. Acknowledging the successful and constructive co-operation of specialists of all the companies, everyday collaboration also continued in the reporting year. In August 2006, a meeting of the council of Inčukalns UGS safety improvement and scientific and technical co-ordination of development was held, with the participation of the leading employees and specialists from "Gazprom", "E.ON Ruhrgas AG", "ITERA Latvija", "VNIIGAZ", "Gazpromenergodagnostika", "Gazpromenergo-fizika", "Giprospeccgaz", "Gazobezopastnostj" and "Latvijas Gāze". After the meeting, its participants signed a protocol in which they suggested that the Inčukalns UGS reconstruction be continued in compliance with the approved investment programme until 2010. According to this plan, during the second stage of the compressor reconstruction, a gas injection unit is due to be installed and reconstruction is due to continue in compliance with the well reconstruction programme developed by "VNIIGAZ".

In 2006, the JSC "Latvijas Gāze" continued successful collaboration with the German company "E.ON Hanse". Specialists from both companies co-operated mostly on issues of technical development policy, operation of the gas transportation and distribution systems, natural gas sales, work with consumers and public utility price regulatory institutions, reorganization, procedures of new gas connections, etc.

In October of the reporting year, a meeting of the council of the Interrepublic Practical Scientific and Technical Association of Gas Employees was held in Latvia. This association primarily consists of gas companies from the former USSR republics. Participants of the meeting became acquainted with

the operation of individual structural units of JSC "Latvijas Gāze" – and discussed the most topical issues, focusing mostly on the modernization of the gas supply system and improvement of its safety.

In 2006, the JSC "Latvijas Gāze" was also visited by the officials of the company "Gasum" and the National Emergency Supply Agency of Finland, as well as a delegation of "Avenir AS" from Norway, its specialists giving presentations on the perspectives of gas supply in Europe.

In December 2006, the specialists of the JSC "Latvijas Gāze" visited "E.ON Hanse" in Hamburg where together with the German specialists carried out a specific task of the gas industry – a cut in a high-pressure gas pipeline, using the "Stoppole" technology.

In the reporting year, the leading specialists of the JSC "Latvijas Gāze" evaluated the expedience of its participation in various international organizations considering the growing necessity to rationalize and increase the efficiency of utilization of the company's resources. The expedience of participation in organizations was evaluated also because the company has varied co-operation programmes with the shareholders of the JSC "Latvijas Gāze", as well as direct contacts with a several natural gas companies, which enables it to obtain and exchange different information without international organizations acting as intermediaries. As the natural gas market of Latvia currently cannot be liberalized due to objective reasons and thus the priorities and problems of the JSC "Latvijas Gāze" to some extent differ from those of the Central and Western European gas companies, as well as due to the high participation fee, in the reporting year the company decided to withdraw from the Gas Infrastructure Europe because this international organization mostly deals with the liberalization of natural gas market and related issues.

At the same time, the JSC "Latvijas Gāze" continued its membership in the International Gas Union, UN Economic Commission for Europe Gas Centre, the German Union of Gas and Water Management (Deutsche Vereinigung des Gas- und Wasserfaches), World Energy Congress, Nordic Gas Association, the "Baltic Gas" association and other organizations.

In 2006, the following areas were set as priorities for financing: culture, sports, science and education, as well as social projects. The goal of the supported projects is to implement a socially responsible policy, facilitating the development of a cultured and healthy society, as well as to help improve the general level of education. The management of "Latvijas Gāze" considers it self-evident that a large and successful company should contribute to the development of the civil society, its education and broadening of its horizon.

Culture

Among the most significant cultural events of Latvia in 2006 one should certainly mention the award ceremony by the JSC "Latvijas Gāze" – the patron of the Latvian National Opera (LNO) – and the concert of the laureates, hailing the most outstanding musicians of the year and opening the new season 2006/2007 of the LNO. Nine prizes were awarded in total – to both the best performers of the past season and laureates for lifelong contribution. The JSC "Latvijas Gāze" not only supports the best artists but also provides financial assistance for strengthening, development and popularization of opera, ballet and music culture in Latvia and abroad.

Similarly, in 2006, "Latvijas Gāze" supported the participation of Anna Šuvajeva, the talented violin student of the Jāzeps Medīņš Music School, in the 10th international Bogdan Warchal competition of young performers in Slovakia. Financial assistance was also provided for the organization of the 800th anniversary of Cēsis, as well as for the publication of the research papers of the 2005 conference on cognitive sciences.

Sport

For almost ten years now the JSC "Latvijas Gāze" has been collaborating with the Latvian Olympic Committee (LOC), and 2006 was no exception. The company rendered financial assistance for the preparation and participation of the Latvian Olympic Team in the Winter Olympic Games in Torino (Italy),

where the first medal for our country in the history of the Winter Olympics was won – a bronze medal in luge. The JSC "Latvijas Gāze" rendered significant financial assistance also to the Latvian Motosport Federation, the Latvian Water Motosport Federation, the Latvian Ice Hockey Federation, the Latvian Basketball Union, as well as to individual sportsmen preparing for important international competitions.

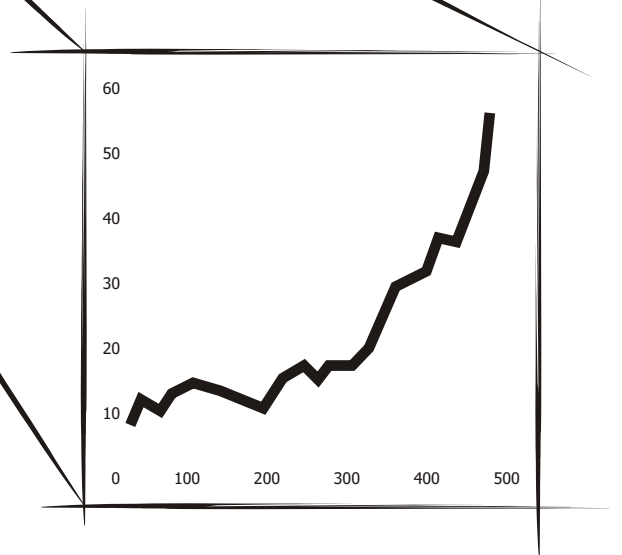
Education and science

For several years in cooperation with the Latvian Academy of Sciences and Latvian Education Fund's target programme "For Education, Science and Culture" the JSC "Latvijas Gāze" awards the annual prize to specialists in cardiology, as well as in gas and heat engineering. In 2006, the prize was awarded to two scientists with considerable work and life experience and two young, promising scientists. The company also participated in the project "Youth in the Labour Market", promoting the profession of gas technology specialist.

Social projects

In the reporting year, the company provided support to the Latvian SOS Children Village Association for the establishment of a SOS children village in Valmiera. Within the framework of the annual charity campaign "Sunny Days for Our Children!", financial assistance was given for the reconstruction and improvement of the parents' house of the Children Clinical University Hospital. Moreover, in 2006, financial support was also provided to the Latvian Children Foundation for the establishment of the Latgale regional centre for children who have suffered from violence. In the same year the company also supported a project of the Gauja National Park – "Protection and Management of Forest Animals". In 2007, the "Latvijas Gāze" will continue to provide financial assistance to various projects, not forgetting about the most sensitive and the least protected social area. It will also keep supporting education, especially in the specialities related to the sector of gas supply.

m³



The company's summarized annual account

1. Activities of the Company in the reporting year

During the year 2006, the Joint Stock Company "Latvijas Gāze" (hereinafter – the Company) retained its position in the fuel market. In the reporting year, the Company devoted its major attention to the fulfilment of the Investment program and to safety increase of the gas supply network operation, as well as to natural gas supply to the consumers in the amounts and quality as specified in the contract.

In the reporting period, 1 719.53 mio nm³ of natural gas were delivered to consumers. In comparison to the year 2005, the volume of natural gas sales increased by 3.3% (in 2005 – 1 664.44 mio nm³). The increase of natural gas sales amount is relatively small due to the record-high air temperature in the second half of the reporting year and the rapid growth of natural gas trade tariffs due to increase of gas purchase prices.

In order to speed up the approach of natural gas price to the prices of oil products in Rotterdam market, with effect from January 1, 2005, amendments to the natural gas supply agreement were enforced, according to which the natural gas purchase price was set by a formula taking into account the actual heavy fuel oil quotation. This formula envisaged increase of prices in three years time by up to 60% at a heavy fuel oil quotation of 200 USD/t. As the actual heavy fuel oil quotation in 2005 noticeably exceeded the highest quotation determined in the agreement, in December 2005 new amendments to the natural gas supply agreement were signed, which as from January 1, 2006 cancelled the ceiling of heavy fuel quotation determined in the previous agreement, thus increasing the gas purchase price at the actual heavy fuel oil quotation by an additional 26%. Furthermore, as from January 1, 2007, amendments to the natural gas supply agreement were enforced, according to which the natural gas purchase price in comparison with the price formula of 2006 was increased by about 54% at heavy fuel oil quotation of 300 USD/t. It is expected that in 2008 natural gas

purchase prices will reach the prices of oil products in the Rotterdam market and their changes will depend only on fluctuations of the heavy fuel oil quotation.

On the basis of the changes in the gas purchase price, the Company in 2005 submitted to the Public Utility Commission (hereinafter – PUC) a natural gas tariff project envisaging gradual increase of natural gas transmission, storage, distribution and sales service and natural gas sales end tariffs from the middle of 2005 thru 2007. The service and sales end tariffs approved by the PUC order No.133 of June 8, 2005 "On natural gas tariffs of the JSC "Latvijas Gāze" in 2006" were enforced as from January 1, 2006 and were applied till May 1, 2006 when they were replaced with the tariffs approved by the PUC order No.73 of March 22, 2006 "On natural gas tariffs of the JSC "Latvijas Gāze" in 2006" (depending on the amount of consumption and heavy fuel oil quotation, the actual increase reached 15–31%).

The total revenue from natural gas sales and other basic activities in 2006 amounted to Ls 182.3 mio (EUR 259.5 mio) in 2005, expenses (excl. administration) – Ls 152.8 mio (EUR 217.4 mio), and gross profit – Ls 29.6 mio (EUR 42.0 mio). The tariff increase provided additional revenues of Ls 18.86 mio (EUR 26.8 mio). In comparison with 2005, net profit of the Company decreased by 11.1% or Ls 2.6 mio (EUR 3.7 mio) and amounted to Ls 21 mio (EUR 29.9 mio), though net rentability of basic activity remained at the level of 2005 – 11.5%. It should be noted that in compliance with the judgment of Stockholm Court of Arbitration and the Swedish Court of Appeal the Company received compensation for losses and interest payment from the state at the total amount of Ls 8.5 mio (EUR 12.1 mio), which basically refers to the previous periods, starting from 2001, which significantly increased the net profit of 2005.

In 2006, much attention was paid by the Company to further expansion of the natural gas distribution system and connection of new users to the existing gas supply system. The total length of natural gas

pipelines on January 1, 2007 reached 5 872.3 km, incl. gas transmission pipelines – 1 281.06 km and distribution pipelines – 4 591.25 km. In the reporting year, gas distribution pipelines worth Ls 4.9 mio (EUR 6.96 mio) were commissioned with a total length of 160 km.

The number of individual consumers using gas for heating in 2006 increased by 4.3 thousand and reached 39.4 thousand at the end of the year. The total number of natural gas users came close to 437.2 thousand.

In 2006, good results were achieved by the operation unit "Inčukalns Underground Gas Storage Facility" (hereinafter – IUGS). During the reporting period, 1.95 billion nm³ were injected into the facility, and the total amount of gas reached 4.46 billion nm³, incl. active gas – 2.32 billion nm³.

In the reporting period, the value of assets of the Company was increased by revaluation of fixed assets received without reimbursement as on 31.12.2006., due to which assets grew by ~Ls 0.4 mio (~EUR 0.6 mio).

In 2006, the Company invested Ls 25.08 mio (EUR 35.7 mio) in modernization of gas supply system and creation of new fixed assets. Of the total investment, 34.6% were utilized for modernization of the IUGS, 21.7% - for development of gas transmission pipeline system, and 32.3% – for development of the distribution system and attraction of new customers.

The most significant projects completed in 2006 were electric supply reconstruction in the IUGS and construction of the new compressor shop KC-1. It is planned that KC-1 will start operating on June 1, 2007.

In the reporting year, internal diagnostics of gas transmission pipeline Izborsk-IUGS was completed, and processing of obtained indications has been commenced. Along with that, pipeline defects found in diagnostics of gas transmission pipelines Pskov-Riga, Vireši-Tallinn and Riga-Daugavpils have been averted. In 2006, a contract has been signed on project development of preparation of gas pipeline Iecava-Liepāja for internal diagnostics, and detail design for construction of pig launcher and receiver units of both lines of gas transmission pipeline Riga-IUGS has been elaborated. For construction of natural gas pipelines in 2006, Ls 6.3 mio (EUR 9 mio) have been utilized. The major commenced projects are construction of gas pipeline on TEC-2 and over Daugava under Dienvidu Bridge in Riga.

The Company's work of the reconstruction of the culture-historical monument – gas reservoir in Vagonu Street 20 has been positively evaluated. The Latvian Constructors' Association has awarded it the title of best construction of 2006 in Latvia in the nomination "Reconstruction".

2. Research and development activities

In order to provide uninterrupted gas supply to users and secure operation of the gas supply system in long term, the Company has worked out "The program for improvement of safety of gas supply system of the Joint Stock Company "Latvijas Gāze" from 2006 thru 2010". It has been prepared on the basis of judgments by Russian companies "Gazobezопасnostj" and "Lentransgaz", institutes "VNIIGAZ" and "Giprospecgaz", as well as German companies "Pipeline Engineering GmbH", "Untergrundspeicher und Geotechnologie-Systeme GmbH", "E.ON Engineering GmbH", "E.ON Ruhrgas International AG" and other partners on the technical condition of equipment and modernization possibilities.

The program envisages investment in safety improvement at the amount of Ls 73.8 mio (EUR 105 mio) in total. It basically includes projects necessary for improvement of system operation safety, gasification of new objects and improvement of gas supply stability throughout the region, covering seasonal consumption fluctuations with gas supplies from the IUGS to Estonia and the Western part of Russia, as well as in further perspective - Lithuania. The greatest investments in the IUGS are intended for installation of new compressors, as well as modernization of wells and gas collection points; in the system of gas transmission pipelines for completion of diagnostics and aversion of detected defects, replacement of line taps, modernization of GRS Riga-1 and GRS TEC-2.

3. Management of financial risks

Operation of the Company is subjected to various financial risks, including credit risk and foreign currencies exchange rate risks. Management of the Company tries to minimize the negative impact of potential financial risks to the financial standing of the Company.

The Company is not directly subjected to the risk of foreign currencies exchange rate fluctuations, as gas price is set in USD and afterwards recalculated in EUR, while gas sales tariffs are set in lats. Settlements for the supplied gas are made in EUR. Considering that as from January 1, 2005 exchange rate of Ls is pegged to that of the EUR, fluctuations of Ls/EUR rate are limited and no significant influence on further financial results is anticipated. Changes of gas purchase prices in USD depending on heavy fuel oil quotation are covered by the natural gas sales tariffs approved by the PUC. To a certain extent they cover also the fluctuations of EUR/USD rate. The risk

of foreign currencies rate fluctuations, which is related to debts to suppliers, is controlled through keeping a significant part of financial resources in deposits of the respective currency.

The financial assets subjected to credit risk mostly consist of cash at bank and debtors' liabilities. Cash and cash equivalents of the Company are kept with the major financial institutions of Latvia. Debtors' liabilities are reflected at their recoverable amount. The Company is subjected to concentration of credit risk because a considerable share of the net turnover refers to a limited number of customers. Four customers of the Company make up to 45% (in 2005 – 43%) of sales, one of the debts of these debtors on December 31, 2006 was 20.7% (in 2005 – 19.9%), the second and the third biggest consisted of 8.8% and 6.2% each (in 2005 – 7% and 6%) of the total amount of debtors' debts.

4. Post balance sheet events

Except for the regular revaluation of buildings, gas transportation system and equipment performed by the Company in 2007, between the last day of the reporting year and the day when the Board signs the report there have been no significant or extraordinary circumstances to affect annual results or financial standing of the Company.

Considering the tendencies of the oil products market and the wish of gas suppliers to create conditions for gas supplies to Latvia equal to those of other countries of the European Union, as from January 1, 2007 amendments to natural gas supply agreement are enforced, determining a new formula for setting the gas purchase price. In comparison to the formula of 2006, the gas purchase price is

increased by 54% on average at heavy fuel oil quotation 300 USD/t.

After signing the amendments to gas supply agreements, in January 2007 the Company submitted to the PUC a new tariff project. With the PUC order No.83 of March 28, 2007 "On natural gas supply tariffs of the JSC "Latvijas Gāze", " the tariffs have been approved and will be enforced as from May 1, 2007. The new tariffs will be pegged to heavy fuel oil quotation in the exchange and will cover the increase of operation costs caused by gas purchase and inflation. Depending on the amount of consumption, the increase of tariffs at heavy fuel oil quotation 260 USD/t will reach 23 - 32%.

5. Board proposal for the distribution of the profit of 2006

	2006	2006
	Ls	EUR
Profit of the current year	21 007 255	29 890 631
Profit share not available for distribution (unrealized deferred tax income in connection with the revaluation of fixed assets)	(1 175 456)	(1 672 523)
Profit available for distribution	19 831 799	28 218 108
Profit distribution proposed:		
Calculated dividends of shareholders (60.4%)	11 970 000	17 031 776
Dividend per share (Ls/1 share)	0.30	0.427
Transfer to reserves provided for in the Company Articles of Association	7 861 799	11 186 332

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

Information on the shareholdings of the members of the Council and the Board of the Company is available from the Board of the Company.

6. Perspective

Considering the investment made for improvement of system operation safety, expansion of gas pipeline network, attraction of new customers, retrieval of debtors' debts in previous years and in the reporting year, as well as the situation in the fuel market of Latvia, the Board of the Company believes that in 2007 the Company will continue developing successfully and take a stable position in the fuel supply market.



A. Dāvis

Chairman of the Board
Minutes of Board Meeting No. 16 (2007)
Riga, April 25, 2007

Profit and loss account for the year ended December 31, 2006

	2006 Ls	2005 Ls	2006 EUR	2005 EUR
1. Net sales	182 343 882	133 385 522	259 451 970	189 790 499
2. Cost of sales	(152 793 672)	(110 318 091)	(217 405 809)	(156 968 502)
3. Gross profit	29 550 210	23 067 431	42 046 161	32 821 997
5. Administrative expenses	(5 993 429)	(5 733 215)	(8 527 881)	(8 157 630)
6. Other operating income	945 035	7 777 520	1 344 664	11 066 414
7. Other operating expenses	(1 433 575)	(1 069 376)	(2 039 793)	(1 521 586)
10. Interest and similar income	2 280 957	4 684 414	3 245 509	6 665 320
11. Revaluation of long term financial investments and short term securities	1 578	1 028	2 245	1 463
12. Interest and similar expenses	(38 126)	(49 108)	(54 249)	(69 874)
13. Provisions for bad and doubtful debtors, net	279 089	(355 321)	397 108	(505 576)
14. Provisions for obsolete and slow moving inventories, net	(41 037)	(71 438)	(58 390)	(101 647)
16. Profit before taxes	25 550 702	28 251 935	36 355 374	40 198 881
17. Corporate income tax for the reporting year	(3 582 831)	(3 697 363)	(5 097 909)	(5 260 874)
18. Deferred income tax	367 087	372 425	522 317	529 913
19. Other taxes	(1 327 703)	(1 286 071)	(1 889 151)	(1 829 914)
20. Current year's profit	21 007 255	23 640 926	29 890 631	33 638 006
Unrealised deferred tax gain related to fixed assets revaluation	(1 175 456)	(1 182 713)	(1 672 523)	(1 682 849)
Profit available for distribution	19 831 799	22 458 213	28 218 108	31 955 157

Balance sheet as at December 31, 2006

ASSETS

	31.12.2006. Ls	31.12.2005. Ls	31.12.2006. EUR	31.12.2005. EUR
Long-term investments				
I. Intangible assets:				
1. Research and development	127 301	414 382	181 131	589 611
2. Concessions, patents, licences, trademarks and similar rights	1 522 251	1 161 904	2 165 970	1 653 241
5. Advance payments for intangible assets	272 766	252 540	388 111	359 332
Total intangible assets:	1 922 318	1 828 826	2 735 212	2 602 184
II. Fixed assets:				
1. Land, buildings, constructions and gas transmission system	168 026 445	167 130 927	239 080 092	237 805 885
3. Equipment and machinery	23 006 758	21 351 082	32 735 669	30 379 853
4. Other fixed assets	1 419 585	1 270 662	2 019 887	1 807 989
5. Advances for fixed assets and fixed assets under construction	33 190 656	24 155 641	47 226 049	34 370 381
Total fixed assets:	225 643 444	213 908 312	321 061 697	304 364 108
V. Long-term financial investments:				
3. Investment in associated companies	80	80	114	114
5. Other securities and investments	5 292	3 714	7 530	5 285
9. Trade debtors	89 135	216 160	126 828	307 568
Total long-term financial investments:	94 507	219 954	134 472	312 967
Total long-term investments:	227 660 269	215 957 092	323 931 381	307 279 259
Current assets				
I. Inventories:				
1. Raw materials and consumables	70 311 771	43 602 436	100 044 637	62 040 676
5. Advances for goods receivable	69 492	14 424	98 878	20 524
Total inventories:	70 381 263	43 616 860	100 143 515	62 061 200
III. Debtors:				
1. Trade debtors	13 958 668	13 020 442	19 861 395	18 526 420
4. Other debtors	1 890 221	1 611 941	2 689 542	2 293 586
7. Deferred expenses	426 544	358 093	606 917	509 520
Total debtors:	16 275 433	14 990 476	23 157 854	21 329 526
IV. Short-term financial investments:				
5. Other securities and investments	19 746	24 121	28 096	34 321
9. Term deposits	7 126 414	-	10 139 974	-
Total short-term financial investments:	7 146 160	24 121	10 168 070	34 321
V. Cash and bank:	11 047 773	23 867 656	15 719 564	33 960 615
Total current assets:	104 850 629	82 499 113	149 189 003	117 385 662
Total assets	332 510 898	298 456 205	473 120 384	424 664 921

Balance sheet as at December 31, 2006

LIABILITIES

	31.12.2006.	31.12.2005.	31.12.2006.	31.12.2005.
	Ls	Ls	EUR	EUR
Shareholders' funds:				
1. Share capital	39 900 000	39 900 000	56 772 585	56 772 585
2. Share premium	14 320 210	14 320 210	20 375 823	20 375 823
3. Long-term investments revaluation reserve	119 122 188	119 007 653	169 495 603	169 332 635
5. Reserves				
c) statutory reserve	39 720 559	29 135 700	56 517 264	41 456 366
d) other reserves	-	2 091 647	-	2 976 146
6. Retained earnings				
a) previous years' retained earnings	2 261 840	1 079 126	3 218 308	1 535 459
b) current year's retained profit	21 007 255	23 640 926	29 890 631	33 638 006
Total shareholders' funds:	236 332 052	229 175 262	336 270 214	326 087 020
Creditors:				
Long-term creditors:				
3. Borrowings from credit institutions	-	17 735	-	25 235
12. Deferred income	8 424 907	6 675 392	11 987 564	9 498 227
15. Deferred tax liability	19 549 651	19 896 526	27 816 647	28 310 206
Total long-term creditors:	27 974 558	26 589 653	39 804 211	37 833 668
Short-term creditors:				
3. Borrowings from credit institutions	16 030	35 470	22 809	50 469
5. Advances received	4 747 502	3 015 972	6 755 087	4 291 342
6. Trade creditors	44 260 732	24 744 413	62 977 348	35 208 128
8. Accounts payable to related companies	10 706 272	7 593 588	15 233 653	10 804 702
10. Taxes and state compulsory social insurance contributions	3 284 708	2 891 109	4 673 718	4 113 677
11. Other creditors	1 993 524	1 759 537	2 836 529	2 503 595
12. Deferred income	315 606	244 122	449 067	347 354
15. Accrued liabilities	2 879 914	2 407 079	4 097 748	3 424 966
Total short-term creditors:	68 204 288	42 691 290	97 045 959	60 744 233
Total creditors:	96 178 846	69 280 943	136 850 170	98 577 901
Total liabilities and shareholders' funds	332 510 898	298 456 205	473 120 384	424 664 921

Statement of changes in equity for the year ended December 31, 2006

Ls

	Share capital	Share premium	Long-term investments revaluation reserve	Other reserves*	Statutory reserve	Retained earnings	Total
	Ls	Ls	Ls	Ls	Ls	Ls	Ls
Balance as at							
31.12.2004.	39 900 000	14 320 210	117 673 829	2 091 647	23 310 942	18 873 884	216 170 512
Dividends	-	-	-	-	-	(11 970 000)	(11 970 000)
Transferred to reserves	-	-	-	-	5 824 758	(5 824 758)	-
Revaluation of fixed assets	-	-	1 679 902	-	-	-	1 679 902
Deferred tax liability arising on the revaluation of fixed assets	-	-	(251 985)	-	-	-	(251 985)
Disposal of revalued fixed assets	-	-	(110 698)	-	-	-	(110 698)
Deferred tax on disposal of revalued fixed assets	-	-	16 605	-	-	-	16 605
Profit for the year	-	-	-	-	-	23 640 926	23 640 926
Balance as at							
31.12.2005.	39 900 000	14 320 210	119 007 653	2 091 647	29 135 700	24 720 052	229 175 262
Dividends	-	-	-	-	-	(13 965 000)	(13 965 000)
Transferred to reserves	-	-	-	(2 091 647)	10 584 859	(8 493 212)	-
Revaluation of fixed assets	-	-	390 988	-	-	-	390 988
Deferred tax liability arising on the revaluation of fixed assets	-	-	(58 648)	-	-	-	(58 648)
Disposal of revalued fixed assets	-	-	(256 241)	-	-	-	(256 241)
Deferred tax on disposal of revalued fixed assets	-	-	38 436	-	-	-	38 436
Profit for the year	-	-	-	-	-	21 007 255	21 007 255
Balance as at							
31.12.2006.	39 900 000	14 320 210	119 122 188	-	39 720 559	23 269 095	236 332 052

Statement of changes in equity for the year ended December 31, 2006

EUR

Follow-up

	Share capital	Share premium	Long-term investments revaluation reserve	Other reserves*	Statutory reserve	Retained earnings	Total
	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Balance as at							
31.12.2004.	56 772 585	20 375 823	167 434 774	2 976 146	33 168 482	26 855 119	307 582 929
Dividends	-	-	-	-	-	(17 031 776)	(17 031 776)
Transferred to reserves	-	-	-	-	8 287 884	(8 287 884)	-
Revaluation of fixed assets	-	-	2 390 285	-	-	-	2 390 285
Deferred tax liability arising on the revaluation of fixed assets	-	-	(358 542)	-	-	-	(358 542)
Disposal of revalued fixed assets	-	-	(157 509)	-	-	-	(157 509)
Deferred tax on disposal of revalued fixed assets	-	-	23 627	-	-	-	23 627
Profit for the year	-	-	-	-	-	33 638 006	33 638 006
Balance as at							
31.12.2005.	56 772 585	20 375 823	169 332 635	2 976 146	41 456 366	35 173 465	326 087 020
Dividends	-	-	-	-	-	(19 870 405)	(19 870 405)
Transferred to reserves	-	-	-	(2 976 146)	15 060 898	(12 084 752)	-
Revaluation of fixed assets	-	-	556 326	-	-	-	556 326
Deferred tax liability arising on the revaluation of fixed assets	-	-	(83 449)	-	-	-	(83 449)
Disposal of revalued fixed assets	-	-	(364 599)	-	-	-	(364 599)
Deferred tax on disposal of revalued fixed assets	-	-	54 690	-	-	-	54 690
Profit for the year	-	-	-	-	-	29 890 631	29 890 631
Balance as at							
31.12.2006.	56 772 585	20 375 823	169 495 603	-	56 517 264	33 108 939	336 270 214

* These reserves were made before registration of the Company in Commercial Register in the amount of 5% from annual profit. Since neither the Commercial Law, nor Company Charter require the creation of such reserves, shareholders made the decision to transfer these reserves to Statutory reserve.

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, 2006

	2006 Ls	2005 Ls	2006 EUR	2005 EUR
I. Cash flows from operating activities				
1. Profit before taxes	25 550 702	28 251 935	36 355 374	40 198 881
Adjustments for:				
- fixed asset depreciation and write-down of intangible assets	13 061 414	11 820 057	18 584 718	16 818 426
- change in provisions for inventories	41 037	71 438	58 390	101 647
- change in provisions for long-term financial investments	(1 578)	(1 028)	(2 245)	(1 463)
- change in accrued expenses for bonuses for reporting year's financial results	13 300	400 830	18 923	570 330
- change in accrued unused annual leave expenses	210 846	(81 524)	300 007	(115 998)
- change in other provisions	248 689	(1 386 000)	353 853	(1 972 100)
- interest and similar income	(2 280 957)	(4 684 414)	(3 245 509)	(6 665 320)
- interest and similar expense	38 126	49 108	54 249	69 874
- profit on sale of fixed assets	(56 281)	(14 720)	(80 081)	(20 945)
Adjustments for:				
Trade debtors increase	(804 357)	(3 271 271)	(1 144 497)	(4 654 599)
Inventories increase	(26 686 765)	(16 097 026)	(37 971 846)	(22 904 005)
Trade creditors' increase	22 615 685	21 156 105	32 179 221	30 102 426
Other debtors' increase	(310 276)	(689 893)	(441 482)	(981 629)
Other creditors' increase	3 546 692	4 894 850	5 046 488	6 964 743
3. Cash generated from operations	35 186 277	40 418 447	50 065 561	57 510 268
Interest paid	(75 969)	(49 108)	(108 094)	(69 874)
Interest received	2 274 112	4 751 219	3 235 770	6 760 376
Corporate income tax paid	(4 030 034)	(5 256 781)	(5 734 222)	(7 479 725)
6. Net cash flows generated from operations	33 354 386	39 863 777	47 459 015	56 721 045
II. Cash flows from investing activities				
Acquisition of fixed assets and intangible assets	(25 077 950)	(24 226 995)	(35 682 708)	(34 471 908)
Proceeds from sale of investments	-	6 400	-	9 106
Proceeds from sale of fixed assets	27 544	16 898	39 192	24 044
Net (increase) / decrease of other investments in term deposits over 90 days, net	(7 126 414)	8 000 000	(10 139 974)	11 382 974
9. Net cash used in investing activities	(32 176 820)	(16 203 697)	(45 783 490)	(23 055 784)

Cash flow statement for the year ended December 31, 2006

Follow-up	2006 Ls	2005 Ls	2006 EUR	2005 EUR
III. Cash flows from financing activities				
Repayment of borrowings	(32 449)	(23 955)	(46 171)	(34 085)
Dividends paid	(13 965 000)	(11 970 000)	(19 870 405)	(17 031 776)
7. Net cash used in financing activities	(13 997 449)	(11 993 955)	(19 916 576)	(17 065 861)
Net (decrease) / increase in cash and cash equivalents	(12 819 883)	11 666 125	(18 241 051)	16 599 400
Cash and cash equivalents at the beginning of the reporting year	23 867 656	12 201 531	33 960 615	17 361 215
Cash and cash equivalents at the end of the reporting year	11 047 773	23 867 656	15 719 564	33 960 615

Notes Accounting policies

(a) Information on the Company

The legal address of the joint stock Company "Latvijas Gāze" is Aristida 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%), JSC Gazprom (34.0%) and LLC ITERA Latvija (16.0%). The Board of the Company consists of Adrians Dāvis (Chairman of the Board), Aleksandrs Mihejevs (Александр Михеев) (Member of the Board, Deputy Chairman of the Board), Jorg Tumat (Member of the Board, Deputy Chairman of the Board from August 16, 2006), Frank Siebert (Member of the Board, Deputy Chairman of the Board till August 15, 2006), Anda Ulpe (Member of the Board) and Gints Freibergs (Member of the Board). The Company's auditor is the certified audit company LLC "PricewaterhouseCoopers" and responsible certified auditor Juris Lapshe.

(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" and LAS No 5 "Long-term contracts".

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

Cash flow statement is prepared using indirect cash flow method.

The accounting policies used by the Company are consistent with those used in the previous accounting period.

(c) Net sales and income recognition

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

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

(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.

	31.12.2006.	31.12.2005.
	Ls	Ls
1 USD	0.536	0.593
1 EUR	0.702804	0.702804

Euro annual accounts are prepared using account closing balances in Ls at the last day of the reporting period, performing conversion to EUR by using the official fixed EUR / Ls rate set by the Bank of Latvia
1 EUR = Ls 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	0.6 - 1
Gas transmission system	2 - 2.5
Machinery and equipment	5 - 20
Furniture and fittings	10 - 20
Computers and equipment	30

Depreciation is not calculated for land and buffer gas.

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

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

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

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

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

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

(g) Inventories

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

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

(h) Account receivables

Accounts receivable are recorded in the balance sheet at their amortised cost less provisions made to cover anticipated loss on bad and doubtful accounts receivable. 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 and accrued expenses for bad and doubtful debts where the management is of the opinion that they will meet the criteria stated in Article 9 of the law "On Corporate Income Tax". 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.

(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.

Translation from Latvian original

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of JSC "Latvijas Gāze"

Report on the Summarised Financial Statements

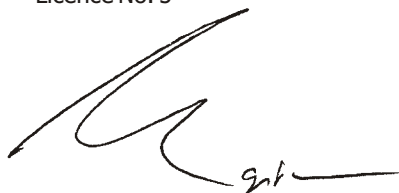
The accompanying summarised financial statements have been derived from the financial statements of JSC "Latvijas Gāze" (the Company) for the year ended 31 December 2006, which are prepared in accordance with the Annual Accounts Act of the Republic of Latvia. These summarised financial statements are 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 26 April 2007 we expressed an unqualified opinion on the financial statements 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
Certified auditor in charge
Certificate No. 116

Member of the Board

Rīga, Latvia
31 May 2007

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