

**JOINT STOCK COMPANY «LATVIJAS GĀZE»  
ANNUAL REPORT 2007**

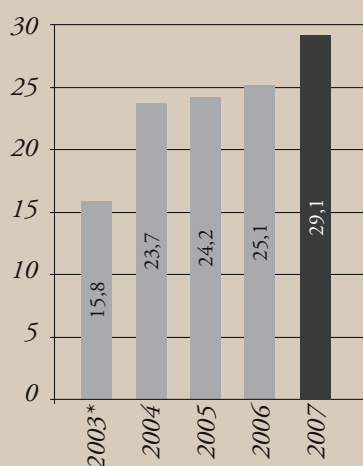
# The Company in 2007

In 2007 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 and Northwestern region of Russia, by developing and modernizing the gas supply system and related services.

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

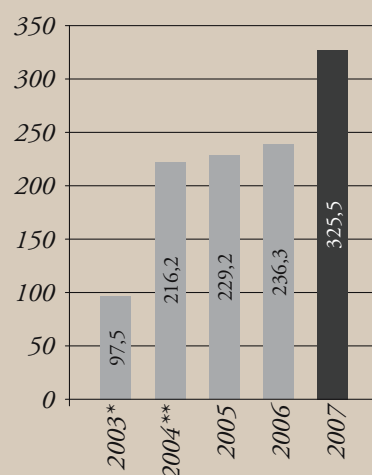
- natural gas purchase, storage, transmission, distribution and sales;
- natural gas transmission and storage for other countries;
- natural gas quantity accounting and quality control;
- operation of the gas supply system, including ensuring its safety and system development.

## Investments (million Ls)



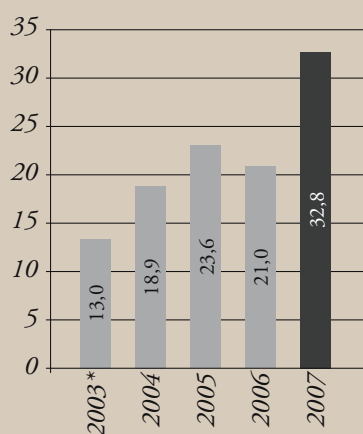
\*JSC "Latvijas Gāze" concern.

## Equity (million Ls)



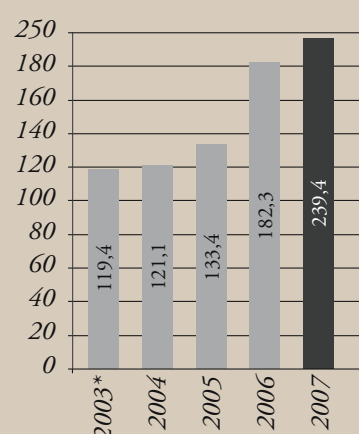
\* JSC "Latvijas Gāze" concern.  
\*\* Equity after revaluation of fixed assets

## Net profit (million Ls)



\*JSC "Latvijas Gāze" concern.

## Net turnover (million Ls)



\*JSC "Latvijas Gāze" concern.

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ANNO  
1862



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# Dear Ladies and Gentlemen,

Although gas has been known in Latvia as a way of energy for more than 145 years, its history started off as late as in 1962 with completion of the project that resulted in the gas transmission pipeline from Dashav reaching Latvia. With this significant moment, the energy system of Latvia saw considerable changes, and nowadays natural gas is one of the strategically most important energy resources in Latvia.

Another efficient and successful year in the history of the JSC «Latvijas Gāze» has passed. The Company continued its development and modernization of the gas supply system of Latvia. To some extent, the year 2007 was also a jubilee year as we celebrated 10 years since privatization of the Company, which gave us stable, safe and long-term strategic shareholders. The successfully chosen and attracted shareholders were the reason for the rapid development of the JSC «Latvijas Gāze» in these ten years. Besides, the Company has secured a stable place in the international natural gas system as an important and strategic participant of the system.

Now, looking back to the past ten years, I can say with full confidence and responsibility that the JSC «Latvijas Gāze» has become one of the most modern and efficiently operating natural gas companies in this region. The Company is not only a natural gas receiver and seller in the local market, but also, with the help of the Inčukalns Underground Gas Storage Facility, ensures stability in the region by operating as a strategically important intermediate in the direction both from the East to the West and the other way round.

Thanks to good and professional co-operation with our shareholders, the professionalism of the JSC «Latvijas Gāze» employees has considerably grown as well. Over this time they have had an invaluable opportunity to obtain the experience and knowledge of colleagues in both Germany and Russia. I also have to mention that this process of exchange of knowledge has also taken place in the opposite direction: colleagues at our shareholder companies – both the Russian OJSC «Gazprom» and the German E.ON Ruhrgas International AG – have learnt and gained experience from the professionals of the Company in solving various complex processes.

It is important to note the financial policy of our shareholders, which is one of the cornerstones of development of the Company, – the majority of the funds profited annually remains at the disposal of the Company, which allows for implementation of numerous development projects important for the Company and the whole country. Thus, the Company each year invests large amounts of funds in modernization of the Inčukalns

Underground Gas Storage Facility and construction of new gas transmission pipelines, as well as modernization and construction of other units of the natural gas infrastructure.

It should be marked that the successful co-operation with the shareholders has enabled the Company to implement a “gently sloping” tariff policy, rising the gas tariffs much slower and thus at a less painful amount. Although the gas prices in the world grow much more rapidly than the tariffs in Latvia, both the JSC «Latvijas Gāze» and our shareholders are aware of the real situation as concerns the paying capacity of the consumers in Latvia. Therefore the tariff increase has been lower than the increase of the natural gas price in the world. The JSC «Latvijas Gāze» and our shareholders realize the social situation in the country, and prior to every increase of the tariffs a detailed but easily comprehensible explanation is given to both the state and the consumers.

In parallel to international projects, the Company will continue developing and implementing the already launched projects for connection of new consumers to the natural gas supply system in order to provide the possibility for every consumer in Latvia to receive one of the most environmentally friendly energy resources. For the management and shareholders of the JSC «Latvijas Gāze», every consumer is important regardless of the gas amount consumed per year. That is why the Company hears all proposals with interest and, as far as possible, implements various gas supply projects in the whole territory of the country. As a socially responsible company, the JSC «Latvijas Gāze» cares not only for its short-term profit, but also for enhancement of its customers’ welfare that will positively influence the state and development of the Company.

I am convinced that also in the future, in collaboration with our shareholders, the JSC «Latvijas Gāze» will take big and strategically deliberative steps in modernization and development of the gas supply system, thus retaining its strategic importance in the region.



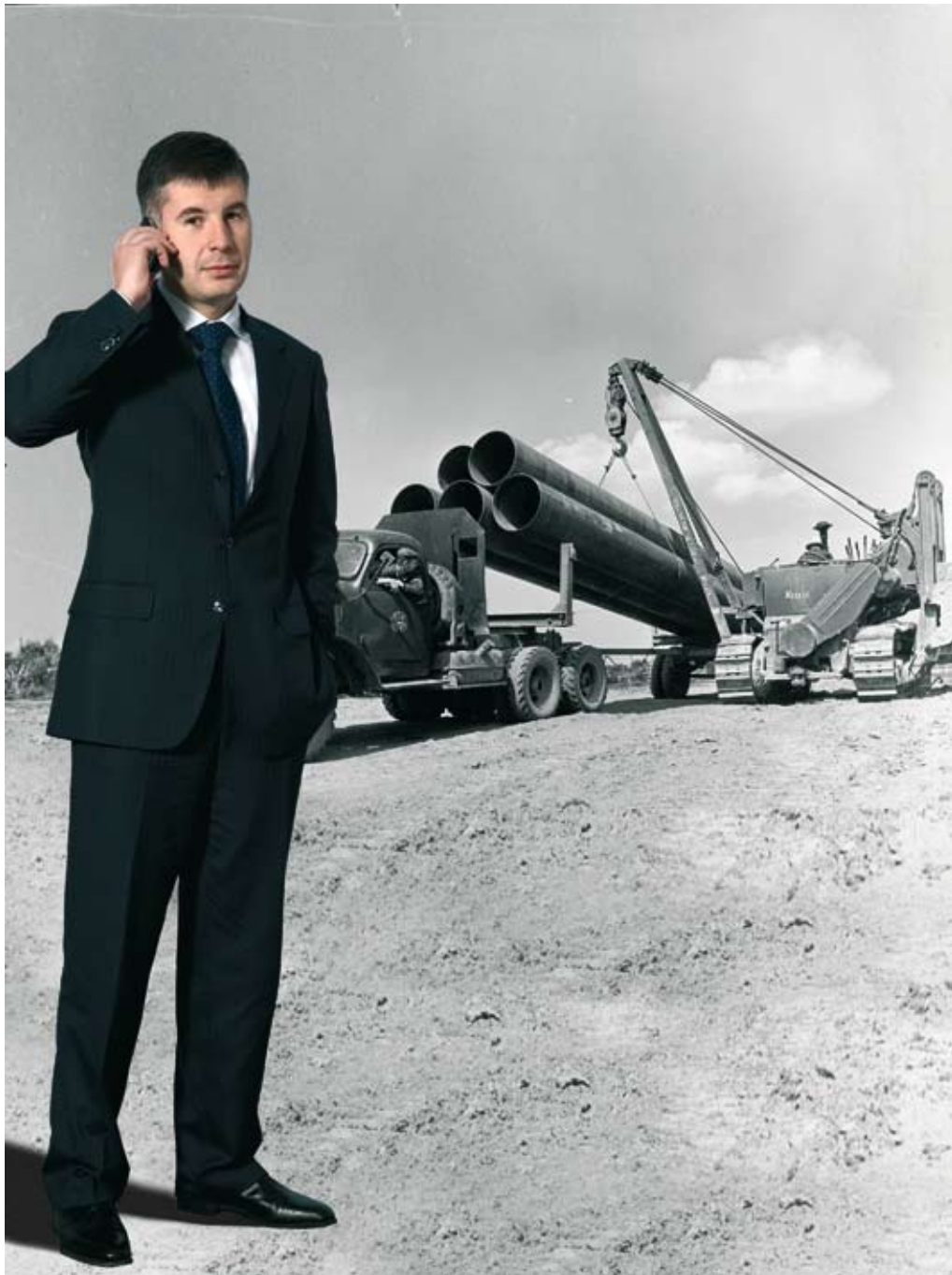
Chairman of the Board

Adrians Dāvis



The first natural gas plant of Riga, built according to the design by the constructor from Berlin, Adolf Kinnel Senior, finished in 1862.

The pedestrian brick bridge across the city channel in Riga, near Bastejkalns, 2007. Every day it is crossed also by the customers of JSC "Latvijas Gāze", whose numbers have reached almost 441 thousand as at to-date.



Kirill Seleznev, the Council Chairman of JSC "Latvijas Gāze".  
Unloading gas pipes, 1961. The gas pipeline Dashav-Minsk-Vilnius-Riga under construction.  
The pipeline main is directing towards Riga.



# Council Report

On April 2, 2007, ten years passed since the day when the strategic investors of the Joint Stock Company "Latvijas Gāze" (hereinafter – the Company) – the Joint Stock Company "Gazprom" and the consortium of two Joint Stock Companies, Ruhrgas and Preussen Elektra, – signed the contracts for purchase of the shares of the Company, thus taking the first step of the process of privatization. These ten years for the Company have been a period of dynamic development, during which it has turned from an enterprise with financial difficulties and outdated infrastructure and equipment into one of the region's most substantial Joint Stock Companies that uses modern technologies and techniques. Due to a successful collaboration with the existing customers and attraction of new ones, the amount of natural gas sales has grown by almost one third in these ten years. The priority of the Company in this period has been provision of uninterrupted and safe gas supply to its consumers, attraction of new customers by expanding the existing natural gas supply networks and provision of the services of gas storage to consumers in other countries.

In the world, however, a rapid increase of the prices of oil products continued last year, and at the end of the year the price of one barrel was rocketing to reach the magic mark of 100 USD. Due to the fact that the natural gas purchase and sale prices in Latvia are set on the basis of the prices of oil products at the international exchange, this situation together with the rapid economic development of Latvia in the first half of the year and the growing inflation throughout the year considerably complicated the conditions of the economic activity of the Company and influenced its performance. Moreover, the gas suppliers kept increasing the gas sale price in order to draw it nearer to the level of the "old" EU countries. Despite the raised gas sale prices and the atypically warm weather in the first and fourth quarter, the amounts of gas sales were only slightly below the level of the previous year and the profit of the Company reached 32.8 million Ls, which is the best result in the history of the Company.

Thanks to the successful collaboration with the Public Utilities Commission and its understanding of the significance of safe natural gas supply in the national economy, an increase of the natural gas tariffs and prices for the consumers was attained in 2007 which provided preconditions for implementation of extensive investment projects. Last year the construction of the compressor shop of Inčukalns UGS and the largest gas regulation station of the Baltic States, as well as the repairs of both gas transmission pipelines connecting Inčukalns UGS and Izborsk compressor shop were completed, thus enabling a considerable rise of the operating pressure in these pipelines. The implementation of these projects not only improves the safety of gas supply, but also gives the possibility to increase the

amount of gas to be supplied to its consumers corresponding to the predicted increase of gas consumption.

In 2007, the Council repeatedly reviewed and approved the changes in the contracts with the natural gas suppliers, the OJSC "Gazprom" and the LLC "Itera Latvija". These changes are related to both the changes of the prices of the gas for sale due to the rise of the prices of oil products and individual contractual conditions that have been adjusted and are now compliant with the norms accepted in the international practice.

The Council has got acquainted with the Corporate governance report, prepared by the Board in compliance with the "Corporate governance principles and recommendations on their implementation" issued by the JSC "Riga Stock Exchange", and holds a view that the Board has done a significant job in order for the Company to observe the recommended corporate governance principles in its operation. The Council also follows these principles.

During the reporting period, the Council regularly received the Board reports on activity and financial and economic standing of the Company. The Council supervised the operation of the Board in all main directions and followed that the Company operates in compliance with the legislation, the Articles of Association of the Company and the resolutions of the Shareholders' meeting, it verified and accepted the budget submitted by the Company as well as made proposals for improvement of the Company's work.

The audit of the Annual Report 2007 of the Company was performed by the international auditor company LLC "PricewaterhouseCoopers". The Council has received the auditor's report, in which it is stated that the financial statements give a true and fair view of the financial position of the JSC "Latvijas Gāze" as of 31 December 2007, and of its financial performance and the cash flows in 2007 in compliance with of Annual Accounts Act of the Republic of Latvia. The Council has reviewed and accepted the Board report on the activity of the Company in the reporting year, the events of research and development, the management of financial risks, as well as proposals regarding distribution of the profit of 2007.

The Council of the Company expresses its acknowledgement to the Board and the employees for their successful work and performance in the year 2007 and wishes success and improvement in the future as well.

Chairman of the Council:



Kirill Seleznev

## The Council of the JSC «Latvijas Gāze»

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The Council of the Company is elected for a period of three years by the Meeting of Shareholders of the JSC «Latvijas Gāze».

The composition of the Council of the JSC «Latvijas Gāze» in the year 2007 was as follows:

### Chairman of the Council:

***Kirill Seleznev***

represents the share of the OJSC «Gazprom».

### Vice-Chairmen of the Council:

***Juris Savickis***

represents the share of the LLC «ITERA Latvija»;

***Stephan Kamphues***

represents the share of «E.ON Ruhrgas International AG».

### Members of the Council:

***Eike Benke***

represents the share of «E.ON Ruhrgas International AG»;

***Marcus Anton Soebrich***

represents the share of «E.ON Ruhrgas International AG»;

***Reiner Lehmann***

represents the share of «E.ON Ruhrgas International AG»;

***Uwe Fip***

represents the share of «E.ON Ruhrgas International AG»;

***Yelena Karpel***

represents the share of the OJSC «Gazprom»;

***Vlada Rusakova***

represents the share of the OJSC «Gazprom»;

***Alexander Krasnenkov***

represents the share of the OJSC «Gazprom»;

***Igor Nazarov***

represents the share of the LLC «ITERA Latvija».

## The Board of the JSC «Latvijas Gāze»

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

In 2007, membership of the Board of the JSC «Latvijas Gāze» was as follows:

***Adrians Dāvis***

Chairman of the Board

***Alekssandr Mihejev***

Board Member, Deputy Chairman of the Board

***Joerg Tumat***

Board Member, Deputy Chairman of the Board

***Gints Freibergs***

Board Member

***Anda Ulpe***

Board Member



The first gas plant in Riga and the park near the city channel, end of the 19th Cent.  
The Board of JSC "Latvijas Gāze". In the front row, from the left: Joerg Tumat, Adrians Dāvis.  
In the back row: Anda Ulpe, Gints Freibergs, Aleksandr Mihejev.



Gas processing plant of Orenburg, Russia.

The control unit at Inčukalns Underground Gas Storage Facility, from where the pumping in and out of natural gas is controlled.

# Shareholders and shares

The year 2007 saw quotation of the shares of JSC «Latvijas Gāze» on the Official List of the Riga Stock Exchange (RSE) and the Official list of the Baltic Stock Exchange (BSE) continue. The capitalization value of the Company at the end of 2007 reached 284.09 million Ls (404.2 million EUR), which is by 127.68 million (181.67 million EUR) less than at the end of 2006 when the capitalization of the Company's shares amounted to 411.77 million Ls (585.9 million EUR).

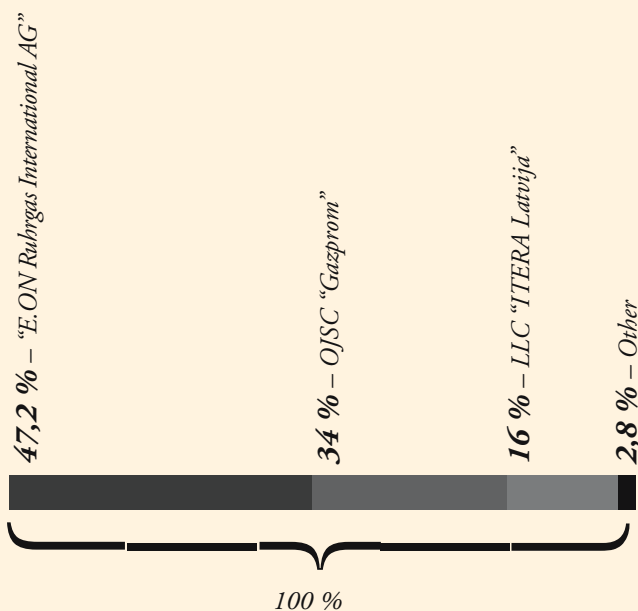
The considerable fall of the share value was related to the overall negative mood in the world financial markets, including the Baltic financial market. By capitalization value at the end of the year, the JSC «Latvijas Gāze» shares took the second place among the securities quoted at the RSE and the eleventh place among the shares quoted at the BSE.

During the reporting year, the price of one share of the JSC «Latvijas Gāze» at the RSE fluctuated within the boundaries from 7.05 Ls to 11.25 Ls (from 10.03 EUR to 16.01 EUR) and at the end of the reporting year reached 7.12 Ls (10.13 EUR), which in comparison to the end of 2006 is by 31.0% less. In the reporting year, the turnover of the shares of the JSC «Latvijas Gāze» at the RSE reached 154 825 shares with the value of 1.6 million Ls (2.28 million EUR), which is by 25 981 shares more than in 2006.

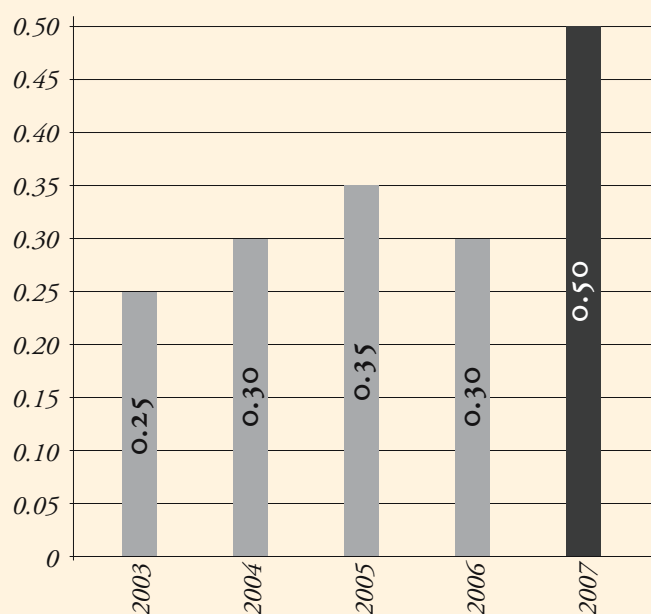
The share capital of the Company at the end of the reporting year still had not changed and amounted to 39.9 million Ls (56.8 million EUR), which is divided into as many shares with the right of voting and the nominal value of 1 Ls (1.42 EUR). The structure of shareholders of the JSC «Latvijas Gāze» did not change either, and at the end of the year 2007 the JSC «Latvijas Gāze» still had three major shareholders – the German company «E.ON Ruhrgas International AG» (47.2% of shares), the Russian OJSC «Gazprom» (34%) and the LLC «ITERA Latvija» (16%). The rest of the shares are owned by minority shareholders, including employees of the JSC «Latvijas Gāze».

On May 16, 2008, the Council of the JSC «Latvijas Gāze» accepted the draft distribution of the profit of the year 2007 as proposed by the Board of the Company, where it was envisaged to pay the dividend of 0.50 Ls (0.71 EUR) per one share or 19.95 million Ls (28.39 million EUR) in total, which is 61% of the Company's profit in 2007. In comparison to the year 2006, the amount of profit to be paid in dividends per one share has grown by 0.20 Ls or 67%. Besides, this is the largest sum paid in dividends per one share since 1997.

## Structure of Shareholders of the JSC «Latvijas Gāze» (%)



## JSC «Latvijas Gāze» dividends per share (Ls/share)



# Natural gas in the energy resource market of Latvia

## Energy balance

The total energy consumption in Latvia continued its growth in 2007. It was contributed to by the development of the country and the rise in living standards. However, despite the stable increase of the number of customers of the JSC «Latvijas Gāze» in recent years, natural gas consumption remained at the level of previous years because there were warm weather conditions in 2007 and energy efficiency measures were carried on in all spheres of consumption.

Although the year 2007 in Latvia saw changes in the methodology of statistics for calculation of consumption of energy resources, natural gas still retained the top position as a separate product, whereas there were changes in the balance of other resources. The most significant group is oil products, mostly including oil products for motor transport, as well as heavy fuel oil, liquefied oil gas and other resources for the needs of industry, energy and households. The calculations of the new methodology indicate that the group of firewood products takes up 22.2% in the energy balance (with the previous methodology – over 30%). Nevertheless, with such indicators Latvia is still among the “greenest” countries in Europe if we add the share of electricity, produced by hydro power stations, and natural gas, which is the most environmentally-friendly type of fuel among the hydrogen resources.

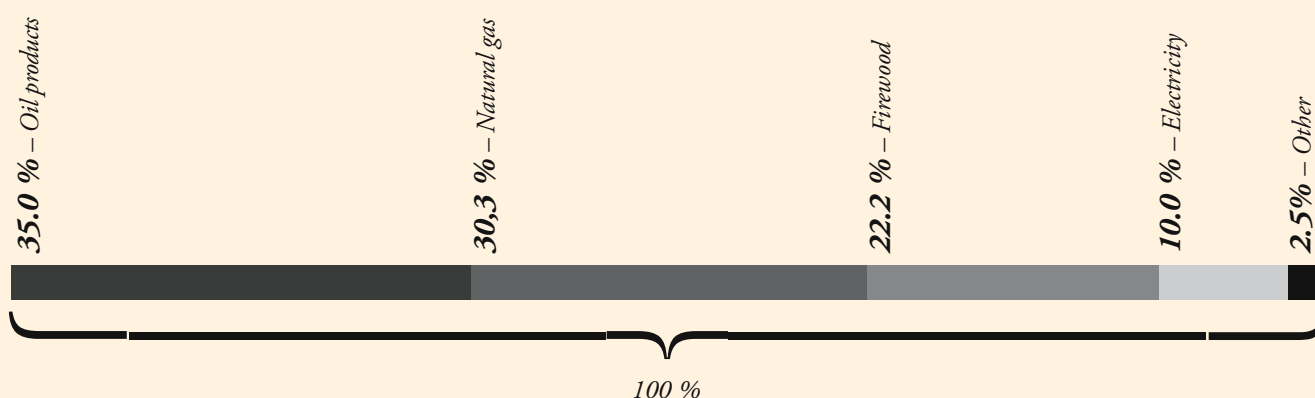
The structure of natural gas consumption by areas, in its turn, has not notably changed, with energy – i.e., power generation, district heating, including cogeneration stations – remaining the main consumption group.

## Price increase

In 2007, the Latvian market was considerably influenced by the prices of energy resources, especially oil and its products, in the global markets. At the beginning of 2007, the price of crude oil at exchanges over the world fluctuated around 50 USD per barrel, whereas at the end of the year the price exceeded 100 USD per barrel for the first time in the history. In January 2007, the price of heavy fuel oil with 1% sulphur content was approximately 240 USD per ton (at the oil products exchange FOB ARA), while in December 2007 it was around 500 USD per ton. Also in December 2007, the oil exporting countries OPEC announced a decision not to increase the amounts of oil production which will have a further negative impact on the dynamics of the oil prices. The still-growing demand for energy resources in China and India should be borne in mind as well.

Such a situation in the oil market resulted in higher natural gas purchase prices from Russia and, consequently, an increase of natural gas tariffs in Latvia as the natural gas purchase price had been set correspondingly to the heavy fuel oil quotation. In December, compared to January, the tariffs for households had risen by about 20% and for industrial customers – by 71-82% depending on consumption. However, such a tendency under the influence of the global market appeared in the prices of other energy resources as well, therefore the price of natural gas retained its competitiveness both in Latvia and in transactions with other countries of the European Union.

## Energy balance in 2007 (%)\*



\* Operative information. Source: Central Statistics Bureau of LR, SJSC «Latvenergo» and JSC «Latvijas Gāze».

# Natural gas in the energy resource market of Latvia (continued)

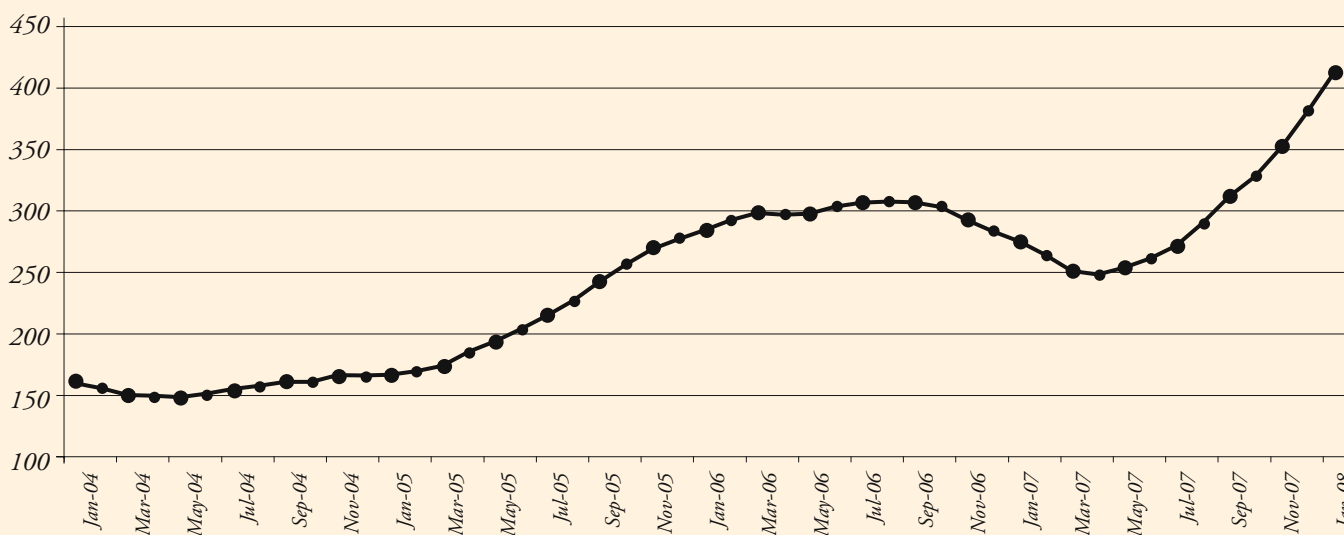
## Events to impact the future

In 2007, the government and professionals sought solutions for diminishing the deficit of electricity in future. Considering that Latvia imports approximately 30% of the electricity it consumes and that Ignalina Nuclear Power Station in Lithuania will be closed by 2010, part of oil shale power stations in Estonia might also be closed and the capacity of interconnection between Russia and Latvia is insufficient, a deficit of base loads for the needs of Latvia of about 300 MW – 500 MW is anticipated in 2012. The problems of shortage of electricity will concern all the countries in the region. Solving these issues, in 2007 an agreement on principle was reached among the governments of Latvia, Lithuania, Estonia and Poland for construction of a new nuclear power station in Ignalina. However, the terms of construction are still unclear, therefore due solutions for generating the missing base loads are sought, and one of the most optimal options is construction of a new (the second)

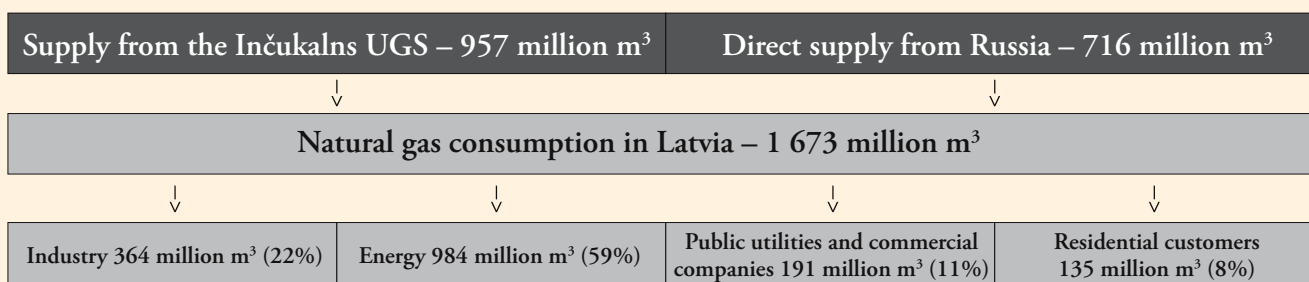
power unit of Riga TPS-2 that would use natural gas and ensure 400 MW of capacity and might be completed by 2012-2014. As soon as in 2008/2009, the first reconstructed power unit of the TPS-2 will be put into operation, also with 400 MW of capacity (the deficit has been calculated taking into account the operating power unit). Construction of the necessary natural gas infrastructure for both power units was completed in 2007. A concrete decision on construction of the second power unit will be made in 2008. Similar projects are already being developed in Lithuania and Kaliningrad.

The year 2007 also saw development of the energy efficiency strategy of Latvia for 2008-2010 (approved in 2008). The strategy envisages particular steps and funding mechanisms for the whole process of heating supply – from heat production to energy efficiency of buildings. In the future, such steps will provide a good possibility to save energy resources, including natural gas, thus compensating part of the price increase.

Price of heavy fuel oil with 1% sulphur content at the oil products exchange FOB ARA (USD/t)



## The structure of natural gas consumption in 2007



# Development

As in previous years, in 2007 the JSC “Latvijas Gāze” paid much attention to further extension of the natural gas distribution system and connection of new users to the existing gas supply system.

During the reporting year, the JSC “Latvenergo” implemented the construction project of the new power unit of the TPS-2 where natural gas will be used as fuel, therefore it was necessary to build a new gas pipeline connection for satisfaction of the needs of this power unit. The maximum planned capacities of the natural gas infrastructure at the TPS-2 equal to approximately one third of the whole consumption of Latvia (240 000 m<sup>3</sup>/h). The construction was begun in October 2006, and currently it is the most complex and largest project in Riga since establishment of the JSC “Latvijas Gāze”. Overall, a 4 kilometres long gas pipeline with 800 mm in diameter was built. It is the biggest pipeline in Latvia (the biggest gas transmission pipeline in Latvia is 700 mm in diameter). A new gas regulation station was built in the Stopiņi County, Riga District. The built infrastructure will be sufficient should the necessity arise to build another power unit for the TPS-2. 5 million Ls (7.12 million EUR) were invested in implementation of the project. The gas regulation station, for its part, will ensure not only maintenance of the TPS-2, but also provision for all needs of the city of Riga, as in parallel to the TPS-2 connection a gas pipeline loop around Riga is under construction, which will considerably improve the safety of natural gas supplies and ensure development for the whole Riga, Riga District and the vicinity.

In the reporting year, the Company completed construction of a gas pipeline for gas supply to Riga Thermal Power Station TPS-2 for the total sum of 3.76 million Ls (5.35 million EUR), of which 2.46 million Ls (3.50 million EUR) were spent for implementation of the project in 2007.

The reporting year also saw completion of the gas pipeline branches for the emerging Dienvidu (South) Bridge, spending 573.1 thousand Ls (815.4 thousand EUR) for this purpose in total.

There is already a contract concluded with the JSC “Latvijas Tilti” for construction of a high-pressure surface gas pipeline over the Dienvidu Bridge. The total costs of this project are estimated to be 714.8 thousand Ls (1.02 million EUR), with 250.8 thousand Ls (356.9 thousand EUR) already spent.

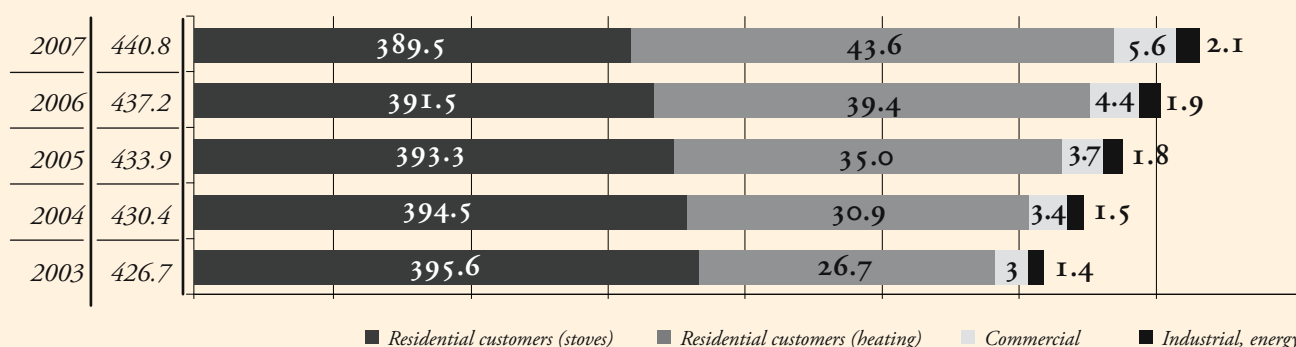
## Investments for development of the Company

The total sum spent for provision of development of the Company in the reporting year amounts to 20.9 million Ls (29.7 million EUR), including 10.80 million Ls (15.37 million EUR) for modernization of the technological equipment and 10.13 million Ls (14.55 million EUR) for gas distribution and transmission pipelines, of which 5.84 million Ls (8.31 million EUR) were spent for construction of service laterals at the total length of 108.29 kilometres, also building 106.17 kilometres of gas distribution pipelines and 12.44 kilometres of branches.

The number of newly gasified individual users in Latvia in 2007 was 4 232 of which 2 831 individual users (houses) were enabled gas supply at the expense of the JSC “Latvijas Gāze”. In 2007, gasification projects were implemented in Līgatne, Inčukalns Rural District, Kadaga (Ādaži Rural District), Cēsis, Sigulda, Vecāķi, Saldus, Babīte Rural District, gasifying apartment houses and private houses, as well as public buildings. The constructed gas pipelines will ensure stable natural gas supply for the existing consumers, as well as an opportunity to develop gasification in the places mentioned.

In the reporting year, the Customer Service Centre of the JSC “Latvijas Gāze” increased its significance, with 8 697 serviced customers in total over the year. The Contract Centre received over 174 thousand calls and sent around 8 thousand letters and fax letters. In comparison to 2006, the number of serviced customers has grown, again testifying to the necessity of such structural units and their efficiency in provision of quality customer service.

### Number of customers (thousands)







Construction of a gas pipeline, the years 1962 and 2007.



The torch lighting ceremony in Jelgava, devoted to connection of enterprises and residential buildings to Dashav gas pipeline, 1966.

Construction of the gas regulation station GRS Rīga-1 and GRS Rīga-3 finished in 2007. GRS Rīga-3 is the biggest station in the Baltic countries, with the total carrying capacity of 300 000 m<sup>3</sup>/h.

# Inčukalns Underground Gas Storage Facility

Inčukalns Underground Gas Storage Facility (hereinafter – Inčukalns UGS) has been a strategic unit of the gas supply system in the Baltic and Russian Northwest region since its establishment because, during the heating season, gas is supplied from the storage facility to consumers not only in Latvia but also in Estonia and Russia. One of the main functions of the JSC «Latvijas Gāze» is still the increase of integrity of Inčukalns UGS in the overall gas supply complex of the Baltic States, Russia and Europe. Considering the growth of fuel usage in the world, including Europe, the existence of gas storage facilities and the use of their potential becomes increasingly important.

Inčukalns UGS is a significant unit of the JSC «Latvijas Gāze», and it has a great importance in the country in general because a large volume of natural gas is stored at the facility. Inčukalns UGS is one of the largest underground gas storage facilities in Europe and thus a great treasure for Latvia as a country of the European Union.

In the season of 2007, 1.18 billion nm<sup>3</sup> of natural gas were injected into Inčukalns UGS in total, and the overall volume of gas at the facility in the course of the reporting year reached 4.47 billion nm<sup>3</sup>, of which 2.33 billion was active gas.

In 2007, the JSC «Latvijas Gāze» invested 29.1 million Ls (41.3 million EUR) into modernization of the gas supply system and creation of new fixed assets. 28% of the total investment were used for increasing the operation safety and modernizing the equipment of Inčukalns UGS.

The most significant unit put into operation in 2007 is the compressor shop KC-1 of Inčukalns UGS. The implementation of this project, including design, took six years, with the total costs reaching 18.9 million Ls (26.9 million EUR).

The year 2007 also saw completion of the capital repair of the compressor No.3 of the gas production shop KC-2.

Other works completed during the reporting year include the assembly of the technological hardware, establishment

of the security system and the assembly of the technological equipment of the methanol feed system for the gas collection point GSP-1 Inčukalns UGS. The unit is due to be put into operation in the summer of 2008. Its total costs at the end of the reporting year reached 10.7 million Ls (15.24 million EUR), and by the end of the project they are predicted at the amount of 12 million Ls (17.1 million EUR).

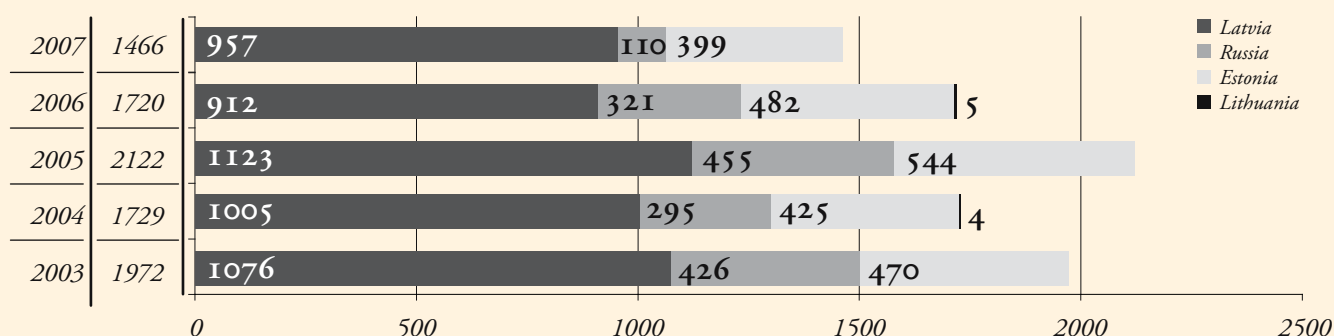
The reporting year saw commencement of the reconstruction of the underground wells in the gas-carrying zone of Inčukalns UGS, as well as completion of the development of the geological and gas dynamic model. The latter will provide more precise information on the deposit of the storage facility and allow for predicting the technological parameters of operation of the deposit.

Also in the reporting year, the digital three-dimensional survey of the communications of Inčukalns UGS was carried out. As a result, it is now possible to receive a map of all communications on the scale of 1:500 including the depth of the communications deposit. The obtained information will be used in creating the geographical information system of Inčukalns UGS.

Investment in improvement of technologies not only gives an economic effect but also makes the process of natural gas storage safer and more environment-friendly. The main purpose of the modernization of Inčukalns UGS is to increase the operation safety of the surface and underground equipment as well as to ensure continuity of operation of the gas storage facility in compliance with the planned capacities.

The JSC «Latvijas Gāze» is characterized by a versatile approach to its basic activity – development and balance of the business requirements with care for the environment and safety. In order to reach it, considerable funds are invested in modernization of technologies, also contributing to each employee's awareness of environment, professional growth and improvement.

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



# Environmental policy

The JSC "Latvijas Gāze" wants to be a competitive, customer-driven and environment-friendly company in its operation, the basic goal being to ensure sustainable, safe and quality natural gas supply. Considering the operation specifics of the JSC "Latvijas Gāze", the management and specialists of the Company pay much attention to study and solution of issues of the environment management.

The JSC "Latvijas Gāze" relates its daily work to responsibility towards the society in the following areas:

- continuous technical and technological development of the energy supply system;
- the safety of natural gas supply and rational use of energy resources;
- continuous training of employees and improvement of their proficiency;
- study of the environmental impact caused by the economic activity, its regular assessment and reduction;
- provision of awareness and safety for the society and each its member;
- ensuring of adequate action in extraordinary situations.

Realization of the environment policy implemented by the Company is closely related to the priorities of the overall strategic plan of the JSC "Latvijas Gāze". Following the widely used scheme of reduction of the environmental impact caused by major companies, the Company has developed a system of environment management and introduced it in the natural gas storage sector. This now enables to provide for transparency of the policy of the environment protection and environment-friendliness in the production process implemented by the JSC "Latvijas Gāze", makes for a better coordination of co-operation and exchange of information among the responsible offices within the Company and beyond.

The basic goals of the environment policy implemented by the JSC "Latvijas Gāze" are to ensure:

- sustainable economic indicators of environment and the economic activity;
- close internal and external communication links and understanding with the state and municipal institutions and the society;
- active development of the personnel;
- due identification of the most significant environmental impacts caused by the economic activity, analysis of the reasons and assessment of the key environmental aspects of the economic activity;

- compliance with, study, and analysis of the requirements of the laws and regulations of the Republic of Latvia and the European Union;
- adequate action in extraordinary situations.

The system of environment management that encompasses all three operation segments of the JSC "Latvijas Gāze" – natural gas storage, transmission and distribution – has been partially adopted by the Company – currently, it has been developed and functions successfully at the Inčukalns UGS, chosen for implementation of the policy because this unit of strategic importance is technically and technologically complicated.

It should be emphasized that the system of environment management is also a way of maintaining close links among specialists within the Company, with the state and municipal officials, as well as the broadest and the most important collaboration partner of the JSC "Latvijas Gāze" – its customers, including the whole society of Latvia.

In monitoring of environmental impact processes performed by the JSC "Latvijas Gāze", special attention is paid to emission of methane or natural gas into the environment. This substance is one of the main gases causing the greenhouse effect. Moreover, it is a non-renewable resource, and natural gas is fully purchased, thus important environment factors are closely related to important financial factors. Therefore all possible measures for provision of rational natural gas supply to consumers are duly planned and put into practice in all natural gas supply systems and units. Inčukalns UGS has been notably modernized, and the Company plans to diagnose all main gas transmission pipelines of the natural gas transmission system and eliminate their defects by the year 2010. Modernization of the gas regulation stations of the transmission systems is also completed, while the distribution system was fully modernized already a couple of years ago. It should be noted that all new infrastructure of the JSC "Latvijas Gāze" is now built in compliance with the best European practice and the highest safety and technological requirements. All the above-mentioned reconstruction and modernization projects have been implemented with a direction towards diminishing of both environmental and financial risks for the Company and enhancement of stability of natural gas supplies, which fully complies with the strategic technology development plans of the Company and are to be highly appreciated in the context of environment protection.

# Gas transmission

The operation unit "Gas Transport" is a structural unit of the JSC "Latvijas Gāze" that performs the functions of natural gas transmission system operator – ensures operation of the system as well as its technical maintenance and development. The natural gas transmission system consists of gas transmission pipelines (hereinafter – GTP), a commercial international gas measurement station, gas regulation stations (hereinafter – GRS), underground pipeline electrochemical protection anticorrosion devices, communication and remote lines, as well as the SCADA system.

The technical policy of the JSC "Latvijas Gāze" is directed towards retention and improvement of the system safety that includes uninterrupted gas supply and fail-safe operation of the system. Therefore the reporting year saw implementation of a number of projects for modernization and improvement of the transmission system safety.

In order to ensure natural gas supply to the new power unit of Riga TPS-2, the JSC "Latvijas Gāze" in the reporting year constructed the gas transmission pipeline-branch and the GRS "Riga-3" with a capacity of 300 000 nm<sup>3</sup>/h. The construction costs of these units were 2.4 million Ls (3.42 million EUR).

Within the framework of the GRS modernization and reconstruction programme its next stage was implemented – reconstruction of two GRSs including replacement of physically and morally outdated equipment with container-type automatic gas regulation stations, spending 0.3 million Ls (0.43 million EUR). The programme was started back in 1998, and currently 87% of the existing 47 GRS are compliant with the latest technical and ecological requirements.

In the reporting year the JSC "Latvijas Gāze" continued pigging of the gas transmission pipelines and repairing of the established defects. On the basis of the final report of pigging and the dangerousness of the defects, the maximum permissible pressure of the particular gas pipeline is determined. After analysis of these data, the operation unit "Gas Transport" together with the competent state control institutions develops a programme for check and repair of the defective pipelines. As a result of its implementation, the maximum permissible pressure of the

pipeline is restored. In order to ensure the pigging replacement of the outdated line valves of the gas transmission pipelines with such valves which have sufficient internal permeability for the pigs to get through the pipelines.

The year 2007 saw replacement of the line valve units of the GTP Iecava-Liepāja. By now, eight line valve units have been replaced and an additional safety valve unit of the GRS Liepāja has been threaded. In performance of these works state-of-the-art methods were applied. In order to complete preparation of this section for pigging, the gas equipment and the necessary materials were purchased in 2007, as well as the contracts were signed for construction of the unified receiver-launcher unit in Džūkste and the receiver unit at the GRS Liepāja.

At the GTP Rīga-Inčukalns UGS, two line valve units have been replaced and a contract has been signed for construction of a pig launcher unit together with replacement of one line valve. In 2008, it is planned to replace other four line valve units and to construct a pig launcher on line 1 of the GTP Rīga – Inčukalns UGS. In order to perform pigging for both lines of the GTP Rīga-Inčukalns UGS, construction of the unified receiver units should be launched in 2008 and completed by mid-2009.

After pigging of the GTP Izborsk-Inčukalns UGS, the length of checked gas pipelines in the reporting year exceeded 50% of the total length of gas transmission pipelines.

In 2007, after elimination of the defects established in the pipeline Pskov-Rīga, the maximum permissible pressure – 54 bars – was reached. Meanwhile the bulk of repairs of the gas pipeline Izborsk-Inčukalns UGS was done in 2007, and in 2008 the permissible pressure will be restored. The maximum permissible pressure is currently limited for the gas transmission pipelines Vireši-Tallinn and Rīga-Daugavpils.

In the reporting year, other modernization projects commenced in previous years were continued, including reconstruction of seven cathodic protection stations and construction of a new one. The year 2007 also saw installation of power supply lines with electric branches onto the gas transmission pipeline valves and valves-branches on the units of GRS (24 objects).

# Personnel

As any company, the JSC «Latvijas Gāze» has developed and implements a personnel policy, the basic goal of which is to provide the company with professional and highly qualified employees. This policy also includes a regular improvement of skills and knowledge of the existing employees of the Company, thus ensuring high operation efficiency and qualitative achievement of the defined strategic goals of the JSC «Latvijas Gāze». The Company prides itself on a stable, educated and successful staff – the employees of the company have a high professional level, readiness for teamwork and a sense of responsibility.

In addition to the regulation of employment relationships stipulated by the laws of the Republic of Latvia, the legal employment relations at the Company are also regulated by the Collective Agreement and the Working Regulations. The main purpose of the Collective Agreement is to provide better working conditions for any employee of the JSC «Latvijas Gāze» in comparison to those laid down in the Labour Law and other laws and regulations regarding employment relations. It should be noted that the Collective Agreement includes the issues of employment guarantees, salaries, social guarantees, work safety and health protection for the employees of the JSC «Latvijas Gāze», as well as the working regulations.

As at December 31, 2007, the JSC «Latvijas Gāze» employed 1 356 persons throughout the territory of Latvia. At the end of the reporting period, 30% of the employees of the JSC «Latvijas Gāze» had higher education, 39% – secondary special education, 25% – secondary education, and 6% – primary education. Education and training of the employees is ensured by promoting acquisition of academic education as well as by various programmes, acquaintance with international experience, participation in various conferences, courses and seminars.

In general, the JSC «Latvijas Gāze» spent 86.5 thousand Ls (123.1 thousand EUR) on professional education and training of its employees in 2007.

For acquiring education at higher educational establishments of Latvia, the JSC «Latvijas Gāze» in 2007 granted benefits for covering the study fee of the academic year 2007/2008 to 19 employees of the Company, setting studies in the specialty of gas technologies as priority.

In 2007, three scholarship-holders of the JSC «Latvijas Gāze» studied at the «Oil and Gas Russian State University», named after I. M. Gubkin, on the first, fourth and fifth years respectively. Other three employees of the Company continued their post-graduate studies at this university. Currently, there are 11 graduates of the «Oil and Gas Russian State University»,

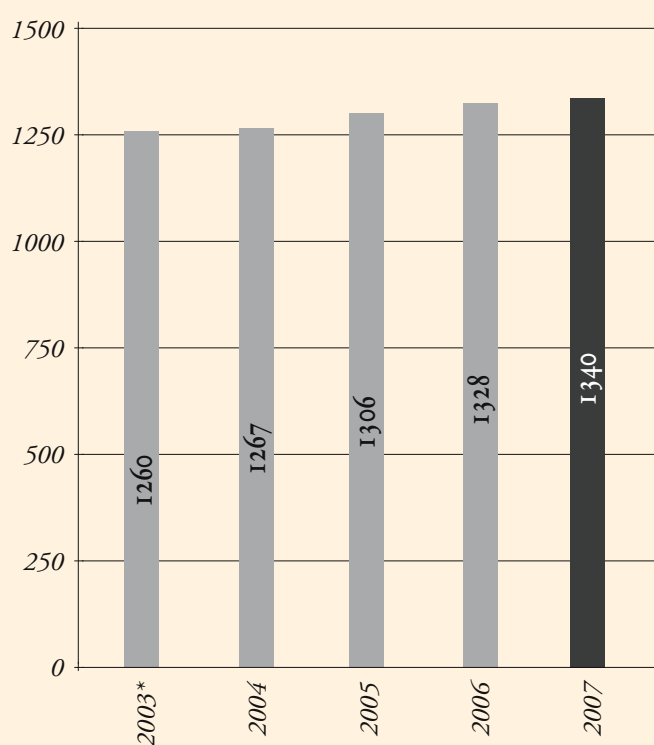
named after I. M. Gubkin, working at the JSC «Latvijas Gāze», eight of them had been awarded scholarships by the Company.

In the reporting year, for 35% of the employees of the JSC «Latvijas Gāze» the length of service at the Company was below 10 years, 37% had worked for 11 to 20 years, 10% – for 21 to 30 years, 8% - for 31 to 40 years, while 2% had worked at the Company for over 41 years.

The Training Centre of the JSC «Latvijas Gāze» educates employees both of its own and other companies, offering training and attestation of gas supply system designers, assembly, construction supervision and operation specialists of all specialties, persons in charge of dangerous equipment and service staff, as well as other professional studies. In the reporting year, a total of 2 574 persons studied at the Training Centre, 890 of them were employees of the JSC «Latvijas Gāze» (87 specialists and 803 workers) and 1 684 employees from other establishments (357 specialists and 1 327 workers).

10 seminars took place at the premises of the Training Centre during the reporting year, with 143 participants in total, including 128 employees of the JSC «Latvijas Gāze» and 15 from other organizations.

*Average number of employees*



\* JSC «Latvijas Gāze» concern

# International co-operation

Following the tradition of previous years, 2007 saw the international co-operation of the specialists of the JSC "Latvijas Gāze" developed in three main blocks – co-operation with the shareholders of the Company, with other foreign gas companies and with various international organizations. The goal of any co-operation is to obtain new information and experience for use in daily work at the JSC "Latvijas Gāze". Obtaining international experience and knowledge is one of the key aspects for provision of successful and safe operation of the Company in the field of gas supply and implementation of measures for improvement of efficiency.

As in previous years, in 2007 the JSC "Latvijas Gāze" had the closest co-operation with the specialists of the shareholders of the Company – the OJSC "Gazprom" (Russia) and the "E.ON Ruhrgas International AG" (Germany). The co-operation enables the Company to implement a number of strategically important and complicated development projects that considerably increase the operation efficiency and safety of the JSC "Latvijas Gāze".

The main directions of cooperation with the representatives of the OJSC "Gazprom" and its subordinate structures were further modernization of Inčukalns UGS, improvement of its operation safety and expansion, development of the gas dynamic three-dimensional model at Inčukalns UGS, pigging of gas pipelines and other projects important for development of the Company.

One of the key events of international co-operation in the year 2007 was the educational trip of twenty-two employees from operational units of the JSC "Latvijas Gāze", representing all units of the distribution networks and the emergency service, to Germany in April. During the trip they got acquainted with the labour organization and practical techniques at the gas companies "E.ON Edis" and "GASAG" in Berlin region, as well as the principles and structure of establishment of gas networks, installation of home connections, maintenance of networks, operation of emergency services and other issues.

In order to continue the exchange of experience, in September there was a seminar held with the participation of not only those employees of operation units and the emergency service who had visited Germany, but also others from the Company. During the seminar, the colleagues from the "E.ON Ruhrgas International AG" introduced the participants with the latest gas supply technologies in Germany.

In the reporting year, the Company was repeatedly visited by specialists from structural units of the "E.ON Ruhrgas International AG", and numerous topical and important issues were discussed with these specialists:

- mid-term planning of economic and financial indicators and prognoses of operating results of the Company;

- optimization of operation of the marketing and sales structural units;
- co-operation with the control department of "E.ON Ruhrgas International AG";
- introduction of a specialized client management programme at the Contact centre.

The year 2007 saw continuation of a particularly successful collaboration with the company "E.ON Hanse". The main fields of co-operation were the policy of technical development, operation of the gas transportation and distribution systems, issues of natural gas sales, work with the consumers, reorganization, work with the regulator, the procedure of new gas connections and other topical issues.

In March 2007, Inčukalns UGS was visited by a large delegation of French representatives. This delegation included the French Parliament Members, representatives of the Ministry of Economics of France, employees of "Gaz de France", other representatives of the French business circles, as well as the leading employees of the Ministry of Economics of the Republic of Latvia. The members of the delegation got acquainted with operation of Inčukalns UGS and appreciated the overall technical condition of the storage facility, emphasizing the large contribution of the JSC "Latvijas Gāze" in modernization of Inčukalns UGS in the recent years.

In June, for its part, Riga hosted the Baltic Regional Energy Forum, which assembled the Prime Ministers of all three Baltic States, ambassadors, parliament deputies, representatives of ministries and specialists of energy from several countries. There were discussions held concerning the prospects and issues of energy in the Baltic States, with both government officials and specialists giving reports. The representatives of the JSC "Latvijas Gāze" reported on gas supply issues. In conclusion of the forum, its participants had an excursion to Inčukalns UGS.

Last year the Company continued optimization of its membership at international organizations and took part in the activities of the International Gas Union, the UN Economic Commission for Europe Gas Centre, the Deutsche Vereinigung des Gas- und Wasserfaches, the World Energy Congress and the Baltic Gas and the Inter-republic Gas Association for Applied and Science-Technical Co-operation.

It should be noted that the leading employees and specialists of the JSC "Latvijas Gāze" spoke at several conferences informing the participants on the most significant activities, projects and other issues important to the JSC "Latvijas Gāze", as well as visited several foreign gas companies with a view to gain experience.

## JSC «Latvijas Gāze» to the society

The goal of the support provided by the JSC "Latvijas Gāze" is to implement a socially responsible policy, contributing to development of culture, formation of a healthy society and improvement of the overall level of education. The JSC "Latvijas Gāze" sees development of the natural gas field and related education and informing of the society on issues related to safe use of natural gas as particularly important, but these priorities do not exclude implementation of other support or charity projects if they are socially active, directed towards development and innovation in the respective field.

### *Culture*

The JSC "Latvijas Gāze" is the main patron of the Latvian National Opera (LNO) since 2004. In the reporting year, a number of new productions – the operas "La Traviata" and "Carmen" and the ballet "Anna Karenina" – appeared on the stage with the support of the Company. For two years already, the JSC "Latvijas Gāze" in collaboration with the LNO organizes an important event in the cultural life of Latvia, the traditional ceremony of annual awards of the Opera patron. The awards are presented at the beginning of the season, appreciating the performance of the best artists in the preceding year. The event is traditionally enriched by a concert of the laureates of the JSC "Latvijas Gāze" prize. It is broadcast by the Latvian Television, thus the success and performance of the artists is seen not solely by the spectators in the Opera hall, but by a much larger audience. In addition to supporting the best, the Company renders help in strengthening and developing the Latvian opera, ballet and music culture and its popularization abroad. Support is given to various international music festivals and competitions, as well as programmes of cultural projects implemented in Latvia.

### *Education and science*

The JSC "Latvijas Gāze" values quality education in Latvia, therefore it supports various projects related to promotion of education. The JSC "Latvijas Gāze" has sustainable collaboration with the Riga Technical University (RTU). The Company provides significant financial support to the university for issuing various educational study aids and payments of scholarships in the gas technology specialties within the framework of the special purpose programme of the Latvian Education Foundation "For Education, Science and Culture". Since 2003, there is also the annual award of the JSC "Latvijas Gāze", the Latvian Academy of Sciences and the special purpose programme of the Latvian Education Foundation "For Education, Science and Culture" for lifetime contribution to science, for a promising debut in the gas, heat engineering and the related chemistry technology branch, as well as the science of cardiology. In 2007, the Company

allocated funds for the winners of the scholarship contest in the gas and venting technology branches and for the cardiac surgery, a branch of cardiology.

Furthermore, being aware of the necessity to support the potential of the Latvian science and its successful integration in the European Union, the JSC "Latvijas Gāze" provides a financial support for organization of various significant scientific conferences (for instance, the conference of cognitive sciences).

### *Social projects*

The Company annually grants considerable resources to a variety of social programmes. Part of the financing allocated for these projects goes for safety and health of children. In 2004, the JSC "Latvijas Gāze" concluded a co-operation agreement with the Centre for Curriculum Development and Examinations (CCDE), which envisages organization of various events for education of children about natural gas use and safety. Within the framework of the agreement, the JSC "Latvijas Gāze" has presented to schools the book "How the Dwarf got acquainted with gas" and the exercise book "Be safe with the Dwarf". Meanwhile, every year during the safety weeks organized by the CCDE, representatives of the Company visit schools and tell children about safety issues in use of natural gas. In co-operation with the Latvian Children's Fund, the JSC "Latvijas Gāze" provides a financial support for treatment of seriously ill children, children's homes, as well as programmes for improved care of mentally challenged children. Within the framework of social projects, the Company helps to implement a variety of environmental protection projects. For instance, in order to preserve the nature of Latvia, the scenery and fauna, funds are allocated for the Nature Park of Lake Engure and the Gauja National Park.

### *Supporting sports*

Already since 1998, the JSC "Latvijas Gāze" is a sponsor of the Latvian Olympic Committee (LOC), and this co-operation has become a stable tradition. During these years, with a financial support by the Company, the LOC has implemented long-term Olympic sports programmes in ice-hockey, football, basketball, tennis, sailing, javelin throw, beach volleyball and other kinds of sports important for Latvia. Besides, the co-operation is mostly planned in such a way that not only the highest-level athletes but also young people regularly participating in the Latvian and European Youth Olympiad feel it. For many sports fans the main sportive event of the year 2008 will be the summer Olympic Games to take place in Beijing. For many years already, the JSC "Latvijas Gāze" has also co-operated with the Latvian Basketball Union.





In the 70-ies and 80-ies of the 20th Century the basketball team of JSC "Latvijas Gāze" participated in both the local and Baltic contests. This tradition is still live to-date.

JSC "Latvijas Gāze" is one of the main long-term sponsors of the Latvian Basketball Association.  
We are united by perseverance, spirit of competing and the joy of winning.



Kristīne Opolais – the solo singer of the Latvian National Opera and the 2006 laureate of the annual award by JSC "Latvijas Gāze". A strong personality, enchanting through her talent and charm.

In a modern interior, warmth and cosiness is provided by the elegant gas fireplace, the year 1906.

# Summarised Annual Accounts

## Report of the Board

### *1. Operation of the Company in the reporting year*

The Joint Stock Company "Latvijas Gāze" is an energy supply company that deals with natural gas supply, storage, distribution and trade. In 1997, the Energy Supply Regulation Council of the Republic of Latvia issued to the Company exclusive licenses for provision of the regulated public utilities until February 10, 2017, whereas on January 31, 2007 the Council of the Public Utility Commission (hereinafter – PUC) issued a license for natural gas trade until February 10, 2012. In compliance with the Energy Law, the Company is a natural gas system operator that ensures uninterrupted and safe natural gas supply to natural gas consumers in Latvia, not allowing overloads of system capacity.

In the reporting year, consumers were supplied 1 673.4 million nm<sup>3</sup> of natural gas. In comparison to the period of 2006, natural gas sales in nm<sup>3</sup> have decreased by 2.7 %. Natural gas consumption has declined due to the relatively high air temperature in the quarters I and IV of 2007 as well as the record-high quotation of oil products at exchanges resulting in a significant increase of natural gas sales end tariffs for Latvia, which in its turn lead to more austere use of resources.

The situation of recent years in the global market of oil products as well as the desire of natural gas suppliers to bring gradually the natural gas supply prices for Latvia closer to the level of the European countries caused a rapid increase of natural gas prices. As of January 1, 2005, the formula of natural gas purchase prices was pegged to the actual heavy fuel oil quotation – up to 200 USD/t. In 2006, the ceiling of natural gas prices was lifted; but in 2007 the price formula was changed, increasing the natural gas purchase price by more than 50% at heavy fuel oil quotation 300 USD/t. Also in 2007, preparation of new amendments to the natural gas supply agreements was continued. These amendments were approved on January 15, 2008. According to them, natural gas price is pegged to heavy fuel oil and gasoline quotation, and natural gas prices in 2008 are expected to reach the level of the European countries and further their changes will depend on fluctuations of oil products at the exchange.

In March 2007, the Company, on the basis of the changes of natural gas purchase prices, submitted to the PUC a project of natural gas tariffs, envisaging an increase of natural gas sales end tariffs as well as those of natural gas transmission, storage, distribution and sale services. With the resolution No.83 "On natural gas sales tariffs of the JSC "Latvijas Gāze"", passed by the Council of the PUC on March 28, 2007, the approved service and natural gas sales end tariffs became effective as of May 1, 2007. The tariffs were approved with heavy fuel oil quotation up to 400 USD/t with a step of 10 USD/t. By application of the tariffs, the average natural gas trade end tariff grew by 36.7%, while the increase by consumer groups depending on annual consumption was 17 % – 44 %.

In 2007, the total income from natural gas sales and other services of business activity reached Ls 239.4 million (EUR 340.7 million), the expenditures (excluding administrative costs) – Ls 195.5 million (EUR 278.2 million) and the gross profit – Ls 43.9 million (EUR 62.5 million). The increase of tariffs gave additional Ls 39.3 million (EUR 55.9 million) of income. In comparison to 2006, the net profit of the Company grew by 56.2% or Ls 11.8 million (EUR 16.8 million), reaching Ls 32.8 million (EUR 46.7 million). The net profitability of business activity was 13.7 % in 2007 and 11.5 % in 2006.

The increase of profit is mostly related to the purchase of gas reserves injected into the Inčukalns Underground Gas Storage Facility (hereinafter – Inčukalns UGS) for consumption in 2007 at the price of 2006.

In the season of 2007, 1.18 billion nm<sup>3</sup> of natural gas was injected into the Inčukalns UGS, with the total gas volume at the facility reaching 4.47 billion nm<sup>3</sup>.

On February 1, 2007, the Company performed revaluation of fixed assets, which raised its asset value by Ls 80.2 million (EUR 114.1 million). Revaluation of fixed assets, that had been received without reward and obtained for a lower price during the reporting year, as of December 31, 2007 increased the asset value by Ls 0.8 million (EUR 1.1 million), resulting in asset value of Ls 475.6 million (EUR 676.8 million).

In 2007, the Company invested Ls 29.1 million (EUR 41.3 million) in modernization of the gas supply system and creation of new fixed assets. 28 % of the total investment were utilized for improvement of operation safety and modernization of equipment at the Inčukalns UGS, 22 % – for modernization of the system of gas transmission pipelines,

and 38 % – for expansion of the distribution networks and renewal of fixed assets. The total number of gasified objects in 2007 grew by 3.5 thousand and reached 440.8 thousand.

The most significant unit commissioned in 2007 is the compressor shop KC-1 of the Inčukalns UGS. Implementation of the project, including designing, took six years, and the total costs reached Ls 18.9 million (EUR 26.9 million).

In the reporting period, assembly of technological devices of the gas collection point GSP-1, establishment of the security system and assembly of technical equipment of the methanol feed system was completed at the facility. The unit is due to commissioning in the summer of 2008. Its total costs are already Ls 10.7 million (EUR 15.2 million). Also at the Inčukalns UGS, reconstruction of underground wells in the gas-carrying zone has been commenced, while development of the gas-dynamic model has been completed. The model will provide more precise information on the deposit of the facility and will allow for predicting the technological parameters of deposit operation. In 2007, the gas pipeline, supplying gas to the new power unit of the JSC "Latvenergo", and the largest gas regulation station in the Baltic States Riga-3 with the maximum throughput up to 300 thousand nm<sup>3</sup> per hour was put into operation. Elimination of the defects found in diagnostics of the gas transmission pipelines and construction of pig launchers and receivers for the gas pipelines Riga – Inčukalns UGS and Iecava – Liepāja is in progress. Diagnostics of the other gas transmission pipeline Izborsk – Inčukalns UGS, its repairs and attestation for raising the operating pressure to 55 bar is fully completed.

For construction of gas distribution pipelines, Ls 7.6 million (EUR 10.7 million) were spent. The major projects: construction of a gas pipeline on the TEC-2 and over the Daugava under the Dienvidu Bridge in Riga.

## ***2. Research and development activities***

In order to ensure uninterrupted gas supply to consumers and safe operation of the gas supply system in long term, the Company has developed "The plan of measures for improvement of safety of the gas supply system of the Joint Stock Company "Latvijas Gāze" from 2006 to 2010". It has been prepared on the basis of judgments of the Russian companies "Gazobezopasnostj" and "Lentransgaz", the institutes "VNIIGAS" and "Giprospeccgaz", as well as the German companies "Pipeline Engineering GmbH", "Untergrundspeiher und Geotechnologie – Systeme GmbH", "E.ON Engineering GmbH", "E.ON Ruhrgas International AG" and other cooperation partners regarding the technical condition of equipment and the possibilities of its modernization.

The plan of measures envisages investment in safety improvement at the total amount of Ls 73.8 million (EUR 105

million). It basically includes projects that are necessary for improvement of operation safety of the system, gasification of new objects and enhanced stability of gas supply in the whole region, covering the seasonal consumption fluctuations with gas supplies from the Inčukalns UGS to Estonia and the Western part of Russia, and in further perspective also to Lithuania.

If the government favours construction of a 400 MW gas station in Riga for providing base capacities of electricity, the infrastructure based on the TEC-2 will be able to provide natural gas supply at the necessary amount for this station as well.

## ***3. Management of financial risks***

Operation of the Company is subject to various financial risks, including credit risk and the risks of foreign currency exchange and interest rate fluctuations. The management of the Company seeks to minimize the negative impact of potential financial risks on the financial performance of the Company.

The Company is not directly subject to the risk of foreign currency exchange rate fluctuations, as the gas purchase price is set in USD and afterwards recalculated in EUR, whereas the gas sales tariffs are set in lats. Settlements for the supplied gas are made in EUR. Since as of January 1, 2005 the lat rate is pegged to the euro rate, the fluctuations of the Ls/EUR rate are limited, and they are not expected to have considerable impact on further financial results. The changes of gas purchase prices in USD depending on heavy fuel oil quotation are covered by the PUC-approved natural gas sales tariffs, which to a certain amount cover the fluctuations of the EUR/USD rate as well. The risk of foreign currency rate fluctuations, related to debts to suppliers, is under control via keeping a considerable share of funds in deposits of the respective currency.

Borrowings of the Company have variable interest rate.

The financial resources that could potentially lead to a certain concentration of the credit risk in the Company are mainly cash as well as customers' debts. The Company is subject to a considerable degree of credit risk concentration because a notable share of the net turnover refers to a limited number of customers. Four of the customers of the Company cover up to 47 % (in 2006 – 45 %) of sales, one of the debts of these debtors as at December 31, 2007 was 20,7 % (in 2006 – 20,7 %), the second and the third were 8,7 % and 6,8 % respectively (in 2006 – 8,8 % and 6,2 %) of the total amount of debtors' debts. The Company has introduced and observes such a credit policy that envisages selling goods on credit only to customers with a good credit history, controlling the amount of credit set for each customer. Purchasers' and clients' debts

are shown at their recoverable value. The partners of the Company in monetary deals are local financial institutions with adequate credit history.

The Company observes prudent management of liquidity risk, ensuring that there are credit resources available for meeting liabilities in due time.

#### 4. Post balance sheet events

On the basis of tendencies in the oil products market and the desire of gas suppliers to make the conditions of natural gas supply in Latvia equal to those in other countries of the European Union, as of January 1, 2008 the amendments to the natural gas supply agreement, providing for a new formula for setting the gas purchase price, became effective. In comparison to the formula of 2007, the gas purchase price has increased by 16% on average at heavy fuel quotation 400 USD/t.

In compliance with the resolution No.555 "On the actual quotation of differential natural gas tariffs and heavy fuel oil" passed by the Council of the PUC on November 23, 2007, as of January 1, 2008 tariffs shall be applied considering the actual weighed average quotation of heavy fuel oil. This resolution enabled the end users to pay less for gas. Getting support from shareholders and using a credit, in May 2007, when heavy fuel oil quotation was at its lowest, the Company purchased the gas remaining at the storage facility for consumption in 2008 for the price of 2007. As the result of the PUC resolution, in the 1st quarter of 2008, when normally, according to the average heavy fuel oil quotation of previous six months, the tariffs set at quotation 400 USD/t would be applied, the tariffs corresponding to quotations 310–330 USD/t took effect.

Since the gas reserves at the Inčukalna UGS will run out by April 2008 and after April 1, 2008, when gas injection commences, natural gas will have to be purchased with the new price formula in effect, in January 2008 the Company sent to the PUC an application on applying heavy fuel oil quotation to fixing of tariffs according to the average quotation of previous six months. On March 27, 2008, the Council of the PUC, evaluating the situation in the market, passed the resolution No.99 "On the actual quotation of differential natural gas tariffs and heavy fuel oil", by which the previous order of application of the actual heavy fuel oil quotations, identical to that stipulated in the natural gas supply agreements, will be restored as of April 1, 2008.

In February 2008, the Council of the PUC approved new methods for calculation of natural gas regulated services tariffs. Along with that, development of a cost attribution model for the gas supply system and its coordination with the PUC is in progress, as well as preparation of a project of natural gas tariff increase.

#### 5. Profit distribution 2007 as suggested by the Board

	2007 Ls	2007 EUR
Profit of the reporting year	32 818 986	46 697 210
Share of profit not available for distribution (income of deferred tax not utilized due to revaluation of fixed assets)	(1 741 185)	(2 477 483)
Share of profit available for distribution	31 077 801	44 219 727
Suggested profit distribution:		
dividends for shareholders (60.8 %)	19 950 000	28 386 293
dividends per one share (Ls /1 share)	0.50	0.711
Reserves stipulated in the Articles of Association	11 127 801	15 833 434

Individual members of the Council and the Board of the Company hold shares and interests in several companies registered in the Register of Enterprises of the Republic of Latvia and have managerial functions there. During the reporting year, the Company did not execute deals of significant amount (except for those mentioned in the financial account) with these companies.

Information on shares of the Company held by members of the Board and the Council of the Company is available at the Board of the Company.

#### 6. Perspective

On the basis of investments into improvement of system operation safety, expansion of the gas pipeline network, attraction of new customers and retrieval of debtors' debts, made in previous years and in the reporting year, as well as considering the situation in the fuel market of Latvia, the Board of the Company considers that the Company will continue its successful development in 2008 and take a stable place in the fuel supply market.

Chairman of the Board



A. Dāvis

Board meeting minutes No. 18 (2008)  
Riga, April 28, 2008

*Profit and loss account for the year ended December 31, 2007*

	2007	2006	2007	2006
	Ls	Ls	EUR	EUR
1. Net sales	239 440 515	182 343 882	340 693 159	259 451 970
2. Cost of sales	(195 532 509)	(152 793 672)	(278 217 695)	(217 405 809)
<b>3. Gross profit</b>	<b>43 908 006</b>	<b>29 550 210</b>	<b>62 475 464</b>	<b>42 046 161</b>
5. Administrative expenses	(7 238 653)	(5 993 429)	(10 299 675)	(8 527 881)
6. Other operating income	2 326 442	945 035	3 310 229	1 344 664
7. Other operating expenses	(1 874 195)	(1 433 575)	(2 666 739)	(2 039 793)
10. Interest and similar income	1 138 801	2 280 957	1 620 368	3 245 509
11. Revaluation of long term financial investments and short term securities	384	1 578	546	2 245
12. Interest and similar expenses	(558 067)	(38 126)	(794 058)	(54 249)
13. Provisions for bad and doubtful debtors, net	172 415	279 089	245 325	397 108
14. Provisions for obsolete and slow moving inventories, net	6 042	(41 037)	8 596	(58 390)
<b>16. Profit before taxes</b>	<b>37 881 175</b>	<b>25 550 702</b>	<b>53 900 056</b>	<b>36 355 374</b>
17. Corporate income tax for the reporting year	(5 973 221)	(3 582 831)	(8 499 128)	(5 097 909)
18. Deferred income tax	1 067 765	367 087	1 519 293	522 317
19. Other taxes	(156 733)	(1 327 703)	(223 011)	(1 889 151)
<b>20. Current year's profit</b>	<b>32 818 986</b>	<b>21 007 255</b>	<b>46 697 210</b>	<b>29 890 631</b>
Unrealised deferred tax gain related to fixed assets revaluation	(1 741 185)	(1 175 456)	(2 477 483)	(1 672 523)
<b>Profit available for distribution</b>	<b>31 077 801</b>	<b>19 831 799</b>	<b>44 219 727</b>	<b>28 218 108</b>

**Balance sheet as at December 31, 2007****(1)**

	31.12.2007. Ls	31.12.2006. Ls	31.12.2007. EUR	31.12.2006. EUR
<b>Assets</b>				
<b>Long-term investments</b>				
<b>I. Intangible assets:</b>				
1. Research and development	78 337	127 301	111 462	181 131
2. Concessions, patents, licences, trademarks and similar rights	1 620 892	1 522 251	2 306 323	2 165 970
5. Advance payments for intangible assets	203 595	272 766	289 689	388 111
<b>Total intangible assets:</b>	<b>1 902 824</b>	<b>1 922 318</b>	<b>2 707 474</b>	<b>2 735 212</b>
<b>II. Fixed assets:</b>				
1. Land, buildings, constructions and gas transmission system	255 258 865	168 026 445	363 200 644	239 080 092
3. Equipment and machinery	36 413 047	23 006 758	51 811 101	32 735 669
4. Other fixed assets	4 390 522	1 419 585	6 247 149	2 019 887
5. Advances for fixed assets and fixed assets under construction	21 621 346	33 190 656	30 764 404	47 226 049
<b>Total fixed assets:</b>	<b>317 683 780</b>	<b>225 643 444</b>	<b>452 023 298</b>	<b>321 061 697</b>
<b>V. Long-term financial investments:</b>				
3. Investment in associated companies	80	80	114	114
5. Other securities and investments	5 676	5 292	8 077	7 530
9. Trade debtors	4 433	89 135	6 308	126 828
<b>Total long-term financial investments:</b>	<b>10 189</b>	<b>94 507</b>	<b>14 499</b>	<b>134 472</b>
<b>Total long-term investments:</b>	<b>319 596 793</b>	<b>227 660 269</b>	<b>454 745 271</b>	<b>323 931 381</b>
<b>Current assets</b>				
<b>I. Inventories:</b>				
1. Raw materials and consumables	85 359 145	70 311 771	121 455 121	100 044 637
5. Advances for goods receivable	209 239	69 492	297 720	98 878
<b>Total inventories:</b>	<b>85 568 384</b>	<b>70 381 263</b>	<b>121 752 841</b>	<b>100 143 515</b>
<b>III. Debtors:</b>				
1. Trade debtors	24 620 661	13 958 668	35 032 044	19 861 395
3. Receivables from affiliated companies	155 261	-	220 917	-
4. Other debtors	920 220	1 890 221	1 309 354	2 689 542
7. Deferred expenses	456 930	426 544	650 152	606 917
<b>Total debtors:</b>	<b>26 153 072</b>	<b>16 275 433</b>	<b>37 212 467</b>	<b>23 157 854</b>
<b>IV. Short-term financial investments:</b>				
5. Other securities and investments	17 809	19 746	25 340	28 096
9. Term deposits	-	7 126 414	-	10 139 974
<b>Total short-term financial investments:</b>	<b>17 809</b>	<b>7 146 160</b>	<b>25 340</b>	<b>10 168 070</b>
<b>V. Cash and bank:</b>				
	44 304 704	11 047 773	63 039 914	15 719 564
<b>Total current assets:</b>	<b>156 043 969</b>	<b>104 850 629</b>	<b>222 030 562</b>	<b>149 189 003</b>
<b>Total assets</b>	<b>475 640 762</b>	<b>332 510 898</b>	<b>676 775 833</b>	<b>473 120 384</b>

**Balance sheet as at December 31, 2007****(2)**

	31.12.2007. Ls	31.12.2006. Ls	31.12.2007. EUR	31.12.2006. EUR
<b>Liabilities</b>				
<b>Shareholders' funds:</b>				
1. Share capital	39 900 000	39 900 000	56 772 585	56 772 585
2. Share premium	14 320 210	14 320 210	20 375 823	20 375 823
3. Long-term investments revaluation reserve	187 441 623	119 122 188	266 705 402	169 495 603
5. Reserves				
c) statutory reserve	47 582 358	39 720 559	67 703 596	56 517 264
6. Retained earnings				
a) previous years' retained earnings	3 437 296	2 261 840	4 890 831	3 218 308
b) current year's retained profit	32 818 986	21 007 255	46 697 210	29 890 631
<b>Total shareholders' funds:</b>	<b>325 500 473</b>	<b>236 332 052</b>	<b>463 145 447</b>	<b>336 270 214</b>
<b>Creditors:</b>				
<b>Long-term creditors:</b>				
12. Deferred income	11 429 762	8 424 907	16 263 086	11 987 564
15. Accruals for post employment benefits and other employee benefits	2 500 000	-	3 557 180	-
15. Deferred tax liability	30 538 257	19 549 651	43 452 024	27 816 647
<b>Total long-term creditors:</b>	<b>44 468 019</b>	<b>27 974 558</b>	<b>63 272 290</b>	<b>39 804 211</b>
<b>Short-term creditors:</b>				
3. Borrowings from credit institutions	20 029 914	16 030	28 500 000	22 809
5. Advances received	5 475 474	4 747 502	7 790 898	6 755 087
6. Trade creditors	62 848 711	44 260 732	89 425 660	62 977 348
8. Accounts payable to related companies	53 251	10 706 272	75 769	15 233 653
10. Taxes and state compulsory social insurance contributions	7 589 341	3 284 708	10 798 659	4 673 718
11. Other creditors	3 449 052	1 993 524	4 907 559	2 836 529
12. Deferred income	432 942	315 606	616 021	449 067
15. Accrued liabilities	5 793 585	2 879 914	8 243 530	4 097 748
<b>Total short-term creditors:</b>	<b>105 672 270</b>	<b>68 204 288</b>	<b>150 358 096</b>	<b>97 045 959</b>
<b>Total creditors:</b>	<b>150 140 289</b>	<b>96 178 846</b>	<b>213 630 386</b>	<b>136 850 170</b>
<b>Total liabilities and shareholders' funds</b>	<b>475 640 762</b>	<b>332 510 898</b>	<b>676 775 833</b>	<b>473 120 384</b>



*Statement of changes in equity for the year ended December 31, 2007*

	<i>Share capital</i>	<i>Share premium</i>	<i>Long-term investments revaluation reserve</i>	<i>Other reserves*</i>	<i>Statutory reserve</i>	<i>Retained earnings</i>	<i>Total</i>
	<i>Ls</i>	<i>Ls</i>	<i>Ls</i>	<i>Ls</i>	<i>Ls</i>	<i>Ls</i>	<i>Ls</i>
<b>Balance as at 31.12.2005.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>119 007 653</b>	<b>2 091 647</b>	<b>29 135 700</b>	<b>24 720 052</b>	<b>229 175 262</b>
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
<b>Balance as at 31.12.2006.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>119 122 188</b>	<b>-</b>	<b>39 720 559</b>	<b>23 269 095</b>	<b>236 332 052</b>
Dividends	-	-	-	-	-	(11 970 000)	(11 970 000)
Transferred to reserves	-	-	-	-	7 861 799	(7 861 799)	-
Revaluation of fixed assets	-	-	81 019 796	-	-	-	81 019 796
Deferred tax liability arising on the revaluation of fixed assets	-	-	(12 152 969)	-	-	-	(12 152 969)
Disposal of revalued fixed assets	-	-	(643 990)	-	-	-	(643 990)
Deferred tax on disposal of revalued fixed assets	-	-	96 598	-	-	-	96 598
Profit for the year	-	-	-	-	-	32 818 986	32 818 986
<b>Balance as at 31.12.2007.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>187 441 623</b>	<b>-</b>	<b>47 582 358</b>	<b>36 256 282</b>	<b>325 500 473</b>

*Statement of changes in equity for the year ended December 31, 2007 (continued)*

	<i>Share capital</i>	<i>Share premium</i>	<i>Long-term investments revaluation reserve</i>	<i>Other reserves*</i>	<i>Statutory reserve</i>	<i>Retained earnings</i>	<i>Total</i>
	<i>EUR</i>	<i>EUR</i>	<i>EUR</i>	<i>EUR</i>	<i>EUR</i>	<i>EUR</i>	<i>EUR</i>
<b>Balance as at 31.12.2005.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>169 332 635</b>	<b>2 976 146</b>	<b>41 456 366</b>	<b>35 173 465</b>	<b>326 087 020</b>
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
<b>Balance as at 31.12.2006.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>169 495 603</b>	<b>-</b>	<b>56 517 264</b>	<b>33 108 939</b>	<b>336 270 214</b>
Dividends	-	-	-	-	-	(17 031 776)	(17 031 776)
Transferred to reserves	-	-	-	-	11 186 332	(11 186 332)	-
Revaluation of fixed assets	-	-	115 280 784	-	-	-	115 280 784
Deferred tax liability arising on the revaluation of fixed assets	-	-	(17 292 117)	-	-	-	(17 292 117)
Disposal of revalued fixed assets	-	-	(916 315)	-	-	-	(916 315)
Deferred tax on disposal of revalued fixed assets	-	-	137 447	-	-	-	137 447
Profit for the year	-	-	-	-	-	46 697 210	46 697 210
<b>Balance as at 31.12.2007.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>266 705 402</b>	<b>-</b>	<b>67 703 596</b>	<b>51 588 041</b>	<b>463 145 447</b>

\* 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, 2007*

	2007	2006	2007	2006
	Ls	Ls	EUR	EUR
<b>I Cash flows from operating activities</b>				
<b>1. Profit before taxes</b>	37 881 175	25 550 702	53 900 056	36 355 374
Adjustments for:				
- fixed asset depreciation and write-down of intangible assets	18 488 470	13 061 414	26 306 722	18 584 717
- change in provisions for inventories	(6 042)	41 037	(8 597)	58 390
- change in provisions for long-term financial investments	(384)	(1 578)	(546)	(2 245)
- change in accrued expenses for bonuses for reporting year's financial results	3 017 300	13 300	4 293 233	18 923
- change in accrued unused annual leave expenses	145 060	210 846	206 401	300 007
- change in other provisions	(248 689)	248 689	(353 852)	353 852
- changes in accruals for post employment benefits and other employee benefits	2 500 000	-	3 557 180	-
- interest and similar income	(1 138 801)	(2 280 957)	(1 620 368)	(3 245 509)
- interest and similar expense	558 067	38 126	794 058	54 249
- Loss / (profit) on sale of fixed assets	44 773	(56 281)	63 706	(80 081)
<b>Adjustments for:</b>				
Trade debtors increase	(10 732 552)	(804 357)	(15 271 046)	(1 144 497)
Inventories increase	(15 000 845)	(26 686 765)	(21 344 279)	(37 971 846)
Trade creditors' increase	7 933 090	22 615 685	11 287 770	32 179 221
Other debtors' increase / (decrease)	974 686	(310 276)	1 386 853	(441 482)
Other creditors' increase	5 706 865	3 546 692	8 120 137	5 046 488
<b>3. Cash generated from operations</b>	<b>50 122 173</b>	<b>35 186 277</b>	<b>71 317 428</b>	<b>50 065 561</b>
Interest paid	(475 694)	(75 969)	(676 852)	(108 094)
Interest received	879 318	2 274 112	1 251 157	3 235 770
Corporate income tax paid	(3 445 795)	(4 030 034)	(4 902 925)	(5 734 222)
<b>6. Net cash flows generated from operations</b>	<b>47 080 002</b>	<b>33 354 386</b>	<b>66 988 808</b>	<b>47 459 015</b>
<b>II. Cash flows from investing activities</b>				
Acquisition of fixed assets and intangible assets	(29 053 278)	(25 077 950)	(41 339 090)	(35 682 708)
Proceeds from sale of fixed assets	59 670	27 544	84 903	39 192
Net (increase) / decrease of other investments in term deposits over 90 days, net	7 126 414	(7 126 414)	10 139 974	(10 139 974)
<b>9. Net cash used in investing activities</b>	<b>(21 867 194)</b>	<b>(32 176 820)</b>	<b>(31 114 213)</b>	<b>(45 783 490)</b>
<b>III. Cash flows from financing activities</b>				
Repayment of borrowings	(15 791)	(32 449)	(22 469)	(46 171)
Received loans	20 029 914	-	28 500 000	-
Dividends paid	(11 970 000)	(13 965 000)	(17 031 776)	(19 870 405)
<b>7. Net cash used in financing activities</b>	<b>8 044 123</b>	<b>(13 997 449)</b>	<b>11 445 755</b>	<b>(19 916 576)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>33 256 931</b>	<b>(12 819 883)</b>	<b>47 320 350</b>	<b>(18 241 051)</b>
Cash and cash equivalents at the beginning of the reporting year	11 047 773	23 867 656	15 719 564	33 960 615
<b>Cash and cash equivalents at the end of the reporting year</b>	<b>44 304 704</b>	<b>11 047 773</b>	<b>63 039 914</b>	<b>15 719 564</b>

# Notes

## Accounting policies

### *(a) Information on the Company*

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

### *(b) Financial statements preparation basis*

Annual accounts are prepared in accordance with the laws of the Republic of Latvia "On Accounting" and "On Annual Accounts of the Companies" and with mandatory Latvian accounting standards. In preparation of these annual accounts following Latvian accounting standards (LAS) are applied: LAS No 1 "Framework of preparation of financial statements", LAS No 2 "Cash flow statement", LAS No 3 "Events after the balance sheet date", LAS No 4 "Change in accounting policies, changes in accounting estimates and prior period errors" and LAS No 5 "Long-term contracts". LAS No 6 "Revenue", LAS No 7 "Property, plant and equipment" and LAS No 8 "Provisions, contingent liabilities and contingent assets".

LAS No 6, LAS No 7 and LAS No 8 become effective for the reporting periods starting in 2007. The implementation of these standards did not leave an effect on the financial statements of the Company.

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

Cash flow statement is prepared using indirect cash flow method.

The accounting policies used by the Company are consistent with those used in the previous accounting period, except for accounting policy (f), regarding change of minimal value of capitalized fixed assets. Management of the Company believes that the change of this policy did not have material impact on the financial position of the Company.

### *(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.

	31.12.2007.	31.12.2006.
	Ls	Ls
1 USD	0.484	0.536
1 EUR	0.702804	0.702804

Euro financial statements 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:

	<i>% per annum</i>
Buildings	1 – 3
Gas transmission system	2 – 2,5
Machinery and equipment	5 – 20
Furniture and fittings	10 – 20
Computers and equipment	30

Depreciation is not calculated for land and buffer gas, advances for fixed assets and assets under construction.

The Company capitalises fixed assets with cost exceeding Ls 150 (EUR 213) and useful life exceeding 1 year (2006: Ls 50 (EUR 71)).

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 offset against the revaluation reserve if the fixed asset is carried at revalued amount. Recoverable amount is the higher of the fair value less costs to sell and the value in use of the related fixed asset.

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

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

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

**(g) Inventories**

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

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

**(h) 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, accruals for post employment and other benefits and provisions for bad and doubtful debts where the management is of the opinion that they will meet the criteria stated in Article 9 of the law "On Corporate Income Tax". The deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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

***(l) Accrued unused annual leave expenses and accrued liabilities***

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

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

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

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

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

***(m) Cash and cash equivalents***

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

***(n) Related parties***

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

***(o) Profit available for distribution***

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

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

# PricewaterhouseCoopers Independent Auditors' report

*Translation from Latvian original \**

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*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 2007, 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 28 April 2008 we expressed an unqualified opinion on the financial statements of the Company for the year ended 31 December 2007 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 Lapse*

Member of the Board



*Olga Bukovska*

Certified auditor in charge  
Certificate No. 170



Riga, Latvia  
13 June 2008

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



"Save gas. Use the small flame!" At the end of the Second World War, the propaganda of gas economy became topical. A poster of the year 1943. Thinking of rational usage of natural resources – ensuring of energy efficiency is topical also nowadays. Natural gas – the source of good energy!

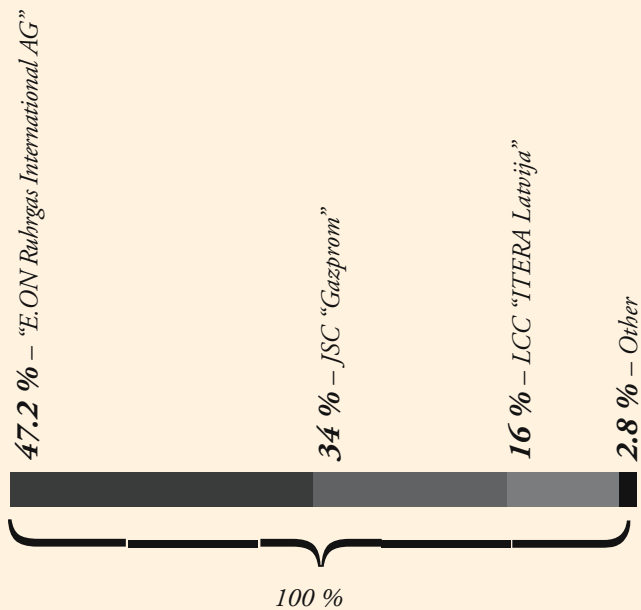


# Facts and Figures

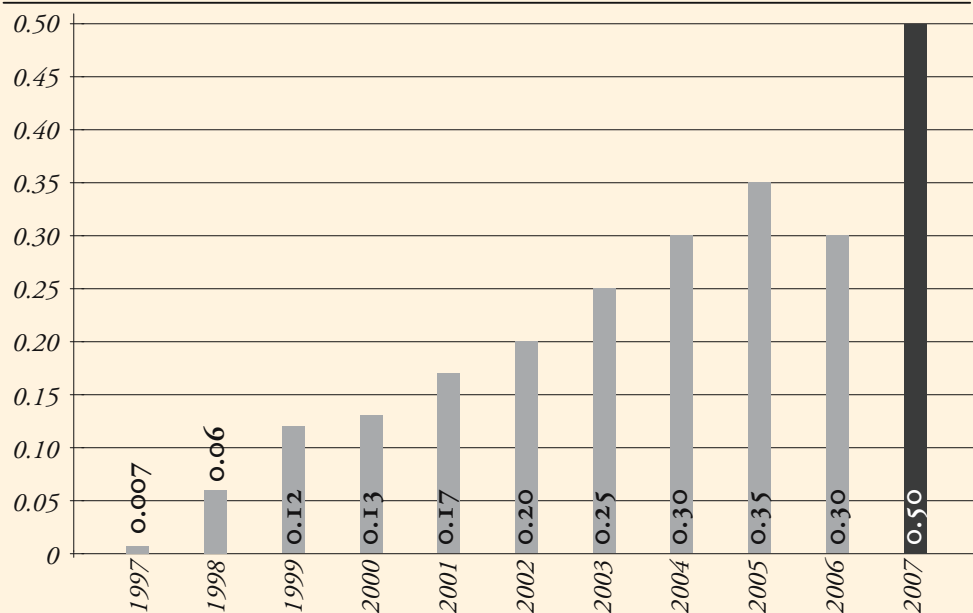
1997–2007



**Shareholder structure of JSC “Latvijas Gāze” (%)**  
*on December 31, 2007*



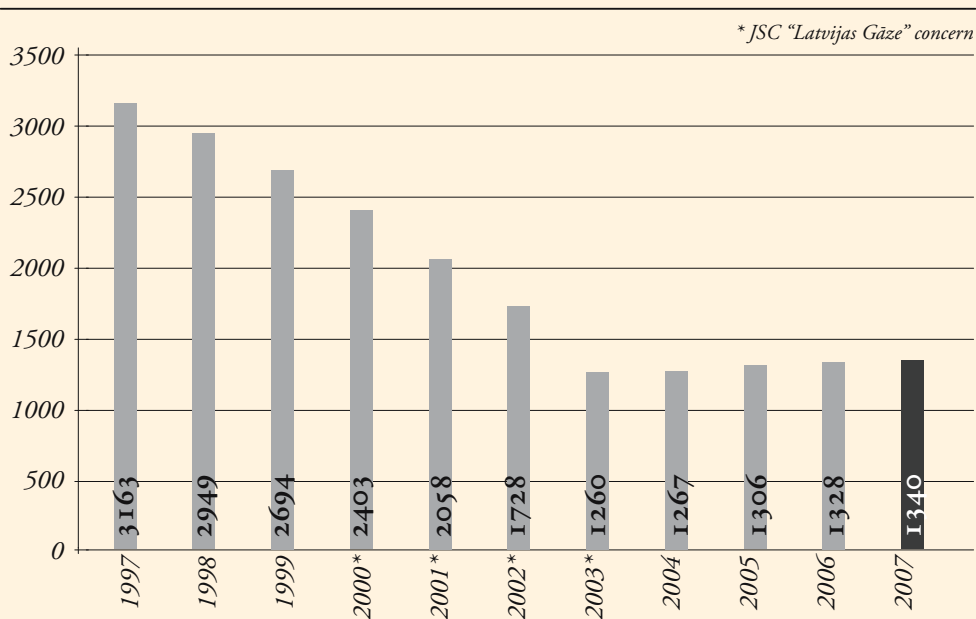
**JSC “Latvijas Gāze” dividend per share (Ls/ share)**



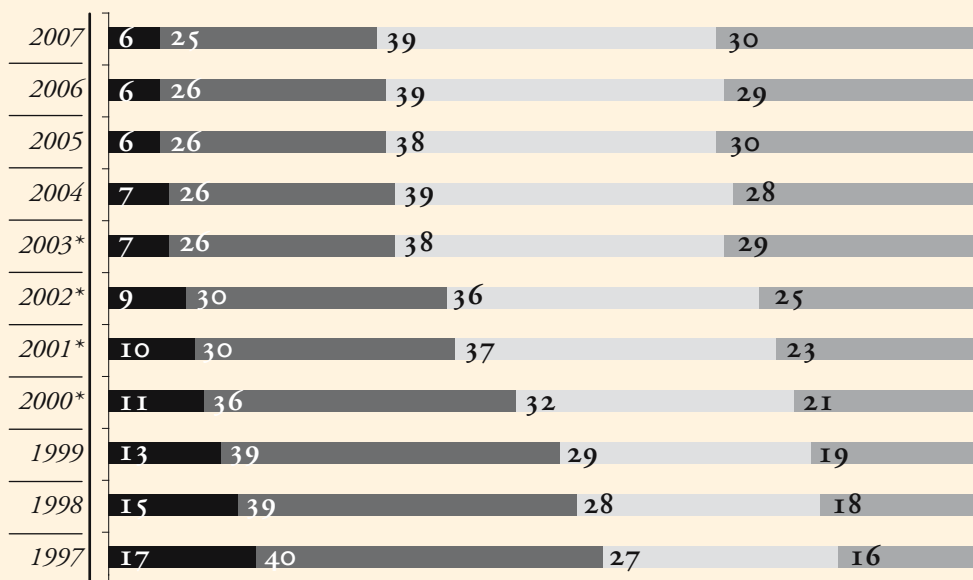
## Trade statistics of JSC "Latvijas Gāze" shares

Price (Ls)	2001	2002	2003	2004	2005	2006	2007
First	3.65	6.65	5.45	5.51	6.2	9.95	10.35
Maximum	11.35	6.8	6.25	6.6	9.9	11.13	11.25
Minimum	3.5	4.8	5.4	5.4	6.15	9.27	7.05
Price of last transaction	6.65	5.49	5.5	6.5	9.61	10.32	7.12
Change %	82.19	-17.44	0.18	18.18	47.85	7.39	-31.01
Turnover (shares)	8,363,161	3,982,263	4,962,617	181,611	63,360	128,844	154,825
Turnover (Ls million)	51.48	21.31	27.34	1.06	0.49	1.32	1.60
Capitalization at the end of the period (Ls million)	265.33	219.05	219.45	259.35	383.44	411.77	284.09

## Average number of JSC "Latvijas Gāze" employees



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



\* JSC "Latvijas Gāze" concern

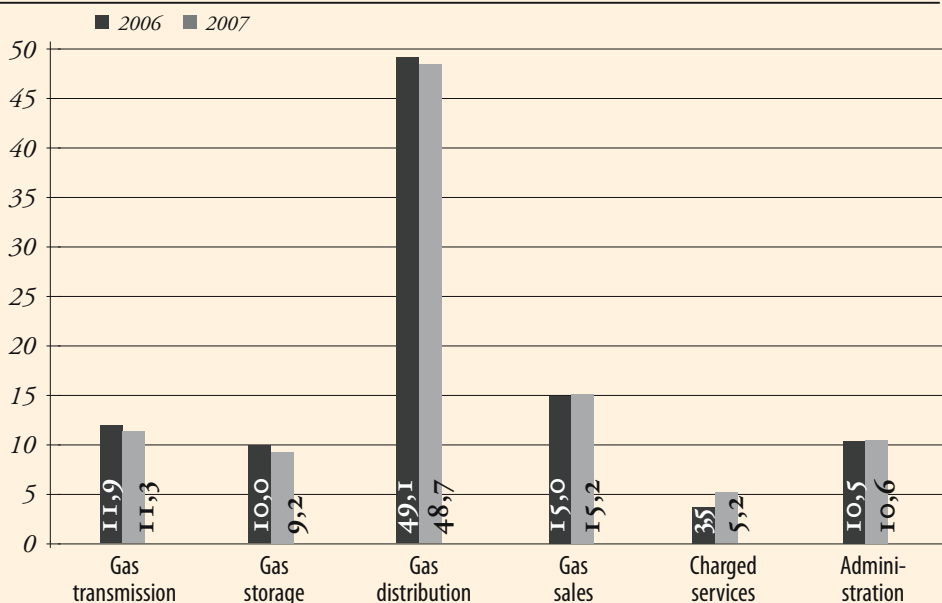
■ Primary

■ Secondary

■ Secondary professional

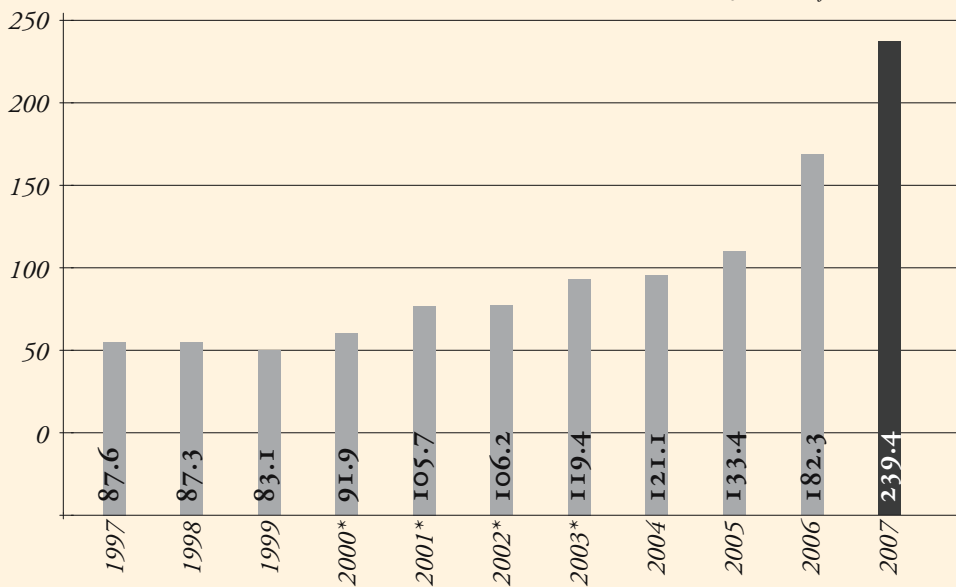
■ Higher

## Division of employees across directions of activities (%)



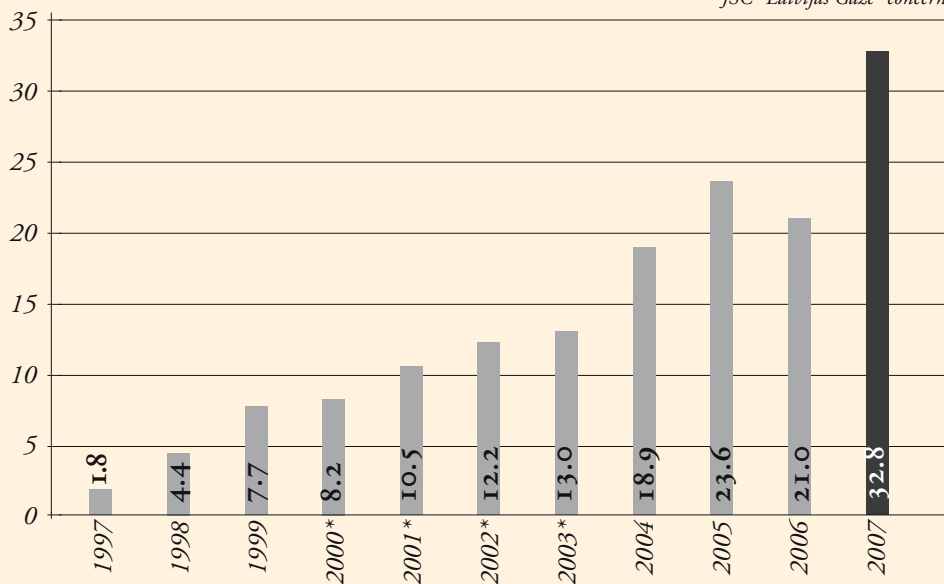
## Net turnover (Ls million)

\* JSC "Latvijas Gāze" concern



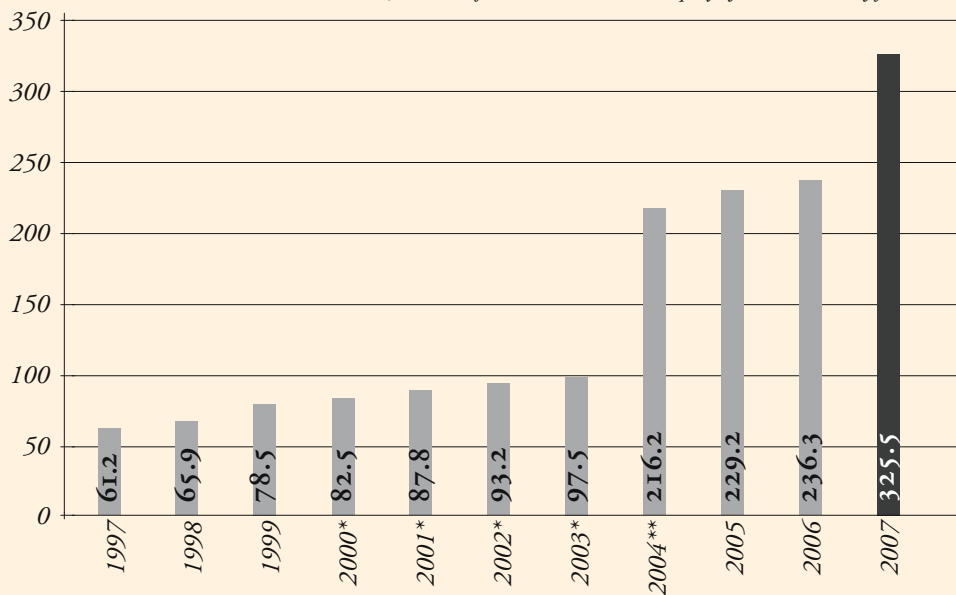
## Net profit (Ls million)

\* JSC "Latvijas Gāze" concern



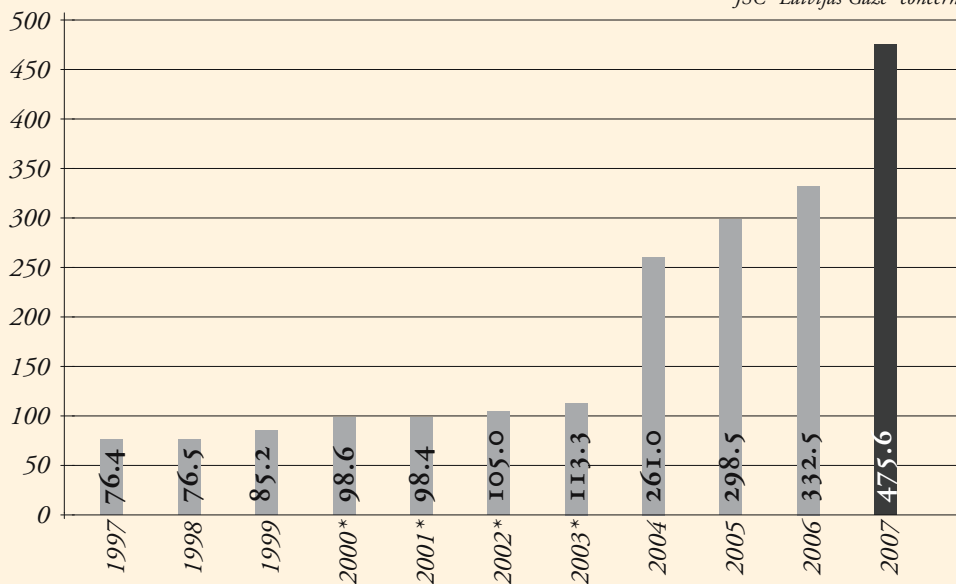
## Equity (Ls million)

\* JSC "Latvijas Gāze" concern    \*\* Equity after revaluation of fixed assets



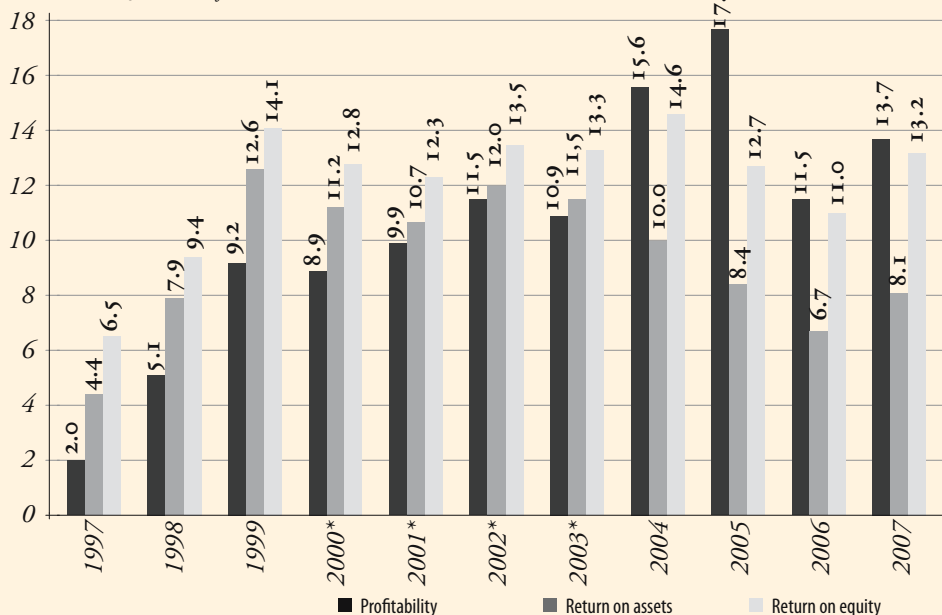
## Assets (Ls million)

\* JSC "Latvijas Gāze" concern



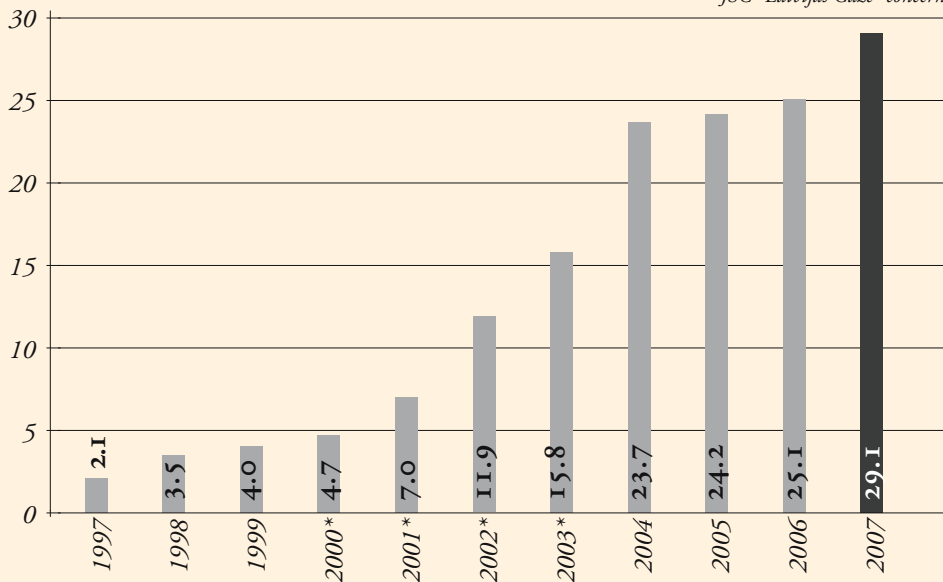
## Main financial indices (%)

\* JSC "Latvijas Gāze" concern



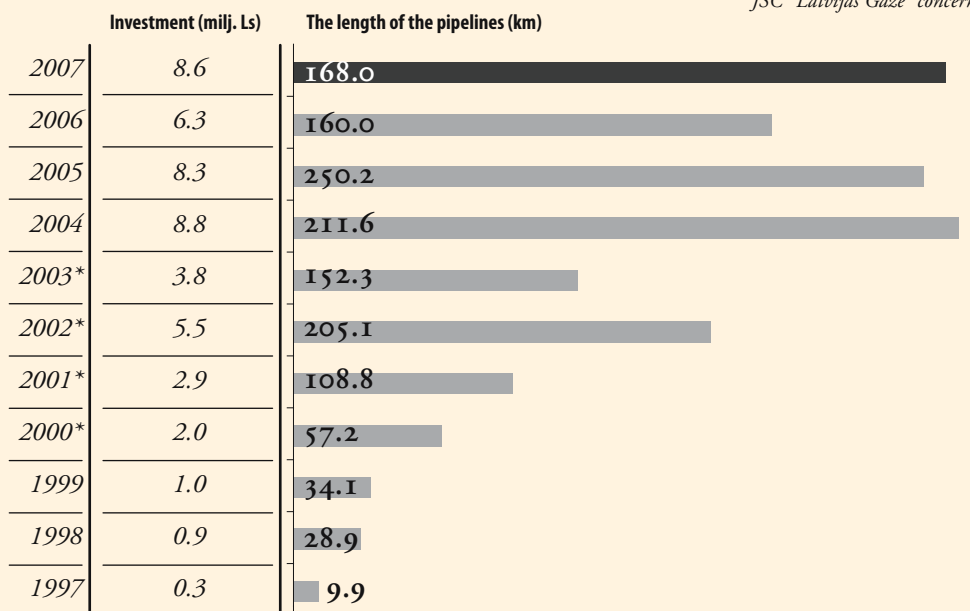
## Investment (Ls million)

\* JSC "Latvijas Gāze" concern

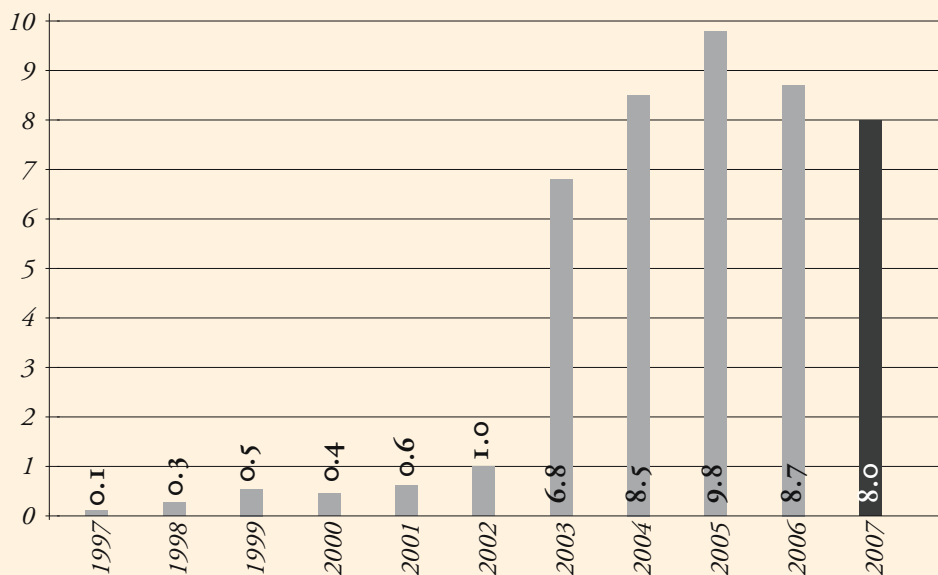


## Construction of new gas pipelines and development of the system of gas distribution pipelines

\* JSC "Latvijas Gāze" concern

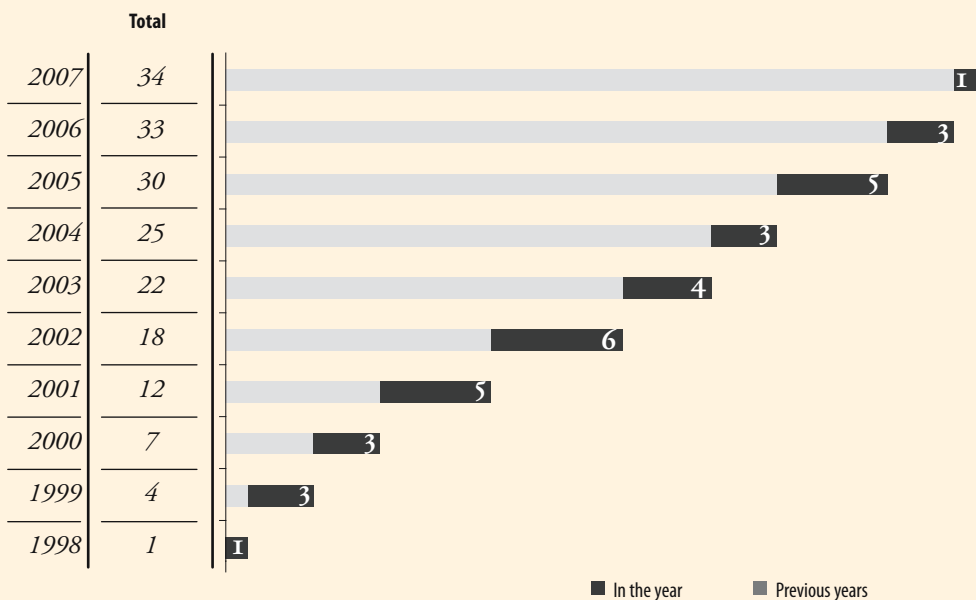


## Investment in modernization of Inčukalns UGS (Ls million)

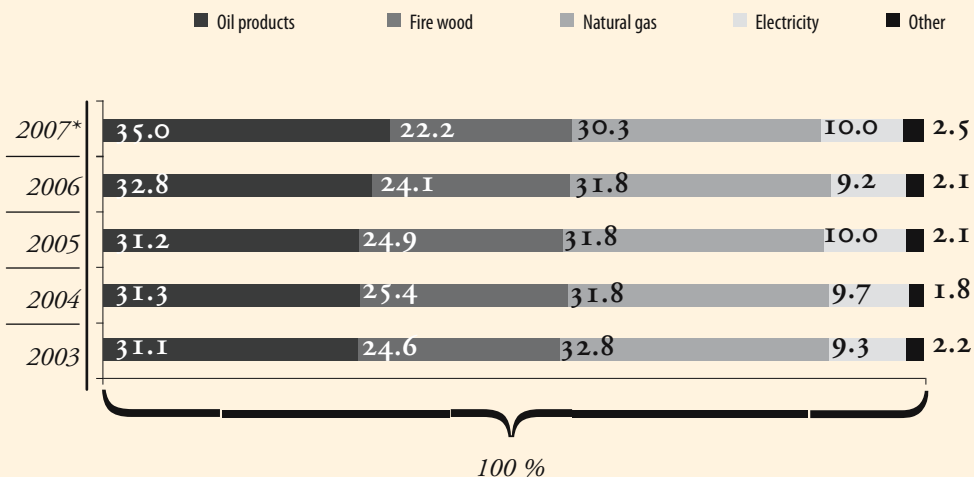




## Modernization of gas regulation stations (quantity)

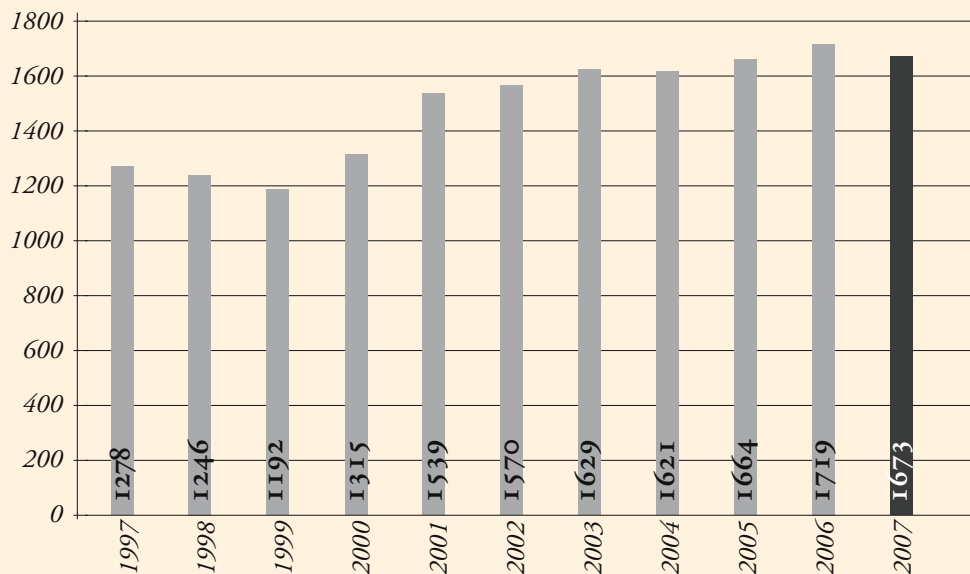


## Primary energy resources balance of Latvia (%)

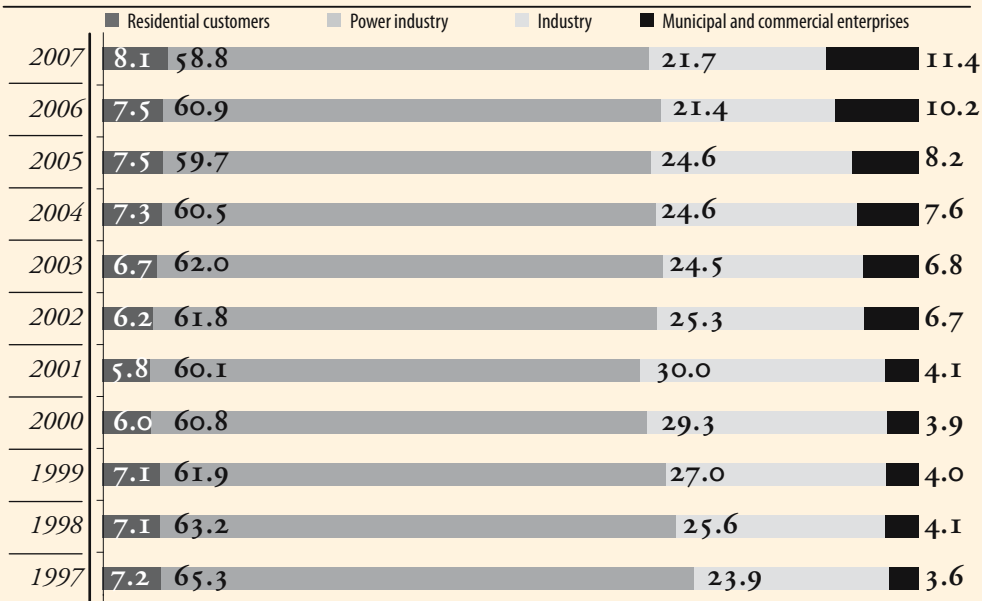


\* Operative information. Source: Central Statistical Bureau of LR, State JSC "Latvenergo", JSC "Latvijas Gāze"

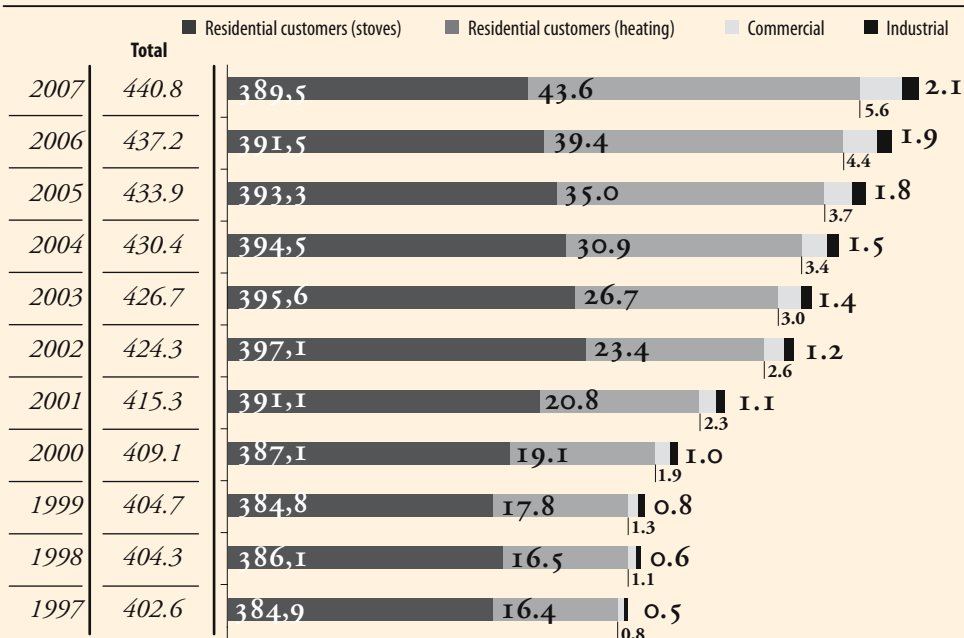
## Volume of natural gas sales (million m<sup>3</sup>)



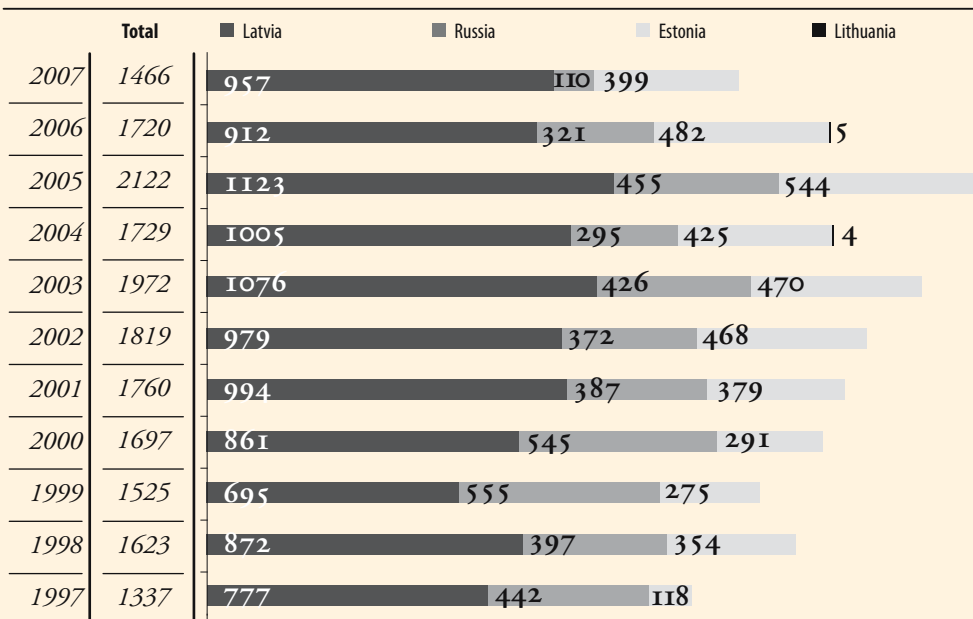
## Natural gas sales in Latvia by industries (%)



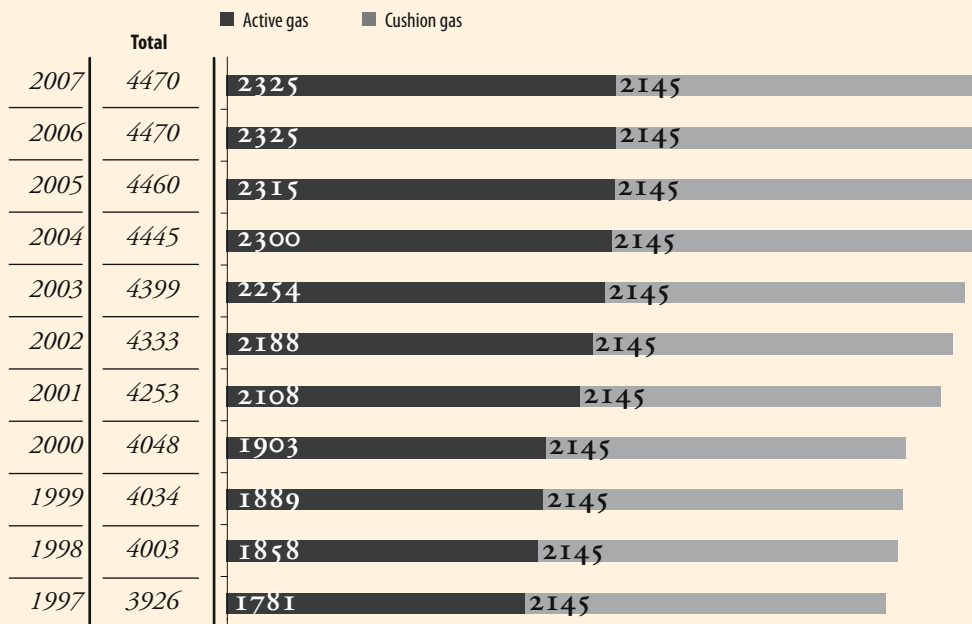
## Number of customers (thousands)



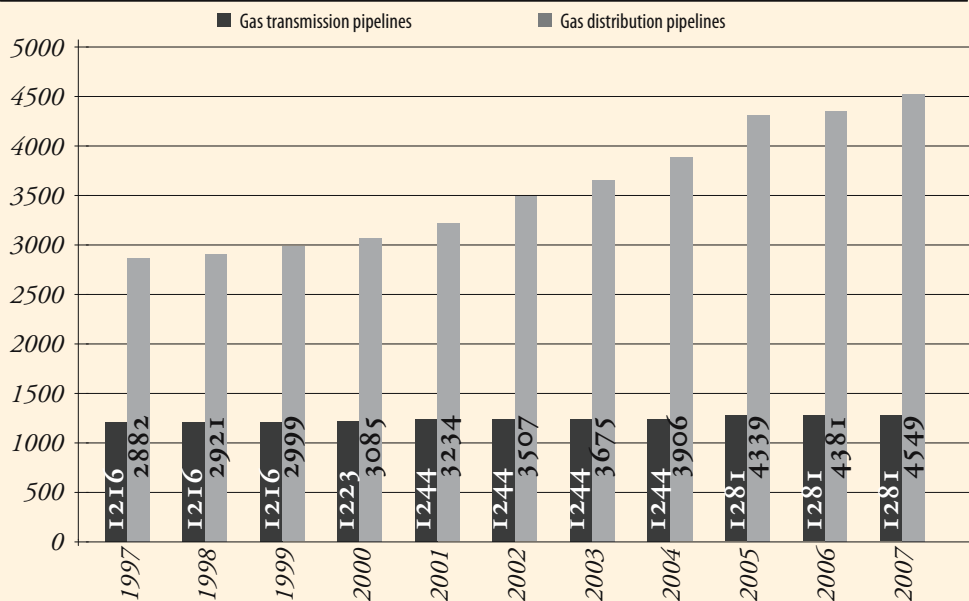
## Natural gas deliveries from Inčukalns UGS (million m<sup>3</sup>)



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



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



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**Printed on environmentally friendly paper.**