AB Klaipėdos Nafta

Financial statements for 2005

Contents

Company details

AB Klaipėdos Nafta

Telephone:	+370 46 391 700
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Registration No.:	BĮ 94-479
Company code:	110648893
Registered office:	Burių 19, LT-91003 Klaipėda-C, Lithuania

Supervisory Board

Dominykas Pečiulis (Chairman)
Vanda Krenienė
Vytautas Aršauskas

Board of Directors

Vladas Gagilas (Chairman)
Saulius Spėčius
Robertas Tamošiūnas
Algimantas Slapšinskas
Arūnas Keraminas

Management

Jurgis Aušra, General Director

Auditors

KPMG Baltics UAB

Banks

AB SEB Vilniaus Bankas
AB Bankas Hansabankas
AB Šiaulių Bankas
AB Sampo Bankas

Financial highlights

LTL'000	2005	2004	2003
Key figures			
Turnover	**84,956**	**106,416**	**115,529**
Gross margin	31,310	37,705	41,650
Operating result	17,186	28,779	27,966
Result before income tax	14,563	24,738	26,487
Result for the year	**10,071**	**18,302**	**21,269**
Non-current assets	449,553	457,513	497,534
Current assets	25,648	38,689	22,304
Total assets	**475,201**	**496,202**	**519,838**
Share capital	342,000	342,000	342,000
Capital and reserves	**392,409**	**387,163**	**377,873**
Non-current liabilities	56,986	90,062	120,837
Current liabilities	25,806	18,977	21,128
Total liabilities	**82,792**	**109,039**	**141,965**
Total equity and liabilities	**475,201**	**496,202**	**519,838**
Net cash flow from operating activities	48,422	71,544	91,265
Net cash flow from investing activities	-22,218	-4,022	-9,694
Net cash flow from financing	-37,968	-52,373	-74,881
Total cash flow	**-11,764**	**15,149**	**6,690**
Average number of employees	**306**	**313**	**321**

Financial ratios

	2005	2004	2003
Net profit ratio	11.9%	17.2%	18.4%
Return on investment	3.6%	5.8%	5.4%
Gross margin	36.9%	35.4%	36.1%
Current ratio	99.4%	203.9%	105.6%
Equity ratio	474.0%	355.1%	266.2%
Return on equity	2.6%	4.8%	5.9%

Financial highlights

Calculation of financial ratios

Net profit ratio	$\frac{\text{Net profit x 100}}{\text{Turnover}}$
Return on investment	$\frac{\text{Profit/loss on operating activities before interest etc. x 100}}{\text{Total assets}}$
Gross margin	$\frac{\text{Gross profit x 100}}{\text{Turnover}}$
Current ratio	$\frac{\text{Current assets x 100}}{\text{Current creditors}}$
Equity ratio	$\frac{\text{Capital and reserves at year end x 100}}{\text{Total liabilities at year end}}$
Return on equity	$\frac{\text{Profit for purposes of analysis x 100}}{\text{Average capital and reserves}}$
Profit for purposes of analysis	Profit/loss on ordinary activities after tax

Management's statement on the annual financial statements

The Management has today discussed and authorized the annual financial statements.

The annual financial statements have been prepared in accordance with International Financial Reporting Standards. We consider that the accounting policies used are appropriate and that the annual financial statements thus give a true and fair view.

Klaipėda, 16 March 2006

Jurgis Aušra
General Director

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Auditors' report to the shareholders of AB Klaipėdos Nafta

We have audited the accompanying balance sheet of AB Klaipėdos Nafta as of 31 December 2005, and the related statements of income, changes in equity and cash flows for the year then ended.

These financial statements are the responsibility of the management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Company as of 31 December 2005, and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Without qualifying our opinion we draw attention to the following matters of note:

- As presented in the Note 19 to the financial statements the Company recalculated the real estate tax for the periods from 2000 to 2004 resulting in a decrease of the tax expenses by 5,383 tLTL. The tax authorities rejected the correction due to which a tax dispute arose. At present, the ultimate outcome of the dispute cannot be predicted. Impairment for eventual losses regarding the recovery of the tax surplus amounting to 4,615 tLTL has not been included in the financial statements.
- As presented in the Note 3 to the financial statements the Company prolonged the useful lifetime of fixed assets. The change in accounting estimate was accounted as of 1 September 2005. The change increased the Company's result for 2005 by approximately 9,105 tLTL.
- As presented in the Note 19 to the financial statements on 1 March 2006 the Company received a claim and became a defendant in a lawsuit alleging infringement of contractual obligations with Riverlake Energy (S) PTE LTD. The Company has filed a counter action. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements

Klaipėda, 16 March 2006
KPMG Baltics UAB

Leif René Hansen
Danish State Authorised
Public Accountant

Rokas Kasperavičius
ACCA and Lithuanian
Certified Auditor

"KPMG Baltics", UAB, a Lithuanian limited liability company, is a member of KPMG International, Swiss cooperative

Įmonės kodas 111616158
PVM kodas LT114949716
Juridinių asmenų registras

Income statement
for the year ended 31 December 2005

	Note	2005	2004
		LTL'000	LTL'000
Turnover		84,956	106,416
Cost of sales	14	-53,646	-68,711
Gross margin		**31,310**	**37,705**
Operating expenses	15	-14,342	-9,305
Other income		218	379
Operating income		**17,186**	**28,779**
Financial income		740	646
Financial expenses		-3,363	-4,687
Financial items, net	16	**-2,623**	**-4,041**
Income before result in associated entities		**14,563**	**24,738**
Share of profit of associates	6	0	0
Income before income tax		**14,563**	**24,738**
Income tax (expenses)	18	-4,492	-6,436
Result for the year		**10,071**	**18,302**
Basic earnings per share (Litas)	20	0.03	0.05

The notes, set out on pages 11-30, form an integral part of these financial statements.

Balance sheet

as at 31 December 2005

	Note	31/12/2005	31/12/2004
		LTL'000	LTL'000
ASSETS			
Non-current assets			
Intangible assets		165	283
Property, plant and equipment	3	422,700	450,811
Construction in progress	3,4	23,493	5,623
Prepayments for non-current assets		2,607	284
Loans granted	5	0	0
Investments in associates	6	0	0
Held to maturity investments	7	588	512
Total non-current assets		449,553	457,513
Current assets			
Loans granted	5	1,231	3,357
Inventories	8	2,249	1,977
Trade accounts receivable	9	3,803	5,243
Accounts receivable from related parties	17	0	0
Other current assets	10	6,698	4,681
Cash and cash equivalents	11	11,667	23,431
Total current assets		25,648	38,689
TOTAL ASSETS		475,201	496,202

Balance sheet

	Note	2005	2004
		LTL'000	LTL'000
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital		342,000	342,000
Legal reserve		12,140	11,220
Other reserves		28,198	21,880
Retained earnings		10,071	12,063
Total shareholders' equity		392,409	387,163
Non-current liabilities			
Interest bearing loans and lease liabilities	12	44,036	76,976
Deferred tax liability	18	12,950	13,086
Total non-current liabilities		56,986	90,062
Current liabilities			
Current portion of interest bearing loans and lease liabilities	12	15,379	12,239
Accounts payable to related parties	17	73	79
Accounts payable to contractors and suppliers		3,803	2,355
Current tax liability		3,327	2,071
Salaries and social security payable		1,499	1,090
Other current liabilities	13	1,725	1,143
Total current liabilities		25,806	18,977
Total liabilities		82,792	109,039
TOTAL EQUITY AND LIABILITIES		475,201	496,202

Commitments and contingencies

The notes, set out on pages 11-30, form an integral part of these financial statements.

Statement of changes in equity

LTL'000	Share capital	Legal reserve	Other reserves	Retained earnings	Total
At 31 December 2003	**342,000**	**10,352**	**38,869**	**-13,348**	**377,873**
Dividends for 2003				-9,012	-9,012
Transfer to legal reserves		868	11,518	-12,386	0
Re-allocated reserves			-28,507	28,507	0
Result for the year				18,302	18,302
At 31 December 2004	**342,000**	**11,220**	**21,880**	**12,063**	**387,163**
Dividends for 2004				-4,825	-4,825
Transfer to legal reserves		920	6,318	-7,238	0
Result for the year				10,071	10,071
At 31 December 2005	**342,000**	**12,140**	**28,198**	**10,071**	**392,409**

The notes, set out on pages 11-30, form an integral part of these financial statements.

Statement of cash flows

LTL'000	2005	2004
Cash flows from operating activities		
Result for the period before taxation	14,563	24,738
Adjustments for		
Depreciation and amortisation	34,366	45,572
Interest (income) expense, net	2,623	4,041
Allowance for inventories and accounts receivable	28	-2,572
Result on fixed assets disposal	634	-87
Booked surplus of oil products and other non-monetary items	-1,197	-462
	51,017	71,230
Changes in current assets and liabilities:		
Change in accounts receivable	-577	-525
Change in inventories	-272	253
Change in other current liabilities	993	17
Total changes in working capital	144	-255
Interest received	633	569
Income tax paid	-3,372	0
Net cash from ordinary activities	48,422	71,544
Cash flows from investing activities		
Acquisition of fixed assets	-24,344	-8,111
Proceeds from sale of property, plant and equipment	0	45
Repayment of loans granted	2,126	4,044
Net cash from investing activities	-22,218	-4,022
Cash flow from financing activity		
Interest paid	-3,337	-4,561
Dividends paid	-4,831	-8,545
Loans repaid	-25,819	-35,006
Financial lease payments	-3,981	-4,261
Net cash used for financing activities	-37,968	-52,373
Net increase (decrease) in cash and cash equivalents	**-11,764**	**15,149**
Cash and cash equivalents at 1 January	**23,431**	**8,282**
Cash and cash equivalents at 31 December	**11,667**	**23,431**

The notes, set out on pages 11-30, form an integral part of these financial statements.

Notes to the financial statements

1. Background information

AB Klaipėdos Nafta (hereinafter - "the Company") was founded by AB Naftos Terminalas (Lithuania) and Lancaster Steel Inc. (USA), acquiring 51% and 49% of the shares respectively. AB Klaipėdos Nafta was registered on 27 September 1994. The registered address of the Company is Burių St. 19, Klaipėda, Lithuania.

Since 1994 a number of share capital increases took place and consequently the shareholders proportions changed and as of 31 December 2005 the share capital of the company amounted to 342,000 tLTL comprising 342,000,000 ordinary shares at par value of 1 Litas each. All shares are authorised, issued and fully paid. The shareholders structure as of 31 December 2005 and 2004 was as follows:

	2005		2004	
	Number of shares (thousand)	Ownership (percent)	Number of shares (thousand)	Ownership (percent)
Government of Lithuania, represented by the Ministry of Economy	241,544	70.6	241,544	70.6
Skandinavska Enskilda Banken Clients	18,776	5.5	10,126	3.0
Other (less than 5% each)	81,680	23.9	90,330	29.4
	342,000	100.0	342,000	100.0

The company mainly provides services of storage and transshipment of oil and oil products to Lithuanian and foreign customers. Income from oil transshipment amounted to 83,015 tLTL in 2005 (104,028 tLTL in 2004).

During 2005 the company transshipped 5,844 thousand tons of oil products (6,528 thousand tons in 2004). The maximum capacity is 7,100 thousand tons.

The major customer is a Lithuanian oil refinery, AB Mažeikių Nafta. Sales to this company amounted to 65,247 tLTL or 79% of the total oil transshipment sales in 2005 (65,186 tLTL or 63% in 2004). The quantity of oil of AB Mažeikių Nafta, transshipped in 2005, amounted to 4,830 thousand tons (4,504 thousand tons in 2004).

Notes to the financial statements

2. Significant accounting policies

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations adopted by the European Union.

Basis of the preparation

The financial statements are presented in Litas. They are prepared on the historical cost basis except for derivative financial instruments, which are stated at their fair value.

The preparation of the financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies of the Company as set out below have been applied consistently and are consistent with those of the preceding year, except as a result of change in accounting policies resulting from amendments to existing IFRS and the introduction of new IFRS applicable as of 1 January 2005 which are described in the paragraph “change in accounting policies” (page 17).

Revenue recognition

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably. Sales are recognised net of VAT and price discounts directly related to sales.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and cash in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

Notes to the financial statements

Accounts receivable and loans

Receivables and loans are initially stated at the fair value of the consideration given and are carried at amortised cost, after allowance for impairment.

Inventories

Inventories are stated at the lower of cost and net realisable value, where cost is defined as acquisition cost with an addition of transportation costs, after allowance for obsolete and slow moving items.

Intangible assets

Intangible fixed assets are stated at cost less accumulated amortisation and impairment loss. Amortisation is provided on the straight-line basis over their useful lives. Useful lives are from 3 to 10 years.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment loss. Depreciation is provided on the straight-line basis over the expected useful lives of the assets.

Items are included in property, plant and equipment when the acquisition cost is higher than 2,000 Litas and an estimated useful life of more than 1 year. Presented below are useful lives of the Company's property, plant and equipment:

Buildings and structures	7-70 years
Machinery and equipment	3-40 years
Other tangible non-current assets	3-20 years

The useful lives are reviewed periodically to ensure that the period of depreciation is consistent with the expected pattern of economic benefits from items in property, plant and equipment.

Repairs are charged to the income statement in the period they are incurred.

Renewals are added to the carrying amount of the property, plant and equipment when it is probable that the future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Company.

Construction in progress represents plant and properties under construction and is stated at cost. This includes cost of construction, plant and equipment and other direct costs. Construction in progress is not depreciated until such time as the relevant assets are completed and put into operational use.

Notes to the financial statements

Held–to-maturity investments

Long-term investments that are intended to be held-to-maturity, such as bonds, are measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on acquisition over the period to maturity. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are amortised or impaired.

Impairment of assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the income statement. Reversal of impairment losses recognised in prior years is recorded when there is an indication that the impairment losses recognised for the asset no longer exist or have decreased. The reversal is recognised in the income statement.

Financial lease

The Company recognises financial leases as assets and liabilities in the balance sheet at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Initial direct costs incurred are included as part of the asset. Lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

A finance lease gives rise to depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for leased assets is the same as for the similar property, plant and equipment.

Operating lease

Leases of assets under which substantially all the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as an expense on a straight-line basis over the lease term.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discounts or premium on settlement.

Gains and losses are recognised in the net income or loss when the liabilities are derecognised, as well as through the amortisation process.

Notes to the financial statements

Borrowing costs

Borrowing costs generally are expensed as incurred. Borrowing costs are capitalised if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalisation or borrowing costs commence when the activities to prepare the asset are in progress and expenditures and borrowing costs are incurred. Borrowing costs are capitalised until the assets are substantially ready for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded.

Legal reserve

A legal reserve is a compulsory reserve under Lithuanian legislation. Annual transfers of 5% of net profit for the year are required until the reserve reaches 10% of the share capital. The legal reserve cannot be distributed to the shareholders and can be used only to increase share capital.

Other reserves

Other reserves include reserves for support, employee benefits and capital expenditure. They are allocated and used at the discretion of shareholders and may be re-allocated for payment of dividends.

Transactions in foreign currency

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction: gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies, on the balance sheet date are recognised in the income statement. Such balances are translated at year-end exchange rates.

Income tax

Income tax charge is based on taxable income for the year and considers deferred taxation. Income tax is calculated based on Lithuanian tax legislation.

In Lithuania in 2005 and 2004 the standard income tax rate was 15%.

Deferred taxes are calculated using the balance sheet liability method. Deferred income tax reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled based on the tax rates enacted or substantially enacted at the balance sheet date.

Notes to the financial statements

Income tax (continued)

Deferred tax assets and liabilities are not discounted. Deferred tax assets are recognised when it is probable that sufficient taxable income will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Company re-assesses unrecognised deferred tax assets and the carrying amount of deferred tax assets.

Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with International Financial Reporting Standards, as published by the International Accounting Standards Board requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, income and expenses and disclosure of contingencies. The significant areas of estimation used in the preparation of the accompanying financial statements relate to depreciation, bad debt allowances and impairment evaluation. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effect of any changes in estimates will be recorded in the financial statements, when determinable.

Related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the party in making financial and operating decisions. The related parties in this report consist of the Company's associated entity, management, shareholders and their family members.

Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements but disclosed when an inflow or economic benefits are probable.

Subsequent events

Post-year-end events that provide additional information about the Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

Segment reporting

The Company operates in one business and geographical segment.

Notes to the financial statements

Comparative figures

Where necessary, the comparative figures have been adjusted to conform to changes in presentation in the current year.

Change in accounting policies

In late 2003 the IASB published a revised version of IAS 32 “Financial Instruments: Disclosure and Presentation”, a revised version of IAS 39 “Financial Instruments: Recognition and Measurement” and “Improvements to International Accounting Standards”, which made changes to 14 existing standards. In the first quarter of 2004 the IASB published IFRS 2 “Share-based Payments”, IFRS 3 “Business Combinations”, IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations” and further amendments to IAS 39. In mid-2005 the IASB issued a further revision to IAS 39 regarding the Fair Value Option. Revised IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”, amongst other matters, requires that changes in accounting policies that arise from the application of new or revised standards and interpretations are applied retrospectively, unless otherwise specified in the transitional requirements of the particular standard or interpretation. The Company adopted these effective from 1 January 2005.

Below we provide the discussion of the impact of the new standards, applicable to the Company.

Financial Instruments

In accordance with IAS 39 requirements, the Company has reviewed its portfolio of financial instruments held at 1 January 2005 and has performed redesignation of these financial instruments into categories as defined by the revised IAS 39. The standard requires retrospective application. In the corresponding financial statements the Company’s financial instruments were classified into the following categories:

-All receivables and deposits originated by the Company were classified as receivables originated by the Company and measured at amortised cost. Current portion of loans and receivables originated by the Company was classified as current assets, based on remaining maturity at the balance sheet date. There was no impact on net income or equity from this redesignation.

-All loans received and other interest bearing borrowings of the Company’s were classified as held to maturity financial instruments and measured at amortised cost as of 1 January 2005. There was no impact on net income or equity from this redesignation.

Notes to the financial statements

Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1 January 2006 or later periods but which the Company has not early adopted, as follows:

– IAS 19 (Amendment), Employee Benefits (effective from 1 January 2006). This amendment relates to accounting of pension plans. As the Company has no benefit plans established, this IAS 19 is not relevant to the Company.

- IAS 21 (Amendment), The Effects of Changes in Foreign exchange Rates – Net Investment in a Foreign Operation (effective from 1 January 2006). Management considered this amendment to IAS 21 and concluded that it is not relevant to the Company.

- IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006). Management considered this amendment to IAS 39 and concluded that it is not relevant to the Company.

– IAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Company believes that this amendment should not have a significant impact on the classification of financial instruments, as the Company does not classify any instruments as at fair value through profit and loss.

– IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006). Management considered this amendment to IAS 39 and concluded that it is not relevant to the Company.

– IFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006). These amendments are not relevant to the Company's operations as the Company is not a first-time adopter of IFRS and does not carry out exploration for and evaluation of mineral resources.

– IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. Management is currently assessing the impact of IFRS 7 and amendment to IAS 1 on the Company's operations. The Company will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

Notes to the financial statements

– IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006). IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of IFRIC 4 on the Company's operations.

– IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006). IFRIC 5 is not relevant to the Company's operations.

– IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005). The interpretation deals with obligations arising from the European Union Directive regulating the collection, treatment, recovery and environmentally sound disposal of waste equipment. IFRIC 6 is not relevant to the Company's operations.

– IFRIC 7, Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective from 1 march 2006). IFRIC 7 is not relevant to the Company's operations.

– IFRIC 8, Scope of IFRS 2 (effective from 1 May 2006). The Interpretation clarifies that the accounting standard IFRS 2 Share-based Payment applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. IFRIC 8 is not relevant to the Company's operations.

Notes to the financial statements

3. Property, plant and equipment

Movements of the Company's property, plant and equipment during 2005 can be specified as follows:

	Buildings and structures	Machinery and equipment	Construction in progress (see Note 4)	Total
Cost at 1 January 2005	381,773	302,632	5,623	690,028
Additions during the period	0	319	24,300	24,619
Retirements	-1,109	-455	0	-1,564
Transfers between captions	4,887	1,543	-6,430	0
Cost at 31 December 2005	385,551	304,039	23,493	713,083
Depreciation and impairment at 1 January 2005	90,963	142,631	0	233,594
Depreciation for the period	17,151	17,075	0	34,226
Depreciation of disposals	-608	-322	0	-930
Depreciation and impairment at 31 December 2005	107,506	159,384	0	266,890
Carrying amount at 31 December 2005	278,045	144,655	23,493	446,193
Carrying amount as of 31 December 2004	290,810	160,001	5,623	456,434
Average depreciated rate	4%	6%		

For the loans received the Company has provided a pledge of property, plant and equipment for the amount of 106,115 tLTL as of 31 December 2005 (214,636 tLTL at 31/12/2004), out of which the loans granted by the Ministry of Finance of Lithuania were secured by the pledged assets of 10,249 tLTL (107,904 tLTL as at 31 December 2004), and the loans granted by the banks were secured by the pledged assets of 95,866 tLTL (106,732 tLTL as at 31 December 2004). The repayment of loans from the banks is guaranteed by the Ministry of Finance of Lithuania.

The Company has acquired 6 reservoirs under finance lease agreements. The book value of these assets amounted to 31,411 tLTL as at 31 December 2005 (34,170 tLTL as at 31 December 2004). These assets secure the financial lease obligation, which amounted to 8,834 tLTL as at 31 December 2005 (12,816 tLTL as at 31 December 2004).

The depreciation charge for 2005 amounts to 34,226 tLTL (45,572 tLTL for 2004). More than 99% of depreciation expenses are included in the cost of sales caption, remaining amount - in the operating expenses caption of the income statement.

Notes to the financial statements

The company's management performed an evaluation of the useful lifetime of non-current assets, based on which new depreciation periods were applied as of 1 September 2005. Due to the change in the accounting estimate, depreciation costs decreased by approximately 60%. The effect of the mentioned change on the financial statements is as follows:

	LTL'000
Effect on one month's depreciation costs	-2,276
Effect on depreciation costs for 2005	-9,105
Effect on the annual depreciation costs	-27,314

Due to the mentioned changed in the accounting estimate the operating profit for 2005 before tax increased by approximately 9,105 tLTL. As to the management, the new depreciation rates present more fairly the actual useful lifetime of specific assets.

4. Construction in progress

The balance of construction in progress amounted to 23,493 tLTL as at 31 December 2005 (5,612 tLTL as at 31 December 2004). At the end of 2005 the major part of the construction in progress amounting to 23,294 tLTL represents the construction of two oil reservoirs with the capacity of 30,000 m3 each. The project shall be finished in March-April 2006. The planned completion costs in 2006 amount to approx. 7,764 tLTL and are financed from internal resources. Prepayment to major contractor, amounting to 1,605 tLTL is included under non-current assets. Retention moneys, amounting to 1,109 tLTL, are included under accounts payable to contractors and suppliers.

New projects

In 2003 the Company prepared an investment program for the period 2004-2010. This program will allow the Company to be more flexible in the market and to enhance reload capacities for oil products as well as crude oil. All the investments are going to be financed from internal resources according to the management plans.

According to this program, total investment for 2005-2010 shall amount to 166 million LTL, including 36 million LTL in 2006.

Notes to the financial statements

5. Loans granted

As part of a settlement for acquired shared AB Naftos Terminalas transferred to the Company rights to the loans granted to UAB Žavesys, AB Girių Bizonas and AB Klaipėdos Mediena.

	Interest rate	Maturity date	As at 31/12/2005	As at 31/12/2004
AB Klaipėdos Mediena	6 months EUR Libor+3%	23/3/2006	1,231	2,672
AB Girių Bizonas	6 months EUR Libor+3%	30/06/2005	0	685
UAB Žavesys	Interest free	30/03/2021	382	396
			1,713	3,753
Less: allowance for loans granted*			-382	-396
Total loans granted, net			1,231	3,357

* The allowance for loans granted comprises full allowance for UAB Žavesys.

The loan granted to AB Klaipėdos Mediena is secured by pledged assets with a pledge value of 5,384 tLTL.

6. Investments in associates

Investments can be specified as follows (in tLTL):

	Ownership percentage	2005	2004
UAB Laivų Bunkeris	34	34	34
Impairment provision		-34	-34
Total investment		0	0

The Company has accounted for the investment in UAB Laivų Bunkeris at cost less impairment provision. The entity performed no operations in 2003-2005. The financial statements of the associated undertaking are not available.

7. Held to maturity investments

On 24 January 2003 as part of a settlement for acquired shared AB Naftos Terminalas transferred to the Company its ownership of bonds. The total nominal value of the bonds is 202 tUSD (equivalent to 588 tLTL as at 31 December 2005). Bonds were issued by the bank of foreign trade Vneshtorgbank (Russia). The repurchase of the bonds is to be made on 14 May 2007 at its face value. The intention is to hold the bonds until the maturity date. The annual interest rate of the bonds is 3%.

Notes to the financial statements

8. Inventories

In tLTL	2005	2004
Spare parts, construction materials and other inventory	4,078	4,229
Oil products	30,877	24,014
	34,955	28,243
Impairment provision	-32,706	-26,266
Carrying amount of inventories	2,249	1,977

As at 31 December 2005 impairment provision of 3,114 tLTL was recorded for slow moving inventories (3,264 tLTL as at 31 December 2004). The remaining impairment provision, amounting to 29,592 tLTL (23,002 tLTL as at 31 December 2004) relates to oil products, surplus of which was accounted after reloading.

9. Trade accounts receivable

Trade accounts receivable can be specified as follows (in tLTL):

	2005	2004
Receivable for reloading of oil products	3,758	5,137
Other trade receivable	45	106
Total trade accounts receivable	3,803	5,243
Less: allowance for doubtful trade accounts receivable	0	0
Trade accounts receivable, net	3,803	5,243

Notes to the financial statements

10. Other current assets

Other current assets can be specified as follows (in tLTL):

	2005	2004
Prepaid taxes	6,426	4,434
Other accounts receivable	112	106
Deferred expenses	224	224
Prepayments	36	17
Total other current assets	6,798	4,781
Less: allowance for doubtful other current assets	-100	-100
	6,698	4,681

Prepaid taxes include 4,615 tLTL of real estate tax (3,873 tLTL as at 31 December 2004), which represents the receivable amount that arose after recalculation of tax for the period 1999-2004. Recalculation was made after the mistake in declared values of the real estate has been detected.

Other accounts receivable include the cost of purchased right of the claim to the cash deposited in the liquidated former USSR bank Vnesekonombank, amounting to 95,266 tUSD (or equivalent 277,243 tLTL). The purchase price of the claim was 100 tLTL. It is considered that the receivable is doubtful, therefore, it is stated at cost less 100% allowance.

11. Cash and cash equivalents

Cash can be specified as follows (in tLTL):

	2005	2004
Cash in banks	3,527	1,488
Cash in hand	414	91
Time deposit	7,726	21,852
Total cash and cash equivalents	11,667	23,431

As of 31 December 2005 the Company had time deposits in the amount of 7,726 tLTL in AB Šiaulių Bankas (4 separate deposit agreements). The annual interest rate is 2.3-3.2% and the maturity dates range in 31-111 days.

According to the syndicated loan agreement (Note 12) the Company has pledged cash in AB SEB Vilniaus Bankas and future cash flows to the bank accounts. The cash in AB SEB Vilniaus Bankas accounts amounts to 3,481 tLTL as at 31 December 2005 (1,365 tLTL as at 31 December 2004).

Notes to the financial statements

12. Interest bearing loans and lease liabilities

Lending institution	Ref	Principal amount (in Litas)	Interest rate	Balance at 31/12/05	Balance at 31/12/04
Syndicated loan AB SEB Vilniaus Bankas, AB Hansabankas and AB Bankas Nord/LB Lietuva	a)	90,012	6 months EUR LIBOR+1.95%	13,332	20,000
Club loan AB SEB Vilniaus Bankas, AB Hansabankas and AB Bankas Nord/LB Lietuva	b)	37,570	LIBOR+1.1%	34,390	35,980
Ministry of Finance of Lithuania	c)	20,419	6 months EUR LIBOR+2.5%	2,762	20,419
UAB Hanza Lizingas	d)	44,424	LIBOR+3.5%	8,835	12,816
Accrued interest for club loan	e)			96	0
Total long term loans and lease liabilities				59,415	89,215
Less: current portion				-15,379	-12,239
Total long term portion net of current maturities				44,036	76,976

a) The syndicated loan comprises loans received from AB SEB Vilniaus Bankas (36,012 tLTL), AB Hansabankas (36,000 tLTL), AB Bankas Nord/LB Lietuva (18,000 tLTL). AB SEB Vilniaus Bankas is performing as a general syndicator (the loan was converted to EUR from USD in August 2003 and amounted to 3,861 tEUR as at 31 December 2005). According to the last amendment the syndicated loan matures on 25 September 2009.

b) The Company repaid the loan from ABN Amro bank by acquiring a loan of 10,881 tEUR from three banks: AB SEB Vilniaus Bankas, AB Hansabankas and AB Bankas Nord/LB Lietuva. The not paid part amounted to 9,960 tEUR as at 31 December 2005. The loan is secured with a guarantee issued by the Ministry of Finance. The loan matures on 31 July 2009.

c) The early repayment of the loan from Ministry of Finance, amounting to 5,114 tEUR (17,658 tLTL) was made in 2005. The loan was fully repaid in February 2006.

d) On 20 December 2000 the Company sold its light oil products storage reservoirs to UAB Hanza Lizingas for an amount of 20,000 tLTL and operates the mentioned property, plant and equipment under a lease back arrangement, classified as long-term financial lease in these financial statements. Financial lease obligations should be repaid by 30 December 2007.

e) Accrued interest represents interest charge for December in respect of club loan.

Notes to the financial statements

12. Interest bearing loans and lease liabilities (continued)

All long-term loans are denominated in EUR, except for lease liabilities, which are denominated in Litas.

The loan granted by AB SEB Vilniaus Bankas, AB Hansabankas and AB Bankas Nord/LB Lietuva is guaranteed by the Government of Lithuania. Property, plant and equipment are pledged on behalf of the Ministry of Finance for the guarantee issued.

The syndicated loan and the loan from the Ministry of Finance are secured by the pledge of property, plant and equipment. For syndicated loan the company has also pledged cash in AB SEB Vilniaus Bankas accounts, including future cash flows to those accounts.

The future maturity of long-term loans is as follows:

Year	Amount to be repaid
2006	11,115
2007	8,256
2008	15,605
2009	15,605
Total long-term loans	50,581

Minimum lease payments of long-term lease liabilities can be specified as follows:

Year	Amount to be repaid
2006	4,685
2007	4,727
Total minimum lease liabilities	9,412
Less: interest	-577
Present value of minimum lease liabilities	8,835
Representing finance lease liabilities:	
Current	4,265
Non-current	4,569
Total	8,834

During 2006 the Company will have to repay loans in the amount of 11,114 tLTL and lease liabilities in the amount of 4,265 tLTL (in total 15,379 tLTL). The current repayment obligations fall throughout the year.

Notes to the financial statements

13. Other current liabilities

Other current liabilities consist of the following (in tLTL):

	2005	2004
Real estate tax	727	0
Land rent payable	586	1,024
Advances received	89	36
Other	323	83
Total current liabilities	1,725	1,143

14. Cost of sales

Cost of sales consists of the following (in tLTL):

	2005	2004
Depreciation and amortisation	34,017	45,442
Salaries, bonuses and social security	10,921	10,966
Heat and steam	3,359	4,310
Railroad expenses	1,240	2,807
Electricity	1,905	2,008
Repair and maintenance of non-current assets	933	1,567
Other	1,271	1,611
Total cost of sales	53,646	68,711

15. Operating expenses

Operating expenses consist of the following (in tLTL):

	2005	2004
Salaries and social security	4,036	2,597
Rent of land and quays	2,945	2,340
Asset insurance	2,908	2,908
Tax on real estate	947	974
Road tax	242	512
Change in allowance for receivables	-14	-3,583
Change in inventory impairment allowance	-150	1,090
Other	3,428	2,467
Total operating expenses	14,342	9,305

Notes to the financial statements

16. Financial income and expenses

Financial income and expenses consist of the following:

	2005	2004
Financial income		
Interest income	615	563
Foreign exchange gain	106	76
Other	19	7
	740	646
Financial expenses		
Interest expenses and loan administration fees	-3,327	-4,493
Foreign exchange loss	-25	-124
Other	-11	-70
	-3,363	-4,687
Total financial income (expenses), net	-2,623	-4,041

17. Transactions with related parties

The related parties of the Company include associated company, management, shareholders, and members of the Board of Directors.

In 2005 salaries for the management amounted to 795 tLTL (662 tLTL in 2004).

There were no significant transactions with other related parties in 2005 and 2004 and related balances as at 31 December 2005.

Transactions with the members of Board

The Company had no transactions with the members of the Board in 2005 and 2004.

Dividends payable

As of 31 December 2005 and 2004 dividends payable amounted to 73 tLTL and 79 tLTL respectively.

Notes to the financial statements

18. Income tax

Movements in deferred tax accounts of the Company during 2005 can be specified as follows:

		2005	2004
Income tax expenses			
Profit before income tax		14,563	24,738
Changes in temporary differences		5,205	3,480
Permanent differences		7,078	12,949
Loss carryforward realised	a)	0	-26,887
Taxable result for the period		26,846	14,280
Current income tax expense		4,027	2,142
Netting off income tax on dividends		-11	-71
Reversal of prior year's income tax		612	0
Change in deferred income tax		-136	4,365
Income tax expenses		4,492	6,436
Temporary differences resulting in deferred tax asset	b)		
Property, plant and equipment		1,380	2,135
Vacation pay accrual		110	89
Allowance for inventory		467	490
Allowance for receivable		72	74
Deferred tax asset before valuation allowance		2,029	2,788
Less: valuation allowance	c)	-72	-74
Deferred income tax asset, net		1,957	2,714
Temporary differences resulting in deferred tax liabilities	b)		
Property, plant and equipment		-14,907	-15,800
Total deferred tax liabilities		-14,907	-15,800
Deferred tax, net	d)	-12,950	-13,086

a) Tax loss carry forward has been fully utilised in 2004;

b) Deferred income tax assets and liabilities were estimated at 15% rate in 2004 and at 15-19% in 2005; the different tax rate was applied taking into consideration the expected realization period of temporary differences. The effect of change in the income tax rate on the deferred tax amounted to 450 tLTL (the deferred tax liability was increased by the mentioned amount).

Notes to the financial statements

18. Income tax (continued)

c) Allowances were made for some deferred tax assets due to uncertainty in respect of their realisation in the future;

d) Deferred tax asset and liability are netted off in the balance sheet of the Company as at 31 December 2005 and 2004, because the deferred tax asset and liability will be realised simultaneously and they are both related to the same tax authority.

Notes without references

19. Commitments and contingencies

Third party inventories held

As of 31 December 2005 the Company was storing 144,370 tons of oil products on behalf of its customers (101,390 tons as of 31 December 2004), which had a value of approximately 137 million LTL (79 million Litas as of 31 December 2004). The Company has insurance coverage for these products as well an insurance against civil liability of 10,000 tLTL for each accident.

Claims

In 2005 the action brought by Klaipėda State Seatort Authority against the company regarding the land rent of 585 tLTL for 2003 was completed. The result of the case was not favourable to the company due to which the mentioned amount was recorded and paid in 2005. Currently the company is in a trial concerning charging the interest of 68 tLTL to the company.

Tax disputes

Other receivables include a receivable from the budget regarding the real estate tax amounting to 4,615 tLTL. In 2004 the company made mistakes in the calculation of the tax on real estate (hereinafter RET) and, taking into consideration the fact that certain assets or their parts had to be recognised as movable assets, submitted the adjusted real estate tax declarations on 1 December 2004. Another reason of the change in RET is the wrong amount of capitalized interest included during the initial evaluation in the average market price. Based on this, the Klaipėda branch of the Company Register Centre updated the information in the central data bank of the Real Estate Register and issued the supporting documentation to the company.

During the year 2005 the tax administrator performed two reviews of the calculation of the real estate tax in the company for the period from 1 January 2000 to 31 December 2004. On 28 February 2006 the company received a “Resolution regarding the review act approval No .(6.5)-54, dated 24 February 2006“, by which the tax administrator does not acknowledge the re-calculation of the tax and requires to pay the tax of 5,383 tLTL for 2000-2004 as well as a penalty amounting to 538 tLTL.

The company does not agree to the mentioned resolution and intends to send a complaint against it to the central tax administrator.

Post balance sheet events

As at 1 March 2006 the company received a copy of the claim from the Klaipėda regional court, in which the plaintiff Riverlake Energy (S) PTE LTD requires to cover the damage amounting to 5,195 tLTL and to follow the contractual obligations. At present, details of the dispute are being investigated on non judicial basis in order to evaluate their validity. In the opinion of AB Klaipėdos Nafta, according to the valid agreements the dispute should be solved between the Seller and the Buyer, as the company provides only stevedoring services and has no ownership right to the cargo.

Notes without references

20. Basic earnings per share

Basic earnings per share reflect the Company's net income, divided by the weighted average number of shares. Calculation of the basic earnings per share is presented below:

	2005	2004
Net income, attributable to the shareholders (in tLTL)	10,071	18,302
Number of shares outstanding (in thousand items)	342,000	342,000
Basic earnings per share (Litas)	0.03	0.05

Diluted earnings per share is the same as basic earnings per share.

21. Personnel expenses and number of employees

	2005	2004
Salaries and wages	9,230	9,785
Premiums and bonuses	2,647	1,003
	11,877	10,788
Number of employees at the end of the year	308	311

Salary costs, amounting to 415 tLTL, are included in the balance of construction in progress.

Social security costs on salaries amounted to 3,586 tLTL.

22. Financial instruments

The company operates in international markets, therefore is exposed to credit, foreign exchanges and liquidity risks.

<u>Credit risk</u>

Credit risks, or the risk of counterparties defaulting, are controlled by the application of credit terms and monitoring procedures. The Company's procedures are in force to ensure on a permanent basis that sales are made to customers with an appropriate credit history and do not exceed an acceptable credit exposure limit.

Notes without references

22. Financial instruments (continued)

Foreign exchange risk

The Company's policy is to match cash flows arising from highly probable future sales and purchases and other expenditures in each foreign currency.

Liquidity risk

The Company's policy is to maintain sufficient cash and cash equivalents.

Fair value of financial instruments

Financial instruments held to maturity in the normal course of business are recorded at cost or redemption amount as appropriate. The recorded amount is described below as the carrying amount, otherwise known as book value.

Fair value is defined as the amount at which the instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidated sale. Fair values are obtained from quoted market prices, discounted cash flow models as appropriate.

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

a) The carrying amount of trade amounts receivable, loans granted, other financial assets and accounts payable approximates their fair value.

b) The fair value of the long-term debt is based on the quoted market price for the same or similar issues or on the current rates available for debt with the same maturity profile. The fair value of non-current loans, borrowings and other payables with variable interest rates approximates their carrying amounts.

The management believes that the exposure to interest rate risk of financial assets and liabilities as of 31 December 2005 was minimal since their deviation from their respective fair values was not significant.