AB Kauno energija

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2004

INDEPENDENT AUDITORS' REPORT
TO THE SHAREHOLDERS OF AB KAUNO ENERGIJA

We have audited the accompanying balance sheet of AB Kauno Energija, a public limited liability company, registered in the Republic of Lithuania ("KE" or the "Company"), as of 31 December 2004 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 Company's 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 as set forth by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of AB Kauno Energija as of 31 December 2004, and the results of its operations and its cash flows for the year then ended in conformity with Business Accounting Standards of the Republic of Lithuania.

UAB ERNST & YOUNG BALTIC
Audit company's licence No. 000514

Jonas Akelis	Rokas Masiulis
Auditor's licence No. 000003	Auditor's licence No. 000168

The audit was completed on 18 March 2005.

Balance sheet

		Notes	As of 31 December 2004	As of 31 December 2003
	ASSETS			
A	**Non-current assets**			
I.	Intangible assets	4	1.435.427	308.281
II.	Property, plant and equipment	5		
II.1.	Land and buildings		44.459.735	26.518.857
II.2.	Structures and machinery		96.915.052	74.169.979
II.3.	Vehicles		1.789.539	1.214.637
II.4.	Equipment and tools		9.030.822	13.867.043
II.5.	Other property, plant and equipment		2.539.919	2.322.724
II.6.	Construction in progress and prepayments		5.925.412	10.467.164
	Total property, plant and equipment		160.660.479	128.560.404
III.	Non-current financial assets			
III.1.	Non-current accounts receivable		646.625	1.178.195
III.2.	Other financial assets		432.677	432.677
	Total non-current financial assets		1.079.302	1.610.872
IV.	Long-term portion of deferred expenses		431.409	534.924
V.	Deferred income tax asset	18	-	2.121.000
	Total non-current assets		**163.606.617**	**133.135.481**
B	**Current assets**			
I.	Inventories, prepayments and contracts in progress			
I.1.	Inventories	6	6.758.729	9.292.425
I.2.	Prepayments and contracts in progress		867.779	1.677.734
	Total inventories, prepayments and contracts in progress		7.626.508	10.970.159
II.	Current receivables			
II.1.	Trade receivables	7	37.825.821	37.062.594
II.2.	Other receivables	7	8.208.005	19.845.947
	Total accounts receivable		46.033.826	56.908.541
III.	Other current assets		10.000	10.000
IV.	Cash and cash equivalents	8	4.956.891	2.265.951
	Total current assets		**58.627.225**	**70.154.651**
	Total assets		**222.233.842**	**203.290.132**

The accompanying notes are an integral part of these financial statements.

Balance sheet (cont'd)

		Notes	As of 31 December 2004	As of 31 December 2003
	EQUITY AND LIABILITIES			
C.	**Equity**			
I.	Share capital	1	118.310.292	118.310.292
II.	Revaluation reserve (result)		-	-
III.	Reserves	9	16.920.601	10.930.126
IV.	Retained earnings (deficit)			
IV.1.	Net profit (loss) for the current year		9.357.368	7.277.422
IV.2.	Net profit (loss) from previous years		(27.643.225)	(28.930.172)
	Total retained earnings (deficit)		(18.285.857)	(21.652.750)
	Total equity		**116.945.036**	**107.587.668**
D.	**Grants and subsidies**		**4.312.243**	**4.415.117**
E.	**Liabilities**			
I.	**Non-current liabilities**			
I.1.	Non-current borrowings	11	43.609.580	56.312.110
I.2.	Leasing liabilities	12	-	39.416
I.3.	Long term trade payable		162.859	254.468
I.4.	Other non-current liabilities		431.409	534.924
I.5.	Deferred income tax liability	18	193.551	-
	Total non-current liabilities		**44.397.399**	**57.140.918**
II.	**Current liabilities**			
II.1.	Current portion of non-current borrowings and leasing liabilities	11, 12	12.469.121	4.410.025
II.2.	Current borrowings	11	5.179.679	4.000.000
II.3.	Trade payables		28.749.641	18.838.831
II.4.	Advances received		857.014	906.581
II.5.	Taxes payable		1.016.974	1.610.783
II.6.	Payroll related liabilities		1.319.010	1.082.799
II.7.	Social security liabilities		873.153	443.315
II.8.	Accrued interest		670.204	70.397
II.9.	Other current liabilities		5.444.368	2.783.698
	Total current liabilities		**56.579.164**	**34.146.429**
	Total equity and liabilities		**222.233.842**	**203.290.132**

The accompanying notes are an integral part of these financial statements.

General Director	Aleksandras Sigitas Matelionis		
Chief Accountant	Violeta Staškūnienė		

Income statement

		Notes	2004	2003
I.	Sales	13		
I.1.	Sales of goods		162.265.632	210.225.688
I.2.	Sales of services provided		8.164.569	8.448.570
	Total sales		170.430.201	218.674.258
II.	Cost of sales	13		
II.1.	Cost of goods sold		(151.107.997)	(181.865.843)
II.2.	Cost of services provided		(7.911.041)	(9.455.883)
	Total cost of sales		(159.019.038)	(191.321.726)
III.	**Gross profit (loss)**		**11.411.163**	**27.352.532**
IV.	Operating expenses	14		
IV.1.	Selling		(6.768.802)	(6.971.855)
IV.2.	General and administrative		(5.171.196)	(8.083.994)
	Total operating expenses		(11.939.998)	(15.055.849)
V.	**Profit (loss) from operations**		**(528.835)**	**12.296.683**
VI.	Other operating income (expenses)	15		
VI.1.	Income		25.583.996	57.557.422
VI.2.	Expenses		(5.878.614)	(58.719.014)
	Other operating income (expenses), net		19.705.382	(1.161.592)
VII.	Income (expenses) from financial and investment activities	16		
VII.1.	Income		2.261.332	4.705.680
VII.2.	Expenses		(9.765.960)	(8.315.349)
	Income (expenses) from financial and investment activities, net		(7.504.628)	(3.609.669)
VIII.	**Profit (loss) from ordinary activities**		**11.671.919**	**7.525.422**
IX.	Extraordinary gain	17	-	-
X.	Extraordinary loss	17	-	-
XI.	**Profit (loss) before tax**		**11.671.919**	**7.525.422**
XII.	Income tax	18	(2.314.551)	(248.000)
XIII.	**Net profit (loss)**		**9.357.368**	**7.277.422**

The accompanying notes are an integral part of these financial statements.

General Director	Aleksandras Sigitas Matelionis		
Chief Accountant	Violeta Staškūnienė		

Statement of changes in equity

	Notes	Share capital	Revaluation reserve (result)	Reserves	Retained earnings (deficit)	Total
Balance as of 31 December 2002		**118.310.292**	**-**	**10.930.126**	**-**	**129.240.418**
Change in accounting policy	3	-	-	-	(28.804.028)	(28.804.028)
Correction of fundamental error	3	-	-	-	(126.144)	(126.144)
Balance as of 31 December 2002 (restated)		**118.310.292**	**-**	**10.930.126**	**(28.930.172)**	**100.310.246**
Net profit for the year		-	-	-	7.277.422	7.277.422
Balance as of 31 December 2003		**118.310.292**	**-**	**10.930.126**	**(21.652.750)**	**107.587.668**
Transfer to reserves		-	-	5.990.475	(5.990.475)	-
Net profit for the year		-	-		9.357.368	9.357.368
Balance as of 31 December 2004		**118.310.292**	**-**	**16.920.601**	**(18.285.857)**	**116.945.036**

The accompanying notes are an integral part of these financial statements.

General Director	Aleksandras Sigitas Matelionis		
Chief Accountant	Violeta Staškūnienė		

Cash flow statement

		2004	2003
I.	**Cash flows from (to) operating activities**		
I.1.	Net profit (loss)	9.357.368	7.277.422
	Adjustments for non-cash items:		
I.2.	Depreciation and amortisation	17.809.273	22.342.504
I.3.	(Reversal) allowance of accounts receivable	(5.118.000)	794.000
I.4.	(Gain) loss from sale of property, plant and equipment	(18.250.015)	992.681
I.5.	Allowance (reversal) for obsolete inventories	(1.290.518)	(518.556)
I.6.	Change in deferred income tax	2.314.551	248.000
I.7.	Impairment of property, plant and equipment	1.573.265	-
I.8.	Accruals	3.376.653	336.000
I.9.	Amortisation of subsidies	(251.838)	(208.671)
I.10.	Elimination of financial and investment activity results	2.057.922	(9.368.699)
		11.578.661	21.894.681
	Changes in working capital:		
I.11.	Decrease (increase) in inventories	3.824.214	8.140.373
I.12.	Decrease (increase) in prepayments	570.023	307
I.13.	Decrease (increase) in trade receivables	4.354.773	43.272.397
I.14.	Decrease (increase) in other receivables	4.602.108	(9.350.969)
I.15.	Deferred income tax	-	(2.369.000)
I.16.	(Decrease) in non-current trade payable	(91.609)	(4.738.203)
I.17.	Increase (decrease) in current trade payable and advances received	9.861.243	(25.439.520)
I.18.	Increase (decrease) in salaries related liabilities	20.545	(1.759.606)
I.19.	(Decrease) in other liabilities to budget	(593.809)	(490.014)
I.20.	Increase (decrease) in accrued interest payable	599.807	(11.997.073)
I.21.	(Decrease) in other liabilities	(173.994)	(1.580.512)
I.22.	Accrued expenses	343.447	3.737.233
	Net cash flows from operating activities	**34.895.409**	**19.320.094**
II.	**Cash flows from (to) investing activities**		
II.1.	(Acquisition) of non-current assets (except investments)	(27.892.239)	(17.206.950)
II.2.	Proceeds from sale of non-current assets (except investments)	568.329	106.495.496
II.3.	(Acquisition) of non-current investments	-	(45.100)
II.4.	Proceeds from sale of non-current investments	-	546.760
II.5.	Increase (decrease) in cash flows from (to) other investing activities	531.570	(71.586)
II.6.	Other investments	-	(10.000)
	Net cash flows from (to) investing activities	**(26.792.340)**	**89.708.620**

The accompanying notes are an integral part of these financial statements.

Cash flow statement (cont'd)

		2004	2003
III.	**Cash flows from (to) financing activities**		
III.1.	Proceeds from loans	45.162.781	93.527.131
III.2.	(Repayment) of loans	(48.603.597)	(187.605.244)
III.3.	Interest (paid)	(2.057.922)	(19.561.473)
III.4.	Financial lease (payments)	(62.355)	(976.719)
III.5.	Grants and subsidies	148.964	490.657
	Net cash flows (to) financing activities	**(5.412.129)**	**(114.125.648)**
IV.	**Net increase (decrease) in cash and cash equivalents**	**2.690.940**	**(5.096.934)**
V.	**Cash and cash equivalents at the beginning of the year**	**2.265.951**	**7.362.885**
VI.	**Cash and cash equivalents at the end of the year**	**4.956.891**	**2.265.951**

The accompanying notes are an integral part of these financial statements.

General Director	Aleksandras Sigitas Matelionis		
Chief Accountant	Violeta Staškūnienė		

Notes to the financial statements

1 General information

AB Kauno energija (hereinafter – "the Company") is a joint stock company registered in the Republic of Lithuania. The address of its registered office is as follows:

Raudondvario pl. 84,
Kaunas,
Lithuania

The Company is involved in heat energy generation and distribution. The Company was registered on 1 July 1997 after the reorganization of AB Lietuvos energija. The Company was given special purpose stock company status, which was cancelled on 8 August 2000. Since then the Company acts as joint stock company. The Company's shares are traded on the Official List of the National Stock Exchange.

As of 31 December 2004 and 2003 the shareholders of the Company were as follows:

	2004		2003	
	Number of shares owned	**Percentage of ownership**	**Number of shares owned**	**Percentage of ownership**
Kaunas city municipality	16.954.892	85,99	16.954.892	85,99
Kaunas district municipality	1.606.168	8,14	1.606.168	8,14
Jurbarkas district municipality board	443.810	2,25	443.810	2,25
Other small shareholders	713.512	3,62	713.512	3,62
	19.718.382	100,00	19.718.382	100,00

All the shares with nominal value of LTL 6 each are ordinary shares and were fully paid as of 31 December 2004 and 2003. The share capital did not change in 2004 and 2003. The Company did not hold its own shares in 2004 and 2003.

AB Kauno energija consists of the Company's central office and the branch of Jurbarko šilumos tinklai.

In 2002 the Company started and in the middle of 2003 finished the sale process of the former main production division - Kaunas elektrinė - to UAB Kauno termofikacijos elektrinė (KTE) that was established by the consortium supervised by the Russian company "Gazprom". Therefore its income decreased in 2004 comparing with 2003, because before this sale the Company was selling electricity produced in Kauno elektrinė. In addition, together with the sales agreement of Kauno elektrinė the Company signed heat purchase-sales agreement and obliged annually to purchase heat from KTE comprising not less than 80 percent from the total demand of Kaunas city integrated district heat network. The agreement is valid for 15 years from the date of subscription.

The Company has established a subsidiary UAB Naujasodžio energijos paslaugos with the purpose of separating non-core activities. In 2003 the Company sold the non-current assets and inventory of branch Naujasodžio energija and activities performed by the former branch consisting of extraction of peat, polyurethane isolation of pipes, installation and repair of heating substations and recreation activity to newly created UAB Naujasodžio energijos paslaugos. Turto bankas has protested this transaction and the Company returned back non-current assets sold to subsidiary and therefore the profit was accounted in the income statement (other activity) (see Note 15). Returned assets were instead rented out to UAB Naujasodžio energijos paslaugos.

In 2004 the Company announced the tender to sell the shares of the subsidiary UAB Naujasodžio energijos paslaugos and the Company's assets leased to the subsidiary. As of the date of issue of these financial statements the Company negotiated with potential customer. In order to present property, plant and equipment at fair value, the Company accounted for impairment loss on property, plant and equipment, amounting to LTL 1.573 thousand. In the Company's accounts as of 31 December 2004 assets rented out to UAB Naujasodžio energijos paslaugos, were accounted at net book value amounting to LTL 25.433 thousand.

1 General information (cont'd)

As it is planned to sell the shares of UAB Naujasodžio energijos paslaugos, therefore, in the balance sheet as of 31 December 2003 and 2004 they were accounted as other current assets and not consolidated into company's financial statements.

In 2004, the average number of employees of the Company was 918 (1.662 in 2003). Significant decrease in number of employees is related to the separation of former branches.

The most important problem in energy field is the atmosphere pollution. As in all Lithuanian energy companies, as well as in AB Kauno energija the most important source of the atmosphere pollution – fuel usage. As in previous year, in 2004 the Company follows Helsinki commission (HELKOM) requirements and ecology requirements for fuel oil usage, stated in Helsinki Convention.

In 2004 in all boiler-houses, belonging to AB Kauno energija fuel oil usage was limited. In 2003 in Domeikava RK two new boilers using gas were installed and in Girionys RK two new boilers using wood cutting and chips were installed, therefore, atmosphere pollution by SO_2 gas significantly decreased in 2004. In 2003 39.094 t SO_2 emitted from Domeikava RK and in 2004 - 0,5 t SO_2. In 2003 23.018 t SO_2 emitted from Girionys RK, and in 2004 - 3.096 t SO_2. In all boiler-houses of AB Kauno energija fuel oil will be used only in emergency cases, except the branch of Jurbarko šilumos tinklai.

According to ecology requirements in 2004 old fuel oil equipment of Petrašiūnai power plant went on liquidation. It is planned to finish liquidation works in 2005.

Reconstruction works of boilers are constantly performed, optimal network schemes and work schedules are being selected to minimize pollution quantity annually emitted to environment.

The Company's generation capacity includes electricity power plants in Petrašiūnai, three district boiler-houses in Kaunas integrated network, 8 regional boiler-houses, 14 district and 58 local boiler-houses. Installed capacity of Petrašiūnai electricity and heating generating units are accordingly 8 MW of electricity generation and 406 MW of heat generation. Total installed capacity of the Company's generating units is 766 MW, consisting of 9 MW of electricity generation and 757 MW of heat generation.

2 Accounting principles

The principal accounting policies adopted in preparing the Company's financial statements for 2004 are as follows:

2.1. Basis of preparation

These financial statements have been prepared in accordance with the Law on Accounting of the Republic of Lithuania, Law on Companies' Financial Statements of the Republic of Lithuania and Lithuanian Business Accounting Standards (BAS), which include the standards and interpretations prepared and approved by the Institute of Accounting of the Republic of Lithuania, effective as of 31 December 2004.

These financial statements have been also prepared in accordance with BAS approved by 31 December 2004 that came into effect on 1 January 2005 but their provisions allow early adoption of the standards, i. e. BAS 18 "Financial assets and financial liabilities", BAS 23 "Impairment of assets" and BAS 24 "Income tax".

2.2. Presentation currency

The amounts shown in these financial statements are presented in the local currency of the Republic of Lithuania, Litas (LTL).

Starting from 2 February 2002, Lithuanian Litas is pegged to EUR at the rate of 3.4528 Litas for 1 EUR, and the exchange rates in relation to other currencies are set daily by the Bank of Lithuania.

2 Accounting principles (cont'd)

2.3. Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognised if it is probable that future economic benefits that are attributable to the asset will flow to the enterprise and the cost of asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortisation and any accumulated impairment losses. Intangible assets are amortised on a straight-line basis over the best estimate of their useful lives.

Licenses

Amounts paid for licences are capitalised and then amortised over their validity period.

Software

The costs of acquisition of new software are capitalised and treated as an intangible asset if these costs are not an integral part of the related hardware. Software is amortised over a period not exceeding 3 years.

Costs incurred in order to restore or maintain the future economic benefits that the Company expects from the originally assessed standard of performance of existing software systems are recognised as an expense when the restoration or maintenance work is carried out.

2.4. Property, plant and equipment

Property, plant and equipment are stated at cost (from AB Lietuvos energija reorganization and subsequent acquisitions) less accumulated depreciation and impairment losses.

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the income statement.

The initial cost of property, plant and equipment comprises its purchase price, including non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the property, plant and equipment have been put into operation, such as repair and maintenance costs, are normally charged to the income statement in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance and / or that they have resulted in an increase of the useful life of the asset, the expenditures are capitalised as an additional cost of property, plant and equipment. The Company capitalizes property, plant and equipment purchases with an acquisition cost above LTL 500.

Depreciation is computed on a straight-line basis over the following average estimated useful lives:

	Years
Buildings	5 – 70
Machinery and equipment	5 – 60
Vehicles	5 – 10
Other non-current assets	3 – 30

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.

Construction-in-progress is stated at cost. This includes the cost of construction, plant and equipment and other directly attributable costs. Construction-in-progress is not depreciated until the relevant assets are completed and put into operation.

2 Accounting principles (cont'd)

2.5. Investments

Pursuant to BAS 18, "Financial assets and financial liabilities", non-current investments (except investments into subsidiaries and associates) are classified as either available-for-sale or held-to-maturity. Investments with fixed or determinable payments and fixed maturity that the Company has the positive intent and ability to hold to maturity, other than loans and receivables originated by the Company, are classified as held-to-maturity investments. Investments acquired principally for the purpose of generating a profit from short-term fluctuations in price and other investments, other than investments held-to-maturity, loans and receivables originated by the Company, are classified as available-for-sale.

Held-to-maturity investments are included in non-current assets unless they mature within twelve months of the balance sheet date. Available-for-sale investments are classified as current assets if management intends to realise them within twelve months of the balance sheet date.

All purchases and sales of investments are recognised on the trade date. Investments are initially measured at cost, which is the fair value of the consideration given, including transaction costs.

Available-for-sale investments are subsequently carried at fair value by reference to their estimated market price at the balance sheet date, without any deduction for transaction costs that the Company may incur on their sale or other disposal. Gains or losses on measurement to fair value of available-for-sale investments are included into result of financial and investment activities in the Company's income statement.

Held-to-maturity investments are carried at amortised cost using the effective interest rate method. The portion of amortisation allocated to the reporting period is recognised in the income statement as interest expenses in financial and investment activities caption.

2.6. Inventories

Inventories are valued at the lower of cost or net realisable value, after impairment evaluation for obsolete and slow moving items. Net realisable value is the selling price in the ordinary course of business, less the costs of completion, marketing and distribution. Cost is determined by the first-in, first-out (FIFO) method. Technological fuel is accounted weighted average method. The cost of finished goods includes the applicable allocation of fixed and variable costs. Unrealisable inventory has been fully written-off.

2.7. Receivables and loans granted

Receivables are initially recorded at the fair value of the consideration given. Current receivables are subsequently carried at cost less impairment, and non-current receivables and loans granted – at amortised cost, less impairment.

2.8. Cash and cash equivalents

Cash includes cash on hand, cash with banks and cash in transit. 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.

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, cash with banks, cash in transit, deposits held at call with banks, and other short-term highly liquid investments.

2.9. Borrowings (loans)

Borrowing costs are expensed as incurred.

Borrowings are initially recognised at fair value of proceeds received, less the costs of transaction. They are subsequently carried at amortised cost, the difference between net proceeds and redemption value being recognised in the net profit or loss over the period of the borrowings. The borrowings are classified as non-current if the completion of a refinancing agreement before authorisation of the financial statements for issue provides evidence that the substance of the liability at the balance sheet date was long-term.

2 Accounting principles (cont'd)

2.10. Financial and operating leases

Financial lease

The Company recognizes 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, to the present value of the minimum lease payments. The rate of discount used when calculating the present value of minimum payments of financial lease is the interest rate of financial lease payment, when it is possible to determine it, in other cases, Company's composite interest rate on borrowings applies. Directly attributable initial costs are included into the asset value. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

The depreciation is accounted for financial lease assets and it also gives rise to financial expenses in the Company's income statement for each accounting period. The depreciation policy for leased assets is consistent with that for depreciable assets that are owned. The leased assets can not be depreciated over the period longer than lease term, unless the Company, according by the lease contract, gets transferred their ownership after the lease term is over.

If the result of sales and lease back transactions is financial lease, any profit from sales exceeding the book value is not recognised as income immediately. It is postponed and amortised over the lease term.

Operating lease

Leases where the lessor retains all the risk and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

The gains from discounts provided by the lessor are recognised as a decrease in lease expenses over the period of the lease using the straight-line method.

If the result of sales and lease back transactions is operating lease and it is obvious that the transaction has been carried out at fair value, any profit or loss is recognised immediately. If the sales price is lower than the fair value, any profit or loss is recognised immediately, except for the cases when the loss is compensated by lower than market prices for lease payments in the future. The profit is then deferred and it is amortised in proportion to the lease payments over a period, during which the assets are expected to be operated. If the sales price exceeds the fair value, a deferral is made for the amount by which the fair value is exceeded and it is amortised over a period, during which the assets are expected to be operated.

2.11. Grants

Grants received in the form of non-current assets or intended for the purchase, construction or other acquisition of non-current assets are considered as asset-related grants. Assets received free of charge are also allocated to this group of grants. The amount of the grants related to assets is recognised in the financial statements as used in parts according to the depreciation of the assets associated with this grant. In the income statement, a relevant expense account is reduced by the amount of grant amortisation.

Grants received as a compensation for the expenses or unearned income of the current or previous reporting period, also, all the grants, which are not grants related to assets, are considered as grants related to income. The income-related grants are recognised as used in parts to the extent of the expenses incurred during the reporting period or unearned income to be compensated by that grant.

The balance of unutilised grants is shown in caption "Grants and subsidies" on the balance sheet.

2.12. Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The Company re-evaluates provisions at each balance sheet date and adjusts them in order to present the most reasonable current estimate. If the effect of the time value of money is material, the amount of provision is equal to the present value of the expenses, which are expected to be incurred to settle the liability. Were discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

2 Accounting principles (cont'd)

2.13. Income tax

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

The standard income tax rate in Lithuania is 15%. Tax losses can be carried forward for 5 consecutive years, except for the losses incurred as a result of disposal of securities and / or derivative financial instruments that can be carried forward for 3 consecutive years. The losses from disposal of securities and / or derivative financial instruments can be only used to reduce the taxable income earned from the transactions of the same nature.

Deferred taxes are calculated using the balance sheet liability method. Deferred income taxes reflect the net tax 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 reverse based on tax rates enacted or substantially enacted at the balance sheet date.

Deferred tax assets have been recognised in the balance sheet to the extent the management believes it will be realised in the foreseeable future, based on taxable profit forecasts. If it is believed that part of the deferred tax asset is not going to be realised, this part of the deferred tax asset is not recognized in the financial statements.

2.14. 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 discounts.

Revenue from sales of goods are recognised when delivery has taken place and transfer of risks and rewards has been completed.

Income from overdue interest are recognised right after they are received.

The Company every month issues bills for the heat energy and water heating services to residents and industrial users of heat energy, delivered till the end of current month, based on monthly measures of heat energy metrics.

2.15. Expense recognition

Expenses are recognised on the basis of accrual and revenue and expense matching principles in the reporting period when the income related to these expenses was earned, irrespective of the time the money was spent. In those cases when the costs incurred cannot be directly attributed to the specific income and they will not bring income during the future periods, they are expensed as incurred.

The amount of expenses is usually accounted as the amount paid or due to be paid, excluding VAT. In those cases when long period of payment is established and the interest is not distinguished, the amount of expenses shall be estimated by discounting the amount of payment using the market interest rate.

2.16. Foreign currencies

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. 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 recognized in the income statement. Such balances are translated at period-end exchange rates.

2 Accounting principles (cont'd)

2.17. Impairment of assets

Financial assets

Financial assets, as well as goodwill are reviewed for impairment at each balance sheet date.

For financial assets carried at amortised cost, whenever it is probable that the Company will not collect all amounts due according to the contractual terms of loans or receivables, an impairment or bad debt loss is recognised in the income statement. The reversal of impairment losses previously recognised is recorded when the decrease in impairment loss can be justified by an event occurring after the write-down. Such reversal is recorded in the income statement. However, the increased carrying amount is only recognised to the extent it does not exceed the amortised cost that would have been had the impairment not been recognised.

Other assets

Other 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 accounted in the same caption of the income statement as the impairment loss.

2.18. Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with Business Accounting Standards requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingencies. The significant areas of estimation used in the preparation of these financial statements relate to depreciation and impairment evaluation. Future events may occur which may 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.

2.19. 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 is probable.

2.20. Subsequent events

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

2.21. Offsetting and comparative figures

When preparing the financial statements, assets and liabilities, as well as revenue and expenses are not set off, except the cases when certain Business Accounting Standards specifically require such set-off.

Where necessary, comparative figures have been adjusted to correspond to the presentation of the current year. Changes in accounting principles and accounting estimates made in the financial statements of the reporting period, are presented in Note 3 to these financial statements.

3 Changes in accounting policies and estimates, correction of fundamental error

Changes in accounting policies

In 2004, after BAS came into effect, the Company changed the accounting policies applied to the deferred income tax, inventory, receivables and property, plant and equipment accounting. The change of accounting policies is reflected in the financial statements has been applied retrospectively according to the requirements of BAS 7 (i.e. by adjusting the financial information for the previous periods, where applicable). Due to this, the Company's retained earnings as of 31 December 2003 and result for the year then ended increased by LTL 3 thousand, and respectively, the retained earnings as of 31 December 2002 decreased by LTL 28.804 thousand. The comparative information in these financial statements is presented as if it would have appeared if the new accounting policies were applied in the previous reporting periods. Due to this reason few articles of the balance sheet and income statement are adjusted.

Correction of fundamental error

When preparing financial statements for the year ended 31 December 2003, the Company erroneously charged to expenses renovation works which should have been capitalized with the total value of LTL 1.284 thousand as of 31 December 2003. Therefore, when preparing the financial statements for the year ended 31 December 2004, the Company applied the requirements of 7 BAS and adjusted the comparative information for the year ended 31 December 2003. After this adjustment, the net profit of the Company for 2003 and retained earnings as 31 December 2003 increased by LTL 1.284 thousand.

	2003	
	Effect on current year retained earnings (deficit)	**Effect on prior year retained earnings (deficit)**
Profit before changes in accounting policies and correction of fundamental error	**5.990.475**	**-**
Changes in accounting policies		
Science research works write-off	526.683	(527.028)
Impairment of property, plant and equipment	-	-
Trade receivables write-off	(794.000)	(27.928.000)
Realisation allowance for inventories	518.556	(2.718.000)
Deferred income tax	(248.000)	2.369.000
	3.239	**(28.804.028)**
Correction of fundamental error	**1.283.708**	**(126.144)**
Profit after corrections	**7.277.422**	**(28.930.172)**

4 Intangible assets

	Concessions, patents, licences, etc.
Cost:	
Balance as of 31 December 2003	955.746
Additions	1.293.680
Disposals and retirements	(2.116)
Balance as of 31 December 2004	2.247.343
Amortisation:	
Balance as of 31 December 2003	647.465
Charge for the year	165.037
Disposals and retirements	(586)
Balance as of 31 December 2004	811.916
Net book value as of 31 December 2004	**1.435.427**
Net book value as of 31 December 2003	**308.281**

5 Property, plant and equipment

	Land and buildings	Structures and machinery	Vehicles	Machinery and equipment	Other property, plant and equipment	Construction in progress and prepayments	Total
Cost:							
Balance as of 31 December 2003	46.797.395	236.331.503	4.376.405	22.942.879	5.644.078	10.467.164	326.559.424
Additions	276.935	10.530.124	784.282	3.545.151	16.307	10.482.152	25.634.951
Returned assets	18.636.011	8.358.038	3.036.332	10.329.078	-	1.044.636	41.404.095
Disposals and retirements	(1)	(1.916.797)	(210.133)	(334.580)	(1.284.594)	-	(3.746.105)
Reclassifications	3.860.424	28.484.522	(345.924)	(18.568.694)	2.638.212	(16.068.540)	-
Balance as of 31 December 2004	69.570.764	281.787.390	7.640.962	17.913.834	7.014.003	5.925.412	389.852.365
Accumulated depreciation:							
Balance as of 31 December 2003	20.278.538	162.161.524	3.161.768	9.075.836	3.321.354	-	197.999.020
Charge for the year	1.077.207	13.723.483	350.765	2.409.142	83.638	-	17.644.235
Accumulated depreciation of returned assets	3.220.033	2.842.901	2.689.293	6.321.384	-	-	15.073.611
Disposals and retirements	-	(244.668)	(206.933)	(181.898)	(891.481)	-	(1.524.980)
Reclassifications	535.251	6.389.098	(143.470)	(8.741.452)	1.960.573	-	-
Balance as of 31 December 2004	25.111.029	184.872.338	5.851.423	8.883.012	4.474.084	-	229.191.886
Net book value as of 31 December 2004	44.459.735	96.915.052	1.789.539	9.030.822	2.539.919	5.925.412	160.660.479
Net book value as of 31 December 2003	26.518.857	74.169.979	1.214.637	13.867.043	2.322.724	10.467.164	128.560.404

5 Property, plant and equipment (cont'd)

As described in Note 3, the Company in 2004 accounted loss from impairment of assets amounting to LTL 1.573 thousand. This impairment is stated in disposals and retirements line in the table above. For other property, plant and equipment impairment loss was not accounted as of 31 December 2004.

The depreciation charge of the Company's property, plant and equipment for the year 2004 amounts to LTL 17.527 thousand (LTL 22.343 thousand in the year 2003). Amount of LTL 17.381 thousand for the year 2004 (LTL 22.213 thousand for the year 2003) was included into cost of sale in the Company's income statement. The remaining amounts were included into operating expenses for the year.

Property, plant and equipment of the Company with a net book value of LTL 85 thousand as of 31 December 2004 (LTL 52 thousand as of 31 December 2003) was pledged to banks as a collateral for the loans received (see Note 11).

Assets not in use in the Company's operations are accounted for under the other property, plant and equipment caption, where part of these assets are leased for the value not less than its depreciation, and the remaining part is expected to be sold by the Company for the value not less then net book value.

Assets leased to UAB Naujasodžio energijos paslaugos are accounted in all the assets groups based on the nature of these assets. In the first half-year of 2005 the Company expects to sell those assets for an amount not less than their net book value.

Unfinished construction of Noreikiškės cogenerating power-plant (LTL 2,33 million) and reconstruction works of the building in Raudondvario pl. 86a (LTL 1,32 million) forms the main part of construction in progress group.

6 Inventories

	2004	2003
Spare parts	2.088.793	2.962.516
Technological fuel	3.028.963	3.985.917
Materials	2.549.455	4.541.894
Other	788	1.542
	7.667.999	11.491.869
Realisation allowance at the beginning of the year	(2.199.444)	(2.718.000)
Change in realisation allowance during the year	1.290.174	518.556
Realisation allowance at the end of the year	(909.270)	(2.199.444)
	6.758.729	9.292.425

The acquisition cost of the Company's slow moving inventories accounted for at net realisable value as of 31 December 2004 amounted to LTL 765 thousand (LTL 2.199 thousand as of 31 December 2003). Changes in the realisation allowance for inventories for the year 2004 and 2003 were included into operating expenses in the Company's income statement.

7 Trade receivables

	2004	2003
Trade receivables, gross	63.117.812	67.751.615
Realisation allowance for doubtful receivables	(25.291.991)	(30.689.021)
Trade receivables, net	37.825.821	37.062.594

Change in realisation allowance for doubtful receivables in 2004 and 2003 is included into operation expenses.

The other receivables as of 31 December 2004 amounted to LTL 8.208.005, as of 31 December 2003 – LTL 19.845.947. As of 31 December 2004 UAB Naujasodžio energijos paslaugos debt to the Company formed the main part of other receivables as it is further disclosed in Note 21.

8 Cash and cash equivalents

	2004	2003
Cash at bank	3.521.026	575.696
Cash on hand	18.699	20.613
Cash in transit	1.417.166	1.669.642
	4.956.891	2.265.951

The Company's foreign and national currency accounts in all banks are pledged as collaterals to secure the loans.

9 Reserves

Legal reserve

A legal reserve is a compulsory reserve under Lithuanian legislation. Annual transfers of not less than 5% of net profit calculated in accordance with BAS are compulsory until the reserve reaches 10% of the share capital. As of 31 December 2004 the Company's legal reserve was fully formed.

Distributable reserves

Distributable reserves are formed based on the decision of the General Shareholders' Meeting on appropriation of distributable profit. These reserves can be used only for the purposes approved by the General Shareholders' Meeting.

9 Reserves (cont'd)

Retained earnings (deficit)

In accordance with the Law on Stock Companies of the Republic of Lithuania and Lithuanian Business Accounting, if the sum of retained earnings (deficit) in the beginning of the year and net profit for the current year is negative, Shareholders meeting has to pass resolution to cover mentioned losses. Amounts are transferred to retained earnings as follows:

a) transfers from reserves, unused in the current year;
b) transfers from legal reserve;
c) transfers from share surplus.

By the date of financial statements management of the Company wasn't informed about the particular actions of the shareholders of the Company, related to this matter.

10 Grants and subsidies

	2004	2003
Balance as of 31 December 2003	**4.415.117**	**4.133.131**
Received during the year		
International development agency of Sweden SIDA	-	490.657
Non-current assets received for free	132.721	-
Research works and equipment for sulphur reduction in fuel oil from the Ministry of Economy	174.870	-
	307.591	490.657
Written-off research works	**(158.627)**	**-**
Amortisation	**(251.838)**	**(208.671)**
Balance as of 31 December 2004	**4.312.243**	**4.415.117**

11 Borrowings

	As of 31 December 2004	As of 31 December 2003
Non-current borrowings		
Non-current borrowings	43.609.580	56.312.110
	43.609.580	56.312.110
Current borrowings		
Current portion of non-current borrowings (other than financial lease)	12.436.152	4.354.117
Current borrowings, secured by the Company's assets	5.179.679	4.000.000
	17.615.831	8.354.117
	61.225.411	64.666.227

11 Borrowings (cont'd)

Terms of repayment of non-current debts are as follows:

	As of 31 December 2004	
Year	**Fixed interest rate**	**Variable interest rate**
2005	9.678.154	7.937.679
2006	7.268.263	-
2007	7.268.263	-
2008	7.268.263	-
2009	7.268.263	-
2010	7.268.263	-
2011	7.268.263	-
	53.287.732	7.937.679

Weighted average effective interest rates of borrowings outstanding at the year-end:

	2004	**2003**
Current borrowings	4,3	5,0
Non-current borrowings	4,9	4,9

Parts of borrowings at the end of the year in national and foreign currencies:

	2004	**2003**
Borrowings denominated in:		
EUR	41.089.463	45.885.571
JPY	12.198.269	14.280.656
LTL	7.937.679	4.500.000
	61.225.411	64.666.227

As of 31 December 2004 the Company had unused funds in credit lines amounting to LTL 13.062 thousand, maturity of which is on different dates, the final one in June 2005.

12 Financial lease

The assets leased by the Company under financial lease contracts consist of equipment. As of 31 December 2004 lease payable balance amounted LTL 32.969 (LTL 77.104 as of 31 December 2003).

13 Sales

For management purposes the Company's activity is organized as one main segment – heat energy supply. The Company is also involved in electricity production, maintenance of heating and hot water supply systems and other activities. The main information about activities is stated below (profit stated in the bottom of the table differs from the profit from operations in the income statement due to segments activities stating purposes where increase in value of receivables and other assets is not considered, also the Company's social payments according to the Company's collective agreement and other amounts with total amount of LTL 898.094 that were reversed as of 31 December 2004 are not included in this table):

	2004			2003		
	Income	**Expenses**	**Profit**	**Income**	**Expenses**	**Profit**
Heat energy	160.951.512	159.484.565	1.466.947	169.113.584	159.407.913	9.705.671
Electricity	1.314.120	1.339.000	(24.880)	32.083.028	21.063.000	11.020.028
Maintenance of heating of buildings and hot water supply systems	8.164.569	9.237.377	(1.072.808)	8.448.570	10.463.915	(2.015.345)
Extraction of peat	-	-	-	6.640.000	10.312.501	(3.672.501)
Isolation of pipes	-	-	-	2.389.076	2.507.978	(118.902)
	170.430.201	**170.060.942**	**369.259**	**218.674.258**	**203.755.307**	**14.918.951**

14 Operating expenses

	2004	**2003**
Selling expenses	6.768.802	6.971.855
General and administrative expenses	5.171.196	8.083.994
	11.939.998	**15.055.849**

Wages and salaries and social security	4.622.377	3.832.779
Depreciation and amortisation of non-current assets	146.260	129.417
Taxes other than income tax	92.816	171.342
(Reversal of) realisation allowance for receivables and other assets	(4.334.310)	(251.239)
Services to the customers	3.707.423	3.128.757
General expenses	3.286.292	2.571.952
Other	4.419.140	5.472.841
	11.939.998	**15.055.849**

Increase in value of receivables and other assets was caused due to reversal of realisation allowance for receivables, non-current assets and inventories. Significant decrease in other activity expenses in 2004 comparing with 2003 is due to reorganization of the Company, establishment of Naujasodžio energijos paslaugos and Kauno elektrinė branches in the end of 2003.

As of 31 December 2004 the Company accounted for accrual of damage compensation to UAB Kauno termofikacijos elektrinė amounting to LTL 2.731.149 (see Note 20).

15 Other operating income (expenses), net

	2004	2003
Other operating income		
Gain on sale of non-current assets	20.834.236	19.686.690
Services provided by the Company	2.912.435	19.276.146
Inventories sold	1.019.395	14.624.218
Other	817.930	3.970.368
	25.583.996	57.557.422
Other operating (expenses)		
Loss from sale of non-current assets	(815.242)	(20.705.562)
Cost of services provided by the Company	(1.403.187)	(15.119.880)
Cost of inventories sold	(2.320.352)	(20.057.660)
Other	(1.339.833)	(2.835.912)
	(5.878.614)	(58.719.014)
	19.705.382	(1.161.592)

As further described in Note 3, gain on sale of non-current assets is mainly due to reversed transaction with UAB Naujasodžio energijos paslaugos on sale of property, plant and equipment.

16 Income (expenses) from financial and investment activities, net

	2004	2003
Income from financial and investment activities		
Overdue interest and fines	1.437.950	793.464
Interest income	25.314	285.954
Foreign currency exchange gain	2.110.126	6.499.270
Other financial income	61.280	499
	3.634.670	7.579.187
(Expenses) from financial and investment activities		
Overdue interest and fines	(6.351.542)	(1.012.205)
Interest expenses	(3.257.471)	(7.303.141)
Foreign currency exchange loss	(1.373.338)	(2.873.507)
Other financial expenses	(156.947)	(3)
	(11.139.298)	(11.188.856)
	(7.504.628)	(3.609.669)

17 Extraordinary gain and loss

Extraordinary gain and loss amounts disclosed in the income statement for the year ended 31 December 2003 in the financial statements for the year ended 31 December 2004 are reclassified to other operating and operating income (expenses).

18 Income tax

	2004	2003
Components of the income tax expense (income)		
Current income tax for the reporting year	-	-
Deferred income tax (income) expense	2.314.551	248.000
Income tax expenses (income) recorded in income statement	2.314.551	248.000

Deferred income tax consists of as follows (thousands LTL):

	2004	2003
Deferred income tax asset		
Loss carried forward	840	4.202
Accounts receivable	3.794	4.728
Allowance for inventories	115	330
Accruals and other	552	-
Deferred income tax asset before valuation allowance	5.301	9.260
Less: valuation allowance	(3.909)	(5.058)
Deferred income tax asset, net	1.392	4.202
Deferred income tax liability		
Investments incentive	(1.586)	(2.081)
Deferred income tax, net	(194)	2.121

19 Financial assets and liabilities and risk management

Interest rate risk

The major part of the Company's borrowings is in fixed interest rates, therefore, the Company does not sustain significant interest rate risk.

Liquidity risk

The Company's policy is to maintain sufficient cash and cash equivalents or have available funding through an adequate amount of committed credit facilities to meet its commitments at a given date in accordance with its strategic plans. The Company's and the Group's liquidity and quick ratios as of 31 December 2004 were 1,04 and 0,92, respectively (2,05 and 1,78 as of 31 December 2003).

19 Financial assets and liabilities and risk management (cont'd)

Fair value of financial instruments

The Company's principal financial instruments not carried at fair value are trade and other receivables, trade and other payables, long-term and short-term borrowings.

Fair value is defined as the amount at which the instrument could be exchanged between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing 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 current trade accounts receivable, current accounts payable and short-term borrowings approximates fair value.
(b) The fair value of non-current 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 borrowings with variable interest rates approximates their carrying amounts.

20 Commitments and contingencies

Assets not in use amounting to LTL 2.286 thousand, which the Company expects to sell for the value not less than balance value are accounted for under property, plant and equipment caption.

In the first half of the year 2005 the Company expects to sell the assets currently rented out to UAB Naujasodžio energijos paslaugos for LTL 23 million.

The Kaunas District Court has handled the case for damage compensation to UAB Kauno termofikacijos elektrinė amounting to LTL 2,7 million and passed a judgement favourable to UAB Kauno termofikacijos elektrinė. Presently the case is under the examination in the Court of Appeal of the Republic of Lithuania. The Company's net profit for the year 2004 is decreased by respective amount of LTL 2,7 million.

The net profit for the year 2004 is decreased by overdue interest amounting to LTL 6,3 million, as decided by court to be paid to AB Lietuvos dujos as overdue interest for gas purchased during 1999 – 2000. This court judgement is appealed against at the Supreme Court.

21 Related party transactions

The parties are considered related when one party has the possibility to control the other one or have significant influence over the other party in making financial and operating decisions. As of 31 December 2004 and 2003 the Company had one related party – subsidiary UAB Naujasodžio energijos paslaugos, which started its activity from 31 December 2003. Transactions with this company in 2004 and 2003 as well as balances as of 31 December 2004 and 2003 were as follows:

2004	**Purchases**	**Sales**	**Accounts receivable**	**Accounts payable**
UAB Naujasodžio energijos paslaugos	5.013.294	744.951	4.327.016	67.999
	5.013.294	744.951	4.327.016	67.999

2003	**Purchases**	**Sales**	**Accounts receivable**	**Accounts payable**
UAB Naujasodžio energijos paslaugos	-	-	13.767.194	3.842
	-	-	13.767.194	3.842

Subsidiary is liable according to the Sales of inventories agreement, signed for sale of inventories to the subsidiary at the beginning of it's activities. Assets lease agreement is valid from 1 October 2004, according to which UAB Naujasodžio energijos paslaugos uses non-current assets in its productions activity.

21 Related party transactions (cont'd)

Remuneration of the management and other payments

The Company's management remuneration amounted to LTL 336 thousand in 2004 (LTL 564 thousand in 2003). Remuneration change in 2004 and 2003 was influenced by the Company's reorganization in the end of 2003. The management of the Company did not receive any loans, guarantees; no other payments or property transfers were made or accrued.

22 Subsequent events

No significant events after balance sheet date were identified in the Company.