VENTSPILS NAFTA

JSC VENTSPILS NAFTA AND ITS SUBSIDIARIES

(UNIFIED REGISTRATION NUMBER 50003003091)

ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

INCLUDING THE FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

TOGETHER WITH
THE INDEPENDENT AUDITORS' REPORT

Ventspils, 2009

Independent Auditors' Report

To the shareholders of JSC Ventspils nafta

Report on the Financial Statements

We have audited 2008 consolidated financial statements of JSC Ventspils nafta and its subsidiaries (the "Group"), which are set out on pages 9 through 60 of the accompanying 2008 Annual Report and which comprise the consolidated balance sheet as at 31 December 2008, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the consolidated financial statements give a true and fair view of the financial position of JSC Ventspils nafta Group as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on Compliance of the Management Report and Corporate Management Report

Furthermore, we have read the Management Report for the year ended 31 December 2008 (included on pages 6 through 8 of the accompanying 2008 Annual Report) and have not noted any material inconsistencies between the financial information included in it and the financial statements for the year ended 31 December 2008.

Furthermore, we have assured ourselves that JSC Ventspils nafta Group has prepared the corporate management report for the year 2008 (included on pages 61 through 77 of accompanying 2008 Annual Report) and verified information presented in the report according to the requirements listed in the section 56.1 first paragraph clauses 3, 4, 6, 8 and 9 and in the section 56.2 second paragraph clause 5 in the Law of the Republic of Latvia On Financial Instruments Market.

SIA Ernst & Young Baltic, License No. 17

Diāna Krišjāne
Latvian Sworn Auditor, Certificate No. 124
Chairperson of the Board

Riga, 15 July 2009

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Council of JSC Ventspils nafta

Chairman of the Council:	Vladimirs Solomatins
Deputy Chairmen of the Council:	Dennis Crema Andris Vilcmeiers Jeffrey Scott Martz
Members of the Council:	Māris Gailis Gints Laiviņš - Laivenieks Mamerts Vaivads Paul Edward Mulholland Ashley John Neale Ansis Sormulis Vladimirs Krastiņš

There have been no changes in the Council during the period from 1 January 2008 to 15 July 2009.

Board of JSC Ventspils nafta

Chairperson of the Board:	Olga Pētersone
Members of the Board:	Normunds Staņēvičs Ilva Purēna Guntis Tīrmanis

The changes in the Board during the period from 1 January 2008 to 15 July 2009 were as follows:

Elected	Dismissed	Name	Position held
26/02/2008	-	Normunds Staņēvičs	Member of the Board
-	26/02/2008	Aldis Āķis	Member of the Board

Statement of management's responsibilities

The Management Board prepares consolidated financial statements for each financial year which give a true and fair view of the state of affairs of the *JSC Ventspils Nafta* and its subsidiaries (hereinafter also – the Group) as of 31 December 2008, the cash flows and the results of the Group for the year 2008 in accordance with International Financial Reporting Standards as adopted by the European Union. In preparing those consolidated financial statements, they:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- prepare the consolidated financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position, financial performance and cash flows of the *JSC Ventspils Nafta* (hereinafter also – the Parent company) and the Group and enable them to ensure that financial statements drawn up from them comply with International Financial Reporting Standards as adopted by the European Union.

Riga, 15 July 2009

On behalf of the Council:

Vladimirs Solomatins
Chairman of the Council

On behalf of the Board:

Olga Pētersone
Chairperson of the Board

Management report

Dear shareholders, customers and cooperation partners,

Due to global and national economic turmoil, year 2008 presented numerous challenges and complicated issues for the management of public *JSC Ventspils nafta* Group meanwhile forcing for immediate assessment and revaluation of the company's further development scenarios for timely response and maximum efficiency and effectiveness - resulting in sustainable and optimal future growth model. As a result of a comprehensive risk analysis, Supervisory Council for *JSC Ventspils nafta* approved the Group's development strategy in December 2008 focusing specialization on development of transit industry related assets as oppose to functions previously pursued by the holding in wider industry range that *JSC Ventspils nafta Group* implemented for several years as a result of active business industry risk diversification policy. By optimizing and reorganizing core business focus *JSC Ventspils nafta Group* as of beginning of 2009 following the end of previous reporting period, the Group manages investments in the transit area – transportation, storage, transhipment of crude oil and petroleum products and international shipping business.

The decision to refocus all attention to development of the historical core business of *JSC Ventspils nafta* in transit industry was made in accordance with recommendations of local and international experts and advisers with the main intention to ensure adequate return on investments in the interests of all shareholders of *JSC Ventspils nafta* in the conditions of global economic turmoil. The selected strategy enables *JSC Ventspils nafta* to focus on one industry area, focusing on growth and improvement of its assets, especially taking into account several decades of experience and success in this industry, as well as the international know-how, which has been actively acquired particularly in the recent years along with involvement of the international shareholder – oil and gas transport and trade conglomerate Vital Group.

By selling *JSC Ventspils nafta* assets in the areas not related to transit business, the Group's long-term assets were transformed into assets of high liquidity, whereas the shareholders of *JSC Ventspils nafta* have gained significant profit, as *JSC Ventspils nafta*, as a parent company's profit after tax reached 40 million lats.

JSC Ventspils nafta Group's consolidated profit after tax attributable to the Parent company's shareholders for 2008 amounts to 29.7 million lats, which is five times more than was planned in *JSC Ventspils nafta Group's* consolidated budget for 2008, which was 5.3 million lats. The consolidated net turnover of *JSC Ventspils nafta Group* for the reporting year reached 63.1 million lats.

In line with the approved strategy, following the end of the reporting year as of beginning of 2009, *JSC Ventspils nafta* is developing and retaining its investments in the subsidiary of crude oil and petroleum products transhipment company *Ventspils nafta termināls Ltd* (51%), the subsidiary being owner and operator of crude oil and petroleum products pipeline *LatRosTrans Ltd* (66%) and the associated company *JSC Latvian Shipping Company* (49.94%). Whereas it has disposed of its shareholdings in the subsidiaries - real property management companies - *Nekustamie īpašumi VN Ltd* (100%) and *Rīgas līcis VN Ltd* (100%), as well as in the subsidiary - printing company - *JSC Preses nams* (95.4%) and the subsidiary - publisher - *Mediju nams Ltd* (95.63%). The profit from disposal of discontinued operations at the consolidated level amounts to 6.6 million lats.

During 2008 the Group has also disposed its real estate properties in Riga, Briāna Street 3 and Palasta Street 10; Ventspils, Talsu Street 75d, Jūrmala, Dubultu prospect 51 and Lejastiezumi at Renda civil parish, Kuldīga district. The profit from sale of real estate properties amounts to 1.7 million lats.

The year 2008 can be characterized by sharp recession and downturn of financial as well as economic results worldwide, and it has considerably influenced the Baltic stock exchange market, which comprises also the NASDAQ OMX stock exchange in Riga, in whose official list the shares of *JSC Ventspils nafta* are officially quoted. In the reporting period, the price of *JSC Ventspils Nafta* shares in the Riga Stock Exchange ranged from LVL 0.68 to LVL 2.40 (average price – LVL 1.92). In the reporting year, in total 1'440 thousand shares were sold in 2'344 transactions, reaching the annual turnover of 2'767 thousand lats, which is 62,6% less than in 2007. Share market capitalization of *JSC Ventspils nafta* was 76.2 million lats as at 31 December 2008.

Management report (cont'd)

The average price of *JSC Ventspils nafta* shares in 2008 was 69 santims lower than in 2007 when it reached LVL 2.61. The average market capitalization of *JSC Ventspils nafta* shares has decreased from 272.6 million lats in 2007 to 200.8 million lats in 2008, i.e. by 71.8 million lats or by 26.3% corresponding to decline in the average share price. The decline in share price is a result of general trends in the global financial instruments markets, the macroeconomic situation and high inflation level in the reporting period in Latvia. However, it has to be taken into account that the average turnover in transactions with *JSC Ventspils nafta* shares per day in 2008 was only 7.6 thousand lats or 0.004% of the average share market capitalization amount. Therefore the market value calculation by usage of insignificant amount of public share market transactions is not representative, as the liquidity level is too low.

In the reporting period, *JSC Ventspils nafta* proved its ability of working also in conditions of the global economic downturn that has notably affected several *JSC Ventspils nafta* subsidiaries working in international markets. At the same time, the economic processes in 2008 globally and in Latvia have confirmed that the conservative planning of *JSC Ventspils nafta* has been prudent and adequate by regularly assessing and planning potential influence of external factors on the operations and financial results of the Group.

The Group has also paid special attention to the management of financial instruments and financial risk ensuring risk averse and up-to-date platform for managing effect of global financial market turmoil effect on the Group's companies.

The *JSC Ventspils nafta* subsidiary *Ventspils nafta termināls Ltd* ensured stable cargo volume level in the reporting year by transhipping in total more than 11.6 million tons of crude oil and petroleum products. Similar to previous years the major proportion of cargos is formed by diesel representing 8.7 million tons delivered by rail and via petroleum products pipeline, followed by 1.4 million tons of gasoline of various grades delivered by rail and 1.1 million tons of crude oil and petroleum product cargos delivered by sea. Events in the global economy, the unfavorable global oil market situation in the last months of the reporting year and the international competition in the transit area have had and after the end of the reporting year still have a significant impact on operating results of Ventspils nafta termināls Ltd, which were affected several months in the reporting period also by the repair works of the main petroleum products pipeline Polotsk-Ventspils in the territory of Belarus, which resulted in a reduced diesel fuel flow in the direction of Ventspils.

At the same time, *Ventspils nafta termināls Ltd* continued active implementation of modernization in 2008, by optimizing company's operational processes and procedures, increasing workforce efficiency and introducing higher requirements in terms of environment protection, thereby adapting to the new economic conditions and strengthening its positions in international market. The aim of modernization is to strengthen the positions of *Ventspils nafta termināls Ltd* as the major crude oil and petroleum products transhipment complex in the Baltic region, by developing its work by following similar principles as in other companies under the Vitol Group worldwide, such as EuroTank in Rotterdam and Amsterdam. For forming successful social dialogue and forming a good social partnership through collective agreement, *Ventspils nafta termināls Ltd* received the annual award Cooperation Partner 2008 from the Free Trade Union Confederation of Latvia in the nomination Private Enterprises.

The most remarkable contribution that *Ventspils nafta termināls Ltd* made into improvement of environment protection in the reporting year was launching the new, modern wastewater treatment plant that is unique in the Baltic region. The plant is fully compliant for treatment for any type of petroleum products and represents the typical operations of *Ventspils nafta termināls Ltd*, that is characterized by variety of transshipped petroleum products – at the present moment, the terminal receives and transships more than 20 types of petroleum products. The company has invested about one million lats in the treatment plant.

According to the previous forecasts of *JSC Ventspils nafta*, in the reporting year, external circumstances still substantially affected another Group's company *LatRosTrans Ltd*, which is working in the sensitive transit area. Oil transportation in the direction of Lithuania via the pipeline owned by *LatRosTrans Ltd* is still not resumed due to the geopolitical situation, and technical reasons, such as repair works at the pipeline sections in the territory of Belarus and corresponding decrease in its capacity, influenced also transportation volumes of petroleum products in direction of Ventspils, as its total transshipment volume has reached 5 million tons in 2008.

Management report (cont'd)

According to the approved schedule, *LatRosTrans Ltd* continued renovation and repair works of the petroleum products pipeline in the reporting year. As before, *LatRosTrans Ltd* has actively worked on elimination of supernormative loss of petroleum products resulting from illegal activities by hiring a security company, regularly inspecting the pipeline, collaborating with the police, allocating considerable resources in recovery of the environment, as well as informing and trying to involve other state authorities in dealing with this issue.

During these financially and economically difficult times *LatRosTrans Ltd* has been continuously decreasing company's operating expenses for already several years, and decrease of 6.7% was achieved in the particular reporting year.

During 2009 the management will continue to peruse organization optimization and cost reduction for all Group companies with the ultimate goal to further increase profitability and ensure long term development sustainability thereby forming solid ground for growth and development in 2009 and following years.

During 2008 the associated company of *JSC Ventspils nafta – JSC Latvian Shipping Company* has been continuing to pursue its strategic goal – ensuring increase of the Group's value and retaining its position among the top ten medium range tanker owners in the world. According to the audited financial statements 2008, *JSC Latvian Shipping Company Group* worked with net profit of 58.7 million US dollars in the reporting year. In comparison with the result of analogue period in 2007, the last year's profit is 8.3 million US dollars or 12% lower, reflecting general unfavourable shipping market trends in the reporting period, especially in the end of it.

In the circumstances of global financial and economic turmoil, *JSC Ventspils nafta* is taking appropriate actions to reduce risks and ensure profit, by careful, focused and purposeful managing of assets owned by it as well as resourcefully planning to achieve goals set by shareholders.

Riga, 15 July 2009

On behalf of the Council:

Vladimirs Solomatins
Chairman of the Council

On behalf of the Board:

Olga Pētersone
Chairperson of the Board

Consolidated income statement

	Note	2008 EUR thousand	2007 EUR thousand
Continuing operations			
Net revenues	4	89 813	94 278
Cost of sales	5	(88 086)	(79 547)
Gross profit		**1 727**	**14 731**
General and administrative expense	6	(9 967)	(9 000)
Other operating income	7	6 941	82 205
Other operating expense	8	(5 213)	(7 333)
Share of profit in associate	18	20 128	24 382
Financial income	10	4 713	4 870
Financial expense	10	(10)	(9 249)
Result before taxes		**18 318**	**100 607**
Corporate income tax	11	(7 770)	(1 868)
Net profit for the year from continuing operations		**10 548**	**98 739**
Discontinued operations			
Profit / (loss) after tax for the year from discontinued operations	12	28 287	(7 399)
Profit for the year		**38 834**	**91 340**
Attributable to:			
Minority interest	24	(3 479)	20 764
Parent company's shareholders		42 313	70 576
		38 834	**91 340**
Earnings per share (Lats per share) attributable to the Parent company's shareholders:			
Diluted and basic earnings per share from countinuing operations	24	0,13	0,74
Diluted and basic earnings/ (loss) per share from discountinuing operations	24	0,27	(0,07)

EUR exchange rate of the Bank of Latvia on 31.December 2008 – 0,702804 LVL.

On behalf of the Council:

Vladimirs Solomatins
Chairman of the Council

On behalf of the Board:

Olga Pētersone
Chairperson of the Board

Consolidated balance sheet

ASSETS

NON CURRENT ASSETS	Note	31/12/2008 EUR thousand	31/12/2007 EUR thousand
Intangible assets	13	**39 268**	**40 525**
Property, plant and equipment			
Land, buildings and pipeline networks	14	125 204	143 505
Machinery and equipment	14	61 159	78 262
Other property, plant and equipment	14	5 356	6 946
Construction in progress	14, 16	1 483	29 510
Prepayments for property, plant and equipment		304	1 248
TOTAL		**193 506**	**259 471**
Investment properties	17	**-**	**45 149**
Investments			
Investments in associated entities	18	178 740	167 744
Receivables from related companies	33	59 130	-
Loan note	19	63 389	61 980
Other non-current financial assets		444	484
TOTAL		**301 703**	**230 208**
TOTAL NON CURRENT ASSETS		**534 478**	**575 353**
CURRENT ASSETS			
Inventories	20	3 456	6 201
Trade accounts receivable	21	2 053	6 185
Receivables from related companies	33	35 485	-
Loans to related companies	33	778	-
Other receivables	22	1 885	4 663
Available for sale financial assets		-	73
Cash and cash equivalents	23	50 876	27 907
TOTAL CURRENT ASSETS		**94 534**	**45 029**
TOTAL ASSETS		**629 012**	**620 382**

EUR exchange rate of the Bank of Latvia on 31.December 2008 – 0,702804 LVL.

On behalf of the Council:

Vladimirs Solomatins
Chairman of the Council

On behalf of the Board:

Olga Pētersone
Chairperson of the Board

Consolidated balance sheet

LIABILITIES AND SHAREHOLDERS' EQUITY

SHAREHOLDERS' EQUITY	Note	31/12/2008 EUR thousand	31/12/2007 EUR thousand
Share capital	24	148 660	148 660
Share premium		60 249	60 249
Legal reserve		1 017	1 017
Reserves resulting from investment in associates	18	(22 461)	(25 454)
Other reserves		277 678	207 102
Profit for the year		42 313	70 576
EQUITY ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE PARENT		**507 456**	**462 150**
Minority interest	24	104 080	107 933
TOTAL SHAREHOLDERS' EQUITY		**611 536**	**570 083**
LIABILITIES			
Non-current liabilities			
Deferred corporate income tax liability	11	1 860	10 034
Non-current portion of financial lease liability	26	10	20 016
TOTAL		**1 870**	**30 050**
Current liabilities			
Current loan from credit institution	25	-	4 348
Current portion of financial lease liability	26	10	2 837
Advances from customers		1 012	916
Trade accounts payable		3 376	5 458
Payables to related companies	33	206	102
Taxes payable	27	7 950	1 049
Other liabilities	28	768	1 342
Accrued liabilities	29	1 555	2 406
Provisions	30	729	1 790
TOTAL		**15 606**	**20 249**
TOTAL LIABILITIES		**17 476**	**50 299**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**629 012**	**620 382**

EUR exchange rate of the Bank of Latvia on 31.December 2008 – 0,702804 LVL.

On behalf of the Council:

Vladimirs Solomatins
Chairman of the Council

On behalf of the Board:

Olga Pētersone
Chairperson of the Board

Consolidated cash flow statement

		2008 EUR thousand	2007 EUR thousand
Cash flows to/ from operating activities			
Profit before tax from continuing operations		18 318	100 564
Profit / (loss) before tax from discontinued operations	12	33 351	(7 329)
Profit before tax		**51 669**	**93 235**
Adjustments for:			
Amortisation and depreciation	13, 14	16 225	14 088
Imparment loss	13, 14	3 026	2 537
Impairment reversed	18	(121)	(43 782)
Long term loan impairment	8	-	1 017
Change in bad debt allowance		-	(70)
Interest income	10	(3 809)	(4 893)
Interest expense		2 150	1 574
Fair value change on investment properties	12,17	(41 895)	(63)
Share of net profit of associate	18	(20 007)	(24 461)
Decrease in investment in associate entity for unrealised profit	18	12 245	-
Foreign exchange (gain) / loss		(904)	9 178
Loss from sale of investment properties	8	618	-
Gain from sale of subsidiaries	12, 7	(9 330)	(37 982)
(Gain)/ loss on disposal of property, plant and equipment	7	(3 005)	6 040
Operating profit or loss before change in working capital		***6 863***	***16 419***
Decrease in inventories		2 089	2 352
(Increase) / decrease in trade accounts receivable		(7 933)	95
(Decrease) / increase in current liabilities		(2 713)	1 675
Cash generated (to) / from operations		***(1 695)***	***20 541***
Corporate income tax paid		(1 069)	(1)
Net cash flows to/ from operating activities		**(2 764)**	**20 540**
Cash flows to/ from investing activities			
Purchase of fixed assets		(13 741)	(11 053)
Proceeds from sale of property, plant and equipment and investment properties		6 201	-
Proceeds from sale of subsidiaries	12	24 395	-
Purchase of shares in associate	18	(121)	(78)
Interest received		3 860	4 893
Deposits received upon maturity		-	13 984
Net cash flows to/ from investing activities		**20 594**	**7 746**
Cash flows to/ from financing activities			
Repayment of borrowings and financial lease liabilities		(2 608)	(6 537)
Proceeds from borrowings		9 785	-
Interest payments		(2 039)	(1 574)
Net cash flows to/ from financing activities		**5 138**	**(8 111)**
Change in cash		22 969	20 175
Cash at the beginning of the year		27 907	7 732
Cash at the end of the year		**50 876**	**27 907**

EUR exchange rate of the Bank of Latvia on 31.December 2008 – 0,702804 LVL.

Consolidated statement of changes in shareholders' equity

	Attributable to the equity holders of the parent							
	Share capital	Share premium	Legal reserve*	Reserves resulting from investment in associates	Other reserves**	Current year's unappro-priated result	**Total**	Minority interest
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR thousand
Balance as of 31 December 2006	**148 660**	**60 249**	**1 017**	**(9 089)**	**197 359**	**9 742**	**407 939**	**57 024**
Foreign currency translation directly recognised in equity	-	-	-	(16 364)	-	-	**(16 364)**	-
Profit for the period	-	-	-	-	-	70 576	**70 576**	20 764
Total income and expenses for the year	-	-	-	*(16 364)*	-	*70 576*	***54 211***	*20 764*
Transfer of 2006 net result	-	-	-	-	9 742	(9 742)	**-**	-
Effect of sale of 49% shares in SIA Ventspils nafta terminals	-	-	-	-	-	-	**-**	30 145
Balance as of 31 December 2007	**148 660**	**60 249**	**1 017**	**(25 454)**	**207 102**	**70 576**	**462 150**	**107 933**
Foreign currency translation and other *reserves directly recognised in equity*	-	-	-	2 992	-	-	**2 992**	-
Profit for the period	-	-	-	-	-	42 313	**42 313**	(3 479)
Total income and expenses for the year	-	-	-	*2 992*	-	*42 313*	***45 306***	*(3 479)*
Minority interests for disposed subsidiaries	-	-	-	-	-	-	**-**	(374)
Transfer of 2007 net result	-	-	-	-	70 576	(70 576)	**-**	-
Balance as of 31 December 2008	**148 660**	**60 249**	**1 017**	**(22 461)**	**277 678**	**42 313**	**507 456**	**104 080**

EUR exchange rate of the Bank of Latvia on 31.December 2008 – 0,702804 LVL.

* Legal reserve represents the Group's share of subsidiary's *LatRosTrans Ltd* legal reserve which was previously provided for in accordance with the law of the Republic of Latvia on Limited Liability Companies in amount of 5% of the prior years' profits. Pursuant to the Commercial Law of the Republic of Latvia, formation of such reserves is no longer required.

** According to the Statutes net result is allocated to Other reserves and used for further development of the Group.