



JSC "Latvijas Gāze"  
Annual Report  
2010

# JSC "Latvijas Gāze" in 2010

**Our objective** is to strengthen the JSC "Latvijas Gāze" position as a leader in the Latvian heating market, by increasing the availability of natural gas, promoting various ways to use it, and ensuring Latvia with one of the most stable natural gas supplies in Europe.

**Our vision** is to transform Latvia into one of Europe's largest natural gas storage centers, utilizing our country's unique geological formations.

**Our mission** is to contribute to the Baltic region's economy, by ensuring the safety of energy supply, the development of the sector, and competitive pricing.

One of the core values of  
JSC "Fatrijas Gāze" is the  
countryside of Latvia. Although  
seemingly so familiar, Latvia's  
countryside never ceases to surprise  
with its changeability and its light,  
elusive, almost airy character.

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# Council Report



*Kirill Seleznev*  
Chairman of the Council

The second half of the year 2010 saw a gradual economic recovery in Latvia. However, the priorities of the Joint Stock Company "Latvijas Gāze" (hereinafter – the Company) in this period remained unchanged: a continuous and safe natural gas supply to existing customers and the attraction of new customers by expanding the natural gas supply networks. The security of supply was ensured not only to Latvian consumers, but also those in the Northwestern Russia, Estonia and Lithuania by the Inčukalns Underground Gas Storage Facility, the importance of which in the Baltic region might grow in the future if new international projects will be implemented. Last year, the performance of the Company was positively influenced not only by the economic recovery, but also a period of sustained cold at the beginning of the year and the increased natural gas consumption for electricity production.

In 2010, the consumers were sold 1 787.6 billion m<sup>3</sup> of natural gas, which is 19.7% more than in 2009. The Company's net profit reached LVL 26.47 million (37.66 million EUR), exceeding the figure of the previous year by LVL 6.5 million (9.25 million EUR). The Company invested LVL 23.3 million (33.15 million EUR) in further modernization, the attraction of new customers and the improvement of safety. The year 2010 saw a further rise of the total number of gas users, reaching 442.4 thousand at the end of the year.

The key projects still in progress are the reconstruction of wells at the Inčukalns Underground Gas Storage Facility and the construction of a gas pipeline under the Daugava riverbed using the horizontal drilling method. Both projects receive half of the required funding within the framework of the European Economic Recovery Programme. One should also mark out the course of the diagnostics of gas transmission pipelines and the elimination of the defects found. By the end of last year, 85% of the total length of the gas transmission

pipelines in Latvia had been inspected and repaired. The diagnostics of international interconnections took place in cooperation with colleagues from Russia, Estonia and Lithuania. The diagnostics and repairs of the pipelines Inčukalns-Izborsk and Inčukalns-Tallinn was completed, while the pipeline Vilnius-Riga is still under inspection.

In 2010, during its meetings, the Council heard and discussed the reports to the Council on the operation of the Company prepared by the Board, reviewed and accepted the draft annual report of the year 2010 and the draft budget of the year 2011. The Council gave the Board directions and recommendations on improving the Company's operation. The Council reviewed and approved the amendments to the agreements with the natural gas suppliers the OJSC "Gazprom" and the LLC "ITERA Latvija" prepared by the Board. Thus, Latvia is guaranteed stable natural gas supplies till 2030 and secured the competitiveness of gas in the market of energy resources.

In 2010 the Vice-Chairman of the Council A. Saul discontinued his service at the Council and a new Council member P. Frankenberg was elected instead of him. The Council expresses gratitude and acknowledgment to A. Saul for his notable work and contribution to the development of the Company and wishes success to the new Council member P. Frankenberg, who was elected as the Vice-Chairman of the Council.

The Council has become acquainted with the Corporate Governance Report for last year prepared by the Board in compliance with the "Principles of Corporate Governance and Recommendations on the Implementation thereof" issued by the JSC "NASDAQ OMX Riga" and holds a view that the Board has done significant work to ensure that the Company complies with the recommended principles of corporate governance. The Council follows the same principles.

During the reporting period, the Council regularly received reports from the Board regarding the operation, economic and financial situation of the Company. The Council supervised the operation of the Company in all key aspects and made sure the Company works in compliance with the laws, the Company's Articles of Association and the resolutions of the Shareholders' meeting, verified and accepted the budget submitted by the Board and made proposals for improving the Company's work.

The Annual Report 2010 of the Company was audited by the International Auditor Company "PricewaterhouseCoopers" LLC. The Council has received the auditor's reports attesting that the financial statements give true and fair view of the financial position of the Company as of 31 December 2010, and of its financial performance and its cash flows for the year then ended in accordance with the Annual Accounts Act of the Republic of Latvia. The Council has reviewed and accepted the Board report on the operation of the Company in the reporting year, research and development measures, financial risk management and suggestions as to the distribution of the profit of the year 2010.

The Council of the Company acknowledges the successful performance of the Board and employees in 2010 and wishes success and progress in future as well.

# Council



*Kirill Seleznev*

**Chairman of the Council**

Head of Gas and Liquid Hydrocarbon Marketing and Processing Division of OJSC "Gazprom" since March 20, 2003, Member of the Board of OJSC "Gazprom".  
2002 – graduated from St. Petersburg State University in Credit Theory and Finance Management.  
1997 – graduated from Baltic State Technical University of St. Petersburg named after D. F. Ustinov in the field of engineering of momentum devices and automated rotation lines.



*Achim Saul*

**Vice-chairman of the Council (until July 2, 2010)**

Since 2008 – Member of the Board of Directors of "E. ON Ruhrgas International AG" in Essen – responsible for foreign branches, legal matters, human resources and organization.  
2005-2008 – Chairman of the Board of "E.ON Gaz România Group", Targumures, Romania.  
1987 – Doctorate (Dr. Ing.) at University of Ruhr, Bochum.



*Juris Javickis*

**Vice-chairman of the Council**

Since 1996 – President of LLC "ITERA Latvija".  
1983-1984 – International Relations Faculty of University for Qualification-Raising of Executives.  
1970-1972 – Postgraduate Course at Riga Polytechnical Institute.



*Peter Andreas Frankenberg*

**Vice-Chairman of the Council (since July 2, 2010)**

Since 2010 – Head of "MU PEG Investment Management and International Shareholdings Mid-/Downstream", Senior Vice-president of "E. ON Ruhrgas AG"; Managing Director of "E. ON Ruhrgas International".  
1992 – Dr. rer. oec. (Dr. Ph.), International Accounting, University of Ruhr, Bochum.



## Joachim Hockertz

Since 2000 – Head of Baltic States Office (2000-2002 "Ruhrgas AG", since 2002 "E.ON Ruhrgas International AG").  
1989-1992 – Max Plank Institute in Muelheim an der Ruhr, Dr. Ph.



## Mario Nullmeier

Since 2005 – Head of Baltic States Office of "E.ON Ruhrgas International AG" in Tallinn, Estonia.  
2000 – Master Degree in Global Business Administration.



## Yelena Karpel

Since 2004 – Member of the Board of Directors of OJSC "Gazprom" following a resolution by shareholders' meeting.  
1968 – Korotchenko Kyiv Economic Institute, Speciality of Industry Planning.



## Vlada Rusakova

Since 2003 – Member of the Board of OJSC "Gazprom", Head of Strategic Development Division.  
1977 – Moscow Oil and Gas Industry Institute named after I. M. Gubkin, Qualification of Engineer in design, planning and operation of oil and gas pipelines, gas storage facilities and oil tanks;  
postgraduate course at Moscow Oil and Gas Industry Institute named after I. M. Gubkin.



## Uwe Fip

Since 2002 – Senior Vice-president of "E.ON Ruhrgas AG", Head of Eastern Gas Supply Department.  
Master Degree in Oil Engineering, Degree in Business Management (Diploma – Merchant).



## Heinz Watzka

Since 2002 – Senior Vice-president of "E.ON Ruhrgas AG", responsible for maintenance of southern gas pipeline system.  
1986 – studies of Machine Manufacturing at Vienna Technical University (Austria), specialized in pump station welding and hydraulic design for oil industry.



## Alexander Korasnenkov

Since 2006 – General Director of LLC "Baltic LNG"  
International Institute of Finance and Economics, Speciality of International Economics and International Relations.



## Igor Nazarov

Since 2007 – Head of Export Division of "NGK ITERA" (Moscow, Russia)  
1982 – Moscow State University of Foreign Affairs (MGIMO) (within the framework of Ministry of Foreign Affairs), Diploma of Commercial Division equivalent to Master of Economics – Economist with proficiency of foreign languages (Italian and English).



# Board of JSC "Latvijas Gāze"



*Anda Ulpe*

**Board Member**

JSC "Latvijas Gāze" Board member since 1997; working in the gas industry since 1984.  
2002 – University of Latvia, Master Degree of Social Sciences in Economics.



*Alexander Mikheyev*

**Board Member, Vice-chairman of the Board**

First Deputy of Head of Gas and Liquid Hydrocarbon Marketing and Processing Division of OJSC "Gazprom" since 2003; working in the gas industry since 1968.  
1968 – Moscow Oil and Gas Industry Institute named after I. M. Gubkin, Qualification of Engineer in design and operation of oil and gas pipelines, gas storage facilities and oil tanks.



*Ariāns Dāvis*

**Chairman of the Board**

JSC "Latvijas Gāze" Chairman of the Board since 1988; working in the gas industry since 1965.  
1997 – Physical Energy Institute of Latvian Academy of Sciences, Doctorate in Engineering (*Dr. sc. ing.*).

*Joerg Lumat*

**Board Member, Vice-chairman of the Board**

Vice-chairman of the Board of JSC "Latvijas Gāze" since 2006.  
2001-2006 – Head of Department at Eastern Gas Acquisitions Division of "E.ON Ruhrgas AG/Ruhrgas AG"; agreements concerning OJSC "Gazprom" shares, eastern gas purchases; working in the gas industry since 1998.  
2001-2004 – University of Hagen, Diploma in Business Administration (*Dipl.-Betriebswirt*).

*Gints Freibergs*

**Board Member**

JSC "Latvijas Gāze" Board member since 1997; working in the gas industry since 1984.  
1984 – Riga Polytechnical Institute, Engineer of Industrial Heat Energy.

# Shares and Shareholders

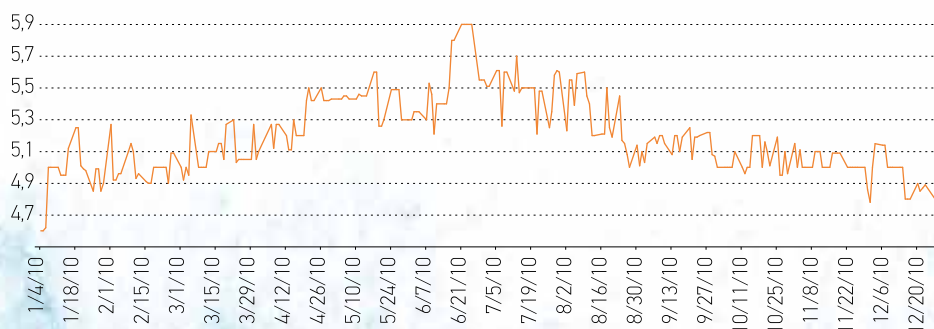
The shares of the JSC "Latvijas Gāze" have been quoted on the "NASDAQ OMX Riga" exchange since February 15, 1999. The share trade code as from August 1, 2004 is GZE1R.

In the reporting period, 25 328 520 of 399 million shares of the JSC "Latvijas Gāze" were in public trading. The nominal share value was LVL 1 (EUR 1.42).

ISIN LV0000100899  
 Stock exchange code GZE1R  
 Indexes B10GI, B10PI, OMXBBCAPGI, OMXBBCAPPI, OMXBBGI, OMXBBPI, OMXBGI, OMXBPI, OMXRGI

	2010	2009	2008	2007	2006
<b>Share price (LVL):</b>					
First	4.57	4.55	7.25	10.35	9.95
Highest	6.00	6.00	8.20	11.25	11.13
Lowest	4.57	3.32	3.62	7.05	9.27
Average	5.15	4.31	6.77	10.34	10.22
Last	4.90	4.10	4.55	7.12	10.32
Change	7.22%	-9.89%	-37.24%	-31.21%	3.72%
Share turnover. pcs	85 493	64 319	46 565	154 825	128 844
Share turnover. million LVL	0.440	0.277	0.315	1.600	1.316
Number of transactions	988	1 267	1 711	1 074	1 066
Profit per share	0.646	0.480	0.477	0.822	0.526
Capitalization (million LVL)	195.510	163.590	181.545	284.088	411.768

## JSC "Latvijas Gāze" share price 01.01.-31.12.2010.



### Increased Share Turnover and Capitalization Value

During the reporting year, the turnover of the Company's shares at "NASDAQ OMX Riga" reached 85 493 shares, exceeding the figure of 2009 by 21 174 shares. Value-wise, the share turnover of 2010 – LVL 0.44 million (EUR 0.63 million) – surpassed the results of the previous two years.

The capitalization value of the JSC "Latvijas Gāze" has grown – at the end of 2010 it reached LVL 195.51 million (EUR 278.19 million), which is by LVL 31.92 million more than at the end of the previous reporting period (LVL 163.59 million or EUR 232.77 million).

By the stock market capitalization value, the JSC "Latvijas Gāze" climbed to first place among the companies quoted at "NASDAQ OMX Riga", whereas among the companies quoted at "NASDAQ OMX Baltic" the JSC "Latvijas Gāze" was eighth, thus improving its positions compared to 2009 when the Company ranked second among the companies quoted at "NASDAQ OMX Riga" and ninth among those quoted at "NASDAQ OMX Baltic".

### Share Price Goes Up

The price of one share of the JSC "Latvijas Gāze" at "NASDAQ OMX Riga" fluctuated from LVL 4.57 (EUR 6.50) to LVL 6.00 (EUR 8.53) over the reporting year, thus having a lower range of fluctuations than in the previous reporting year when the share price at the stock exchange ranged from LVL 3.32 (EUR 4.72) to LVL 6.00 (EUR 8.53).

The peak of the share price on the market was reached in the second half of June 2010, while the lowest share price was observed at the very beginning of the year.

At the end of the reporting year, the share price reached LVL 4.90 (EUR 6.97), which is by 7.2% more than in late 2009 when one share of the company cost LVL 4.10 (EUR 5.83).

### Seventh Most Valuable Company in Latvia Structure of Shareholders Unchanged

According to the data of the annual study conducted by the company of investment bankers "IBS Prudentia",

"NASDAQ OMX Riga" and the business magazine "Kapitāls", the JSC "Latvijas Gāze" was the seventh most valuable company in Latvia in 2010.

The JSC "Latvijas Gāze" was ranked fifth and tenth in this list in 2009 and 2008 respectively.

It also emerges from the study that the value of the company this year is LVL 226.18 million, which is by 20% less than in 2009 when it was estimated at LVL 283.45 million.

### Structure of Shareholders Unchanged

The structure of shareholders of the JSC "Latvijas Gāze" did not change in the reporting year. At the end of 2010, the company had three shareholders with over 5% of the share capital – the German company "E.ON Ruhrgas

International GmbH" (47.2% of shares), the Russian OJSC "Gazprom" (34% of shares) and the LLC "ITERA Latvija" (16% of shares). 2.8% of shares are held by minor shareholders, including employees of Company.

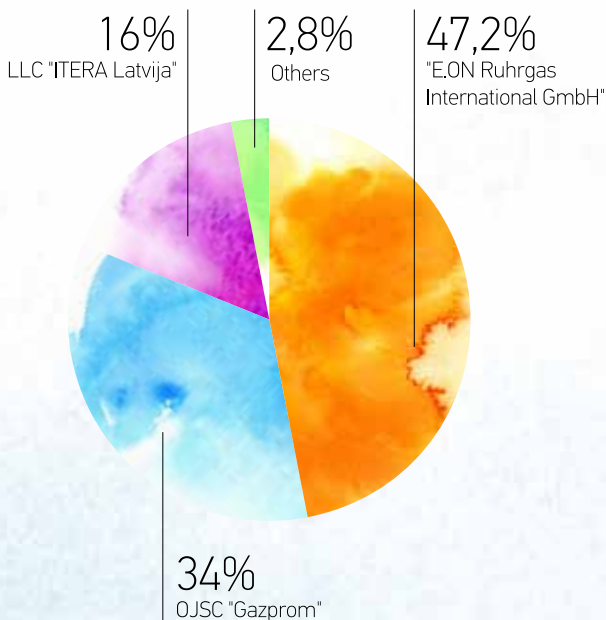
### Increased Amount of Dividends Paid

The draft distribution of the profit of 2010 prepared by the Board of the JSC "Latvijas Gāze" envisages the payment of dividends in the amount of LVL 0.50 (EUR 0.7) per share or LVL 19.95 million (EUR 28.39 million) in total, which equals 75.4% of the Company's profit in 2010.

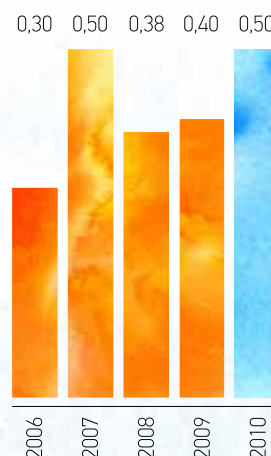
Compared with 2009, the amount of dividends due to be paid for one share has increased by LVL 0.10 or 25.0 %.

The above indicates that in the reporting year the JSC "Latvijas Gāze" has continued its successful operation yielding profit to the Company's shareholders.

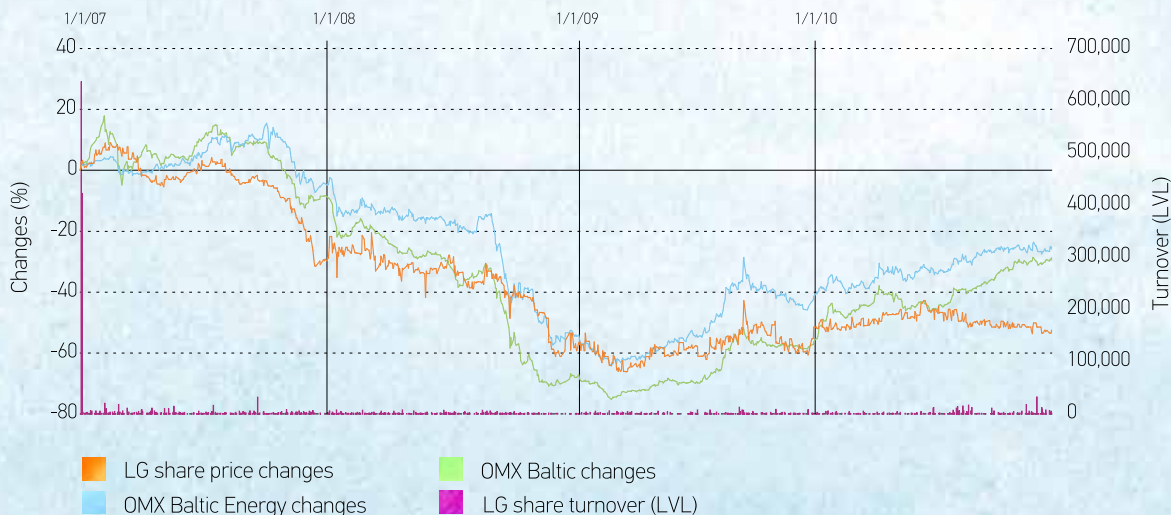
### Structure of shareholders of the JSC "Latvijas Gāze" (%) as at 31.12.2010.



### JSC "Latvijas Gāze" dividends per share (LVL share)



### JSC "Latvijas Gāze" share price, turnover and extension of OMX Riga, OMX Baltic, OMX Baltic Energy (01.01.2007. - 31.12.2010.)



# Natural Gas in the Energy Resources Market

## Trends of Energy Consumption

The cold weather and the increased electricity production in the reporting year have positively influenced energy, stimulating the overall energy production and consumption in the national economy.

According to the data of the Central Statistics Bureau of the Republic of Latvia, electricity production in 2010 reached 6627 gigawatt hours (GWh), which is by 19% more than the year before.

The overall electricity consumption in Latvia in 2010 was 7500 GWh, of which net electricity import was 12%, i.e. by 11% less than in 2009. Electricity consumption in the industrial sector grew by 5%, while households consumed 3% less electricity. The total net import of energy resources decreased by 27%, including a 53% net import drop for electricity and 8.2% for oil products.

The overall natural gas consumption in 2010 was 1 788 million m<sup>3</sup>, which is by 20% more than in the previous year. There was an increase in all consumer groups. The key factor of the increase was the cold winter early in the year, especially in January when the average temperature of the month was -11.5°C.

The use of natural gas in electricity production in the summer of 2010, for its part, was propelled due to electricity supplies to the Baltic region being cut because of repairs of electricity transmission lines in Russia. As a result, consumption by the JSC "Latvenergo" accounted for half of the consumption increase.

## Factors Influencing Development of the Natural Gas Market

A key factor, which was pronounced in the reporting year and will influence the development of the natural gas market in the future, is the development of cogeneration in Latvia.

More thermal energy and electricity was produced in 2010 than in any of the preceding ten years.

In 2010, there were 71 operative cogeneration stations in Latvia with the total electric capacity of 948 megawatts (MW), producing 3050 gigawatt hours (GWh) of electricity and 4673 GWh of thermal energy, which is 59% of the total volume of thermal energy produced. 98% of cogeneration stations used natural gas to produce electricity and thermal energy.

Within a year, the number of cogeneration stations in Latvia had grown by 15 and the installed electric capacity had increased by 14 MW.

An important factor with a potential adverse effect on the attraction of natural gas in the context of developing new cogeneration station projects is the amendments to the *Regulations on electricity generation and pricing of generating electricity in cogeneration* of the Cabinet of Ministers. Taking effect on November 1, 2010, these amendments envisage discontinuation of the state support, provided by the law "On the Electricity Market", to the development of cogeneration stations that produce energy using fossil energy resources, including natural gas.

However, the impact of those amendments is mitigated by the resolution passed by the Ministry of Economics in February 2010, whereby the proposal of the Board of the JSC "Latvenergo" to sign contracts on the implementation of the reconstruction project for the second stage of the Thermal Power Station-2 (TPS-2). In the long term, the implementation of the project will increase the demand for natural gas.

The new combined-cycle gas turbine power unit is designed to be similar to the first power unit of the TPS-2, which was put into operation in 2009. The unit's installed capacity will consist of 427 MW of electric capacity and 270 MW of thermal capacity. The technology of the new unit provides an efficiency factor of 37% in the condensation mode and 88% in the cogeneration mode – the old unit had an efficiency factor of 33% and 82% respectively, thus the new power unit will use the fuel more effectively.

The reconstruction of the second stage of the TPS-2 will cost EUR 332 million, and it is due for completion in 2014. The expected lifespan is at least 20 years for the gas turbine and 30 years for the steam turbine.

A notable event that might influence the natural gas market of Latvia and the Baltic region in whole is the possible construction of a liquefied natural gas (LNG) terminal. This project was revealed in 2010.

On December 14, 2010, the Council for Coordination of Large-Scale and Strategically Important Investment Projects, headed by the Prime Minister of the Republic of Latvia Valdis Dombrovskis, conceptually seconded the LNG terminal project and directed the JSC "Latvenergo" to carry out a preliminary study till mid-2011 regarding the feasibility of construction of an LNG terminal in Latvia so

that after studying the opinions the Council could decide whether to commence and implement the activities possible and planned in the project.

Although the Latvian government has defined the agreement with the other Baltic States regarding the construction of a liquefied natural gas terminal in Latvia as a strategic task, in practice there were many uncertainties concerning this issue during the reporting year, just as with the development of the project in general.

As a negative factor in terms of the competitiveness of gas one should mention the increase of tax rates determined by the state economic policy. A resolution passed in the reporting year stipulated that as of January 1, 2011 the reduced rate of the value added tax (VAT) applied to natural gas for household use would rise from 10% to 12% and the basic rate of the VAT would increase from 21% to 22%. Moreover, on June 8, 2011, it was decided to abolish the reduced VAT rate, thus as of July 1, 2011 the regular rate of 22% would apply to households as well. Another resolution envisages the application of excise tax to natural gas used by households and in heat supply as of July 1, 2011.

## Dynamics of Natural Gas Prices

The pricing of natural gas during the reporting period was determined by the prices of oil products (heavy fuel oil and diesel fuel) at the global exchanges, the fluctuations of currency rates (the euro and the US dollar), as well as natural gas reserves at the Inčukalns Underground Gas Storage Facility. Along with the aforementioned, the end-user tariffs of natural gas were also affected by tax fluctuations.

## Most Rapid Price Drop in Europe

According to calculations by Eurostat (see Eurostat. *Data in Focus 47/2010*), the natural gas prices in Latvia in the first half of 2010, compared with the first half of 2009, had the sharpest drop in the European Union. Eurostat estimates that in the first half of 2010 natural gas cost by 40% less for households and by 34% less for industrial customers year-on-year. The natural gas price had fallen from 10.27 LVL/GJ to 6.18 LVL/GJ for households and from 7.68 LVL/GJ to 5.08 LVL/GJ for industrial customers.

## Price Increase in the Second Half-year

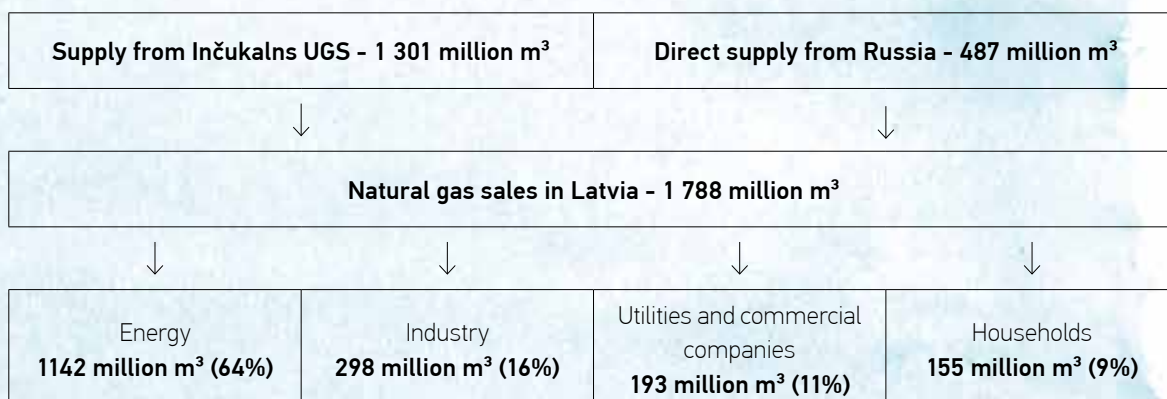
The natural gas tariffs for industrial customers, which had been falling throughout 2009 and reached their lowest point in November, remained low till March 2010. Over that time, the consumers were partially supplied from the Inčukalns UGS with natural gas purchased in the autumn of 2009.

With the beginning of the new natural gas injection season in April, the tariffs for industrial customers began to increase rapidly, reaching their maximum in the summer months of 2010, then decreased, but still remained above the level of March 2010. The rise stemmed from the increased oil prices, as well as excise tax which was briefly – from July 1 through August 31, 2010 – applied in the amount of LVL 15.6 (EUR 22.2) per 1000 m<sup>3</sup> of natural gas.

## Changes in Contractual Provisions

In 2010, the JSC "Latvijas Gāze" began negotiations with the main natural gas supplier the OJSC "Gazprom" on changes in the natural gas price calculation formula that could result in a lower level of natural gas prices in 2011. Eventually, in December 2010 the JSC "Latvijas Gāze" signed an agreement with the OJSC "Gazprom" on the calculation of natural gas supply price for the following year. The agreement envisaged a reduction by 15% under equal conditions compared with the previous price calculation formula.

## Natural gas flows in 2010



# Development

## JSC "Latvijas Gāze" Collaborates with the European Commission

The reporting year saw a continuation of the previously commenced collaboration with the European Commission (EC). The JSC "Latvijas Gāze" considers reliable natural gas supplies to the consumers its main objective, therefore one of the company's priorities on an international scale in 2010 was the work on preparing documents meeting the requirements of the Regulation (EU) No. 994/2010 of the European Parliament and the Council concerning measures to safeguard security of gas supply.

Together with the Ministry of Economics (MoE) and the Public Utility Commission (PUC), an *Assessment of Natural Gas Supply Risks in Latvia* was prepared and submitted to the EC.

In order to draw up a joint assessment of natural gas risks in the Baltic States and accordingly a plan to eliminate these risks, the *Working Group of Regional Collaboration for the Security of Gas Supply* was set up following an initiative by the EC, and the JSC "Latvijas Gāze" was also involved in its work.

The preparation of the assessment of Baltic natural gas supply risks in collaboration with Lithuanian and Estonian colleagues continues in 2011.

## Implementation of Baltic Energy Market Interconnection Plan

The reporting year saw progress in implementing the *Baltic Energy Market Interconnection Plan* (BEMIP) started in 2009.

A special working group, initiated by the EC, was set up of representatives of the Finnish, Estonian, Latvian, Lithuanian and Polish transmission system operators, ministries responsible for the energy sector, and regulators. The main task of the working group was to aggregate information on the investment projects in the region, notably plans of building liquefied natural gas (LNG) terminals and the related infrastructure, and to submit this information to the *High-level working group* composed of representatives of the EU countries' governments.

Based on the information prepared, the aforementioned working group will have to decide upon a single LNG terminal to be co-funded by the EC in the region.

The company actively participated in the working group, preparing the necessary information regarding the infrastructure objects required for a successful operation of the terminal.

## Documents for Future Support by EU Funds under Preparation

Latvia has begun to develop its national position for the new period of acquisition of the EU funds, which will run from 2014 through 2020. The position will determine the fields and projects eligible for future support by EU funds.

During the reporting period, the JSC "Latvijas Gāze" in collaboration with the MoE prepared a brief project of development of the Latvian gas supply system covering the development of both the Inčukalns UGS and the gas pipeline networks. The project is included in the list of projects recommended for the EU funding by the Ministry of Foreign Affairs of the Republic of Latvia.

## Detached Houses Dominant among New Connections

The number of new natural gas connections of the JSC "Latvijas Gāze" in the reporting year reached 901. Those included 24 industrial and 64 commercial customers, but the majority (71%) were detached houses (640) and apartments with natural gas heating (128) and gas stoves (45). Furthermore, 208 other objects were increased capacity during the reporting year, including 171 gas-enabled apartments, which had heating boilers installed.

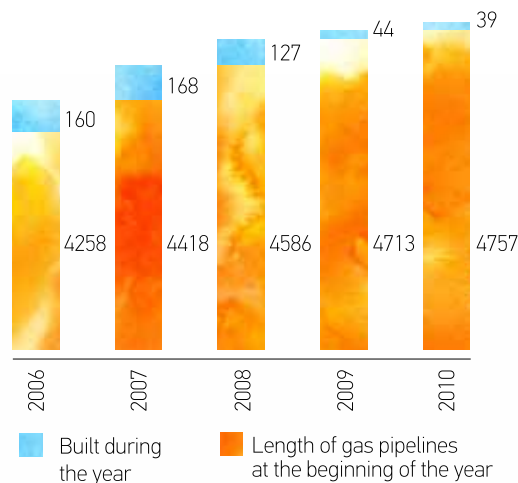
In 2010, the natural gas consumption by the newly connected customers and those with increased capacity was 4.3 million m<sup>3</sup>. More than a half of the new consumption, i.e. around 2.3 million m<sup>3</sup>, was brought by industrial customers.

Since 2010, with the Company's initiative, the customers have been provided a simpler model of connection building with a unified pricing of construction and design services provided by ten design and construction companies – collaboration partners of the JSC "Latvijas Gāze". It is an important step towards offering to customers a more comprehensible and in most cases lower-priced solution of connection.

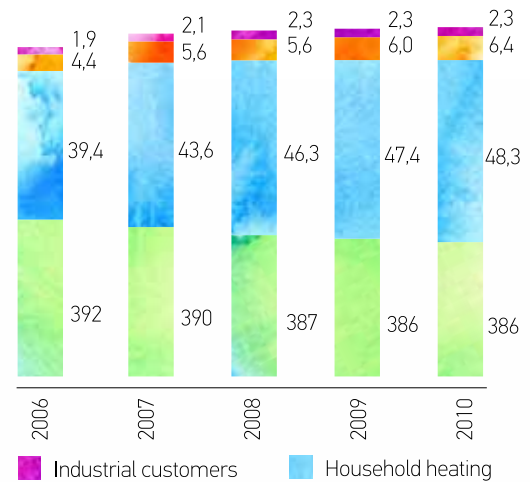
## LVL 1.9 million Invested in Development of Networks

In 2010, the JSC "Latvijas Gāze" invested LVL 1.9 million in the development of the natural gas distribution networks. Overall, 39 km of new gas distribution pipelines were built. The direct investments of the JSC "Latvijas Gāze" in construction objects reached LVL 1.5 million, with 33 km of gas distribution pipelines built, while

## Construction of new gas pipelines (km)



## Number of JSC "Latvijas Gāze" customers (thousands)



LVL 0.1 million was spent on construction objects developed on the basis of authorization contracts, with 6 km of pipelines built. 1.8 km of high-pressure gas pipeline has been replaced in Liepāja, investing LVL 0.3 million. Within the framework of direct investment construction objects, 5 km of branch lines were built.

## Work with Potential Customers Becomes More Intense

During the reporting year, the Customer Promotion Department of the JSC "Latvijas Gāze" did a lot of work in exploring customers not only in those construction objects where new gas distribution pipelines are due to be built, but also in objects already gas-enabled. In order to strengthen the aforementioned direction within the framework of the Customer Promotion Department, a dedicated group was set up to attract customers in gas-enabled construction objects.

Each customer receives an offer for implementing the particular connection based on the most efficient solution possible, and the planned expenses of natural gas connection are evaluated together with the customer and in collaboration with the partners of the JSC "Latvijas Gāze" – design and construction companies.

The reporting year saw amendments to the methods of the JSC "Latvijas Gāze" used in determining the total connection costs upon connecting the natural gas users' gas supply systems to natural gas distribution pipelines and increasing the permissible load, which provides for the alignment and simplified application of the connection fee.

## Gas Pipeline of Riga Bypass Line Now Completed

The main project of the reporting year in the field of gas distribution pipelines was the construction of a

high-pressure gas pipeline on the Riga bypass line.

The year 2010 saw the completion of the 500 mm high-pressure gas distribution pipeline of the third stage of the Riga bypass line started in the previous year and the related infrastructure along the motorway A5 (Salaspils-Babīte) from Gaismas to Ķekava.

The total costs of the 14 km gas pipeline were LVL 2.7 million. In the reporting year, a 6.7 km section thereof was built with an investment of LVL 0.9 million. With the implementation of this project, the construction of the high-pressure distribution system of the 40 km Riga bypass line was completed, enabling additional security and stability of supply for customers in Riga and the vicinity.

One should also mention the gasification of Garciems housing estate in Carnikava municipality, with 9 km of gas transmission pipelines built in 2010 (investment of LVL 0.2 million), as well as the newly built gas transmission pipelines in Baltezers of Ādaži municipality, the housing estates of Valteri and Kaugurciems in the town of Jūrmala, as well as the replacement of 1.8 km of high- and mid-pressure gas pipelines in the city of Liepāja (LVL 0.3 million).

## Improvement of IT Services

The year 2010 saw the completion of the 2<sup>nd</sup> stage of the customer e-services portal development with improvements in operation and the range of services. During the reporting year, industrial customers began to use the portal, and at the end of the year the number of users reached 30% of the number of customers. A more active attraction of household customers began in summer after the change of tariffs, and at the end of the year around 10% of household customers used the portal. Improvements in terms of the range of services continue in 2011.



# Inčukalns Underground Gas Storage Facility



The structure of the JSC "Latvijas Gāze" includes the Inčukalns Underground Gas Storage Facility, which is the only functioning storage facility in the Baltic States, and it ensures the stability of regional gas supply. During the summer season when natural gas consumption in the region is several times lower than in cold weather, natural gas is injected into the facility for delivery to customers in Latvia, Estonia, the Northwestern Russia and (to a lesser extent) Lithuania in the heating season. With the help of the facility, the reliability and capacity of natural gas supplies to Latvian customers does not depend on the demand in other countries because during the heating season they are fully supplied with natural gas from the Inčukalns UGS.

## Operation Figures of Inčukalns Underground Gas Storage Facility

The natural gas injection season at the Inčukalns UGS started on April 12, 2010. Upon the beginning of natural gas injection, the reserves of natural gas at the Inčukalns UGS were 51 million m<sup>3</sup>. The injection season at the Inčukalns UGS was completed on October 18, 2010, and in the course thereof 2034 million m<sup>3</sup> of natural gas was injected, which is by 820 million m<sup>3</sup> more than in 2009. At the end of the injection season, the volume of active natural gas at the Inčukalns UGS reached 1992 million m<sup>3</sup>, which is by 83 million m<sup>3</sup> less than at the end of the previous injection season. The injected volumes fully covered the natural gas consumption needs during the heating season of 2010-2011 in Latvia, as well as the neighbouring countries' demand.

During the injection season of 2010, gas injection into the Inčukalns UGS was twice interrupted, switching to the gas extraction mode. These transitions took place due to repairs on the gas transmission pipeline Valdai-Pskov-Riga.

## Modernization of Wells

In the reporting year, the modernization of fifteen wells in accordance with the best European practice began. The modernization of wells will improve their safety and reduce the risks of failure. The project is implemented using the co-funding granted by the European Commission, and this is the first experience of the employees of the Inčukalns UGS in such kind of a project. For instance, in order to avoid inter-column gas migration, such innovative technologies as sectional perforation and filling of migration paths with a special substance, thermo-gel, are used. The costs of well modernization are LVL 7 million, while those of the whole project approach LVL 10 million. The project is due for completion in 2011.

The EC resolution was based on the project of the increase of gas pipeline connection capacity and the enhancement of security of gas supply between Latvia and Lithuania, prepared by the JSC "Latvijas Gāze" jointly with colleagues from the JSC *Lietuvos Dujos* within the framework of the *European Energy Program for Recovery* (EEPR) and submitted to the EC in 2009. The project is due for completion by the end of 2011.

It should be added that in November 2010 representatives of the EC visited the construction objects and were satisfied with the course of implementation of the project.

## Development of Geographic Information System (GIS)

The reporting year saw the development of the geographic information system (GIS) database for the Inčukalns UGS, and the project is to be completed in 2011. The total costs of the GIS project are almost LVL 300 000. Using the GIS system, it will be possible to obtain visual and technical information on any object at the Inčukalns UGS. The information system will enable the company to accumulate, analyse and visualise the information on the objects of the Inčukalns UGS.

## Further Construction of Gas Drying Unit

In 2010, the construction of a gas drying unit within the framework of compressor shop No.1 continued. In July, the supplies of technological equipment by the company "Pietro Fiorentini S.P.A." were completed, making it possible to begin the assembly of the gas drying installations.

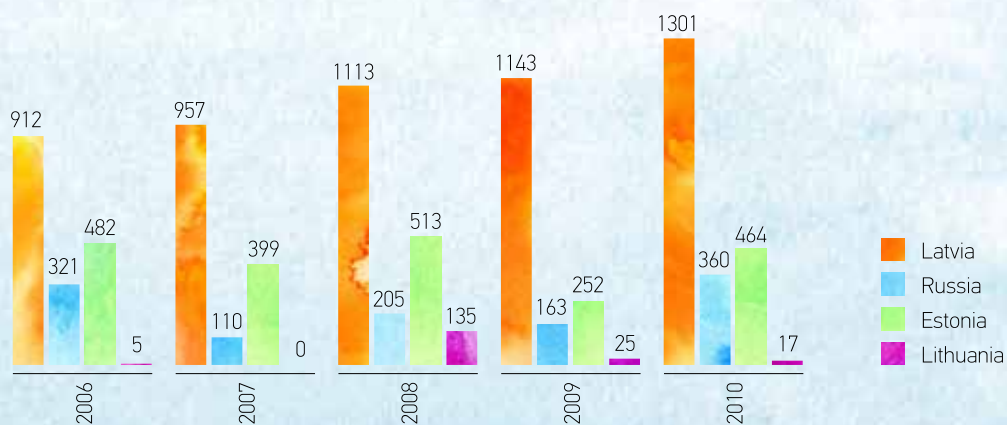
The construction of the gas drying unit is due for completion in 2011. When the new complex is put into operation, the storage facility will have a better daily gas extraction capacity. The total construction and equipment costs are approximately LVL 9 million.

## Repair at Compressor Shop No.2

In the reporting year, the capital repair of compressor No.5 at the second compressor shop of the Inčukalns UGS began. The ensemble of compressor shop No.2 consists of five gas-powered combustion motor compressors, which ensure the increase of natural gas pressure and the injection of natural gas into the facility.

With the aggregate having undergone capital repair, there will be lower risks related to possible damages and facility idleness during repairs. The capital repair of the compressor is due to be completed in 2011, with the total costs of the project around LVL 1.3 million.

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



# Natural Gas Transmission

The structure of the natural gas transmission system of the JSC "Latvijas Gāze" includes gas transmission pipelines (hereinafter – GTP), gas regulation stations (hereinafter – GRS), anticorrosive electrochemical protection equipment for underground pipelines, communication and remote control lines, the information system SCADA and the commercial international metering station *Korneti*.

The functions of natural gas transmission system operator are performed by the operation unit "Gas Transport". Its duties also include reception of natural gas from Russia and its supply for injection into the Inčukalns UGS, supply to the natural gas distribution system, as well as transmission to foreign countries. Furthermore, "Gas Transport" is responsible for gas pressure regulation in the natural gas transmission system, its purification, odorisation and commercial metering.

The JSC "Latvijas Gāze" invested approximately 6.9 million lats in modernizing the gas transmission pipeline system. This amount is around 30% of the Company's total investments.

## Reconstruction of GTP *Rīga-Panevežys* Begins, Co-funded by EC

On May 1, 2010, the capital repair of the underwater passage of the GTP *Rīga-Panevežys* across the River Daugava was started. The construction operations are part of the joint project of the JSC "Latvijas Gāze" and *Lietuvos Dujos AB* entitled *Enhancement of bidirectional flows between Latvia and Lithuania*, co-funded by the European Commission (EC). The cost of the Daugava crossing is EUR 5 million, half of which has been granted by the EC.

The construction was performed by the LLC "Baltijas Energo Būve" in collaboration with the JSC "Latvijas Gāze". The key stage of the capital repair was the laying of the pipeline crossing the river, and it involved the horizontal directional drilling method. This job was entrusted to the German company "LMR Drilling".

By the end of 2010, within the framework of the capital repair of the underwater passage, the development and agreement of detail design had been completed and the construction permits had been received. In order for the reconstruction not to hinder natural gas flows, two temporary bypass lines were built on the gas pipeline *Rīga-Panevežys*. Using the horizontal drilling method,

a drill hole of 1 500 metres in length and 900 mm in diameter was created, and two gas pipes of 775 metres in length and 700 mm in diameter, to be laid in the drill hole, were welded and checked onshore.

Having assessed the risks emerging from operating the equipment used in the construction of the underwater passage in the winter period and the possibility that the pipeline might stick inside the drilling channel, in December 2010 the Board of the Company decided to suspend the construction of the underwater passage of the GTP *Rīga-Panevežys*, scheduling its resumption for 2011 when the air temperature would become favourable for construction activities.

## Preparation of Gas Transmission Pipelines for Diagnostics

During the reporting year, the company continued the preparation and performance of GTP diagnostics. The method applied is internal GTP diagnostics via pigs that ensure multi-stage cleaning and intelligent diagnostics of gas pipelines. Before performing diagnostics, the operation unit "Gas Transport" needs to build pig launcher and pig receiver units and replace the GTP line valves, the internal permeability of which prevents the pigs from moving freely along the pipelines. In the reporting period, the JSC "Latvijas Gāze" completed the preparation of the GTP *Iecava-Liepāja* and *Rīga-Panevežys* for pigging.

In order to improve the operation safety of the GTP system, it was decided to perform diagnostics on gas pipeline branches to GRS as well, using portable mobile chambers. For this purpose, six portable pig chambers were purchased in 2010.

## Diagnostics of GTP *Iecava-Liepāja*, *Rīga-Panevežys* and *Rīga-Inčukalns UGS*

The internal GTP diagnostics and a due elimination of defects found thereby ensure unhindered functioning and safety of the transmission system. The internal diagnostics of pipes is performed with a view to determine the maximum permissible operating pressures of GTP in order to be able to maintain a higher pressure in the pipelines if the natural gas volumes to be transmitted increase in the future. Despite the considerable expense involved, the diagnostics completed so far have met expectations.

During the reporting year, the Company in collaboration with "Weatherford Kopp GmbH" continued the internal diagnostics of the GTP *Iecava-Liepāja*, which had been started in 2008. This gas pipeline was built in 1966 and is second oldest in Latvia. Based on the first results of diagnostics, the analysis of report, the inspection of defects and the repair began in 2010 with the help of specialists from the *Physically Technical Institute of Belarus*. The diagnostics of pipeline and the repairs of defects found thereby are due for completion in 2012.

The reporting year also saw further internal diagnostics of the GTP *Rīga-Panevėžys* in collaboration with the companies "ROSEN Europe b.v." and "Lietuvos Dujos AB". The diagnostics on this pipeline will also continue in 2011, whereas the elimination of defects is due to extend till 2014.

In October 2009, an agreement was signed with the company "ROSEN Europe b.v." concerning the internal diagnostics of both lines of the GTP *Rīga-Inčukalns UGS*. The diagnostics of both gas pipelines was fully completed in the reporting year, whereas the elimination of defects found thereby is due for completion in 2011.

## Repair of Gas Transmission Pipelines

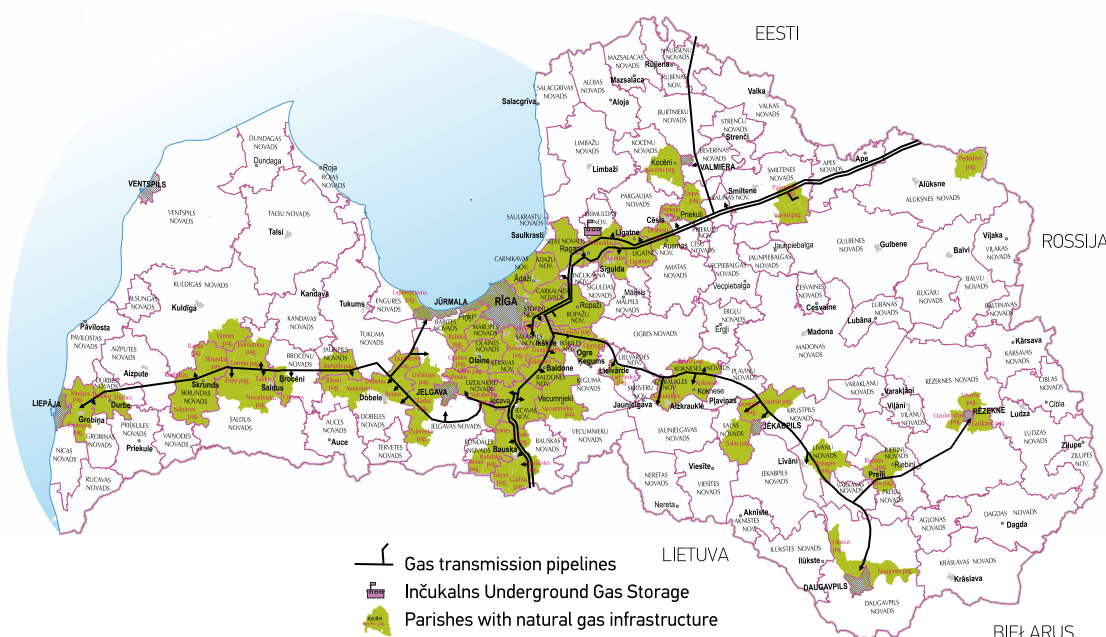
After inspecting the defects found and analysing their danger, the operation unit "Gas Transport" develops a programme of inspection and repair of damaged gas pipelines. In 2010, based on such a programme, damaged pipes were replaced on GTP *Pskov-Rīga* and *Rīga-Inčukalns UGS*. Based on the data of internal GTP diagnostics, repairs took place on GTP *Rīga-Daugavpils* and *Iecava-Liepāja*.

The amount of outer anti-corrosion coating renovated on GTPs in 2010 exceeded 5 000 metres. The GTPs undergoing the renovation of coating were *Rīga-Inčukalns UGS* and *Pskov-Rīga*.

In order to raise the level of GTP operation safety, taking into account the results of studies of previous years and in line with the fixed assets maintenance programme of the JSC "Latvijas Gāze", thirteen underwater passages across small rivers, brooks and ditches were repaired in 2010, including renovation of outer anti-corrosion coating.

During the reporting year, the Company reconstructed ten cathodic protection stations and replaced 48 outdated gas transmission system valves.

## Parishes with natural gas infrastructure



# Personnel

## Labour Force Demand and Supply Trends in Latvia in 2010

According to the data of the Central Statistics Bureau of the Republic of Latvia, the proportion of job seekers among the economically active population was 20.5% in the 1st quarter of 2010. Starting with the second quarter, the unemployment indices improved and a gradual decrease of the level of unemployment was noticeable every month. In the 4th quarter of 2010, the proportion of job seekers among the economically active population of the country fell to 16.9%. Although the officially registered level of unemployment diminished, the number of job seekers was still high, and in the 4th quarter of 2010 there were 193 400 job seekers in Latvia.

## Structural Labour Force Changes

As at December 31, 2010, there were 1 257 permanent employees at the JSC "Latvijas Gāze". Thus, the number of employees at the Company has remained at approximately the same level as at the end of the previous reporting year.

42% or 525 employees had been working at the Company for up to ten years, 34% (422) – from 11 to 20, 16% (204) – from 21 to 30, 7% (93) – from 31 to 40, and 1% (13) had been working at the company for 41 and more years.

In 2010, 15% of the Company's employees were up to 30 years of age, 18% – from 31 to 40, 23% – from 41 to 50, 34% – from 51 to 60, while 10% were older than 61 years.

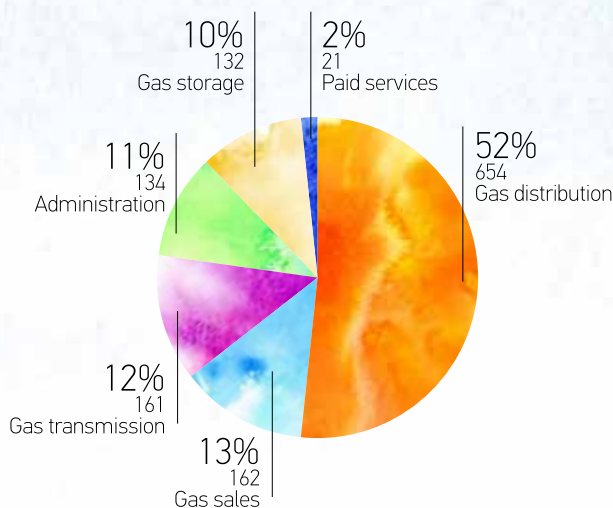
Implementing the staff policy, the previous reporting year saw a considerable decrease of the number of pensionage employees, while the proportion of employees in the age groups of up to 30 and 31 to 40 grew. These trends continued in 2010.

The instability of the labour market, which resulted in employees quitting the Company and the unwillingness of young employees to work at one Company for a long time seeking a higher salary and better social guarantees, has ended. The reporting year saw the situation change, and the proportion of employees who have been working at the Company for up to ten years is now higher and fewer employees are choosing to quit the Company.

## Description of Employees by Areas of Activity

The average breakdown of the employees of the JSC "Latvijas Gāze" by areas of activity in 2010: 52% of employees worked at gas distribution, 13% - at gas sales, 12% - at gas transmission, 11% - at administration, 10% - at gas storage and 2% - at the department of paid services.

## Breakdown of employees by areas of activity, % avg No. of people



## Changes in Operation Unit "Gas Transport"

In order to ensure that work on corrosion protection of gas transmission pipelines is organized effectively, the Electrochemical Protection Service was formed as part of the operation unit "Gas Transport" and took over the functions of the operation of cathodic protection stations, repairs and intensive measurement from the Line Maintenance Service.

On April 1, 2010, the automobile gas filling compressor stations *Rīga-2*, *Liepāja* and *Daugavpils* were closed, and on May 1, 2010, the structural unit *Automobile Gas Filling Compressor Service* with 15 staff units was excluded from the operation unit *Gas Transport*.

## Education

As of the end of the reporting year, 31% of the employees of the JSC "Latvijas Gāze" had a higher education, 40% – a secondary special education, 25% – a secondary education, and 4% – an elementary education. Compared with the previous reporting year, there have not been notable changes in this field.

### Higher Costs for Professional Education and Qualification-Raising

The education and qualification-raising of the Company's employees is ensured both by promoting the acquisition of academic education and via various training programmes, learning from foreign experience and participating in conferences, courses and seminars.

The JSC "Latvijas Gāze" spent LVL 87 600 on the professional education and qualification-raising of employees in 2010 and LVL 67 000 in 2009.

For the academic education at the higher education establishments of Latvia, with studies in the speciality of gas technologies as priority, in 2010 the Company granted material backing to fourteen employees in the total amount of LVL 20 134 to cover the study fee of the academic year 2010/2011, the state compulsory social insurance contributions and the personal income tax.

Apart from that, in 2010 grants worth LVL 20 348, including LVL 10 368 for the second semester of the academic year 2009/2010 and LVL 9 980 for the first semester of the academic year 2010/2011, were paid to 24 employees.

In 2010, seven employees obtained a higher education funded by the JSC "Latvijas Gāze". Six of them took a bachelor degree, one – a master degree.

Also in 2010, two JSC "Latvijas Gāze" scholarship holders continued studies at the Russian State Oil and Gas University named after I. M. Gubkin. Currently, there are

eleven graduates of the afore-mentioned university employed by the Company, and nine of them were granted the Company's scholarship during their studies.

### Operation of Training Centre

Compared with the previous reporting period, the operation of the Company's Training Centre intensified in 2010. This is by the fact that the number of people taught has remained at the level of the previous year (99%). However, there was a decrease in the number of groups (85%), and the number of man-hours, which was 66% of the figure for 2009.

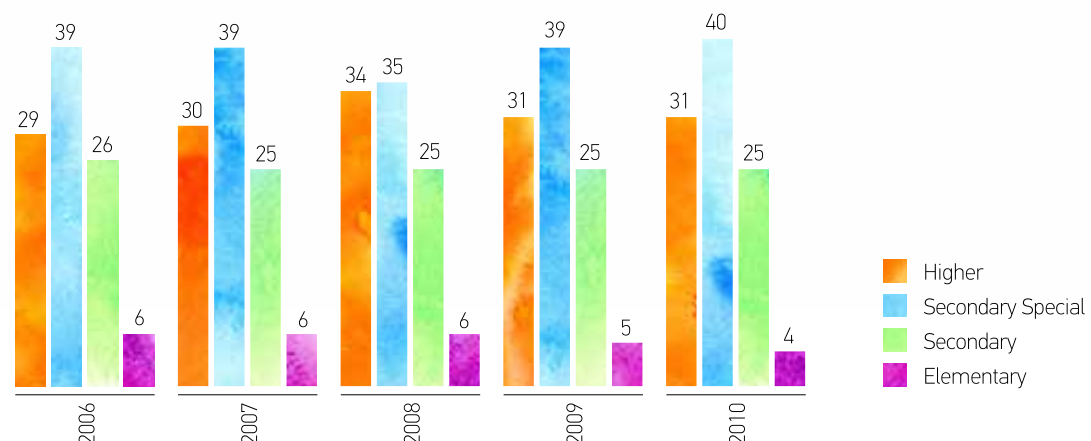
In 2010, 1 384 employees of the JSC "Latvijas Gāze" and 879 employees of other companies were taught at the *Training Centre*. According to the data of the Training Centre, the number of employees of the JSC "Latvijas Gāze" taught in the reporting year has grown by 130%, whereas that of employees of other companies has fallen by approximately 28%.

Among other activities of the Training Centre one should mention the development of the training centre informative system. In the reporting year, the section Training Centre on the Company's website obtained its full functionality, including that of electronic application for training. Over the period from July 2010 through to the end of the year, almost 300 electronic applications for Training Centre courses were processed.

The reporting year also saw the development and approval of the procedure of organization of training of the JSC "Latvijas Gāze" employees and the revision of the existing curricula, questions of exam tickets, handouts of listeners and lecturers.

It should be added that in 2010 two partnership contracts on participation in attracting EU funds for training the Company's employees in 2011-2013 were signed.

### Education profile of employees (%)



*A drop of water and paint. When it touches the paper, it lays out the morning fog over the plains of Lemgale in thick swathes.*

## *International Co-operation*

JSC "Latvijas Gāze" developed in three main directions. Firstly, co-operation with the Company's shareholders, followed by co-operation with the gas companies of other countries, as well as various international organizations.

### Co-operation with Company's Shareholders

The year 2010 saw the continuation of the previously established co-operation with specialists of the Company's shareholders OJSC "Gazprom" and "E.ON Ruhrgas AG" or their subsidiaries.

The main areas of co-operation during the reporting year were a further modernization of the Inčukalns UGS, the improvement of operation safety of the gas supply system, the issues of operation of gas transmission pipelines, the pigging of gas pipelines, the work with customers etc.

### Co-operation with "E. ON Ruhrgas AG"

Under the co-operation agreements signed with "E. ON Ruhrgas AG", support was received from the German colleagues in such fields as natural gas sales and marketing, the organization of work with customers and

the assessment of individual operation units in terms of work with customers.

"E. ON Ruhrgas AG" advised the employees of the Latvian enterprise on numerous specific procurement issues, such as placing orders using digital catalogues, the structure of umbrella agreements, the organization of purchase tender procedure, the evaluation of suppliers, the optimization of warehouse reserves etc.

The specialists of the Company were also consulted upon issues related to the latest natural gas technologies.

Within the framework of co-operation, the employees of the Company both met with their German colleagues in Latvia and visited Germany, mainly "E. ON Ruhrgas AG" and other structural units of "E. ON", participating in some forums, such as the marketing days conference *Dialogmarketingtage 2010*, and other events.

One should also mention the support of "E. ON Ruhrgas AG and Open Grid Europe GmbH" for the construction of the new natural gas passage across the River Daugava. Since the JSC "Latvijas Gāze" has no experience in using horizontal directional drilling technologies, the recommendation of the German colleagues are of particular importance for the successful implementation of this project.



## Visit of "E. ON Gas Storage AB" Employees at Inčukalns UGS

In June 2010, the return visit of the colleagues from "E.ON Gas Storage AB" took place. They were fully briefed about the Inčukalns UGS and gas transport issues.

During the visit of the German colleagues in Latvia, the specialists developed direct contacts and extensive discussions. To continue the co-operation, representatives of the JSC "Latvijas Gāze" will visit the German colleagues next year.

## Participation in International Organizations

The Company continued to develop its participation in international organizations. During the reporting period, the JSC "Latvijas Gāze" took part in the activities of the International Gas Union, the German Technical and Scientific Association for Gas and Water *DVGW (Deutsche Vereinigung des Gas- und Wasserfaches)*, the World Energy Congress, the professional unions *Eurogas* and *Baltic Gas*, as well as the Inter-republic Association for Applied and Science-Technical Gas Co-operation.

Among the activities in the reporting year, one should highlight the successful co-operation with the German Technical and Scientific Association for Gas and Water *DVGW*. During the classes held at the training centre of the JSC "Latvijas Gāze", the employees of *DVGW* informed the specialists on the new technical regulations of internal natural gas pipeline installations. There was an exchange of information with the German colleagues regarding other news in the field of technical norms as well.

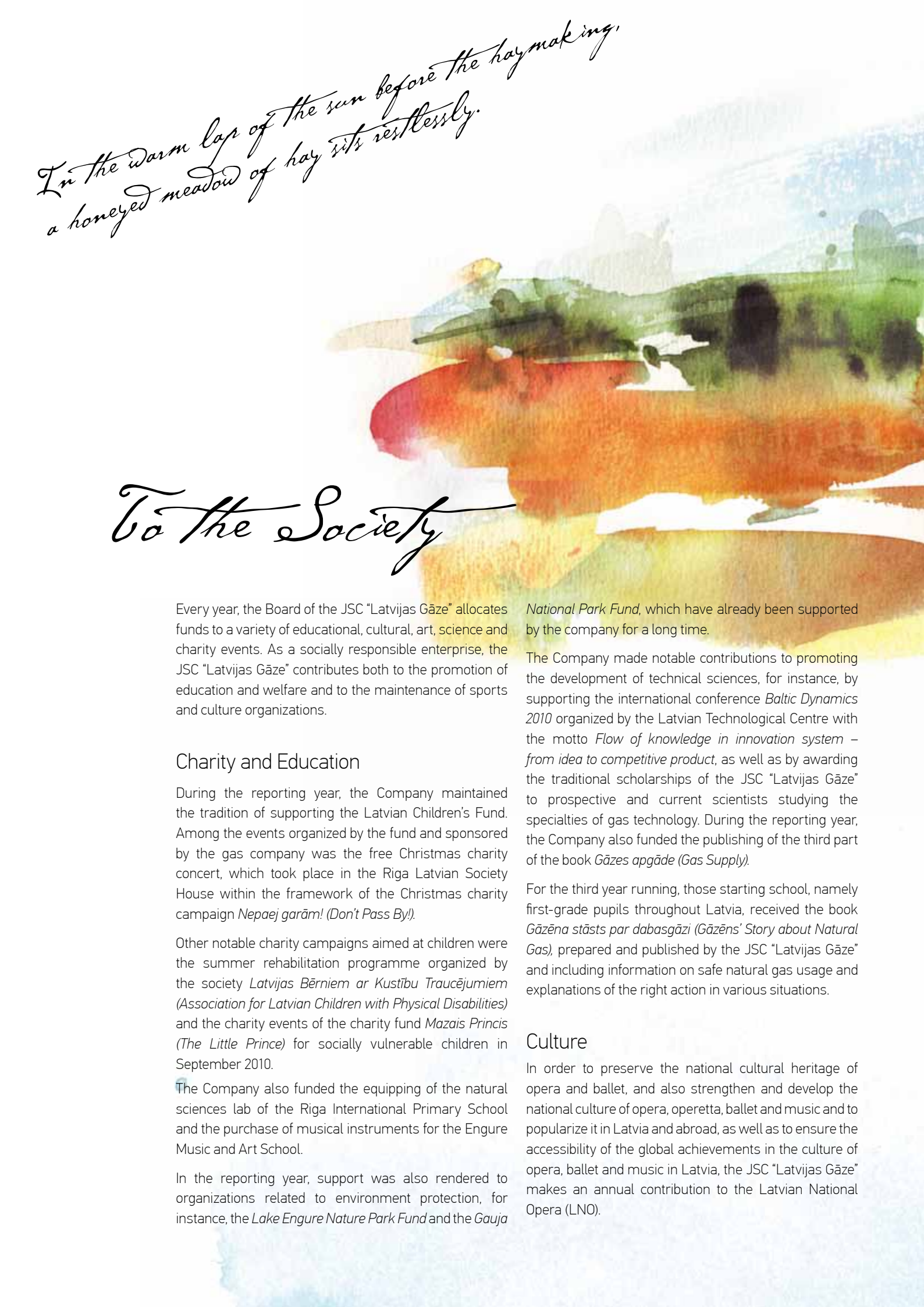
## Application for Participation in Organization of European Gas Transmission System Operators

The JSC "Latvijas Gāze" addressed the *European Network of Transmission System Operators for Gas (ENTSOG)* with a request to admit the company as an associated member of this organization.

*ENTSOG* was established on the basis of the Regulation No.715/2009 of the European Commission and the Council with an aim to form a common European gas market and develop cross-border natural gas trading.

The JSC "Latvijas Gāze" has submitted to this organization projects that have already been included in the ten-year development plan of *ENTSOG*. This activity is also one of the preconditions for receiving support from the EC.





*In the warm lap of the sun before the haymaking,  
a honeyed meadow of hay sits restlessly.*

## *To the Society*

Every year, the Board of the JSC "Latvijas Gāze" allocates funds to a variety of educational, cultural, art, science and charity events. As a socially responsible enterprise, the JSC "Latvijas Gāze" contributes both to the promotion of education and welfare and to the maintenance of sports and culture organizations.

### Charity and Education

During the reporting year, the Company maintained the tradition of supporting the Latvian Children's Fund. Among the events organized by the fund and sponsored by the gas company was the free Christmas charity concert, which took place in the Riga Latvian Society House within the framework of the Christmas charity campaign *Nepaej garām!* (*Don't Pass By!*).

Other notable charity campaigns aimed at children were the summer rehabilitation programme organized by the society *Latvijas Bērniem ar Kustību Traucējumiem* (*Association for Latvian Children with Physical Disabilities*) and the charity events of the charity fund *Mazais Princis* (*The Little Prince*) for socially vulnerable children in September 2010.

The Company also funded the equipping of the natural sciences lab of the Riga International Primary School and the purchase of musical instruments for the Engure Music and Art School.

In the reporting year, support was also rendered to organizations related to environment protection, for instance, the *Lake Engure Nature Park Fund* and the *Gauja*

*National Park Fund*, which have already been supported by the company for a long time.

The Company made notable contributions to promoting the development of technical sciences, for instance, by supporting the international conference *Baltic Dynamics 2010* organized by the Latvian Technological Centre with the motto *Flow of knowledge in innovation system – from idea to competitive product*, as well as by awarding the traditional scholarships of the JSC "Latvijas Gāze" to prospective and current scientists studying the specialties of gas technology. During the reporting year, the Company also funded the publishing of the third part of the book *Gāzes apgāde* (*Gas Supply*).

For the third year running, those starting school, namely first-grade pupils throughout Latvia, received the book *Gāzēna stāsts par dabasgāzi* (*Gāzēns' Story about Natural Gas*), prepared and published by the JSC "Latvijas Gāze" and including information on safe natural gas usage and explanations of the right action in various situations.

### Culture

In order to preserve the national cultural heritage of opera and ballet, and also strengthen and develop the national culture of opera, operetta, ballet and music and to popularize it in Latvia and abroad, as well as to ensure the accessibility of the global achievements in the culture of opera, ballet and music in Latvia, the JSC "Latvijas Gāze" makes an annual contribution to the Latvian National Opera (LNO).

The co-operation of the JSC "Latvijas Gāze" and the LNO began in 2005. As is traditional, the new theatre season is inaugurated by the ceremony of the JSC "Latvijas Gāze" Award and the concert of the laureates, which is one of the major cultural events of the year. In 2010, the award was presented in seven nominations. *The Tryptich*, consisting of three one-act plays by Giacomo Puccini: *The Cloak*, *Sister Angelica* and *Gianni Schicchi*, was named the best LNO production of the season.

In 2010, the Company also sponsored a new production of the opera *Eugene Onegin* and funded the purchase of a new lighting console for the LNO.

The Company's support was also rendered to a new staging of William Shakespeare's play *Twelfth Night* at the Mikhail Chekhov Riga Russian Theatre, a new staging of *The Story of Adam* at the Latvian National Theatre, as well as some activities of the Liepāja and Daile Theatre.

Furthermore, in 2010, the Company supported such highlevel cultural events as the concert at the Rundāle Castle on October 17, 2010 – devoted to the 200<sup>th</sup> anniversary of Frederic Chopin and organized by the Hermann Braun Foundation, the annual Bach music festival etc.

In order to nurture the development of Latvian dance, support was rendered to the folk-dance ensemble *Vektors* (*Vector*) of the Riga Technical University for participation in the international folklore festival *Pierides Musses* and to the Latvian Dance Sport Federation for organizing the Latvian championship in Latin American dances and the 6<sup>th</sup> International Youth Choreography Festival – Competition Rīgas pavasaris 2010 (*Riga Spring 2010*).

## Sports

The JSC "Latvijas Gāze" is one of the major sports patrons in Latvia, having contributed to the development of the Latvian Olympic Movement and professional sports for more than ten years. The Company is a sponsor of the Latvian Olympic Committee, and since 1997 the contributions by the Company have been used to co-fund the country's best athletes who prepare for the Olympic Games and other competitions as members of the Latvian Olympic Team. At the 21<sup>st</sup> Winter Olympic Games held in Vancouver (Canada) in February 2010, two silver medals – in skeleton and luge – were won.

In 2010, the Company provided financial support to the professional organizations of biathlon, ice-hockey, bobsleigh, volleyball, basketball, tennis and orienteering.

During the reporting year, the participation of the Latvian senior, junior and youth orienteering teams at competitions and the organization of the first stage of the Latvian Cup was sponsored. The JSC "Latvijas Gāze" also helped the Latvian athletes to prepare for the *World's Strongest Man 2010* competition.

The Latvian Ice-Hockey Federation, for its part, received support for the organization of the World U-18 Ice-Hockey Championships for Division 1, while the Latvian Volleyball Federation – for the organization of the second qualification round of the European Youth Volleyball Championships in Jelgava.

*The rays of the last evening light shine  
upon the wind that throws around the  
waters of the Baltic Sea.*



## *Environmental Policy*



In 2010, the JSC "Latvijas Gāze" continued several projects in compliance with the environmental policy developed by the Company.

The main objective of the environmental policy in the reporting year was the achievement of sustainable results in terms of environment protection and economic activity, ensuring due identification of the key environmental impacts of economic activity, analysis of the causes thereof and speedy assessment of environmental issues occurred, also guaranteeing operative action appropriate for emergency situations when necessary.

Successful implementation of the environmental policy inter alia includes the need for regular work on the study and analysis of the requirements of normative acts and the ensuring of observance thereof.

Along with the above, the Company's environmental

policy during the reporting period included work with the staff, the necessity to maintain close internal and external communication links and to promote mutual understanding when cooperating with the state and municipal institutions and the society.

### Work on Natural Gas Storage System Operation Standardization in Compliance with ISO14001:2004

One of the key results of work done during the reporting period is the assurance of compliance of the natural gas storage system operation with the requirements of the ISO 14001:2004 standard.

The standard attests that the Company's operation is directed toward sustainable development, observing



high requirements in both production process and environment protection.

On November 10, 2010, the independent certification institution *Bureau Veritas Latvia* issued to the Company a renewed attestation of conformity of the natural gas storage system operation to the standard requirements.

The attestation extends the term of validity of the ISO 14001:2004 certificate, issued to the Company in 2004, until December 22, 2013.

### Preparation of an Environmental Normative Significant for Operation of the Inčukalns UGS

March 15, 2011 is the expiration date of the B-category permit of pollutive activities (No. RIT-R-B-0350). This permit had been issued to the operation unit of the

JSC "Latvijas Gāze" Inčukalns UGS by the Lielrīga Regional Environmental Board.

The document above specified the limits of emission of hazardous substances in the air from 350 emission sources, emissions in surface water from one emission source, as well as industrial waste waters in the porous underground layer, where natural gas is stored, from two emission sources.

The reception of a new permit was hindered by the transition of the Inčukalns UGS from the supervisory scope of the Lielrīga Regional Environmental Board to that of the Valmiera Regional Environmental Board. Thus, it was necessary to establish new communication links with the experts of the Valmiera Regional Environmental Board. As a result of prolific cooperation, an application for the reception of a new permit for B-category pollutive activity at the Inčukalns UGS was drawn up.

*Fine brush strokes outline the  
blue and green lines of the forest.*



# Board Report

## 1. Operation of the Company in the Reporting Year

The Joint Stock Company "Latvijas Gāze" (hereinafter – the Company) is an energy supply company engaged in natural gas transmission, storage, distribution and sale. In 1997, the Energy Supply Regulation Council of the Republic of Latvia issued to the Company exclusive license for the provision of regulated public services till February 10, 2017. On January 31, 2007, the Public Utility Commission (hereinafter – the PUC) issued to the Company a license for natural gas sale till February 10, 2012. Under the Energy Law, the Company is a natural gas supply system operator, which ensures uninterrupted and safe natural gas supply to customers in Latvia, avoiding overloads of system capacity.

Over the reporting year, the users were supplied 1 787.6 million m<sup>3</sup> of natural gas. In comparison to 2009, natural gas sales in m<sup>3</sup> grew by 19.7%. The rapid increase of natural gas sales stemmed more from emergency situations than long-term changes in the users' demand. The rise of natural gas consumption was mainly facilitated by the record-low air temperature in the first quarter of 2010 and the use of natural gas for electricity generation in the summer of 2010 when due to repairs of power transmission lines in the territory of Russia electricity supplies to the Baltic region were interrupted.

Already in 2009, the natural gas purchase prices set for Latvia reached the level of the natural gas market of European countries, so in 2010 they were only influenced by changes in oil product quotations at the stock exchange, currency rates and gas supply flows.

In 2010, natural gas was sold to customers for the natural gas sale end-user tariffs set in the resolution No. 247 "On natural gas supply tariffs of the Joint Stock Company "Latvijas Gāze" of the PUC dated July 24, 2008. Under the resolution No. 258 "On the procedure of application of resolution No. 247" of the PUC dated June 2, 2010, these tariffs are exclusive of excise tax.

The applied differential natural gas sale end-user tariffs consist of two parts: fixed regulated service tariffs and the natural gas sale price, which changes with a step of 5 Ls/thousand nm<sup>3</sup> depending on the actual natural gas purchase costs. For users with the annual natural gas consumption over 25 thousand nm<sup>3</sup>, the applicable natural gas sale end-user tariff changes monthly, whereas for users with the annual natural gas consumption up to 25 thousand nm<sup>3</sup> – once in six months, i. e., on January 1 and July 1.

During 2010, the natural gas sale end-user tariffs for natural gas users with the annual consumption up to 25 thousand nm<sup>3</sup> also changed on September 1, 2010 because in July and August 2010 natural gas used as fuel was subjected to the excise tax of 15.6 Ls/thousand nm<sup>3</sup> (22.2 EUR/thousand nm<sup>3</sup>).

In 2010, the Company sold natural gas and provided services to customers for Ls 353.4 million (EUR 502.8 million), which is by 7.2 % more than in the respective period of 2009; the expenditures (excluding administrative costs) were Ls 314.7 million (EUR 447.7 million) and the gross profit – Ls 38.7 million (EUR 55 million). The increase of the net turnover stemmed from changes in the natural gas sales volume and natural gas sale price, as well as the improved efficiency of use of the Inčukalns Underground Gas Storage Facility (hereinafter – the Inčukalns UGS).

Over the season of 2010, 2.03 billion m<sup>3</sup> of natural gas were injected into the Inčukalns UGS and 2.14 billion m<sup>3</sup> were withdrawn. Compared to the season of 2009, the volume of natural gas injected rose by 67.5%, while that of natural gas withdrawn – by 35.8 %. During the reporting period there was increased usage of the Inčukalns UGS for the needs of other countries due to weather conditions in the neighbouring states.

The Company completed the year 2010 with a net profit of Ls 26.47 million (EUR 37.66 million), which is by Ls 6.5 million more than that of 2009 – Ls 19.97 million (EUR 28.41 million). The net profitability of business activity was 7.5% in 2010 and 6.1% in 2009.

In 2010, the Company invested Ls 23.3 million (EUR 33.2 million) in the modernization of the gas supply system and the creation of new fixed assets. 30 % of the total investment was spent on the modernization of the gas transmission pipeline system, 46 % – on the improvement of the operation safety and the modernization of equipment at the Inčukalns UGS, and 21% – on the expansion of distribution networks and the renewal of fixed assets. The total number of gas-enabled objects at the end of the year reached 442.4 thousand.

On August 17, 2010, the Company received the resolution No. C(2010) 5554 of the European Commission dated August 13, 2010 on the award of a financial grant to Action No. EEPR-2009-INTg-RF-LV-LT-I2.566527/ I2.566531/ SI2.566541/ SI2.566543 under the EC Regulation No. 663/2009 on gas and electricity interconnections. With this resolution, the modernization of 15 wells at the Inčukalns UGS and the construction of a gas passage below the River Daugava and a pig receiver was granted Ls 7 million (EUR 10 million).

During the reporting period, the reconstruction of four wells at the Inčukalns UGS was completed and equipment was received for modernization of 11 wells in 2011. The total costs amount to Ls 4.3 million (EUR 6.1 million). The reconstruction of the gas drying unit at CS-1 is in progress, with Ls 4.9 million (EUR 7 million) invested in the reporting year and Ls 7.6 million (EUR 10.8 million) since the beginning of the project. The object is to be commissioned in late 2011.

The elimination of defects found during the diagnostics of gas transmission pipelines continues. Ls 2.4 million (EUR 3.4 million) have been spent on renovation of gas pipelines. The construction of an underwater gas pipeline under the River Daugava has begun, with Ls 3.7 million (EUR 5.3 million) taken up during the reporting year. The total costs of the object are estimated at Ls 5.3 million (EUR 7.5 million).

Ls 1.4 million (EUR 2 million) were spent on the construction of gas distribution pipelines in 2010. The year 2010 saw completion of the project of gas supply stabilization in the city of Riga and its vicinity, started in 2006. Within the framework of the project, a gas pipeline of 9.5 km in length was renovated and a high-pressure gas distribution pipeline of Riga bypass line in the length of 30.4 km was built. The total costs of the project reached Ls 5.8 million (EUR 8.3 million), incl. Ls 0.9 million (EUR 1.3 million) in 2010. The replacement of the gas pipeline in Liepāja, at Brīvības Street, was also commenced in 2010 and is expected to be completed in 2011, with the total costs estimated at around Ls 0.5 million (EUR 0.7 million).

## 2. Research and Development

In order to ensure uninterrupted natural gas supply to users and safe operation of the gas supply system in long term, the Company has developed the "Plan of measures for the improvement of safety of the gas supply system of the Joint Stock Company "Latvijas Gāze" 2010-2015". It has been prepared based on the findings made by the Russian companies "Gazobezopasnostj" and "Lentransgaz", the institutes "VNII GAZ" and "Giprospeccgaz", as well as the German companies "Pipeline Engineering GmbH", "Untergrundspeicher und Geotechnologie – Systeme GmbH", "E.ON Engineering GmbH", "E.ON Ruhrgas International AG" and other partners regarding the technical condition of equipment and modernization options.

The plan of measures envisages investment in safety improvement for the total amount of Ls 50.6 million (EUR 72 million). This basically includes projects aimed at the improvement of system safety, the gasification of new objects and the enhancement of gas supply stability in the whole region.

## 3. Financial Risk Management

The operation of the Company is exposed to a variety of financial risks, including credit risk and risks of fluctuation of foreign currency rates and interest rates. The management of the Company seeks to minimize the negative impact of potential financial risks on the financial state of the Company.

The Company is not directly subjected to the risk of fluctuation of foreign currency rates as the gas purchase price is set in USD and subsequently recalculated into EUR, whereas gas sale tariffs are set in lats. Settlements for the supplied gas are made in EUR. The lats rate is pegged to the euro rate since January 1, 2005, so fluctuations of the Ls/EUR rate are limited and unlikely to have a notable influence on further financial results. Gas purchase price changes in USD depending on the oil products quotation are covered by the PUC-approved natural gas sale tariffs, which to a certain extent cover the fluctuations of both the Ls/EUR and EUR/USD rate. The risk of fluctuation of foreign currency rates as concerns debts to suppliers is kept under control by holding a considerable part of cash assets in deposits of the respective currency.

As of the end of the reporting year, the Company has no loans, thus it is not subjected to credit risk.

The financial assets subjected to credit risk basically consist of customer debts and cash. The Company is exposed to a considerable degree of credit risk because a notable share of the net turnover applies to a limited number of customers. Four of the Company's customers make up to 54.5% (in 2009 – 45.5%) of sales, one of these debtors as of December 31, 2010 was 22.1% (in 2009 – 25.5%), the second and third debtors were 7.5% and 6.4% respectively (in 2009 – 8% and 9.3%) of the total amount of customer debts. The Company has introduced and observes a credit policy that envisages selling goods on credit only to customers with a good credit history, controlling the amount of credit set for each customer.

The customer debts are shown at their recoverable value. The Company's partners in monetary transactions are local financial institutions with proper credit history.

The Company observes cautious liquidity risk management, ensuring sufficient availability of credit resources for meeting liabilities in due time.

## 4. Post Balance Sheet Events

During the period between the last day of the reporting year and the date of signing of this report, there have been no significant events that would have a material effect on the year end result.



## 5. Distribution of the Profit of 2010 as suggested by the Board

	2010 Ls	2010 EUR
Profit of the reporting year	26 466 382	37 658 269
Share of profit not available for distribution (income of deferred tax not realised due to the revaluation of fixed assets)	(1 544 136)	(2 197 108)
Share of profit available for distribution	24 922 246	35 461 161
Suggested distribution of profit:		
dividends to shareholders (75.4%)	19 950 000	28 386 293
dividends per one share (Ls/1 share)	0.50	0.711
Statutory reserves	4 972 246	7 074 868

Some members of the Council and the Board of the Company hold shares and interests at numerous companies registered in the Register of Enterprises of the Republic of Latvia, and they perform managerial functions there. Over the reporting year, the Company has not executed transactions of considerable amount (except for those listed in the financial statement) with these companies.

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

## 6. Future Prospects

Having regard of the investments in the improvement of the system operation safety, the expansion of the gas pipeline network and the attraction of new customers made in previous years and in the reporting year, as well as considering the situation in the fuel market of Latvia, the Board of the Company believes that in 2011 the Company will continue successful development and take a stable place in the fuel supply market.

Chairman of the Board  
A. Dāvis



Board meeting minutes No. 16 (2011)  
Riga, April 29, 2011

# Summary financial statements

Profit and loss account for the year ended December 31, 2010

	2010 Ls	2009 Ls	2010 EUR	2009 EUR
1 Net sales	353 345 051	329 705 288	502 764 712	469 128 360
2 Cost of sales	(314 673 148)	(293 889 591)	(447 739 551)	(418 167 215)
<b>3 Gross profit</b>	<b>38 671 903</b>	<b>35 815 697</b>	<b>55 025 161</b>	<b>50 961 145</b>
5 Administrative expenses	(7 093 340)	(7 357 915)	(10 092 914)	(10 469 369)
6 Other operating income	2 193 068	1 420 125	3 120 455	2 020 656
7 Other operating expenses	(3 031 124)	(2 427 984)	(4 312 900)	(3 454 711)
10 Other interest income and similar income	2 602 591	2 952 736	3 703 153	4 201 365
11 Changes of long term financial investments and short term securities	(666)	(190)	(948)	(270)
12 Interest expenses and similar expenses	(2 605 893)	(1 202 833)	(3 707 852)	(1 711 478)
13 Provisions for bad and doubtful debtors, net	951 855	(5 184 331)	1 354 368	(7 376 638)
14 Provisions for obsolete and slow moving inventories, net	(360 508)	(36 918)	(512 957)	(52 529)
<b>16 Profit before taxes</b>	<b>31 327 886</b>	<b>23 978 387</b>	<b>44 575 566</b>	<b>34 118 171</b>
17 Corporate income tax for the reporting year	(5 877 826)	(3 941 679)	(8 363 393)	(5 608 504)
18 Deferred income tax	1 771 001	92 113	2 519 908	131 066
19 Other taxes	(754 679)	(162 124)	(1 073 812)	(230 683)
<b>20 Current year's profit</b>	<b>26 466 382</b>	<b>19 966 697</b>	<b>37 658 269</b>	<b>28 410 050</b>
Unrealised deferred tax gain related to fixed assets revaluation	(1 544 136)	(1 636 688)	(2 197 108)	(2 328 798)
<b>Current year's profit available for distribution</b>	<b>24 922 246</b>	<b>18 330 009</b>	<b>35 461 161</b>	<b>26 081 252</b>

## Balance sheet as at December 31, 2010

(1)

	31.12.2010. Ls	31.12.2009. Ls	31.12.2010. EUR	31.12.2009. EUR
<b>Assets</b>				
<b>Long-term investments</b>				
<b>I. Intangible assets:</b>				
1. Research and development	-	1 705	-	2 425
2. Concessions, patents, licenses, trade marks and similar rights	2 083 740	2 306 915	2 964 895	3 282 445
5. Advance payments for intangible assets	145 501	122 974	207 029	174 976
<b>Total intangible assets:</b>	<b>2 229 241</b>	<b>2 431 594</b>	<b>3 171 924</b>	<b>3 459 846</b>
<b>II. Fixed assets:</b>				
1. Land, buildings, constructions and gas transmission system	258 558 421	263 359 486	367 895 489	374 726 789
3. Equipment and machinery	38 540 368	41 660 762	54 838 004	59 277 925
4. Other fixed assets	4 958 457	4 960 979	7 055 247	7 058 835
5. Advances for fixed assets and fixed assets under construction	14 932 379	5 125 997	21 246 862	7 293 636
<b>Total fixed assets:</b>	<b>316 989 625</b>	<b>315 107 224</b>	<b>451 035 602</b>	<b>448 357 185</b>
<b>V. Long-term financial investments:</b>				
3. Investment in associated companies	80	80	114	114
5. Other securities and investments	3 121	3 787	4 440	5 388
<b>Total long-term financial investments:</b>	<b>3 201</b>	<b>3 867</b>	<b>4 554</b>	<b>5 502</b>
<b>Total long-term investments:</b>	<b>319 222 067</b>	<b>317 542 685</b>	<b>454 212 080</b>	<b>451 822 533</b>
<b>Current assets</b>				
<b>I. Inventories:</b>				
1. Raw materials and consumables	10 975 404	83 532 693	15 616 593	118 856 315
5. Advances for goods receivable	24 228 064	1 793	34 473 429	2 551
<b>Total inventories:</b>	<b>35 203 468</b>	<b>83 534 486</b>	<b>50 090 022</b>	<b>118 858 866</b>
<b>III. Debtors:</b>				
1. Trade debtors	35 551 434	20 631 192	50 585 133	29 355 542
3. Receivables from affiliated companies	1 483 215	1 571 574	2 110 425	2 236 148
4. Other debtors	386 220	1 909 682	549 542	2 717 233
7. Deferred expenses	431 190	494 387	613 528	703 450
<b>Total debtors:</b>	<b>37 852 059</b>	<b>24 606 835</b>	<b>53 858 628</b>	<b>35 012 373</b>
<b>IV. Short-term financial investments:</b>				
5. Other securities and investments	198	198	282	282
<b>Total short-term financial investments:</b>	<b>198</b>	<b>198</b>	<b>282</b>	<b>282</b>
<b>V. Cash and bank:</b>	<b>37 572 880</b>	<b>35 810 287</b>	<b>53 461 392</b>	<b>50 953 448</b>
<b>Total current assets:</b>	<b>110 628 605</b>	<b>143 951 806</b>	<b>157 410 324</b>	<b>204 824 969</b>
<b>Total assets</b>	<b>429 850 672</b>	<b>461 494 491</b>	<b>611 622 404</b>	<b>656 647 502</b>

## Balance sheet as at December 31, 2010

(2)

	31.12.2010. Ls	31.12.2009. Ls	31.12.2010. EUR	31.12.2009. EUR
<b>Liabilities</b>				
<b>Shareholders' funds:</b>				
1. Share capital	39 900 000	39 900 000	56 772 585	56 772 585
2. Share premium	14 320 210	14 320 210	20 375 823	20 375 823
3. Long-term investments revaluation reserve	185 612 319	186 218 357	264 102 536	264 964 851
5. Reserves				
c) statutory reserve	64 076 387	61 706 378	91 172 485	87 800 266
6. Retained earnings				
a) previous years' retained earnings	8 585 176	6 948 488	12 215 605	9 886 808
b) current year's retained profit	26 466 382	19 966 697	37 658 269	28 410 050
<b>Total shareholders' funds:</b>	<b>338 960 474</b>	<b>329 060 130</b>	<b>482 297 303</b>	<b>468 210 383</b>
<b>Creditors:</b>				
<b>Long-term creditors:</b>				
12. Deferred income	13 855 294	13 824 375	19 714 307	19 670 313
15. Accruals for post employment benefits and other employee benefits	5 207 023	4 415 984	7 408 926	6 283 380
16. Deferred tax liability	27 821 844	29 699 793	39 586 917	42 258 998
<b>Total long-term creditors:</b>	<b>46 884 161</b>	<b>47 940 152</b>	<b>66 710 150</b>	<b>68 212 691</b>
<b>Short-term creditors:</b>				
5. Advances received	5 384 991	6 640 438	7 662 152	9 448 492
6. Trade creditors	10 587 192	59 120 418	15 064 218	84 120 776
8. Accounts payable to related companies	1 146 560	1 469 909	1 631 408	2 091 492
10. Taxes and state compulsory social insurance contributions	12 594 348	9 492 572	17 920 143	13 506 713
11. Other creditors	581 615	655 563	827 564	932 782
12. Deferred income	7 565 290	823 691	10 764 438	1 172 007
15. Accrued liabilities	6 146 041	6 291 618	8 745 028	8 952 166
<b>Total short-term creditors:</b>	<b>44 006 037</b>	<b>84 494 209</b>	<b>62 614 951</b>	<b>120 224 428</b>
<b>Total creditors:</b>	<b>90 890 198</b>	<b>132 434 361</b>	<b>129 325 101</b>	<b>188 437 119</b>
<b>Total liabilities and shareholders' funds</b>	<b>429 850 672</b>	<b>461 494 491</b>	<b>611 622 404</b>	<b>656 647 502</b>

## Statement of changes in equity for the year ended December 31, 2010

	Share capital Ls	Share premium Ls	Long-term investments revaluation reserve Ls	Statutory reserve Ls	Retained earnings Ls	Total Ls
<b>Balance as at 31.12.2008.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>186 917 922</b>	<b>58 710 159</b>	<b>25 106 707</b>	<b>324 954 998</b>
Dividends	-	-	-	-	(15 162 000)	(15 162 000)
Transferred to reserves	-	-	-	2 996 219	(2 996 219)	-
Revaluation of fixed assets	-	-	119 952	-	-	119 952
Deferred tax liability arising on the revaluation of fixed assets	-	-	(17 993)	-	-	(17 993)
Disposal of revalued fixed assets	-	-	(942 969)	-	-	(942 969)
Deferred tax on disposal of revalued fixed assets	-	-	141 445	-	-	141 445
Profit for the year	-	-	-	-	19 966 697	19 966 697
<b>Balance as at 31.12.2009.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>186 218 357</b>	<b>61 706 378</b>	<b>26 915 185</b>	<b>329 060 130</b>
Dividends	-	-	-	-	(15 960 000)	(15 960 000)
Transferred to reserves	-	-	-	2 370 009	(2 370 009)	-
Revaluation of fixed assets	-	-	80 974	-	-	80 974
Deferred tax liability arising on the revaluation of fixed assets	-	-	(12 146)	-	-	(12 146)
Disposal of revalued fixed assets	-	-	(793 960)	-	-	(793 960)
Deferred tax on disposal of revalued fixed assets	-	-	119 094	-	-	119 094
Profit for the year	-	-	-	-	26 466 382	26 466 382
<b>Balance as at 31.12.2010.</b>	<b>39 900 000</b>	<b>14 320 210</b>	<b>185 612 319</b>	<b>64 076 387</b>	<b>35 051 558</b>	<b>338 960 474</b>

## Statement of changes in equity for the year ended December 31, 2010 (continued)

	Share capital EUR	Share premium EUR	Long-term investments revaluation reserve EUR	Statutory reserve EUR	Retained earnings EUR	Total EUR
<b>Balance as at 31.12.2008.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>265 960 242</b>	<b>83 537 030</b>	<b>35 723 625</b>	<b>462 369 305</b>
Dividends	-	-	-	-	(21 573 581)	(21 573 581)
Transferred to reserves	-	-	-	4 263 236	(4 263 236)	-
Revaluation of fixed assets	-	-	170 677	-	-	170 677
Deferred tax liability arising on the revaluation of fixed assets	-	-	(25 602)	-	-	(25 602)
Disposal of revalued fixed assets	-	-	(1 341 724)	-	-	(1 341 724)
Deferred tax on disposal of revalued fixed assets	-	-	201 258	-	-	201 258
Profit for the year	-	-	-	-	28 410 050	28 410 050
<b>Balance as at 31.12.2009.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>264 964 851</b>	<b>87 800 266</b>	<b>38 296 858</b>	<b>468 210 383</b>
Dividends	-	-	-	-	(22 709 034)	(22 709 034)
Transferred to reserves	-	-	-	3 372 219	(3 372 219)	-
Revaluation of fixed assets	-	-	115 215	-	-	115 215
Deferred tax liability arising on the revaluation of fixed assets	-	-	(17 282)	-	-	(17 282)
Disposal of revalued fixed assets	-	-	(1 129 703)	-	-	(1 129 703)
Deferred tax on disposal of revalued fixed assets	-	-	169 455	-	-	169 455
Profit for the year	-	-	-	-	37 658 269	37 658 269
<b>Balance as at 31.12.2010.</b>	<b>56 772 585</b>	<b>20 375 823</b>	<b>264 102 536</b>	<b>91 172 485</b>	<b>49 873 874</b>	<b>482 297 303</b>

Changes in Statutory reserves can only be made with shareholders' approval. Revaluation reserve and share premium cannot be distributed to shareholders.

## Cash flow statement for the year ended December 31, 2010

	2010 Ls	2009 Ls	2010 EUR	2009 EUR
<b>I Cash flows from operating activities</b>				
<b>1. Profit before taxes</b>	<b>31 327 886</b>	<b>23 978 387</b>	<b>44 575 566</b>	<b>34 118 171</b>
Adjustments for:				
- fixed asset depreciation and write-down of intangible assets	21 027 365	21 034 911	29 919 244	29 929 983
- difference between the actual and forecasted purchase cost of natural gas and income from participation charge	6 167 075	(3 411 381)	8 774 957	(4 853 958)
- change in provisions for inventories	360 508	36 918	512 957	52 529
- change in provisions for long-term financial investments	666	2 150	948	3 059
- change in accrued expenses for bonuses for reporting year's financial results	(278 000)	298 000	(395 558)	424 015
- change in accrued unused annual leave expenses	96 490	(179 804)	137 292	(255 839)
- change in other provisions	35 933	148 702	51 128	211 583
- changes in accruals for post employment benefits and other employee benefits	791 039	(256 662)	1 125 546	(365 197)
- other interest and similar income	(2 602 591)	(2 952 736)	(3 703 153)	(4 201 365)
- interest and similar expense	2 605 893	1 202 833	3 707 852	1 711 478
- loss / (profit) on sale of fixed assets	(525 131)	148 686	(747 194)	211 561
<b>Adjustments for:</b>				
Trade debtors decrease / (increase)	(14 831 884)	17 344 606	(21 103 870)	24 679 151
Inventories decrease	48 717 219	32 539 603	69 318 358	46 299 683
Trade creditors' decrease	(48 856 575)	(25 469 390)	(69 516 643)	(36 239 677)
Other debtors' decrease	2 373 200	3 343 957	3 376 760	4 758 022
Other creditors' decrease	(4 891 431)	(5 585 330)	(6 959 878)	(7 947 209)
<b>3. Cash generated from operations</b>	<b>41 517 662</b>	<b>62 223 450</b>	<b>59 074 312</b>	<b>88 535 990</b>
Interest and similar payments	-	(21 050)	-	(29 951)
Interest and similar income	2 671 503	2 695 446	3 801 206	3 835 275
Corporate income tax paid	(3 290 742)	(1 445 232)	(4 682 304)	(2 056 380)
<b>6. Net cash flows generated from operating activities</b>	<b>40 898 423</b>	<b>63 452 614</b>	<b>58 193 214</b>	<b>90 284 934</b>
<b>II. Cash flows used in investing activities</b>				
Acquisition of fixed assets and intangible assets	(23 303 560)	(17 188 207)	(33 157 979)	(24 456 615)
Proceeds from sale of fixed assets	127 730	47 723	181 743	67 904
Dividends received	-	1 960	-	2 789
<b>9. Net cash used in investing activities</b>	<b>(23 175 830)</b>	<b>(17 138 524)</b>	<b>(32 976 236)</b>	<b>(24 385 922)</b>
<b>III. Cash flows used in financing activities</b>				
Repayment of borrowings	-	(1 787 886)	-	(2 543 933)
Dividends paid	(15 960 000)	(15 162 000)	(22 709 034)	(21 573 581)
<b>7. Net cash used in financing activities</b>	<b>(15 960 000)</b>	<b>(16 949 886)</b>	<b>(22 709 034)</b>	<b>(24 117 514)</b>
<b>Net increase during the reporting year in cash and cash equivalents</b>	<b>1 762 593</b>	<b>29 364 204</b>	<b>2 507 944</b>	<b>41 781 498</b>
Cash and cash equivalents at the beginning of the reporting year	35 810 287	6 446 083	50 953 448	9 171 950
<b>Cash and cash equivalents at the end of the reporting year</b>	<b>37 572 880</b>	<b>35 810 287</b>	<b>53 461 392</b>	<b>50 953 448</b>

## Accounting policies

### (a) Information on the Company

The legal address of the Joint Stock Company "Latvijas Gāze" is Vagonu street 20, Riga (until January 3, 2010 Aristīda Briāna street 6, Riga). The Company is registered in Commercial Register with common registration number 4000 300 0642. The Company's main shareholders are E.ON Ruhrgas International AG (47.23%), JSC Gazprom (34.0%) and LLC Itera Latvija (16.0%). The Board of the Company consists of Adrians Dāvis (Chairman of the Board), Aleksandrs Mihejevs (Александр Михеев) (Member of the Board, Deputy Chairman of the Board), Jörg Tumat (Member of the Board, Deputy Chairman of the Board), Anda Ulpe (Member of the Board) and Gints Freibergs (Member of the Board). The Company's auditor is the certified audit company SIA "PricewaterhouseCoopers" and responsible certified auditor Olga Bobrova.

### (b) Financial statements preparation basis

Financial statements are prepared in accordance with the Accounting Act and Annual Accounts Act of the Republic of Latvia and the effective Latvian accounting standards (LAS).

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

Cash flow statement is prepared using indirect cash flow method.

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

### (c) Net sales and income recognition

Sales are recognised upon delivery of gas or performance of services. Net sales represent the total of goods and services sold during the year net of discounts, value added tax and the difference between the actual and forecasted purchase cost of natural gas, which is used for determination of applicable natural gas selling price for the following month. Applicable natural gas selling price is calculated based on latest available data. The exchange rate for EUR/USD set by ECB in the last day of the previous month, actual gross calorific value as well as planned volume of received and delivered gas are used in the calculation. Actual purchase costs of natural gas are calculated based on methodology approved by the the Public Utility Commission (PUC's) Council, taking into account the exchange rate of EUR/USD at the last day of the month when gas is delivered, actual gross calorific value as well as actual volume of gas received from suppliers.

Accrual of interest income is ceased, if its recoverability is uncertain. Based on prudence principle, penalties, including fines for late payments for gas, are recognised when received.

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

### (d) Foreign currency translation

The Company maintains its accounts in Latvian Lats. All transactions denominated in foreign currencies are converted to Lats at the exchange rate set by the Bank of Latvia prevailing on the day on which the transactions took place. Monetary assets and liabilities denominated in foreign currencies are translated in Lats in accordance with the official Bank of Latvia exchange rate for the last day of the reporting period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

	31.12.2010.	31.12.2009.
	Ls	Ls
1 USD	0.535	0.489
1 EUR	0.702804	0.702804

Euro financial statements are prepared using account closing balances in Ls at the last day of the reporting period, performing conversion to EUR by using the official fixed EUR / Ls rate set by the Bank of Latvia 1 EUR = Ls 0.702804 (1 EUR = Ls 0.702804, determined by Bank of Latvia as of December 30, 2004 reposing to resolution of the Council of Bank of Latvia) for all period January 1, 2010 till December 31, 2010.



### (e) Intangible assets

Intangible assets are recorded at historic cost net of accumulated amortisation. Amortisation is calculated on a straight-line basis to write down each intangible asset to its estimated residual value over its estimated useful life. Generally, intangible assets are amortised over a period of 5 years.

### (f) Fixed assets

Fixed assets are recorded at historic cost or revalued amount net of accumulated depreciation and impairment charge.

Increase in value arising on revaluation is shown in equity under "Long-term investments revaluation reserve". Decrease that offsets a previous increase of the same asset's value recognised in the said reserve is charged against that reserve; any further decrease is charged to the current year's profit and loss account.

Depreciation is calculated on a straight-line basis to write down each fixed asset to its estimated residual value over its estimated useful life using following rates set by management:

	% per annum
Buildings	1 – 3
Gas transmission system	2 – 2.5
Machinery and equipment	5 – 20
Furniture and fittings	10 – 20
Computers and equipment	30

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

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

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

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

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

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

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

### (g) Inventories

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

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

**(h) Accounts receivable**

Accounts receivable are recorded in the balance sheet at their amortised cost less provisions made to cover anticipated loss on bad and doubtful accounts receivable. Provisions for bad and doubtful accounts receivable are established when there is an objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of provisions for bad and doubtful accounts receivable is the difference between the amortised cost and the recoverable amount. The amount of the provision for bad and doubtful accounts receivable is recognised in the profit and loss account.

**(i) Other long-term investments**

Other long-term investments are disclosed at the cost less provisions created to cover losses on other than temporary diminution of value of investments. Assessment of investments is made each year based on latest available financial information.

**(j) Borrowings**

Borrowings are recognised initially at the proceeds received net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account.

**(k) Taxes**

Corporate income tax for the reporting period is included in the annual accounts based on the management's calculations prepared in accordance with Latvian Republic tax legislation.

Deferred tax is provided for using liability method on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the annual accounts. The deferred tax is calculated based on currently enacted tax rates that are expected to apply when the temporary differences reverse. The principal temporary differences arise from different fixed assets depreciation and intangible asset amortisation rates, accrued unused annual leave and bonus expenses, accruals for post employment and other benefits and provisions for bad and doubtful debts where the management is of the opinion that they will meet the criteria stated in Article 9 of the law "On Corporate Income Tax", and other accrued expenses and provisions for write down to net realisable value of inventory. The deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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

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

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

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

The Company provides defined benefits upon retirement and in the period of employment for employees whose employment conditions meet defined criteria according to the Employment contract. Amount of benefit liability is calculated based on current salary level and number of employees, which are entitled or may become entitled to receive those payments, as well as based on actuarial assumptions. Once a year an actuary evaluates these liabilities. Expected benefit expenses are accrued during the employment period.

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

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

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

### **(n) Related parties**

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

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

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

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

### **(p) Bases of preparation of summary financial statements**

These summary financial statements, which comprise the balance sheet as at December 31, 2010, the profit and loss account, statement of changes in equity and cash flow statement for the year then ended, have been prepared by extraction, without any modification, from the relevant information included in the Company's annual accounts. Accordingly, these summary financial statements are consistent with those accounts.



Great force lies within Latvia's verdant nature, so great that every day it is there discovered anew. Catching the beauty of this force in all the richness of its half-tints is a special art. These are the skills that we improve and expand upon every year.



# *Independent Auditor's Report*

## To the Shareholders of JSC "Latvijas Gāze" Report on the Summary Financial Statements

The accompanying summary financial statements, which comprise the balance sheet as at December 31, 2010 and the profit and loss account, statement of changes in equity and cash flow statement for the year then ended, are derived from the audited financial statements of JSC "Latvijas Gāze" for the year ended December 31, 2010. We expressed an unmodified audit opinion on those financial statements in our report dated April 29, 2011. Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements.

The summary financial statements do not contain all the disclosures required by Annual Account Act. Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of JSC "Latvijas Gāze".

### *Management's Responsibility for the Summary Financial Statements*

Management is responsible for the preparation of a summary of the audited financial statements in accordance with the relevant requirements established in Accounting policies section (P) Preparation Regulations of Summary Financial Statements.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with International Standard on Auditing (ISA) 810, "Engagements to Report on Summary Financial Statements."

### *Opinion*

In our opinion, the summary financial statements derived from the audited financial statements of JSC "Latvijas Gāze" for the year ended December 31, 2010 are consistent, in all material respects, with those financial statements, in accordance with the relevant requirements established in Accounting policies section (P) Preparation Regulations of Summary Financial Statements.

PricewaterhouseCoopers SIA  
Certified audit company  
Licence No. 5

Ahmed Abu Sharkh  
Chairman of the Board

Olga Bobrova  
Certified auditor in charge  
Certificate No. 170

Riga, Latvia  
14 June 2011

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

*PricewaterhouseCoopers SIA, Kr. Valdemara iela 19, Rīga LV-1010, Latvia  
T: +371 6709 4400, F: +371 6783 0055, LV40003142793, [www.pwc.lv](http://www.pwc.lv)*

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