Annual Unaudited Condensed Consolidated Financial Statements of 2016

Latvenergo Group is the most valuable company in Latvia and among the most valuable companies in the Baltics. The asset value of Latvenergo Group reaches almost EUR 4.0 billion.

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Unaudited Condensed Consolidated Financial Statements*

** Prepared in accordance with the International Financial Reporting Standards as adopted by the European Union*

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Investor Conference Webinar about financial results of 2016

19.04.2017.

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DISCLAIMER

The financial report includes forward-looking statements that are subject to risks, uncertainties and other important factors beyond the control of Latvenergo Group; therefore, the actual results in the future may differ materially from those stated or implied in the future projections.

The report has been prepared in Latvian and in English. In the event of any discrepancies between the Latvian and the English reports, the Latvian version shall prevail.

Summary

- **Lower electricity and gas prices in Latvia**
  In 2016, electricity spot price in Latvia and Lithuania decreased by 14% and 13% respectively. This decrease is mainly attributable to the opening of *NordBalt* interconnection between Sweden and Lithuania leading to a convergence of electricity price between the Baltic and the Nordic bidding areas. Due to the downtrend in crude oil price during 2016, the average natural gas price dropped by 24% compared to last year.

- **Latvenergo maintains leading electricity supplier position in the Baltics**
  Latvenergo Group has successfully maintained the leading electricity supplier position in the Baltics ensuring approximately 30% of the market share in the region. Retail electricity supply outside Latvia comprises approximately one third of the total retail electricity supply.

- **Increased generation of electricity and thermal energy**
  Amount generated by the power plants of Latvenergo Group in 2016 was 4,707 GWh of electricity and 2,675 GWh of thermal energy. In comparison to last year, electricity output generated at Riga CHPPs has increased by 9% and at Daugava HPPs – by 36%. Riga CHPPs managed to react effectively to the market situation in the region by offering a competitively priced electricity. The amount of thermal energy generated increased by 11% compared to 2015. This was mainly due to a considerably lower average ambient air temperature in January and November 2016.

- **28% EBITDA growth**
  In 2016, revenue of Latvenergo Group has remained at the same level as in 2015, and it is EUR 931.6 million. At the same time, EBITDA has increased by 28% reaching EUR 393.2 million. EBITDA has grown in all of the operating segments. Results were positively affected by higher electricity output at Daugava HPPs, lower natural gas and electricity prices, as well as increase in distribution service revenue.

- **The balanced distribution system tariffs came into force**
  On 1 August 2016, the new balanced electricity distribution system service tariffs came into force, promoting efficient utilization of distribution grid connection capacity.

- **Investment in network assets – 2/3 of the total**
  In 2016, the overall amount of investment was EUR 200.7 million of which nearly 64% were invested in network assets. A substantial part of investment was invested in environmentally friendly and environmental development projects – in 2016, EUR 35.2 million were invested in the reconstruction of Daugava HPPs hydropower units.

- **Successful completion of *green* bond offering programme**
  On 14 April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million. The issue was carried out under the second bond offering programme. In October 2016, Moody's assigned the highest Green Bond Assessment grade. The overall amount of bonds represents approximately 1/4 of total borrowings.

- **Latvenergo AS Supervisory Board elected**
  On 16 December 2016, the Shareholder's Meeting of Latvenergo AS elected the Supervisory Board of Latvenergo AS. The Council consists of five independent members: Andris Ozoliņš (Chairman of the Supervisory Board), Andris Liepiņš (Deputy Chairman), Baiba Anda Rubesa, Mārtiņš Bičevskis, and Martin Sedlacky. The Supervisory Board is elected for a five-year term.

- **Moody's reconfirms the credit rating**
  After the end of the reporting period, on 16 February 2017, Moody's reconfirmed Latvenergo AS credit rating of Baa2 with a stable outlook.

Latvenergo Group in Brief

Latvenergo Group is the largest pan-Baltic power supply utility operating in electricity and thermal energy generation and trade, electricity distribution services and lease of transmission system assets.

Latvenergo Group is comprised of the parent company Latvenergo AS and seven subsidiaries. All shares of Latvenergo AS are owned by the State and they are held by the Ministry of Economics of the Republic of Latvia.

Latvenergo AS is a shareholder in an associated company – Pirmais Slēgtais Pensiju Fonds AS (46.3%; Latvenergo Group – 48.15%) along with a shareholding in Rīgas siltums AS (0.005%).

Latvenergo Group divides its operations into three operating segments: generation and trade, distribution and lease of transmission system assets. This division in segments is made according to the needs of the internal organisational structure, which forms the basis for a regular performance monitoring, decision-making on resources allocated to segments and their performance measurement. From a commercial point of view, each segment is managed differently.

The generation and trade segment comprises electricity and thermal energy generation operations, conducted by Latvenergo AS and Liepājas enerģija SIA, as well as electricity trade (incl. electricity wholesale) in the Baltics carried out by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB. Mandatory procurement is administrated by Enerģijas publiskais tirgotājs AS.

	Country of operations	Type of operation	Participation share
Latvenergo AS	Latvia	Generation and trade of electricity and thermal energy	
Sadales tīkls AS	Latvia	Electricity distribution	100%
Latvijas elektriskie tīkli AS	Latvia	Lease of transmission system assets	100%
Enerģijas publiskais tirgotājs AS	Latvia	Administration of electricity mandatory procurement process	100%
Elektrum Eesti OÜ*	Estonia	Electricity trade	100%
Elektrum Lietuva UAB	Lithuania	Electricity trade	100%
Liepājas enerģija SIA	Latvia	Thermal energy generation and trade in Liepaja, electricity generation	51%

* Elektrum Eesti OÜ owns a subsidiary Elektrum Latvija SIA, which is not engaged in any business activities.

The distribution segment provides electricity distribution services in Latvia (approximately 99% of the territory). Services are provided by Sadales tīkls AS – the largest distribution system operator in Latvia (about 830 thousand customers). Distribution system tariffs are approved by the Public Utilities Commission (PUC).

The lease of transmission system assets segment is managed by Latvijas elektriskie tīkli AS – the company that owns the transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points) and conducts their lease to the transmission system operator Augstsprieguma tīkls AS. The payments for the lease of transmission system assets are calculated in accordance with the methodology approved by the PUC.

Latvenergo Group in Brief

Strategy of Latvenergo Group for 2013–2016

Strategy of Latvenergo Group (2013–2016 incl.) was developed and approved at the end of 2012. The strategy represented a transparent and rational development of Latvenergo Group in pan-Baltic conjuncture during the opening of the Baltic electricity market and development of new electricity interconnections.

Latvenergo Group strategy included the following operational objectives to be reached until 2016:

- strengthening of market position in the Baltics;
- diversification of electricity generation sources;
- balanced development of networks.

The objectives stated in the strategy are fulfilled:

- Latvenergo Group is the largest electricity trader in Baltic electricity retail market with economically sound market share of 30%. The Group successfully operates in open electricity market environment.
- In power generation development, we have renewed the existing capacities and invested in new ones. We focused on economically sound investment in generation plants having low emission intensity. The largest energetics project in the Baltics in decades – reconstruction of Riga CHPP-2 – has been completed. Also, Daugava HPPs hydropower unit reconstruction programme is successfully continued. It is planned for completion by 2022.
- Purposefully implementing the comprehensive long-term development plan of the distribution network that was developed during the strategic period, we have achieved significant improvement of electricity supply continuity indicators. Compared to 2012, System Average Interruption Duration Index (SAIDI) was reduced by 55% and System Average Interruption Frequency Index (SAIFI) - by 35%.

Strategy of Latvenergo Group for 2017–2022

On 19 October 2016, the Shareholder's Meeting approved the strategy of Latvenergo Group for 2017–2022.

Taking into consideration the main challenges within the industry and business environment, three main operational objectives are defined in the strategy:

- strengthening of sustainable and economically sound market position in core markets (in the Baltics), meanwhile considering a geographic and / or product / service expansion;
- development of generation portfolio that fosters synergy with trade and that promotes value increase of the Group;
- development of a customer-driven, functional, safe and efficient network.

Along with the strategy approval, financial targets of Latvenergo Group have been set. The targets are subdivided in three groups – profitability, capital structure and dividend policy.

The financial targets are set to ensure:

- ambitious, but at the same time achievable profitability, which is consistent with the average ratios of benchmark companies in European energy sector, and which provides for an adequate return for the business risk;
- optimal and industry relevant capital structure that limits the potential financial risks;
- adequate dividend policy that is consistent with the planned investment policy and capital structure targets.

Target group	Ratio	Year 2022
Profitability	Return on equity	> 6%
Capital structure	Net debt to equity	< 50%
	Net debt to EBITDA	< 3 times
Dividend policy	Dividend payout ratio	> 80%

Strategy development comprehended detailed industry and operating environment analysis, evaluation of business opportunities, and discussions with industry experts and stakeholders.

During the preparation process of the strategy requirements of OECD Guidelines on Corporate Governance of State-Owned Enterprises, Law on Governance of Capital Shares of a Public Person and Capital Companies, and requirements of Guidelines for Drawing up of the Medium-Term Operational Strategy for State-Owned Enterprises approved by Cross-Sectoral Coordination Centre were met.

Key Performance Indicators

Operational Figures

		2016	2015	2014	2013	2012
Retail electricity supply	GWh	7,580	7,869	8,688	7,954	8,287
Electricity generation	GWh	4,707	3,882	3,625	4,854	5,077
Thermal energy generation	GWh	2,675	2,408	2,560	2,566	2,712
Number of employees		4,131	4,177	4,563	4,512	4,457
Moody's credit rating		Baa2 (stable)	Baa2 (stable)	Baa3 (stable)	Baa3 (stable)	Baa3 (stable)

Financial Figures

		2016	2015	2014	2013	2012
Revenue	MEUR	931.6	929.1	1,010.8	1,099.9	1,063.7
EBITDA*	MEUR	393.2	307.0	236.8	248.7	244.1
Profit	MEUR	129.8	85.0	29.8	46.1	50.9
Assets	MEUR	3,901.0	3,517.4	3,486.6	3,575.4	3,517.8
Equity	MEUR	2,418.2	2,096.7	2,020.8	2,021.7	2,007.0
Net debt*	MEUR	607.6	692.9	706.2	689.3	604.5
Investments	MEUR	200.7	190.5	177.6	224.9	264.3

Financial Ratios

	2016	2015	2014	2013	2012
Net debt / EBITDA*	1.7	2.3	2.9	2.6	2.4
EBITDA margin*	42%	33%	23%	23%	23%
Return on equity*	5.8%	4.1%	1.5%	2.3%	2.6%
Return on assets*	3.5%	2.4%	0.8%	1.3%	1.5%
Return on capital employed*	5.3%	3.8%	1.7%	2.1%	2.6%
Net debt / equity*	25%	33%	35%	34%	30%

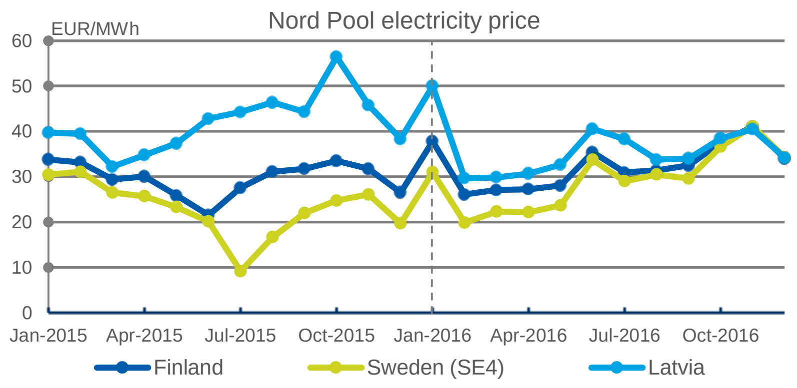
* Definitions of ratios and terms are available in the List of Abbreviations and Formulas on page 19

Operating Environment

Operation of new interconnections contributes to electricity price convergence in the Baltics

Year 2016 was marked in the Baltic electricity market by stronger integration of the Baltic and Nordic regions. Two new international interconnections *NordBalt* (700 MW) and *LitPol* (500 MW) were launched. The launch of electricity interconnections contributed to liquidity improvement in the market and convergence of electricity spot prices between the bidding areas.

Compared to the previous year, in 2016, the average electricity spot price was higher in the Nordics and Estonia. The price increase was influenced by colder weather conditions in January, repair works in the Nordic electricity transmission interconnection networks and largest nuclear power plants in summer months, as well as lower level of hydropower reservoir fill in Scandinavia in the last quarter of 2016. The average electricity spot price in Finland bidding area increased by 9% and reached 32.4 EUR/MWh, while in Estonia bidding area it rose by 6% to 33.1 EUR/MWh.



The electricity prices in Latvia and Lithuania in 2016 have decreased. Compared to 2015, the average electricity spot price in Latvia and Lithuania bidding areas decreased by 14% and 13% respectively, and reached 36.1 EUR/MWh in Latvian and 36.5 EUR/MWh in Lithuania bidding area. The decline in electricity price in Latvia and Lithuania was mainly driven by the launch of electricity interconnection *NordBalt* at the beginning of 2016, consequently contributing to the convergence of electricity spot prices between the bidding areas of the Baltic and Nordic countries. In addition, the decline in electricity price in Latvia and Lithuania was influenced by a fall in natural gas price in Latvia by 24% facilitating a more competitive electricity output of the Riga CHPPs thus precluding electricity price increase risk in the region.

From the energy balance position, Latvia and Lithuania are deficit region countries. Prior to the launch of the new international interconnections *NordBalt* (700 MW) and *LitPol* (500 MW) at the beginning of 2016, the shortage of transmission capacity between power systems of Latvia and Estonia was an important factor affecting the market price, which determined higher electricity prices in Latvia and Lithuania bidding areas. Even after the opening of the new interconnections electricity spot prices in Latvia and Lithuania bidding areas remained higher than in Estonia bidding area. The average electricity price in Latvia bidding area in 2016 was on average by 3.0 EUR/MWh higher than in Estonia (in 2015: 10.7 EUR/MWh).

In 2016, total amount of electricity generated in the Baltics increased by 9% compared to last year, and it was 19.1 TWh. The consumption of electricity increased by 3% – in 2016 it reached 25.8 TWh, while in 2015 it was 24.9 TWh. Thus, the net import volume of electricity in the Baltics has decreased by 10%, and in 2016 it was 6.6 TWh (in 2015: 7.4 TWh).

Due to efficient work of Riga CHPPs and an increase of Daugava HPPs generation volume, the total amount of electricity generated in Latvia has increased by 17% and it was 6.2 TWh (in 2015: 5.3 TWh).

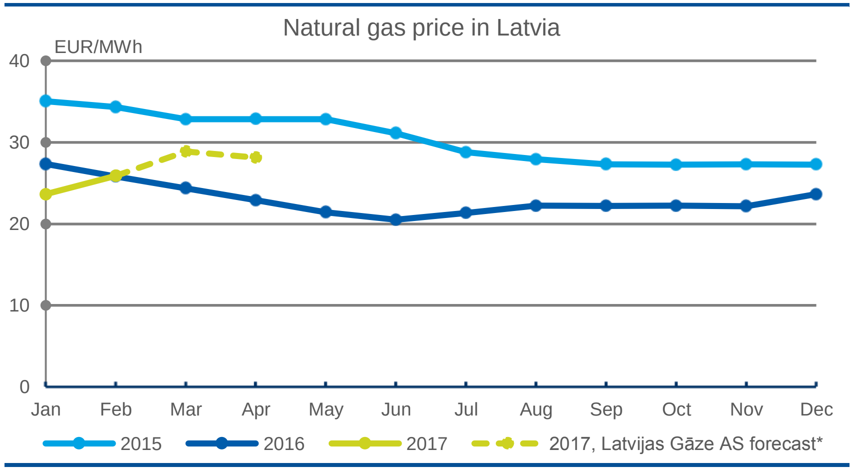
Operating Environment

Natural gas price in Latvia lower

The natural gas price in Latvia is linked to the crude oil product price (to the previous 9-month average heavy fuel oil and diesel quotations index). Due to index change, in 2016, the average price of natural gas (incl. the excise tax and transmission costs) in Latvia for the user group with consumption above 100,000 thousand nm^3 was 23.0 EUR/MWh, which is by 24% lower than in 2015 when it was 30.4 EUR/MWh. The decline of natural gas price is related to the falling prices of crude oil – the average price of *Brent* oil in 2016 decreased by 17% compared to 2015 reaching 43.6 USD/bbl (in 2015: 52.4 USD/bbl).

The decrease in oil prices in 2016 was due to its persistent oversupply in the global oil market. Nevertheless, at the end of the year, after OPEC and other major oil-exporting countries agreed on output cuts, oil prices rose. In December, it reached an average of 53.3 USD/bbl. Thus, it is expected that natural gas price will rise in 2017, conforming to Latvijas Gāze AS gas tariff forecasts in February and in the coming months.

According to Energy Law, it is expected that on 3 April 2017, natural gas market in Latvia will be fully open for all users. Thus, free competition will be ensured in the market and conditions created for traders to expand their business opportunities.



* Tariff forecast of Latvijas Gāze AS in February 2017
http://www.lg.lv/uploads/filedir/File/Vestnesis/2017/2017.02_tarifi.pdf

Slowdown in economic growth in the Baltics

In 2016, the Baltic States experienced an economic growth, which was mainly driven by an increase in household consumption. According to the statistical office of the European Union (Eurostat) the gross domestic product growth rate in 2016 compared to the previous year in Latvia was 1.6% (in 2015: 2.6%), in Lithuania – 2.7% (2.1%) and in Estonia** 1.1% (1.4%). The pace of economic growth in Latvia was positively influenced by improvement in manufacturing and service sectors, countered by a significantly lower activity in the construction industry.

According to *Eurostat* data, in December 2016, the consumer prices in all the Baltic countries have increased. The inflation in Latvia was 2.1%, in Lithuania – 2.0% and in Estonia – 2.4%. In December 2016, compared to December 2015 the consumer price level in the Eurozone increased by 1.1%.

Moody's, credit rating for the Baltic States has not changed in 2016. The credit rating of Latvia and Lithuania is A3 with stable outlook. The credit rating for Estonia is A1 with stable outlook.

** Forecast of European Commission for 2016 https://ec.europa.eu/info/node/9750

Operating Environment

Latvenergo AS Supervisory Board elected

In accordance with the Law On Governance of Capital Shares of a Public Person and Capital Companies, and OECD recommendations, on 16 December 2016, the Shareholder's Meeting of Latvenergo AS elected the Supervisory Board of Latvenergo AS. Its main goal is to enhance efficiency of public assets' management. The Supervisory Board consists of five independent members: Andris Ozoliņš, Andris Liepiņš, Baiba Anda Rubesa, Mārtiņš Bičevskis, and Martin Sedlacky. The Supervisory Board is elected for a five-year term.

Changes in distribution service tariff

As of 1 August 2016, the new balanced electricity distribution system service tariff came into force. The price of electricity distribution consists of two components – a fixed fee for the provision of the connection, and a variable component according to consumed amount.

The new balanced tariffs contribute to effective use of power grid connection capacity. Distribution service tariffs that were effective from April 2011 until 1 August 2016, did not cover all the distribution service costs.

Dividends

According to the law "On the medium-term budgetary framework for 2017, 2018 and 2019" Latvenergo AS in the coming years anticipate a dividend payout for the use of the state capital in the amount of EUR 90.1 million in 2017, in 2018 – EUR 121.7 million and in 2019 – EUR 129.5 million. The actual amount of dividend payout is set at the Shareholder's Meeting of Latvenergo AS after the approval of the annual report, upon evaluation of the results of the previous year.

Latvenergo Group's capital structure ratios (net debt to equity in 31 December 2016 – 25%) are sufficient to proceed with the dividend payout. Latvenergo AS dividends, in addition to the Subsidised Energy Tax (SET) revenue, will be used as a source of funding for the State budget programme *Electricity user support*, thereby retaining the mandatory procurement public service obligation (PSO) fee at the current level during the following years.

Financial Results

In 2016, Latvenergo Group's revenue has not changed significantly compared to last year, and comprises EUR 931.6 million.

EBITDA and profit of the Group increased

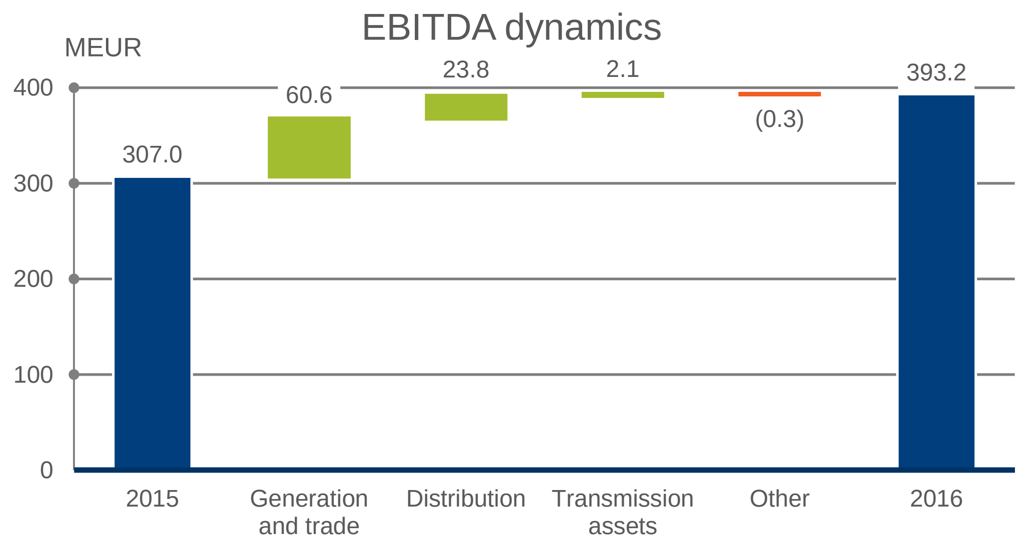
During the reporting period, Latvenergo Group's EBITDA increased by 28% reaching EUR 393.2 million, while Latvenergo Group's profit in 2016 was EUR 129.8 million.

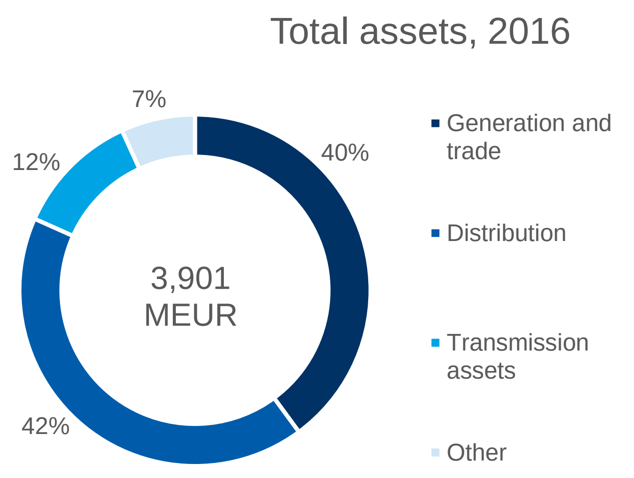
The results of the Group were positively impacted mainly by 36% higher electricity output at Daugava HPPs, as well as lower natural gas and electricity prices in Latvia. Compared to last year, the natural gas price was by 24% lower, while the electricity price was by 14% lower. Results were also positively impacted by EUR 22.9 million increase in distribution service revenue.

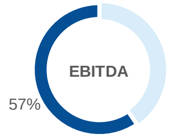
EBITDA has increased in all of the operating segments. Furthermore, the EBITDA margin has improved and reached 42% (in 2015: 33%).

Consequently, profit growth has raised the return on equity to 5.8%, while in the corresponding period last year it was 4.1%.

Financial figures		2016	2015	Δ	Δ, %
Revenue	MEUR	931.6	929.1	2.5	0%
EBITDA	MEUR	393.2	307.0	86.1	28%
Net profit	MEUR	129.8	85.0	44.8	53%
Assets	MEUR	3,901.0	3,517.4	383.6	11%







Generation and Trade

Segment weight in Latvenergo Group

Revenue	59%
EBITDA	57%
Assets	40%
Employees	24%

The generation and trade is the largest operating segment of Latvenergo Group both by revenue and EBITDA value. The majority or 86% of the segment revenue consists of revenue from electricity and related services, while 14% comes from thermal energy supply.

In 2016, revenue of the segment decreased by 4% and comprises EUR 584.1 million. The decrease in revenue was determined by EUR 9.8 million lower thermal energy revenue, driven by lower average price of natural gas. Another factor that had a negative effect on the revenue was the reduction of electricity market price.

EBITDA for the segment increased by 37%, reaching EUR 224.5 million. The results of the segment were positively influenced by higher electricity output at Daugava HPPs, as well as lower prices of the natural gas and electricity.

In 2016, Latvenergo Group increased the amount of electricity generated in its plants. Overall, 62% (in 2015: 49%) of the amount of the total retail electricity supply was generated in Daugava HPPs and Riga CHPPs.

Operational figures		2016	2015	Δ	Δ, %
Electricity supply	GWh	7,580	7,869	(289)	(4%)
Electricity generation	GWh	4,707	3,882	825	21%
Thermal energy generation	GWh	2,675	2,408	267	11%

Financial figures		2016	2015	Δ	Δ, %
Revenue	MEUR	584.1	610.1	(26.0)	(4%)
EBITDA	MEUR	224.5	163.9	60.6	37%
Assets	MEUR	1,557.0	1,548.3	8.7	1%
Investments	MEUR	60.0	57.3	2.7	5%
EBITDA margin		38.4%	26.9%	11.6	43%

Latvenergo Group's electricity trading portfolio management policy provides for a balanced portfolio, aimed at minimizing the impact of electricity market price fluctuations on financial results. The Group applies electricity financial instruments to hedge against fluctuations of electricity purchase expenses resulting from price volatility in the power exchange.

Along with the opening of new interconnections, at the beginning of 2016, the electricity prices in the Baltics depict a tendency to converge with prices in the Nordic countries. Thereby, in the Baltics use of the Nordic financial instruments is even more effective. Closer correlation of electricity prices with the Nordic countries is expected after the completion of the Estonia–Latvia interconnection construction in 2020.

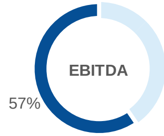
Trade

In 2016, Latvenergo Group has successfully maintained the leading electricity supplier position in the Baltics. Latvenergo Group has approximately 30% of the market share of the Baltic electricity retail market. The overall amount of retail electricity trade outside Latvia accounts for almost 1/3 of the total, reaching 2,376 GWh, which is by 20% higher than the amount provided by competing electricity suppliers in Latvia.

> *Elektrum* electricity products are the most purchased in the Baltics

In 2016, we have supplied 7,580 GWh of electricity to the Baltic retail customers (in 2015: 7,869 GWh). The decrease in the amount of electricity supplied is primarily related to intensified price competition environment in large business customers segment.

Latvenergo Group supplies electricity to the Baltic countries through trade brand *Elektrum*. Its product range consists of a variety of electricity products, tailored to different power consumption volumes and habits, allowing customers to choose the most suitable product for them.



Generation and Trade

Latvenergo Group has managed to maintain stable client portfolio in the Baltics. The total number of foreign clients exceeds 34.7 thousand. Sales activities in Lithuania and Estonia were mainly focused on small and medium sized enterprises. The total number of our clients in this segment has increased by 3%

Latvenergo Group's electricity trade volume in Latvia was 5,204 GWh; in Lithuania – 1,464 GWh and in Estonia – 912 GWh.

Operational figures		**2016**	**2015**	**Δ**	**Δ, %**
Electricity supply	GWh	7,580	7,869	(289)	(4%)
Electricity generation	GWh	4,707	3,882	825	21%
Daugava HPPs	GWh	2,449	1,805	644	36%
Riga CHPPs	GWh	2,206	2,025	181	9%
Liepaja plants and small plants	GWh	52	52	0	0%
Thermal energy generation		2,675	2,408	267	11%
Riga CHPPs	GWh	2,417	2,175	243	11%
Liepaja plants and small plants	GWh	258	234	24	10%

Generation

In 2016, the total amount generated by the power plants of Latvenergo Group comprised 4,707 GWh of electricity and 2,675 GWh of thermal energy.

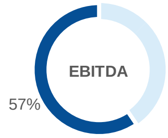
Overall, the amount of electricity generated compared to 2015 has increased by 21%.

In 2016, the amount of power generated by Riga CHPPs was increased by 9%, reaching 2,206 GWh. Favourable conditions for power generation at Riga CHPPs were fostered by the decline in average price of the natural gas by 24% compared to last year. Riga CHPPs ensured effective and operative electricity generation thus precluding the risk of electricity price increase in the region. The role of Riga CHPPs was particularly significant during interruption periods in interconnection operation, as well as, at times when there were fluctuations in generation supply and demand in the neighbouring countries.

In 2016, the amount of power generated by Daugava HPPs has increased by 36%, reaching 2,449 GWh (in 2015 – 1,805 GWh). The increase was fostered by higher water inflow in the river Daugava during the second half of 2016.

Due to optimal mix of Latvenergo Group's generation at Riga CHPPs and Daugava HPPs and the opportunities to import, consumers in the Baltic States benefit from both the price convergence to the Nordic price level and the price stability on the long-term.

In 2016, the total amount of thermal energy generated by Latvenergo Group increased by 11%. The increase was determined by a comparatively lower average ambient air temperature in January and November. According to the data provided by the Central Statistical Bureau of the Republic of Latvia, during the heating season in 2016 (January–April and October–December), the average temperature in Riga was +2.1 ºC, while during 2015 it was +4.0 ºC.



Generation and Trade

Mandatory procurement

As of 1 April 2014, according to the Electricity Market Law, the public trader functions are performed by Enerģijas publiskais tirgotājs AS (until 1 April 2014 – by Latvenergo AS).

Public trader functions comprise obligation to purchase electricity from generators, who have a granted right to supply the generated electricity for the mandatory procurement under electricity purchase tariffs set by legislation, and to pay guaranteed fee for electrical capacity installed at cogeneration power plants.

Mandatory procurement PSO fee remains at the previous level

Mandatory procurement expenditures* are covered through a mandatory procurement PSO fee charged to the end-users in Latvia. The mandatory procurement PSO fee is determined on the basis of the actual costs in the preceding year and approved by the PUC. Mandatory procurement PSO fee changes enter into force on 1 April of the following year.

After the reporting period, on 16 February 2017, the PUC approved the mandatory procurement PSO fee as of 1 April 2017 in the amount of EUR 2.679 cents / kWh, which remains at the same level since 1 April 2014. According to the mandatory procurement component calculation, the division between cogeneration and renewable energy components has changed. Since 1 April 2017 OI cogeneration component has decreased to EUR 1.185 cents / kWh (previously – EUR 1.625 cents / kWh), while the renewable energy component rose to EUR 1.494 cents / kWh (previously – EUR 1.054 cents / kWh). To limit the increase of mandatory procurement PSO fee, there is a State grant in the amount of EUR 62.9 million expected in 2017.

Revenues from SET, which was introduced on 1 January 2014, are used as a funding source for the above mentioned State Budget programme. In the upcoming years, according to the law "On the medium-term budgetary framework for 2017, 2018 and 2019" Latvenergo AS dividends for the use of state capital are expected to be used as additional funding.

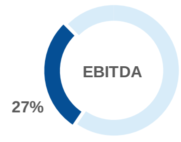
In 2016, mandatory procurement expenditures were EUR 238.0 million (in 2015: EUR 255.7 million). The decrease in expenditure is related to a comparatively lower price of the natural gas.

Following the price reduction, mandatory procurement expenses are lower for cogeneration, biomass and biogas power plants.

In 2016, the assets recognized as unearned PSO fee revenue have not changed significantly and comprise EUR 142.1 million. In April 2016, State grant in the amount of EUR 59.2 million was received, which corresponds to ¾ of the overall grant. The remaining part of the grant in the amount of EUR 19.7 million was received after the reporting period, on 7 February 2017.

Unsettled revenue on mandatory procurement PSO fee recognized as assets		**2016**	**2015**	**Δ**	**Δ, %**
At the beginning of the period	MEUR	**141.1**	**79.0**	**62.0**	**78%**
Mandatory procurement PSO fee income	MEUR	177.7	173.3	4.4	3%
Received State grant	MEUR	59.2	20.3	38.9	191%
Mandatory procurement expenditures *	MEUR	238.0	255.7	(17.7)	(7%)
Incl. cogeneration	MEUR	140.1	155.3	(15.2)	(10%)
Incl. renewable energy resources	MEUR	97.1	99.6	(2.5)	(3%)
At the end of the period	MEUR	**142.1**	**141.1**	**1.1**	**1%**

* Mandatory procurement expenditures – costs of electricity purchased within the mandatory procurement and guaranteed fee for electrical capacity installed at power plants minus revenues from sale of purchased electricity on the Nord Pool exchange and plus the costs of mandatory procurement balancing



Distribution

Revenue
31%

EBITDA
27%

Assets
42%

Employees
61%

Segment weight in Latvenergo Group

The distribution segment is the second largest segment of Latvenergo Group both by revenue and assets. In 2016, revenue of the segment increased by 8% compared to last year and reached EUR 308.4 million, while EBITDA increased by 29% reaching EUR 105.5 million.

The value of distribution assets exceeds EUR 1.6 billion

In 2016, results of the segment were positively impacted by the increase of distribution service revenue (EUR 22.9 million). Growth was determined by the new rebalanced distribution system services tariff that came into force on 1 August 2016. Also, the revenue increase was impacted by 3% higher amount of electricity distributed, and electricity revenue at a regulated tariff received at the beginning of 2015 that were recognized in 2014.

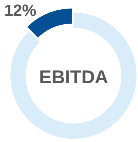
Investment in distribution assets in 2016 has increased by 4% compared to last year, and it reaches EUR 106.4 million.

Operational figures		**2016**	**2015**	**Δ**	**Δ, %**
Electricity distributed	GWh	6,465	6,263 *	202	3%
Distribution losses		4.6%	4.6%	0	0%
SAIFI	number	3.1	3.2	(0.1)	(3%)
SAIDI	minutes	286	350	(64)	(18%)
Financial figures		**2016**	**2015**	**Δ**	**Δ, %**
Revenue	MEUR	308.4	284.4	24.1	8%
EBITDA	MEUR	105.5	81.7	23.8	29%
Assets	MEUR	1,629.1	1,312.8	316.3	24%
Investments	MEUR	106.4	102.0	4.4	4%
EBITDA margin		34.2%	28.7%	5.5	19%

* The volume of electricity distributed excludes 123 GWh; that amount corresponds to the regulated electricity tariff revenues received at the beginning of 2015 that were recognized in 2014

In 2016, revaluation of the distribution assets was accomplished. It must be performed at least once every five years. Due to revaluation, the value of distribution assets has increased by EUR 262.5 million. Therefore, the value of equity and assets of Latvenergo Group increased.

As a result of revaluation and investment, assets of the segment have increased by 24% and comprise EUR 1,629.1 million. Large-scale investments in modernisation of the network are scheduled also for the following years in order to increase the safety and quality of network services, lessen SAIFI and SAIDI indicators, as well as minimize the risk of network disorders caused by severe weather conditions. Since 2012, SAIDI is decreased by 55%, and SAIFI – by 35%.



Lease of Transmission System Assets

Segment weight in Latvenergo Group

Revenue	5%
EBITDA	12%
Assets	12%
Employees	0.2%

Gradual inclusion of regulatory asset revaluation reserve into the rent ensures revenue increase

Revenue of the transmission system asset lease segment represents 5% of Latvenergo Group revenue. In 2016, revenue of the segment increased by 4% reaching EUR 48.4 million, while EBITDA increased by 5% reaching EUR 47.1 million.

The increase in revenue and EBITDA is determined by inclusion of the value of transmission system asset revaluation reserve into the lease for Augstsprieguma tīkls AS.

Financial figures		2016	2015	Δ	Δ, %
Revenue	MEUR	48.4	46.6	1.8	4%
EBITDA	MEUR	47.1	45.0	2.1	5%
Total assets	MEUR	448.7	432.0	16.7	4%
Investments	MEUR	25.5	17.5	8.1	46%

In 2016, revaluation of the transmission assets was accomplished. It must be performed at least once every five years. Due to revaluation, the value of transmission assets has increased by EUR 18.7 million.

The return on transmission system assets in 2016 was 2.4% (in 2015: 4.7%). The change in the ratio value is due to impairment of the transmission assets.

During the reporting year, investment in transmission system assets was EUR 25.5 million, which is by EUR 8.1 million more than in the last year.

Investments

In 2016, the total amount of investment has increased by 5% compared to the last year and it is EUR 200.7 million.

Investment in network assets – 2/3 of the total

To ensure high quality of network service, technical parameters and operation safety, a significant amount is invested in the modernisation of power network. In 2016, the amount invested in the networks represented 64% of the total investment.

In 2016, the amount invested in Daugava HPPs hydropower unit reconstruction was EUR 35.2 million.

Investment projects:

Daugava HPPs hydropower unit reconstruction programme (Daugava HPPs reconstruction)

Deeming environmentally safe, sustainable and competitive operations and effective water resource management as highly important, Latvenergo Group proceeds with gradual overhaul of eleven Daugava HPPs hydropower units that have not been overhauled yet. The programme is scheduled for completion until 2022, with the estimated total reconstruction costs exceeding EUR 200 million. The completed workload within the contract reached EUR 86.7 million as of 31 December 2016. The reconstruction will provide for further 40-year operation of hydropower units.

Kurzeme Ring project

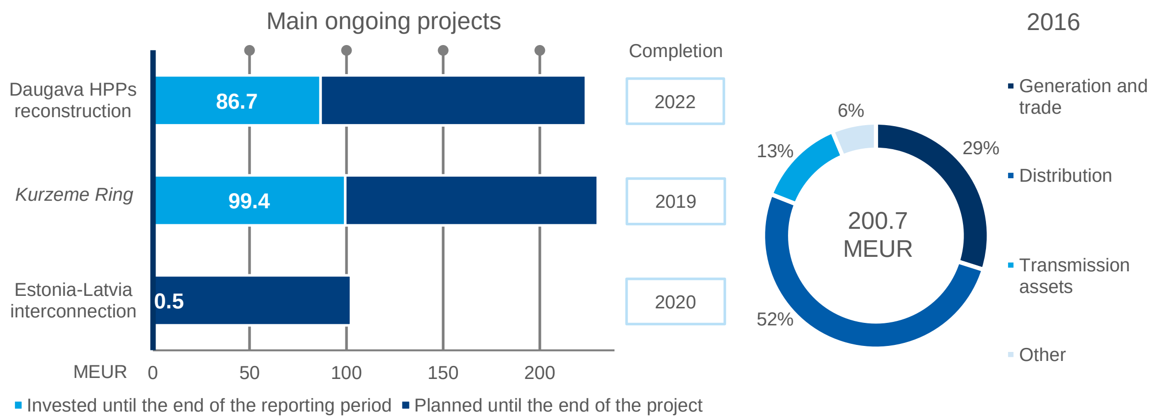
The implementation of *Kurzeme Ring* project is fostering an increase in power supply safety in Kurzeme region and Latvia as a whole, providing for an opportunity of a more effective use of the Lithuania–Sweden marine cable *NordBalt*, allowing further integration of the Baltics into the Nordic electricity market.

The *Kurzeme Ring* project is scheduled for completion in 2019, and the total project construction costs are expected to constitute approximately EUR 230 million. The project has three stages. Investment in the first and second stage of the project comprised a total of EUR 95 million, of which approximately half was covered by the European Commission. For the final stage of the project *Ventspils–Tume–Rīga* a 45% European Union co-funding of construction cost was attracted and environmental assessment has been completed.

In 2016, an agreement on 330 kV line engineering and construction has been signed.

Estonia – Latvia third power transmission network interconnection

The project bears a major significance to the future electricity transmission infrastructure of the whole Baltic region. The construction of the new 330 kV interconnection is scheduled for completion until the end of 2020 and the total construction costs of the project in Latvia are estimated approximately at EUR 100 million. During 2016, the environmental impact assessment of the interconnection project has been approved, and the development of preliminary route project is completed. In August 2016, the activities and location of construction of the interconnection were approved, and it has received a status of an object of national interest. The project is co-funded by the EU covering 65% of eligible costs.



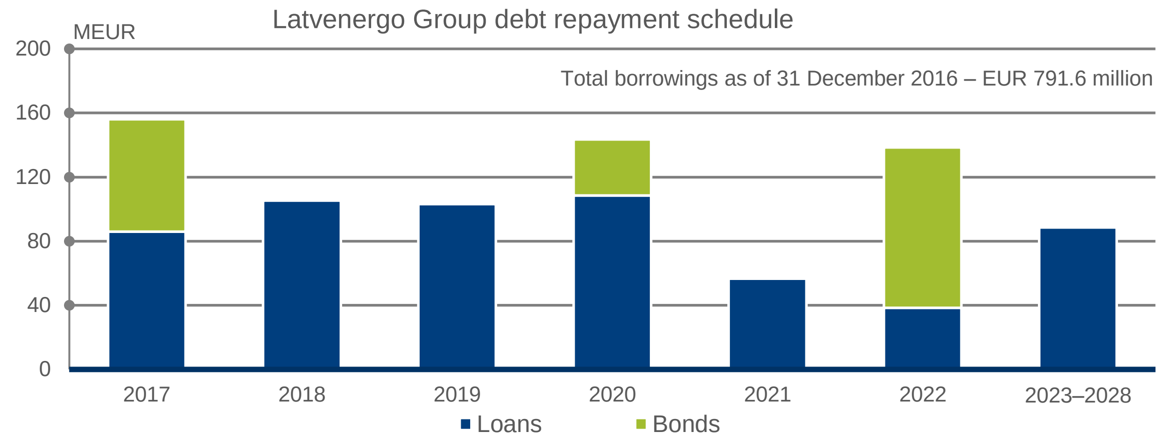
Funding and Liquidity

Latvenergo Group finances its investments from its own resources and external long-term borrowed funds, which are regularly and timely sourced in financial and capital markets. Timely planned sourcing of borrowings is also crucial in order to ensure loan refinancing risk management and debt repayment in due term. External borrowings are ensured to cover requirements at least for the following 12 months.

Moody's assigns the highest Green Bond Assessment grade

As of 31 December 2016, the Group's borrowings are EUR 791.6 million (31 December 2015: EUR 797.5 million), comprising loans from commercial banks, international investment banks, and bonds of EUR 205 million. On 14 April 2016, Latvenergo AS issued *green* bonds in the amount of EUR 25 million, thus completing the second bond offering programme of EUR 100 million. Moody's assigned a Baa2 (stable) credit rating for the bonds. As of 12 October 2016, Moody's assigned the highest Green Bond Assessment grade of GB1 (excellent). This marks the first time when Moody's assesses *green* bonds and even assigns excellent grade for *green* bonds issued in Eastern Europe.

External funding sources in the long run are purposefully diversified, thus creating a balance between lender categories in the total loan portfolio.



As of 31 December 2016, all borrowings are denominated in the euro currency. The weighted average repayment period was 4.0 years (31 December 2015: 4.5 years). Borrowings from financial institutions had a variable interest rate, comprising 3, 6 or 12 month EURIBOR and a margin. Taking into account the effect of interest rate swaps and bonds with fixed interest rate, 62% of the borrowings had a fixed interest rate with an average period of 2.1 year as of 31 December 2016. The effective weighted average interest rate (with interest rate swaps) was 1.9% (31 December 2015: 2.4%). Sufficient coverage of debt service requirements has been ensured (interest coverage ratio – 16.8).

As of 31 December 2016, the net borrowings of Latvenergo Group are EUR 607.6 million (EUR 692.9 million), while the net debt/EBITDA ratio is 1.7 (2.3).

Latvenergo Group maintains sufficient liquidity reserves in order to implement the investment programme and fulfil its commitments according to the debt repayment schedule. As of 31 December 2016, the liquid assets (cash and short term deposits up to 3 months) of Latvenergo Group reached EUR 184.0 million (EUR 104.5 million), while the current ratio was 2.2 (1.9). In 2016, all the binding financial covenants set in Latvenergo Group loan agreements have been met.

After the reporting period, on 16 February 2017, Moody's reconfirmed Latvenergo AS credit rating of Baa2 with stable outlook.

Statement of Management Responsibility

Based on the information available to the Management Board of Latvenergo AS the *Latvenergo Annual Unaudited Condensed Consolidated Financial Statements of 2016*, including the Management Report (have been prepared in accordance with International Financial Reporting Standards that are approved by the European Union), in all material aspects give a true and fair view of assets, liabilities, financial position and profit and loss of Latvenergo Group.

The *Latvenergo Annual Unaudited Condensed Consolidated Financial Statements of 2016* are approved by the Management Board of Latvenergo AS on 27 February 2017.

The Management Board of Latvenergo AS:

Āris Žīgurs
Chairman of the Board

Guntars Baļčūns
Member of the Board

Uldis Bariss
Member of the Board

Māris Kuņickis
Member of the Board

Guntis Stafeckis
Member of the Board

List of Abbreviations and Formulas

Abbreviations

bbl –	barrel of oil (158.99 litres)
Daugava HPPs –	Daugava hydropower plants
EBITDA –	earnings before interest, corporate income tax, share of profit or loss of associates, depreciation and amortization, and impairment of intangible and fixed assets
kV –	kilovolt
MEUR –	million euros
MW –	megawatt
MWh –	megawatt hour (1,000,000 MWh = 1,000 GWh = 1 TWh)
nm^3 –	normal cubic meter
OECD –	The Organisation for Economic Co-operation and Development
PSO –	public service obligation
PUC –	Public Utilities Commission
Riga CHPPs –	Riga combined heat and power plants
SAIDI –	System Average Interruption Duration Index
SAIFI –	System Average Interruption Frequency Index
SET –	Subsidised Energy Tax

Formulas

Net debt = borrowings at the end of the period - cash and cash equivalents at the end of the period

Net debt/EBITDA =

$$\frac{(\text{net debt at the beginning of 12 months period} + \text{net debt at the end of 12 months period}) \times 0.5}{\text{EBITDA (12-months rolling)}}$$

$$\text{EBITDA margin} = \frac{\text{EBITDA (12-months rolling)}}{\text{revenue (12-months rolling)}} \times 100\%$$

$$\text{Net debt/equity} = \frac{\text{net debt at the end of the reporting period}}{\text{equity at the end of the reporting period}} \times 100\%$$

$$\text{Return on assets} = \frac{\text{net profit (12-months rolling)}}{\text{average value of assets}} \times 100\%$$

$$\text{Average value of assets} = \frac{\text{assets at the beginning of 12 months period} + \text{assets at the end of 12 months period}}{2}$$

$$\text{Return on equity} = \frac{\text{net profit (12-months rolling)}}{\text{average value of equity}} \times 100\%$$

$$\text{Average value of equity} = \frac{\text{equity at the beginning of 12 months period} + \text{equity at the end of 12 months period}}{2}$$

$$\text{Return on capital employed} = \frac{\text{operating profit of 12 months period}}{\text{average value of equity} + \text{average value of borrowings}} \times 100\%$$

Average value of borrowings =

$$\frac{\text{borrowings from FI at the beginning of 12 months period} + \text{borrowings from FI at the end of 12 months period}}{2}$$

Interest coverage ratio =

$$\frac{\text{net cash flow from operating activities (12-month rolling)} - \text{changes in working capital} + \text{interest expense (12-month rolling)}}{\text{interest expense (12-month rolling)}}$$

$$\text{Current ratio} = \frac{\text{current assets at the end of the reporting period}}{\text{current liabilities at the end of the reporting period}}$$

$$\text{Return on segment assets} = \frac{\text{operating profit of the segment (12-months rolling)}}{\text{average value of segment assets}} \times 100\%$$

Unaudited Condensed Consolidated Financial Statements

Consolidated Statement of Profit or Loss

	Notes	2016	2015
		EUR'000	EUR'000
Revenue	5	931,619	929,128
Other income		7,947	4,880
Raw materials and consumables used	6	(385,808)	(470,444)
Personnel expenses		(96,019)	(94,609)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment		(232,626)	(198,827)
Other operating expenses		(64,575)	(61,940)
Operating profit		**160,538**	**108,188**
Finance income		2,328	2,926
Finance costs		(14,156)	(18,579)
Profit before tax		**148,710**	**92,535**
Income tax	7	(18,870)	(7,496)
Profit for the year		**129,840**	**85,039**

Consolidated Statement of Comprehensive Income

	2016	2015
	EUR'000	EUR'000
Profit for the year	**129,840**	**85,039**
Other comprehensive income to be reclassified to profit or loss in subsequent periods (net of tax):		
- gains from change in hedge reserve	2,847	4,077
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	**2,847**	**4,077**
Other comprehensive income / (loss) not to be reclassified to profit or loss in subsequent periods (net of tax):		
- gains on revaluation of property, plant and equipment	269,485	20,485
- losses as a result of re–measurement on defined post–employment benefit plan	(2,946)	(1,158)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	**266,539**	**19,327**
Other comprehensive income for the year, net of tax	**269,386**	**23,404**
Total comprehensive income for the year	**399,226**	**108,443**

Consolidated Statement of Financial Position

	Notes	31/12/2016	31/12/2015
		EUR'000	EUR'000
ASSETS			
Non–current assets			
Intangible assets and property, plant and equipment (PPE)	8	3,370,331	3,090,661
Investment property		327	696
Non–current financial investments		41	41
Investments in held–to–maturity financial assets		17,034	20,609
Other non–current receivables		987	1,712
Total non–current assets		**3,388,720**	**3,113,719**
Current assets			
Inventories	9	41,458	24,791
Trade receivables and other receivables	10	273,957	263,452
Deferred expenses		3,227	3,008
Investments in held-to-maturity financial assets		3,520	7,859
Derivative financial instruments		6,134	–
Cash and cash equivalents	11	183,980	104,543
Total current assets		**512,276**	**403,653**
TOTAL ASSETS		**3,900,996**	**3,517,372**
EQUITY			
Share capital		1,288,715	1,288,531
Reserves		937,074	669,596
Retained earnings		185,306	131,662
Equity attributable to equity holder of the Parent Company		**2,411,095**	**2,089,789**
Non–controlling interests		7,084	6,913
Total equity		**2,418,179**	**2,096,702**
LIABILITIES			
Non–current liabilities			
Borrowings	12	714,981	714,291
Deferred income tax liabilities		316,069	273,987
Provisions		18,643	15,984
Derivative financial instruments		7,947	8,291
Other liabilities and deferred income		195,406	196,386
Total non–current liabilities		**1,253,046**	**1,208,939**
Current liabilities			
Trade and other payables		149,547	121,256
Borrowings	12	76,584	83,192
Derivative financial instruments		3,640	7,283
Total current liabilities		**229,771**	**211,731**
TOTAL liabilities		**1,482,817**	**1,420,670**
TOTAL EQUITY AND LIABILITIES		**3,900,996**	**3,517,372**

Consolidated Statement of Changes in Equity

	Attributable to equity shareholder of the Parent Company				Non–controlling interests	TOTAL
	Share capital	Reserves	Retained earnings	Total		
	EUR'000	EUR'000	EUR'000	**EUR'000**	EUR'000	**EUR'000**
As of 31 December 2014	**1,288,446**	**645,829**	**79,995**	**2,014,270**	**6,531**	**2,020,801**
Increase in share capital	85	–	–	**85**	–	**85**
Dividends for 2014	–	–	(31,479)	**(31,479)**	(1,148)	**(32,627)**
Total contributions and profit distributions recognised directly in equity	**85**	**–**	**(31,479)**	**(31,394)**	**(1,148)**	**(32,542)**
Profit for the year	–	–	83,509	**83,509**	**1,530**	**85,039**
Other comprehensive income / (loss)	–	23,767	(363)	**23,404**	–	**23,404**
Total comprehensive income	**–**	**23,767**	**83,146**	**106,913**	**1,530**	**108,443**
As of 31 December 2015	**1,288,531**	**669,596**	**131,662**	**2,089,789**	**6,913**	**2,096,702**
Increase in share capital	184	–	–	**184**	–	**184**
Dividends for 2015	–	–	(77,413)	**(77,413)**	(1,377)	**(78,790)**
Adjustment of property, plant and equipment revaluation reserve, including deferred income tax effect	–	(4,854)	5,711	**857**	–	**857**
Total contributions and profit distributions recognised directly in equity	**184**	**(4,854)**	**(71,702)**	**(76,372)**	**(1,377)**	**(77,749)**
Profit for the year	–	–	128,292	**128,292**	1,548	**129,840**
Other comprehensive income / (loss)	–	272,332	(2,946)	**269,386**	–	**269,386**
Total comprehensive income	**–**	**272,332**	**125,346**	**397,678**	**1,548**	**399,226**
As 31 December 2016	**1 288 715**	**937,074**	**185,306**	**2,411,095**	**7,084**	**2,418,179**

Consolidated Statement of Cash Flows

	Notes	2016	2015
		EUR'000	EUR'000
Cash flows from operating activities			
Profit before tax		148,710	92,535
Adjustments:			
- Amortisation, depreciation and impairment of intangible assets and PPE		237,003	202,903
- Net financial adjustments		4,580	16,213
- Other adjustments		(313)	(735)
Operating profit before working capital adjustments		**389,980**	**310,916**
Increase in current assets		(26,837)	(29,857)
Decrease in trade and other payables		(844)	(20,825)
Cash generated from operating activities		**362,299**	**260,234**
Interest paid		(15,529)	(19,189)
Interest received		2,457	1,606
Repaid / (paid) corporate income tax and real estate tax		(8,041)	3,627
Net cash flows from operating activities		**341,186**	**246,278**
Cash flows from investing activities			
Purchase of intangible assets and PPE		(185,674)	(188,915)
Proceeds on financing from EU funds and other financing		242	17,972
Proceeds from redemption of held–to–maturity financial assets		7,914	70
Net cash flows used in investing activities		**(177,518)**	**(170,873)**
Cash flows from financing activities			
Proceeds from issued debt securities (bonds)	12	26,267	74,893
Proceeds on borrowings from financial institutions	12	55,744	30,000
Repayment of borrowings	12	(87,452)	(134,875)
Dividends paid to equity holder of the Parent Company		(77,413)	(31,479)
Dividends paid to non–controlling interests		(1,377)	(1,148)
Net cash flows used in financing activities		**(84,231)**	**(62,609)**
Net increase in cash and cash equivalents		**79,437**	**12,796**
Cash and cash equivalents at the beginning of the year	11	104,543	91,747
Cash and cash equivalents at the end of the year	**11**	**183,980**	**104,543**

Notes to the Consolidated Financial Statements

1. Corporate Information

All shares of public limited company Latvenergo or Latvenergo AS (hereinafter – the Parent Company) are owned by the Republic of Latvia and are held by the Ministry of Economics of the Republic of Latvia. The registered address of Latvenergo AS is 12 Pulkveža Brieža Street, Riga, Latvia, LV–1230. According to the Energy Law of the Republic of Latvia, Latvenergo AS is designated as a national economy object of State importance and, therefore, is not subject to privatisation.

Latvenergo AS is power supply utility engaged in electricity and thermal energy generation, as well as supply of electricity. Latvenergo AS is one of the largest corporate entities in the Baltics.

Latvenergo AS heads the Latvenergo Group (hereinafter – the Group) that includes following subsidiaries:

- Sadales tīkls AS (since 18 September 2006) with 100% interest held;
- Elektrum Eesti OÜ (since 27 June 2007) and its subsidiary Elektrum Latvija SIA (since 18 September 2012) with 100% interest held;
- Elektrum Lietuva UAB (since 7 January 2008) with 100% interest held;
- Latvijas elektriskie tīkli AS (since 10 February 2011) with 100% interest held;
- Enerģijas publiskais tirgotājs AS (since 25 February 2014) with 100% interest held;
- Liepājas enerģija SIA (since 6 July 2005) with 51% interest held.

Latvenergo AS and its subsidiaries Sadales tīkls AS, Latvijas elektriskie tīkli AS and Enerģijas publiskais tirgotājs AS are also shareholders with 48.15% interest held in Pirmais Slēgtais Pensiju Fonds AS that manages a defined–contribution corporate pension plan in Latvia.

Latvenergo Consolidated Annual Report 2015 has been approved on 5 May 2016 by the Latvenergo AS Shareholder's meeting (see on Latvenergo AS web page section "Investors" – http://www.latvenergo.lv/eng/investors/reports/).

Annual Unaudited Condensed Consolidated Financial Statements of 2016 include the financial information in respect of the Parent Company and its all subsidiaries for the year ended 31 December 2016 and comparative information for the year ended 31 December 2015.

Annual Unaudited Condensed Consolidated Financial Statements of 2016 were authorised by the Latvenergo AS Management Board on 27 February 2017.

2. Summary of Most Significant Accounting Policies

These Consolidated Unaudited Interim Condensed Financial Statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union and principal accounting policies applied to these financial statements were identical to those used in the Consolidated Financial Statements for the 2015 financial year. These policies have been consistently applied to all reporting periods presented, unless otherwise stated. Where it is necessary, comparatives are reclassified.

New or revised IFRS and amendments to International Financial Reporting Interpretations Committee interpretations (IFRIC) that became mandatory for the Group from 1 January 2016 did not have any impact to the significant Group's accounting policies and these Consolidated Interim Condensed Financial Statements.

The Condensed Consolidated Financial Statements are prepared under the historical cost convention, except for some financial assets and liabilities (including derivative financial instruments) measured at fair value through profit or loss and for the revaluation of property, plant and equipment carried at revalued amounts to other comprehensive income as disclosed in accounting policies presented in the Latvenergo Consolidated Annual Report 2015.

Condensed Consolidated Financial Statements had been prepared in euros (EUR) currency and all amounts shown in these Condensed Consolidated Financial Statements are presented in thousands of EUR.

3. Financial Risk Management

3.1. Financial Risk Factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value and cash flow interest rate risk), credit risk, pricing risk and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

Risk management (except for pricing risk) is carried out by the Parent Company's Treasury department (the Group Treasury) according to the Financial Risk Management Policy approved by the Parent Company's Management Board. The Group Treasury identifies, evaluates and hedges financial risks in close co–operation with the Group's operating units / subsidiaries. The Parent Company's Management Board by approving the Financial Risk Management Policy provides written principles for overall risk management, as well as written policies covering specific areas, such as interest rate risk, foreign exchange risk, liquidity risk, and credit risk, use of financial instruments and investment of excess liquidity. Pricing risk management is carried out by the Parent Company's Electricity Trading department according to Electricity Wholesale Regulation approved by the Parent Company's Management Board.

a) Market Risk

I) Foreign Currency Exchange Risk

The introduction of euro in Latvia as of 1 January 2014 prevented the euro currency risk, which primarily was arising from settlements in foreign currencies for borrowings, capital expenditures and imported electricity. As of 31 December 2016 the Group had borrowings denominated only in euros.

In 2016, the Parent Company had not any certain investments, which were exposed to foreign currency risks. The introduction of euro in Lithuania as of 1 January 2015 prevented the euro currency risk arising from Parent Company's investments in subsidiary in Lithuania.

Management has set up a Financial Risk Management Policy inter alia to manage the Group's foreign currencies exchange risk against functional currency. To manage the Group's foreign currencies exchange risk arising from future transactions and recognised assets and liabilities, the Financial Risk Management Policy is to use forward contracts. Foreign currencies exchange risk arises when future transactions or recognised assets or liabilities are denominated in a currency that is not the Group's functional currency.

II) Cash Flow and Fair Value Interest Rate Risk

As the Group has significant floating interest–bearing assets and liabilities exposed to interest rate risk, the Group's financial income and operating cash flows are substantially dependent on changes in market interest rates.

The Group's cash flow interest rate risk mainly arises from long–term borrowings at variable rates. They expose the Group to a risk that finance costs might increase significantly when interest rates rise up. The Group's policy is to maintain at least 35 % of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between 2 – 4 years.

The Group analyses its interest rate risk exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and hedging. Based on these scenarios, the Group calculates the impact on profit and loss as well as on cash flows of a defined interest rate shift.

The Group's borrowings with floating rates do not impose fair value interest rate risk. Derivatives such as interest rate swaps are the only source of fair value interest rate risk.

III) Price Risk

Price risk is the risk that the fair value and cash flows of financial instruments will fluctuate in the future due to reasons other than changes in the market prices resulting from interest rate risk or foreign exchange risk. The purchase and sale of goods produced and the services provided by the Group under the free market conditions, as well as the purchases of resources used in production is impacted by the price risk.

The most significant price risk is related to purchase of electricity. To hedge the risk related to changes in the price of electricity the Parent Company purchases electricity forward and future contracts.

b) Credit Risk

Credit risk is managed at the Group level. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks, outstanding receivables. Credit risk exposure in connection with trade receivables is limited due to broad range of the Group's customers. The Group has no significant concentration of credit risk with any single counterparty or group of counterparties having similar characteristics. Impairment loss has been deducted from gross accounts receivable (Note 10).

Credit risk related to cash and short–term deposits with banks is managed by balancing the placement of financial assets in order to maintain the possibility to choose the best offers and to reduce probability to incur losses.

No credit limits were exceeded during the reporting period, and the Group management does not expect any losses due to occurrence of credit risk.

c) Liquidity Risk

The Group's policy of liquidity risk management is to maintain sufficient amount of cash and cash equivalents, the availability of long and short term funding through an adequate amount of committed credit facilities to meet commitments according to the Group's strategic plans as well as to compensate the fluctuations in the cash flows due to occurrence of variety of financial risks.

The Group management is monitoring rolling forecasts of the Group's liquidity reserve, which comprises of undrawn borrowing facilities, and cash and cash equivalents.

3.2. Capital Risk Management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern as well as to ensure necessary financing for investment program and to avoid breaches of covenants, which are linked to capital structure and are stipulated in the majority of loan agreements.

In order to maintain or adjust the capital structure, the Group may evaluate the amount and timing of raising new debt due to investment programs or initiate new investments in the share capital by shareholder. Also asset revaluation directly influences the capital structure. To comply with loan covenants, the Group monitors capital on the basis of the capital ratio.

This ratio is calculated by dividing the equity by the sum of total assets and nominal value of issued and outstanding financial guarantees.

According to the Group's strategy and defined loan covenants as per loan agreements the capital ratio shall be maintained at least at 30% level.

4. Operating Segment Information

Operating Segments

For segment reporting purposes, the division into operating segments is based on the Group's internal management structure, which is the basis for the reporting system, performance assessment and the allocation of resources by the operating segment decision maker.

The Group divides its operations into three main operating segments – generation and trade, distribution and lease of transmission system assets. In addition, Corporate Functions, that cover administration and other support services, are presented separately.

Generation and trade comprises the Group's electricity and thermal energy generation operations, which are organised into the legal entities: Latvenergo AS and Liepājas enerģija SIA; electricity trade (including electricity wholesale), in the Baltics carried out by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB, as well as administration of the mandatory procurement process provided by Enerģijas publiskais tirgotājs AS.

The operations of the distribution operating segment relates to the provision of electricity distribution services in Latvia and is managed by the subsidiary Sadales tīkls AS (the largest distribution system operator in Latvia) and by Latvenergo AS – the owner of real estate assets related to distribution system assets.

The operations of the lease of transmission system assets operating segment is managed both by Latvijas elektriskie tīkli AS – the owner of transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points), which provides financing of investments in these assets, and Latvenergo AS – the owner of real estate assets related to the transmission system assets, providing the lease of these assets to the transmission system operator Augstsprieguma tīkls AS.

The following table presents revenue, profit information and segment assets of the Group's operating segments. Inter–segment revenue is eliminated on consolidation.

	Generation and trade	Distribution	Lease of transmission system assets	Corporate Functions	TOTAL segments	Adjustments and eliminations	Consolidated
Year ended 31 December 2016	EUR'000	EUR'000	EUR'000	EUR'000	**EUR'000**	EUR'000	**EUR'000**
Revenue							
External customers	570,828	306,700	45,879	8,212	**931,619**	–	**931,619**
Inter–segment	13,310	1,712	2,538	46,330	**63,890**	(63,890)	–
Total revenue	**584,138**	**308,412**	**48,417**	**54,542**	**995,509**	**(63,890)**	**931,619**
Results							
Segment profit	**138,185**	**7,154**	**10,642**	**4,557**	**160,538**	**(11,828)**	**148,710**
Capital expenditure	59,964	106,436	25,513	12,664	**204,577**	(3,900)	**200,677**
Year ended 31 December 2015							
Revenue							
External customers	593,937	282,752	44,151	8,288	**929,128**	–	**929,128**
Inter–segment	16,173	1,599	2,459	46,198	**66,429**	(66,429)	**–**
Total revenue	**610,110**	**284,351**	**46,610**	**54,486**	**995,557**	**(66,429)**	**929,128**
Results							
Segment profit	**87,221**	**(4,177)**	**20,750**	**4,394**	**108,188**	**(15,653)**	**92,535**
Capital expenditure	57,305	101,997	17,453	14,423	**191,178**	(717)	**190,461**

Segment Assets

	Generation and trade	Distribution	Lease of transmission system assets	Corporate Functions	TOTAL segments	Adjustments and eliminations	Consolidated
	EUR'000	EUR'000	EUR'000	EUR'000	**EUR'000**	EUR'000	**EUR'000**
As of 31 December 2016	1,557,032	1,629,107	448,707	88,196	**3,723,042**	177,954	**3,900,996**
As of 31 December 2015	1,555,399	1,336,611	432,030	89,350	**3,413,390**	103,982	**3,517,372**

Adjustments and Eliminations

Finance income and expenses, fair value gains and losses on financial assets are not allocated to individual segments as the underlying instruments are managed on a group basis.

Taxes and certain financial assets and liabilities are not allocated to those segments as they are also managed on a group basis.

Capital expenditure consists of additions of property, plant and equipment, intangible assets and investment properties including assets from the acquisition of subsidiaries.

Reconciliation of Profit

	2016	2015
	EUR'000	EUR'000
Segment profit	**160,538**	**108,188**
Finance income	2,328	2,926
Finance costs	(14,156)	(18,579)
Profit before tax	**148,710**	**92,535**

Reconciliation of Assets

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Segment operating assets	**3,723,042**	**3,413,390**
Connection usage rights	(32,791)	(30,852)
Non–current financial investments	41	41
Held–to–maturity financial assets	20,554	28,468
Derivative financial instruments	6,134	–
Other assets and assets held for sale	36	1,782
Cash and cash equivalents	183,980	104,543
Group operating assets	**3,900,996**	**3,517,372**

5. Revenue

	2016	2015
	EUR'000	EUR'000
Electricity supply and electricity services	483,960	495,010
Distribution system services	290,084	267,189
Heat sales	82,709	92,525
Lease of transmission system assets	46,457	43,630
Other revenue	28,409	30,774
Total revenue	**931,619**	**929,128**

6. Raw Materials and Consumables Used

	2016	2015
	EUR'000	EUR'000
Electricity:		
– purchased electricity	148,447	196,602
– fair value (income) / loss on electricity forwards and futures	(6,514)	446
– electricity transmission services costs	72,584	73,849
	214,517	**270,897**
Energy resources costs	137,720	164,397
Raw materials, spare parts and maintenance costs	33,571	35,150
Total raw materials and consumables used	**385,808**	**470,444**

7. Income Tax

	2016	2015
	EUR'000	EUR'000
Current tax	23,488	5,011
Deferred tax	(4,618)	2,485
Total income tax	**18,870**	**7,496**

8. Intangible Assets and Property, Plant and Equipment

	Intangible assets	Land, buildings and facilities	Technology equipment and machinery	Other property, plant and equipment	Assets under construction	TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	**EUR'000**
As of 31 December 2016						
Cost	48,138	4,615,210	2,059,129	186,445	155,405	**7,064,327**
Accumulated amortisation, depreciation and impairment	(35,116)	(2,342,854)	(1,185,491)	(124,545)	(5,990)	**(3,693,996)**
Net book amount	**13,022**	**2,272,356**	**873,638**	**61,900**	**149,415**	**3,370,331**
As of 31 December 2015						
Cost	46,545	4,469,448	2,072,520	173,118	94,201	**6,855,832**
Accumulated amortisation, depreciation and impairment	(32,483)	(2,455,220)	(1,149,878)	(121,484)	(6,106)	**(3,765,171)**
Net book amount	**14,062**	**2,014,228**	**922,642**	**51,634**	**88,095**	**3,090,661**

9. Inventories

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Raw materials and materials	17,438	17,983
Natural gas	17,506	–
Other inventories	8,173	8,422
Allowance for raw materials and other inventories	(1,659)	(1,614)
Total inventories	**41,458**	**24,791**

10. Trade Receivables and Other Current Receivables

Trade Receivables, net

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Receivables		
– Electricity supply and electricity services customers	133,865	121,112
– Heating customers	11,629	11,735
– Other trade receivables	24,969	25,405
	170,463	**158,252**
Allowances for impairment of trade receivables		
– Electricity supply and electricity services customers	(44,367)	(43,319)
– Heating customers	(391)	(423)
– Other trade receivables	(2,873)	(2,347)
	(47,631)	**(46,089)**
Receivables, net		
– Electricity supply and electricity services customers	89,498	77,793
– Heating customers	11,238	11,312
– Other trade receivables	22,096	23,058
	122,832	**112,163**
Unsettled revenue on mandatory procurement public service obligation fee recognised as assets *	142,132	141,060
Other current receivables and accrued income	8,993	10,229
Total trade receivables and other current receivables	**273,957**	**263,452**

* Unsettled revenue on mandatory procurement PSO fee is recognised as assets in net amount, by applying agent principle, as difference between revenue from sale of electricity in Nord Pool AS power exchange by market price, received mandatory procurement PSO fees, received State grant for compensating the increase of mandatory procurement costs and costs of purchased electricity under the mandatory procurement from electricity generators who generate electricity in efficient cogeneration process or using renewable energy sources, as well as guaranteed fees for installed electrical capacity in cogeneration plants (over 4 MW)

Movements in Allowances for Impairment of Trade Receivables

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**46,089**	**44,003**
Receivables written off during the year as uncollectible	(1,511)	(2,143)
Allowance for impaired receivables	3,053	4,229
At the end of the year	**47,631**	**46,089**

11. Cash and Cash Equivalents

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Cash at bank	176,626	89,391
Short–term bank deposits	7,000	10,000
Restricted cash and cash equivalents *	354	5,152
Total cash and cash equivalents	**183,980**	**104,543**

* Restricted cash and cash equivalents consist of the financial security for participating in NASDAQ OMX Commodities Exchange

12. Borrowings

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Non–current borrowings from financial institutions	509,501	534,586
Issued debt securities (bonds)	205,480	179,705
Total non–current borrowings	**714,981**	**714,291**
Current portion of non–current borrowings from financial institutions	74,219	80,842
Accrued interest on non–current borrowings	594	848
Accrued coupon interest on issued debt securities (bonds)	1,771	1,502
Total current borrowings	**76,584**	**83,192**
Total borrowings	**791,565**	**797,483**

Movement in Borrowings

	2016	2015
	EUR'000	EUR'000
At the beginning of the year	**797,483**	**827,222**
Borrowings received	55,744	30,000
Borrowing repaid	(87,452)	(134,875)
Issued debt securities (bonds)	26,266	74,902
Change in accrued interest on borrowings	(476)	234
At the end of the year	**791,565**	**797,483**

13. Related Party Transactions

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state. Related parties of the Group are associates, Shareholder of the Parent Company who controls or who has significant influence over the Group's entities in accepting operating business decisions, key management personnel of the Group's entities including members of Supervisory body – Audit committee and close family members of any above–mentioned persons, as well as entities over which those persons have control or significant influence.

Balances at the end of the period arising from sales / purchases of goods or services

	31/12/2016	31/12/2015
	EUR'000	EUR'000
Trade payables to related parties:		
– Other related parties	236	252
Total payables	**236**	**252**

In the reporting year ended 31 December 2016 remuneration to the Group's management includes remuneration to the members of the Management Boards, Supervisory Board of the Parent Company and Supervisory body of the Group entities, including salary, social insurance contributions and payments to pension plan and is amounted to EUR 1,977.7 thousand (2015: EUR 1,993.5 thousand) and included in the Consolidated Income Statement position 'Personnel expenses'.

14. Events after the Reporting Period

On 7 February 2017 Enerģijas publiskais tirgotājs AS received the remaining part of State grant for compensation of mandatory procurement PSO costs in the amount of 19,7 million EUR.

On 16 February 2017 Enerģijas publiskais tirgotājs AS submitted to Public Utilities Commission calculation of mandatory procurement public service obligation fees as of 1 April 2017 in the amount of EUR 2.679 cents/kWh.

On 16 February 2017 international credit rating agency Moody's Investors Service has affirmed the credit rating of Latvenergo AS to Baa2 (stable).

There have been no other significant events subsequent to the end of the reporting year that might have a material effect on the Annual Unaudited Condensed Consolidated Financial Statements of 2016.

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