

## AS LATVENERGO

### **Supplement No.2 to the Base Prospectus of the Programme for the issuance of Notes in the amount of LVL 85,000,000 or its equivalent in EUR**

This document (the “**Supplementary Prospectus**”) constitutes a supplement to the Base Prospectus of AS Latvenergo (the “**Company**”) Programme for the issuance of Notes in the amount of LVL 50,000,000 or its equivalent in EUR (the “**Base Prospectus**”), approved by the Company on 23 November 2012 and registered with the Latvian Financial and Capital Market Commission on 28 November 2012.

This Supplementary Prospectus, which is a part of the Base Prospectus, is a supplement to the Base Prospectus and should be read together with the Base Prospectus.

This Supplementary Prospectus has been prepared:

- (i) due to the fact that the Company has decided to increase the aggregate principal amount of the Notes to be issued under the Programme from LVL 50,000,000 or its equivalent in EUR to LVL 85,000,000 or its equivalent in EUR;
- (ii) due to the fact that the Company has approved audited consolidated annual report of the Group for the year ended 31 December 2012;
- (iii) in order to make other relevant changes in the Base Prospectus.

1. Section under the heading “Authorisation of the Shareholders Meeting of the Issuer” on page 31 of the Base Prospectus shall be replaced as follows:

“The shareholder of the Issuer has at its meetings on 13 June 2012 (Meeting minutes No.7., 3.§) and on 19 April 2013 (Meeting minutes No.4., 4.§) authorised the issue of the Notes and authorised the Management Board of the Issuer to approve the characteristics of the Notes, the Base Prospectus, as well as any amendments thereof.”

2. Section under the heading “Principal Amount and Issuance of the Notes” on page 31 of the Base Prospectus shall be replaced as follows:

“The Issuer may issue the Notes up to an aggregate principal amount of LVL 85,000,000 (eighty five million lats) or its equivalent in EUR. The terms and conditions of each Series of Notes shall consist of these General Terms and Conditions and the Final Terms. The General Terms and Conditions shall apply for each Series of Notes.”

3. The heading and first Section of the form of the final terms on page 44 of the Base Prospectus shall be replaced as follows:

**“Final Terms dated [●]  
AS Latvenergo  
Issue of [●] Notes due [●]  
under the LVL 85,000,000 (or equivalent in EUR)  
Programme**

These Final Terms together with the General Terms and Conditions of the LVL 85,000,000 (or equivalent in EUR) Programme of AS Latvenergo, as set forth in the Base Prospectus of the Programme dated 23 November 2012 [as supplemented by supplement(s) dated [●] [and [●]], constitutes the Final Terms of the

Series of Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus.”

4. Due to the amendments in Sections “Information About the Group”, “Information About the Group’s Business Operations”, “Administrative, Management and Supervisory Bodies”, “Board Practices”, “Selected Consolidated Financial Information” and “Financial and Trend Information”, the aforementioned Sections, and for ease of reference – also Sections “Organisational Structure”, “Shareholders”, “Additional Information” and “Glossary”, on pages 47-67 of the Base Prospectus shall be replaced as it is stated in Annex No.2 of this Supplementary Prospectus.
5. Description of the risk factors under the headings “Regulated electricity and heat market”, “Electricity market opening in Latvia”, “Foreign expansion” and “Risk of breaching financial covenants and other obligations under the loan agreements” shall be replaced as follows:

***“Regulated electricity and heat market***

Approximately 60 per cent of the Group’s revenues during 2012 were generated by primary business activities in regulated electricity and heat markets. Although, it is expected that due to electricity market liberalization the proportion of income from regulated electricity market will decrease, it will still represent significant share of the Group’s revenues.

The revenue in regulated electricity and heat markets is highly dependable on tariffs approved by the regulator, as well as it is dependable on legislative norms governing methodology of applying respective tariffs.

The tariffs are reviewed or approved by the regulator based on the Group’s proposals and in accordance with the methodology. There are risks that not all costs will be covered by such regulated tariffs or by other reasoning, such as social and political, not allowing the Group to recover full costs. Besides, there is a risk of material adverse effect on the Group due to delayed decisions on regulatory issues by respective state authorities or due to changes in local or EU legislative environment governing relevant regulatory matters.

***Electricity market opening in Latvia***

The market liberalization and the opening of the electricity market in Latvia started in 2007. The electricity market for certain groups of electricity consumers is open for competition and since 1 November 2012 electricity market is open for all customers in Latvia, except the household segment. It is expected that electricity market for households will be opened in the foreseeable future, but certain date is not yet set. Delay, suspension or revision of the deregulation process thus may have a material adverse effect on the Group.

Additionally, market opening is expected to create more competitive environment and the Group expects new market entrants, thus there is a risk of diminishing market share, and risk of decreasing price at which the Group is able to sell its electricity. That may have material adverse effect to the Group’s business and financial position. In addition, the Group may face potential competitors from neighbouring countries that can exploit their competitive advantages resulting from ability to generate large volumes of electricity at a lower marginal cost than the Group.

***Foreign expansion***

Simultaneously with opening of electricity markets in neighbouring countries the Group commenced expansion into new electricity markets of Lithuania and Estonia. In 2012, the market share obtained by the Group in Lithuanian electricity market was 11 per cent (unregulated market share – 17 per cent) and in Estonian electricity market – 6 per cent (unregulated market share - 18 per cent). As from 1 January 2013, the electricity market in Estonia is fully open for competition, while the Lithuanian market is open for all customers except the household segment. The opening of all retail electricity markets for competition in the Baltic States is reasonably expected by the end of 2015. Newly created electricity markets are not mature, thus causing risks and opportunities due to anticipated increase of client switching between prospective electricity suppliers. The market share in the Baltic’s indicates the Group’s current standing, but there is a risk that the market share may be possibly diminished or the Group may be unable to attain anticipated market share growth thus causing adverse effects on the Group’s business and financial position.

Notwithstanding that there are no indications on possible decisions that may suspend, alter or significantly delay market liberalization processes, such suspensions, alterations and delays may cause negative consequences to the Group's business and financial position.

***Risk of breaching financial covenants and other obligations under the loan agreements***

The existing Group's long term loan agreements generally have certain financial covenant clauses. In addition, the loan agreements provide for certain other obligations and representations the violation of which may lead to an event of default and acceleration of the loans. While the Group has not breached such provisions in the past, however, the Group's ability to comply with covenants and restrictions contained in the loan agreements may be affected by events beyond its control, including prevailing economic, financial, legal and industry conditions. In the event that these obligations were to be breached, the involved creditors would be able to declare an event of default pursuant to the relevant facility agreements and require prepayment of the entire outstanding amounts. Due to the cross default clauses in the loan agreements, the Company may need to refinance substantial part of its outstanding debt. Ability to raise funding for refinancing of respective debt portfolio or negotiate other terms with the existing lenders might be limited, thus causing significant going concern risk for the Group."

6. Second paragraph under the heading "General" on page 2 of the Base Prospectus shall be replaced as follows:

"Items included in this Base Prospectus, as well as in the audited consolidated annual reports of the Group for the years ended 31 December 2010, 2011 and 2012 respectively are measured using the currency of the primary economic environment in which the Group's entity operates (the "**Functional Currency**"). Those items for consolidation propose are presented in LVL, which is the Issuer's Functional Currency and the Group's presentation currency. All transactions denominated in foreign currencies are translated into the Functional Currency at the exchange rates set by the central bank of the respective primary economic environment in which the respective Group's entity operates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the Functional Currency using the exchange rate set by the central bank of the respective primary economic environment in which the respective Group's entity operates at the last day of the reporting period. The resulting gain or loss is charged to the Consolidated Income Statement. For consolidation purposes the results and financial position of all the Group's entities (none of which has the currency of a hyper-inflationary economy) that have a Functional Currency different from LVL are translated into LVL as follows: (i) assets and liabilities for each financial position presented are translated at the closing rate set by the Bank of Latvia at the date of that financial position; (ii) income and expenses for each income statement are translated at average exchange rates set by the Bank of Latvia (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate set by the Bank of Latvia on the dates of transactions)."

7. Section under the heading "Third Party Information and Statement by Experts and Declarations of any Interest" on page 29 of the Base Prospectus shall be replaced as follows:

"This Base Prospectus contains auditor's reports for 2010, 2011 and 2012. During the preparation of the Base Prospectus, information provided on the websites of the Central Bureau of Statistic of Latvia, Eurostat, AS SEB banka and the Public Utilities Commission was used. This information has been accurately reproduced and as far as the Company is aware and was able to ascertain from the information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading."

8. First paragraph under the heading "Credit Ratings" on page 28 of the Base Prospectus shall be replaced as follows:

"The Issuer is rated Baa3 with a stable outlook by Moody's Investors Service. The rating and outlook was reaffirmed on 19 March 2013."

9. Paragraphs (d) and (e) under Section "Documents on Display" on page 76 of the Base Prospectus shall be replaced with new paragraph (d) follows:

"(d) Latvenergo Group Sustainability and Annual Report 2012 (Latvenergo Group Annual Report 2012 prepared according to IFRS)."

10. Section under the heading "Taxation of the Noteholders Entities" on pages 68-69 of the Base Prospectus shall be replaced as follows:

"Resident Entities

An entity will be considered as a resident of Latvia for tax purposes if it is or should have been established and registered in the Republic of Latvia in accordance with the legislative acts of the Republic of Latvia. This may also include permanent establishments of foreign entities in Latvia.

In accordance with the Law on Corporate Income Tax the income from the Notes (interest payments, as well as gains) for the resident entities, will not be subject to any withholding tax in Latvia, however such income will be included in the annual taxable income of the respective entities, subject to the corporate income tax at the rate of 15 per cent. Currently the Parliament of the Republic of Latvia is considering amendments to the Law on Corporate Income Tax, which would provide that if the Notes are listed on a regulated market of the European Union or the European Economic Area, the gains realised from the sale of the Notes may be excluded from the taxpayer's annual taxable income in Latvia.

Non-Resident Entities

In accordance with the Law on Corporate Income Tax the interest income from the Notes for non-resident entities will not be taxable in Latvia, except:

- if the receiver qualifies as an affiliated party to the Issuer within the meaning of the Law on Corporate Income Tax, in which case: (i) if the receiver is a resident of European Union until 30 June 2013 5 per cent withholding tax would apply, deductible by the Issuer before the payment, whereas after that date such payments would be exempt from tax in Latvia; (ii) if the receiver is a resident of another country until 31 December 2013 10 per cent. withholding tax would apply, deductible by the Issuer before the payment, whereas after that date such payments would be exempt from tax in Latvia;
- if the receiver is located in tax haven, as determined by the Republic of Latvia Cabinet Regulations No. 276 Regulations on Low Tax or Zero Tax Countries and Territories, in which case 15 per cent. withholding tax would apply, deductible by the Issuer upon the payment, unless an exemption relief is received from the State Revenue Service.

The income from the alienation of the Notes will not be subject to tax in Latvia."

11. Section under the heading "Resident Individuals" on page 69 of the Base Prospectus shall be replaced as follows:

„In accordance with the Estonian Income Tax Act an individual will be considered as a resident of Estonia for taxation purposes:

- if the individual's place of residence is in Estonia, or
- if the individual stays in Estonia for at least 183 days over a period of 12 consecutive calendar months, or
- if the individual is Estonian diplomat who is in foreign service.

If the residency determined on the basis of an international agreement to which Estonia is a party differs from the residency determined pursuant to the Estonian Income Tax Act, the provisions of the international agreement apply.

In accordance with the Estonian Income Tax Act the interest income from the Notes received by a resident individual is subject to income tax at the rate of 21 per cent. Income tax which has been withheld on interest income received from abroad is deducted from the income tax to be paid in Estonia, in accordance with the conditions specified in the Estonian Income Tax Act.

The income from the transfer of the Notes is also subject to income tax at the rate of 21 per cent. Income tax is charged on the gain derived from the transfer of the Notes, i.e. on the difference between the acquisition cost and the selling price of the Notes. Resident individual has a right to deduct documented expenses

directly related to the transfer of the Notes from the gain. Resident individual also has a right to deduct any loss suffered upon the transfer of other securities from the gain derived from the transfer of the Notes, in accordance with the conditions specified in the Estonian Income Tax Act.

Different taxation rules apply for the transfer of the Notes if the resident individual uses an investment account as specified in the Estonian Income Tax Act. It is possible for individuals to postpone the tax liability created on income derived from the transfer of financial assets as specified in the Estonian Income Tax Act (including publicly offered securities and securities traded in a securities market) until the gain is withdrawn from the investment account to be used for other purposes (i.e. not to be reinvested into other financial assets)."

12. Section "The Republic of Latvia" on pages 73-75 of the Base Prospectus shall be replaced as it is stated in Annex No.3 to this Supplementary Prospectus.
13. In order to reflect the amendments stated above in the Summary of the Base Prospectus, the Summary of the Base Prospectus shall be replaced as it is stated in Annex No.1 to this Supplementary Prospectus.

This Supplementary Prospectus has been registered with the Latvian Financial and Capital Market Commission.

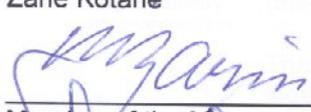
The Supplementary Prospectus should be read together with the Base Prospectus. The definitions used in the Base Prospectus are applicable also to this Supplementary Prospectus. In the event of any discrepancy between this Supplementary Prospectus and the Base Prospectus or any other document incorporated in the Base Prospectus by reference, the Supplementary Prospectus shall take precedence.

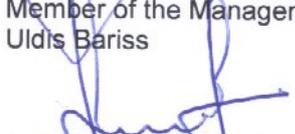
Riga, 23 April 2013

Management Board of AS Latvenergo:

  
 Chairman of the Management Board (CEO)  
 Āris Žīgurs

  
 Member of the Management Board (CFO)  
 Zane Kotāne

  
 Member of the Management Board (CCO)  
 Uldis Bariss

  
 Member of the Management Board (CAO)  
 Arnis Kurgs

  
 Member of the Management Board (COO)  
 Māris Kuņickis

## ANNEX No.1

## SUMMARY

This summary is made up of disclosure requirements known as “**Elements**”. These Elements are numbered in Sections A-E (A.1-E.7). This summary contains all the Elements required to be included in a summary for this type of securities and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements. Even though an Element may be required to be inserted in the summary because of the type of securities and the issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary together with a statement of that the Element is not applicable.

## Section A - Introduction and warnings

A.1 This summary must be read as an introduction to this Base Prospectus and any decision to invest in the Notes should be based on a consideration of the Base Prospectus as a whole, including the documents attached to the Base Prospectus, and the Final Terms of the relevant Notes.

Where a claim relating to the information contained in this Base Prospectus is brought before a court in a Member State, the plaintiff may, under the national legislation of the Member State where the claim is brought, be required to bear the costs of translating the Base Prospectus before the legal proceedings are initiated.

Civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the Base Prospectus or it does not provide, when read together with the other parts of the Base Prospectus, key information in order to aid investors when considering whether to invest in such securities.

## Section B - Issuer

B.1	Legal and commercial name	The Issuer’s legal and commercial name is Akciju sabiedrība Latvenergo.
B.2	The domicile and legal form of the issuer, the legislation under which the issuer operates and its country of incorporation	<p>The Issuer is a public limited company (<i>akciju sabiedrība</i>) incorporated pursuant to the laws of the Republic of Latvia on 8 October 1991. The Issuer is registered with the Commercial Register of the Republic of Latvia under the registration number 40003032949 and its registered address is Pulkveža Brieža 12, Rīga, LV-1230, Latvia (telephone number +371 67 728 222).</p> <p>The Issuer operates according to the legislation of the Republic of Latvia. The main legal acts of the Republic of Latvia which regulate the operations of the Issuer are:</p> <ul style="list-style-type: none"> <li>- the Commercial Law (<i>Komerclikums</i>);</li> <li>- the Law on State and Municipality Capital Shares and Capital Companies (<i>Likums “Par valsts un pašvaldību kapitāla daļām un kapitālsabiedrībām”</i>);</li> <li>- the Energy Law (<i>Enerģētikas likums</i>); and</li> <li>- the Electricity Market Law (<i>Elektroenerģijas tirgus likums</i>).</li> </ul>
B.4b	A description of any known trends affecting the issuer and the industries in which it operates	At the date of this Base Prospectus there are no information on any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the Issuer’s or the Group’s prospects and the industries in which the Issuer or the Group operates in the financial year of 2013.
B.5, B14	If the issuer is part of a group, a description of the group and the issuer’s position within the group	<p>The Issuer is a parent company of the Group. As at the date of the Base Prospectus the Group includes the Issuer and its six subsidiaries:</p> <ul style="list-style-type: none"> <li>- three companies incorporated in Latvia: AS Latvijas elektriskie tīkli (100 per cent), AS Sadales tīkls (100 per cent), and SIA Liepājas enerģija (51 per cent);</li> </ul>

If the issuer is dependent upon other entities within the group, this must be clearly stated

- Elektrum Lietuva UAB (100 per cent) incorporated in Lithuania; and
- Elektrum Eesti OÜ (100 per cent) incorporated in Estonia. Elektrum Eesti OÜ is also the sole shareholder of SIA Elektrum Latvija.

The Issuer is also a shareholder in two associated companies:

- Nordic Energy Link AS (Estonia) (25 per cent); and
- AS Pirmais Slēgtais Pensiju Fonds (Latvia) (the Issuer's shareholding - 46.3 per cent (the Group's shareholding - 48.15 per cent)).

The Issuer has also a 0.005 per cent shareholding in the Latvian company AS Rīgas Siltums.

**B.9** Where a profit forecast or estimate is made, state the figure  
Not applicable. The Issuer has not made any profit forecast or profit estimate in this Base Prospectus.

**B.10** A description of the nature of any qualifications in the audit report on the historical financial information  
Not applicable. None of the audit reports on the Group's audited consolidated annual reports for the years ended 31 December 2010, 2011 and 2012 respectively includes any qualifications.

**B.12** Selected historical key financial information regarding the issuer, presented for each financial year of the period covered by the historical financial information, and any subsequent interim financial period accompanied by comparative data from the same period in the prior financial year except that the requirement for comparative balance sheet information is satisfied by presenting the year end balance sheet information  
The following summary of the Group's consolidated financial performance and key performance indicators as of, and for each of the years ended 31 December 2010, 2011 and 2012 has been extracted, without any adjustment, from the Group's consolidated financial statements in respect of those dates and periods.

		Year ended 31 December 2010	Year ended 31 December 2011	Year ended 31 December 2012
		<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>Financial Highlights</b>				
Revenue	LVL thousand	567,386	681,767	751,038
Including electricity and electricity services sales	LVL thousand	476,737	593,092	600,511
Heat sales	LVL thousand	71,863	69,233	90,548
EBITDA	LVL thousand	207,240	179,892	171,783
EBITDA margin		37%	26%	23%
Operating profit	LVL thousand	61,826	52,656	49,587
Operating margin		11%	8%	7%
Net profit	LVL thousand	44,325	43,778	35,741
Net profit margin		8%	6%	5%
Return on assets (ROA)		2.2%	1.9%	1.5%
Return on equity (ROE)		4.0%	3.2%	2.6%
Non-current assets at the end of the period	LVL thousand	1,942,231	2,026,594	2,180,111
Total assets at the end of the period	LVL thousand	2,279,266	2,288,004	2,472,290
Total equity at the end of the period	LVL thousand	1,344,748	1,351,576	1,410,510
Borrowings at the end of the period	LVL thousand	545,607	513,334	595,235
Cash flows from operating activities	LVL thousand	160,563	180,399	150,769
Capital expenditure	LVL thousand	127,539	198,723	185,723
Net debt at the end of the period	LVL thousand	311,342	404,457	424,810
Net debt/EBITDA ratio		1.5	2.2	2.5
<b>Operating Highlights</b>				
Retail electricity supply	GWh	7,620	8,980	8,287
Wholesale electricity supply	GWh	1,414	2,283	1,886
Electricity produced in power plants	GWh	5,869	5,285	5,077
Total amount of purchased	GWh	3,339	6,150	5,273

A statement that there has been no material adverse change in the prospects of the issuer since the date of its last published audited financial statements or a description of any material adverse change

A description of significant changes in the financial or trading position subsequent to the period covered by the historical financial information	electricity				
	Including purchased electricity from independent producers	GWh	693	759	1,036
	The rest amount of purchased electricity	GWh	2,646	5,392	4,237
	Aggregate heat sales	GWh	2,928	2,524	2,669
	Number of employees at the end of the period		4,517	4,490	4,457
	Moody's credit rating of the Issuer		Baa3 (stable)	Baa3 (stable)	Baa3 (stable)

There has been no material adverse change in the prospects of the Issuer or the Group since the date of the audited consolidated annual report of the Group for 2012.

There has been no material adverse change in the Issuer's or the Group's financial or trading position since 31 December 2012.

**B.13** A description of any recent events particular to the issuer which are to a material extent relevant to the evaluation of the issuer's solvency

Not applicable. There have not been any recent material events that would be relevant for assessing solvency of the Issuer and the Group.

**B.15** A description of the issuer's principal activities

The Group divides its operations into three main operating segments – generation and supply, distribution system services and management of transmission system assets.

*The generation and supply operating segment* comprises the Group's electricity and heat generation operations, which are organised into the legal entities: the Issuer and SIA Liepājas enerģija, as well as wholesale and retail electricity sales operations which are conducted Pan-Baltic by the Issuer and the Issuer's subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

*The operations of the distribution system services operating segment* relates to the provision of electricity distribution services in Latvia and is managed by the Issuer's subsidiary AS Sadales tīkls, the largest distribution system operator in Latvia, and the Issuer - the owner of the distribution system real estate assets. In 2011 distribution assets (excluding the real estate) owned by the Issuer were invested in the equity of AS Sadales tīkls for the purpose of establishing the distribution system operator as required by the market liberalisation.

*The management of transmission system assets operating segment* comprises construction and maintenance of the transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points) as well as the lease of assets to the transmission system operator AS Augstsprieguma tīkls. The Republic of Latvia has applied the second unbundling model under EU Directive 2009/72/EC, which provides that the electricity transmission system assets shall remain with a vertically integrated utility, while the activities of the transmission system operator are independently managed. The results of the management of transmission system assets segment derives from activities both of the Issuer's subsidiary AS Latvijas elektriskie tīkli, in which transmission system assets (excluding the real estate) were invested by the Issuer in 2011, and the Issuer - the owner of the transmission system real estate assets.

**B.16** To the extent known to the issuer, state whether the issuer is directly or indirectly owned or controlled and

The Issuer is incorporated as a public limited company (*akciju sabiedrība*) under the laws of the Republic of Latvia. The Republic of Latvia is the sole shareholder of the Issuer. The Ministry of Economics of the Republic of Latvia holds all the shares in the Issuer on behalf of the Republic of Latvia.

by whom and describe the nature of such control.

- B.17 Credit ratings assigned to the issuer or its debt securities at the request or with co-operation of the issuer in rating process
- The Issuer is rated Baa3 with a stable outlook by Moody's Investors Service. The rating and outlook was reaffirmed on 19 March 2013.
- The Series of Notes issued under the Programme may also be rated or unrated. Such ratings will not necessarily be the same as the rating assigned to the Issuer. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

**Issue specific summary:**

The Notes to be issued [are not/have been/are expected to be] rated [by:[●]]

## Section C - Securities

- C.1 A description of the type and the class of the securities being offered and/or admitted to trading, including any security identification number
- Unsecured Notes with an aggregate nominal value up to LVL 85,000,000 or its equivalent in EUR.
- The Notes are dematerialized debt securities in bearer form.
- The identification numbers (ISIN codes) for each Series of Notes will be provided in the Final Terms.

**Issue specific summary:**

Number of Series of Notes: [●]

ISIN Code: [●]

- C.2 Currency of the securities issue
- LVL or EUR.
- Issue specific summary:**  
The currency of the Notes: [●]
- C.5 A description of any restrictions on the free transferability of the securities
- The Notes are freely transferable securities. However, the Notes cannot be offered, sold, resold, transferred or delivered in such countries or jurisdictions or otherwise in such circumstances in which it would be unlawful or require measures other than those required under Latvian laws, including the United States of America, Australia, Canada, Hong Kong and Japan.

- C.8, C.9 A description of the rights attached to the securities including
- ranking
  - limitations to those rights
  - the nominal interest rate
  - the date from which interest becomes payable and the due dates for interest
  - where the rate is not fixed, description of the underlying on which it is based
  - maturity date and arrangements
- Ranking**
- The Notes constitute direct, unsecured and unguaranteed obligations of the Issuer, ranking *pari passu* without any preference among each other and with all unsecured, unguaranteed and unsubordinated indebtednesses of the Issuer, save for such obligations as may be preferred by mandatory provisions of the law.
- Issue Price**
- The Notes may be issued at their nominal amount or at a discount or a premium to their nominal amount.
- Interest rate**
- The Notes shall bear interest at fixed Annual Interest Rate. The interest on the Notes will be paid annually at the dates specified in the Final Terms of the relevant Series of Notes. Interest shall accrue for each interest period from and including the first day of the interest period to (but excluding) the last day of the interest period on the principal amount of Notes outstanding from time to time. The first interest period commences on the Issue Date and ends on the first Interest Payment Date. Each consecutive interest period begins on the previous Interest Payment Date and ends on the following Interest Payment Date. The last interest period ends on the Maturity Date.

- for the amortisation of the loan, including the repayment procedures
- an indication of yield
- name of representative of debt security holders

Interest in respect of the Notes will be calculated on the basis of the actual number of days elapsed in the relevant interest period divided by 365 (or, in the case of a leap year, 366), i.e. a day count convention Act/Act (according to International Securities Market Association) will be used.

**Issue specific summary:**

Interest Payment Date: [●] each year

**Indication of Yield**

An expected Yield to Maturity Range for the Series of Notes being offered will be specified in the Final Terms of the respective Series of Notes. However, during the Placement Period of the respective Series of Notes the Issuer has a right to update the expected Yield to Maturity Range.

**Determination of the Final Yield to Maturity, Interest Rate and Issue Price**

The Final Yield to Maturity will be determined after the Placement Period on the basis of submitted Purchase Orders of the investors. The Final Yield to Maturity shall be the same for all investors acquiring the Notes of the respective Series of Notes during the offering.

The Annual Interest Rate (the coupon) shall be set by rounding down the Final Yield to Maturity to the nearest tenth of the rounded digit (which itself is set in percentage terms).

The Issue Price of the Notes will be established by the Issuer according to the formula provided in the Final Terms.

**Issue specific summary:**

Formula for calculation of the Issue Price: [●]

The Issue Price of the Notes established according to the respective formula will be rounded down to the nearest thousandth of the rounded digit under arithmetic rounding rules.

Information about the established Annual Interest Rate, Issue Price, the aggregate principal amount of the respective Series of Notes and definitive amount of the Notes to be issued will be published on the Issuer's website [www.latvenergo.lv](http://www.latvenergo.lv) and will, if so agreed between the Issuer and the Issuing Agent, also be published on the Issuing Agent's website [www.seb.lv](http://www.seb.lv), as well as submitted to the Financial and Capital Market Commission after allotment of the Notes to the investors.

**Maturities**

Each Series of Notes may have a maturity between 5 (five) and 7 (seven) years or such other maturity as the Issuer decides, but in any case not shorter than 12 (twelve) months.

**Issue specific summary:**

Maturity Date: [●]

**Redemption**

The Notes shall be repaid in full at their nominal amount at the Maturity Date. The Issuer does not have a right to redeem the Notes prior to the Maturity Date, unless the Issuer has prepaid the Notes in case of Change of Control or an Event of Default or in case the Noteholders' Meeting, upon proposal of the Issuer, has decided that the Notes shall be redeemed prior to the Maturity Date.

**Representative of debt security holders**

The rights of the Noteholders to establish and/or authorize an organization/person to represent interests of all or a part of the Noteholders are not contemplated, but on the other hand these are not restricted. The Noteholders should cover all costs/fees of

such representative(s) by themselves.

- |      |   |   |
|------|---|---|
| C.10 | If the security has a derivative component in the interest payment, provide a clear and comprehensive explanation to help investors understand how the value of their investment is affected by the value of the underlying instrument(s), especially under the circumstances when the risks are most evident | Not applicable. The Notes have no derivative component in the interest payment.   |
| C.11 | Indication as to whether the securities offered are or will be the object of an application for admission to trading, with a view to their distribution in a regulated market or other equivalent markets with indication of the markets in question  | The Issuer will submit an application regarding inclusion of each Series of Notes in the official list of AS NASDAQ OMX Riga. An application will be prepared according to the requirements of AS NASDAQ OMX Riga and will be submitted to AS NASDAQ OMX Riga not later than 3 (three) months after the Issue Date of the respective Series of Notes. |

## Section D - Risks

D.2 Key information on the key risks that are specific to the issuer

### Risks Related to Macroeconomic Conditions

- The ongoing market liberalization in Latvia, Lithuania and Estonia, further Group's expansion into neighbouring energy markets creates growing exposures of the Group's business and financial results to macroeconomic developments. Thus local, as well as global macroeconomic trends may have a material adverse effect on the Group's business and financial position.
- Severe and long-term downturn in the economy would have an impact on the Group's customers and may have a negative impact on the Group's growth and results of operations through reduced electricity consumption, as well as limited funding availabilities.

### Risks Related to Business Operations

- The sole shareholder of the Issuer is the Republic of Latvia. Thus, certain and substantial shareholder's decisions alternating the Group's strategic orientation or decisions in respect of dividend policy, capital structure and other material issues could have a material adverse effect on the Group.
- The Group's revenues in regulated electricity and heat markets are highly dependable on tariffs approved by the regulator, as well as on applicable legislative norms for the methodology thereof. There are risks that not all costs will be covered by such approved tariffs, as well as that changes in local or EU legislative environment governing relevant regulatory matters may have an

adverse effect on the Group.

- The delay or suspension of the currently ongoing electricity market liberalization in Latvia may have material adverse effect on the Group. Besides, the market opening is expected to create more competitive environment and the new market entrants, which may reduce the Group's market share, as well as may affect the pricing policy and the Group's business and financial position.
- The Group's expansion in the markets of other Baltic States may be affected by delays in market liberalization processes, as well as the Group may not be able to obtain the expected market share there.
- The Group's electricity generation portfolio does not meet the needs of the electricity supply portfolio, thus throughout the year approximately two-thirds of the Group's electricity supply to retail sector is subject to price volatility risks in the electricity wholesale market. There is a risk that availability of hedging instruments is limited due to low liquidity in the market or hedging does not provide the required efficiency.
- The Group's core business operations are partially influenced by weather conditions. In addition, the heat demand is influenced by the competitive position in heat supply market. Due to this, the Group's overall financial position may be influenced by seasonality, weather fluctuations, as well as long-term shifts in climate.
- The Issuer's participation (which at this date is uncommitted) in Visaginas nuclear power plant project may expose the Issuer to certain risks in relation to the operation and decommissioning of nuclear facilities, the manipulation, treatment, disposal and storage of radioactive materials and the potential harmful effects on human health of such materials. Besides, the project would be capital intensive and may require significant investments and/or guarantees from the Group.
- Due to the fact that the electricity transmission system assets in Latvia are owned by the Group, but operated by a third party AS Augstsprieguma tīkls, there is a risk that the transmission system operator incorporates in the long-term plan less investment in the existing assets than would be required to maintain the assets, thus reducing their value and causing loss to the Group. In addition, since part of the investments is co-financed by the EU funds, in case of objections from the EU the Group may need to increase its financing share in the existing transmission system asset construction projects, which accordingly would reduce the available funds for other projects or could result in increased debt levels.
- In addition to aforementioned risks, the Group's business and financial position may be negatively affected by a counterparty risk, political and regulatory risk, asset damage risk, litigation and dispute risk, resource risk, execution of investment projects risk, distribution system investment risk, sovereign debt crisis risk, environmental damage, health and safety risk.

### **Financial Risks**

- The Group is exposed to currency risk, as all Group's outstanding loans are denominated in euro currency, and the significant part of the expenses is in euro, but the main part of the Group's incomes is in lats. Although, lat is pegged to euro, any unfavourable fluctuations in lats/euro exchange rate or exchange rate policies in the future may have material adverse impact on the Group's operations, prospects and financial results.

D.3 Key information on the key risks that are specific to the securities

- The violation of the financial covenants or certain other obligations and representations under the loan agreements, may lead to an event of default and acceleration of the loans. Due to the cross default clauses in loan agreements, the Issuer may need to refinance substantial part of its outstanding debt.
- A downgrade of the Issuer's credit rating may increase its costs of funding and/or reduce its access to funding and may require the Issuer to provide additional security for contracts which may increase the costs of transactions. Any adverse change in an applicable credit rating could also adversely affect the trading price of the Notes.
- In addition to aforementioned risks, the Group's business and financial position may be negatively affected by the interest rate risk and liquidity risk.
- The Notes may not be a suitable investment for all investors. Thus, each potential investor in the Notes must assess the suitability of that investment in light of its own circumstances, including the effects on the value of such Notes and the impact this investment will have on its overall investment portfolio.
- The investors may forfeit the interest and principle amount invested, in case the Issuer becomes insolvent.
- The Notes will be unsecured obligations of the Issuer, without any additional guarantees and securities; in case of the Issuer's insolvency the Noteholders will become unsecured creditors.
- Due to the fact that in accordance with the Latvian laws certain key-assets of the Issuer can only be owned by the Issuer or its wholly-owned subsidiaries, claims will not be enforceable against such assets.
- Any adverse change in the financial condition or prospects of the Issuer may have a material adverse effect on the liquidity of the Notes, and may result in a material decline in their market price, and thus may affect prompt and full payment to the Noteholders.
- The Notes constitute a new issue of securities by the Issuer, thus it is possible that an active market for the Notes may not develop or may not be maintained, as well as it may be affected by the changes in market and economic conditions, financial conditions and prospects of the Issuer, which accordingly may have an impact on the liquidity and market price of the Notes.
- The Notes will bear interest at a fixed interest rate, which accordingly exposes a risk that a price of such security may be affected by the changes in the market interest rate. Also inflation may result in a decline of the market price of the Notes, as it decreases the purchasing power of a currency unit and respectively the received interest.
- The payments on the Notes will be made in LVL or EUR (depending on the currency of the respective Notes), accordingly the fluctuations in exchange rates and interest rates may adversely affect the value of the Notes, if the investor's financial activities are denominated principally in another currency unit. The government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect the applicable exchange rate. In addition, investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.
- In case the Notes are rated by independent credit rating agencies, such ratings may not reflect the potential impact of all risks related to the Notes, as

well as it may be revised or withdrawn by the rating agency at any time.

- The Notes are governed by the laws of the Republic of Latvia, as in force from time to time, which may change during the validity of the Notes, thus no assurance can be given as to the impact of any such possible change of laws or regulations. Hence, such changes may have a material adverse effect on the Issuer, as well as the Notes.
- The investment activities of certain investors are subject to legal investment laws and regulations, or reviews or regulations by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent the Notes are legal investment for the investor, use of the Notes as a collateral, as well as if there are no other restrictions applicable for the purchase or pledge of the Notes.
- The Notes do not contain covenants governing the Issuer's operations and do not limit its ability to merge, to sell the assets or otherwise effect significant transactions that may have a material adverse effect on the Notes and the Noteholders. Thus, in the event that the Issuer enters into such a transaction, Noteholders could be materially adversely affected. Furthermore, subject to the relevant amendments to the law, the current shareholder of the Issuer may dispose any or all of its shareholding.
- Only the shareholder of the Issuer has voting rights in the shareholders meetings of the Issuer. The Notes carry no such voting rights. Consequently, the Noteholders cannot influence any decisions by the Issuer's shareholders concerning, for instance, the capital structure of the Issuer.
- The decisions of the Noteholders Meeting (including amendments to the General Terms and Conditions of the Notes) will be binding to all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.
- The Issuer is not prohibited from issuing further debt. This, accordingly, may increase the number of claims that would be entitled to share rateably with the Noteholders in any proceeds distributed in connection with an insolvency of the Issuer. Further, any provision which confers, purports to confer, or waives a right to create security interest in favour of third parties, such as a negative pledge, is ineffective against third parties, thus such security interest in favour of a third party, even if created in breach of the Issuer's obligations and undertakings herein, would be a valid and enforceable security interest over the pledged asset.

## Section E - Offer

- |      |  |   |
|------|--|---|
| E.2b | Reasons for the offer and use of proceeds when different from making profit and/or hedging certain risks | The Group has established a capital expenditures programme in relation to the maintenance and renewal of the Group's generation, distribution and transmission network assets. The net proceeds from the issue of the Notes will be used by the Issuer for financing part of the capital expenditures programme, including but not limited to financing of renewal of transmission and distribution lines, reconstruction of transformer substations, investments in voltage quality improvement, as well as replacement of overhead lines with cable lines to improve the quality and reliability of electricity supply to customers and to reduce the network losses. |
| E.3  | A description of the terms and conditions of the offer   | <p><b>The Arranger of the Programme and Issuing Agent</b></p> <p>The Arranger of the Programme and the Issuing Agent is AS SEB banka (registration number: 40003151743, legal address: Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia).</p>   |

**Issue Date**

The Issue Date will be specified in the Final Terms of the respective Series of Notes.

**Issue specific summary:**

Issue Date: [●]

**Aggregate principal amount**

The aggregate principal amount of each Series of Notes shall be specified in the Final Terms.

**Issue specific summary:**

Aggregate principal amount: [●]

**Nominal amount of the Note**

The nominal amount of each Note shall be at least EUR 100, in case the Notes are issued in EUR, or at least LVL 100, in case the Notes are issued in LVL.

**Issue specific summary:**

Nominal amount of the Note: [●]

**Minimum Investment Amount**

The Notes will be offered for subscription in a Minimum Investment Amount which will be specified in the Final Terms of the respective Series of Notes.

**Issue specific summary:**

Minimum Investment Amount: [●]

**Placement Period**

Placement Period for each Series of Notes will be specified in the Final Terms.

**Issue specific summary:**

Placement Period: [●]

**Covenants**

Change of Control, Negative Pledge, Cross Default and others.

**Depository**

The Notes will be book-entered within AS Latvian Central Depository (*AS Latvijas Centrālais Depozitārijs*).

**Applicable law**

Latvian Law.

E.4	A description of any interest that is material to the issue/offer including conflicting interests	Save for the commissions to be paid to the Arranger of the Programme and the Issuing Agent, so far as the Issuer is aware, no person involved in the offer of the Notes has an interest material to the issue/offer, nor any conflicting interests.
E.7	Estimated expenses charged to the investor by the issuer or offeror	No expenses or taxes will be charged to the investors by the Issuer in respect to the issue of the Notes. However, the investors may be obliged to cover expenses which are related to the opening of the securities accounts with credit institutions or investment brokerage firms, as well as commissions which are charged by the credit institutions or investment brokerage firms in relation to the execution of the investor's purchase or selling orders of the Notes, the holding of the Notes or any other operations in relation to the Notes. Neither the Issuer, nor the Arranger of the Programme or the Issuing Agent will compensate the Noteholders for any such expenses.

## INFORMATION ABOUT THE GROUP

### General information

The legal and commercial name of the Company is AS Latvenergo. The Company is a public limited company (*akciju sabiedrība*) incorporated pursuant to the laws of the Republic of Latvia on 8 October 1991. The Company is registered with the Commercial Register of the Republic of Latvia and operates according to the legislation of the Republic of Latvia. All the shares of the Company are owned by the Republic of Latvia and held by the Ministry of Economics of the Republic of Latvia.

#### *Basic information*

Registration number: 40003032949  
Registered address: Pulkveža Brieža 12, Rīga, LV-1230, Latvia  
Webpage: [www.latvenergo.lv](http://www.latvenergo.lv)  
Telephone number: +371 67 728 222

### History and development of the Group

In October 1939, the first hydroelectric unit of Ķegums hydropower plant - the first hydropower plant on the River Daugava, was launched.

On 22 December 1939, the National Electricity Company Ķegums was founded, which is the historical starting point of the Group.

In 2<sup>nd</sup> half of the 20<sup>th</sup> century the power system in the territory of Latvia was developed and the electrification of Latvia was launched. The main power plants were constructed and gradually put into operation, including Pļaviņas hydropower plant (1965) and Rīga hydropower plant (1974) on the River Daugava and Rīga TEC-1 combined heat and power plant (1955) and Rīga TEC-2 combined heat and power plant (1975). The transmission and distributions systems were established throughout the respective time period.

During 1990 – 2012, extensive reconstruction and renovation works of the power stations and transmission and distributions systems were made in order to improve the capacity, efficiency and safety.

In 1989, the production company Latvenergo was established.

In 1991, the production company Latvenergo was restructured into a state owned enterprise.

In 2001, Latvenergo's wholly-owned subsidiary AS Augstsprieguma tīkls was established, which deals with the transmission of electric power. In 2005, AS Augstsprieguma tīkls started to function as the legally independent transmission system operator.

In 2005, the Company's subsidiary SIA Liepājas Enerģija was established, which deals with electricity and thermal energy generation, transmission and sales in Liepāja district. The Company possess a 51 per cent controlling share in SIA Liepājas Enerģija.

In 2006, the Company's wholly-owned subsidiary AS Sadales tīkls was established, which deals with the distribution of electric power. In 2007, AS Sadales tīkls started to function as the legally independent distribution system operator.

In 2007-2008, the Group expanded its business abroad. The Company's wholly-owned subsidiaries Latvenergo Kaubandus OÜ was established in Estonia and Latvenergo Prekyba UAB in Lithuania with the main business area - electricity trade in each particular country. In 2012, the Estonian and Lithuanian subsidiaries acquired a new trade name – Elektrum – and were registered as Elektrum Eesti OÜ and Elektrum Lietuva UAB.

In 2011-2012, for the purpose of fulfilling the requirements of legal and functional unbundling of transmission system ownership from generation, distribution and supply activities, the Company's wholly-owned subsidiary AS Latvijas elektriskie tīkli was established to be the owner of the electricity transmission system

and the transmission system operator AS Augstsprieguma tīkls was sold to the Republic of Latvia in person of the Ministry of Finance.

At the date of this Base Prospectus the Company is the parent company of the Group. The Group includes six subsidiaries, of which five are wholly-owned by the Company.

### Key consolidated figures

The following table summarizes key consolidated financial data and the volume of electricity sales and generation for the period 2008 to 2012.

		2008	2009	Year ended 31 December 2010 (Audited)	2011	2012
<b>Key Financial data (the Group)</b>						
Revenue	LVL million	476	501	567	682	751
EBITDA <sup>1)</sup>	LVL million	107	145	207	180	172
Net profit	LVL million	7	20	44	44	36
Total assets at the end of the period	LVL million	1,681	1,699	2,279	2,288	2,472
Total equity at the end of the period	LVL million	866	889	1,345	1,352	1,411
Net debt at the end of the period <sup>2)</sup>	LVL million	393	352	311	404	425
Net debt/EBITDA ratio <sup>3)</sup>		3.7	2.4	1.5	2.2	2.5
<b>Electricity sales and generation (the Group)</b>						
Electricity supply	GWh	7,461	6,659	7,620	8,980	8,287
Generated electricity	GWh	4,566	4,872	5,869	5,285	5,077

1) EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible and fixed assets.

2) Net debt – borrowings at the end of the year minus cash and cash equivalents at the end of the period.

3) Calculated for rolling twelve months.

The equity of the Group has increased steadily from LVL 866 million in 2008 to LVL 1,411 million at the end of 2012. The capital structure of the Group has been stable, with equity to assets ratio ranging between 52 per cent and 60 per cent since 2008. Net profit of the Group in 2012 was LVL 36 million, by LVL 8 million less than in 2011. The results of the year were negatively impacted by LVL 11 million increase of provisions for receivables compared to 2011, of which major part relates to specific one off provision for a single client. There have not been any recent material events that would be relevant for assessing solvency of the Company and the Group.

### Strategic perspective

Developments towards further integration of the Baltic electricity market with that of the Nordic region is expected to continue over the next few years. It is expected that additional connection between Estonia and Finland will be available in 2014, extending total connection to 1,000 MW from the current 350 MW. In addition, in 2016 Lithuania will be connected to Sweden through the 700 MW cable connection being constructed. These factors will change the characteristics of the Baltic electricity market, increasing availability of electricity imports from Scandinavia to the Baltics and changing the pricing principles in the market. As the size of the Scandinavian market is considerably larger, the market price of electricity will be determined by demand and supply relationship in Scandinavia and the Baltic markets will be price takers in the integrated Nordic electricity market. The Group aims to make use of the business opportunity that the new market situation in Baltics creates. The following sections summarise key strategic challenges and goals in main operations of the Group.

#### *Electricity supply*

The Group supplies electricity in all three Baltic markets. The Group expanded its operations to Estonia and Lithuania from the time of the market openings in these countries. Since first market experience, the Group has adjusted internal processes and systems with a focus to continuously improve and extend the Group's customer services. In 2012, the Group was the largest retail electricity supplier by its market share in the Baltics.

Although electricity markets are not yet fully liberalized in the Baltics, it is expected that market liberalization will be completed by the end of 2015. As of 1 January 2013, the share of the regulated market in the Baltics has contracted substantially to approximately 25 per cent. Since 1 January 2013 the Estonian electricity market has become opened to all customers, while the Lithuanian market was opened to all corporate business customers. Responding to the new market openings and development of the Group's retail customer sector is the Group's key strategic objective for next three to five years. The key challenge in the electricity supply segment is to sustain the Groups overall Baltic market share by substituting market share loss in Latvia with increased market shares in Estonia and Lithuania.

#### *Electricity and Heat Generation*

The Group's electricity generation business line operations are well integrated with the retail market aspirations, thus partly providing internal hedge between generation and electricity supply. This allows diminishing the exposure to electricity price fluctuations and provides the Group with opportunity to benefit from own generation. At the same time, the generation portfolio is sufficiently flexible and most of the time enables switching to imports to explore low price periods available in the Nordic electricity market. The Group benefits from a large proportion of hydro generation capacity, as well as newly renovated combined heat and power plant units, which allows the Group to effectively combine heat and electricity output generation during the heating season.

The Group's key strategic targets for the generation segment are related to current plant efficiency improvements and diversification of the Group's generation portfolio. The basis of efficiency improvement is the existing hydro power plants where the Group would aim to optimise resource consumption by improving production efficiency rate. The diversification of the generation portfolio is assessed in two directions – geographical expansion within the Baltics and underlying generation resource variations. One of the strategically interesting opportunities is participation in Visaginas nuclear power plant project in Lithuania.

#### *Distribution sector*

The balanced maintenance and further modernisation of the distribution network in Latvia is another strategic target of the Group. The electricity distribution operations are regulated activities that provide stable cash flows to the Group. Appreciating that further investments in the network directly impact network tariffs, the Group is undergoing one time process to define network investment prioritizing criteria. The investment priorities shall take into account existing electricity consumption which shall improve the rate of return on distribution assets.

## INFORMATION ABOUT THE GROUP'S BUSINESS OPERATIONS

The Group divides its operations into three main operating segments – generation and supply, distribution system services and management of transmission system assets.

*The generation and supply operating segment* comprises the Group's electricity and heat generation operations, which are organised into the legal entities: the Company and SIA Liepājas enerģija, as well as wholesale and retail electricity sales operations which are conducted Pan-Baltic by the Company, and the Company's subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

*The operations of the distribution system services operating segment* relates to the provision of distribution services in Latvia and is managed by the Company's subsidiary AS Sadales tīkls, the largest distribution system operator in Latvia, and the Company - the owner of the distribution system real estate assets. In 2011 distribution assets (excluding the real estate) owned by the Company were invested in the equity of AS Sadales tīkls for the purpose of establishing the distribution system operator as required by the market liberalisation.

*The management of transmission system assets operating segment* comprises construction and maintenance of the transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points) as well as the lease of assets to the transmission system operator AS Augstsprieguma tīkls. The Republic of Latvia has applied the second unbundling model under EU Directive 2009/72/EC, which provides that the transmission system assets shall remain with a vertically integrated utility, while the activities of the transmission system operator are independently managed. The results of the management of transmission system assets segment derives from activities both of the Company's subsidiary AS Latvijas elektriskie tīkli, in which transmission system assets (excluding the real estate) were invested by the Company in 2011, and the Company - the owner of the transmission system real estate assets.

In addition to these three main operating segments there are *corporate functions*, comprising administration and other support services, although these do not form a separate operating segment.

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

### Generation and supply

Generation and supply is the largest operating segment of the Group, comprising 65 per cent of Group total revenues and 43 per cent of Group total assets for the year 2012. Generation and supply segment revenue reached LVL 525 million, while the segment's EBITDA was LVL 74 million in 2012. Supply can be further subdivided into two groups – unregulated and regulated electricity supply. In addition, the Group's wholesale trading unit manages the Group's energy portfolio. The wholesale unit balances the Group's electricity demand and supply in all three Baltic States.

The aggregate operating segment revenues also include revenues from sales of heat produced at the Group's plants. The heat sales amounted to LVL 91 million in 2012, accounting for 12 per cent of total Group revenues. Approximately 90 per cent of total heat produced by the Group is sold to the Riga district heating company at regulated tariffs.

The generation business is subdivided according to generation types – CHPPs, HPPs and other generation units. Total installed electrical capacity of the Group's plants is 2,349 MW, of which 34 per cent are represented by CHPPs and 65 per cent by HPPs. The total installed thermal energy capacity of the Group is 2,052 MW.

#### *Unregulated electricity market retail*

The Group has historically managed to replace the market share decrease in the Latvian market with expanding operations and increased market shares in Estonia and Lithuania respectively. In 2012, the Group sold more electricity (1,580 GWh) outside of Latvia than it lost to competitors in Latvia (920 GWh).

### *Market outlook*

The Baltic electricity market is currently in the process of liberalisation, which is promoted by the implementation of the Baltic Energy Market Interconnection Plan (BEMIP). The market liberalization and the opening of the electricity market in Latvia started in 2007, in Lithuania and Estonia in 2010. As of 1 November 2012 the Latvian electricity market is open for all customer segments with the exception of the household segment. It is expected that in Latvia the electricity market for households will be opened in the foreseeable future, although no date is yet set. Since 1 January 2013 the Estonian electricity market has become opened to all customers, while the Lithuanian market was opened to all corporate business customers. As a consequence, the share of regulated market in the Baltics has declined to approximately 25 per cent as from 1 January 2013. It is expected that the Lithuanian electricity market will be fully open in 2015.

### *Size of the market and competition*

In 2012, the size of the Baltic electricity market was approximately 25 TWh. The largest market is Lithuania with 10 TWh, followed by the Estonian market with 8 TWh and the Latvian market with 7 TWh. The Lithuanian market is also the largest Baltic market in terms of number of consumers – 1.5 million. The Estonian electricity market is the largest among the three countries measured by per capita electricity consumption. The relatively higher electricity consumption level in Estonia is explained by the country's substantial level of industrialization and a relatively higher number of homes heated with electricity.

The Group is the largest electricity retailer in the Baltic's servicing about one third of all Baltic clients. The Group is a market leader in Latvia, holding an 88 per cent market share in 2012 (unregulated market share – 81 per cent). The Group's market shares in Lithuania and Estonia in 2012 were 11 per cent (unregulated market share - 17 per cent) and 6 per cent (unregulated market share - 18 per cent) respectively. The Group's main competitor in the Baltic market is Eesti Energia, holding approximately 32 per cent of the overall Baltic market, and being the market leader in Estonia. The market is more fragmented in Lithuania, where the Group is among the four largest market players. A significant competitor in all three markets is also the Russian electricity supplier Inter Rao with its subsidiaries in Lithuania, Latvia and Estonia.

To further strengthen the Group's retail operations, the new retail brand "Elektrum" was developed and introduced in Estonia and Lithuania in 2012. The key aim of the introduction of "Elektrum" brand name is to establish the perception of the brand as a local player in all three markets.

With the expected further liberalization of the electricity market in the Baltic States, the Group has further developed its product portfolio aimed specifically to meet the preferences of retail customers.

### *Regulated electricity market retail*

A precondition for retail sales in the regulated Latvia's market is a valid public supplier license which is issued by the Public Utilities Commission ("**PUC**") for a period of five years. The Company's current public supplier licence is valid until 14 October 2013. Under the license, the Company has an obligation to supply electricity at regulated tariff to qualifying market customer in Latvia. As of 31 December 2012, the Company had approximately 840 thousand regulated market customers. Until 1 November 2012, the regulated tariff in Latvia was available for all household and commercial customers whose main fuse rating does not exceed 100A. As from 1 November 2012 only the household customer segment is subject to regulated tariffs. Application for a new public supplier licence may be initiated 3 months prior the expiration date of the current licence.

In addition to other tasks, the PUC is the state body responsible for developing tariff calculation methodologies, as well as reviewing tariff calculations prepared by the Company. On 1 April 2011, a new fixed end user tariff of LVL 0.1065 per kWh (*Base tariff*) came in force. Based on the current methodology, the PUC approves the end user tariff, for which the electricity component represents approximately 33 per cent of the total tariff. The electricity component in the current base tariff is included at the estimated electricity market price of LVL 35 per MWh. There is, however, a special provision in the current tariff plan, which allows the household segment to apply a decreased tariff for the first 1200 kWh used per year. The decreased tariff (*Start tariff*) is LVL 0.0818 per kWh.

## Electricity wholesale trade

The key tasks of the Group's electricity wholesale unit include the balancing of electricity demand and supply in all three Baltic States for the Group's supply and generation portfolios. The Group's electricity wholesale unit also manages ancillary power supply services and the mandatory electricity procurement process from the generators in Latvia that qualify for special state support plans.

In addition, the Group's electricity wholesale unit is responsible for managing electricity price fluctuation risks including the use of electricity price hedging transactions for this purpose.

The Group conducts physical electricity trading on the Nord Pool Spot bidding areas for Estonian and Lithuania, in bilateral markets with other electricity producers, as well as trades electricity derivatives on the Nasdaq OMX Commodities exchange. The Nord Pool Spot bidding area is expected to open in Latvia on 3 June 2013.

The electricity public supplier licence provides an obligation for the Group to purchase electricity from supported generation types under the feed-in tariff scheme (a policy mechanism designed to accelerate investments in renewable energy technologies). With this state support, the Government aims to increase the amount of electricity produced through renewable sources. The higher costs for producing electricity through renewable sources are covered through a public service obligation fee charged to the end users. The feed-in tariff in Latvia applies to two groups of generation types – renewable generation units (such as wind farms, small hydro generators, biomass and biogas) and effective cogeneration units. The intensity of the state support varies with the generation type. The public service obligation fee is changed on 1 April each year, and is based on the actual costs incurred in the previous year and the actual amount of electricity procured. From the 1 April 2013, the fee is set at LVL 18.9 per MWh, and the next revision of the fee is planned for 1 April 2014. The Group's CHPPs and Liepāja plant receive payments from feed-in tariff schemes.

The Company calculates and transfers support to qualifying generation units, as well as recalculates and submits to the PUC for approval annual public service obligation fees.

## Generation

The Group has a balanced energy production portfolio, consisting of efficient power stations and renewable energy sources. The Group generates electricity at three HPPs on the River Daugava, two CHPPs in Riga, the Liepāja city plants, the Aiviekste HPP and the Ainaži wind power plant. Thermal energy is produced at the two Riga CHPPs, the Liepāja city plants and the Ķegums boiler house. The Group produces about 80 per cent of the total electricity output in Latvia and about 70 per cent of the total thermal energy output in Riga.

The total electrical capacity of generators installed at the Group's production facilities as at 31 December 2012 was 2,349 MW, whereas the total heat generation capacity of installed thermal generation facilities was 2,052 MW.

The Group's installed electrical capacity as per 31 December 2012:

	<i>(MW)</i>
Daugava HPPs .....	1,536
Riga CHPPs .....	806
Liepāja plants .....	6
Small plants .....	1
<b>Total</b> .....	<b>2,349</b>

The Group's thermal energy capacity of installed generation facilities as per 31 December 2012:

	<i>(MW)</i>
Riga CHPPs .....	1,840
Liepāja plants .....	208
Small plants .....	4
<b>Total</b> .....	<b>2,052</b>

### *Generation at HPPs*

The Group's three largest HPPs – the *Pļaviņas*, *Ķegums* and *Rīga* plants - are located on the River Daugava. In 2012, the respective HPPs produced 71 per cent of the total electricity generated by the Group. Although, the HPPs have a large installed capacity, their ability to generate electricity is dependent on the water inflow. HPPs usually operate at full capacity only during spring flooding, which typically lasts for about one to two months. Peak electricity production typically occurs in April.

*The Pļaviņas HPP* is the largest HPP in the Baltics in terms of installed capacity. It started operations in 1968 with ten hydropower units with a total capacity of 825 MW. Following a reconstruction of six of the hydropower units during 1991 to 2001 the plants installed capacity was increased to 869 MW. Another three hydropower units were upgraded during 2007 to 2010, resulting in a total capacity of 894 MW for the plant. The reconstruction of the hydropower units has not only resulted in increased capacities and efficiency ratios but also an increasing share of energy produced from renewable sources.

*The Ķegums HPP* is the oldest on the River Daugava, built in 1936-1939 and restored in 1945-1947. Initial installed capacity was 72 MW. The total current capacity of *the Kegums HPP* is 240 MW, with 168 MW installed in 1979 by adding three new hydropower units.

*The Rīga HPP* entered into service in 1974 and has six hydropower units with a total capacity of 402 MW.

### *Generation at CHPPs*

The Riga CHPPs are used mostly to cover the requested thermal load, generally working in cogeneration mode. Because of this, electricity generation at the Riga CHPPs is largely dependent on thermal energy consumption, which is affected by weather conditions, i.e. external air temperature, duration of the heating season and efficiency of thermal energy consumption. The Riga CHPPs use natural gas as the primary fuel, which is the most environmentally friendly type of fossil fuel available for power generation.

The Riga 1<sup>st</sup> combined heat and power plant ("**Riga TEC-1**") was built in the years 1954 to 1958 and fully reconstructed in 2005. The power plant operates two gas turbines, one steam turbine and three water boilers for centralised heating. The installed electrical capacity and thermal capacity at Riga TEC-1 is 144 MW and 493 MW respectively.

The Riga 2<sup>nd</sup> combined heat and power plant ("**Riga TEC-2**") is the largest combined heat and power plant in Latvia. It was launched in 1973. The power plant operates three power-generating steam boilers, two steam turbines, one combined-cycle gas turbine unit, as well as four water boilers. The installed electrical capacity of Riga TEC-2 is 662 MW and its thermal capacity is 1,347 MW. In 2011, a reconstruction of all four water boilers was completed, allowing for reduced nitrogen oxide emissions. The ongoing reconstruction project of Riga TEC-2, which includes the complete replacement of old Riga TEC-2 power facilities with a new combined-cycle gas turbine power unit, is scheduled for completion in 2013.

### *Other generation units*

The Company holds 51 per cent of the equity in SIA Liepājas enerģija. This company provides generation and supply of thermal energy to the Latvia's city of Liepāja. Total installed thermal energy capacity is 208 MW, and its electrical capacity is 6 MW. In late 2012, a biomass combined heat and power plant with 2 MW electrical capacity and 10 MW thermal capacity was commissioned as part of the Liepāja generation facilities system.

### **Distribution system services**

Distribution system services are performed by the Company's subsidiary AS Sadales tīkls, and in 2012 the Group's revenues from distribution services accounted for 26 per cent of total Group revenues, and distribution system services' assets - for 35 per cent of total Group assets. The distribution system services segment revenues reached LVL 210 million, while the segment's EBITDA was LVL 61 million in 2012. The electricity distribution network ensures the flow of electricity from the electricity transmission network and distributed generation to the electricity consumers, who are connected to low-voltage (0.4 kV) and medium-voltage (6–20 kV) grid. The total length of low and medium-voltage cable and overhead lines at the end of 2012 was 94,701 km, with 28,966 transformers and 26,034 transformer substations with a total installed capacity of 5,751 MVA. The distribution system operator provides equal access to the electricity network,

which is one of the prerequisites for allowing competition on the Latvian electricity market. AS Sadales tīkls is the largest distribution operator in Latvia, serving approximately 900 thousand customers and covering 99 per cent of Latvia's territory. AS Sadales tīkls holds a distribution operation licence valid until 30 June 2027.

The PUC develops methodology for and approves tariffs for distribution system operators. Subsequent to approval of the current distribution system tariff, the Company invested distribution system assets in AS Sadales tīkls, thus increasing the regulatory asset base. Increased asset base is not yet incorporated in the distribution system tariff.

### Management of transmission assets

The Group's revenues from lease and management of transmission assets accounted for 5 per cent of total Group revenues, and the segment's assets - for 11 per cent of total Group assets for the year 2012. The management of transmission system assets segment revenues reached LVL 40 million, while the segment's EBITDA was LVL 25 million in 2012.

According to amendments to the Electricity Market Law (*Elektroenerģijas tirgus likums*), reflecting to the requirements of the European Parliament and the Council Directive 2009/72/EC, transmission system operators need to be unbundled from electricity generation, distribution and sale. On 2 January 2012, all shares of the transmission system operator AS Augstsprieguma tīkls owned by the Company were sold to the Ministry of Finance of the Republic of Latvia. In 2011, the Company established a new subsidiary, AS Latvijas elektriskie tīkli, for the purpose of fulfilling the requirements of legal and functional unbundling of transmission system ownership from generation, distribution and supply activities. In 2011 transmission system assets owned by the Company were invested in the equity of AS Latvijas elektriskie tīkli.

The primary functions of AS Latvijas elektriskie tīkli is the management of the existing 330 kV and 110 kV power transmission lines, substations and switching substations in Latvia, as well as upgrading and new construction in relation to the transmission network in accordance with the transmission system operator's (AS Augstsprieguma tīkls) requirements. The assets are leased to the transmission system operator.

At the end of 2012, the total length of electricity transmission lines equalled 5,260 km, of which 110 kV lines accounted for 76 per cent and 330 kV lines for 24 per cent. There are fifteen 330 kV substations with an aggregate installed transformer capacity of 3,325 MVA and a hundred and twenty one 110 kV substations with an aggregate installed transformer capacity of 4,902 MVA. The latest 330 kV substation at Riga TEC-2 was constructed in 2008.

On 30 January 2013, the Public Utilities Commission (PUC) Advisory Council passed a decision concerning the certification of the transmission system operator. This is a prerequisite for the establishment of the Nord Pool Spot Latvian bidding area in 2013.

### Capital expenditures

The Group's operations are capital intensive and require significant capital expenditures. The following table summarises the Group's total capital expenditures.

		2008	2009	2010	2011	2012
Capital expenditures	LVL million	197	105	(Audited) 128	199	186

#### *On-going investments (committed capital expenditures)*

The table below provides information as of 31 December 2012 on contractually committed capital expenditures of the Group.

LVL million	2013	Next years
Generation and sales.....	39.5	30.2
Distribution system service.....	7.6	0.1
Management of transmission assets.....	45.1	4.4
Corporate functions .....	4.8	3.6
<b>Total committed.....</b>	<b>97.0</b>	<b>38.3</b>
<b>Total committed excluding major projects <sup>(1)</sup>.....</b>	<b>28.6</b>	<b>36.0</b>

(1) Excluding the reconstruction project of Riga TEC-2 and the NORDBALT -02 - 330kV "Kurzeme Ring" first and second stage.

The Group has two major on-going committed capital expenditure projects – the reconstruction project of Riga TEC-2 and the NORDBALT-02 – 330kV "Kurzeme Ring" first and second stage. Other commitments represent regular maintenance and replacements.

#### *Reconstruction project of Riga TEC-2*

The reconstruction project of Riga TEC-2 is the Group's most significant on-going investment. The new TEC-2 power unit is scheduled to be launched in 2013. The EPC (engineering, procurement, construction) contract for the construction of the unit amounts to LVL 226 million. As of 31 December 2012, EPC work equalling LVL 219 million has been performed in relation to the Riga TEC-2 project.

The project includes the complete replacement of old Riga TEC-2 power facilities with a new combined-cycle gas turbine power unit (with electrical capacity of 420 MW and thermal capacity – 270 MW), which will improve the efficiency of the plant. The amount of electricity generated is expected to be increased, once the new Riga TEC-2 power unit is operational, and thereby reducing Latvia's dependence on imported electricity, as well as enhancing electricity supply reliability. Using of highly effective cogeneration power plants will reduce primary fuel consumption (natural gas). The implementation of this project will result in conformity with EU Directive 2001/80/EC and 2010/75/EU, which specifies the maximum allowed threshold amount of emissions in flue gas. With the completion of the Riga TEC-2 energy unit in 2013 all cogeneration facilities of the Group will be renewed.

#### *NORDBALT -02 - 330kV "Kurzeme Ring"*

In accordance with the Baltic Energy Market Interconnection Plan, the Baltic States will introduce an electricity market based on the NordPool principles. In order to provide possibilities for external market players to join the electricity market in the Baltic States, it is necessary to develop the infrastructure with respect to grid connections: the Baltic interconnection with Sweden, Finland and Poland, as well as internal infrastructure in order to provide possibilities for increased amounts of electricity to be transferred via the Baltic transmission network. To realize the Baltic interconnection projects the existing transmission network in the Western part of Latvia (Kurzeme) needs to be reinforced and the 330 kV "Kurzeme Ring" constructed. Total length of this transmission ring is estimated to approximately 343 km with a voltage of 330 kV. The "Kurzeme Ring" construction is expected to be fully implemented by 2018 in the following three step process:

- (1) In the first step, the distribution facilities of 330kV have been reconstructed at substations *Riga TEC-1* and *Imanta* during 2012. Completion of the *Riga Ring* construction, including a new 330 kV cable line between the *Riga TEC-1* and *Imanta* substations with the total length of 14 km, is scheduled for completion by autumn 2013;
- (2) In the second step, the reconstruction of the existing 110 kV power transmission line between *Grobina* and *Ventspils*, strengthening it with a 118 km long 330 kV overhead line, is scheduled by the mid-2014 along with expanding of the *Grobina* substation, construction of new 330 kV switching substation at *Ventspils* substation and reconstruction of *Aizpute* and *Alsunga* 110 kV substations;
- (3) The third step relates to the reinforcing of the existing 110 kV overhead line connection *Ventspils–Dundaga–Tume–Rīga* to a 330 kV overhead line (approximately 211 km) and is scheduled for completion by 2018.

As at 31 December 2012, the committed capital expenditures for the first and second stage of the project amounted to LVL 66 million and LVL 23 million had been invested in the project. The project is co-funded

through the European Energy Programme for Recovery with an amount up to half of the eligible expenses for the project.

#### *Other investments*

In addition to the committed investments, the Group plans to further increase the efficiency rate of Daugava HPPs by continuing the hydro unit reconstruction programme.

The reconstruction of remaining 11 hydropower units is expected to be completed in 2022 and the total costs of the reconstruction are estimated to exceed LVL 100 million.

#### *Financing*

The Group uses cash flow from operating activities and borrowed funds to finance the investments in relation to the committed capital expenditures. In 2012, cash flows from operating activities for the Group amounted to LVL 151 million.

External funding currently consists of bilateral bank loans and proceeds from bonds issued. The Group has established long-standing funding cooperation with supranational financial institutions and commercial banks.

The Group's gross debt as of 31 December 2012 was LVL 595 million with the following debt maturity schedule:

		<b>2013</b>	<b>2014</b>	<b>2015-2017</b>	<b>2018 - 2025</b>	<b>Total</b>
Debt repayment	LVL million	74	88	279	154	595

The table below provides information about the Group's borrowings by lender category as of 31 December 2012.

	<b>2012</b>
	<i>(LVL millions)</i>
International investment banks .....	338
International commercial banks .....	32
Financial institutions registered in the Republic of Latvia .....	211
Debt securities (bonds) issued .....	14
<b>Total</b> .....	<b>595</b>

Borrowings outstanding were used for funding the Group's investment program including the modernisation of power generation, transmission and distribution facilities.

As of 31 December 2012 total long term committed credit lines available for the Group amounted to EUR 207 million.

The Group's currently outstanding loans are all floating interest rate loans with interest accruing on 3 or 6 month Euribor plus a margin. The interest rate risk is partially hedged with interest rate swaps. As at 31 December 2012 the weighted average interest rate of the Group's outstanding borrowings was 2.87 per cent (with the effect of the interest rate swaps), the weighted average applicable margin was 0.74 per cent. As of 31 December 2012, all borrowings were denominated in Euro.

## ORGANISATIONAL STRUCTURE

As at the date of this Base Prospectus the Group comprises the parent company AS Latvenergo and its six subsidiaries:

Company Name	Country of incorporation	Business activity	Proportion of ownership
<b>Subsidiaries:</b>			
AS Sadales tīkls	Latvia	Electricity distribution	100 per cent
AS Latvijas elektriskie tīkli	Latvia	Management of electricity transmission system assets	100 per cent
Elektrum Eesti OÜ (previous name - Latvenergo Kaubandus OU)	Estonia	Electricity sales	100 per cent
SIA Elektrum Latvija (subsidiary of Elektrum Eesti OÜ)	Latvia	Electricity sales	100 per cent
Elektrum Lietuva UAB (previous name - Latvenergo Prekyba UAB)	Lithuania	Electricity sales	100 per cent
SIA Liepājas Enerģija	Latvia	Thermal energy generation, transmission, distribution and sales (in Liepāja city)	51 per cent

The Company is also a shareholder in two associated companies:

- Nordic Energy Link AS (Estonia), with principal business of electricity transmission, (25 per cent); and
- AS Pirmais Slēgtais Pensiju Fonds (Latvia), management of pension plans, (the Company's shareholding - 46.3 per cent (the Group's shareholding - 48.15 per cent)).

The Company has also a 0.005 per cent shareholding in the Latvian company AS Rīgas Siltums.

On 2 January 2012, the Company sold all its shares in the wholly-owned subsidiary AS Augstsprieguma tīkls to the Ministry of Finance of the Republic of Latvia.

## ADMINISTRATIVE, MANAGEMENT AND SUPERVISORY BODIES

In accordance with the Commercial Law, the Law on State and Municipality Capital Shares and Capital Companies and the Financial Instruments Market Law, the Company has the following management and supervisory bodies:

- *Shareholders' meeting*, which represents shareholder interests, rights and obligations. As state owned entities in Latvia are not allowed to establish supervisory boards, the shareholders' meeting also performs all the supervisory functions of the Company and the Group. The State Secretary of the Ministry of Economics of the Republic of Latvia is the sole shareholder representative in the shareholders' meetings;
- *Audit Committee*, which was established in August 2012 according to the requirements of the Financial Instruments Market Law (*Finanšu instrumentu tirgus likums*). The charter of the Audit committee was approved by the Company's shareholders' meeting on 22 August 2012. The Audit Committee has started its operations in December 2012; the members of the Audit Committee are Mr. Torben Pedersen, Mr. Svens Dinsdorfs and Mrs. Inita Hāne; and
- *Management Board* of the Company, which consists of five management board members who are involved in operations of the Company and supervision of the Group.

According to the Law on State and Municipality Capital Shares and Capital Companies, supervisory boards are not permitted in the Company's wholly-owned subsidiaries: AS Sadales tīkls and AS Latvijas elektriskie tīkli. Supervision of these subsidiaries is executed through the shareholders' meeting, according to provisions established in the Electricity Market Law. Supervisory boards are established for the foreign subsidiaries of the Company: Elektrum Eesti OÜ and Elektrum Lietuva UAB. Supervisory functions at these subsidiaries are ensured by three Management Board members of the Company.

The Latvian subsidiary SIA Liepājas enerģija is supervised by the Supervisory Board consisting of six members.

### The Company's Management Board

The Company's Management Board consists of five members elected for a term of three years by the shareholders' meeting based upon an evaluation of necessary competences, experience and expected sphere of responsibility. The shareholders' meeting also appoints one of the members of the Management Board as Chairman of the Management Board.

All Management Board members are executive directors of the Company, and are involved in the daily operations of the Company.

At the date of this Base Prospectus the members of the Management Board of the Company are:

**Mr. Āris Žīgurs** - Chief Executive Officer and Chairman of the Management Board, responsible for management of corporate strategy, international affairs and strategy, communication, human resource management, security and transport services. Mr. Žīgurs is a member of the Board of Directors at the Union of the Electricity Industry of Europe ("EURELECTRIC"), as well as the vice-president of the Latvian National Committee of the World Energy Council.

**Mrs. Zane Kotāne** - Chief Financial Officer, responsible for business planning and control, treasury, accounting, risk management and insurance. Mrs. Kotāne is a member of the supervisory boards of the Company's subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

**Mr. Uldis Bariss** - Chief Commercial Officer, responsible for management of electricity supply, wholesale activities, marketing and customer service, customer settlements, IT&T and regulatory affairs. Mr. Bariss is a representative of the Company in the Latvian Chamber of Commerce and Industry and a member of the supervisory boards of the Company's subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

**Mr. Māris Kuņickis** - Chief Operating Officer, responsible for generation planning, technical management of HPPs and CHPPs, generation project management, project maintenance, technical inspection, research and

development, environment and safety at work. Mr. Kuņickis is a representative of the Company in Latvian Association of Power Engineers & Energy Constructors and a substitute member of the Board of Directors at the EURELECTRIC.

**Mr. Arnis Kurgs** – Chief Administrative Officer, responsible for managing legal affairs, document registration and management, procurement and logistics, real estate management and operational support. Mr. Kurgs is a member of the supervisory boards of the Company’s subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

The business address of each Member of the Management Board is Pulkveža Brieža 12, Riga, LV-1230, Latvia.

### **Conflict of interest**

In accordance with the Law on Prevention of Conflict of Interest in Activities of Public Officials, all members of the management boards of state owned companies have the status of state officials. As such, all Management Board members of the Company and its fully owned subsidiaries in Latvia are state officials, and subject to detailed requirements of this Law. The Law permits to combine their office of public official only with activities which are indicated by the law as compatible (e.g., offices in a trade union, an association or similar organisation, the work of teacher, scientist and creative work) in order to prevent personal or material interest in the activity of the state official. In accordance with the Law, all state officials are obliged to submit an annual declaration of interest.

The Company confirms that the members of the Management Board of the Company do not have conflicts of interests between their duties relating to the Company and their private interests and/or their other duties.

### **Development of Supervision Principles**

Supervision of the Company is performed in accordance with the Commercial Law (*Komerclikums*) and the Law on State and Municipality Capital Shares and Capital Companies (*Likums “Par valsts un pašvaldību kapitāla daļām un kapitālsabiedrībām”*). Following changes in the legislation, the supervisory boards of all state capital companies in Latvia, including that of the Company, were dismissed in 2009. Since then shareholders’ meetings have ensured the supervision of the state capital companies.

On 4 June 2012, the Cabinet of Ministers of the Republic of Latvia approved the Concept for Governance of State Owned Entities, which stipulates that large and very large state owned entities, including the Company, should reinstate supervisory boards. It is expected that the detailed law on Governance of State Owned Entities will be passed in 2014, followed by reinstatement of supervisory boards soon after.

### **Employees**

The Group had 4,457 employees as at 31 December 2012, of whom 74 per cent were men and 26 per cent women. The average age of the employees was 44.2 years. The Group’s staff turnover was 5 per cent in 2012.

The opinions of all Group’s employees on issues of the Collective Bargaining Agreement are represented by “Enerģija” Trade Union in Latvia. About 70 per cent of the Group’s employees are members of this union. The Group notifies “Enerģija” Trade Union on, among other things, planned changes in the organisation of the Group and its subsidiaries or remuneration, and reports on the execution of the Collective Bargaining Agreement and on the fulfilment of occupational health and safety requirements, as well as agrees terminations of employment of members of “Enerģija” Trade Union, if any.

## BOARD PRACTICES

In accordance with the Law on State and Municipality Capital Shares and Capital Companies (*Likums "Par valsts un pašvaldību kapitāla daļām un kapitālsabiedrībām"*), a supervisory board cannot be established for the Company. As a result, the supervisory bodies of the Company are the Shareholders' Meeting and the Audit Committee.

To the best of its knowledge the Company complies with current Latvian corporate governance regime for the State owned entities.

### **Audit Committee**

The establishment of the Audit Committee and its charter were approved in August 2012 by the Shareholder of the Company. The Audit Committee consists of three members: Mr. Torben Pedersen, Mr. Svens Dinsdorfs and Mrs. Inita Hāne. The Audit Committee is fully operational since December 2012.

The Members of the Audit Committee are elected by the Shareholders' Meeting of the Company for a term of three years. The Audit Committee operates on the basis of the Commercial Law (*Komerclikums*), the Financial Instruments Market Law (*Finanšu instrumentu tirgus likums*) and the Regulation of the Audit Committee as approved by the Shareholders' Meeting of the Company.

In addition to the standard responsibilities of the audit committees, such as supervision of financial reporting processes, internal control assessments, oversight of the internal audit function and the external auditor, the Audit Committee of the Company also has a responsibility for supervision of the fraud risk management plan implementation.

The Audit Committee shall report its assessments and findings to the Shareholders' Meeting at least once a year.

## SHAREHOLDERS

All shares of the Company are owned by the Republic of Latvia. The holder of the Company's shares is the Ministry of Economics of the Republic of Latvia, whose representative - the State Secretary of the Ministry of Economics, represents the shareholder's interests at shareholders' meetings.

Pursuant to the Energy Law (*Enerģētikas likums*), the Company's business is designated as of national importance and, therefore, the Company's shares are not subject to privatisation or alienation.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table is a summary of the Group's consolidated financial performance and key performance indicators for the three financial years ended 31 December 2010, 31 December 2011 and 31 December 2012 respectively. The information set out in the table below has been extracted (without any material adjustment) from, and is qualified by reference to and should be read in conjunction with the audited consolidated annual reports of the Group for the years ended 31 December 2010, 2011 and 2012 respectively, each of which is attached to this Base Prospectus and forms an integral part of this Base Prospectus. Annual reports of the Group are prepared according to International Financial Reporting Standards ("IFRS").

		Year ended 31 December 2010	Year ended 31 December 2011	Year ended 31 December 2012
		<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>Financial Highlights</b>				
Revenue	LVL thousand	567,386	681,767	751,038
Including electricity and electricity services sales	LVL thousand	476,737	593,092	600,511
Heat sales	LVL thousand	71,863	69,233	90,548
EBITDA <sup>1)</sup>	LVL thousand	207,240	179,892	171,783
EBITDA margin <sup>2)</sup>		37%	26%	23%
Operating profit <sup>3)</sup>	LVL thousand	61,826	52,656	49,587
Operating margin <sup>4)</sup>		11%	8%	7%
Net profit	LVL thousand	44,325	43,778	35,741
Net profit margin <sup>5)</sup>		8%	6%	5%
Return on assets (ROA) <sup>6)</sup>		2.2%	1.9%	1.5%
Return on equity (ROE) <sup>7)</sup>		4.0%	3.2%	2.6%
Non-current assets at the end of the period	LVL thousand	1,942,231	2,026,594	2,180,111
Total assets at the end of the period	LVL thousand	2,279,266	2,288,004	2,472,290
Total equity at the end of the period	LVL thousand	1,344,748	1,351,576	1,410,510
Borrowings at the end of the period	LVL thousand	545,607	513,334	595,235
Cash flows from operating activities	LVL thousand	160,563	180,399	150,769
Capital expenditure	LVL thousand	127,539	198,723	185,723
Net debt at the end of the period <sup>8)</sup>	LVL thousand	311,342	404,457	424,810
Net debt/EBITDA ratio <sup>9)</sup>		1.5	2.2	2.5
<b>Operating Highlights</b>				
Retail electricity supply	GWh	7,620	8,980	8,287
Wholesale electricity supply	GWh	1,414	2,283	1,886
Electricity produced in power plants	GWh	5,869	5,285	5,077
Total amount of purchased electricity	GWh	3,339	6,150	5,273
Including purchased electricity from independent producers	GWh	693	759	1,036
The rest amount of purchased electricity	GWh	2,646	5,392	4,237
Aggregate heat sales	GWh	2,928	2,524	2,669
Number of employees at the end of the period		4,517	4,490	4,457
Moody's credit rating of the Issuer		Baa3 (stable)	Baa3 (stable)	Baa3 (stable)

- 1) EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible and fixed assets.
- 2) EBITDA margin – EBITDA / revenue.
- 3) Operating profit – earnings before income tax, finance income and costs.
- 4) Operating margin – operating profit / revenue.
- 5) Net profit margin – net profit / revenue.
- 6) Return on assets (ROA) – net profit rolling twelve months / average value of assets (assets at the beginning of twelve months period + assets at the end of the period/2).
- 7) Return on equity (ROE) – net profit rolling twelve months / average value of equity (equity at the beginning of twelve months period + equity at the end of the period/2).
- 8) Net debt – borrowings at the end of the period minus cash and cash equivalents at the end of the period.
- 9) Calculated for rolling twelve months."

## FINANCIAL AND TREND INFORMATION

### Historical Financial Information

The Group's consolidated audited annual reports as of and for the financial years ended 31 December 2012, 2011 and 2010 (prepared according to IFRS) are attached to this Base Prospectus and forms an integral part of this Base Prospectus.

### Legal and Arbitration Proceedings

Except as described below, the Group is not engaged in any governmental, legal or arbitration proceedings, or is aware of any such proceedings pending or threatened against it during the 12 months prior to the date of this Base Prospectus that may have, or have had in the recent past, significant effects on the Company and/or the Group's financial position or profitability.

#### *Claim of injured person*

A person having been injured by high voltage electricity have submitted a claim for physical damages and moral compensation in a total amount of LVL 500 000. The claim was denied by the courts of first and second instances. The reasoning for rejection of the claim is that the injury to the claimant was caused in a course of its labour relation with a third party in a real property owned by that third party and without any guilt of the Company. Claimant has submitted the cassation appeal, but it is not yet heard by the court.

#### *Claim in relation to electricity tariffs*

On 25 June 2012, the Administrative Regional court finished a review of complaints of electricity end users on the electricity tariff approved according to the decision of the Management Board of the Company of 25 January 2011 and carried out a judgement repealing such tariff as of the day it has been approved. In the judgement the court recognised that the PUC has insufficiently reviewed the documents underlying the increase in the tariff and has not ensured that the increase is evidenced with additional costs of the Company. In addition, the court resolved that the tariff for the first 1200 kWh does not cover the economically substantiated costs of the Company and ensure profitability. However, the court concluded that the tariff for the consumed electricity above 1200 kWh is determined at the level corresponding to substantiated costs. As a result, the court decided that the differentiation of tariffs below and above 1200 kWh was contradictory to the tariff methodology and thus inconsistent with the Law on Regulators of Public Utilities and therefore not applicable.

As the judgement of the court according to the Company's opinion contains substantial legal mistakes and misinterpretations, both the PUC, as a defendant, and the Company as a third party submitted cassation complaints.

On 31 January 2013, the Senate of the Supreme Court carried out a decision setting aside the judgement of the Administrative Regional court from 25 June 2012 and forwarding the matter to be adjudicated *de novo* in the Administrative Regional court. The Senate stated that the Administrative Regional court had incorrectly defined the object of the case and thus the finding to repeal the decision of the regulatory body would not result in repealing of tariffs. The Senate also pointed that the Company as the third party in the proceedings had no obligation to compensate the damages to the electricity users, but this obligation laid on the regulatory body as a respondent. The Senate clearly indicated that only applicants, but not all captive electricity users were entitled to receive compensation in case if tariffs would be found ungrounded or unlawful.

The Administrative Regional court will start a review of the case on 16 May 2013.

It is important to note that until a final and non-appealable judgement is announced, the Company is applying present tariffs that are in force as from 1 April 2011.

### *Claim in relation to public service obligation fee*

The decision No.44 of the Public Utilities Commission (PUC) dated 20 February 2013 on approving the public service obligation fee has been challenged in the Administrative court. The public service obligation fee is a payment made by each electricity end-user in Latvia to compensate for expenses of the public trader accrued due to purchasing electricity for regulated prices in a framework of feed-in tariff scheme. The applicants of claim have challenged the interpretation of the existing methodology and thus the justification of the costs to be included in the public service obligation fee. The total amount of such costs under legal dispute is estimated at LVL 15.6 million.

### *Criminal proceedings in relation to power supply disruptions*

The extensive power supply disruptions due to extreme weather conditions (heavy snowfall and icing causing damage to electricity distribution system) during December 2010 – January 2011 were considered as grounds for initiating criminal proceedings on alleged negligence (lack of adequate diligence) of officials of the Company's subsidiary and electricity distribution system operator AS Sadales tīkls. Considering the fact that electricity supply disruptions were observed in a large geographical area of Latvia, there were initiated four separate criminal proceedings. Investigations under the aforementioned proceedings are performed by regional offices of Latvia police (i.e. Kurzeme Police Department, Zemgale Police Department, Latgale Police Department and Jēkabpils Police Department). In accordance with the legal acts of the Republic of Latvia only individuals can be held criminally liable, not legal entities, and thus these adjudications in criminal proceedings will not be applicable to the company AS Sadales tīkls. With regards to any damages or losses sentenced within these proceedings, the Company does not envisage a high possibility of such being binding to AS Sadales tīkls, but if otherwise stipulated by the final adjudication of the court, all risks are insured and all mentioned cases have already been disclosed to the corresponding insurers.

### *Incident of corruption*

In June 2010 criminal proceedings were launched on a number of executives of the Group suspected in corruption and money laundering. Neither the Company, nor the Subsidiaries of the Company are involved in the ongoing investigation.

The Group has reviewed internal processes for the purpose of bringing the Group's internal control procedures in line with best practice, thus further reducing the risks of corruption, illegal activity or fraud within the Group. As a result, the Group's Fraud Risk Management Plan was approved in April 2012 and special measures to improve the internal control system were introduced.

### **Significant Changes in Financial or Trading Position**

There has been no material adverse change in the Company's or the Group's financial or trading position since 31 December 2012.

### **Trend Information**

There has been no material adverse change in the prospects of the Company or the Group since the date of the audited consolidated annual report of the Group for 2012.

At the date of this Base Prospectus there are no information on any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the Company's or the Group's prospects and the industries in which the Company or the Group operates in the financial year of 2013.

### **Future Outlook**

The Issuer has not made any profit forecast or profit estimate in this Base Prospectus.

### **Recent Developments**

The Group's consolidated audited annual report as of and for the financial year ended 31 December 2012 shows that Group net profit in 2012 has reached LVL 36 million (2011: LVL 44 million). Group revenues and EBITDA in 2012 was LVL 751 million (2011: LVL 682 million) and LVL 172 million (2011: LVL 180 million)

respectively. Return on equity for the year 2012 amounted to 2.6 per cent (2011: 3.2 per cent). In 2012, the Group supplied 8,287 GWh electricity to retail clients translating into a 33 per cent market share in the Baltics, compared with 8,980 GWh supplied during 2011.

## ADDITIONAL INFORMATION

### Share Capital

The amount of the share capital of the Company is LVL 904 604 960 and it is composed of 904 604 960 shares. All shares are paid up. All shares are registered shares and they are dematerialised. The nominal value of a share is LVL 1.

In accordance with the Energy Law (*Enerģētikas likums*) all shares of the Company are the property of the Republic of Latvia and they are not a subject to privatisation or alienation.

### Articles of Association

The Company is registered with the Commercial Register of the Republic of Latvia under registration number 40003032949.

The objects and purposes of the Company are stated in Clause 2 of the Articles of Association of the Company of which the main objects are to generate electricity and heat, to sell electricity and to provide telecommunication services.

### Material Contracts

Except as described below, the Group has not entered into any material contracts outside the ordinary course of business, which could result in either the Company or any of the Group companies coming under an obligation or entitlement that is material to the Company's ability to meet its obligations to the Noteholders in respect of the Notes.

On 3 March 2010 the agreement on reconstruction of the Riga TEC-2 was concluded with the Turkish company Gama Guc Sistemleri Muhendislik ve Taahhut Anonim Sirketi. According to this agreement the reconstruction works shall be completed in 2013. The project includes the complete replacement of old TEC-2 power facilities with a new combined-cycle gas turbine power unit improving the efficiency of the plant. The implementation of this project will result in conformity with EU Directive No. 2001/80/EC and 2010/75/EU, which specifies the maximum allowed threshold amount of emissions in flue gas. Through the use of highly effective cogeneration power plants the primary fuel consumption (natural gas) will decrease per energy unit produced, and, as a result of this, air pollution will be reduced.

**GLOSSARY**

<b>“A”</b>	Ampere, a unit for measuring allowed load, which is usually limited by the main fuse
<b>“GW”</b>	Gigawatts, a unit for measuring the capacity to produce electricity. One gigawatt equals 1,000,000,000 watts.
<b>“GWh”</b>	Gigawatt hours, a unit for measuring the generation and consumption of electricity.
<b>“kV”</b>	Kilovolts, a unit for measuring voltage or electrical tension. One kilovolt equals 1,000 volts.
<b>“kWh”</b>	Kilowatt hours, a unit for measuring the generation and consumption of electricity. One thousand watts over the period of an hour.
<b>“MVA”</b>	Megavolt ampere, a unit of measure of apparent power.
<b>“MW”</b>	Megawatts, a unit for measuring the capacity to produce electricity. One megawatt equals 1,000,000 watts.
<b>“MWh”</b>	Megawatt hours, a unit for measuring the generation and consumption of electricity. One million watts over the period of an hour.
<b>“TW”</b>	Terawatts. A unit for measuring the capacity to produce electricity. One terawatt equals 100,000,000,000 watts.
<b>“TWh”</b>	Terawatt hours, a unit for measuring the generation and consumption of electricity. One terawatt hour is equal to sustained electricity consumption of approximately 114 MW for a period of one year.

## THE REPUBLIC OF LATVIA

### General

Latvia is a small, open economy with exports contributing notably to its GDP. Export growth has been the main driver of the economic recovery from the recent downturn. Still the bulk of the country's economic activity is in the services' sector. Owing its geographical location, transit services are well developed. During the period 2000-2007 the Latvian economy grew on average 8.7 per cent. Between 2005 and 2007, Latvia's GDP growth accelerated to an average rate of 10.3 per cent per annum. The main growth stimulus was linked to extensive increase in domestic demand, which was facilitated by substantial capital inflows. Between 2008 and 2010 affected by the global financial crisis Latvian economy turned into severe recession. A cumulative drop in GDP of 21.2 per cent was one of the biggest in Europe. Since 2011 a sound pick up of economic activity is observed. During 2012 Latvia was able to produce a respectable pace of growth of 5.6 per cent. Thereby Latvia succeeded to remain the fastest growing economy in the EU second year in a row. Several sectors, trade manufacturing and construction showed solid growth. Unemployment continued to shrink. At the same time, inflation stayed low, which contributed to the improvement of purchasing power. The positive trends facilitated the activation of private consumption that partly offset external weakness. Current economic trends are expected to continue, although at a bit more moderate pace in 2013. GDP is expected to grow by 3.8 per cent in 2013 and then growth will pick up to 5 per cent in 2014.

GDP, (%)	2009	2010	2011	2012	2013	2014
Latvia	-17,7	-0,9	5,5	5,6	3,8	5,0
EU (27) average	-4,3	2,1	1,6	-0,3	0,1	1,6

Source: Eurostat; SEB banka

### Inflation

The rate of inflation reached its peak in 2008. During the downturn deflation period was observed. Since 2010 consumer prices started to pick up again. Private consumption was stabilizing and the impact of external factors on inflation increased considerably. The spike of inflation in 2011 was determined by the increase of prices for fuel, clothing and footwear, as well as food, which was linked to the processes in the global markets. Tax hike was also the reason behind the prices movements. After rapid surge in the first months of 2011 price rise was abated due to global price trend and weak global economic growth. So far inflation has subsided and reached new lows. Low inflation environment will dominate in 2013, though it will continue to be subject to global processes that swiftly show up in inflation. The continued economic recovery will increase pressure on prices gradually in a longer-term perspective.

Inflation, HICP, average, (%)	2009	2010	2011	2012	2013	2014
Latvia	3,3	-1,2	4,2	2,3	1,4	3,0
EU (27) average	1,0	2,1	3,1	2,6	-	-

Source: Eurostat; SEB banka

### Unemployment

Along with the economic downturn, situation in the labour market deteriorated dramatically. The lowest point in the labour market was registered in the 1st quarter of 2010. In the following quarters, along with the gradual pick up in the economic activity, the situation in the labour market started to progress. The unemployment rate has come down from its peak at 20.5 per cent in the first quarter 2010 and stood at 13.8 per cent in the fourth quarter 2012.

Unemployment, %	2008	2009	2010	2011	2012
Latvia	7,5	16,9	18,7	16,2	14,9

Source: Central Statistical Bureau

## Public Finances

On December 21, 2011, Latvia officially concluded its three-year international loan program. The planned amount of the international loan program was EUR 7.5 billion of which Latvia used the EUR 4.4 billion which has to repay by 2025. Economic downturn brought a shortfall in revenues and led to increased budget deficit. The fiscal stabilization in Latvia was carried out at decisively. Within three years (from 2009 to 2011) the budget deficit was cut from 9.8 per cent of GDP to 3.4 per cent of GDP. Solid economic growth made it possible to beat budget deficit targets in 2012. Proceeding prudency Latvia is on a way towards balanced budget. Planned budget deficit for 2013 is 1.4 per cent of GDP and further down to 0.3 per cent deficit to GDP in 2015. The table below shows the government surplus or deficit as a percentage of GDP in Latvia between 2007 and 2012, compared to the average of the 27 EU Member States, as determined by Eurostat.

<b>Government surplus/(-)deficit as percentage of GDP</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Latvia	-4.2	-9.8	-8.1	-3.6	-1,2
EU (27) average	-2,4	-6,9	-6,5	-4,4	-

Source: Eurostat

Until 2008 Latvia's debt level was one of the lowest among EU member states – 9 per cent, respectively. During the crisis Public sector debt rose sharply to 44.5 per cent of GDP in 2010 but decreased to 41.9 per cent of GDP in 2011 and to 40.7 per cent in 2012. The table below shows the Public debt as a percentage of GDP in Latvia, compared to the average of the 27 EU Member States, as determined by Eurostat.

<b>Government gross debt as a percentage of GDP</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Latvia	19,8	36,9	44,4	41,9	40,7
EU (27) average	62,2	74,6	80,0	82,5	-

Source: Eurostat

## Foreign Trade

Latvia's geographical position favours foreign trade, with the availability of ice-free ports as well as a well developed railway and road transport infrastructure. In 2012, the total volume of goods in foreign trade of Latvia at current prices reached LVL 15.6 billion or 13.7 per cent up comparing to 2011. Of which exports volume increased by LVL 899.3 million or 15.0 per cent, whereas imports volume by LVL 977.9 million or 12.7 per cent. The share of exports in the total volume of foreign trade increased up to 44.2 per cent (43.7 per cent in 2011). The foreign trade balance improved. In 2012, increase in all biggest goods groups' exports was observed. Total exports development was affected by exports volume increase of agriculture and food products that provided more than 40 per cent of all exports increase. Considerable increase for the exports of machinery and metal and its production was also observed. These both goods groups made about 30 per cent of total exports increase. In 2012, imports of engineering industry, mineral products, and agriculture and food products increased at the same pace. In total, this group formed two thirds of imports increase.

## Balance of Payments

Rapid decrease in foreign capital inflow during the crisis caused significant adjustments to the balance of payments. Driven by domestic demand the current account deficit reached -22.6 per cent of GDP in 2006. In a short period current account balance became positive, reaching 8.6 per cent of GDP in 2009. After astonishing adjustment during the downturn period resuming private consumption and increasing capital spending reflecting in gradually deteriorating current account balance. The current account showed a deficit of 1.7 per cent of GDP in 2012. A moderate current account deficit is likely to persist in 2013 and will gradually increase as expansion of economy will accelerate in years to come.

<b>Current account, % of GDP</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Latvia	-13,1	8,6	2,9	-2,2	-1,7

Source: The Bank of Latvia

2012

LATVENERGO  
GROUP  
SUSTAINABILITY  
AND ANNUAL  
REPORT



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# New Experience in Latvia and on the Baltic Energy Market

## 1.1

I am pleased to look back at the achievements of Latvenergo Group in 2012 together with you – the Sustainability Report presents the most significant aspects of the operation of the Group. The information disclosed in the report is addressed to all stakeholders of the Group. The sustainability report published by Latvenergo Group is the only audited sustainability report in Latvia.

In my opinion, 2012 is characterised by a number of advances significant for the operation and development of the Group:

- successful takeover of the Baltics as the main arena of our business;
- development of the new Latvenergo Group strategy until 2016 on the basis of sector development trends in the Baltics;
- advancement of corporate governance principles through creation of the Audit Committee and separation of the roles, responsibilities and accountability of the Management Board members and the executive directors;
- successful first issue of Latvenergo AS bonds, attracting funding for implementation of capital investment projects and diversifying the range of lenders.

This is not the first year of the Baltic electricity market being our home market, and it is already difficult even to imagine working in a local single-country market. We have become familiar enough with the habits of customers in the neighbouring countries – we are able to evaluate and creatively incorporate these habits into our market offers, which is one of the reasons why, as regards the Baltic market, we are here to stay.

We are proud to declare that Latvenergo Group has successfully retained the leading position in electricity supply in a competitive market environment. Our market share constitutes 33% of the overall Baltic electricity market, where the total consumption is approximately 25.4 TWh. In 2012, 8.3 TWh of electricity was supplied to retail customers in the Baltics.

Latvenergo Group has succeeded in compensating a decreased market share in Latvia (920 GWh) with a larger amount of electricity supplied outside Latvia (1,580 GWh).

Our successes are considerable: currently we hold an 11% share in the Lithuanian electricity market and a 6% share in Estonia, while the number of customers in Lithuania and Estonia has almost doubled in 2012.

For more successful operation in Estonia and Lithuania, in the second half of the previous year we created a new trade brand *Elektrum*, which should become a significant and positively distinguishable symbol of the Group. Already few months after starting to operate under the new brand, the situation in Estonia shows that this was the right choice – neighbours do like us. Our regional experience is valuable – from it, with the on-going in continued liberalisation of the electricity market, we draw ever new ideas that may also be implemented and offered to customers here in Latvia.

In the end of 2012, Latvenergo Group strategy until 2016 was approved. Our specialists have developed it by taking into account the European Union (EU) Regulations for the energy sector and the targets set therein, the rapid changes both in the energy sector and in the Baltic business environment, and the results of consultations with sector experts, scientists, and entrepreneurs.

In order to fit in the sector development dynamics, which are far from modest, and to attain specific growth qualities, three cornerstones or overarching goals of the strategy of Latvenergo Group are:

- strengthening of market position in the Baltics,
- diversification of energy generation sources,
- balanced network development.

The new strategy of Latvenergo Group calls for focus on observance and strengthening of good governance practices in order to ensure transparency of operations of the Group and promote the perception of Latvenergo as an open, efficient and responsible corporate group among the society, customers, and partners. This is also shown by the establishment of the Audit Committee and separation of the roles and duties of the Management Board and the executive directors.

The Group supports fair business practices, observes fair competition rules and does not engage in transactions that restrict competition, are corruptive or discriminatory. This is an important milestone in the development of the Group, and



it has been established by understanding earned through harsh examples. We must be impeccable in all spheres of life and work. We may not be negligent and make mistakes, especially in preparation for the electricity market opening to households in Latvia.

In the very end of the year, we issued Latvenergo AS bonds for the first time. This is undoubtedly a very significant step in the development of the Group, which shows not only the professional work of financial specialists but also the stability, reputation and competitiveness of the company: demand for the bonds several times exceeded supply on the market. This is a very significant achievement also in respect to the rating of the Group, and, moreover, we will have additional funds for development and a diversified range of lenders, while the bondholders will possess bonds of a strong and profitable company.

I am sure that the issue of Latvenergo AS bonds is a significant event not only for the Group but also for everyone directly or indirectly involved. We are the first Latvian state-owned company that confirms its economic and governance maturity in this way, and I hope that our example will encourage other state-owned companies as well. I think that this step will also resonate positively in another context, namely – in a sense, this is both a confirmation of development perspective of Latvia, as well as a specific impulse for continued facilitation of economic activity in Latvia, where stagnation is replaced by ever stronger economic environment.

In 2013, along with the issue of bonds and meeting the requirements of the Financial Instruments Market Law, we have begun to publish quarterly financial statements on the Latvenergo website and on the website of NASDAQ OMX Riga AS. The publication of financial statements is planned to continue on a quarterly basis.

The financial results of Latvenergo Group in 2012 indicate growth – with a 10% increase compared to 2011, the total income exceeds EUR 1 billion (income in 2012: LVL 751 million).

In 2012, Latvenergo Group generated slightly more than 5 TWh of electricity, which is approximately 80% of the total amount of electricity generated in Latvia, and approximately 72% of it was generated from renewable energy resources. Electricity generation output and financial results were positively affected by the amount of electricity generated in

the Daugava hydropower plants, which is one of the largest amounts in the recent years. Meanwhile, reduction of the electricity market price and increase of natural gas price prevented the full use of installed capacities in Riga combined heat and power plants, resulting in a markedly lower amount of electricity generated in comparison with the previous years. The composition of CHPP electricity and heat capacity gives a flexibility to choose production modes, ensuring both the necessary increase of generated thermal energy by 6% for heat supply in Riga as well as electricity generation in economically justified conditions thus mitigating the negative impact of mandatory procurement costs.

In 2012, we continued an extensive investment programme, investing a total of LVL 185.7 million. The largest investment projects are reconstruction of Riga TEC 2 and the reconstruction of *Kurzeme Ring*. As part of the Riga TEC 2 reconstruction, we will replace fully the old power facilities with a new combined-cycle gas turbine power unit, which will improve the operational efficiency of the plant, transforming it into one of the most efficient gas cogeneration plants in the Baltics. In turn, the *Kurzeme Ring* project, which is a part of a larger, international energy infrastructure development project *NordBalt*, will ensure the strengthening of the transmission network in the western region of Latvia.

Extensive investments have also been made into maintenance and renovation of distribution and transmission networks to improve the quality of the system service, to decrease the duration of electricity supply interruptions due to scheduled repairs or unexpected damage, as well as to ensure appropriate voltage quality.

An intensive drafting process of a long-term distribution network development plan took place in 2012, implementing respective improvements in the technical policy both for improved quality of distribution services and in respect to electricity lines in rural territories and forested areas.

To avoid resting on our laurels and to maintain the leading position in the generation of green energy, we are planning to invest in the renovation and maintenance of the generation capacities of Daugava HPPs. It is estimated that investments in the reconstruction of hydropower units will exceed LVL 100 million until 2022, thus ensuring their continued operation for the following 40 years.

In compliance with the requirements of Directive 2009/72/EC of the European Parliament and of the Council of 13 July

2009 providing that a transmission system operator shall be unbundled from vertically integrated utility, Augstsprieguma tīkls AS began a separate life outside the Group in the beginning of 2012. For the Group, this is a new development in the business cooperation and in the new professional relationship-building model. Augstsprieguma tīkls AS is the company that bears the burden of maintaining the energy provision infrastructure on a national level, substantiating new large-scale energy projects, as well as ensuring the cross-border supply. Stability of the energy system and energy supply safety – these are strategic issues.

In 2012, Latvenergo Group has also received a number of significant praises and awards: Latvenergo AS has been named the most valuable company in Latvia for the fourth year in a row in the „Top 101 most valuable Latvian companies” (*Latvijas vērtīgāko uzņēmumu TOP 101*) by the *Kapitāls* magazine in cooperation with Prudentia IBS and the NASDAQ OMX Riga exchange. The value of Latvenergo has been estimated at LVL 876 million. In the Latvian company reputation rankings, compiled by the *Lietišķā Diena* newspaper in cooperation with the Nord Porter Novelli agency, Latvenergo AS took the leading position in the electricity, gas and water supply sector and has also been praised for the most rapid rise in reputation from the 44<sup>th</sup> position in 2011 to the 15<sup>th</sup> position in 2012.

As well in 2012, Latvenergo Group has consistently continued to implement its corporate social responsibility policy, investing effort and resources to increase the welfare of the environment and society. Such activities as long-term children and youth education on electrical safety, support for science and education, preservation of industrial heritage, support for society and Latvian culture, as well as environmental protection and energy efficiency should be noted. Over the last year Latvenergo AS has begun a large-scale energy efficiency project for households, monitoring the electricity consumption with technologies that have not been used in Latvia before.

The greatest challenge for Latvenergo AS in the foreseeable future will be the involvement of Latvian households in the electricity market. For us this means active consideration and action already now, in order to be prepared for the challenges as soon as the market opens. Gaining experience of a Baltic company imposes new duties on us and motivates towards new ambitions and achievements!

Dr. sc. ing. **Āris Žīgurs,**  
Chairman of the Management Board of Latvenergo AS



# LATVENERGO GROUP PROFILE

PREPARED IN ACCORDANCE WITH  
THE GRI (GLOBAL REPORTING INITIATIVE)  
GUIDELINES G3.1 APPLICATION LEVEL B+



# 1.1 REPORTING PRINCIPLES



# 1.1 Reporting Principles

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## Aspects disclosed in the report are significant for sustainable development and cooperation with stakeholders

Since 2009, the Latvenergo Group (hereinafter also referred to as *the Group*) Sustainability Report has been published in accordance with the reporting standards specified in the GRI (Global Reporting Initiative) Guidelines. Sustainability Reports for 2009 and 2010 have been prepared in accordance with Level C requirements of the GRI Guidelines G3.0, while the requirements for Level B+ were met in 2011, expanding the scope of information disclosed.

The disclosure development process of the information included in the Sustainability Report was continued this year as well, and the report has been prepared in accordance with the Level B+ requirements of the latest GRI Guidelines G3.1 (published in March 2011).

The information on the Latvenergo Group profile (1.1 – 4.17)

and 42 performance indicators (minimum requirement – 20 indicators) has been fully disclosed in the Sustainability Report.

GRI Profile indicators disclosed in the respective section are indicated on the left side at the beginning of each profile section.

The scope of disclosed information includes 11 energy sector-specific indicators (marked EU) that are disclosed in accordance with the requirements of the GRI Electric Utilities Sector Supplement. The disclosed performance indicators have been selected by evaluating their importance in the context of sustainable development and significance in cooperation with stakeholders.

The Profile section contains general information on the Group, its strategy, governance, management and operating segments, while information on management approach to environmental matters, labour practices and decent work, product responsibility, society and economic responsibility, as well as key performance indicators within these areas, are disclosed in the performance indicators section.

The Sustainability Report discloses information on Latvenergo Group, the core business areas of which are generation and supply of electricity and thermal energy, electricity distribution and management of transmission system assets.

The geographic scope of Latvenergo Group activities covers Latvia, Lithuania and Estonia.

In order to provide stakeholders with more complete information on Latvenergo Group operations, the Sustainability Report 2012 includes an expanded scope of information on the Group strategy, governance and management, as well as other issues that Latvenergo Group considers relevant to its stakeholders.

The Group management performed an initial study to determine the extent and key issues of information that should be disclosed in the report. The study was carried out in three stages. In the first stage, the key performance indicators were identified on the basis of the management approach and cooperation with stakeholders. In the next stage, the significance of these indicators in the context of sustainable development of Latvenergo Group and their compliance with the needs and expectations of pre-defined stakeholders were assessed. In conclusion, the results of the study were discussed, verified and supplemented through internal discussions with the responsible business function managers of the respective areas.

The information comprised in the report has been obtained from internal information systems, where data collection and quality are under full control of the Group. Implemented

### GRI report application level criteria

REPORT APPLICATION LEVEL	C	C+	B	B+	A	A+
Profile Disclosures	Report on: 1.1, 2.1 – 2.10, 3.1 – 3.8, 3.10 – 3.12, 4.1 – 4.4, 4.14 – 4.15	Report Externally Assured	Report on all criteria listed for Level C plus: 1.2, 3.9, 3.13, 4.5 – 4.13, 4.16 – 4.17	Report Externally Assured	Same as requirement of Level B	Report Externally Assured
Management Approach	Not Required		Management Approach Disclosures for each indicator Category		Management Approach Disclosures for each indicator Category	
Performance Indicators & Sector Supplement Performance Indicators	Report fully on a minimum of any 10 Performance Indicators, including at least one from each of: social, economic and environment *		Report fully on a minimum of any 20 Performance Indicators, at least one from each of: economic, environment, human rights, labour, society and product responsibility **		Respond on each core and Sector Supplement indicator with due regard to the materiality Principle by either: a) reporting on the indicator or b) explaining the reason for its omission	

\* Performance Indicators may be selected from any finalised Sector Supplement, but 7 of the 10 must be from the original GRI Guidelines

\*\* Performance Indicators may be selected from any finalised Sector Supplement, but 14 of the 20 must be from the original GRI Guidelines



internal control systems ensure the reliability of data. Furthermore, to achieve a comparative evaluation of the Group development across its operating segments, the data in the report have been disclosed on a multi-year perspective. Data measurement methods have not been changed significantly compared to the previous reports. Collection methods of the reported data have been specified. Three data collection methods were used:

- measurement – the data were measured precisely;
- estimate – the data were estimated approximately on the basis of assumptions;
- calculation – the data were obtained using calculations.

The information included in the Report is addressed to all stakeholders of Latvenergo Group, the most important of which are customers, society, employees, and the Shareholder. Furthermore, readers of the Report include credit institutions, financial investors, and individuals and organisations with an interest in the operations of Latvenergo Group and its sustainable development. A summary of the information included in the Sustainability Report in accordance with the GRI Guidelines is provided in the annex. The overall level of information disclosure is divided into three categories: not disclosed, partly disclosed and fully disclosed. All indicators included in the Report are fully disclosed.

GRI indicators 4.2, 4.3, 4.9 and 4.10 do not apply to Latvenergo Group.

For the second consecutive year, an independent external audit has been performed on the Group Sustainability Report. Ernst & Young Baltic SIA has provided the auditor's report on the Sustainability Report 2012.

All Sustainability Reports of the Group are publicly available on the international Sustainability Disclosure Database of GRI, as well as on the Latvenergo Group's website – <http://www.latvenergo.lv>. E-mail address for questions and suggestions related to the Sustainability Report: [sustainability@latvenergo.lv](mailto:sustainability@latvenergo.lv).

## GRI Performance and Sector Supplement indicators disclosed in the Report



# 1.2

## GROUP PROFILE



# 1.2 Group Profile

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## Latvenergo Group is the leading power supplier in the Baltics

Latvenergo Group is the largest power supply company in the Baltics engaged in generation and supply of electricity and thermal energy, provision of electricity distribution services and management of transmission system assets.

The structure of Latvenergo Group is composed of companies led by Latvenergo AS, which holds the decisive influence. The Group comprises the parent company Latvenergo and six subsidiaries as at the end of 2012. Latvenergo AS also has a shareholding in two associated companies – Nordic Energy Link AS and Pirmais Slēgtais Pensiju Fonds AS, along with a shareholding in Rīgas siltums AS (0.005%).

The most significant changes in Latvenergo Group structure are related to the sale of shares of Augstsprieguma tīkls AS. The Republic of Latvia, represented by the Ministry of Finance, is the sole owner of Augstsprieguma tīkls AS as of 2 January 2012.

More information about the operating segments and customers of Latvenergo Group is disclosed in Section 1.7 of the Report.

## Latvenergo AS shareholding in subsidiaries and associated companies in 2012

	COUNTRY OF OPERATION	TYPE OF OPERATION	SHAREHOLDING
Latvenergo AS	Latvia	Generation and supply of electricity and thermal energy	
Latvijas elektriskie tīkli AS	Latvia	Transmission system asset management	100%
Sadales tīkls AS	Latvia	Electricity distribution	100%
Elektrum Eesti OÜ	Estonia	Electricity supply	100%
Elektrum Latvija SIA (subsidiary of Elektrum Eesti OÜ)	Latvia	Electricity supply	100%
Elektrum Lietuva UAB	Lithuania	Electricity supply	100%
Liepājas enerģija SIA	Latvia	Electricity and thermal energy generation and supply	51%
Nordic Energy Link AS	Estonia	Electricity transmission	25%
Pirmais Slēgtais Pensiju Fonds AS*	Latvia	Pension plan management	46.3%

\*Latvenergo Group shareholding – 48.15%

## Latvenergo Group company contacts

	REGISTERED OFFICE	WEBSITE
Latvenergo AS	Pulkveža Brieža iela 12, Rīga, Latvia, LV-1230	<a href="http://www.latvenergo.lv/">http://www.latvenergo.lv/</a>
Latvijas elektriskie tīkli AS	Dārziema iela 86, Rīga, Latvia, LV-1073	<a href="http://www.let.latvenergo.lv/">http://www.let.latvenergo.lv/</a>
Sadales tīkls AS	Šmerļa iela 1, Rīga, Latvia, LV-1160	<a href="http://www.sadalestikls.lv/">http://www.sadalestikls.lv/</a>
Elektrum Eesti OÜ	Liivalaia 45, 10145 Tallinn, Eesti	<a href="http://www.elektrum.ee/">http://www.elektrum.ee/</a>
Elektrum Latvija SIA	Pulkveža Brieža iela 12, Rīga, Latvia, LV-1010	
Elektrum Lietuva UAB	A.Goštauto g. 40B, Vilnius LT- 01112, Lithuania	<a href="http://www.elektrum.lt/">http://www.elektrum.lt/</a>
Liepājas enerģija SIA	Ludviķa iela 15, Liepāja, Latvia, LV-3401	<a href="http://www.liepajasenerģija.lv/">http://www.liepajasenerģija.lv/</a>



# 2012

## GENERAL FACTS

100% of shares are state-owned

Vertically integrated power supply company

4,457 employees

## FINANCIAL PERFORMANCE

Revenue	M LVL	751.0
Profit	M LVL	35.7
Asset value	M LVL	2,472.3
Capital expenditure	M LVL	185.7
Credit rating	Moody's	Baa3 (stable)

## SALES FIGURES

Retail electricity supply	GWh	8,287
Market share in the Baltics	%	33
Customers	thousands	~900
Aggregate heat supply	GWh	2,669

## TECHNICAL PARAMETERS

Installed electrical capacity	MW <sub>el</sub>	2,349
Installed thermal capacity	MW <sub>th</sub>	2,052
Distribution		
line length	km	94,701
transformer capacity	MVA	5,751
Transmission		
line length	km	5,260
transformer capacity	MVA	8,227



# 1.3

## GROUP STRATEGY



# 1.3 Group Strategy

1.2

## Sector development trends in the region – basis for the new strategy of the Group

The strategy of Latvenergo Group approved at the end of 2012 establishes the key strategic objectives and organization development tasks until 2016. The strategy is designed taking into account the energy sector regulations of the European Union (EU) and the objectives established therein, as well as the Baltic business environment and its foreseeable changes.

The most significant development trends in the Baltic energy sector are the liberalisation of the electricity market and its integration with the Nordic market, as well as reduction of greenhouse gas emissions, with increasing role of renewable resources and enhancement of energy efficiency.

### Electricity market liberalisation and integration with the Nordic market

In 2009, the European Commission, together with the heads of state of the Baltic Sea region countries, approved the Baltic Energy Market Interconnection Plan (BEMIP) aiming at integration of the Baltic States into the EU energy market.

Pursuant to BEMIP, the electricity market in all three Baltic States is gradually opening and merging with the Nordic electricity market, also including the creation of the Nord Pool trade exchange bidding areas in the Baltics. In the beginning of 2013, along with the opening of the Estonian electricity market, the open electricity market share in the Baltics reached 75%. A full opening of the electricity market takes

place gradually, in the foreseeable future involving Latvian households, and in 2015 – Lithuanian households as well, reaching a 100% open electricity market. Electricity market liberalisation is expected to bring in new market players and intensify the competition.

As part of the Baltic electricity market integration, in addition to the existing interconnection (350 MW) between Estonia and Finland, the construction of another interconnection is scheduled to be finished in 2014, bringing total connection capacity to 1000 MW. Also, the construction of a 700 MW interconnection between Lithuania and Sweden is planned to be finished in 2016. After the construction of interconnections, electricity prices in Baltics will be increasingly determined by electricity demand and supply in Scandinavia.

### European Energy 2020 strategy

EU has outlined its vision for further energy-related developments in the European *Energy 2020* strategy, set as a basis for achieving the following ambitious 20-20-20 targets by 2020:

- reduction of greenhouse gas emissions by 20% from the level in 1990;
- increase of the renewable energy share to 20% of the total energy consumption;
- achievement of 20% energy efficiency improvement in comparison with the base scenario.

The greenhouse gas emission reduction, increase of renewable energy share, and energy efficiency targets prescribed by the *Energy 2020* strategy within the framework of the EU legislative process are established as legally binding for EU Member States. Ambitions to achieve the defined targets have also been demonstrated by the EU in the *Energy Roadmap 2050*. The defined targets affect the

electricity generators choice of electricity generation sources, the growth of the role of renewable energy resources in energy generation and pricing, and the changes in energy consumption as a result of energy efficiency.

### The strategy of Latvenergo Group

Taking into consideration the trends in the energy sector, Latvenergo Group has set the following strategic goals until 2016:

- **strengthening of the position in the Baltic market** to become a permanent and equal electricity retail participant in all three Baltic States, maintaining an economically justified market share and increasing the number of customers by focusing on small and medium-sized enterprises and households;
- **diversification of electricity generation sources**, which provides that, economically justified and profitable investment opportunities that ensure energy source diversification and have low emission intensity must be chosen at restoration of generation capacities and development of new projects. Also, in the context of this goal, it is planned to improve the safety level and the useful life of existing generation capacities;
- **balanced development of networks**, which provides to ensure incessant energy supply and set investment priorities on objects with a foreseeable long-term demand for provision of services. Balanced development of distribution networks also includes ensuring planned maintenance works and further distribution network modernisation.

Furthermore, the strategy of Latvenergo Group intends to focus on observance and strengthening of good corporate governance principles to promote awareness among customers and partners of Latvenergo as of an open, efficient and responsible Group.



# 1.4 GROUP GOVERNANCE



# 1.4 Group Governance

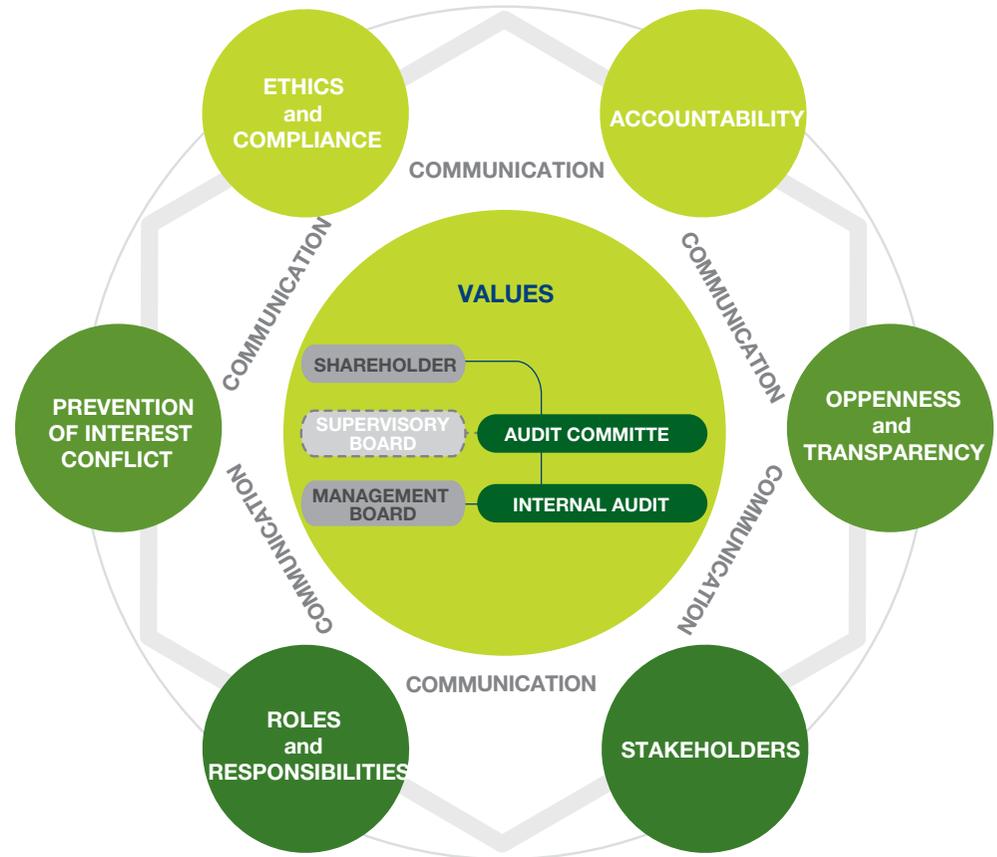
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Latvenergo Group improves constantly its corporate governance in accordance with the internationally accepted governance practices. An independent Audit Committee has been established as a supervisory body, which commenced its work in late 2012. It is expected that in the following years, the Supervisory Board will be reinstated as the supervisory body in state-owned companies: following the requirements of the Law on State and Municipality Capital Shares and Capital Companies, the Supervisory Board of Latvenergo AS was abolished in 2009 assigning the supervisory functions to the Shareholders' Meeting. The governance structure of the Group companies is defined in the Corporate Governance Policy of Latvenergo Group.

**Governance of the Group complies with good corporate governance principles**

Under the on-going Latvenergo Group strategy until 2016, the key elements of the Group governance principles (that apply to governance and supervisory bodies and are under special attention of the Group) are described in the Corporate Governance model of Latvenergo Group. Development and strengthening of these principles are preconditions not only for a successful implementation of the Latvenergo Group strategy but also for the maintenance and increase of the value of the Group.

## Corporate Governance Model



## Shareholder

All shares of Latvenergo AS are owned by the Republic of Latvia and held by the Ministry of Economics of the Republic of Latvia. The interests of the Shareholder at the Shareholders' Meeting are represented by the State Secretary of the Ministry of Economics. The Shareholders' Meetings are convened in accordance with the requirements and in the terms prescribed by the Law on State and Municipality Capital Shares and Capital Companies. According to the Energy Law, Latvenergo AS is an object of national importance, and its shares may not be privatised or alienated.

Main duties of the Latvenergo AS Shareholders' Meeting are:

- constant supervision of the Management Board activities;
- appointment and revocation of the Management Board members, as well as determining their remuneration;
- appointment and revocation of the Audit Committee members, as well as approval of their remuneration;
- supervision of the compliance of the company operations with legislation, its Articles of Association and the decisions of the Shareholders' Meeting;
- approval of transactions between the company and a Management Board member or an auditor;
- approval of the annual report of the company;
- decision-making on the profit distribution of the company profit for the preceding year.

16 Shareholders' Meetings were held in 2012. The most important decisions made in 2012 were the approval of the Annual Report 2011, rise of the share capital, appointment of the Auditor, and establishment of the Audit Committee.

## Supervisory Board

In 2009, pursuant to the requirements of the Law on State and Municipality Capital Shares and Capital Companies, the Supervisory Board was abolished in all state-owned companies, including Latvenergo AS, transmitting supervisory functions to the Shareholders' Meeting.

The Supervisory Board has been retained as a supervisory body at fully-owned Latvenergo AS subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB, which operate outside the territory of Latvia and thus are not subjects to the regulations of the Republic of Latvia. Supervisory functions at these subsidiaries are ensured by three Supervisory Board members, who at the same time are members of the Management Board of Latvenergo AS. Supervisory functions in Liepājas enerģija SIA, where the equity share of Latvenergo is 51%, are carried out by a Supervisory Board of 6 persons,

half of whom are representatives of Latvenergo AS. The activity of the Management Board of Sadales tīkls AS and Latvijas elektriskie tīkli AS is supervised by the Shareholders' Meeting, whose interests are represented by the Management Board of Latvenergo AS.

The Concept of Managing State-Owned Capital Shares, approved on 4 June 2012 by the Cabinet of Ministers of the Republic of Latvia, in addition to other requirements prescribes reinstatement of supervisory boards in large and very large companies, including Latvenergo AS, Sadales tīkls AS and Latvijas elektriskie tīkli AS. The restoration of the Supervisory Board is desirable because it would ensure the governance of Latvenergo Group in accordance with good corporate governance practice.

## Management Board

The Management Board of Latvenergo AS is responsible for the operation of the Group. The Latvenergo AS Management Board consists of five members. Upon evaluation of the necessary competencies, experience and expected sphere of responsibility, they are elected by the Shareholders' Meeting for a term of three years. The Management Board operates in accordance with the Articles of Association and the Rules of the Management Board approved at the Shareholders' Meeting. Meetings of the Management Board are conducted to manage the operation of the Group and to make decisions promptly. 62 meetings of the Management Board were convened in 2012.

Main duties of the Management Board of Latvenergo AS are:

- management and representation of the company;
- supervision and management of the company affairs;
- accounting for the business activities of the company as well as its accounting compliance with the law;
- management of the company property.

The Management Board is accountable to the Shareholder and has a joint and several responsibility for the observance of all applicable laws and regulations, execution of the decisions made at the Shareholders' Meeting and the financial activity of the Group. Members of Latvenergo AS Management Board do not own shares in the associated companies of the Group. In addition, the Management Board of Latvenergo AS carries out the functions of the Shareholder in the wholly-owned subsidiaries.

## Audit Committee

Improving the corporate governance of Latvenergo Group, in December 2012, the Audit Committee has commenced its operation in Latvenergo AS. The necessity to establish

the Audit Committee was determined by the issuance of bonds and, consequently, the requirements of the Financial Instrument Market Law.

In addition to the common duties of an audit committee, such as supervision of the financial report preparation process, the operational efficiency of internal controls and risk management system, as well as supervision of the internal audit business function and the activity of a certified auditor, the duties of the Audit Committee of Latvenergo AS include supervision of the implementation of the Fraud Risk Management Plan in order to promote the transparency of the operations of Latvenergo Group.

The Audit Committee reports on its operation and performance to the Shareholders' Meeting of Latvenergo AS.

Upon assessing the required competencies and professional experience, on 4 December 2012 the Shareholders' Meetings elected three members of the Audit Committee. All the members of the Audit Committee are independent specialists who are not related to the operational activities of the Group. Members of the Audit Committee are appointed for a three-year term.

## Internal Audit

The Internal Audit is an independent unit of the internal control of Latvenergo, whose task is to evaluate and assist in improving the efficiency of the risk management, environment of internal controls and corporate governance processes of the Group. Operation of the Internal Audit is based on the International Standards for the Professional Practice of Internal Auditing, prepared and issued by the international Institute of Internal Auditors.

Main functions of the Internal Audit are:

- verification of the reliability and comprehensiveness of the financial information;
- evaluation of the reliability of the management information system;
- evaluation of the compliance of the operation of the Group with internal and external regulations;
- verification of economic use of resources, their control and protection against loss;
- improvement of internal regulatory documents in accordance with the needs of internal control.

The director of the Internal Audit once per quarter reports to the Latvenergo AS Shareholders' Meeting on the operation of the Internal Audit. As of 2013, with the establishment of the Audit Committee, the director of the Internal Audit reports to the Audit Committee.





### 1 Āris Žīgurs

Chairman of the Management Board

Date appointed: 16. 11. 2012  
Expiration of the term: 15. 11. 2015

Āris Žīgurs (47) has more than twenty years of business experience. In 2010, as a result of a competitive recruitment procedure, Ā. Žīgurs was elected as the Chairman of the Latvenergo AS Management Board. Before his employment at Latvenergo AS, Ā. Žīgurs had worked for fifteen years as the President and Chairman of the board at a Riga thermal energy supply company Rigas Siltums AS. His prior experience also includes the position of the Commercial Director of the Heat Management Board at former Latvenergo VAS, as well as work at municipal companies. In 1998, Ā. Žīgurs graduated from the Faculty of Engineering at the Latvia University of Agriculture. In 2004, he was awarded a Master Degree in Business Administration from the Riga Technical University Riga Business School. In 2009, Ā. Žīgurs received a Doctor of Science degree in engineering in the energy sector at RTU. This was followed by completing the executive education programme for professional board members at the Baltic Institute of Corporate Governance in 2010. Ā. Žīgurs is a Member of the Board of Directors at the Union of the Electricity Industry of Europe – EURELECTRIC, as well as the Vice-President of the Latvian National Committee of the World Energy Council.

### 2 Zane Kotāne

Member of the Management Board

Date appointed: 16. 11. 2012  
Expiration of the term: 15. 11. 2015

Zane Kotāne (35) has more than fifteen years of experience in fulfilling various finance-related duties at a number of Latvian as well as international companies. Before her employment at Latvenergo AS, Z. Kotāne had been the Head of the Unit for Business Analysis and Reporting at the Commercial Department of AirBaltic Corporation AS. She was a financial director at an international investment group for five years, after spending eight years working at an international audit and consulting company, specialising in finance and risk management, which included two years of valuable experience in Hungary. In 1997, Z. Kotāne graduated from the Stockholm School of Economics in Riga with a Bachelor degree in Economics and Business Administration. In 2011, she completed the executive education programme for professional board members at the Baltic Institute of Corporate Governance.



### 3 Māris Kuņickis

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Member of the Management Board

Date appointed: 16. 11. 2012  
Expiration of the term: 15. 11. 2015

Māris Kuņickis (33) has over ten-year experience in business, including six years in corporate management. Before the employment in the Management Board of Latvenergo AS, commenced by M. Kuņickis in 2010, he was the Director of the Riga Municipality Agency Rīgas Gaisma. His work experience at Rīgas Gaisma began as early as 2000, taking him through a number of positions related to technology and development. In 2002, M. Kuņickis received a Bachelor degree in engineering at the Riga Technical University, Faculty of Power and Technical Engineering, followed by a 2005 Master degree at the University of Latvia, Faculty of Physics and Mathematics. In 2011, he was appointed as a Member of the Board at the Latvian Association of Power Engineers and Energy Constructors (LAPEEC).

### 4 Arnis Kurgs

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Member of the Management Board

Date appointed: 16. 11. 2012  
Expiration of the term: 15. 11. 2015

Arnis Kurgs (45) is an experienced lawyer who has been active in his profession for more than twenty years. Since 1995, A. Kurgs has been employed at Latvenergo AS, handling legal affairs. Since 2006, he has been active on its Management Board. Prior to his employment at Latvenergo AS, he also worked as a legal advisor for the Ministry of Maritime Affairs, the Riga City Council and the Saeima. A. Kurgs has received a construction technician qualification at the Malta Technical School. In 1993, A. Kurgs graduated from the Faculty of Law of the University of Latvia. In 2005 and 2006, he continued his education at the professional Master study programme of law at the School of Business Administration Turība. In 2010, he completed the executive education programme for professional board members at the Baltic Institute of Corporate Governance.

### 5 Uldis Bariss

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Member of the Management Board

Date appointed: 16. 11. 2012  
Expiration of the term: 15. 11. 2015

Uldis Bariss (47) has over twenty-year business experience at the largest companies in Latvia. Since 2005, U. Bariss has been a Member of the Latvenergo AS Management Board, handling various business functions, including finance and business management. Previously (from 2002 to 2005), U. Bariss worked in positions related to projects, finance and business optimisation at the company. Before employment at Latvenergo AS, he had worked for Lattelekom SIA for nine years, being in charge of finances. U. Bariss received a Master degree in economics at the University of Latvia in 2004. In 2008, he graduated from the Executive Master of Business Administration (EMBA) professional Master studies programme at the Stockholm School of Economics in Riga, while in 2010, he completed the executive education programme for professional board members at the Baltic Institute of Corporate Governance.



## Audit Committee

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### 1 Torben Pedersen

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Chairman of the Audit Committee

Date appointed: 05.12.2012  
Expiration of the term: 04.12.2015

T. Pedersen (63) has acquired an international experience as an audit partner at *Arthur Andersen* from 1994 to 2001 and at *Deloitte* from 2001 to 2010. T. Pedersen is an expert of investor environment requirements for large companies and has been a Board Member of the Danish Chamber of Commerce in Lithuania. T. Pedersen graduated from the Aarhus Business School in Denmark, where he received a Master Degree in economics and audit. Additionally, in Denmark T. Pedersen has received a Chartered Accountant qualification.

### 2 Inita Hāne

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Member of the Audit Committee

Date appointed: 05.12.2012  
Expiration of the term: 04.12.2015

I. Hāne (34) is the Chief Financial Officer at Prime Holding SIA, previously – the Senior Manager at PriceWaterhouseCoopers SIA, and also has audited the financial statements of Latvenergo AS, therefore she is acquainted with the operation of the company. I. Hāne has acquired a Bachelor Degree in public relations at Vidzeme University and graduated from the BA School of Business and Finance with a Master Degree in finance. I. Hāne is a member of the Association of Chartered Certified Accountants and has received a Certified Internal Auditor (CIA) certificate.

### 3 Svens Dinsdorfs

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Member of the Audit Committee

Date appointed: 05.12.2012  
Expiration of the term: 04.12.2015

Since 2006, Svens Dinsdorfs (36) is the CFO and Management Board member of ELKO Grupa AS and has successfully implemented the bond issuance of ELKO Grupa AS. Previously, Svens Dinsdorfs was the CFO of Sirowa Riga AS. He has also been the Vice President in Strategic Development Matters and the Director of Business Control at Air Baltic AS from 1998 until 2004. S. Dinsdorfs graduated from the Stockholm School of Economics in Riga with a Bachelor Degree in finance and economics and further received a Master Degree at Stockholm School of Economics.



## Roles, Responsibilities and Accountability

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The roles, responsibilities and accountability of the governance and supervisory bodies are largely determined by external regulations. For supervision and governance of

the Group operation to be efficient, roles, responsibilities and accountability of governance and supervision bodies are additionally described in the internal documents of the Group.

The main internal regulations are the Articles of Association of each company and Rules of governance and supervisory bodies.

## Ethics and Compliance

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Latvenergo Group follows high ethical principles in professional activity and ensures compliance of its operation with the requirements of laws and regulations. By following these terms, the governance and supervisory bodies of the Group set the pattern and promote the observance of ethical norms and compliance with regulations. These norms are explained and updated continuously, and their observance is constantly controlled. Observance of ethical norms and

compliance is ensured to strengthen the control environment proactively. Latvenergo Group follows closely the changes in external laws and regulations and performs the necessary actions for implementing the new statutory requirements in its operations, as well as informs the employees about the changed statutory requirements.

The Group supports fair business practice, follows the rules of fair competition and does not engage in transactions that

restrict competition, are corruptive or discriminative. The Code of Ethics of Latvenergo Group prohibits fraud and corruption and prevents conflicts of interest. Business partners of Latvenergo Group are encouraged to follow similar ethical principles, and at conclusion of an agreement they are asked to certify that the cooperation is based on fair business cooperation principles

## Prevention of Interest Conflict

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In accordance with the Law on Prevention of Conflict of Interest in Activities of Public Officials, members of the management boards of state-owned companies have the status of state officials. The law restricts the activity of Management Board members outside their authority in order to prevent personal or material interest in holding the respective office. Management Board members must submit a declaration for public officials on income received, positions held, transactions concluded, business activities and other information.

During the execution of duties, governing and supervisory bodies of the Group ensure the observance of principles regarding the prevention of conflict of interest. The goal of the management is to promote awareness of situations with a potential conflict of interest by providing explanations, training and control.

The management of the Group companies strives to establish preventive and detective controls for prevention of situations with a conflict of interest.

In order to prevent situations with a conflict of interest, types of interest conflict (real, potential, apparent) have been defined in the Code of Ethics of Latvenergo Group.

## Openness and Transparency

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The transparency principle applies both to the transparency of governance principles of Latvenergo Group (including duties, responsibility and remuneration) and to the transparency and explanation of financial and operational results.

Transparency of Latvenergo Group governance principles is ensured by publishing the Latvenergo AS corporate governance report (in accordance with the requirements of NASDAQ OMX Riga AS) as well as by ensuring the availability of information on the website and in the sustainability

report, which, as of 2009, is prepared in accordance with the requirements of GRI Guidelines, which also prescribe transparency of the information in the areas related to the environment, employees, work environment, society, and product and economic responsibility. The sustainability report published by Latvenergo Group is the only audited sustainability report in Latvia.

Transparency of the financial and operational results of Latvenergo is ensured by publishing the Annual Report of

the Group, which, as of 2002, is prepared in accordance with the International Financial Reporting Standards adopted by the EU. Interim financial reports are published since the first half-year of 2012. Furthermore, as of 2013, interim quarterly financial reports are published in accordance with the requirements of the Financial Instrument Market Law. The financial reports and other information that is relevant to the investors and cooperation partners are published on the new section „Investors” of the Latvenergo website.



### Remuneration Policy of the Management Board

The legislation in force in the Republic of Latvia – the Law on State and Municipality Capital Shares and Capital Companies as well as the regulations issued by the Cabinet of Ministers in accordance with this Law – prescribe a regulatory framework for determination of Management Board member remuneration in state capital companies.

The monthly salary of the Management Board members is tied to the average monthly salary of employees in the public sector over the preceding year, which is published in the official statistical bulletin issued by the Central Statistical Bureau, and multiplied by a ratio based on the size of the company. For the Chairman of the Management Board of Latvenergo AS, this ratio may not exceed 6, while the monthly salary of the Member of Latvenergo AS Management Board may not exceed 90% of the determined monthly salary of the Chairman of the Management Board. The monthly salaries of the Management Board members are recalculated annually. Members of the Management Board who are relieved of their position before the expiration of the term may be entitled to severance payment, the amount of which may not exceed two months-remuneration. The severance payment is not paid if a Management Board member is discharged due to gross abuse of authority, neglect of duty or inadequate performance, as well as in cases where harm has been done to the company.

Once a year, following approval of the Annual Report, the

Shareholders' Meeting may decide on paying a bonus to the Management Board members for successful performance and fulfilment of goals set for the company. The bonus may not exceed the amount of one-month salary. Payment of a bonus is also possible if the company has no tax debts and there has been profit, or if there have been losses that were planned in order to implement a development (investment) programme and that have not been caused by unlawful action or inaction of the Management Board.

All the material benefits stipulated in the Latvenergo AS Collective Agreement apply to the Management Board members, including monthly payments into the Pension Fund in a 5% amount of the monthly salary. The remuneration policy does not provide the option to pay the remuneration in the form of shares or share options. In 2012, the total remuneration of the Chairman of the Management Board of AS Latvenergo A. Žīgurs is LVL 47,369, to the Members of the Management Board: Z. Kotāne – LVL 40,221, M. Kupickis – LVL 42,665, A. Kurgs – LVL 42,571 and U. Bariss – LVL 41,831.

In the end of 2012, the laws and regulations of the Republic of Latvia were amended, enabling the Chairman and Members of the Management Board to perform additional duties within the company and be compensated for it. As of 18 January 2013, the total amount of the remuneration of a Management Board member may not exceed the average monthly salary of employees in the country over the preceding

year, which is published in the official statistical bulletin issued by the Central Statistical Bureau, multiplied by ten. The percentage of remuneration for performance of the duties of the Chairman of the Management Board may not be less than 60% of his total remuneration. The remuneration of a Member of the Management Board who holds an additional position in the company may not exceed 90% of the remuneration of the Chairman of the Management Board as determined by the principle mentioned above.

### Dividend Policy

The disbursement of dividends of Latvenergo AS is regulated by the Law on State and Municipality Capital Shares and Capital Companies of the Republic of Latvia and the Cabinet of Ministers Regulation No. 1471 of 15 December 2009 on Procedure on how to Determine and Transfer to the State Budget the Share of the Profit Payable for the Use of State Capital issued on its basis.

Pursuant to the Law on the State Budget for 2013, 90% of the net profit remaining in Latvenergo AS possession is payable in dividends for 2012, but the total amount in dividends may not exceed 36 million lats. In accordance with the requirements of laws and regulations, the share payable in dividends is going to decrease during the following years, and in 2013 and 2014 will be 80% and 70% respectively. Pursuant to the Concept of State Capital Share Management, the applicable long-term dividend policy will be differentiated in accordance with the goals of the company.

## Stakeholders

Latvenergo Group is one of the largest companies in the Baltics. In 2012, Latvenergo Group had approximately 900,000 customers, representing households and large, medium and small enterprises, organisations and state and local government institutions. A wide range of services relevant to the development of national economy and to daily activities determines the impact of Latvenergo Group on a wide range of stakeholders and the respective responsibility.

In order to ensure successful cooperation and mutual gain, Latvenergo Group has identified the stakeholders and issues, which are important to them. Latvenergo Group builds cooperation with stakeholders on the basis of the following principles:

- inclusivity;
- materiality;
- responsiveness.

Cooperation between Latvenergo Group and its stakeholders takes place on various levels:

- consult – clarification of current issues;
- negotiate – collective discussions;
- involve – exchange of opinions while acting independently;
- collaborate – joint decision making and action.



STAKEHOLDER	LEVEL OF ENGAGEMENT	REPRESENTATIVES	ENGAGEMENT METHODS AND TOPICS
Shareholder	Collaborate	Ministry of Economics of the Republic of Latvia	Cooperation with the shareholder takes place on a regular basis and is conducted according to the requirements prescribed by the legislation. Additionally, the Ministry of Economics is responsible for developing and implementing the energy sector policy, establishing development principles for the sector and devising regulatory provisions on operations within it. Latvenergo Group is actively involved in professional discussions with the policymakers of the sector.
Customers	Involve	Households and business customers	Latvenergo Group seeks to increase the customer satisfaction. Customer opinions are identified annually by conducting customer satisfaction studies and surveys. The main questions in surveys concern satisfaction with services, their price and quality.
Employees	Negotiate and involve	Current and potential employees	The main cooperation areas are the rights and obligations of employees and the employer, work procedures, safe work environment, staff expertise and remuneration. In order to motivate employees to increase work performance, productivity and level of employee responsibility and initiative, Latvenergo Group carries out quarterly assessment of the job duty performance. In the annual personnel development discussions, employees discuss with the employer the achievement of annual objectives and the necessity for training in order to improve the professional competence.
Trade union	Negotiate and involve	Trade union „Energija”	Representatives of the Group and its companies communicate consequently (9 meetings in 2012) with the trade union representatives on the organization of work and other current issues. On 14 November 2012, an agreement was signed to prolong the term of the Collective Agreement until 31 December 2013. Representatives of the trade union were involved in the tender committee for choosing the employee health and accident insurance policy.
Society	Consult, negotiate and involve	Residents, media	The Group communicates with the society and involves it in resolving current issues, as well as carries out explanatory measures. Latvenergo Group has carried out 30 public discussions about the impact of infrastructure objects on the environment and residents. In addition, the Group supports a wide range of social responsibility activities (education of children and young people, support for science and education in the energy sector, preservation of industrial heritage, openness to culture and sports, environmental protection, etc.).
Professional Associations and Sector Specialists	Consult and involve	See below „Representation in Associations, Organizations and Unions”	In order to represent its interests in formation of politics and the regulatory environment, the Group delegates its representatives to participate in various national associations and professional organizations, as well as in international organizations and unions.
Business partners	Involve	Current and potential suppliers and service providers	The most important issue for the business partners is clear and open criteria for procurement tenders that ensure equal competitive conditions to all suppliers. Within the framework of cooperation, Latvenergo Group surveys regularly its business partners and identifies the areas that require improvement. The cooperation is systematic.
Lenders and Investors	Consult and collaborate	Lenders, investors, <i>Moody's</i> Investors Service	Latvenergo Group ensures regular exchange of information about the financial results and performance of the Group, thus ensuring the attraction of the necessary funding. A section for investors has been created on the website of the Group. Interim financial reports are being published since 2012.
Educational institutions	Collaborate	Schools, colleges, universities	Latvenergo Group participates in the development of educational programmes and provides internship opportunities for students. Students from the Riga Technical College improve regularly their theoretical knowledge and practical skills in the Educational Centre of Latvenergo Group. The Group in cooperation with student associations organizes regular contests for students.
Government institutions	Consult and involve	PUC, CC and other government institutions	Regular and close cooperation is maintained with institutions that oversee the operations of Latvenergo Group within the statutory framework. Core cooperation areas are the electricity tariffs, compliance with laws and regulations and improvement of the regulatory environment. The Public Utilities Commission (PUC) is entitled and obliged to issue administrative acts binding on the providers of public services. Thus, cooperation with PUC is aimed at supervision of the conditions for public service provision and improvement of the regulatory environment. Latvenergo Group constantly provides information to the PUC on the operation and financial results of the Group. The Competition Council (CC) focuses on facilitating fair competition and ensuring the transparency of service provision.



## Stakeholders (sequel)

### Representation in associations, organisations and unions

By delegating representatives to the national associations and professional organisations as well as to international organisations and unions, Latvenergo Group obtains up-to-date information about the current events and

essential issues in the energy sector, as well as ensures the protection of its interests in development of international and national policy documents and formation of the regulatory environment.

### Participation of Latvenergo Group in national associations and professional organisations

ASSOCIATION, PROFESSIONAL ORGANISATION	REASONS FOR PARTICIPATION
Latvian Association of Power Engineers and Energy Constructors (LAPEEC)	Participation in LAPEEC provides Latvenergo Group with the opportunity to participate in the improvement of regulations and standards of the electrical power engineering and energy construction, organisation of personnel certification and training programmes, promotion of coordinated use of renewable energy resources in electricity generation, solving of issues related to vocational education in the sector, conducting of scientific research and organisation of scientific-technical events.
Latvian Association of Large Dams	Participation in the association ensures exchange of information about various aspects of dams and hydro-technical structures, innovations in dams and water reservoirs, as well as solving of safety issues.
Latvian Association of Heat Supply Companies	The association represents interests of the members in the centralised development process of heat supply and cogeneration and devising of heat supply development plans and applicable laws and regulations.
Latvian Chamber of Commerce and Industry (LCCI)	LCCI facilitates protection of the interests of Latvenergo Group in the legislative process related to business in general and to the energy sector in particular.
Employers' Confederation of Latvia (ECL)	ECL ensures representation of the employers interests in the legislation drafting process in the areas of employment law and labour protection. By cooperating with ECL, the Group improves constantly the labour protection conditions, participates in the Council of Energy Sector Experts and cooperates in projects related to the employment law and corporate social responsibility.
Institute for Corporate Sustainability and Responsibility, Latvian Advisory Council	Participation in the council systematically increases the understanding of corporate sustainability and responsibility issues, providing reliable measurements of sustainability as well as skills in applying international practice. Latvenergo Group participates in the index research conducted by the Institute for Corporate Sustainability and Responsibility following an internationally recognized methodology for the evaluation of corporate sustainability and responsibility.
World Energy Council, Latvian National Committee (WEC LNK)	Participation provides the opportunity to receive current information about the research, extraction, transport, transformation and efficient use of energy resources both on national and international scale.



## Participation of Latvenergo Group in international organisations and unions

INTERNATIONAL ORGANISATION, UNION	REASONS FOR PARTICIPATION
Baltic Development Forum (BDF)	Current issues affecting the Baltic Sea region, including those related to the energy sector, are addressed and discussed in the Baltic Development Forum, involving entrepreneurs, politicians, researchers, officials and journalists. Latvenergo Group develops cooperation and engages in exchange of information with the institutions and companies of the Baltic Sea region, positioning Latvenergo Group as the leader in the Baltics free electricity market.
Baltic Institute of Corporate Governance (BICG)	Along with the participation in the institute, the management of Latvenergo Group gains deeper knowledge about the best governance practices and shows readiness of the Group to implement these practices.
Association of the Electricity Industry of Europe – EURELECTRIC	By participating in the association, Latvenergo Group has the opportunity to take part in the drafting process of policy documents and laws and regulations on EU electricity industry and to obtain the current information on the sector development trends and forecasts, which are useful for forecasting trends on the national level. In order to improve the competitiveness of the industry and promote its development, EURELECTRIC represents the interests of the electricity industry on an international scale. Participation of the Group representatives in the association, according to an agreement, is ensured by the Latvian Association of Power Engineers and Energy Constructors, a member of EURELECTRIC.
Organization for Economic Cooperation and Development (OECD), Business and Industry Advisory Committee (BIAC)	Participation in BIAC provides the opportunity to participate in discussions about internationally significant decisions on business development. BIAC is an independent organization that participates in the creation of OECD policies and provides its members with current information about the business development initiatives of OECD. In July 2012, a discussion about the admission of new countries to the OECD, including Latvia, has been initiated.

## Commitments to External Initiatives

In addition to the provisions of the applicable legislation Latvenergo Group observes requirements of the following external initiatives standards LVS EN ISO 14001:2004, LVS EN ISO 9001:2009, LVS OHSAS 18001:2007. Compliance with the requirements of the standards is audited and certified by the certification company Det Norske Veritas Latvia SIA.

Social and environmental aspects, including the principles of social responsibility of the voluntary standard ISO 26000, are also voluntary implemented by Latvenergo Group in its business and relationships with stakeholders.



# 1.5 GROUP MANAGEMENT



# 1.5 Group Management

1.2

Latvenergo Group is managed by the Management Board of Latvenergo AS that has been executing both the strategic and the operational management of the Group.

2.10

In order to improve the management model of Latvenergo Group, promote the implementation of the strategic goals and improve the operational oversight, on 1 January 2013, changes were introduced to the management structure of Latvenergo Group, which resulted in the creation of a new level of operational management – executive directors (chief officers). With the creation of the executive management level, the roles, responsibilities and accountability of the Management Board and the chief officers have been clearly distinguished. The allocation of roles, responsibilities and accountability has been implemented in order to comply with good principles of corporate governance.

4.8

4.11

**Integrated strategic and operational management promotes goal attainment and increases value of the Group**

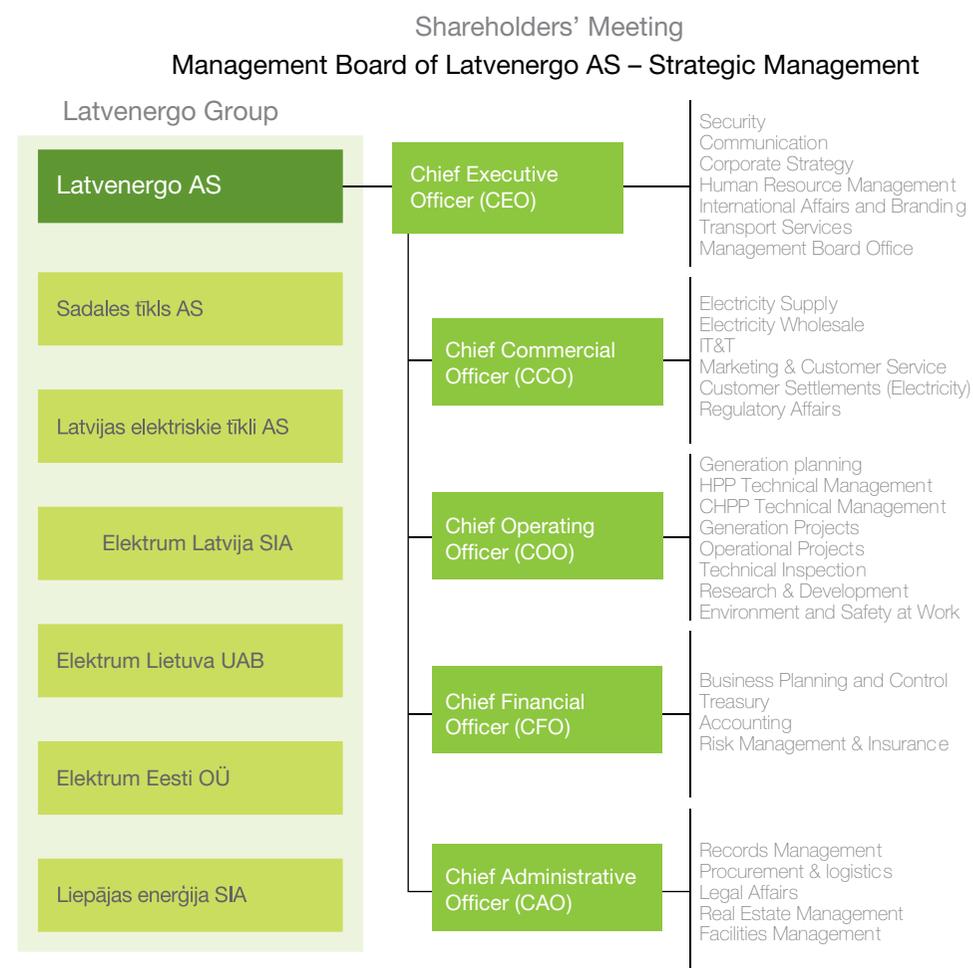
The strategic management of Latvenergo Group is implemented by the Management Board, and its main tasks are to define the strategic direction of the Group, its development plans, goals and policies. In turn, chief officers conduct the operational management of Latvenergo AS, including the achievement of the goals defined by the Management Board, the implementation of the strategy and policies, as well as other everyday duties according to the delegation of the Management Board.

The areas of accountability of the chief officers have been clearly defined and subordinated functions and oversight of administrative decisions within the framework of these functions have been separated. Therefore, each executive officer is individually accountable for the operational activity of his or her subordinated functions to the CEO,

thus ensuring the cooperation between divisions and the adoption of resolutions according to the strategy of the Group. Considering the previous experience and knowledge of the Group operation, these duties are carried out by the Management Board members of Latvenergo AS:

- Āris Žīgurs – Chief Executive Officer (CEO)
- Uldis Bariss – Chief Commercial Officer (CCO)
- Māris Kuņickis – Chief Operating Officer (COO)
- Zane Kotāne – Chief Financial Officer (CFO)
- Amis Kurgs – Chief Administrative Officer (CAO)

## Organizational Structure of Latvenergo Group Management (as of 01.01.2013)



## COSO cube



In order to ensure successful oversight and efficiency of the Group operation, the management has introduced and continuously improves the integrated internal control system that is based on the principles developed by COSO (Committee of Sponsoring Organizations of the Treadway Commission). This system is made up of 5 main elements, the implementation of which leads to achieving the goals of the internal control – efficiency of the Group operations, credibility of the financial reporting, and compliance with the laws and regulations governing its operation.

By mutually integrating these principles, the management is able to monitor the operations of the Group, at the same time focusing on further development and achievement of the set goals. The presence of an effective internal control system ensures the accessibility and reliability of information and creates confidence regarding the ability of the Group to manage risks and changes.

## Control Environment

The core elements of the control environment are the Group vision, mission, values, development strategy, organizational structure, delegation of duties, as well as the management philosophy and operating style. The goal of the strategy is to create a common understanding of development goals within the Group. The organizational structure of Latvenergo Group is built according to the Latvenergo strategy and

arranged according to the functional principle. The goal of such structure is to promote the creation of specialization and competencies within a company or business function, thereby stimulating adoption of responsible and fast decisions, as well as the rational use of resources. In turn, the management philosophy and operating style reflect our attitude towards work and developments that are relevant to

the Group both in the country and in the energy sector. The values of Latvenergo Group are responsibility, efficiency and openness. The values determine our actions in relation to our customers, colleagues, partners and society. A more detailed description of the vision, mission and values of the Group is given in the Section „Group Profile“.

## Risk Assessment

The activity of Latvenergo Group is characterized by a responsible and active attitude towards risks by implementing and continuously improving the risk management system that provides regular, reliable and comprehensive information on the relevant risks of the Group and the corresponding risk eliminating measures. The goal of the risk management is to ensure implementation of the development strategy and achievement of the goals of the Group, minimizing the influence of adverse events.

The risk management system includes the risk identification, impact assessment, planning and implementation of elimination measures. Information on the most relevant risks to the Group and their evaluation is constantly updated, introducing changes where necessary. Evaluation of relevant business risks and actualization of long-term risks in the following year is carried out simultaneously with the development of the next year budget.

Risks that are identified within the risk management process and influence the operation of Latvenergo Group, are classified in five material risk types:

- **strategic risks** – comprise the most significant uncertainties which derive from operations of the Group and could adversely affect opportunities to achieve the strategic goals. These risks are under direct control of Latvenergo Group and they are managed by consistent monitoring the progress of goal achievement;
- **legal environment risks** – resulting from factors of the regulatory environment that could negatively impact operations of the Group or its ability to meet goals. The legal environment risks are beyond the control of Latvenergo Group;
- **external risks** – implies uncertainties resulting from changes in supply and resource markets with a significant impact. These factors, including the impact of

competitor, customer, partner operations on the Group ability to attain its goals, appear regardless of the Group operation;

- **safety risks** – implies risk factors, which occurrence cause damage or loss of assets or, by an increased threat from third parties, interfere the operation of the Group and thereby may lead to financial losses;
- **operational risks** – comprise contingencies and uncertainties, which may appear during operational processes of the Group.

Latvenergo Group is aware of the increase of complexity and unpredictability of risks caused by environmental changes and connection with developments in other sectors, countries and geopolitical regions. Therefore, risk management is constantly improved, and its elements are implemented in a unified system.

## Control Activities

To ensure the compliance of Latvenergo Group operation with laws and regulations, as well as the Group vision, mission, values and development strategy, the management

has developed and constantly improves certain control measures in the form of internal documents, work groups and reports.

The main internal control documents are policies that cover several companies of Latvenergo Group. The most significant policies implemented in Latvenergo Group are: Code of



Ethics; Corporate Governance Policy; Environmental Policy; Accounting Record Keeping Policy; Workplace Safety Policy; Personnel Training and Development Policy; Organizational Development Policy; Investment Funding Policy; Financial Risk Management Policy; Crisis Management Policy; Communication Policy; Corporate Social Responsibility Policy; Human Resources Management Policy; New Employee Integration Policy.

In addition to policies, Latvenergo Group also develops and maintains other internal control documents – procedures, regulations, orders, methodologies, job descriptions, rules

for organizational units, etc. The management promotes a constant improvement of policies and internal control documents, aligning them with changes in legislation requirements, industry tendencies and business processes.

The most significant control activity approved in 2012 is the Fraud Risk Management Plan, the implementation and performance of which is supervised by the Audit Committee. Within the framework of the plan a compliance officer position was established. The goal of this control measure is to minimize the risk of fraud and improve preventively the efficiency of the existing control measures.

In order to ensure efficient work management and decision-making, work groups are created of delegated representatives who have various know-hows, skills and competencies. Thus the exchange of opinions and knowledge among employees as well as increased employee motivation and engagement in decision-making are created.

To provide the management of Latvenergo Group with the most up-to-date information on the Group activity, regular internal reports are created and the accuracy, reliability and comparability of the collected information are ensured.

## Information and Communication

The management of Latvenergo Group pays a particular attention to provide employees with information. The main channels of information exchange and communication are intranet, staff newsletter Latvenergo vēstis (Latvenergo News), internal record keeping systems, electronic

communication (e-mail), internal databases, employee forums, seminars, etc. The internal opinion polling is conducted along with employee development interviews and competence evaluation, thus ensuring the feedback. Within the framework of information exchange and communication,

the management focuses on the selection of issues for communication, primarily discussing issues that are relevant at a given time, as well as regularly communicates long-term, annual and quarterly plans..

## Monitoring

Through constant improvement of the Group governance system, the monitoring of the management performance is carried out by the Internal Audit, the Audit Committee and the external auditor. All these institutions are independent in their operation.

Information on the necessity of updating the integrated management system, the implementation of the goals of the previous period, the results of internal and external audits and the implemented corrective and preventive measures is periodically collected. Conclusions on the activity of the

integrated management system and proposals for the next period are made based on the analysis of the information.

## Supervisory bodies

INSTITUTION	OBJECTIVE	MONITORING FIELDS AND TASKS	REPORTING
Auditor	To verify the credibility and accuracy of information and the compliance of financial statements with the IFRS	<ul style="list-style-type: none"> <li>● revision of consolidated financial statements</li> <li>● evaluation of the risk of nonconformity caused by fraud or errors</li> <li>● verification of capability of the internal control to ensure the accuracy of the information included in financial statements</li> <li>● evaluation of the validity of accounting principles and management accounting estimates</li> </ul>	Once a year, after the finalization of the consolidated financial statements, the Auditor reports to the Shareholders' Meeting
Audit Committee	To oversee the preparation process of the Group financial reports and the operation of the internal control systems, thus stimulating transparency in the company	<ul style="list-style-type: none"> <li>● oversight of the financial statement preparation process, the efficiency of internal controls and the operation of risk management system</li> <li>● monitoring of the Internal Audit and its operations</li> <li>● supervision of the implementation of the Fraud Risk Management Plan</li> </ul>	At least once a year, the Audit Committee reports to the Shareholders' Meeting regarding its activity and the performance of its tasks
Internal Audit	To evaluate and assist to governance institutions and organizational units in improvement of the efficiency of risk management, internal control and corporate governance processes	<ul style="list-style-type: none"> <li>● credibility and comprehensiveness assessment of the financial information</li> <li>● reliability evaluation of the management information system</li> <li>● compliance assessment of everyday activity with laws and regulations Articles of Association and other internal regulations</li> <li>● rationality and productivity appraisal of resource use, safe control and protection against losses</li> <li>● evaluation of internal regulations' sufficiency and compliance with the needs of internal control</li> </ul>	At least once a quarter, the Internal Audit director reports to the Audit Committee (2012: to the Shareholders' Meeting) on revisions conducted and the main problems identified



## Awards

The awards received indicate the sustainability of Latvenergo Group, which is ensured by a thoughtful consideration of the processes related to energy generation and supply, workplace safety, environmental protection, cooperation with stakeholders, customer service, etc.

The most significant awards received by Latvenergo Group in 2012:

### **The Most Valuable Company of Latvia Award**

In the *Top 101 Most Valuable Companies of Latvia*, created by the *Kapitals* magazine in cooperation with Prudentia IBS and NASDAQ OMX Riga AS exchange, Latvenergo AS is ranked as the most valuable company of Latvia. The company has received the award for the fourth consecutive year. In 2012, Latvenergo AS worth is estimated at LVL 876 million.

### **Gold category of the Latvian Sustainability Index**

In 2012, Latvenergo AS has been awarded the Gold category rating of the Latvian Sustainability Index and it is the only state-owned company that has been awarded this title. Latvenergo AS participates in the Latvian Sustainability Index for the third year, receiving the Silver category rating in 2010 and 2011. Latvenergo AS has also received a Certificate of Recognition from the Ministry of Economics of the Republic of Latvia for outstanding results in the Sustainability Index, becoming the most sustainable state-owned company in Latvia in 2012, as well as a Certificate of the Ministry of Welfare granting the status of a family-friendly enterprise.

### **The National Champion in the European Business Awards**

In 2012, Latvenergo AS became one of the five Latvian champions in the European Business Awards nomination for the Award for Environmental and Corporate Sustainability. In the selection process, in several rounds an international jury evaluated the business ethics of European companies, their relations with stakeholders and capacity to long term operations, flexibly adapting to the dynamic market conditions.

### **One of the largest taxpayers in the country**

Latvenergo AS is one of the three largest taxpayers in the country for 2011 – this was announced by the Ministry of Finance and the State Revenue Service during the ceremony of the „Top 500 Awards” organized by the *Dienas Bizness* publishing house in autumn 2012.

### **A safe company with a favourable work environment**

In 2012, Latvenergo AS participated in the competition of the Employers Confederation of Latvia „Determination and Awarding of the Safe Company Confirmation Symbol” and obtained the symbol and the status of a Safe Company. Latvenergo AS received the main award for the long-term implementation of safe place safety and training environment strategy.

### **The Pride of Customer Service 2012**

Latvenergo AS customer service consultant Igors Gobalovs gained award Pride of Customer Service 2012. The goal of this competition is to improve the public recognition of customer service specialists as well as to promote an improvement of customer service quality in Latvian companies.

### **The top position in the Company reputation list in the sector of electricity, gas and water supply**

In the list provided for the 8<sup>th</sup> year in succession by the newspaper *Lietišķā Diena* in cooperation with the agency *Nord Porter Novell*, Latvenergo AS was ranked as the most

reputable company in the Latvian sector of electricity, gas and water supply. Latvenergo AS also has been praised for the most rapid rise in reputation from the 44<sup>th</sup> place in 2011 to the 15<sup>th</sup> place in 2012.

### **The Most Desirable Employer 2012**

In the study of *WorkingDay* Latvia SIA, Latvenergo AS has been recognized as the most desirable employer in 2012. The company has risen by one position compared to 2011 and is placed two positions higher than in 2010.

In December 2012, the employment and career portal CV Market Latvia conducted a poll of employees and job seekers, declaring Latvenergo AS to be one of the ten most desirable employers in Latvia in 2012. All the Top 10 companies were recognized as winners however, Latvenergo AS received the largest number of votes.

In January 2013, in the study conducted by the Internet personnel selection company *CV-Online Latvia* Latvenergo AS was recognized as the most desirable and most popular employer in Latvia.



# 1.6

## CORPORATE GOVERNANCE REPORT/ AUDIT COMMITTEE REPORT



# Corporate Governance Report

## The first corporate governance report has been prepared in accordance with the principles of NASDAQ OMX Riga AS

The Management Board of Latvenergo AS has evaluated the compliance of the company with the *Principles of Corporate Governance and Recommendations on their Implementation* approved by NASDAQ OMX Riga AS on 1 June 2010. These principles prescribe the requirements with respect to the Shareholders' Meeting, the Management Board, the Supervisory Board, disclosure of information, internal control

and risk management and remuneration policy of governing bodies.

Upon evaluating both the governance system of the company and its compliance with the principles in 2012, the Management Board of Latvenergo AS confirms that the company in all key material aspects has complied with all the principles of corporate governance, apart from those relating to the restrictions under the Law on State and Municipality Capital Shares and Capital Companies, which provides that no supervisory board is established for state capital companies and prescribes a different procedure for convening Shareholders' Meetings, as well as regulate the profit distribution in state capital companies.

Latvenergo AS Corporate Governance Report for 2012 is publicly available on the Latvenergo website <http://www.latvenergo.lv> and the website of NASDAQ OMX Riga <http://www.nasdaqomxbaltic.com/>. Detailed information on compliance with the corporate governance principles is presented in the „Group Governance” and

„Group Management” Sections of the Latvenergo Group Sustainability Report 2012.

From overall 83 NASDAQ OMX Riga corporate governance principles, 56 are complied fully, 10 are not applicable to company operations, while compliance with 17 principles is restricted by laws and regulations.



# Report of the Audit Committee

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The Audit Committee of Latvenergo AS operates under the Commercial Law and Financial Instruments Market Law of the Republic of Latvia and the Rules of the Audit Committee approved by the Shareholder. The Audit Committee held its first meeting in December 2012.

Taking into account limited time of operations, in relation to the accounts for 2012, the Audit Committee has reviewed the external audit process, inquiries of key risks and findings.

We have informed the members of the Management Board of our opinions and related suggestions based on the work of the Audit Committee. No restrictions have been imposed on our actions, and representatives of Latvenergo AS have ensured us with availability of the necessary information.

Having considered the assurance provided by representatives of Latvenergo AS as well as after discussions of work done by the external audit, nothing has come to our attention that make us to believe that internal controls of Latvenergo AS do not provide a reliable basis for the preparation of the annual financial statements.

We submit the summary of our assessment to the Shareholders' Meeting of Latvenergo AS on the date of approval of Consolidated Annual Report.

**Torben Pedersen,**  
Chairman of the Audit Committee

**Inita Hāne,**  
Member of the Audit Committee

**Svens Dinsdorfs,**  
Member of the Audit Committee



# 1.7

## DESCRIPTION OF OPERATING SEGMENTS



# 1.7 Description of Operating Segments

The Group operates in three core operating segments to attain the new strategic goals

The activity of Latvenergo Group is organised along three core operating segments: *generation and supply, distribution and management of transmission system assets.*

The *generation and supply* operating segment includes generation of electricity and thermal energy, which is ensured by Latvenergo AS and Liepājas enerģija SIA, as well as electricity wholesale and supply in the Baltic States by Latvenergo AS and subsidiaries Elektrum Eesti OÜ and Elektrum Lietuva UAB.

The *distribution system services* operating segment provides electricity distribution services in Latvia. Service is provided by Sadales tīkls AS – the largest distribution system operator in Latvia.

The *management of transmission system assets* operating segment in Latvia is handled by Latvijas elektriskie tīkli AS (the owner of transmission system assets) leasing the assets to the transmission system operator Augstsprieguma tīkls AS.

## 1.7.1 Generation and Supply

[EU1]

[EU2]

[EU3]

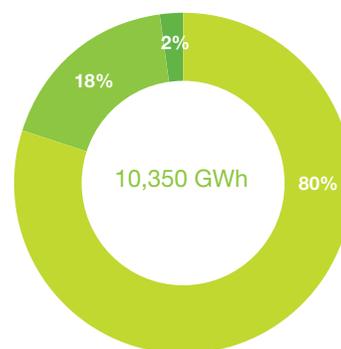
Generation and supply is the largest operating segment of the Group both in turnover (65%) and asset value (43%). Activities within this segment include supply of generated and procured electricity to retail customers in the Baltics and in wholesale market (mostly on the Nord Pool Spot exchange) and generation and supply of thermal energy for the purpose of heating the part of Riga on the right side of the Daugava and the city of Liepāja.

Most of the income from the generation and supply segment derives from operations on unregulated market. The tariff-regulated operational income consists of:

- thermal energy generation;
- public service obligation fee (Latvenergo AS acts as a public supplier conducting the mandatory electricity procurement process;
- electricity supply to households until the full opening of the electricity market in Latvia.

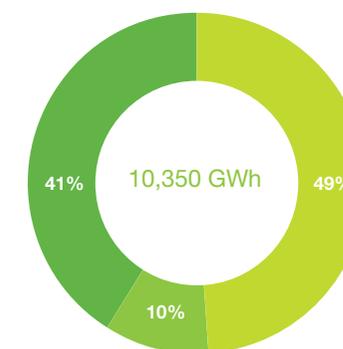
In 2012, the total amount of electricity supplied in retail and wholesale (including own-use electricity) constituted 10,350 GWh, which is historically one of the highest annual supplied electricity rates. Electricity supply was even greater in 2011, totalling 11,436 GWh. Most of the electricity generated in 2012 (80%) was supplied to retail customers. Latvenergo Group is the largest electricity supplier in the Baltics, with a 33% market share.

Latvenergo Group electricity balance sheet in 2012



- Retail electricity supply
- Wholesale electricity supply
- Electricity for own use

In general, most of the electricity supplied is generated by Latvenergo Group generation facilities. In 2012, Latvenergo Group facilities generated 5,077 GWh, which represents 49% of the total electricity supply.



- Gross electricity generation
- Electricity procured from generators in Latvia
- Purchased electricity

In 2012 the amount purchased from other generators in Latvia amounted to 1,036 GWh (an increase of 36%).



The amount of electricity generated and purchased abroad constituted 4,237 GWh in 2012. The electricity was purchased in the Nord Pool Spot (mostly in the Estonian and Lithuanian bidding areas) and in BaltPool UAB exchanges, as well as through bilateral transactions with electricity wholesale suppliers. 423 GWh were purchased from small producers in Estonia (2011: 300 GWh). Electricity in Estonia is purchased in order to diversify procurement sources.

**Integrated generation and supply is our advantage in competitive market conditions**

In addition, the generation capacities of Latvenergo Group ensures such ancillary electricity services as provision of emergency capacity reserves and supply of regulating electricity to transmission system operators, as well as supply of balancing electricity. Balancing electricity is supplied to transmission system operators, electricity generators and consumers in Estonia and Latvia.

**Latvenergo Group electricity balance sheet (2008 – 2012)**

	UNIT	METHOD	2008	2009	2010	2011	2012
Retail electricity supply	GWh	m/c	7,461	6,659	7,620	8,980	<b>8,287</b>
Wholesale electricity supply*	GWh	m/c	415	1,206	1,414	2,283	<b>1,886</b>
Electricity for own use	GWh	m/c	169	151	174	173	<b>177</b>
<b>TOTAL</b>	<b>GWh</b>		<b>8,045</b>	<b>8,016</b>	<b>9,208</b>	<b>11,436</b>	<b>10,350</b>
Gross electricity generation	GWh	m/c	4,566	4,872	5,869	5,285	<b>5,077</b>
Electricity procured from generators in Latvia	GWh	m/c	637	636	693	759	<b>1,036</b>
Purchased electricity*	GWh	m/c	2,842	2,508	2,646	5,392	<b>4,237</b>
<b>TOTAL</b>	<b>GWh</b>		<b>8,045</b>	<b>8,016</b>	<b>9,208</b>	<b>11,436</b>	<b>10,350</b>

\* including ancillary electricity services and electricity wholesale operations to reduce the price risk  
m – measured, e – estimated, c – calculated



### Major part of electricity is generated from renewable resources

Latvenergo Group has balanced electricity generation capacities, comprising hydropower plants and efficient, reconstructed combined heat and power plants. Reconstruction of the combined heat and power plants is scheduled for completion in 2013, along with the commissioning of the Riga 2nd combined heat and power plant (Riga TEC-2) second unit.

In total, Latvenergo Group generates approximately 82% of the total output of electricity in Latvia and about 70% of the total thermal energy in Riga. Most of the electricity and thermal energy is generated by three Daugava hydropower plants (HPPs) and two Riga combined heat and power plants (CHPPs). Electricity is also generated by generation facilities in Liepaja, Aiviekste HPP, Ainazi wind power plant (WPP) and Kegums boiler house.

The total installed electrical capacity of the Latvenergo Group generation facilities as at the end of 2012 is 2,349 MW<sub>el</sub>, while the installed thermal energy capacity of the thermal energy generation facilities is 2,052 MW<sub>th</sub>. The changes in installed electrical and thermal capacity are linked to the completion of a biomass cogeneration plant in Liepaja in late 2012 (thermal capacity – 10 MW<sub>th</sub>, electrical capacity – 2 MW<sub>el</sub>).

In 2012, Latvenergo Group has generated 5,077 GWh of electricity and 2,712 GWh of thermal energy at its generation facilities.

### Electrical capacity of installed generation facilities (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Daugava HPPs	MW <sub>el</sub>	e	1,511	1,511	1,536	1,536	1,536
Riga CHPPs	MW <sub>el</sub>	e	806	806	806	806	806
Liepaja plants	MW <sub>el</sub>	e	-	-	4	4	6
Small plants	MW <sub>el</sub>	e	1	1	1	1	1
<b>TOTAL</b>	<b>MW<sub>el</sub></b>		<b>2,319</b>	<b>2,319</b>	<b>2,347</b>	<b>2,347</b>	<b>2,349</b>

m – measured, e – estimated, c – calculated

### Thermal energy capacity of installed generation facilities (2008 - 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Riga CHPPs	MW <sub>th</sub>	e	1,724	1,724	1,840	1,840	1,840
Liepaja plants	MW <sub>th</sub>	e	427	427	431	198	208
Small plants	MW <sub>th</sub>	e	4	4	4	4	4
<b>TOTAL</b>	<b>MW<sub>th</sub></b>		<b>2,155</b>	<b>2,155</b>	<b>2,275</b>	<b>2,042</b>	<b>2,052</b>

m – measured, e – estimated, c – calculated



## Electricity generation (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Daugava HPPs	GWh	m	3,038	3,391	3,445	2,823	<b>3,627</b>
Riga CHPPs	GWh	m	1,524	1,476	2,402	2,425	<b>1,409</b>
Liepaja plants	GWh	m	-	-	18	33	<b>37</b>
Small plants	GWh	m	4	5	4	4	<b>4</b>
<b>TOTAL</b>	<b>GWh</b>		<b>4,566</b>	<b>4,872</b>	<b>5,869</b>	<b>5,285</b>	<b>5,077</b>

m – measured, e – estimated, c – calculated

## Thermal energy generation (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Riga CHPPs	GWh	m	2,388	2,366	2,673	2,315	<b>2,446</b>
Liepaja plants	GWh	m	334	312	321	248	<b>261</b>
Small plants	GWh	m	5	6	6	5	<b>5</b>
<b>TOTAL</b>	<b>GWh</b>		<b>2,727</b>	<b>2,684</b>	<b>3,000</b>	<b>2,568</b>	<b>2,712</b>

m – measured, e – estimated, c – calculated

## Daugava Hydropower Plants

Daugava HPPs provide an environmentally friendly way of electricity generation because they operate on water – a renewable energy resource.

In 2012, three Daugava hydropower plants generated 3,627 GWh of electricity, which is considerably more than the long-term average output. The amount of electricity generated by Daugava HPPs in 2012 comprised 71% of the total electricity output of Latvenergo Group.

Although the installed capacity of generation facilities at hydropower plants is high, their ability to generate electricity depends on the water inflow in the river Daugava. Outside the spring flooding season, Daugava HPPs operate in the cascade mode to cover the peak loads. Thus it is possible to accumulate water and generate electricity when demand is high and prices increase (i.e. during the day-time peak hours).

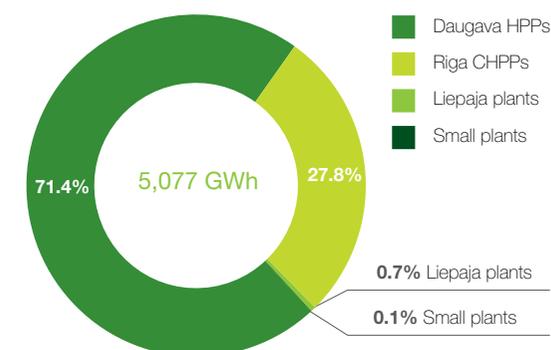
Daugava HPPs operate at full capacity during the spring flooding season, which lasts for about one to two months. During this period, Latvenergo Group is able to cover entirely its customer demand as well as to export the excess. The inflow of water during the spring flooding exceeds inflow during low water periods (winter and summer) more than 10 times.

## Chronology of Daugava HPPs Construction

Kegums HPP, built in 1936 – 1939 and renovated in 1945 – 1947, is the oldest hydropower plant on the river Daugava. The initial installed capacity of the plant was 72 MW. The total current capacity of Kegums HPP is 240 MW, with 168 MW installed in 1979 by adding three new hydropower units.

Plavinas HPP is the largest hydropower plant in the Baltics in terms of installed capacity. The power plant entered into

## Electricity generation in 2012



## Thermal energy generation in 2012



service in 1968 with ten hydropower units – at that time their total capacity was 825 MW. A scheduled reconstruction of six hydropower units was carried out from 1991 to 2001, as a result of which the installed capacity of the plant reached 869 MW. The reconstruction process of the hydropower units continued from 2007 to 2010, and three hydropower units were upgraded, increasing the installed capacity of the plant to 894 MW. As a result of reconstruction of the hydropower units, their capacities and efficiency ratios have been increased, thus also increasing the amount of energy generated from renewable sources.

Riga HPP entered into service in 1974 and has 6 installed hydropower units with a total capacity of 402 MW. Plavinas HPP and Riga HPP can also operate in synchronous compensator mode (regulating voltage in high-voltage electric networks), which allows the transmission system operator to ensure specified voltage quality.

### Capital Investments

A gradual renovation of unreconstructed Daugava HPPs hydropower units is scheduled over the course of the next ten years. Twelve of 23 operating hydropower units have already been modernised.

The reconstruction is expected to improve hydro turbine parameters (efficiency ratios and installed capacity), increasing the amount of power output from renewable energy sources. It will also ensure reliability and sustainability of the Daugava HPPs operation within the entire power supply system. The reconstruction process of the hydropower units is expected to be completed until 2022, with total costs of reconstruction of the remaining unreconstructed hydropower units is estimated to exceed LVL 100 million. The reconstruction of hydropower units will ensure their continued operation for the next 40 years.

In 2012 the total capital investment in Daugava HPPs assets constituted LVL 12.1 million, which have been invested in several hydraulic structure safety projects. The most significant projects are renovation of dam slopes at Riga HPP, replacement of block transformers and relocation of a 330 kV switching point at Plavinas HPP, renewal of the bridge girders for the portal crane and reinforced concrete support structures at Plavinas HPP, as well as reconstruction of the hydropower units and the antechamber ice protection system at Kegums HPP.

### Electric capacity of installed generation facilities at Daugava HPPs (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Kegums HPP	MWeI	e	240	240	240	240	240
Plavinas HPP	MWeI	e	869	869	894	894	894
Riga HPP	MWeI	e	402	402	402	402	402
<b>TOTAL</b>	<b>MWeI</b>		<b>1,511</b>	<b>1,511</b>	<b>1,536</b>	<b>1,536</b>	<b>1,536</b>

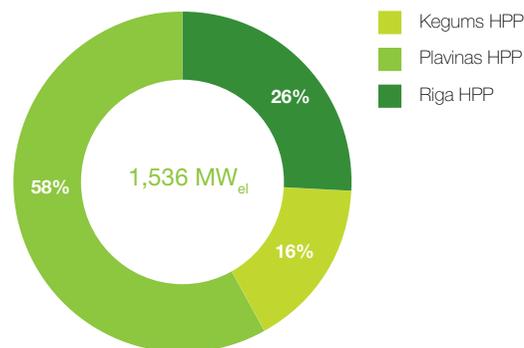
m – measured, e – estimated, c – calculated

### Electricity generation at Daugava HPPs (2008 – 2012)

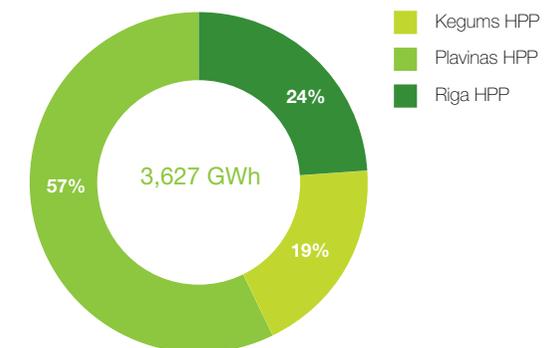
	UNIT	METHOD	2008	2009	2010	2011	2012
Kegums HPP	GWh	m	594	668	621	532	702
Plavinas HPP	GWh	m	1,718	1,931	1,991	1,621	2,067
Riga HPP	GWh	m	726	792	833	670	858
<b>TOTAL</b>	<b>GWh</b>		<b>3,038</b>	<b>3,391</b>	<b>3,445</b>	<b>2,823</b>	<b>3,627</b>

m – measured, e – estimated, c – calculated

### Electrical capacity of generation facilities installed at Daugava HPPs in 2012



### Electricity generation at Daugava HPPs in 2012



## Riga Combined Heat and Power Plants

The Riga combined heat and power plants (Riga CHPPs) are run mostly to cover the demanded thermal capacity and they predominantly operate in the cogeneration mode. Thus, generation of electricity at the combined heat and power plants depends largely on thermal energy consumption, which respectively depends on climate conditions (i.e. external air temperature) and duration of the heating season, as well as on the electricity market situation.

In late 2008, along with the completion of the first power unit of Riga TEC-2 (total electrical capacity – 400 MW), electricity in this plant may also be generated in the condensation mode, which is a significant factor from the perspective of power supply reliability. The availability of Riga TEC-2 capacities in condensation mode also ensures the restriction of the imported electricity price when electricity transmission capacities are insufficient (mostly during the summer).

The primary fuel used by the Riga CHPPs is natural gas, which is the environmentally friendliest of all fossil fuels used for power generation. Seeking to ensure the reliability of thermal energy supply (for situations when there is an emergency cut-offs of natural gas supply), the Riga CHPPs store a back-up fuel reserves. At the moment fuel available

for emergency situations is fuel oil at Riga TEC-2 and diesel fuel – at Riga 1st combined heat and power plant (Riga TEC-1). Within the next few years a transition from the use of fuel oil to diesel fuel is expected at Riga TEC-2 (for emergency situations).

In 2012, Riga CHPPs generated 1,409 GWh of electricity, considerably less than previously. The decrease in electricity generation was influenced mainly by the electricity market conditions in 2012 with relatively low electricity prices. For the most part, these conditions were determined by increased water inflow with consequent higher electricity generation volume in the Nordic countries and by comparatively high price of natural gas, which made electricity generation in cogeneration mode less competitive.

The amount of electricity generated by Riga CHPPs accounted for 28% of the total electricity output by Latvenergo Group in 2012. The amount of thermal energy generated by Riga CHPPs was 2,446 GWh. Heat produced at Riga CHPPs is supplied to the Riga district heating company at regulated tariffs.

## Chronology of Riga CHPPs Construction

Riga TEC-1 was built in 1954 – 1958 and fully reconstructed – in 2005. Two gas turbines, one steam

turbine and three water boilers for centralised heating are exploited in the power plant. The installed electrical capacity at Riga TEC-1 is 144 MW<sub>el</sub>, whereas its thermal capacity is 493 MW<sub>th</sub>.

Riga TEC-2 is the largest combined heat and power plant in Latvia. It was launched in 1973. The reconstruction of Riga TEC-2 was initiated in 2006 and the first stage (the first power unit) was completed in late 2008. Three power-generating steam boilers, two steam turbines, one combined-cycle gas turbine (CCGT) unit as well as four water boilers are exploited in the power plant. The installed electrical capacity of TEC-2 is 662 MW<sub>el</sub>, and its thermal capacity is 1,347 MW<sub>th</sub>. In 2012, the construction of the second CCGT unit continued; it is scheduled for completion in 2013. After the completion of the second power unit of Riga TEC-2, the inefficient and environmentally unfriendly power units, commissioned between 1972 – 1979, will be suspended.

After the commissioning of the second power unit of Riga TEC-2 the electrical capacity of the cogeneration facilities of TEC-2 will reach 832 MW<sub>el</sub>, and the combined thermal energy capacity of both power units will reach 544 MW<sub>th</sub>.

## Capital Investments

The most significant on-going investment project of Latvenergo Group is the reconstruction of Riga TEC-2. The total value of the contract for the construction of the unit amounts to LVL 226 million.

The project implies a replacement of old generation facilities at Riga TEC-2 with a new CCGT power unit, improving the efficiency of the power plant – it will become one of the most efficient combined heat and power plants in the Baltics. After the commissioning of the plant, electricity output is to be increased, thus reducing dependence of Latvia on electricity imports and improving the reliability of electricity supply. It should also be noted that implementation of the project will ensure the compliance with regulations on maximum allowed thresholds of NOx and CO emissions in flue gas: NOx – 50 mg/m<sup>3</sup>, CO – 100 mg/m<sup>3</sup> at 15% O<sub>2</sub> content in the flue gas. Upon completion of the Riga TEC-2 power unit overhaul in 2013, all of the combined heat and power facilities of Latvenergo Group will be fully renovated.

Total investments in Riga CHPP assets in 2012 constituted LVL 73.6 million, including LVL 50.8 million in a general contractor agreement for the Riga TEC-2 reconstruction project. In 2012 all major construction works of facilities in the power unit were completed, and installation is scheduled for 2013.

### Electricity generation at Riga CHPPs (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Riga TEC-1	GWh	m	687	567	669	655	328
Riga TEC-2	GWh	m	837	909	1,733	1,770	1,081
<b>TOTAL</b>	<b>GWh</b>		<b>1,524</b>	<b>1,476</b>	<b>2,402</b>	<b>2,425</b>	<b>1,409</b>

m – measured, e – estimated, c – calculated

### Thermal energy generation at Riga CHPPs (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Riga TEC-1	GWh	m	785	845	909	788	976
Riga TEC-2	GWh	m	1,603	1,521	1,764	1,527	1,470
<b>TOTAL</b>	<b>GWh</b>		<b>2,388</b>	<b>2,366</b>	<b>2,673</b>	<b>2,315</b>	<b>2,446</b>

m – measured, e – estimated, c – calculated



## Liepaja Plants

Latvenergo AS holds 51% shares in Liepājas enerģija SIA. The company ensures generation, transmission, distribution and supply of thermal energy in the city of Liepaja, as well as generation of electricity in cogeneration mode. In late 2012, a biomass combined heat and power plant with 2 MW electrical capacity and 10 MW thermal capacity was commissioned as part of the Liepaja generation facilities system. Thus, at the end of 2012, the total installed thermal capacity at Liepaja plants amounts to 208 MW, and the total electrical capacity – to 6 MW.

EU Cohesion Fund co-funding in the amount of LVL 2.2 million has been attracted for the bio-cogeneration plant construction project. The plant operates on renewable fuel – woodchips. The estimated output of the unit is 60 GWh of thermal energy per year, which forms about 20% of the total thermal energy generated in Liepaja plants.

In 2012, Liepaja plants generated 261 GWh of thermal energy (2011: 248 GWh) and 37 GWh of electricity (2011: 33 GWh). An increase of the thermal energy output was determined by weather conditions (lower average temperature during the heating season) and new customer connections. While increased electricity generation volume was due to the commissioning of the bio-cogeneration plant.

Technical improvements (reconstruction of heat sources and heating networks) performed in 2012 allowed to reduce thermal energy tariffs in Liepaja by 13% as from 1 November 2012.

The development plans of Liepājas enerģija SIA provides the completion of a new 30 MW boiler house (Kaiju iela 33) operating on a woodchip fuel. The boiler house is scheduled to generate 90 GWh of thermal energy per year, substituting about 40% of the thermal energy previously generated by natural-gas fuelled boilers. Implementation of the project involves EU Cohesion Fund co-funding in the amount of

LVL 4 million. Reconstruction of Liepaja transmission and distribution networks is also planned to continue, thereby reducing heat losses.

## Small Plants

Generating facilities within the energy system of Latvenergo Group also include two small power plants – Ainazi WPP, with a capacity of 0.6 MW<sub>el</sub>, and Aiviekste HPP, with a capacity of 0.8 MW<sub>el</sub>.

In turn Kegums boiler house, generates only the thermal energy, with an installed thermal energy capacity of 4 MW. Kegums boiler house is fuelled by woodchips.

The small plants generated 4 GWh of electricity in 2012, or about 0.1% of the total electricity generated by Latvenergo Group. Kegums boiler house sold 5 GWh of thermal energy in 2012.



## Latvenergo Group benefits from the expansion of the Baltic electricity market

In 2012, along with the increase of the unregulated market share in the Baltics, Latvenergo Group successfully retained its leadership in electricity supply. The market share of Latvenergo Group constitutes 33% of the overall Baltic electricity market, with the total consumption of approximately 25,400 GWh. Around 80% of the electricity is supplied to customers in Latvia, while the other 20% – to retail customers in Lithuania and Estonia.

Under increasing competitive conditions, Latvenergo Group has been able to recoup its loss of the market share in Latvia

by expanding operations and increasing its share in the Estonian and Lithuanian markets. In 2012, the total amount of electricity supplied in Lithuania and Estonia was 1,580 GWh, which is considerably more than the amount supplied by competitors in Latvia – 920 GWh. In 2012 the number of retail customers in Lithuania and Estonia increased two-fold.

In 2012, Latvenergo Group supplied 8,287 GWh of electricity to retail customers in the Baltics (2011: 8,980 GWh). The reduction of the supplied electricity volume is explained primarily by a shift in supply strategy, increasing the focus on small and medium-sized enterprises and households.

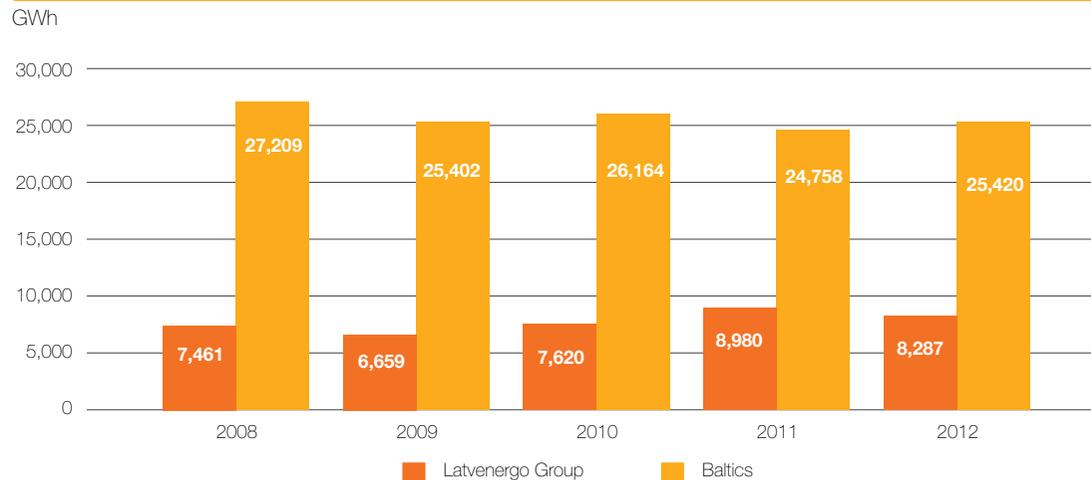
The amount of electricity supplied by Latvenergo Group in Latvia is 6,708 GWh (market share – 88%; open market share – 81%), Lithuania – 1,058 GWh (11%; 17%); Estonia – 522 GWh (6%; 18%). Along with the acquisition of new customers and the economic recovery in 2012, the distribution of retail customer groups has changed significantly. The greatest increase was observed in the industrial customers segment, which represents 30% of total sales in 2012 (2011: 28%). In division by segments,

customers in the industrial segment represent only 1% of the total customers. 97% of customers are residential (households), while other customers (commercial, institutional, etc.) account for the remaining 2%.

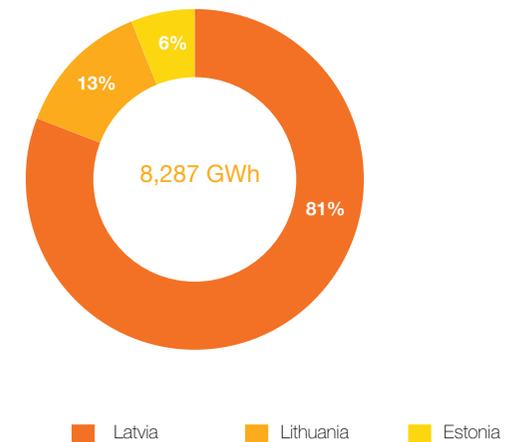
In 2012, 5,875 GWh or 71% of the total electricity supplied by Latvenergo Group was retailed on the open electricity market. 2,412 GWh or 29% (2011: 3,650 GWh or 41%) of the total retail supply were supplied at a regulated tariff in Latvia.

Throughout the Baltic States, the generation and supply segment of Latvenergo Group has 23,020 customers who purchase electricity at agreed prices as at the end of 2012. 22,033 of them were based in Latvia, 940 in Lithuania and 47 in Estonia. Electricity at regulated tariffs (in Latvia) was supplied to 835 thousand household customers and approximately 3,440 legal entities entitled to receive the universal service.

Retail electricity supply in the Baltics (2008 - 2012)



Retail electricity supply in the Baltics 2012



## Electricity Product Development

In 2012, in order to promote acquisition of new customers and retain the existing ones, Latvenergo Group paid a particular attention to development of products and services.

Along with the market-opening in Estonia and Lithuania, Latvenergo Group has developed a varied range of electricity products and introduced a new trade brand – *Elektrum*. All electricity products are available for consideration at customer portals *elektrum.ee* and *elektrum.lt*. These portals allow concluding an electricity supply agreement quickly and easily in an electronic form. Customers can freely select the most appropriate electricity product, considering such criteria as consumption profile and type of connection.

For the third successive year, in 2012, in cooperation with insurance company BALTA AAS, we continued offering to Latvian electricity market customers the Energy Risk Insurance (ERI). ERI provides insurance for all machinery and technological equipment, machine tools, stock, gear, goods, raw materials, unfinished and finished products that are owned by a customer, as well as other movable assets within the insurance policy coverage zone beyond the electric facility ownership borders. In 2012, more than 700 of Latvenergo Group customers were insured in terms of the

ERI project with nearly 40 successfully resolved insurance cases.

## Regulatory Environment in the Baltics

Electricity supply can be divided into unregulated and regulated electricity market segments.

In compliance with the terms of the public supplier license, Latvenergo AS is obliged to ensure the supply of electricity at regulated tariffs to qualifying market customers in Latvia. The public supplier license issued by the Public Utilities Commission is valid until 14 October 2013. Until November 2012, electricity was also supplied at regulated tariffs to business customers with input protection device current rating under 100 amperes and the connection voltage up to 400 V. Since 1 November 2012, electricity at regulated tariffs is supplied to households only.

In addition, the public supplier license obliges Latvenergo AS to purchase electricity from electricity generators in Latvia who have a granted right to generate electricity for the mandatory procurement under electricity purchase tariffs set in the regulations. The aim of this support is to increase the amount of electricity generated in an efficient cogeneration and through renewable energy sources (in wind power

plants, small hydropower plants, biomass and biogas plants). The additional costs of mandatory procurement are charged to all electricity end-users in Latvia, in proportion to their electricity consumption. The mandatory procurement public service obligation fee is annually recalculated based on the actual mandatory procurement costs for the preceding year. The mandatory procurement public service obligation fee is approved by the Public Utilities Commission.

In 2012 the amount purchased from other generators in Latvia under the mandatory procurement process amounted to 1,019 GWh (2011: 754 GWh). The increase in mandatory electricity procurement volume was mainly determined by launching of new biomass and biogas power plants.

As of 1 January 2013, the share of the regulated market in the Baltics has declined substantially. The Estonian electricity market has become opened to all customers, while the Lithuanian market – to all business customers. As a result, the overall regulated share of the Baltic market decreased to approximately 25% (at the end of 2012 it was 41% in the Baltics: 21% in Latvia, 65% in Estonia and 35% in Lithuania). The market opening for households in Latvia is expected in the foreseeable future. While a full opening of the Lithuanian market is expected in 2015.



## 1.7.2 Distribution System Services

[EU4]

### Investments in distribution network development are made aiming to improve service quality and technical parameters

Distribution system services is the second largest operating segment of Latvenergo Group in terms both of revenue (26%) and asset value (35%). Operation of this segment is characterised by provisioning of distribution system services at regulated tariffs to approximately 900 thousand users.

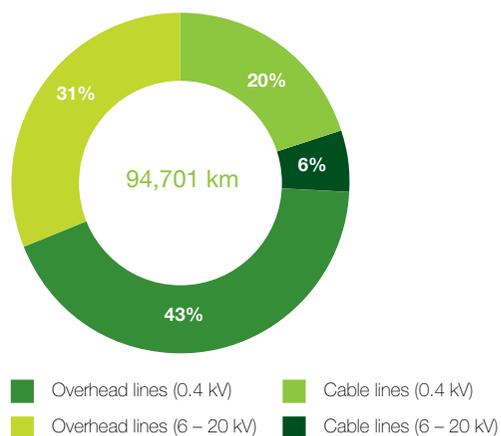
The distribution service is provided by Sadales tīkls AS – the largest distribution system operator in Latvia. Sadales tīkls AS is also the owner of the distribution system assets, with an electricity distribution network that covers approximately 99% of the territory of Latvia. Sadales tīkls AS has received an operating licence, which is valid until 30 June 2027. The Public Utilities Commission develops the tariff calculation methodology and approves distribution service tariffs. The distribution system operator ensures an equal access to the distribution network, which is one of the prerequisites for promoting competition in the electricity market of Latvia.

The distribution system assets owned by Sadales tīkls AS ensure a flow of electricity between the electricity transmission system, electricity generators connected to the distribution network and electricity consumers, who are connected to a low-voltage (0.4 kV)

or medium-voltage (6 – 20 kV) power transmission lines. The total length of low-voltage and medium-voltage lines is 94,701 km as at the end of 2012. The Group has 28,966 distribution network transformers and 26,034 transformer substations with a total installed capacity of 5,751 MVA.

In 2012 the amount of electricity received in the distribution network amounted to 6,900 GWh. The increase was determined by higher outputs of electricity generators connected to the distribution network, reaching 907 GWh (2011: 627 GWh) and is largely related to the creation of new generation connections. In turn, the increase of distributed electricity was due to an increase in consumption by the customers who have connection to low-voltage (0.4 kV) or medium-voltage (6 – 20 kV) power lines. The consumption by these customers increased by 4.3% reaching 6,468 GWh.

### Length of power transmission lines in 2012



### Distributed electricity and losses (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Distributed electricity	GWh	m/c	6,664	6,143	6,380	6,199	<b>6,468</b>
Electricity distribution losses, technological and internal consumption	GWh	m/c	507	484	460	447	<b>432</b>
<b>TOTAL</b>	<b>GWh</b>		<b>7,171</b>	<b>6,627</b>	<b>6,840</b>	<b>6,646</b>	<b>6,900</b>
Electricity losses	%	m/c	6.7	6.9	6.4	6.4	<b>5.9</b>

m – measured, e – estimated, c – calculated

### Electricity received in the distribution network (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
From transmission network	GWh	m/c	6,845	6,217	6,320	6,019	<b>5,993</b>
From small generators	GWh	m/c	326	410	520	627	<b>907</b>
<b>TOTAL</b>	<b>GWh</b>		<b>7,171</b>	<b>6,627</b>	<b>6,840</b>	<b>6,646</b>	<b>6,900</b>

m – measured, e – estimated, c – calculated



In 2012, Sadales tīkls AS continued implementing several activities in order to reduce electricity losses, technological and operational consumption. In 2012, this indicator decreased to 432 GWh (2011: 447 GWh). Between 2008 and 2012 total electricity distribution losses, technological and operational consumption reduced by 75 GWh, or 15%. In turn, electricity losses as a share of the electricity distributed decreased from 6.7% to 5.9%. The percentage of distribution losses in total electricity amount received by the network is a significant indicator of the efficiency of the operating segment of distribution (see also the EU12 indicator).

Maintenance and renewal of distribution networks requires considerable annual investments in order to improve the quality of the distribution system service, reduce scheduled and unscheduled power outages, and ensure an adequate voltage quality.

Compared to previous years, the workload on distribution network maintenance, including replacement of poles, regular electrical inspections, defect identification and clean-out of power lines, has increased significantly.

The volume of distribution network maintenance works, which implies replacing supports, conducting regular inspections and defect detection at electrical installations, as well as clean-out of transmission lines, has increased compared to the previous years.

In order to ensure an operative recovery from large-scale damages, an action plan for cooperating with local governments and other accountable institutions was developed, and the necessary amendments to the Energy Law, the Protection Zone Law, the Law on Forests, the Law on Motor Roads, the Construction Law and related Cabinet regulations were proposed.

## Distribution network maintenance (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	<b>2012</b>
Defect identification in overhead lines	km	m	15,396	11,735	10,265	10,100	<b>10,253</b>
Defect identification at distribution nodes and substations	number	m	4,297	3,141	2,773	3,014	<b>2,870</b>
Clean-out of transmission lines	ha	m	2,175	2,599	2,973	1,688	<b>3,965</b>
Trimming of trees that pose a hazard	number	m	5,202	10,919	25,367	113,018	<b>187,687</b>
Repairs at switching stations and substations	number	m	2,231	2,248	1,517	1,472	<b>1,267</b>
Poles replaced	number	m	26,534	27,442	27,114	25,617	<b>28,379</b>
Wires adjusted	w/km	m	3,240	3,236	3,497	3,748	<b>3,472</b>
Overhead cable suspension (AMKA)	km	m	460	387	400	428	<b>509</b>

m – measured, e – estimated, c – calculated



## Capital Investments

The amount of capital investments in 2012 increased to LVL 58.4 million (2011: 45.8 million). By investing in distribution network electrical installation (substations, switchgear, transformers and power lines) reconstruction, modernization and innovative technical solutions, Sadales tīkls AS ensures an improvement of secure, high-quality distribution service to customers.

In 2012, Automatization and Cable programmes were realized actively under the Sadales tīkls AS investment programme. Under the Automatization Programme, remotely controllable circuit breakers and damage location sensors, which provide immediate information on network power supply damage, were built, thus ensuring prompt power supply troubleshooting. While medium-voltage overhead lines mainly in forested areas under the Cable Programme were changed to cable lines, thus reducing the number of electrical damage caused by adverse weather conditions.

In 2012, a total of 361 km of medium-voltage lines (2011: 323 km) and 916 km low-voltage lines (2011: 703 km) as well as 388 transformer substations (2011: 617) were reconstructed, enhancing voltage quality for 3,048 customer sites (2011: 2,640). 6,944 connections (2011: 6,968) were constructed. Under the cable programme, a total of 144 km medium-voltage cable lines (2011: 16 km) were constructed in 2012.

In cooperation with professional consultants, a distribution network development and reconstruction plan, which is expected to be implemented in 2013, is being developed to continue to improve the distribution service quality. The distribution network development and reconstruction plan will permit to optimize investments in distribution network, clarify and harmonize network construction architecture and prioritize the specific network construction sites. Guidelines, criteria and methodology for optimal investment planning will be specified in the development plan.

## Investments in distribution assets (2008 - 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Investments	M LVL	c	80.5	52.3	26.2	45.8	58.4

m – measured, e – estimated, c – calculated

## Reconstruction and maintenance (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Overhead lines constructed (0.4 kV)	km	m	118	70	62	60	64
Cable lines constructed (0.4 kV)	km	m	566	475	307	643	852
<b>TOTAL low-voltage power lines</b>	<b>km</b>	<b>m</b>	<b>684</b>	<b>545</b>	<b>369</b>	<b>703</b>	<b>916</b>
Overhead lines constructed (6 – 20 kV)	km	m	292	176	169	262	149
Cable lines constructed (6 – 20 kV)	km	m	95	98	64	61	212
Cable lines constructed (6 – 20 kV) (Cable Programme)	km	m				16	144
<b>TOTAL medium-voltage power lines</b>	<b>km</b>	<b>m</b>	<b>387</b>	<b>274</b>	<b>233</b>	<b>339</b>	<b>505</b>
Transformer substations reconstructed	number	m	344	358	437	617	388
Connections constructed	number	m	12,756	7,509	5,906	6,968	6,944

m – measured, e – estimated, c – calculated



## 1.7.3 Management of Transmission System Assets

[EU4]

**Investments are made in transmission assets – the most significant project is the *Kurzeme Ring***

The management of transmission system assets operating segment represents about 5% of the turnover of Latvenergo Group and 11% of the value of its assets. The transmission system asset management functions are conducted by Latvijas elektriskie tīkli AS. The operations of this segment comprise construction and maintenance of the transmission system assets (330 kV and 110 kV power transmission lines, substations and switching substations) as well as their lease to the transmission system operator – Augstsprieguma tīkls AS.

On 2 January 2012, in compliance with the requirements of the European Parliament and Council Directive No. 2009/72/EC of 13 July 2009, which provides unbundling of the transmission system operator from a vertically integrated electric utility, shares of Augstsprieguma tīkls AS, previously owned by Latvenergo AS, were sold to the Ministry of Finance of the Republic of Latvia. In order to manage the transmission system assets in 2011 Latvijas elektriskie tīkli AS was established: the assets, previously owned by Latvenergo AS, were transferred to the new company, which now conducts maintenance and construction of transmission system assets according to the orders placed by Augstsprieguma tīkls AS.

In accordance with the PUC council decision No. 18 of 30 January 2013 on Certification of the Electricity Transmission System Operator by the end of 2014 Augstsprieguma tīkls AS has to take over the functions and personnel related to construction and maintenance of the transmission system assets of Latvijas elektriskie tīkli AS; Latvijas elektriskie tīkli AS will remain the owner of the transmission system assets, leasing them to Augstsprieguma tīkls AS.

### Length of power transmission lines (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
330 kV	km	m/c	1,250	1,250	1,250	1,250	<b>1,250</b>
110 kV	km	m/c	3,995	4,010	4,010	4,006	<b>4,010</b>
<b>TOTAL</b>	<b>km</b>		<b>5,245</b>	<b>5,260</b>	<b>5,260</b>	<b>5,256</b>	<b>5,260</b>

m – measured, e – estimated, c – calculated

### Number of transformer substations, transformers, installed capacities (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Substations (330 kV)	number	m	15	15	15	15	<b>15</b>
Autotransformers (330 kV)	number	m	20	21	21	21	<b>22</b>
Installed capacity of autotransformers (330 kV)	MVA	m/c	3,075	3,200	3,200	3,200	<b>3,325</b>
Transformer substations (110 kV)	number	m	117	119	119	119	<b>121</b>
Transformers (110 kV)	number	m	241	243	243	243	<b>244</b>
Installed capacity of transformers (110 kV and 10 kV booster transformers)	MVA	m/c	4,403	4,698	4,806	4,829	<b>4,902</b>

m – measured, e – estimated, c – calculated

As at the end of 2012, the total length of power transmission lines was 5,260 km, of which 110 kV lines form 76% but 330 kV – 24%. Fifteen 330 kV substations with a total automatic transformer capacity of 3,325 MVA and one

hundred and twenty-one 110 kV substations with a total transformer installed capacity of 4,902 MVA are used in order to provide the operation of the transmission network. The latest 330 kV substation at TEC-2 was built in 2008.



## Capital Investments

In accordance with the Baltic Electricity Market Interconnection Plan (BEMIP), which aims to integrate the Baltic States into the European Union energy market, it is planned to create interconnections between the Baltics and Sweden, Finland and Poland. Efficient operation of these interconnections requires also the development of the internal power supply infrastructure in the Baltic States, ensuring higher electrical capacity within the Baltic transmission network.

Consequently, in 2009, the most significant on-going investment project *Kurzeme Ring* was launched in order to enhance the reliability of electricity transmission within the Kurzeme region. The total length of the transmission ring is expected to be around 343 km. The *Kurzeme Ring* project is to be completed in three stages:

- the first stage – in 2012 distribution facilities of 330 kV have been reconstructed at substations TEC-1 and Imanta. Construction of the *Riga Ring*, including a new 330 kV cable line between the TEC-1 and Imanta substations with the total length of 14 km, is scheduled for completion by autumn 2013;
- the second stage – reconstruction of the existing 110 kV power transmission line between Grobina and Ventspils, by strengthening it with a 118 km long 330 kV overhead line, is scheduled by the mid-2014 along with expansion of the Grobina substation, construction of new 330 kV switching substation at Ventspils substation and reconstruction of Aizpute and Alsunga 110 kV substations;
- the third stage – provides the reconstruction of the existing 110 kV overhead line connection Ventspils–Dundaga–Tume–Riga, by reinforcing it with a 330 kV overhead (approximately 211 km) line; the reconstruction is to be completed by 2018.

The total construction costs of the *Kurzeme Ring* project are to constitute LVL 140 million (EUR 200 million euros), including LVL 66 million for the execution of the first and second stage of the project. The project is co-funded through the European Energy Programme for Recovery with an amount up to half of the project construction expenses. A half of the environmental impact assessment cost of the project is co-financed through the *Trans-European Energy Networks programme*.

According to the development plan of electricity transmission system of Latvia, developed by transmission system operator Augstsprieguma tīkls AS, it is planned to launch

the construction of *Third Electricity Transmission Network Interconnection* between Estonia and Latvia. The 330 kV interconnection line will increase the throughput capacity available between power systems in Latvia and Estonia. The planned length of the new 330 kV interconnection line is approximately 190 km and it is scheduled for completion by 2020. In 2012, a co-financing of environmental impact assessment and development of the preliminary project of the transmission line through the *Trans-European Energy Networks programme* was approved.

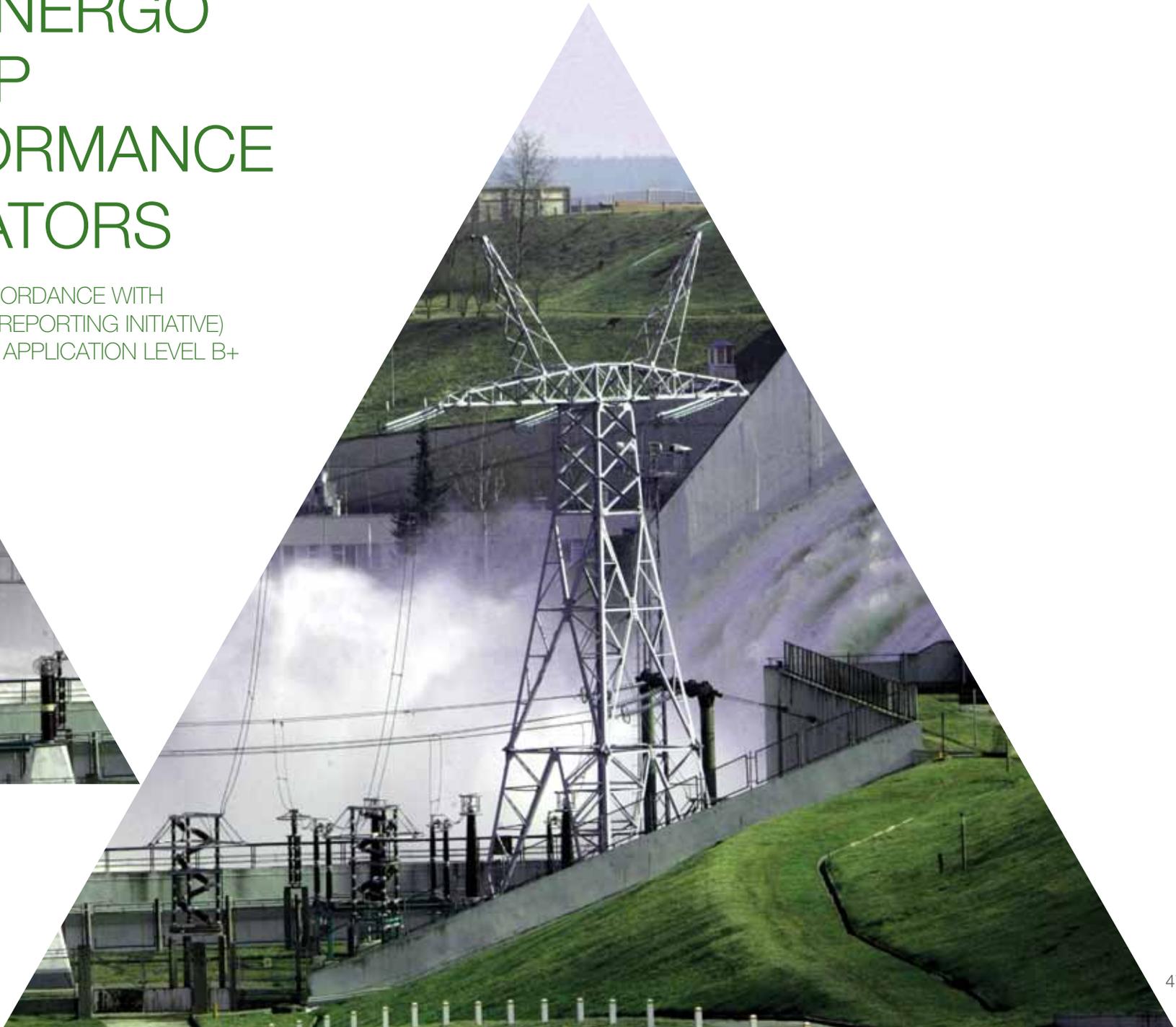
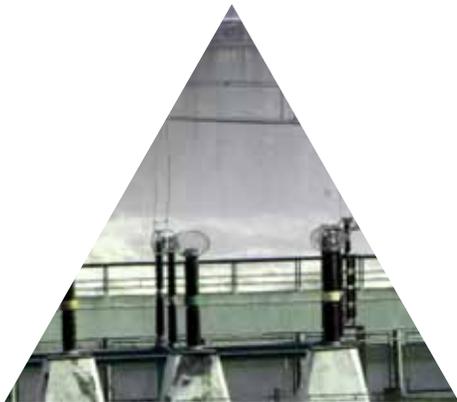
In 2012 LVL 23.5 million (2011: LVL15.1 million) were invested in transmission networks, with LVL 16.1 million (2011: LVL 4.7 million) invested in construction of the *Kurzeme Ring*. Other major projects in 2012 were replacement of 110 kV transformers at Kekava, Dzintari and Ropazi substations and the assembly of a new bay for the second power unit connection at 330 kV substation TEC-2. In 2012, construction was completed in two 110 kV substations – Pope and Skulte.

## Investments in transmission system assets (2008 – 2012)



# LATVENERGO GROUP PERFORMANCE INDICATORS

PREPARED IN ACCORDANCE WITH  
THE GRI (GLOBAL REPORTING INITIATIVE)  
GUIDELINES G3.1 APPLICATION LEVEL B+



# 2.1 ENVIRONMENT



## 2.1 Environment

### Management Approach

As any industrial activity, the operation of Latvenergo Group also has an environmental impact. Care for the environment is one of the foundations for sustainable development of Latvenergo Group. Our efforts, both in making investments and in ensuring the right use of equipment, are focused on environmentally friendly activities, reducing or eliminating environmental risks.

The key principles of Latvenergo Group in relation to environmental protection are defined in the Environmental Policy. One of the primary Environmental Policy issues is the reduction of the impact on climate change in accordance with the initiatives and decisions of the European Parliament and the Council. The key principles of the Environmental Policy that characterize the environmental philosophy of the Group and its attitudes towards the environment are:

- ▲ reducing the pollutant emissions ;
- ▲ using natural resources efficiently;
- ▲ taking care of preservation of biodiversity;
- ▲ regularly and honestly informing the society and stakeholders about environmental activities;
- ▲ acting in an environmentally-friendly way and invite the society and partners to act similarly.

In addition to the requirements of the state legislation, the Environmental Management System is maintained in accordance with the requirements of LVS EN ISO 14001:2004 standard.

Care for the environment  
is one of the cornerstones for  
the sustainable development  
of Latvenergo Group

We are proud of our achievements in generating electricity from renewable energy resources, our goal-oriented actions and environmentally-friendly technologies. In 2012,

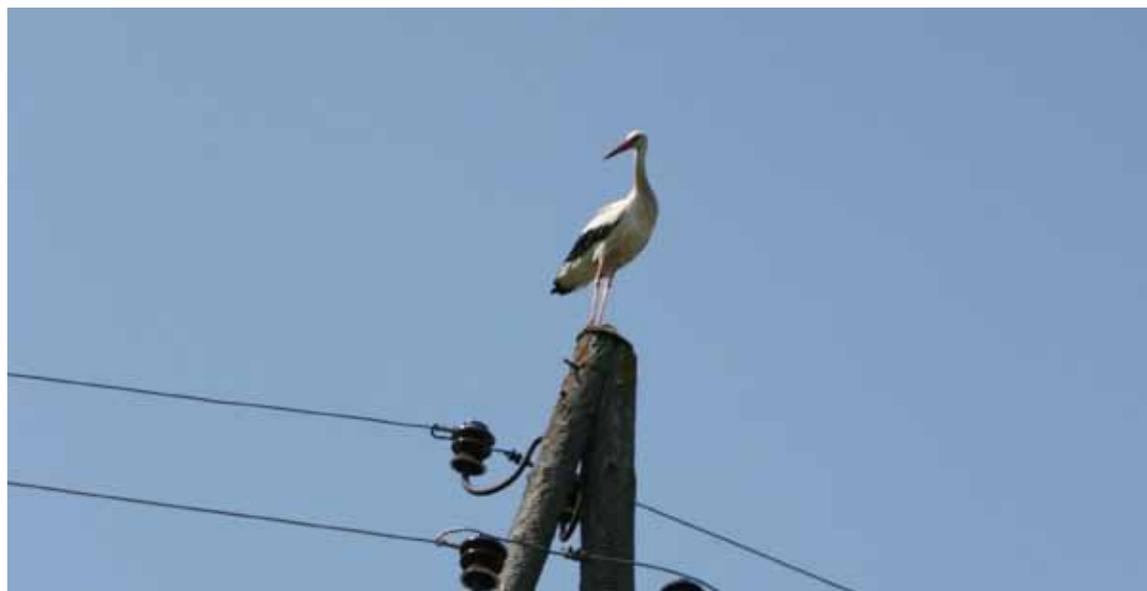
72% or 3,635 GWh of the total electricity output (or 44% of the amount of retail electricity supplied) were generated using renewable energy resources, while 28% of electricity have been produced in cogeneration stations that use an environmentally-friendly fuel – natural gas.

To strengthen the position of Latvenergo Group among the most environmentally-friendly power supply companies in Europe, environmental issues are actively addressed, and the performance of the Group in the field of environmental protection has improved. The most significant activities in 2012:

- ▲ completion of the bio-cogeneration plant of Liepājas enerģija SIA (2 MW electrical capacity and 10 MW thermal capacity);
- ▲ reconstruction of the Plavinas HPP hydropower unit No. 1, the Kegums HPP hydropower unit No. 1 and Riga HPP hydropower unit No. 6;
- ▲ reconstruction of the Plavinas HPP oil depot;
- ▲ improvement of the water metering system in the Riga TEC-2;

- ▲ enhancement of energy efficiency of buildings in transmission and distribution sites;
- ▲ development and coordination of the operating regulations for the Daugava hydropower plant water reservoirs with local governments;
- ▲ receipt of the Environmental State Bureau acceptance of the Industrial accident elimination programme at Riga TEC-1;
- ▲ assessment of the environmental impact of the 3<sup>rd</sup> stage of *Kurzeme Ring* transmission network development project *Tume-Riga* and of the 3<sup>rd</sup> *Estonian-Latvian Interconnection*.

Meanwhile, to improve the awareness and understanding of employees regarding the efficient use of natural resources and the compliance with environmental protection legislation, the annual initiative to determine the most environmentally-friendly site continues, evaluating the physical consumption of resources and the amount of managed waste. In 2012, a travelling prize „The Greenest site” has been awarded to Jelgava department of Sadales tīkls AS.



## Materials used by weight or volume / Direct energy consumption by primary energy source

[EN1]

[EN3]

In electricity and thermal energy generation, Latvenergo Group uses renewable energy resources (water, wind and wood), as well as fossil fuel (mainly natural gas) and, in small amounts, other types of fuel. In 2012, renewable energy resources accounted for more than 40% of the total energy resource consumption, significantly exceeding the proportion of previous years. The rest amount of consumed energy resources is composed mainly of fossil fuel.

Generation of electricity and generation of thermal energy have a different proportion of consumption of primary energy resources between renewable and fossil energy resources.

As regards generation of electricity, in 2012 renewable energy resources composed 66% of primary energy resource consumption, while an environmentally-friendly fossil fuel – natural gas – made up 34%. The high proportion of renewable energy resources was mainly ensured by the electricity output in Daugava HPPs.

In turn, renewable energy resources accounted for 1.2% of the total primary energy resource consumption for thermal energy generation. The thermal energy generation in the Kegums boiler house and in the biomass cogeneration plant, which was opened in Liepaja in November 2012, is fuelled by wood.

### Consumption of primary energy resources (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	<b>2012</b>
Water, wind*	TJ	m/c	10,937	12,239	12,416	10,177	<b>13,072</b>
Natural gas	TJ	m/c	17,425	15,937	22,006	21,618	<b>17,364</b>
Wood	TJ	m/c	58	65	57	49	<b>147</b>
Others (diesel fuel, fuel oil, coal)	TJ	m/c	24	1	15	6	<b>1</b>

\*the amount of resources evaluated as the amount of power produced using these resources (3.6GJ=1MWh)  
m – measured, e – evaluated, c – calculated

### Direct energy consumption by primary energy source for generation of electricity (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	<b>2012</b>
Water, wind*	TJ	m/c	10,937	12,239	12,416	10,177	<b>13,072</b>
Natural gas	TJ	m/c	7,540	6,451	12,620	11,388	<b>6,746</b>
Wood	TJ	m/c					<b>14</b>

\*the amount of resources evaluated as the amount of power produced using these resources (3.6GJ=1MWh)  
m – measured, e – evaluated, c – calculated

### Direct energy consumption by primary energy source for generation of thermal energy (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	<b>2012</b>
Natural gas	TJ	m/c	9,884	9,487	9,386	10,231	<b>10,618</b>
Wood	TJ	m/c	58	65	57	49	<b>133</b>
Others (diesel fuel, fuel oil, coal)	TJ	m/c	24	1	15	6	<b>1</b>

m – measured, e – evaluated, c – calculated



## Total water withdrawal by source

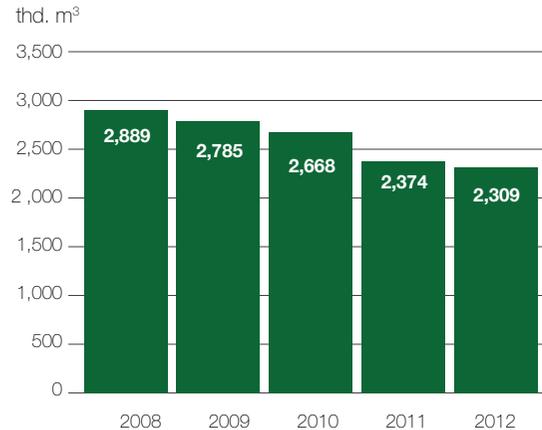
[EN8]

Latvenergo Group uses water resources mainly to ensure the generation processes. A relatively small amount of water is used for other internal needs and for provision of potable water to residents.

Water consumption balance of Latvenergo Group includes surface, underground and supply system water. In 2012, water used for operational needs amounted to 2,309 thousand m<sup>3</sup>, of which 2,087 thousand m<sup>3</sup> of surface water, 133 thousand m<sup>3</sup> of underground water and 89 thousand m<sup>3</sup> of supply system water.

In 2012, the largest amount of surface water resources (2,082 thousand m<sup>3</sup>) was consumed at Riga TEC-2, using water from the Daugava River in cooling systems. In turn, the largest amount of underground water (33 thousand m<sup>3</sup>) was consumed at Riga TEC-1 as feed-water for heating network preparation.

### Total water withdrawal (2008 - 2012)



## Strategies, current actions, and future plans for managing impacts on biodiversity

[EN14]

The care of preservation of biodiversity and reduction of the environmental impact of its activity is one the key principles of the Latvenergo Group Environmental Policy. In its operations the Group plans and implements measures that are aimed to preserve biodiversity. The main initiatives in this field are the protection of white storks, replenishment of fish resources and strengthening of the Daugava riverbanks.

### Bird protection

Latvenergo Group cooperates with the Latvian Ornithological Society (LOS) in relation to bird protection and research issues. Particular attention is paid to the issue of protecting the white stork. We can be proud that so many birds of this specially protected species (approximately 10,000 pairs) nest in Latvia. Poles of communication lines and power lines are the most frequent sites selected by these birds for nesting. In 2012, on electricity line poles 7,957 stork nests were found, which is by 701 more compared to 2011. To comply with the safety requirements of electricity supply and reduce the cases of white stork deaths on electricity transmission

lines, in 2012, in coordination with the environmental authorities, 692 potentially dangerous nests were removed from electricity line poles. During the nesting period of storks, the birds are disturbed very rarely – only if safety of electricity supply and society is endangered.

For the second consequent year, Latvenergo Group together with LOS organizes the White Stork Monitoring project in order to collect information on the white stork population in Latvia. To continue research and obtain comprehensive information on the nesting habits of white storks, the *White Stork Diary* has been created.

In 2012, Latvenergo Group cooperated closely with LOS during the implementation of the *Kurzeme Ring* project. LOS conducts a comprehensive research regarding the possible impact of the *Kurzeme Ring 2<sup>nd</sup> stage Dundaga – Tume* on specially protected bird species, identifying the power line sections where construction work limitations should be observed during the nesting period.



### Fish resource replenishment and strengthening of the Daugava riverbanks

The annual contribution of Latvenergo Group to replenishment of fish resources is LVL 607.4 thousand, and for strengthening of the Daugava River banks and renovation of the protective engineering structures – LV 850 thousand. 886.3 thousand salmon and brown trout smolts and fries, 707.2 thousand pikeperch, whitefish and vimba fries have been released into the Daugava River basin, as well as 8.3 million of pike and lamprey larvae.

In 2012, Latvenergo Group continued cooperation with the *Mēs zivīm* (We to fish) society. In May 2012, artificial spawning nests were placed in the Kegums HPP reservoir to stimulate replenishment of common fish species of the Daugava River basin.



## Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk

[EN15]

One of the significant environmental protection concerns for Latvenergo Group is preservation of biodiversity. The IUCN Red List species of fish and birds that are affected by the activity of Latvenergo Group are:

- ▲ white stork (*Ciconia ciconia*);
- ▲ salmon (*Salmo salar*);
- ▲ sea trout (*Salmo trutta*);
- ▲ lamprey (*Lampetra fluviatilis*).

The identified risk level for these species is insignificant (*least concern*).

## Total direct and indirect greenhouse gas emissions by weight/ Allocation of CO<sub>2</sub> emissions allowances or equivalent, broken down by carbon trading framework

[EN16]

[EU5]

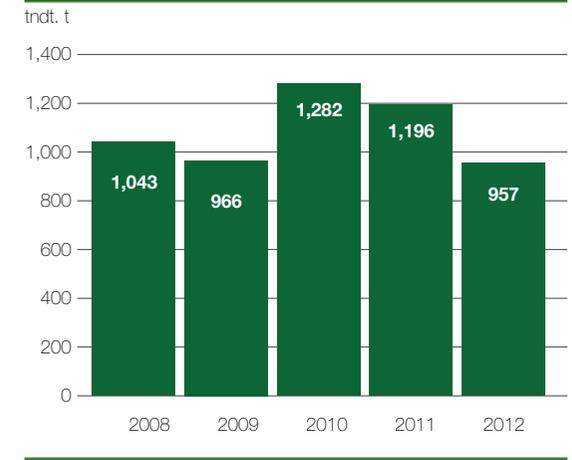
Greenhouse gas induced climate change is one of the most pressing global environmental issues. Modernization of Latvenergo Group facilities, replacing older and less efficient facilities with such that comply with the Best Available Techniques reference documents, is a significant investment in the reduction of climate change and meeting the set goals.

In 2012, the incineration facilities of Latvenergo Group emitted 956,913 t of CO<sub>2</sub>, including emissions from facilities that participate in the European Union Emissions Trading System (incineration facilities with a rated thermal input above 20 MW) and from those that do not participate (11,748 t CO<sub>2</sub>). Also, the CO<sub>2</sub> emission volume includes indirect CO<sub>2</sub> emission associated with energy generation process. Latvenergo Group does not produce any other types of direct greenhouse gas emissions.

On 1 January 2008, the second period of the European Union Emissions Trading System (EU ETS) began, lasting until 31 December 2012. In accordance with the Latvian National Emissions Allowance Allocation Plan 2008 – 2012, the TEC-1 and TEC-2 generating facilities were assigned 1,401,375 allowances in 2012, the Liepaja generating facilities – 111,023 allowances. One tonne of CO<sub>2</sub> emissions is equivalent to 1 allowance.

The Latvian National Emissions Allowance Allocation Plan 2008 – 2012 provides the use of the Kyoto Protocol flexible mechanism within the EU ETS – the Emission Reduction Units (ERU) and Certified Emission Reduction (CER) units obtained as a result of Joint Implementation projects and Clean Development Mechanisms. The maximum quantity of these units that may be used in the EU ETS is 10% of the number of allowances allocated for each facility. Latvenergo Group takes this opportunity, replacing 10% of the allocated allowances with CER, purchasing the allowances on the market.

### CO<sub>2</sub> emission (2008 – 2012)



## Initiatives to reduce greenhouse gas emissions and reductions achieved

[EN18]

The use of efficient and modern technologies is one of the main methods to reduce emissions and save resources. One of the combined heat and power plant performance indicators is the fuel use ratio. In the reconstructed facilities of the combined heat and power plants of Latvenergo Group, this ratio is between 81% and 90%.

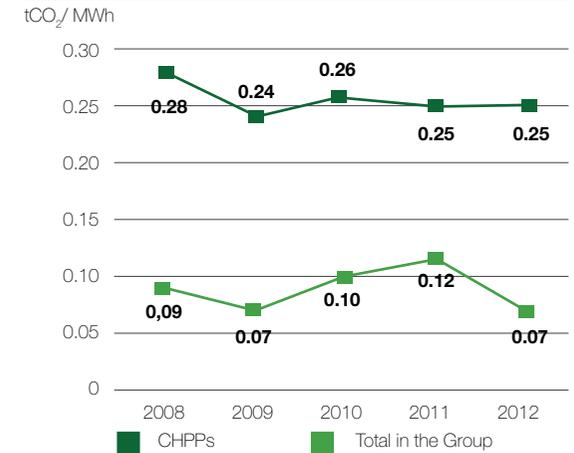
As a result of the significantly higher efficiency of the Riga TEC-2 first unit, CO<sub>2</sub> emissions per generated energy unit were significantly reduced.

Generally, the Group has very low specific CO<sub>2</sub> emission indicators per unit of electricity generated. In 2012, CO<sub>2</sub> emission per generated electricity unit was 0.07 t of CO<sub>2</sub>/MWh<sub>el</sub> (2011: 0.12 t of CO<sub>2</sub>/MWh<sub>el</sub>), while in the combined heat and power plants only (Riga TEC-1 and

Riga TEC-2), the specific CO<sub>2</sub> emission per electricity unit produced was 0.25 t of CO<sub>2</sub>/MWh<sub>el</sub> (2011: 0.25 t of CO<sub>2</sub>/MWh<sub>el</sub>). In 2012, the total reduction of specific CO<sub>2</sub> emission indicators in comparison with 2011 is determined by a decreased share of Riga CHPPs output in the total generated electricity volume.

The Group continues the upgrading of CHPPs with the construction of the second power unit at Riga TEC-2. The technology used in the second unit conforms to the Best Available Techniques, as a result of which, the specific CO<sub>2</sub> emission is expected to be as low as that for the energy generated in the first power unit.

### CO<sub>2</sub> emission per unit of electricity generated (2008 – 2012)



## NO<sub>x</sub>, SO<sub>x</sub> and other significant air emissions by type and weight

[EN20]

The emission of harmful substances into the atmosphere depends directly on the fuel used, the efficiency of its use and the type of technology. Natural gas is one of the most environmentally-friendly types of fuel and it is used by Latvenergo Group not only in the combined heat and power plants but also, where possible, in the small boiler houses. However, the combustion of natural gas beside carbon dioxide emits other harmful substances into the atmosphere. These substances are nitrogen oxides (NO<sub>x</sub>), carbon monoxide (CO).

Fuel oil and diesel fuel combustion additionally produces sulphur dioxide (SO<sub>2</sub>), solid particles and vanadium (V) pentoxide emissions. During the storage of fuel oil and diesel fuel, hydrocarbons are produced. In 2012, fuel oil and diesel fuel were not used in energy generation.

The thermal energy generation in boiler houses of the Group as well as in the bio-cogeneration plant of Liepājas enerģija SIA are fuelled by wood. Wood combustion produces NO<sub>x</sub>, CO and solid particle emissions.

During the implementation of the CHPP reconstruction

### NO<sub>x</sub>, CO, SO<sub>2</sub> and other emissions (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
NO <sub>x</sub>	t	m/c	1,638	1,425	1,349	912	<b>602</b>
CO	t	m/c	533	345	250	356	<b>293</b>
SO <sub>2</sub>	t	c	22	0	11	5	<b>0</b>
Other*	t	c	12	10	10	10	<b>10</b>

\* including emissions of solid particles, vanadium, hydrocarbons  
m – measured, e – evaluated, c – calculated

projects, the older, less efficient facilities were replaced with new, efficient facilities in compliance with the Best Available Techniques reference documents. Thus, the specific emissions and concentration levels of harmful substances in flue gases, nitrogen oxides (NO<sub>x</sub>) in particular, were significantly reduced. Generating electricity in the

Riga TEC-2 first unit, the NO<sub>x</sub> emission per unit of energy generated was 0.1 kg/MWh, which is 83% less than it would be if generated in the old unit (0.6 kg/MWh). As a result of implementation of the Riga TEC-2 reconstruction project, the statutory requirements that define the maximum allowed threshold of NO<sub>x</sub> and CO emissions in flue gases will be met:



NOx – 50 mg/m<sup>3</sup> and CO – 100 mg/m<sup>3</sup> at 15% O<sub>2</sub> content in flue gases.

In order to limit the emission of polluting substances from combustion plants and to comply with the statutory thresholds, Latvenergo Group conducts the monitoring and registration of polluting substances, as well as plans and

implements energy efficiency and environmental protection measures both for large and small capacity emission sources. The modernization of facilities is relevant in terms of both efficiency and environmental protection. Taking into consideration technological, economic and environmental aspects, Latvenergo Group plans to discontinue the use of fuel oil (emergency fuel at Riga TEC-2) replacing it with diesel

fuel, which is more environmentally friendly. As a result of the emergency fuel storage reconstruction, the TEC-2 pollutant emissions during the use of emergency fuel along with the consumption of resources for maintaining the fuel storage will be reduced significantly.

## Total weight of waste by type and disposal method

[EN22]

In accordance with the priority sequence of waste processing methods in Latvenergo Group, in cases when waste production causes cannot be eliminated or waste amounts cannot be reduced, the waste is consigned for recycling or management.

According to the legislative requirements, Latvenergo Group conducts separated collection of municipal and hazardous waste, and maintains and arranges collection sites. Besides, a separated collection and consigning for management of various types of production waste (for example, used tires, scrap metal, construction waste, etc.) has been implemented. Both the municipal and the hazardous waste are transferred to waste management companies that have waste management and utilization licenses.

Latvenergo Group companies employ management systems for used imported packaging and waste, electrical and electronic equipment (WEEE).

### Waste and recycled materials (2011 – 2012)

WASTE	UNIT	METHOD	2011	2012	HAZARDOUSNESS	MANAGEMENT METHOD
Municipal waste	t	m/c	3,602	2,320	non-hazardous	consigned for management
Hazardous waste	t	m	387	330	hazardous	consigned for management
Production waste	t	m	1,402	2,807	non-hazardous	consigned for management
Imported packaging	t	m	426	424	non-hazardous	consigned for recycling
WEEE*	t	m	18	17	hazardous	consigned for recycling
RECYCLED MATERIALS						
Used transformer oil	t	m	82	81	hazardous	regenerated for repeated use

\* waste of electrical and electronic equipment  
m – measured, e – evaluated, c – calculated

## Total number and volume of significant spills

[EN23]

To ensure compliance with the environmental protection legislation, the Group cooperates actively with the state environmental institutions, providing information related to the environmental protection, organizing environmental impact

assessments, implementing the provisions of polluting activity permits, as well as having consultations on issues related to the environmental protection.

In 2012, no significant spills of hazardous chemicals or other polluting substances in the environment occurred, nor any other violations were identified.

## Monetary value of significant fines and total number of non-monetary sanctions for noncompliance with environmental laws and regulations

[EN28]

In 2012, twenty-two planned thematic inspections by the State Environmental Service of the Ministry of Environmental Protection and Regional Development of the Republic of Latvia, as well as two planned inspections were conducted

in Latvenergo Group by the Health Inspectorate of the Ministry of Health of the Republic of Latvia. In 2012, no significant reprimands or sanctions were received from the controlling institutions. No fines were paid.



# 2.2

## EMPLOYEES AND WORK ENVIRONMENT



## 2.2 Employees and Work Environment

### 2.2.1 Employment and Work Environment

#### Management Approach

**Employees are the most important resource of Latvenergo Group. We believe that sustainable development is based on the desire and determination of employees to perform their duties professionally and effectively. The human resource (HR) development of the Group depends on the accumulation and transfer of knowledge, as well as improvement of new competencies that are essential in competitive conditions.**

Employees of Latvenergo Group are employed in the Baltic region. Principles regarding workforce management and development in Latvenergo Group are integrated in each related policy in compliance with the Group-wide principal guidelines. The primary goal of HR development is to attract employees who are:

- ▲ interested in achieving goals;
- ▲ motivated to develop personal competencies and improve work efficiency;
- ▲ open to changes and creative in designing new solutions;
- ▲ faithful and responsible.

Latvenergo Group, in its turn, as the employer is responsible for the work environment for employees in its broadest definition. Work environment is created and maintained in order to:

#### **Ensure the employee competency development**

Latvenergo Group ensures the improvement of employee competencies and efficiency, as well as links the goals of the Group and each employee.

The specific character of the Group business determines that accumulation and transfer of knowledge is essential for providing sustainability, also including a well-considered and balanced replacement of employees who have reached the retirement age with new employees.

#### **Promote employee knowledge and awareness**

Latvenergo Group always seeks to improve and simplify the work organization and communication. The internal communication and management practices are based on the principle of openness and facilitate effective communication,

promoting a sense of belonging and understanding of collective goals. Constant communication between employees and managers of all levels is ensured in the electronic environment (intranet, e-mail).

Internal training regarding the Group mission, values, ethical standards, internal working regulations, safety and labour protection requirements, safe work methods, and other significant topics is also provided to all new employees to expedite integration and awareness of employees.

**Employees, their skills and knowledge – an essential resource for the sustainability of the Group**

#### **Promote employee engagement**

Engagement of employees is highly valued at Latvenergo Group – the employee satisfaction and opinion survey system is constantly improved. Employees are provided with an opportunity to extend all matters of interest during the annual personnel development discussions.

#### **Ensure safe and motivating working conditions**

Latvenergo Group as the employer ensures employees with workplaces that are adequate to perform of their duties, with proper personal protective equipment and technical resources, as well as provides employee training on labour safety issues and safe work methods. In compliance with the requirements of OHSAS 18001 specification, an occupational health and safety management system is implemented and maintained in the core business divisions of Latvenergo Group.

Employees are provided with motivating and result-oriented compensation – the basic salary is determined according to employee competencies, whereas the variable part of the remuneration depends on the quality of work performed. Latvenergo Group observes gender equality principles both in the structure and remuneration of employees.



Igors Gobalovs – award winner of The Pride of Customer Service 2012



## Total workforce by employment type, employment contract, and region broken down by gender

[LA1]

The number of Latvenergo Group employees in 2012 was 4,457, of whom 74% were men and 26% women. The relatively high proportion of males in the employee structure can be explained by industry specific factors, in particular, the prevailing share of technical professions. The Group is always improving its processes and ensures the structure that would enable to optimize the number of employees. The goal of this process is to reduce costs without affecting the service quality. In the last five years, in the course of internal process optimization and work organization changes, the number of employees decreased by 918 employees or 17%. The reduction rate has dropped, and in the last two years there have been minor changes in the number of employees.

Most of employment contracts in Latvenergo Group are concluded for an indefinite period of time and only 1% of the total number of contracts is concluded for a fixed term – for 2% of women and 1% of men employed in the Group.

15 employees work part-time, forming only 0.3% of the total number of employees (0.2% of men and 0.6% of women).

### Distribution of employees by business divisions (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Generation and supply	number	m	1,080	989	951	920	940
Distribution system services	number	m	3,098	2,656	2,552	2,543	2,502
Management of transmission system assets*	number	m	607	533	495	493	438
Corporate functions	number	m	590	523	519	534	577
	<b>number</b>		<b>5,375</b>	<b>4,701</b>	<b>4,517</b>	<b>4,490</b>	<b>4,457</b>

\* since 2 January 2012 Augstsprieguma tīkls AS is unbundled from the Group  
m – measured, e – estimated, c – calculated

## Total number and rate of new employee hires and employee turnover by age group, gender, and region

[LA2]

There is a low employee turnover in Latvenergo Group. In 2012, employment was terminated with 240 employees or 5% of the Group employees (including 6% of women and 5% of men employed in the Group), whereas 265 new employees were hired (including 7% of women and 6% of men employed in the Group).

### Employee turnover in 2012

AGE GROUP	UNIT	METHOD	NEW EMPLOYEE HIRES		EMPLOYMENT TERMINATED	
			MEN	WOMEN	MEN	WOMEN
less than 30	number	m	133	41	39	15
31-40	number	m	27	27	31	14
41-50	number	m	21	7	21	15
over 50	number	m	4	5	78	27
<b>TOTAL</b>	<b>number</b>		<b>185</b>	<b>80</b>	<b>169</b>	<b>71</b>

m – measured, e – estimated, c – calculated



## Percentage of employees covered by collective bargaining agreements

[LA4]

To accommodate social and economic interests of Latvenergo Group employees, Latvenergo AS, Sadales tīkls AS, Latvijas elektriskie tīkli AS have concluded the Latvenergo Collective Bargaining Agreement. Along with the provisions of the national laws and regulations, the Collective Bargaining Agreement provides employees with

additional guarantees. The Collective Bargaining Agreement is applicable to 97% of the Group employees, and this rate has not changed in recent years.

A highly positive fact is that the collective bargaining agreements made by the companies within the Group are applicable to all employees, not only to trade union members.

Thus, each employee is provided with equal treatment as well comprising additional social guarantees, therefore reducing the possibility of conflict between employees and the employer.

## Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region and by gender

[LA7]

Accident records are maintained in accordance with criteria defined in the laws and regulations of the Republic of Latvia. In 2012, 18 accidents occurred in the companies of Latvenergo Group (2011: 13 accidents), of which 3 women were affected. The increased occurrences of accidents in 2012 are related to such accident types that are qualified as

„not serious” (15 in 2012 and 9 in 2011). No jobsite fatalities occurred in 2012.

After the accidents, Latvenergo Group performed work environment risk reassessment and repeated instructions for employees. During the instructions, reasons of the occurrence of accidents were discussed and analysed

with employees. 455 working days (2011: 343 working days) were lost due to accidents in 2012. One case of occupational disease was registered in 2012.

5 contractors (all of them men) were injured in accidents during their onsite work at Latvenergo Group.

## Health and safety topics covered in formal agreements with trade unions

[LA9]

In order to represent employee labour safety interests, trustees in work-related issues are elected at the general meeting of employees, organized by the management of Latvenergo AS in co-operation with the trade union Enerģija. Employee delegates participate in the meeting where nominated candidates are elected by voting. Trustees are elected for a three-year term. The total number of labour safety trustees elected in Latvenergo Group is 74, thus forming 1.7% of the total number of employees.

Issues related to labour safety and occupational health are covered by the Collective Bargaining Agreement, which, in addition to the provisions of national laws and regulations, imposes obligation like provision of support to trade unions and labour safety trustees and coverage of special medical treatment costs to employees, who have been injured in accidents.

Also, the Collective Bargaining Agreement defines an obligation of the employer to provide employees with health and accident insurance, additional vacation days, and extra pay in case of incapacity for work. These conditions allow employees to take better care of their health.



## Percentage of employees receiving regular performance and career development reviews, by gender

[LA12]

The basis for Latvenergo Group staff training and growth planning are the annual personnel development discussions, according to which a decision is made about the need of employee competency development, qualification raising and enhancement of growth opportunities.

Personnel development discussions are conducted by the direct superior of each employee. Development reviews engage employees who have worked a full calendar year. The percentage of employees who took part in development discussions reached 85% in 2012 (2011: 78%). This indicator is similar regardless of the employee gender (men – 86%, women – 82%).

Employees are provided with opportunities for professional growth and training both in external educational establishments and internal trainings. Internal training includes seminars designed and conducted by Group employees as well as training in the Training Centre of Sadales tīkls AS, where employees improve mostly their professional expertise in electrical sciences, working with dangerous equipment, and improve their computer skills. In addition, internal training is provided by mentors. On average, one employee dedicated 17 hours to training in 2012 (2011: 16 hours).

Latvenergo Group provides financial support to employees for obtaining qualification at educational institutions. A total of 71 employees received financial support in 2012.

In 2012, in order to ensure integration of newly hired employees, 6 seminars were organized where 168 employees enhanced their knowledge about the Group strategy, values, Code of Ethics, and Group policies.

In order to ensure the availability of human resources in the future, Latvenergo Group promotes occupations required for its core operations and introduces young people with career and development opportunities in Latvenergo Group.

In 2012, Latvenergo Group provided internship opportunities for more than 250 trainees and students from various educational institutions, with the majority studying programmes related to the core operations of the Group.

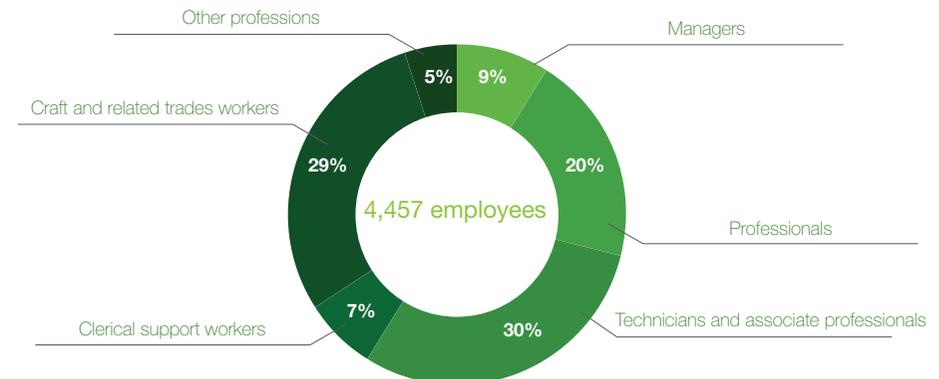
## Composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership, and other indicators of diversity

[LA13]

Latvenergo Group professional breakdown complies with the Profession Classifier of the Republic of Latvia. High-qualification employees, such as managers, senior specialists, specialists, and skilled employees in 2012 represented 88% of the total number of employees in the Group. The proportion of managers in the Group was 9% of the total number of employees, and it is considered to be an effective indicator. Almost half of employees has a higher education. Latvenergo Group has an equal treatment to all employees and they are by no means divided according to their belonging to any minority group.

Classification of employees by occupational group and gender shows that most employees among men are qualified as craft and related trades workers (38%), technicians and associate professionals (28%) and least as clerical support

### Distribution of employees by profession, as of 31.12.2012

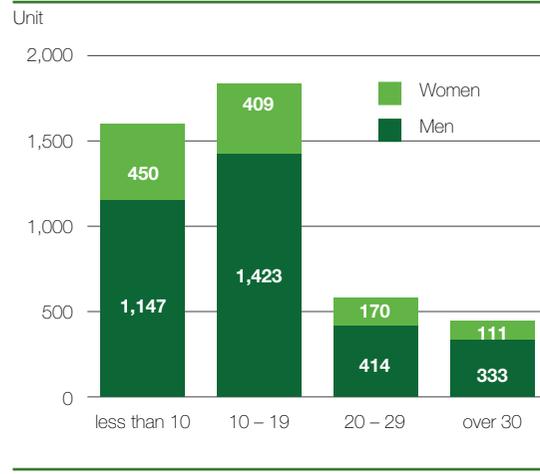


workers (only 1% of men). Among women employed in the Group, most of employees are qualified as technicians and associate professionals (36%), professionals (25%), clerical support workers (25%), and least of all as craft and related trades workers (2%). The specific character of the industry determines the high proportion of technical professions as well as the unequal breakdown by gender in the groups of craft and related trades workers and clerical support workers.

Classification by category and age group indicates that most commonly employees who are 30 years old or younger are craft and related trades workers (32%) and less frequently managers (3%), whereas employees over 51 years of age are most frequently technicians and associate professionals (32%) and less frequently clerical support workers (5%).

Most of the Group employees are long-term employees – length of service of 64% employees (of which 76% men and 24% women) exceeds 10 years.

**Distribution of employees by length of service, as of 31.12.2012**



## Ratio of basic salary and total remuneration of women to men by employee category

[LA14]

The basic salary of each employee is related to the job evaluation and correspondence of employee competencies to the requirements of the particular position. Job performance evaluation criteria are equal within the same position. Besides, based on these criteria, all Group employees have equal opportunities to receive a variable part of remuneration.

To analyse cross-gender remuneration differences, basic salary should be compared between women and men who perform similar job duties with the same job title. In total, basic salary of 2,000 employees were compared, representing 45% of the total number of employees.

The ratio of basic salary set in the contract for women and men, who perform similar duties within the category group, shows that Latvenergo Group observes the gender equality principle regarding employee remuneration.

### Ratio of basic salary of women to men by employee category

PROFESSIONS	METHOD	RATE OF EMPLOYEES COMPARED	BASIC SALARY WOMEN/MEN, INTERVAL
Managers	c	47%	0.94 – 1.03
Professionals	c	33%	0.92 – 1.05
Technicians and associate professionals	c	69%	0.92 – 1.03
Clerical support workers	c	40%	0.94 – 1.04
Craft and related trades workers	c	31%	0.98 – 1.08
Other professions	c	32%	0.90 – 1.04

m – measured, e – estimated, c – calculated



## 2.2.2 Human Rights

### Management Approach

**In all of its operating segments, Latvenergo Group respects the basic human rights secured in the Constitution of the Republic of Latvia, laws, and binding international treaties. Moreover, Latvenergo Group shapes its working environment and processes so as to prevent any infringement or violation of human rights of partners employees within the limits of possible influence of Latvenergo Group.**

The compliance with the principles of human rights is defined in the Code of Ethics, aimed to create unified rules of ethical conduct, ensuring respect, trust, and loyalty applicable not only to Latvenergo Group employees but also to partner practices.

The Code of Ethics is to establish that employees should avoid actions or comments that could be considered humiliating, offensive or discriminating. It is the obligation of all managers to observe and implement the norms of the Code of Ethics.

Compliance with the Code of Ethics is one of the employee evaluation criteria and is taken into account upon considering the advantages of an employee at internal job placement competitions and preservation of employment relations.

### The Group observes equal treatment with respect to all human rights aspects

Also, other internal documents define the compliance with the human rights principles and ensure the rights of every employee to:

- ▲ safe, harmless to health, and non-discriminating environment;

- ▲ equal treatment upon job placement, development, and work evaluation;
- ▲ working and rest time, labour payment;
- ▲ express an opinion and to exercise freedom of associations and collective bargaining;
- ▲ report on possible cases of violation of rights.

Latvenergo Group treats all Group employees equally regardless of gender, race, ethnic or national belonging, age, disability, religious, political or other beliefs, social origin, financial or marital status, sexual orientation, or other characteristics.

## Operations and significant suppliers identified in which the right to exercise freedom of association and collective bargaining may be violated or at significant risk, and actions taken to support these rights.

[HR 5]

Latvenergo Group employees may individually engage in various associations and trade unions, without representing the employer, and no approval by the employer is required for such involvement. Latvenergo Group guides and supports employees in active participation in societies and associations that provide free exchange of experience,

promote professional growth of employees and their engagement in highlighting and solving issues, which are relevant to the Group.

Latvenergo Group cooperates with suppliers who observe ethical standards and respect human rights in their activities, support the Group in establishing fair cooperation, and

perform no corruptive and fraudulent actions. Latvenergo Group invites its contract partners to observe ethical principles and asks them to acknowledge and represent – upon signing the agreements – that cooperation is based on principles of fair business cooperation.



# 2.3 SOCIETY



## 2.3 Society

### Management Approach

**Latvenergo Group provides services that are essential to the society on a pan-Baltic level, performs capital investments in the energy infrastructure and assumes both statutory and additional voluntary responsibility for its actions. The Group cooperates with different groups within the society in order to promote common well-being and improvement of the environment.**

In its core operations, Latvenergo Group pays special attention to the economic, environmental and social aspects of sustainability, including the creation of new jobs, research and development, environmental protection and support of education and science.

Latvenergo Group is a well-organized and transparent example of best practices in implementation of the corporate social responsibility principles both on Latvian and pan-Baltic level. In its day-to-day activities and relationships with stakeholders, Latvenergo Group respects values, which are relevant to social, environmental and human right aspects.

In order to promote the increase of public welfare and improvement of the state of the environment, the Group implements the Corporate Social Responsibility (CSR) policy. Activities under this policy are evaluated by the CSR Activity Management Committee and, according to its recommendations, approved by the Management Board of the parent company of the Group.

The Group provides support to projects and activities that meet the following criteria:

- ▲ take place on a pan-Baltic level;
- ▲ are related to energy (the energy sector or human energy);
- ▲ provide a substantial long-term impact and benefit to the society;
- ▲ ensure the engagement of broad community groups;
- ▲ promote public awareness of the business divisions of the Group and their current issues;
- ▲ conform to the strategy of the Group.

The main directions of Latvenergo Group social responsibility activities are as follows:

### Education of children and young people

In order to reduce electrocution-related injuries and promote the energy sector and engineering professions, Latvenergo Group, in cooperation with educational institutions and experts, carries out annual projects for children and young people dedicated to the electrical safety.

In 2012, an educational portal on physics for schoolchildren <http://www.fizmix.lv> was developed in cooperation with teaching staff of educational institutions, physics practitioners and students. The portal is aimed at increasing schoolchildren interest in physical sciences and promoting their understanding of the related topics in an engaging form.

In cooperation with educational institutions and experts, for the 17<sup>th</sup> year in a row Latvenergo Group organises an erudition contest "eXperiments" for the 8<sup>th</sup> and 9<sup>th</sup>-graders. The project is aimed at educating young people on safe and efficient use of electricity in everyday life and at school. 194 teams (a total of 1,164 participants) from the entire Latvia took part in the "eXperiments" 2011/2012 erudition contest. According to the data aggregated by market research company TNS Latvia, The final of the contest, broadcasted live in LNT TV channel, was watched by 235,000 people.

In 2012, Latvenergo Group took part in the spring and autumn Safety Weeks, organised by the National Centre for Education of the Ministry of Education and Science of the Republic of Latvia. Latvenergo Group also participated in the event *Mēs – bērnu drošībai Jelgavā!* (We – for children's safety in Jelgava), organized by the Jelgava precinct of the State Police Zemgale regional authority, with the aim to promote children and young people awareness of electrical safety-related issues.

**Responsibility towards the society and stakeholders promotes development of the Group**



### Support for science and education in the energy sector

In 2012, attesting to its interest in the creation of high-quality educational programmes, Latvenergo Group announced a contest and rewarded the authors of the best higher education study papers related to the energy sector. The results of the contest are available on the website <http://www.latvenergo.lv>.

In cooperation with the Latvian Academy of Sciences, Latvenergo Group announced its 12<sup>th</sup> Annual Prize competition, which is aimed at motivating Latvian scientists to conduct researches, especially applied researches for the facilitation of energy sector development and innovative environment.

Latvenergo Group took part in the preparation of the Science Festival, which was part of the 150-year anniversary of the Riga Technical University. Latvenergo Group also contributes to the prize fund of the *Mehu dienas* (Mech Days) organized by the Student Council of the Faculty of Engineering of the Latvia University of Agriculture.

### Preservation of industrial heritage

The Museum of Energy of Latvenergo Group collects, preserves and studies the documental and industrial heritage of the Latvian electrical energy industry and Latvenergo Group that reflects the role of energy sector in the development of the national economy, welfare and attractive living environment.

The museum also stores a globally unique collection – 1,736 glass plate negatives, taken by Eduards Kraucs, documenting the construction of the Kegums power plant (1936 – 1940). This collection has been included in the Latvian national registry of the UNESCO *Memory of the World programme*. In May, the Museum of Energy in Kegums participated in the *Museum Night* event for the sixth time, where 5,000 visitors viewed the museum exhibits and were advised on efficient use of electricity. In September, the Museum of Energy took part in the Scientists' Night

project in Andrejsala. During the event, parents with children participated in the *Elektrodrošības ABC* (Electrical Safety ABC) class as well as watched educational films on electrical safety.

In cooperation with the Recruitment and Youth Guard Centre of the Ministry of Defence of the Republic of Latvia and the National Armed Forces, Latvenergo Group supports the patriotic game *Jaunie Rīgas sargi: Latvijas hronikas* (The New Guards of Riga: Chronicles of Latvia), organised by the Latvian War Museum.

### Openness to culture and sport

Latvenergo Group continues to participate in the preservation of Latvian cultural values by supporting the preparation of the Liepāja Symphony Orchestra concert, the concert programme of the youth choir *Kamēr...*, the organisation of the music festival of Kremerata Baltica orchestra, the preparation of the XXV Nationwide Latvian Song and XV Dance Festival, shows of the Latvian National Opera and the Latvian National Theatre in the 2012/2013 season and the concert of a charity event *Nāc līdzās Ziemassvētkos!* (Come along in Christmas!).

In 2012, Latvenergo Group supported the creation of the photo book *Vidzeme* that includes photographs of Daugava HPP cascade objects, Aiviekste HPP and Riga CHHPs in addition to the historical centres of the towns of Vidzeme, architectural monuments and natural objects.

Latvenergo Group supported the 22<sup>nd</sup> Latvian cyclist Unity Ride in Sigulda, which is a large-scale sporting event of the national importance. The team of Latvenergo Group, representing the largest number of participants, also took part in the Unity Ride.

### Environmental protection

In 2012, Latvenergo Group continued its cooperation with the Latvian Ornithological Society (LOS) regarding bird protection and the *Mēs zivīm* (We to Fish) association in protection and replenishing of fish resources in the Daugava basin. The study carried out as part of the Monitoring of White Storks

project of Latvenergo Group and LOS ascertained that 66.5% of the white storks in Latvia have made their nests on power line poles. Therefore, the Group is responsible for finding solutions to ensure the quality of the power supply without disruption of white stark nesting.

In March 2012, employees of Latvenergo Group together with specialists of the *Mēs zivīm* association made artificial fish spawning nests from fir branches. In May, these nests were placed in the Daugava near Kaibala and Ikskile to encourage roach, bream, perch and pike to spawn there.

Additional information on the environmental protection activities carried out by the Group is presented in the Section "Environment".

### Energy end-use efficiency activities

To promote society awareness of energy efficiency, the Energy Efficiency Centre of Latvenergo Group, in cooperation with non-governmental and other organisations, provides free consultations on ways to efficiently and safely use electricity in daily life as well as organises workshops and lectures, and prepares and publishes informative materials.

Similarly, in 2012, specialists of the Energy Efficiency Centre involved in off-site activities, visited children summer camps, participated in events organised by student councils as well as discussions and workshops held by the Latvian agricultural producer organisation *Zemnieku Saeima* (Farmers Parliament).

### Social support campaigns

Social support campaigns for socially vulnerable families with children continued in 2012. These families were granted an option to receive cards for settling electricity payments in the amount of LVL 53.70 from municipal social services in cities and regions. Large families that joined the tariff compensation programme in 2011 were provided with an option to pay for 3,600 kWh per year at the start tariff in 2012 as well. In 2012, social support was provided in the total amount of LVL 502,000.

## Percentage of operations with implemented local community engagement, impact assessments, and development programs

[SO1]

In order to mitigate a potential harm or its risk to the environment, implement the precautionary principle and ensure society engagement in decision-making, public discussions regarding the following projects have taken place in 2012: the 3rd stage of the *NORDBALT-02-330kV Kurzeme Ring project* (7 public discussions) and the *Third Electricity Transmission Network Interconnection between Estonia and Latvia* (23 public discussions).

To take care of the safety of residents in the municipalities within the area affected by the Daugava hydropower plant reservoirs, representatives of Latvenergo Group meet with the relevant state services each year before the spring flooding season to ensure coordinated and coherent action in the event of potential flood threats and preventing flood damage. During the Daugava hydropower plant repair period (summer) they inform the municipalities and residents in these areas

about lowering of the water levels in the reservoirs. Current information is also placed on the website of the Group.

Communication with various community groups is carried out in order to effectively explain the business process and decisions of Latvenergo Group. The most active communication in 2012 was related to:

- ▲ liberalization of the electricity market in the Baltics,

emphasizing the necessity to ensure equal competition conditions for all participants in the electricity market;

- ▲ promotion of visibility on a pan-Baltic level, introducing the society with the new trade brand Elektrum and generation facilities of Latvenergo Group, emphasizing the significance of green electricity;
- ▲ issue of bonds, emphasizing the importance of related processes for the operations of Latvenergo Group and at the same time promoting the attraction of potential investors;
- ▲ Visagina NPP project, emphasizing its potential

commercial and economic input into the development of Latvia and the Baltics;

- ▲ strategy of Latvenergo Group, explaining the strategic direction and goals of the Group;
- ▲ improvement of the electricity supply quality in the regions;
- ▲ mandatory procurement as a support for electricity generation in Latvia.

Latvenergo Group involves the public through the media, by disseminating press releases and organizing press conferences, as well as by building feedback meeting

the stakeholders (incl. experts of the sector, customers, educational institutions) in person at conferences, public consultations and events organised by the Group. To communicate with the society, the Group also uses social networks, issues the *Energo Forums* (Energy Forum) e-magazine and the *Elektroenerģijas Tirgus Apskats* (Electricity Market Review) customer bulletin, as well as places current information on its website.

The Group does not have an information system that could assess the percentage of performed activities of each type in the total number of social activities.

## Percentage and total number of business units analysed for risks related to corruption

[SO2]

During scheduled and unscheduled internal audits within Latvenergo Group, corruption risks and the efficiency of internal controls in mitigating these risks are always evaluated.

General evaluation of corruption risks within the audit framework is conducted at all Latvenergo Group subsidiaries.

## Actions taken in response to incidents of corruption

[SO4]

In 2012, the Code of Ethics of Latvenergo Group was amended, putting emphasis on prohibition of corruption, fraud and a situation of conflict of interest.

In accordance with the Code of Ethics, managers of all levels, leading specialists, experts, project managers and other employees that participate in decision-making as part of their job duties must submit a conflict of interest declaration to the employer once a year. This declaration is also submitted by employees who have been or could get in a situation that involve conflict of interest while performing their duties. Similarly, new employees, upon commencing their employment, must sign an affirmation, thereby confirming their understanding of conflict of interest situations and

commitment to prevent occurrence of such situations in their work. The Code of Ethics of Latvenergo Group lays down restrictions on acceptance and offering of gifts: in performing their job duties, employees may not accept or offer any material reward, including material or other kind of benefit, including gifts, gratitude money, commission, or valuables as inducement or reward.

Employees must assess not only their own commercial activity outside of the Group but also that of their relatives and family members, if it is closely related to the business of the Group, and must report all such situations to the employer.

In order to ensure the Group companies staff awareness of

conflict of interest situations and steps to be taken to prevent them, the Group carries out explanatory measures, manager and employee training, organises discussions on prevention of conflict of interest situations and mitigating of fraud and corruption risk.

In addition to the amendments in the Code of Ethics, in 2012 the Fraud Risk Management Plan was approved and the Fraud Risk Management Committee was formed to ensure an efficient management of fraud risk in Latvenergo Group. The section on the governance of the Group contains a more comprehensive description of the goals and operation of the Fraud Risk Management Plan.

## Total value of financial and in-kind contributions to political parties, politicians and related institutions by country

[SO6]

The Corporate Social Responsibility Policy of Latvenergo Group does not permit financial or in-kind contributions to political organisations.



# 2.4 PRODUCT RESPONSIBILITY



## 2.4 Product responsibility

### Management Approach

Latvenergo Group actively seeks to increase the value of products provided to customers. In our business we strive to consider the differences and requirements entailed by operation both on a Baltic scope and in regulated and unregulated market segments. In the regulated market segment, Latvenergo Group focuses on the efficiency of customer service, on meeting the regulatory requirements and on ensuring the necessary service standards. In turn, in the unregulated market segment, Latvenergo Group concentrates on a personalized approach as well as on product differentiation according to the needs of customers, motivating them to continue cooperation with Latvenergo Group.

In 2012 the liberalization of the electricity market gradually continued in the Baltics. As of 1 November 2012, only the household customer segment retained an opportunity to buy electricity at regulated tariffs in Latvia. The Estonian electricity market was fully opened on 1 January 2013, and gradual opening of the market continues in Lithuania as well. Along with the market liberalization in the Baltics, Latvenergo Group continues to focus on initiatives and activities that promote competitiveness and help to maintain the market leader position. Creation and implementation of the new brand is intended to strengthen the position of the Group in the Baltic electricity market and promote an increase of the value of products provided to the customers.

### Goals and Results

In 2012, a new trade brand *Elektrum* was launched in Lithuania and Estonia. The objective of the new brand implementation is to promote the recognition of the Group on a Baltic scope and highlight our values in respect to customers. *Elektrum* is positioned as a dynamic and open supplier that focuses its activities on customers by using a flexible and friendly approach. The core values of the new trade brand are liveliness, personal approach and smartness. The trade brand unifies the customer needs and the feasibility of an energy expert – the electricity supplier.

### *Elektrum* – a personal approach to customer needs

Latvenergo Group has put forward a competitive electricity product strategy as one of the cornerstones of the customer attraction strategy. Along with expanding the supply in Lithuania and Estonia, a new range of electricity products was developed on the basis of segmentation by customer needs.

### Customer Service in the Baltics

As part of a developing convenient customer service options in the electronic environment, customers in Estonia and Lithuania are offered to choose the most suitable product and conclude an electricity supply agreement by themselves on *Elektrum* websites.

In order to develop and streamline the customer service in Latvia, the following activities and improvements were implemented in 2012:

- ▲ attraction of customers to a balanced payment service – in 2012 the number of users of this service has grown 2.2 times;
- ▲ in Latvenergo customer service centres we have initialized offering an option to sign applications electronically, thus decreasing the servicing time and reducing a wasteful paper consumption;
- ▲ involvement of the technical staff in the customer service resulting in a customer being provided with an opportunity to conclude electricity supply and system service agreements at home;
- ▲ we began sending reminders regarding requirements to report the meter readings. Reminders are sent by e-mail;
- ▲ a new portal *e-st.lv*, where each customer of Sadales tīkls AS may conveniently register meter readings, was developed. In future it is planned to expand the portal and improve its functionality.



*Elektrum* products for Estonian households



*Elektrum* products on the Lithuanian market





### Organisational Responsibility

Communication with customers in Lithuania and Estonia is ensured mainly through the customer service portals *elektrum.ee* and *elektrum.lt*. In 2012, we started to service customers by phone as well.

Meanwhile, customer service in Latvia is carried out through the following channels: self-service portal *e-latvenergo.lv*, customer service by phone, customer service in person at customer service centres and customers have an opportunity to submit questions electronically by e-mail; customer issues are also addressed in social networks. This way, the customer is provided with the opportunity to choose his preferential and the most convenient form of communication.

The most popular customer service channel is the portal *e-latvenergo.lv*, which number of visits has grown almost ten-fold since 2008 and currently is twice as that of customer service by phone – the second most frequently visited customer service channel. In 2012 the communication with customers by e-mail has also increased by 20%. Increased communication both in the portal *e-latvenergo.lv* and by e-mail shows that the principle of promoting a broader use of electronic customer service options in self-service environment consistently implemented by Latvenergo Group has positive results.

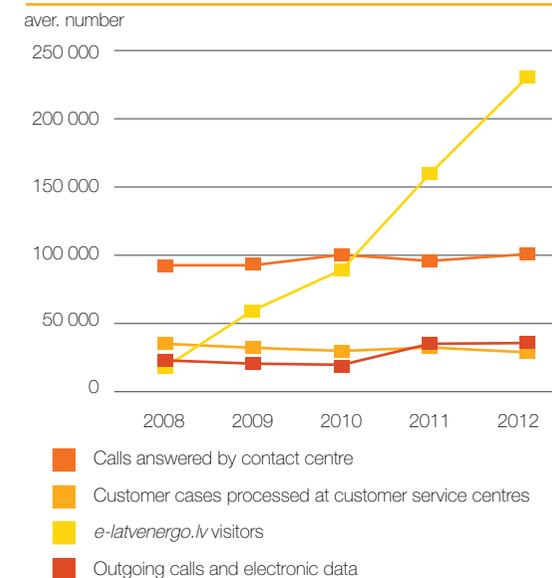
A free-of-charge 24-hour call centre service and service in person at any of 10 Latvenergo customer service centres or 13 corporate customer service offices are offered to suit customers convenience as well.

Additionally, in 2012 a growing popularity of services in social networks was experienced, favoured because of the communication speed and the friendly attitude.

Overall in 2012, the average number of contacts with customers per month in various customer service channels was 167 thousand. Only 293 of those were client complaints, which correspond to approximately 0.03% of the total number of clients of the Group. 6% of all complaints were justified and 4% – partially justified. For comparison: in the previous year an average of 395 complaints was processed each month, 8% of which were justified and 6% – partially justified. Responses to customer complaints were provided promptly – 58% of complaints were responded to within 15 days.

In order to reduce the response time and ensure a mutual understanding of the solution to the customer issues, in 2012 41% (2011: 31%) of customer complaints were resolved through direct communication by phone.

Number of customers serviced average per month (2008 – 2012)



Percentage of complaints responded to within 15 days (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Percentage of complaints responded to within 15 days	%	m/c	27	55	51	52	58

m – measured, e – estimated, c – calculated



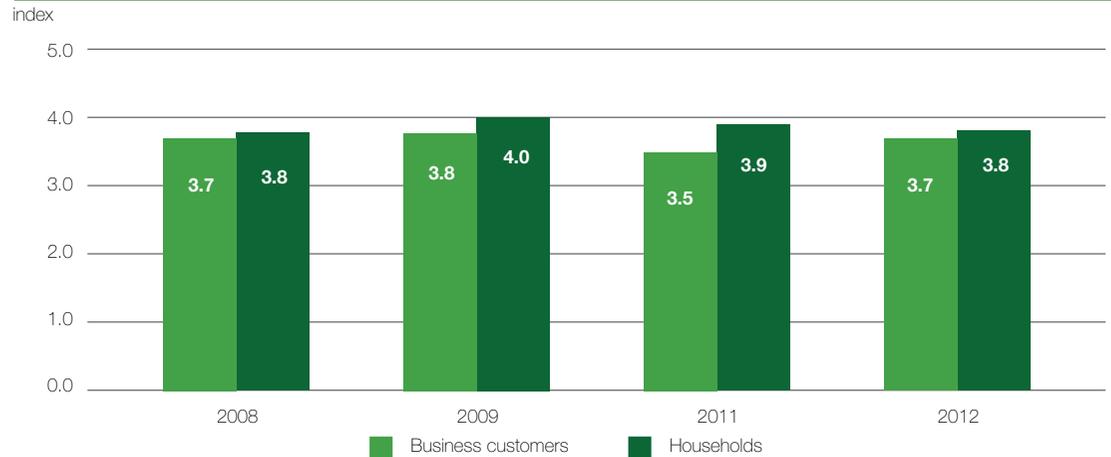
## Practices related to customer satisfaction, including results of surveys measuring customer satisfaction

[PR5]

To ensure high quality customer service, Latvenergo Group, in cooperation with sociological research agencies, conducts regular studies of customer satisfaction and loyalty, identifying of the service aspects that can be developed and improved. The level of customer satisfaction is evaluated in several aspects – the total satisfaction with the company, its services, customer service, payment options, information accessibility and content. Customer satisfaction and loyalty is evaluated in household and business customer segments.

A representative customer survey was conducted in the end of 2012, showing a slight decrease in the customer satisfaction index in the household segment compared to the previous years. However, this is explained by a general downward trend in satisfaction indicators for public utilities. In turn, customer satisfaction indicators in the business customer segment improved.

**Customer satisfaction index among business customers and households (2008 – 2009; 2011 – 2012)\***



\* No customer satisfaction study was carried out in 2010

## Programmes for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion and sponsorship

[PR6]

In communication with customers and in marketing activities, Latvenergo Group ensures that information complies not only with the state regulations and standards of fair competition but also with the Code of Ethics of Latvenergo Group. Communication in Latvenergo Group companies is always constructed in a manner that conforms to the values of Latvenergo Group.

In order to inform the society and customers about services and current events, the Group uses several media channels: the press, television, Internet, mail, brochures and other informative materials, mobile text messages, etc.

In 2012, Latvenergo Group carried out a number of sponsorship projects. The most important of those were the social support programmes for socially vulnerable families

with children and large families, providing them with support in the total amount of LVL 502 thousand. Latvenergo Group has ensured compliance with laws and regulations and adherence to the requirements of the Corporate Social Support Policy of Latvenergo Group in the implementation of all sponsorship projects.



## Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes

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[PR7]

In 2012, there were no cases of non-compliance with the state regulations or failure to observe the provisions of voluntary codes of conduct in Latvenergo Group marketing activities.

## Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data

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[PR8]

Latvenergo Group holds an extensive customer database, the processing and maintenance of which complies with all statutory requirements in terms of data security and observance of confidentiality. Customer service processes are adapted to ensure confidentiality of data.

Data safety and protection concerns are also observed in the customer authorisation process within the customer portal while ensuring access to a sensitive information in the customer service and conducting direct communication activities.

In 2012, 5 complaints were registered concerning a possible violation of customer data privacy, of which two were unjustified; an explanation was provided to the petitioners. Other complaints were related to errors in the customer database. The errors in the customer database were resolved immediately upon receiving the complaints.

## Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services

---

[PR9]

Latvenergo Group seeks to ensure the maximum quality for the provision of its services. If provision of electricity distribution services is deemed to be inconsistent with quality requirements, the customer is compensated for the losses incurred.

Thus, in 2012, compensation for damaged electrical equipment due to distribution network disturbances was paid in 83 cases, in the total amount of LVL 20 thousand.

In addition, a reduced electricity distribution tariff for inadequate voltage quality was applied to 38 customer sites.

## Percentage of population not served in licensed distribution or service areas

---

[EU26]

The service area specified in the electricity distribution licence covers 99% of the territory of the Republic of Latvia. Electricity distribution is provided to approximately 900 thousand electricity distribution service customers.

Electricity distribution services are provided to all households that have concluded an agreement on electricity supply in the licence specified service zone.



## Power outage frequency (SAIFI) and average power outage duration (SAIDI)

[EU28]

[EU29]

The key performance indicator characterising electricity distribution, to which Sadales tīkls AS pays a particular attention, is the average power supply outage, which is calculated per single customer over a year and expressed in frequency (System Average Interruption Frequency Index, SAIFI) and minutes (System Average Interruption Duration Index, SAIDI).

Electricity supply outage indicators are divided into scheduled and unscheduled ones. A scheduled duration and frequency outages occur mainly due to distribution network maintenance and overhaul, whereas the duration and frequency of unscheduled electricity supply outages are determined by unfavourable weather conditions (storm, snow break, flood) and damages or thefts by third parties.

In 2012, the following activities were carried out to decrease the duration of electricity supply interruptions caused by unscheduled outages:

- ▲ medium-voltage lines were equipped with 300 damage location sensors;
- ▲ 90 remotely controllable circuit breakers that ensure quick damage localization were installed;
- ▲ medium-voltage transmission lines in forested areas were replaced with cable lines at a total length of 144 km.

In addition to these activities, a systematic work on electric line clean-out and maintenance is carried out: in the last years a particular emphasize is put on trimming the dangerous trees and performing vertical cutting of branches along transmission lines using a helicopter.

### Power outage frequency (2011 – 2012)

	UNIT	METHOD	2011	2012
Unscheduled: natural phenomena (massive damage)	number	m/c	1.5	<b>0.5</b>
Unscheduled: damage (including those caused by third parties)	number	m/c	3.2	<b>3.4</b>
Scheduled: network maintenance and overhaul	number	m/c	0.9	<b>0.9</b>
<b>System average interruption frequency index (SAIFI) TOTAL</b>	<b>number</b>		<b>5.6</b>	<b>4.8</b>

m – measured, e – estimated, c – calculated

### Power outage duration (2011 – 2012)

	UNIT	METHOD	2011	2012
Unscheduled: natural phenomena (massive damage)	minutes	m/c	416	<b>116</b>
Unscheduled: damage (including those caused by third parties)	minutes	m/c	293	<b>255</b>
Scheduled: network maintenance and overhaul	minutes	m/c	236	<b>265</b>
<b>System average interruption duration index (SAIDI) TOTAL</b>	<b>minutes</b>		<b>945</b>	<b>636</b>

m – measured, e – estimated, c – calculated

It is planned that a particular attention will be paid and preventive measures implemented to reduce the frequency

and duration of power supply outage in the following years as well.

## Average plant availability factor by energy source and by regulatory regime

[EU30]

The plant availability factor for Daugava HPPs and Riga CHPPs is calculated as the period of time during which a plant can operate at the nominal capacity. The remaining time is provided for scheduled and unscheduled operation interruptions, such as repair works.

### Average plant availability (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Daugava HPPs	%	m/c	90	87	84	86	<b>90</b>
Riga CHPPs	%	m/c	87	89	85	82	<b>86</b>

m – measured, e – estimated, c – calculated



# 2.5

## ECONOMIC PERFORMANCE



## 2.5 Economic Performance

### Management Approach

Latvenergo Group is one of the greenest electricity generators in Europe. In 2012, major part or 72% of the electricity generated by Latvenergo Group were produced from renewable energy resources. Therefore, investments in maintenance of the existing generation capacities and construction of new ones play a significant role in retention of our current status. In turn, the reliability of energy supply is the main factor for renovation and maintenance of the transmission and distribution infrastructure.

In order to retain our leadership in the green energy generation, we must take measures to renovate and maintain Daugava HPPs generation capacities. The total investment in reconstruction of hydropower units is estimated to exceed LVL 100 million by 2022, ensuring a continued operation for the next 40 years.

### Increase in the economic value generated by the Group attests to its growth and significance in the Baltics

The remaining electricity output of Latvenergo Group is mainly generated in combined heat and power stations in the cogeneration mode, which is one of the most efficient ways of energy generation leading to savings of primary energy resources, thereby reducing the negative environmental impact (in terms of CO<sub>2</sub> and other harmful emissions).

Following the commissioning of the second Riga TEC-2 power unit in 2013, all combined heat and power generation capacities will be fully renovated and replaced with efficient and environmentally friendly generation capacities. As a result of the capital investments, energy is generated in a more environmentally responsible way.

Along with generation of green energy, Latvenergo Group shows stable financial performance, which is evident from its financial reports. More detailed information on the Group performance is available in the Latvenergo Consolidated Annual Report 2012.

Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments

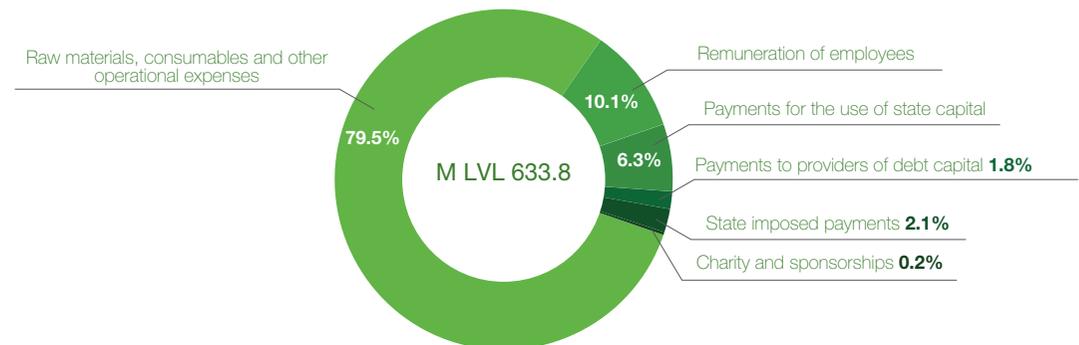
[EC1]

In 2012, the economic value generated by Latvenergo Group increased by 10%, reaching LVL 758.7 million. The increase in economic value generated reflects the development of the Group and has a positive effect on the distributed economic value, which has increased by 12% compared to 2011 reaching LVL 633.8 million or 84% (2011: 82%) of the total economic value generated.

Most of the distributed economic value (80%) consists of operating expenses, including costs of purchased electricity, electricity services, fuel and other operating costs. Due to an increase in price of resources and increased volume of operations, these costs have increased by 16%. LVL 39.9 million or 6.3% of the distributed economic value were paid in dividends for 2011. Latvenergo Group is the largest payer of dividends for the use of the state capital.

The undistributed economic value of Latvenergo Group in 2012 was LVL 124.9 million, which have been used towards investments. In 2012 Latvenergo Group invested a total of LVL 185.7 million.

### Distributed economic value in 2012



## Economic value generated and distributed (2011– 2012)

	UNIT	METHOD	2011	2012
<b>Economic value generated</b>	<b>M LVL</b>	<b>c</b>	<b>689.2</b>	<b>758.7</b>
Revenue and other income	M LVL	c	685.3	755.0
Income from financial activities	M LVL	c	4.0	3.7
<b>Economic value distributed</b>	<b>M LVL</b>	<b>c</b>	<b>565.7</b>	<b>633.8</b>
Raw materials, consumables and other operational expenses	M LVL	c	435.4	504.1
Remuneration of employees	M LVL	c	61.6	64.2
Payments for the use of state capital	M LVL	c	35.0	39.9
Payments to providers of debt capital	M LVL	c	14.0	11.3
State imposed payments	M LVL	c	17.0	13.6
Charity and sponsorships	M LVL	c	2.8	0.9
<b>Retained economic value</b>	<b>M LVL</b>	<b>c</b>	<b>123.5</b>	<b>124.9</b>
Depreciation and amortisation	M LVL	c	115.6	119.6
Savings and reserves	M LVL	c	7.9	5.3

m – measured, e – estimated, c – calculated



## Significant financial assistance received from government

[EC4]

Latvenergo Group has not received any subsidies, grants or other financial assistance from the State Budget of Latvia. At the same time, by implementing considerable investment projects, Latvenergo Group seeks ambitiously to attract

co-financing (foreign financial assistance). One of the major projects with co-financing is the *NORDBALT-02 330kV Kurzeme Ring* project co-financed under the *European Energy Programme for Recovery*. EU Cohesion Funds

co-financing has been attracted for a bio-cogeneration plant construction project and a project on reconstruction of heating networks in Liepaja.

## Average generation efficiency of thermal plants by energy source and regulatory regime

[EU11]

Efficiency is considered as essential in Latvenergo Group power generation process. Generation efficiency indicators are calculated as a relation of the generated electricity and thermal energy to the energy required for generation. The following table shows efficiency indicators of Latvenergo Group by generation facilities. Generally, during the five-year period, the efficiency indicators of generation facilities have improved.

### Generation facility efficiency indicators (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	2012
Daugava HPPs	m <sup>3</sup> /kWh	m/c	19.2	19.3	19.6	19.4	19.4
Riga CHPPs	%	m/c	85	86	85	87	85
Liepaja plants	%	m/c	67	68	72	75	78
Kegums boiler house	%	m/c	80	79	78	80	83

m – measured, e – estimated, c – calculated



## Distribution losses as a percentage of total electricity

[EU12]

A percentage of distribution losses in relation to the total electricity received by the network is a significant indicator of the efficiency of the distribution services segment. In 2012, distribution losses were reduced to 5.9% of the electricity received by the distribution network. This is the lowest rate of losses recorded to the date.

The reduction of losses is a result of purposeful work. Replacement of electricity meters, reorganisation of electricity recording system as well as a regular monitoring of payments for the consumed electricity have been carried out. Additional information on the segment of distribution services is provided in Section 1.7.2 of the Report.

### Distribution losses (2008 – 2012)

	UNIT	METHOD	2008	2009	2010	2011	<b>2012</b>
Distribution losses	%	n/a	6.7	6.9	6.4	6.4	<b>5.9</b>

m – measured, e – estimated, c – calculated



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\* GRI Profile indicators 4.2, 4.3, 4.9 and 4.10 are not applicable to Latvenergo Group



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**INDEPENDENT AUDITOR'S REVIEW REPORT ON THE LATVENERGO GROUP SUSTAINABILITY REPORT 2012****To the management of AS Latvenergo**

We have been engaged by the management of AS Latvenergo to perform limited review procedures in respect to the Sustainability Report of AS Latvenergo and its subsidiaries ('the Group') for the year ended 31 December 2012.

*Management's Responsibility*

The Management of the Group is responsible for the preparation and presentation of the Sustainability Report 2012, in accordance with the requirements of the B level application of The Global Reporting Initiative Guidelines ('GRI Guidelines'), issued by The Global Reporting Initiative (GRI), a non-profit organisation with secretariat based in Amsterdam, the Netherlands. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the Sustainability Report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. The Management is responsible for ongoing activities regarding the environment, health & safety, quality, social responsibility and sustainable development, and for the preparation and presentation of the Sustainability Report in accordance with the applicable criteria.

*Our responsibility*

Our responsibility is to express a conclusion on the Sustainability Report based on our review. We conducted our engagement in accordance with the International Standard on Assurance Engagements (ISAE) 3000, 'Assurance engagements other than audits or reviews of historical financial information', issued by the International Auditing and Assurance Standards Board (IAASB). A review consists of making inquiries, primarily of persons responsible for preparing the Sustainability Report, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with IAASB's Standards on Auditing and Quality Control. The procedures performed consequently do not enable us to obtain an assurance that would make us aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Our assurance does not comprise the assumptions used by the Group or whether or not it is possible for the Group to reach certain future targets described in the report (e.g. goals, expectations and ambitions).

The criteria on which our review is based on are the parts of the "Sustainability Reporting Guidelines, G3.1" published by GRI as well as the accounting and calculation principles that the Group has developed. We consider these criteria suitable for the preparation of the Sustainability Report.

Our review has, based on an assessment of materiality and risk, included the following procedures:

- an assessment of suitability and application of the criteria regarding the stakeholders' need for information;
- an assessment of the outcome of the Group's stakeholder dialogue;
- interviews with the responsible management, at Group level, subsidiary level, and at selected business units in order to assess if the qualitative and quantitative information stated in the Sustainability Report is complete, accurate and sufficient;
- review of internal and external documents in order to assess if the information stated in the Sustainability Report is complete, accurate and sufficient;
- an evaluation of the design of the systems and processes used to obtain, manage and validate sustainability information;



**INDEPENDENT AUDITOR'S REVIEW REPORT ON THE LATVENERGO GROUP SUSTAINABILITY REPORT 2012 (CONTINUED)**

- verifying the information included in the Sustainability report 2012 through enquires to the relevant management of the Group;
- a reconciliation of financial information with the Group's Consolidated Annual Report 2012 ;
- an assessment of the Group's declared application level according to GRI guidelines;
- an assessment of the overall impression of the Sustainability Report, and its format, taking into consideration the consistency of the stated information with applicable criteria,
- testing performance data, on a selective basis, substantively at both an operational and corporate level;
- inspecting documentation to corroborate statements of management and senior executives in our interviews;
- a reconciliation of the reviewed information with the sustainability information in the Group's Consolidated Annual Report 2012 .

*Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that the Sustainability Report 2012 of Latvenergo AS and its subsidiaries has not, in all material respects, been prepared in accordance with the above stated criteria.

SIA Ernst & Young Baltic  
Licence No. 17

A handwritten signature in blue ink, appearing to read "Diāna Krišjāne".

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

Riga, 23 April 2013

# LATVENERGO CONSOLIDATED ANNUAL REPORT 2012

PREPARED IN ACCORDANCE WITH THE INTERNATIONAL  
FINANCIAL REPORTING STANDARDS AS ADOPTED BY EU  
AND  
INDEPENDENT AUDITOR'S REPORT



# 1. Key Figures

	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Revenue	475,856	500,513	567,386	681,767	751,038	677,082	712,166	807,318	970,067	1,068,631
EBITDA <sup>1)</sup>	107,052	144,885	207,240	179,892	171,783	152,321	206,153	294,876	255,963	244,425
Operating profit <sup>2)</sup>	18,345	31,446	61,826	52,656	49,587	26,103	44,744	87,970	74,923	70,556
Net profit	7,328	19,556	44,325	43,778	35,741	10,427	27,826	63,069	62,290	50,856
Dividends	13,001	20,230	35,000	39,900	28,546	18,499	28,785	49,801	56,773	40,618
TOTAL assets	1,680,567	1,699,491	2,279,266	2,288,004	2,472,290	2,391,231	2,418,158	3,243,103	3,255,536	3,517,752
Non-current assets	1,475,618	1,462,114	1,942,231	2,026,594	2,180,111	2,099,615	2,080,401	2,763,546	2,883,583	3,102,019
TOTAL equity	866,331	889,440	1,344,748	1,351,576	1,410,510	1,232,678	1,265,559	1,913,404	1,923,119	2,006,975
Borrowings	496,317	507,225	545,607	513,334	595,235	706,195	721,716	776,329	730,408	846,943
Net debt <sup>8)</sup>	392,767	352,287	311,342	404,457	424,810	558,857	501,259	443,000	575,492	604,450
Cash flows from operating activities	84,419	138,174	160,563	180,399	150,769	120,117	196,604	228,461	256,685	214,526
Capital expenditure	197,311	104,506	127,539	198,723	185,723	280,748	148,699	181,472	282,757	264,260
						2008	2009	2010	2011	2012
Net debt/EBITDA ratio						3,7	2,4	1,5	2,2	2,5
EBITDA margin <sup>3)</sup>						22%	29%	37%	26%	23%
Net profit margin <sup>4)</sup>						2%	4%	8%	6%	5%
Capital ratio <sup>5)</sup>						52%	52%	59%	59%	57%
Return on assets (ROA) <sup>6)</sup>						0,5%	1,2%	2,2%	1,9%	1,5%
Return on equity (ROE) <sup>7)</sup>						0,9%	2,2%	4,0%	3,2%	2,6%
Retail electricity sales	GWh					7,461	6,659	7,620	8,980	8,287
Electricity produced in power plants	GWh					4,567	4,871	5,869	5,285	5,077
Aggregate heat sales	GWh					2,634	2,600	2,928	2,524	2,669
Number of employees at the end of the year						5,375	4,701	4,517	4,490	4,457
Moody's credit rating of the Parent Company						A3 (negative)	Baa3 (negative)	Baa3 (stable)	Baa3 (stable)	Baa3 (stable)

1) EBITDA – earnings before interest, income tax, share of result of associates, depreciation and amortisation, and impairment of intangible and fixed assets  
2) Operating profit – earnings before income tax, finance income and costs  
3) EBITDA margin – EBITDA / revenue

4) Net profit margin – net profit / revenue  
5) Capital ratio – equity/ total assets  
6) Return on assets (ROA) – net profit / average value of assets (assets at the beginning of the year + assets at the end of the year/2)

7) Return on equity (ROE) – net profit / average value of equity (equity at the beginning of the year + equity at the end of the year/2)  
8) Net debt – borrowings from financial institutions at the end of the year minus cash and cash equivalents at the end of the year

## 2. Management Report

Latvenergo Group (hereinafter – Latvenergo Group) is a pan-Baltic power supply company operating in electricity and thermal energy generation and supply, provision of electricity distribution and management of transmission system assets services.

### Latvenergo Group revenue in 2012 increased by 10% compared to 2011, exceeding EUR 1 billion

Latvenergo Group revenue in 2012 increased by 10% compared to 2011, exceeding EUR 1 billion. Revenue increased in the generation and supply, the distribution services as well as in the management of transmission system assets segment.

An unusually high water inflow in the Nordic countries and falling coal and CO<sub>2</sub> allowance prices in 2012 resulted in a significant decrease in the market price of electricity both in the Baltic and in the Nordic countries. While an increase in natural gas price in Latvia by nearly 30% was determined by a rise of crude oil price.

### Latvenergo Group has obtained 33% market share in the Baltics

Despite the adverse electricity market conditions, in 2012 Latvenergo Group maintained net profit in strong positive level – LVL 35.7 million (LVL 43.8 million in 2011).

Positively financial results are mainly affected due to a higher generated electricity volume in Daugava HPPs, while it is negatively affected by higher costs of the electricity

purchased in the mandatory procurement process.

In 2012 Latvenergo Group supplied 8,287 GWh of electricity to retail clients obtaining 33% market share in the Baltics. With a further opening of the Baltic electricity market, Latvenergo Group revised its retail strategy focusing on small and medium-sized enterprises and households. In 2012 the retail customers in Lithuania and Estonia increased almost two-fold. A diverse range of electricity products were developed and launched in 2012. These products are offered in Estonia and Lithuania under the new retail brand of Latvenergo Group – Elektrum.

In 2013 the market share of the Baltic regulated market will continue to drop. Since 1 January 2013 the electricity market in Estonia is deregulated for all customers, while in Lithuania – for all commercial customers. Full opening of the electricity market in Latvia is expected to occur on autumn 2013. With a further liberalization of the Baltic electricity market, in 2013 Latvenergo Group will continue to carry out targeted electricity sales activities and strengthen its position in the Baltic electricity market.

### Investments are made in order to improve the distribution network service quality and its technical parameters

Group capital investments in 2012 amounted to LVL 185.7 million (LVL 198.7 million in 2011), of which most significant investment is made in generation assets – LVL 95.1 million. The completion of on-going reconstruction project of Riga CHPP-2 (LVL 50.8 million in 2012) is scheduled for 2013. In 2012 capital investments in the project Kurzeme Ring, that is a part of the international energy infrastructure development project NordBalt and provides strengthening of the transmission network in the western region of Latvia, amounted to LVL 16.1 million.

In 2012 the amount invested in transmission and distribution network assets has significantly increased reaching 44% of

the total Group investments (2011: 29%). Investments are made in order to improve the distribution network service quality and its technical parameters, such as frequency and duration of outages, voltage quality and others.

### To diversify its sources of funding Latvenergo AS has executed the issuance of corporate bonds in 2012

To diversify its sources of funding, at the end of 2012 and at the beginning of 2013 Latvenergo AS has successfully executed two series of the issuance of corporate bonds in amount of EUR 50 million under the total LVL 50 million programme. Latvenergo Group maintains a stable capital structure and good liquidity ratios.

With the issuance of corporate bonds Latvenergo Group net debt as at 31 December 2012 has increased to LVL 424.8 million (2011: LVL 404.5 million). In 2012 all the binding financial covenants set in Latvenergo Group loan agreements have been met.

In 2012 AS Latvenergo rate by the Moody's Investors Service remains Baa3 with a stable outlook.

Latvenergo Group's activities are exposed to a variety of financial risks: market risk, credit risk, pricing risk and liquidity risk. The Group's risk management programme is focused on the unpredictability of financial markets and minimizing potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

### Main perspectives of the new strategy – strengthening its position in the Baltic electricity market

Latvenergo Group Strategy until 2016, approved at the end of 2012, forms a transparent and rational vision of pan-Baltic development during the opening of the Baltic electricity market and development of new electricity interconnections. Main perspectives of the strategy - strengthening its position in the Baltic electricity market, diversification of generating sources and balanced development of networks.

Overall we can conclude that operations of Latvenergo Group in 2012 are successful and have contributed to achieve objectives defined in Latvenergo Group strategy. We run our business by acknowledging of client needs, impact of our operations on environment and society in pan-Baltic. Development of Latvenergo Group will be continued in 2012.

## Post balance sheet events

On 19 April 2013 the Shareholders Meeting of Latvenergo AS decided to increase the aggregate principal amount of the notes to be issued under the Programme from 50 million lats or its equivalent in euro to 85 million lats or its equivalent in euro with book-entry within AS Latvian Central Depository and listing on AS NASDAQ OMX Riga.

There are no other post balance sheet events that would materially affect the financial position of the Group as at 31 December 2012.

## Statement of management responsibility

Based on the information available to the Management Board of Latvenergo AS in all material aspects Latvenergo Consolidated Annual Report 2012 have been prepared in accordance with applicable laws and regulations and gives a true and fair view of assets, liabilities, financial position and profit and loss of the Latvenergo Group. All information included in the Management report is true.

## Profit distribution

Fulfilling the requirements of the Law on state and municipality owned shares and companies, Regulations No. 1074 of the Cabinet of Ministers of Latvia dated 25 November 2010 On amendments of regulations No. 1471 dated 15 December 2009 On Procedure how the payable part of the profit for the use of the state's capital is determined and paid into the state's budget and the Law on state's budget for 2013, the Management Board of Latvenergo AS proposes to allocate LVL 28.5 million to be paid out in dividends, the rest of profit transfer to Latvenergo AS reserves.

The distribution of profit for 2012 is subject to a resolution of Latvenergo AS Shareholders' meeting.

### The Management Board of Latvenergo AS:



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Āris Žigurs,  
Chairman of the Board



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Zane Kotāne,  
Member of the Board



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Uldis Bariss,  
Member of the Board



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Māris Kuņickis,  
Member of the Board



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Arnis Kurgs,  
Member of the Board

23 April 2013



# 3. Consolidated Financial Statements

## Consolidated Income Statement

	NOTES	2012	2011	2012	2011
		LVL'000	LVL'000	EUR'000	EUR'000
Revenue	6	751,038	681,767	1,068,631	970,067
Other income	7	3,939	3,486	5,605	4,960
Raw materials and consumables used	8	(475,528)	(408,192)	(676,616)	(580,805)
Personnel expenses	9	(64,152)	(61,572)	(91,280)	(87,609)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	13.a, 14.a	(122,196)	(127,236)	(173,869)	(181,040)
Other operating expenses	10	(43,514)	(35,597)	(61,915)	(50,650)
<b>Operating profit</b>		<b>49,587</b>	<b>52,656</b>	<b>70,556</b>	<b>74,923</b>
Finance income	11.a	3,479	3,736	4,950	5,316
Finance costs	11.b	(11,250)	(13,956)	(16,007)	(19,858)
Share of profit of associates	15	253	232	360	330
<b>Profit before taxes</b>		<b>42,069</b>	<b>42,668</b>	<b>59,859</b>	<b>60,711</b>
Income tax	12	(6,328)	564	(9,003)	802
<b>Profit for the year from continuing operations</b>		<b>35,741</b>	<b>43,232</b>	<b>50,856</b>	<b>61,513</b>
<i>Discontinued operations (transmission system operator)</i>					
Profit for the year from discontinued operations	29	-	546	-	777
<b>Profit for the year</b>		<b>35,741</b>	<b>43,778</b>	<b>50,856</b>	<b>62,290</b>
Profit attributable to:					
- Owners of the Parent Company		35,302	43,328	50,231	61,650
- Non-controlling interest		439	450	625	640

## Consolidated Statement of Comprehensive Income

	NOTES	2012	2011	2012	2011
		LVL'000	LVL'000	EUR'000	EUR'000
<b>Profit for the year</b>		<b>35,741</b>	<b>43,778</b>	<b>50,856</b>	<b>62,290</b>
<b>Other comprehensive income:</b>					
Gains on revaluation of property, plant and equipment	20	68,829	81	97,935	115
Losses on currency translation differences		-	(14)	-	(19)
Losses from change in hedge reserve	20, 21.c	(4,883)	(4,335)	(6,948)	(6,168)
Other comprehensive income / (loss) for the year, net of tax		63,946	(4,268)	90,987	(6,072)
<b>TOTAL comprehensive income for the year</b>		<b>99,687</b>	<b>39,510</b>	<b>141,843</b>	<b>56,218</b>
<b>Attributable to:</b>					
- Owners of the Parent Company		99,248	39,060	141,218	55,578
- Non-controlling interest		439	450	625	640

The notes on pages 90 to 144 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:




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Āris Žigurs,  
Chairman of the Board




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Zane Kotāne,  
Member of the Board




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Uldis Bariss,  
Member of the Board




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Māris Kuņickis,  
Member of the Board




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Arnis Kurgs,  
Member of the Board

23 April 2013

## Consolidated Statement of Financial Position

	NOTES	31/12/2012	31/12/2011	31/12/2012	31/12/2011
		LVL'000	LVL'000	EUR'000	EUR'000
<b>ASSETS</b>					
<b>Non-current assets</b>					
Intangible assets	13.a	5,804	6,601	8,258	9,392
Property, plant and equipment	14.a	2,148,077	1,999,502	3,056,439	2,845,035
Investment property		1,116	-	1,588	-
Investments in associates	15	4,948	4,696	7,040	6,682
Other non-current receivables		32	125	45	178
Investments in held-to-maturity financial assets	21.a	20,134	15,670	28,649	22,296
<b>TOTAL non-current assets</b>		<b>2,180,111</b>	<b>2,026,594</b>	<b>3,102,019</b>	<b>2,883,583</b>
<b>Current assets</b>					
Inventories	16	15,604	13,949	22,203	19,848
Trade receivables	17.a	77,821	73,809	110,729	105,021
Other receivables	17.b	24,092	17,611	34,279	25,058
Derivative financial instruments	21.c	4,237	2,450	6,029	3,486
Investments in held-to-maturity financial assets	21.a	-	44,714	-	63,622
Cash and cash equivalents	18	170,425	108,877	242,493	154,918
<b>TOTAL current assets</b>		<b>292,179</b>	<b>261,410</b>	<b>415,733</b>	<b>371,953</b>
<b>TOTAL ASSETS</b>		<b>2,472,290</b>	<b>2,288,004</b>	<b>3,517,752</b>	<b>3,255,536</b>
<b>EQUITY</b>					
<b>Equity attributable to owners of the Parent Company</b>					
Share capital	19	904,605	325,862	1,287,137	463,660
Non-current assets revaluation reserve	20	465,738	974,899	662,685	1,387,156
Hedge reserve	20	(13,130)	(8,247)	(18,682)	(11,734)
Other reserves	20	77	10,269	110	14,611
Retained earnings		49,761	45,773	70,803	65,129
<b>Equity attributable to equity holders of the parent</b>		<b>1,407,051</b>	<b>1,348,556</b>	<b>2,002,053</b>	<b>1,918,822</b>
Non-controlling interest		3,459	3,020	4,922	4,297
<b>TOTAL equity</b>		<b>1,410,510</b>	<b>1,351,576</b>	<b>2,006,975</b>	<b>1,923,119</b>

	NOTES	31/12/2012	31/12/2011	31/12/2012	31/12/2011
		LVL'000	LVL'000	EUR'000	EUR'000
<b>LIABILITIES</b>					
<b>Non-current liabilities</b>					
Borrowings	21b	520,830	462,888	741,074	658,630
Deferred income tax liabilities	12	187,822	172,425	267,246	245,339
Provisions for post-employment benefits	22a	7,760	7,734	11,042	11,004
Environmental provisions	22b	2,748	1,783	3,910	2,537
Derivative financial instruments	21c	12,555	10,629	17,864	15,124
Other liabilities and deferred income	23	105,425	94,815	150,007	134,910
<b>TOTAL non-current liabilities</b>		<b>837,140</b>	<b>750,274</b>	<b>1,191,143</b>	<b>1,067,544</b>
<b>Current liabilities</b>					
Trade and other payables	24	135,999	121,214	193,509	172,472
Income tax payable		1,892	1,024	2,692	1,457
Borrowings	21b	74,405	50,446	105,869	71,778
Derivative financial instruments	21c	12,144	13,134	17,279	18,688
Issued guarantees	26	200	336	285	478
<b>TOTAL current liabilities</b>		<b>224,640</b>	<b>186,154</b>	<b>319,634</b>	<b>264,873</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>2,472,290</b>	<b>2,288,004</b>	<b>3,517,752</b>	<b>3,255,536</b>

The notes on pages 90 to 144 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:




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Āris Žigurs,  
Chairman of the Board




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Zane Kotāne,  
Member of the Board



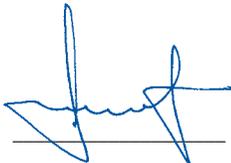

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Uldis Bariss,  
Member of the Board




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Māris Kuņickis,  
Member of the Board




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Arnis Kurgs,  
Member of the Board

23 April 2013

## Consolidated Statement of Changes in Equity

	ATTRIBUTABLE TO OWNERS OF THE PARENT COMPANY					Non-controlling interest	TOTAL	ATTRIBUTABLE TO OWNERS OF THE PARENT COMPANY					Non-controlling interest	TOTAL
	Share capital	Reserves	Retained earnings	TOTAL				Share capital	Reserves	Retained earnings	TOTAL			
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>As at 31 December 2010</b>	<b>323,544</b>	<b>972,278</b>	<b>46,356</b>	<b>1,342,178</b>	<b>2,570</b>	<b>1,344,748</b>	<b>460,362</b>	<b>1,383,427</b>	<b>65,958</b>	<b>1,909,747</b>	<b>3,657</b>	<b>1,913,404</b>		
Increase in share capital (Note 19)	2,318	-	-	2,318	-	2,318	3,298	-	-	3,298	-	3,298		
Dividends for 2010 (Note 20)	-	-	(35,000)	(35,000)	-	(35,000)	-	-	(49,801)	(49,801)	-	(49,801)		
Transfer to reserves	-	10,257	(10,257)	-	-	-	-	14,594	(14,594)	-	-	-		
<b>TOTAL contributions by and distributions to owners of the company, recognised directly in equity</b>	<b>2,318</b>	<b>10,257</b>	<b>(45,257)</b>	<b>(32,682)</b>	<b>-</b>	<b>(32,682)</b>	<b>3,298</b>	<b>14,594</b>	<b>(64,395)</b>	<b>(46,503)</b>	<b>-</b>	<b>(46,503)</b>		
Profit for the year	-	-	43,328	43,328	450	43,778	-	-	61,650	61,650	640	62,290		
<b>Other comprehensive income (Note 20):</b>														
Change in hedge reserve	-	(4,335)	-	(4,335)	-	(4,335)	-	(6,168)	-	(6,168)	-	(6,168)		
Currency translation differences	-	2	(16)	(14)	-	(14)	-	3	(22)	(19)	-	(19)		
Revaluation of PPE	-	81	-	81	-	81	-	115	-	115	-	115		
Disposal of revalued PPE	-	(1,362)	1,362	-	-	-	-	(1,938)	1,938	-	-	-		
<b>TOTAL other comprehensive income/(loss) for the year</b>	<b>-</b>	<b>(5,614)</b>	<b>1,346</b>	<b>(4,268)</b>	<b>-</b>	<b>(4,268)</b>	<b>-</b>	<b>(7,988)</b>	<b>1,916</b>	<b>(6,072)</b>	<b>-</b>	<b>(6,072)</b>		
<b>TOTAL comprehensive income/(loss) for the year</b>	<b>-</b>	<b>(5,614)</b>	<b>44,674</b>	<b>39,060</b>	<b>450</b>	<b>39,510</b>	<b>-</b>	<b>(7,988)</b>	<b>63,566</b>	<b>55,578</b>	<b>640</b>	<b>56,218</b>		
<b>As at 31 December 2011</b>	<b>325,862</b>	<b>976,921</b>	<b>45,773</b>	<b>1,348,556</b>	<b>3,020</b>	<b>1,351,576</b>	<b>463,660</b>	<b>1,390,033</b>	<b>65,129</b>	<b>1,918,822</b>	<b>4,297</b>	<b>1,923,119</b>		
Increase in share capital (Note 19)	578,743	(577,990)	-	753	-	753	823,477	(822,406)	-	1,071	-	1,071		
Dividends for 2011 (Note 20)	-	-	(39,900)	(39,900)	-	(39,900)	-	-	(56,773)	(56,773)	-	(56,773)		
Transfer from reserves	-	(10,257)	10,257	-	-	-	-	(14,594)	14,594	-	-	-		
<b>TOTAL contributions by and distributions to owners of the company, recognised directly in equity</b>	<b>578,743</b>	<b>(588,247)</b>	<b>(29,643)</b>	<b>(39,147)</b>	<b>-</b>	<b>(39,147)</b>	<b>823,477</b>	<b>(837,000)</b>	<b>(42,179)</b>	<b>(55,702)</b>	<b>-</b>	<b>(55,702)</b>		
Adjustments of revaluation reserve	-	-	(1,606)	(1,606)	-	(1,606)	-	-	(2,285)	(2,285)	-	(2,285)		
Profit for the year	-	-	35,302	35,302	439	35,741	-	-	50,231	50,231	625	50,856		
<b>Other comprehensive income (Note 20):</b>														
Change in hedge reserve	-	(4,883)	-	(4,883)	-	(4,883)	-	(6,948)	-	(6,948)	-	(6,948)		
Currency translation differences	-	65	(65)	-	-	-	-	93	(93)	-	-	-		
Revaluation of PPE	-	68,829	-	68,829	-	68,829	-	97,935	-	97,935	-	97,935		
<b>TOTAL other comprehensive income/(loss) for the year</b>	<b>-</b>	<b>64,011</b>	<b>(65)</b>	<b>63,946</b>	<b>-</b>	<b>63,946</b>	<b>-</b>	<b>91,080</b>	<b>(93)</b>	<b>90,987</b>	<b>-</b>	<b>90,987</b>		
<b>TOTAL comprehensive income for the year</b>	<b>-</b>	<b>64,011</b>	<b>33,631</b>	<b>97,642</b>	<b>439</b>	<b>98,081</b>	<b>-</b>	<b>91,080</b>	<b>47,853</b>	<b>138,933</b>	<b>625</b>	<b>139,558</b>		
<b>As at 31 December 2012</b>	<b>904,605</b>	<b>452,685</b>	<b>49,761</b>	<b>1,407,051</b>	<b>3,459</b>	<b>1,410,510</b>	<b>1,287,137</b>	<b>644,113</b>	<b>70,803</b>	<b>2,002,053</b>	<b>4,922</b>	<b>2,006,975</b>		

The notes on pages 90 to 144 are an integral part of these Consolidated Financial Statements.

## Consolidated Statement of Cash Flows

	NOTES	2012	2011	2012	2011
		LVL'000	LVL'000	EUR'000	EUR'000
<b>Cash flows from operating activities</b>					
Profit before tax		42,069	42,668	59,859	60,711
<b>Adjustments for:</b>					
- Amortisation, depreciation and impairment of non-current assets	13.a,14.a	122,196	127,236	173,869	181,040
- Loss from disposal of non-current assets		689	2,089	980	2,973
- Discontinued operations		-	546	-	777
- Investments accounting at equity method	15	(252)	(232)	(359)	(330)
- Interest expense	11.b	15,008	16,090	21,354	22,894
- Interest income	11.a	(2,502)	(3,465)	(3,560)	(4,931)
- Fair value (gains) / losses on derivative financial instruments	8, 11	(5,871)	9,284	(8,353)	13,209
- Changes in provisions	22	991	820	1,411	1,167
- (Gains) / losses on currency translation differences	11	(841)	748	(1,197)	1,065
Increase in inventories		(1,655)	(2,448)	(2,355)	(3,483)
Increase in receivables		(3,818)	(5,218)	(5,432)	(7,425)
Increase in trade and other payables		18,520	21,631	26,352	30,778
<b>Cash generated from operations</b>		<b>184,534</b>	<b>209,749</b>	<b>262,569</b>	<b>298,445</b>
Interest paid		(19,141)	(15,424)	(27,235)	(21,946)
Interest received		1,515	2,148	2,156	3,057
Income tax paid		(16,139)	(16,074)	(22,964)	(22,871)
<b>Net cash generated from operating activities</b>		<b>150,769</b>	<b>180,399</b>	<b>214,526</b>	<b>256,685</b>
<b>Cash flows from investing activities</b>					
Purchase of intangible assets and PPE		(175,996)	(182,301)	(250,420)	(259,391)
Proceeds on financing from EU funds		2,416	1,479	3,438	2,104
Purchase of held-to-maturity assets		(3,626)	(74,567)	(5,160)	(106,099)
Proceeds from redemption of held-to-maturity assets		44,974	17,180	63,992	24,445
<b>Net cash used in investing activities</b>		<b>(132,232)</b>	<b>(238,209)</b>	<b>(188,150)</b>	<b>(338,941)</b>
<b>Cash flows from financing activities</b>					
Proceeds on issued debt securities (bonds)		14,020	-	19,949	-
Proceeds on borrowings from financial institutions	21.b	116,947	4,357	166,401	6,199
Repayment of borrowings	21.b	(48,056)	(36,936)	(68,378)	(52,555)
Dividends paid		(39,900)	(35,000)	(56,773)	(49,800)
<b>Net cash generated/(used in) financing activities</b>		<b>43,011</b>	<b>(67,579)</b>	<b>61,199</b>	<b>(96,156)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>61,548</b>	<b>(125,389)</b>	<b>87,575</b>	<b>(178,412)</b>
Cash and cash equivalents at the beginning of the year	18	108,877	234,266	154,918	333,330
<b>Cash and cash equivalents at the end of the year</b>	<b>18</b>	<b>170,425</b>	<b>108,877</b>	<b>242,493</b>	<b>154,918</b>

The notes on pages 90 to 144 are an integral part of these Consolidated Financial Statements.

# Notes to the Consolidated Financial Statements

## 1. CORPORATE INFORMATION

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All of the shares of public limited company Latvenergo or Latvenergo AS (hereinafter – the Parent Company) are owned by the State of Latvia and are held by the Latvian Ministry of Economy. The registered address of the Company is 12 Pulkveža Brieža St., Riga, LV-1230, Latvia. Pursuant to the Latvian Energy Law, Latvenergo AS is designated as the business operations of national importance and, therefore, is not subject to privatisation.

The Parent Company is engaged in the production and sale of electrical power and heat, electricity trading, as well as provision of IT and telecommunication services in the territory of Latvia and the EU. The Parent Company is one of the largest corporate entities in Latvia.

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

- Sadales tīkls AS (18.09.2006.);
- Elektrum Eesti OÜ (27.06.2007.) and its subsidiary Elektrum Latvija SIA (18.09.2012.);
- Elektrum Lietuva UAB (07.01.2008.);
- Latvijas elektriskie tīkli AS (10.02.2011.);
- Liepājas enerģija SIA (06.07.2005.).

The Parent Company's associates:

- Nordic Energy Link AS carries out the functions of the operator of an interconnection power cable between Estonia and Finland;
- Pirmais Slēgtais Pensiju Fonds AS manages a defined-contribution corporate pension plan in Latvia.

The Parent Company's participating interest in subsidiaries and associates is disclosed in Note 15.

Since 15 August 2011 until the date of signing off this Annual Report, the Management Board of Latvenergo AS includes the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Arnis Kurgs and Zane Kotāne.

The Consolidated Financial Statements for year 2012 include the financial information in respect of the Parent Company and its all subsidiaries (hereinafter – the Group) for the annual period ending 31 December 2012 and comparative information for year 2011.

Latvenergo AS Management Board has approved for issue the Consolidated Financial Statements on 23 April 2013. The decision on approval of the Consolidated Financial Statements is made by Shareholder's meeting.



## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these Consolidated Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. Where it necessary comparatives are reclassified.

### 2.1. Basis of Preparation

The Consolidated Financial Statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted for use in the European Union. Due to the European Union's endorsement procedure, the standards and interpretation not approved for use in the European Union are presented in this note as they may have impact on the Consolidated Financial Statements in the following periods if endorsed.

The Consolidated Financial Statements are prepared under the historical cost convention, as modified by the revaluation of land and buildings, financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss as disclosed in accounting policies presented below.

All amounts shown in these Consolidated Financial Statements are presented in thousands of Latvian Lats (LVL), and are translated into Euros (EUR) using official currency rate of the Bank of Latvia 1EUR = 0.702804 LVL.

The preparation of the Consolidated Financial Statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the Parent Company Management's best knowledge of current events and actions, actual results ultimately may differ from those. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the Consolidated Financial Statements are disclosed in Note 4.

#### **Adoption of new and revised standards and interpretations**

Certain new IFRSs became effective for the Group from 1 January 2012.

- **Amendment to IFRS 7 Financial Instruments - Enhanced De-recognition Disclosure Requirements**
- **Amendment to IAS 12 Income tax: Deferred tax - Recovery of Underlying Assets**

The amendments did not impact the financial statements of the Group or its financial position, because the Group did not have items or transactions addressed by these changes.

- **IFRS 8 Operating segments**

IFRS 8 is obligatory applied to financial statements of entities whose debt or equity instruments are traded in public market (or entities that prepares, or are in the process of preparing its financial statements for the purpose of issuing financial instruments).

Preparing financial statements for year 2012 the Group has applied this standard and has reported its operating segments according to IFRS 8 requirements (see Note 5). To report information on the Group operating segments – business segments, the Group has reported its core segments based on the Group's internal management structure, which is the basis for Group's operating segments regular performance assessment and decision making.

#### **Standards issued but not yet effective**

The Group has not applied the following IFRS and IFRIC interpretations that have been issued as of the date of authorisation of these financial statements for issue, but which are not yet effective:

- **Amendment to IAS 1 Financial Statement Presentation - Presentation of Items of Other Comprehensive Income** (effective for financial years beginning on or after 1 July 2012)

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for

example, upon de-recognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has no impact on the Group's financial position or performance. The Group has not yet evaluated the impact of the implementation of this amendment.

- **Amendment to IAS 19 Employee Benefits** (effective for financial years beginning on or after 1 January 2013)

There are numerous amendments to IAS 19, they range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The Group has not yet evaluated the impact of the implementation of this amendment.

- **Amendment to IAS 27 Separate Financial Statements** (effective for financial years beginning on or after 1 January 2014)

As a result of the new standards IFRS 10, IFRS 11 and IFRS 12 this standard was amended to contain accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. IAS 27 Separate Financial Statements requires an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9 Financial Instruments. The implementation of this amendment will not have any impact on the financial statements of the Group.

- **Amendment to IAS 28 Investments in Associates and Joint Ventures** (effective for financial years beginning on or after 1 January 2013)

As a result of the new standards IFRS 10, IFRS 11 and IFRS 12 this standard was renamed and addresses the application of the equity method to investments in joint ventures in addition to associates. The implementation of this amendment will not have any impact on the financial statements of the Group.

■ **Amendment to IAS 32 Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities** (effective for financial years beginning on or after 1 January 2014)

This amendment clarifies the meaning of „currently has a legally enforceable right to set-off“ and also clarifies the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The Group has not yet evaluated the impact of the implementation of this amendment.

■ **Amendment to IFRS 7 Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities** (effective for financial years beginning on or after 1 January 2013)

The amendment introduces common disclosure requirements. These disclosures would provide users with information that is useful in evaluating the effect or potential effect of netting arrangements on an entity's financial position. The amendments to IFRS 7 are to be retrospectively applied. The Group has not yet evaluated the impact of the implementation of this amendment.

■ **IFRS 9 Financial Instruments – Classification and Measurement** (effective for financial years beginning on or after 1 January 2015, once endorsed by the EU)

IFRS 9 will eventually replace IAS 39. The IASB has issued the first two parts of the standard, establishing a new classification and measurement framework for financial assets and requirements on the accounting for financial liabilities. The Group has not yet evaluated the impact of the implementation of this standard.

■ **IFRS 10 Consolidated Financial Statements** (effective for financial years beginning on or after 1 January 2014)

IFRS 10 establishes a single control model that applies to all entities, including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled and, therefore, are required to be consolidated by a parent. Examples of areas of significant judgment include evaluating de facto control, potential voting rights or whether a decision maker is acting as a principal or agent. IFRS 10 replaces the part of IAS 27 Consolidated and Separate Financial Statements related to consolidated financial statements

and replaces SIC 12 Consolidation — Special Purpose Entities. The Group has not yet evaluated the impact of the implementation of this standard.

■ **IFRS 11 Joint Arrangements** (effective for financial years beginning on or after 1 January 2014)

IFRS 11 eliminates proportionate consolidation of jointly controlled entities. Under IFRS 11, jointly controlled entities, if classified as joint ventures (a newly defined term), must be accounted for using the equity method. Additionally, jointly controlled assets and operations are joint operations under IFRS 11, and the accounting for those arrangements will generally be consistent with today's accounting. That is, the entity will continue to recognize its relative share of assets, liabilities, revenues and expenses. The Group has not yet evaluated the impact of the implementation of this standard.

■ **IFRS 12 Disclosures of Interests in Other Entities** (effective for financial years beginning on or after 1 January 2014)

IFRS 12 combines the disclosure requirements for an entity's interests in subsidiaries, joint arrangements, investments in associates and structured entities into one comprehensive disclosure standard. A number of new disclosures also will be required such as disclosing the judgments made to determine control over another entity. The Group has not yet evaluated the impact of the implementation of this standard.

■ **Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment Entities** (effective for financial years beginning on or after 1 January 2014, once endorsed by the EU)

The amendments apply to entities that qualify as investment entities. The amendments provide an exception to the consolidation requirements of IFRS 10 by requiring investment entities to measure their subsidiaries at fair value through profit or loss, rather than consolidate them. The implementation of this amendment will not have any impact on the financial statements of the Group, as the parent of the Group is not an investment entity.

■ **IFRS 13 Fair Value Measurement** (effective for financial years beginning on or after 1 January 2013)

The main reason of issuance of IFRS 13 is to reduce complexity and improve consistency in application when measuring fair value. It does not change when an entity is required to use fair value but, rather, provides guidance on how to measure fair value under IFRS when fair value

is required or permitted by IFRS. The Group has not yet evaluated the impact of the implementation of this standard.

■ **Improvements to IFRSs** (effective for financial years beginning on or after 1 January 2013, once endorsed by the EU)

In May 2012 IASB issued omnibus of necessary, but non-urgent amendments to its five standards:

- IFRS 1 First-time adoption of IFRS;
- IAS 1 Presentation of Financial Statements;
- IAS 16 Property, Plant and Equipment;
- IAS 32 Financial instruments: Presentation;
- IAS 34 Interim Financial Reporting.

The adoption of these amendments may result in changes to accounting policies but will not have any impact on the financial position or performance of the Group.

■ **IFRIC Interpretation 20 Stripping Costs in the Production Phase of a Surface Mine** (effective for financial years beginning on or after 1 January 2013)

This interpretation applies to stripping costs incurred in surface mining activity during the production phase of the mine ('production stripping costs'). Interpretation will have no impact on the Group's financial statements, as the Group is not involved in mining activity.

The Group plans to adopt the above mentioned standards and interpretations on their effectiveness date provided they are endorsed by the EU.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

## 2.2. Consolidation

### **a) Subsidiaries**

Subsidiaries, which are those entities where the Group has control over the financial and operating policies of the entity, financial reports are consolidated. The existence of control is assumed when the Parent Company voting rights in the subsidiary is more than 50%.

Subsidiaries' financial reports are consolidated from the date on which control is transferred to the Parent Company and are no longer consolidated from the date when control ceases. General information about entities included in consolidation and its primary business activities are disclosed in Note 15.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured, as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Costs directly attributable to the acquisition are expensed to the Consolidated Income Statement as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in business combination are measured initially at their fair values at the acquisition date. Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in the income statement.

Intercompany transactions, balances and unrealised gains on transactions between the Group's entities are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

### **b) Transactions with non-controlling interests**

The Group treats transactions with non-controlling interests as transactions with equity owners of the Group's Parent Company. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in the Group's equity.

### **c) Associates**

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognized at cost. Under this method the Group's share of its associate's post-acquisition profits and losses is recognized in the Consolidated Income Statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in associate equals or exceeds its interest in associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

## 2.3. Disclosures of operating segments

For segment reporting purposes the Group allocates division into operating segments 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 chief operating decision maker, the parent company's management board.

The Group allocates its operations into three main operating segments – generation and supply, distribution system services and management of transmission system assets. In addition Corporate Functions, that covers administration and other support services, are presented separately.

## 2.4. Foreign currency translation

### **a) Functional and presentation currency**

Items included in the Consolidated Financial Statements are measured using the currency of the primary economic environment in which the Group's entity operates („the functional currency“). The Consolidated Financial Statements have been prepared in Latvian Lats (LVL), which is the Parent's functional, and the Group's second presentation currency – Euro (EUR).

### **b) Transactions and balances**

All transactions denominated in foreign currencies are translated into functional currency at the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into functional currency using the exchange rate at the last day of the reporting year. The resulting gain or loss is charged to the Consolidated Income Statement.

### **c) Consolidation of the Group's foreign companies**

The results and financial position of all the Group's entities (none of which has the currency of a hyper-inflationary economy) that have functional currency different from the presentation currency are translated into the presentation currency as follows:

- 1) Assets and liabilities for each financial position presented are translated at the closing rate at the date of that financial position;
- 2) Income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of transactions).

## 2.5. Intangible assets

### a) Licenses and software

Licenses and software are shown at historical cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of licenses and software over their estimated useful lives (5 years). Computer software development costs recognized as assets are amortised over their estimated useful lives, not exceeding a period of five years.

### b) Greenhouse gas emission allowances

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost. Allowances received from the Government free of charge are recognised at zero cost. Emission rights are recognised at cost when the Group is able to exercise the control. In case the quantity of emitted greenhouse gases exceeds the quantity of allowances allocated by the state free of charge, a provision is set up for the difference based on the market price of greenhouse gas emission allowances at the reporting period. Allowances are accounted for within 'Intangible assets' (see Note 13 b). The forward agreements for purchase or sale of emission allowances for trade rather than for own uses in the Group are defined as derivatives (see points 2.21 b), 3.3 and Note 21 c), IV).

## 2.6. Property, plant and equipment

All property, plant and equipment (PPE) are stated at historical cost or revalued amount (see point 2.9) less accumulated depreciation and accumulated impairment loss.

The cost comprises the purchase price, transportation costs, installation, and other direct expenses related to the acquisition or implementation. The cost of the self-constructed item of PPE includes the cost of materials, services and workforce. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of an item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance expenses are charged directly to the Consolidated Income Statement when the expenditure is incurred. Borrowing costs are capitalised proportionally to the part of the cost of fixed assets under construction over the period of construction. Effective part of the changes in the fair value of forward foreign currencies exchange contracts,

the purpose of which is to hedge currency exchange risk on PPE items, are also capitalised and included in the Consolidated Income Statement along with the expenses of depreciation over the useful life of the asset or at the disposal of the asset.

If an item of PPE consists of components with different useful lives, these components are depreciated as separate items.

Type of property, plant and equipment	Estimated useful life, years
<b>Buildings and facilities, including</b>	
- Hydropower plants, thermal power plants	15 – 80
- Electricity transmission lines	30 – 50
- Electricity distribution lines	20 – 30
<b>Technology equipment and machinery, including</b>	
- Hydropower plants	3 – 12
- Thermal power plants	3 – 10
- Transmission and distribution machinery and equipment	10
<b>Other property, plant and equipment</b>	<b>2 – 5</b>

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see point 2.8).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. Those are included in the Consolidated Income Statement. If revalued property, plant and equipment have been sold, appropriate amounts are reclassified from revaluation reserve to retained earnings of previous accounting periods.

Homogenous items with similar useful lives are accounted for in groups.

Land is not depreciated. Depreciation on the other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives, as follows:

All assets under construction are stated at historical cost and comprised costs of construction of fixed assets and assets under construction. The initial cost includes construction and installation costs and other direct costs related to construction of fixed assets. Assets under construction are not depreciated as long as the relevant assets are completed and assigned for the operation.

## 2.7. Leases

### *a) The Group is the lessee*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the Consolidated Income Statement on a straight-line basis over the period of the lease.

### *b) The Group is the lessor*

Assets leased out under operating leases are recorded within property, plant and equipment at historic cost less depreciation. Depreciation is calculated on a straight-line basis to write down each asset to its estimated residual value over estimated useful life. Rental income from operating lease and advance payments received from clients (less any incentives given to lessee) are recognised in the Consolidated Income Statement on a straight-line basis over the period of the lease.

## 2.8. Impairment of non-financial assets

Assets that are subject to depreciation or amortisation and land are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market expectations regarding the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognised in the other comprehensive income within PPE revaluation reserve for the assets accounted at revalued amount and in the Consolidated Income Statement within amortisation, depreciation and impairment charge expenses for the assets that are accounted at amortised historical cost and for the assets accounted at revalued amount in case if impairment charge exceeds revaluation surplus previously recognised on individual asset.

The key assumptions used in determining impairment losses are based on the Group entities' or the Parent Company's management best estimation of the range of economic conditions that will exist over the remaining useful life of the asset, on the basis of the most recent financial budgets and forecasts approved by the management for a maximum period of 10 years. Assets are reviewed for possible reversal of the impairment at each reporting date. The reversal of impairment is recognised in the Consolidated Income Statement. Reversal of impairment loss for revalued assets is recognised in the Consolidated Income Statement to the extent that an impairment loss on the same revalued asset was previously recognised the income statement; the remaining reversals of impairment losses of revalued assets are recognised in Other Comprehensive Income.

## 2.9. Revaluation of property, plant and equipment

Revaluations have been made with sufficient regularity to ensure that the carrying amount of property, plant and equipment items subject to valuation does not differ materially from that which would be determined using fair value at the end of reporting period.

The following property, plant and equipment groups are revalued regularly but not less frequently than every five years:

### *a) Buildings and facilities, including*

- Daugava hydropower plants' buildings and facilities,
- Buildings and facilities of transmission system,
- Buildings and facilities of distribution system;

### *b) Technology equipment and machinery, including*

- Daugava hydropower plants' technology equipment and machinery,
- Technology equipment and machinery of electricity transmission system,
- Technology equipment and machinery of electricity distribution system;

### *c) Other property, plant and equipment, including*

- Other PPE of Daugava hydropower plants',
- Other PPE of transmission system,
- Other PPE of distribution system.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the Consolidated Statement of Financial Position as „Property, plant and equipment revaluation reserve” in shareholders' equity. Decreases that offset previous increases of the same asset are charged in 'Other comprehensive income' and debited against the revaluation reserve directly in equity; all other decreases are charged to the current year's Consolidated Income Statement. Any accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after the revaluation equals its revalued amount.

Property, plant and equipment revaluation reserve is decreased at the moment, when revalued asset has been eliminated or disposed.

Revaluation reserve cannot be distributed in dividends, used for indemnity, reinvested in other reserves, or used for other purposes.

## 2.10. Inventories

Inventories are stated at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost is determined using the weighted average method.

Purchase cost of inventories consists of the purchase price, import charges and other fees and charges, freight-in and related costs as well as other costs directly incurred in bringing the materials and goods to their present location and condition. The value of inventories is assigned by charging trade discounts, reductions and similar allowances.

Amount of inventories as of the end of reporting period is verified during inventory count.

At the end of each reporting year the inventories are reviewed for any indications of obsolescence. In cases when obsolete or damaged inventories are identified allowances are recognised. During the reporting year at least each month has revaluation of the inventories been performed

with purpose to identify obsolete and damaged inventories. Provisions for an impairment loss are recognised for those inventories.

The following basic principles are used in determining impairment losses for idle and obsolete inventories:

- Machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 12 months are impaired in amount of 90%,
- Other inventories that haven't turned over during last 12 months are fully impaired,
- Machinery and equipment of hydropower plants and thermal power plants that haven't turned over during last 6 months are impaired in amount of 45%,
- Other inventories that haven't turned over during last 6 months are impaired in amount of 50%,
- Allowances are not calculated for the inventory of heating materials necessary to ensure uninterrupted operations of heat power plants,
- Allowances are not calculated for scrap metal obtained in the process of fixed assets' dismantling, which are accounted at lower carrying value or realisable value.

## 2.11. Trade and other receivables

Trade receivables are recognized initially at fair value and subsequently measured at amortised cost, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of repayment.

Significant financial difficulties of the debtor, probabilities that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered as indicators that the trade receivable is impaired.

An allowance for impairment of doubtful debts is calculated on the basis of trade receivables aging analysis according to estimates defined by the Group entities and the Parent Company's management, which are revised at least once a year. Allowances for electricity trade receivables are calculated for debts overdue 45 days, and, if the debt is overdue for more than 181 day, allowances are established at 100%. For other trade receivables allowances are

calculated for debts overdue 31 day, and, if the date of payment is overdue for more than 91 day, allowances are established at 100% (see Note 17 a). Individual impairment assessments are performed for the debtors if their debt balance exceeds LVL 500 thousand or EUR 711 thousand and debt repayment schedule has been individually agreed. The level of allowance for such type of debtors is based on the individual risk assessment of insolvency probability.

The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Consolidated Income Statement within selling and customer services costs. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against selling and customer services costs in the Consolidated Income Statement.

## 2.12. Cash and cash equivalents

Cash and cash equivalents include cash balances on bank accounts, demand deposits at bank and other short-term deposits with original maturities of three months or less.

## 2.13. Dividend distribution

Dividend distribution to the Parent Company's shareholders is recognised as a liability in the Consolidated Financial Statements in the period in which the dividends are approved by the Parent Company's shareholders.

## 2.14. Pensions and employment benefits

### a) Pension obligations

The Group makes monthly contributions to a closed defined contribution pension plan on behalf of its employees. The plan is managed by the non-profit public limited company Pirmais Slēgtais Pensiju Fonds, with the participation of the Group companies amounting for 50% of its share capital. A defined contribution plan is a pension plan under which the Group pays contributions into the plan. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior periods. The contributions amount to 5% of each pension plan member's salary. The Group recognizes the

contributions to the defined contribution plan as an expense when an employee has rendered services in exchange for those contributions.

### b) Provisions for post-employment obligations arising from collective agreement

In addition to the aforementioned plan, the Group provides certain post-employment benefits to employees whose employment meets certain criteria. Obligations for benefits are calculated taking into account the current level of salary and number of employees eligible to receive the payment, historical termination rates as well as number of actuarial assumptions.

The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

The liability recognised in the Consolidated Statement of Financial Position in respect of post-employment benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds. The Group uses projected unit credit method to establish its present value of fixed benefit obligation and related present and previous employment expenses. According to this method it has been stated that each period of work makes benefit obligation extra unit and the sum of those units comprises total Group's obligations of post-employment benefits. The Group uses objective and mutually compatible actuarial assumptions on variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

Actuarial gains or losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Consolidated Income Statement in the period in which they arise. Past service costs are recognised immediately in the Consolidated Income Statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

## 2.15. Income tax

### a) Corporate income tax

#### *Latvia and Lithuania*

Income tax expense for the period comprises current income tax and deferred income tax. Current income tax charges are calculated on current profit before tax using the tax rate 15% in accordance with applicable tax regulations as adjusted for certain non-deductible expenses/non-taxable income and are based on the taxable income reported for the taxation period.

#### *Estonia*

Under the Income Tax Act, the annual profit earned by entities is not taxed in Estonia. Corporate income tax is paid on dividends, fringe benefits, gifts, donations, costs of entertaining guests, non-business related disbursements and adjustments of the transfer price. From 1 January 2008, the tax rate on the net dividends paid out of retained earnings is 21/79. In certain circumstances, it is possible to distribute dividends without any additional income tax expense. The corporate income tax arising from the payment of dividends is accounted for as a liability and expense in the period in which dividends are declared, regardless of the actual payment date or the period for which the dividends are paid.

### b) Deferred income tax

#### *Latvia and Lithuania*

Deferred income tax is provided in full, using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax is determined using tax rates (and laws) that have been enacted by the end of reporting period and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit of the respective Group entity will be available against which the temporary differences can be utilized.

Tax incentives for new technological equipment are not considered when calculated deferred income tax.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

#### *Estonia*

Due to the nature of the taxation system, the entities registered in Estonia do not have any differences between the tax bases of assets and their carrying amounts and hence, no deferred income tax assets and liabilities arise.

## 2.16. Borrowings

Borrowings are recognised initially at fair value. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the Consolidated Income Statement over the period of the borrowings.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability at least for 12 months after the end of reporting period.

## 2.17. Borrowing costs

General and specific borrowing costs directly attributable to the acquisition or construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

## 2.18. Provisions

Provisions are recognised when the Group has a present obligation as a result of past event; it is probable that an outflow of resources embodying economic benefits will be

required to settle the obligation, and when a reliable estimate can be made of the amount of the obligation. Provisions are not recognized for future operating losses.

Provisions are presented in the Consolidated Statement of Financial Position at the best estimate of the expenditure required to settle the present obligation at the end of reporting period. Provisions are used only for expenditures for which the provisions were originally recognized and are reversed if an outflow of resources is no longer probable.

Provisions are measured at the present value of the expenditures expected to be required settling the obligation by using pre-tax rate that reflects current market assessments of the time value of the money and the risks specific to the obligation as a discount rate. The increase in provisions due to passage of time is recognized as interest expense.

Environmental protection provisions are recognised to cover environmental damages that have occurred before the end of the reporting period when this is required by law or when the Group's past environmental policies have demonstrated that the Group has a constructive present obligation to liquidate this environmental damage. Experts' opinions and prior experience in performing environmental work are used to set up the provisions (see Note 22 b).

## 2.19. Grants

Property, plant and equipment received at nil consideration are accounted for as grants. Grants are recognised at fair value as deferred income and are credited to the Consolidated Income Statement on a straight-line basis over the expected lives of the related assets.

### *Financing provided by European Union funds*

The Group ensures the management, application of internal controls and accounting for the Group's projects financed by the European Union funds, according to the guidelines of the European Union and legislation of the Republic of Latvia.

Accounting of the transactions related to the projects financed by the European Union is ensured using separately identifiable accounts. The Group ensures separate accounting of financed projects with detailed income and expense, non-current investments and value added tax in the relevant positions of the Group's Consolidated Income Statement and Consolidated Statement of Financial Position.

## 2.20. Financial instruments – initial recognition, subsequent measurement and de-recognition

### **a) Financial assets**

#### *I) Initial recognition and measurement*

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

All financial assets are recognised initially at fair value plus transaction costs, except in the case of financial assets recorded at fair value through profit or loss.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

#### *II) Subsequent measurement*

##### **Financial assets at fair value through profit or loss**

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the income statement. Financial assets designated upon initial recognition at fair value through profit or loss are designated at their initial recognition date and only if the criteria under IAS 39 are satisfied. The Group has not designated any financial assets at fair value through profit or loss.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held for trading or designated at fair value through profit or loss.

These embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss.

### **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the EIR method, less impairment. The losses arising from impairment are recognised in the income statement in finance costs for loans and in cost of sales or other operating expenses for receivables.

### **Held-to-maturity investments**

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held to maturity when the Group has the positive intention and ability to hold them to maturity. After initial measurement, held to maturity investments are measured at amortised cost using the EIR, less impairment.

### *III) De-recognition*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- 1) the rights to receive cash flows from the asset have expired,
- 2) the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

### **b) Financial liabilities**

#### *I) Initial recognition and measurement*

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, bank overdrafts, loans and borrowings, financial guarantee contracts, and derivative financial instruments.

#### *II) Subsequent measurement*

##### **Financial liabilities at fair value through profit or loss**

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. This category includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement.

### **Loans and borrowings**

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the income statement.

### *III) De-recognition*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de-recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

## 2.21. Derivative financial instruments and hedging activities

The Group uses derivatives such as forward foreign exchange contracts, interest rate swaps, electricity swaps and CO<sub>2</sub> emission allowances forward contracts to hedge risks associated with currency exposures, the interest rate and purchase price fluctuations.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate (see point 3.3).

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The Group designates certain derivatives as hedges of a particular risk associated with a recognised liability or highly probable forecast transactions denominated in foreign currency (cash flow hedge), other derivatives are accounted for at fair value through profit or loss.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of the derivative instruments is presented as current or non-current based on settlement date. Derivative instruments that have maturity of more than twelve months and have been expected to be held for more than twelve months after the end of the reporting year are classified as non-current assets or liabilities. Those derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

### **a) Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in equity within 'Hedging reserve'. The gain or loss relating to the ineffective portion, if such arise, would be recognised immediately in the Consolidated Income Statement.

Amounts accumulated in equity are recycled in the Consolidated Income Statement in the periods when the hedged item affects profit or loss.

The gain or loss relating to the ineffective portion of electricity swaps hedging variable electricity prices and interest rate swaps hedging variable rate borrowings is recognised in the Consolidated Income Statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the Consolidated Income Statement.

### **b) Financial assets at fair value through profit and loss**

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

Changes in the fair value of derivatives at fair value through profit or loss, ineffective part of changes in the fair value of hedging derivatives and amounts accumulated in equity that are recycled to the Consolidated Income Statement, are classified according to the purpose of the derivatives – gains/losses from electricity SWAP agreements and CO<sub>2</sub> forward contracts are recognised within 'Raw materials and consumables used', while gains/losses from interest rate SWAP agreements and forward foreign currencies exchange contracts are recognised within 'Finance costs' or 'Finance income'.

## 2.22. Revenue recognition

Revenue comprises the value of goods sold and services rendered in the ordinary course of the Group's activities. The Latvian regulatory authority (Public Utilities Commission) determines tariffs for electricity and heat. Revenue is measured at the fair value of the consideration received or receivable, net of value-added tax, estimated returns, rebates and discounts. Revenue is recognized as follows:

### **a) Electricity sales**

The Group records electricity sales to residential customers on the basis of reported meter readings. Where relevant, this includes an estimate of the electricity supplied between the date of the last meter reading and the year-end. Electricity sales to corporate customers are recognized on the basis of issued invoices according to meter readings of customers. Revenues from electricity sales to associated users are based on regulated tariffs approved by Public Utilities Commission, while revenues from market participants - on contractual prices included in electricity trade agreements. Revenues from trade of electricity in energy exchanges NordPool and BaltPool are based on the calculated market prices.

### **b) Heat sales**

The Group recognizes revenue from sales of thermal energy at the end of each month on the basis of the meter readings.

### **c) Connection fees**

When connecting to the electricity network, the clients must pay a connection fee that partly reimburses for the cost of infrastructure to be built to connect the client to the network. Connection fees are carried in the Consolidated Statement of Financial Position as deferred income and amortized to Consolidated Income Statement on a straight-line basis over the estimated customer relationship period.

### **d) Sales of transmission and distribution services**

Revenues from electricity transmission and distribution services are based on regulated tariffs that are subject to approval by the Public Utilities Commission. The Group recognizes revenue from sales of transmission and distribution services at the end of each month on the basis of the automatically made meter readings or customers' reported meter readings.

### **e) Sales of IT & telecommunication services**

Revenues derived from information technology services (internet connection services, data communication services), open electronic communication network and telecommunication services to customers are recognised on the basis of invoices which are prepared for clients upon either usage of services listed in telecommunications billing system.

#### **f) Interest income**

Interest income is recognized using the effective interest method. Interest income is recorded in the Consolidated Income Statement as „Finance income“.

#### **g) Dividend income**

Revenue is recognised when the Group's right to receive the payment is established, which is generally when shareholders approve the dividend.

### 2.23. Related parties

The parties are considered related when one party has a possibility to control the other one or has significant influence over the other party in making financial and operating decisions.

### 2.24. Non-current assets held for sale

The Group classifies non-current assets as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use, and sale will be considered highly probable. Non-current assets held for sale are measured at the lower of their carrying amount and fair value less costs of selling.

### 2.25. Share capital

The Group's share capital consists of ordinary shares.

### 2.26. Trade payables

The Group's trade payables are recognized initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

### 2.27. Investment property

Investment properties are land or a building or part of a building held by the Group as the owner to earn rentals or for capital appreciation, rather than for use in the production of goods or supply of services or for administrative purposes, or sale in the ordinary course of business. The investment properties are initially recognised and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses. The applied depreciation rates are based on estimated useful life set for respective fixed asset categories – from 15 to 80 years.

### 2.28. Held-to-maturity investments

Held-to-maturity financial assets are non-derivative financial assets, quoted on an active market, with fixed or determinable payments and fixed maturities that the Group's Management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available for sale. Held-to-maturity financial assets with maturities more than 12 months from the end of the reporting period are included in non-current assets; however those with maturities less than 12 months from the end of the reporting period are classified as current assets.

The Group follows the IAS 39 guidance on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. This classification requires significant judgement. In making this judgement, the Group evaluates its intention and ability to hold such investments to maturity.

If the Group fails to keep these investments to maturity other than for specific circumstances explained in IAS 39, it will be required to reclassify the whole class as available-for-sale. Therefore the investments would be measured at fair value not at amortised cost.

Purchases and sales of financial assets held-to-maturity are recognized on trade date – the date on which the Group commits purchase of the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired. Held-to-maturity financial assets are carried at amortised cost using the effective interest rate method, net of accumulated impairment losses. Gains and losses arising from changes in the amortised value of the financial instruments are included in the Consolidated Income Statement in the period in which they arise.

### 2.29. Issued guarantees

Guarantees issued are initially recognised at fair value, which is usually equal to the premium received. Subsequently they are measured at the higher of the amount expected to be paid and the amount initially recognised less accumulated amortisation.

### 2.30. Events after the reporting period

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



## 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 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 derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

#### Financial assets and liabilities by categories

	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through profit or loss	Held-to-maturity assets	Loans and receivables	Derivatives used for hedging	Financial assets at fair value through profit or loss	Held-to-maturity assets
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Financial assets as at 31 December 2012</b>								
Derivative financial instruments (Note 21 c, I)	-	4,237	-	-	-	6,029	-	-
Trade receivables, net (Note 17 a)	77,821	-	-	-	110,729	-	-	-
Other non-current receivables	32	-	-	-	45	-	-	-
Accrued income and other financial current receivables (Note 17 b)	7,693	-	-	-	10,946	-	-	-
Held-to-maturity financial assets (Note 21 a)	-	-	-	20,134	-	-	-	28,649
Cash and cash equivalents (Note 18)	170,425	-	-	-	242,493	-	-	-
	<b>255,971</b>	<b>4,237</b>	<b>-</b>	<b>20,134</b>	<b>364,213</b>	<b>6,029</b>	<b>-</b>	<b>28,649</b>
<b>Financial assets as at 31 December 2011</b>								
Derivative financial instruments (Note 21 c, I)	-	2,345	105	-	-	3,337	149	-
Trade receivables, net (Note 17 a)	73,809	-	-	-	105,021	-	-	-
Other non-current receivables	125	-	-	-	178	-	-	-
Accrued income and other financial current receivables (Note 17 b)	7,595	-	-	-	10,807	-	-	-
Held-to-maturity financial assets (Note 21 a)	-	-	-	60,384	-	-	-	85,919
Cash and cash equivalents (Note 18)	108,877	-	-	-	154,918	-	-	-
	<b>190,406</b>	<b>2,345</b>	<b>105</b>	<b>60,384</b>	<b>270,924</b>	<b>3,337</b>	<b>149</b>	<b>85,919</b>

	Derivatives used for hedging	Other financial liabilities at amortised cost	Liabilities at fair value through the profit or loss	Derivatives used for hedging	Other financial liabilities at amortised cost	Liabilities at fair value through the profit or loss
	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000
<b>Financial liabilities as at 31 December 2012</b>						
Borrowings (Note 21 b)	-	595,235	-	-	846,943	-
Derivative financial instruments (Note 21 c, I)	17,367	-	7,332	24,711	-	10,432
Issued guarantees (Note 26)	-	-	200	-	-	285
Trade and other payables (Note 24)	-	97,790	-	-	139,142	-
	<b>17,367</b>	<b>693,025</b>	<b>7,532</b>	<b>24,711</b>	<b>986,085</b>	<b>10,717</b>
<b>Financial liabilities as at 31 December 2011</b>						
Borrowings (Note 21 b)	-	513,334	-	-	730,408	-
Derivative financial instruments (Note 21 c, I)	10,592	-	13,171	15,071	-	18,741
Issued guarantees (Note 26)	-	-	336	-	-	478
Trade and other payables (Note 24)	-	78,161	-	-	111,213	-
	<b>10,592</b>	<b>591,495</b>	<b>13,507</b>	<b>15,071</b>	<b>841,621</b>	<b>19,219</b>

## a) Market risk

### I) Foreign exchange risk

The Group is exposed to currency risk primarily arising from settlements in foreign currencies for recognized assets and liabilities (mainly, borrowings), capital expenditures and imported electricity.

However, the peg of Lat to Euro at the beginning of the year 2005 resulted in limited EUR / LVL currency risk, as the Group had no any substantial liabilities in any other foreign currency except Euro. At 31 December 2012 the Group had none of their borrowings denominated in other currencies than the Euro (Note 21 b).

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 recognized assets and liabilities, the Group uses forward contracts, transacted by the Group Treasury. Foreign currencies exchange risk arises when future transactions or recognized assets or liabilities are denominated in a currency that is not the Group's functional currency or Euro.

Except for the transactions described below the Group does not have any material balances of financial assets and liabilities denominated in currencies other than LVL and EUR. The Group Treasury's Financial Risk Management Policy

is to hedge all anticipated cash flows (capital expenditure and purchase of inventory) in each major foreign currency that might create significant currency risk. During 2012 the Group had one committed capital expenditure project whose expected transactions in USD created significant currency risk and qualified as 'highly probable' forecast transactions for hedge accounting purposes (Note 21 c, V).

The Parent Company has certain investments in associates and subsidiaries outside Latvia (Estonia and Lithuania); who are exposed to foreign currency risks. Currency exposure arising from the net assets of the Group's foreign operations in Estonia and Lithuania is limited as subsidiaries outside Latvia have insignificant amount of assets. Estonia has joined Euro zone, but Lithuania has fixed currency peg to Euro.

### II) Cash flow and fair value interest rate risk

As the Group has no significant floating interest-bearing assets, the Group's financial income and operating cash flows are not substantially dependent on changes in market interest rates.

However, during 2012, if Euro and Lats interest rates had been 50 basis points higher or lower with all other variables held constant, the Group's income from the cash reserves held at bank for the year would have been LVL 222 thousand or EUR 316 thousand higher or lower (2011: LVL 344 thousand or EUR 489 thousand).

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. To hedge a cash flow risk, the Group has entered into 17 interest rate swap agreements with the total notional amount LVL 269.1 million or EUR 382.8 million (2011: 15 interest rate swap agreements in total amount of LVL 241.5 million or EUR 343.6 million) (Note 21 c, II).

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. For each simulation, the same interest rate shift is used for all currencies. The scenarios are run only for liabilities that represent the major interest-bearing positions.

Based on the various scenarios, the Group manages their cash flow interest rate risk by using floating-to-fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. As at 31 December 2012 46% of the Group's borrowings (31/12/2011: 47%) had fixed interest rate (taking into account the effect of the interest rate swaps)

and average fixed rate duration 2 years (2011: 2.13 years). Generally, the Group raises long-term borrowings at floating rates and swaps them into fixed rates that are lower than those available if the Group borrowed at fixed rates directly. Under the interest rate swaps, the Group agrees with other parties to exchange, at specified intervals (primarily semi-annually), the difference between fixed contract rates and floating-rate interest amounts calculated by reference to the agreed notional amounts.

During 2012, if interest rates on Euro denominated borrowings at floating base interest rate (after considering hedging effect) had been 50 basis points higher or lower with all other variables held constant, the Group's post-tax profit for the year would have been LVL 1,205 thousand or EUR 1,715 thousand lower or higher (2011: LVL 1,261 thousand or EUR 1,794 thousand).

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.

At 31 December 2012, if short and long term Euro interest rates had been 50 basis points higher or lower with all other variables held constant fair value of interest rate swaps would

have been LVL 4,577 thousand or EUR 6,512 thousand higher or lower (31/12/2011: LVL 4,112 thousand or EUR 5,851 thousand). Furthermore LVL 481 thousand or EUR 684 thousand (2011: LVL 649 thousand or EUR 924 thousand) would have been attributable to Consolidated Income Statement and LVL 4,096 thousand or EUR 5,828 thousand (2011: LVL 3,463 thousand or EUR 4,927 thousand) to the Consolidated Statement of Comprehensive Income as hedge accounting item.

### 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 and CO<sub>2</sub> emission allowances. To hedge the risk the Parent Company has purchased electricity swap contracts and CO<sub>2</sub> emission allowance forward contracts that

are used to hedge the risk related to changes in the price of electricity (Note 21 c, III) and CO<sub>2</sub> allowances (Note 21 c, IV).

### 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 17).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 18), trade and other receivables (Note 17), nominal amounts of issued guarantees (Note 26).

Maximum credit risk related to the issued guaranties amounts to the outstanding loan balances as at the end of the year (see Note 26). For banks and financial institutions,

## Assessment of maximum possible exposure to credit risk

	NOTE	31/12/2012	31/12/2011	31/12/2012	31/12/2011
		LVL'000	LVL'000	EUR'000	EUR'000
Trade receivables	17 a	77,821	73,809	110,729	105,021
Accrued income	17 b	7,574	6,986	10,777	9,940
Other non-current financial receivables		32	125	45	178
Other current financial receivables	17 b	119	609	169	867
Cash and cash equivalents	18	170,425	108,877	242,493	154,918
Derivative financial instruments	21 c	4,237	2,450	6,029	3,486
Held-to-maturity financial assets	21 a	20,134	60,384	28,649	85,918
		<b>280,342</b>	<b>253,240</b>	<b>398,891</b>	<b>360,328</b>

independently rated parties with own or parent bank's minimum rating of investment grade are accepted. Otherwise, if there is no independent rating, management performs risk control to assess the credit quality of the financial counterparty, taking into account its financial position, past co-operation experience and other factors. After performed assessment individual credit limits are set based on internal ratings in accordance with principles set by the Financial Risk

Management Policy. The basis for estimating the credit quality of financial assets not past due and not impaired is credit ratings assigned by the rating agencies or, in their absence, the earlier credit behaviour of clients and other parties to the contract.

For estimation of the credit quality of fully performing trade receivables two rating categories are used:

- Customers with no overdue receivables,
- Customers with overdue receivables.

Credit limits are regularly monitored.

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.

The table below shows the balance of cash and cash equivalents by financial counterparties at the end of the reporting period:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Investment level credit rating	140,730	96,499	200,241	137,306
No or non-investment level credit rating	29,695	12,378	42,202	17,612
	<b>170,425</b>	<b>108,877</b>	<b>242,493</b>	<b>154,918</b>

No credit limits were exceeded during the reporting period, and the Group entities' management does not expect any losses from non-performance by these counterparties.

### 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 entities' management is monitoring rolling forecasts of the Group's liquidity reserve, which comprises of undrawn borrowing facilities (Note 21 b), and cash and cash equivalents (Note 18).

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the settlement terms. The amounts disclosed in the table are the contractual undiscounted cash flows. Contractual undiscounted cash flows originated by the borrowings are calculated taking into account the actual interest rates at the end of the reporting period.

### Liquidity analysis (contractual undiscounted cash flows)

	Less than 1 year	Between 1 and 2 years	Between 3 and 5 years	Over 5 years	TOTAL	Less than 1 year	Between 1 and 2 years	Between 3 and 5 years	Over 5 years	TOTAL
<b>31/12/2012</b>	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Borrowings	83,461	94,162	295,795	172,450	<b>645,868</b>	118,754	133,980	420,878	245,374	<b>918,986</b>
Derivative financial instruments	22,088	7,720	5,854	-	<b>35,662</b>	31,429	10,984	8,329	-	<b>50,742</b>
Issued guarantees	8,994	-	-	-	<b>8,994</b>	12,797	-	-	-	<b>12,797</b>
Trade and other payables*	97,790	-	-	-	<b>97,790</b>	139,142	-	-	-	<b>139,142</b>
	<b>212,333</b>	<b>101,882</b>	<b>301,649</b>	<b>172,450</b>	<b>788,314</b>	<b>302,122</b>	<b>144,964</b>	<b>429,207</b>	<b>245,374</b>	<b>1,121,667</b>
<b>31/12/2011</b>										
Borrowings	58,746	81,093	301,216	141,315	<b>582,370</b>	83,588	115,385	428,592	201,073	<b>828,638</b>
Derivative financial instruments	22,009	11,371	5,197	1,085	<b>39,662</b>	31,316	16,179	7,395	1,544	<b>56,434</b>
Issued guarantees	9,922	-	-	-	<b>9,922</b>	14,118	-	-	-	<b>14,118</b>
Trade and other payables*	<b>78,161</b>	-	-	-	<b>78,161</b>	<b>111,213</b>	-	-	-	<b>111,213</b>
	<b>168,838</b>	<b>92,464</b>	<b>306,413</b>	<b>142,400</b>	<b>710,115</b>	<b>240,235</b>	<b>131,564</b>	<b>435,987</b>	<b>202,617</b>	<b>1,010,403</b>

\* Excluding advances received, deferred income, tax related liabilities and other non-current or current non-financial payables

## 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.

The capital ratio figures were as follows:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
TOTAL equity	1,410,510	1,351,576	2,006,975	1,923,119
TOTAL assets	2,472,290	2,288,004	3,517,752	3,255,536
Outstanding financial guarantees issued	8,994	9,922	12,797	14,118
<b>Capital Ratio</b>	<b>57%</b>	<b>59%</b>	<b>57%</b>	<b>59%</b>

## 3.3. Fair value estimation of financial instruments

The fair value of financial instruments is defined as the amount at which an instrument could be exchanged in a current transaction between financially uncommitted, knowledgeable, willing parties other than by forced or liquidation sale. Fair values are estimated based on market prices and discounted cash flow models as appropriate (Note 4 c).

The fair value of financial instruments traded in active markets is based on quoted market prices at the end of reporting period. The quoted market prices used for financial assets held by the Group is the current bid prices.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group use a variety of methods and make assumptions that are based on market conditions existing at each end of reporting period. Estimated discounted cash flows are used to determine fair value for the remaining financial instruments.

The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows, by discounting their future contractual cash flows at current market interest rates for similar financial instruments.

The fair value of electricity swap agreements is calculated as discounted difference between actual market and settlement prices multiplied by the volume of the agreement.

The fair value of CO<sub>2</sub> emission allowances for greenhouse gases forward contracts is calculated as discounted difference between actual market and settlement prices for CO<sub>2</sub> emission allowances multiplied by the volume of the forward contract.

Calculated fair values of financial instruments are compared to bank's revaluation reports.



## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Estimates and judgments are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

### **a) Estimates concerning property, plant and equipment**

#### *I) Useful lives of property, plant and equipment*

The Group makes estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at the end of each reporting period and are based on the past experience as well as industry practice. Previous experience has shown that the actual useful lives have sometimes been longer than the estimates. As at 31 December 2012, the net book amount of property, plant and equipment of the Group totalled LVL 2,148 million or EUR 3,056 million (31/12/2011: LVL 1,999 million or EUR 2,845 million), and the depreciation charge of continuing operations for the reporting period was LVL 117.3 million or EUR 166.9 million (2011: LVL 113 million or EUR 160.8 million) (Note 14 a). If depreciation rates were changed by 10%, the annual depreciation charge would change by LVL 11.7 million or EUR 16.7 million (2011: LVL 11.3 million or EUR 16.1 million).

#### *II) Recoverable amount*

When the events and circumstances indicate a potential impairment, the Group performs impairment tests for items of property, plant and equipment. According to these tests assets are written down to their recoverable amounts, if

necessary. When carrying out impairment tests management uses various estimates for the cash flows arising from the use of the assets, sales, maintenance, and repairs of the assets, as well as in respect of the inflation and growth rates. The estimates are based on the forecasts of the general economic environment, consumption and the sales price of electricity. If the situation changes in the future, either additional impairment could be recognised, or the previously recognised impairment could be partially or fully reversed. Such factors as high maintenance and reconstruction costs, low load of several auxiliaries, comparatively substantial maintenance expense, limited facilities to sell property, plant and equipment in the market and other essential factors have an impact of decreasing of the recoverable amounts. If discount rate used for the purposes of impairment charge calculation would be lower or higher by one per cent point the current year's impairment charge on technological equipment would be by LVL 27.9 million or EUR 39.7 million higher or lower (2011: LVL 32.0 million or EUR 45.5 million). Impairment charges recognised during the current reporting year are disclosed in Note 14 b.

#### *III) Revaluation*

External, certified valuers have performed revaluation of the Group's property, plant and equipment by applying the depreciated replacement cost model. Valuation has been performed according to international standards on property valuation and IAS 16, Property, plant and equipment, based on current use of property, plant and equipment. As a result of valuation, depreciated replacement cost was determined for each asset. Depreciated replacement cost is calculated as land's instant market value at its current use, increased by the replacement cost of existing buildings and refinements on the said land plot and decreased by the depreciation expenses and other impairment losses. Results of revaluation are described in Note 14 a.

### **b) Recoverable amount of trade receivables**

The estimated collectability of accounts receivable is assessed on an individual basis for each customer. In case individual assessment is not possible due to the large number of individual balances, receivables are classified into groups of similar credit risk characteristics and are collectively assessed for impairment, using historical loss experience. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The circumstances indicating an impairment loss may include initiated insolvency of the debtor and inability to meet payment terms (Note 2.11.). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss incurred (Note 17).

### **c) Fair value estimation for financial instruments**

The following table presents the Group's financial assets and liabilities that are measured at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2),
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

As at 31 December 2012	Level 1	Level 2	Level 3	TOTAL balance	Level 1	Level 2	Level 3	TOTAL balance
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Assets</b>								
Electricity trading derivatives used for hedging (Note 21 c, III)	-	4,195	-	4,195	-	5,969	-	5,969
Forward foreign exchange contracts used for hedging (Note 21 c, V)	-	42	-	42	-	60	-	60
<b>TOTAL assets</b>	-	4,237	-	4,237	-	6,029	-	6,029
<b>Liabilities</b>								
<i>Financial liabilities at fair value through profit or loss:</i>								
- Electricity trading derivatives (Note 21 c, III)	-	3,841	-	3,841	-	5,465	-	5,465
- Interest rate derivatives (Note 21 c, II)	-	3,491	-	3,491	-	4,967	-	4,967
Electricity trading derivatives used for hedging (Note 21 c, III)	-	4,123	-	4,123	-	5,866	-	5,866
Interest rate derivatives used for hedging (Note 21 c, II)	-	13,244	-	13,244	-	18,845	-	18,845
<b>TOTAL liabilities</b>	-	24,699	-	24,699	-	35,143	-	35,143
<b>As at 31 December 2011</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>TOTAL balance</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>TOTAL balance</b>
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Assets</b>								
<i>Financial assets at fair value through profit or loss:</i>								
- Forward foreign exchange contracts (Note 21 c, V)	-	105	-	105	-	149	-	149
Electricity trading derivatives used for hedging (Note 21 c, III)	-	2,060	-	2,060	-	2,931	-	2,931
Forward foreign exchange contracts used for hedging (Note 21 c, V)	-	285	-	285	-	406	-	406
<b>TOTAL assets</b>	-	2,450	-	2,450	-	3,486	-	3,486
<b>Liabilities</b>								
<i>Financial liabilities at fair value through profit or loss:</i>								
- Electricity trading derivatives (Note 21 c, III)	-	5,366	-	5,366	-	7,635	-	7,635
- CO <sub>2</sub> emission allowances forward contracts (Note 21 c, IV)	-	4,597	-	4,597	-	6,541	-	6,541
- Interest rate derivatives (Note 21 c, II)	-	3,208	-	3,208	-	4,565	-	4,565
Electricity trading derivatives used for hedging (Note 21 c, III)	-	1,981	-	1,981	-	2,819	-	2,819
Interest rate derivatives used for hedging (Note 21 c, II)	-	8,611	-	8,611	-	12,252	-	12,252
<b>TOTAL liabilities</b>	-	23,763	-	23,763	-	33,812	-	33,812

#### **d) Recognition of connection service fees**

Connection and other service fees are recognised as income over the estimated customer relationship period, which is 20 years (see Note 23). The estimated customer relationship period is based on the Management's estimate. In the reporting period the Group's received connection fees totalled LVL 6.8 million or EUR 9.7 million (2011: LVL 9.8 million or EUR 13.9 million), and to the Consolidated Income Statement credited LVL 6.2 million or EUR 8.8 million (2011: LVL 5.4 million or EUR 7.7 million).

If the estimated customer relationship period is reduced/increased by 25%, the annual income from connection service fees would increase/decrease by LVL 1.5 million or EUR 2.2 million (2011: LVL 1.4 million or EUR 2.0 million).

#### **e) Recognition and revaluation of provisions**

As at 31 December 2012, the Group had set up provisions for environmental protection and post-employment benefits totalling LVL 10.5 million or EUR 14.9 million (31/12/2011: LVL 9.5 million or EUR 13.5 million) (Note 22). The amount

and timing of the settlement of these obligations is uncertain. A number of assumptions and estimates have been used to determine the present value of provisions, including the amount of future expenditure, inflation rates, and the timing of settlement of the expenditure. The actual expenditure may also differ from the provisions recognised as a result of possible changes in legislative norms, technology available in the future to restore environmental damages, and expenditure covered by third parties. For revaluation of provisions for post-employment obligations have been estimated probability of retirement in different employees' aging groups that are determined on the basis of previous experience as well as variable demographic factors and financial factors (including expected remuneration increase and determined changes in benefit amounts).

#### **f) Evaluation of effectiveness of hedging instruments**

The Group has concluded significant number of swap transactions to hedge the risk of the changes in prices of electricity and interest rate fluctuations to which cash flow

hedge risk accounting is applied and the gains and losses from changes in the fair value of the effective hedging instruments and items secured against risk are included in respective equity reserve. The evaluation of the effectiveness of the hedging is based on Management's estimates with regard to future purchase transactions of electricity and signed variable interest loan agreements. When hedging instruments turn out to be ineffective, gains/losses from the changes in the fair value is recognized in the Consolidated Income Statement (Note 21 c).

## **5. 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 chief operating decision maker.

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

*The generation and supply operating segment* comprises the Group's electricity and heat generation operations, which are organised into the legal entities: Latvenergo AS and Liepājas enerģija SIA, as well as electricity sales operations, including wholesale, which are conducted Pan-Baltic by Latvenergo AS, Elektrum Eesti OÜ and Elektrum Lietuva UAB.

*The operations of the distribution system services 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 Latvenergo AS – the owner of the distribution system real estate assets. In 2011, the distribution assets (excluding the real estate) owned by the Parent Company, were invested in Sadales tīkls AS.

*The management of transmission system assets operating segment* comprises construction and maintenance of the transmission system assets (330 kV and 110 kV transmission lines, substations and distribution points) as well as the lease of assets to the transmission system operator Augstsprieguma tīkls AS. The Republic of Latvia has applied the second unbundling model under EU Directive 2009/72/EC, which provides that the electricity transmission system assets shall remain with a vertically integrated utility,

while the activities of the transmission system operator are independently managed. The results of the management of transmission system assets segment derives from activities both of the subsidiary Latvijas elektriskie tīkli AS, in which transmission system assets (excluding the real estate) were invested by Latvenergo AS in 2011, and Latvenergo AS – the owner of the transmission system real estate assets.



The following table presents revenue, profit information and segment assets and liabilities of the Group's operating segments:

LVL	Generation and supply	Distribution system services	Management of transmission system assets	Corporate functions	Discontinued operations	TOTAL segments	Adjustments and eliminations	Consolidated
Year ended 31 December 2012	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
<b>Revenue</b>								
External customers	504,672	204,953	36,962	4,452	-	751,039	(1)	751,038
Inter-segment	19,861	4,620	2,712	31,770	-	58,963	(58,963)	-
<b>TOTAL revenue</b>	<b>524,533</b>	<b>209,573</b>	<b>39,674</b>	<b>36,222</b>	<b>-</b>	<b>810,002</b>	<b>(58,964)</b>	<b>751,038</b>
<b>Results</b>								
Amortisation, depreciation and impairment loss	42,082	54,758	16,483	8,873	-	122,196	-	122,196
Investments in associates	4,946	1	1	-	-	4,948	-	4,948
<b>Segment operating profit</b>	<b>31,682</b>	<b>5,893</b>	<b>8,086</b>	<b>4,236</b>	<b>-</b>	<b>49,897</b>	<b>(7,828)</b>	<b>42,069</b>
<b>Segment assets at the end of the period</b>	<b>1,067,218</b>	<b>872,491</b>	<b>269,691</b>	<b>59,192</b>	<b>-</b>	<b>2,268,592</b>	<b>203,698</b>	<b>2,472,290</b>
<b>Segment liabilities at the end of the period</b>	<b>77,143</b>	<b>104,308</b>	<b>34,050</b>	<b>4,035</b>	<b>-</b>	<b>219,536</b>	<b>842,244</b>	<b>1,061,780</b>
Capital expenditure	95,072	58,445	23,468	8,738	-	185,723	-	185,723
<b>Year ended 31 December 2011</b>								
<b>Revenue</b>								
External customers	489,070	188,775	312	3,625	3,804	685,586	(3,819)	681,767
Inter-segment	40,812	2,078	37,341	34,157	57,798	172,186	(172,186)	-
<b>TOTAL revenue</b>	<b>529,882</b>	<b>190,853</b>	<b>37,653</b>	<b>37,782</b>	<b>61,602</b>	<b>857,772</b>	<b>(176,005)</b>	<b>681,767</b>
<b>Results</b>								
Amortisation, depreciation and impairment loss	49,263	51,528	17,253	8,894	298	127,236	-	127,236
Investments in associates	4,693	1	1	-	1	4,696	-	4,696
<b>Segment operating profit</b>	<b>41,011</b>	<b>3,341</b>	<b>6,097</b>	<b>1,422</b>	<b>2,123</b>	<b>53,994</b>	<b>(11,326)</b>	<b>42,668</b>
<b>Segment assets at the end of the period</b>	<b>927,880</b>	<b>862,185</b>	<b>260,600</b>	<b>60,207</b>	<b>2,721</b>	<b>2,113,593</b>	<b>174,411</b>	<b>2,288,004</b>
<b>Segment liabilities at the end of the period</b>	<b>73,969</b>	<b>106,092</b>	<b>6,320</b>	<b>4,178</b>	<b>1,724</b>	<b>192,283</b>	<b>744,145</b>	<b>936,428</b>
Capital expenditure	130,141	45,803	12,406	10,176	-	198,526	197	198,723

EUR	Generation and supply	Distribution system services	Management of transmission system assets	Corporate functions	Discontinued operations	TOTAL segments	Adjustments and eliminations	Consolidated
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>Year ended 31 December 2012</b>								
<b>Revenue</b>								
External customers	718,084	291,622	52,592	6,335	-	1,068,633	(2)	1,068,631
Inter-segment	28,260	6,574	3,859	45,205	-	83,898	(83,898)	-
<b>TOTAL revenue</b>	<b>746,344</b>	<b>298,196</b>	<b>56,451</b>	<b>51,540</b>	<b>-</b>	<b>1,152,531</b>	<b>(83,900)</b>	<b>1,068,631</b>
<b>Results</b>								
Amortisation, depreciation and impairment loss	59,877	77,914	23,453	12,625	-	173,869	-	173,869
Investments in associates	7,038	1	1	-	-	7,040	-	7,040
<b>Segment operating profit</b>	<b>45,079</b>	<b>8,385</b>	<b>11,505</b>	<b>6,028</b>	<b>-</b>	<b>70,997</b>	<b>(11,138)</b>	<b>59,859</b>
<b>Segment assets at the end of the period</b>	<b>1,518,515</b>	<b>1,241,443</b>	<b>383,736</b>	<b>84,222</b>	<b>-</b>	<b>3,227,916</b>	<b>289,836</b>	<b>3,517,752</b>
<b>Segment liabilities at the end of the period</b>	<b>109,765</b>	<b>148,417</b>	<b>48,449</b>	<b>5,741</b>	<b>-</b>	<b>312,372</b>	<b>1,198,405</b>	<b>1,510,777</b>
Capital expenditure	135,275	83,160	33,392	12,433	-	264,260	-	264,260
<b>Year ended 31 December 2011</b>								
<b>Revenue</b>								
External customers	695,884	268,603	444	5,158	5,413	975,502	(5,435)	970,067
Inter-segment	58,070	2,957	53,131	48,601	82,239	244,998	(244,998)	-
<b>TOTAL revenue</b>	<b>753,954</b>	<b>271,560</b>	<b>53,575</b>	<b>53,759</b>	<b>87,652</b>	<b>1,220,500</b>	<b>(250,433)</b>	<b>970,067</b>
<b>Results</b>								
Amortisation, depreciation and impairment loss	70,095	73,318	24,549	12,654	424	181,040	-	181,040
Investments in associates	6,679	1	1	-	1	6,682	-	6,682
<b>Segment operating profit</b>	<b>58,353</b>	<b>4,754</b>	<b>8,675</b>	<b>2,023</b>	<b>3,021</b>	<b>76,826</b>	<b>(16,115)</b>	<b>60,711</b>
<b>Segment assets at the end of the period</b>	<b>1,320,254</b>	<b>1,226,779</b>	<b>370,800</b>	<b>85,667</b>	<b>3,872</b>	<b>3,007,372</b>	<b>248,164</b>	<b>3,255,536</b>
<b>Segment liabilities at the end of the period</b>	<b>105,248</b>	<b>150,955</b>	<b>8,993</b>	<b>5,945</b>	<b>2,453</b>	<b>273,594</b>	<b>1,058,823</b>	<b>1,332,417</b>
Capital expenditure	185,174	65,172	17,652	14,479	-	282,477	280	282,757

## 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.

Inter-segment revenue is eliminated on consolidation.

## Reconciliation of profit

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Segment profit (EBIT)</b>	<b>49,897</b>	<b>53,994</b>	<b>70,997</b>	<b>76,826</b>
Gain on held-to-maturity assets (Note 7)	227	611	323	870
Gain on disposal of revalued PPE	(537)	(536)	(764)	(763)
Inter-segment sales (elimination)	-	(596)	-	(848)
Gain from discontinued operations	-	(817)	-	(1,162)
Finance income (Note 11.a)	3,479	3,736	4,950	5,316
Finance costs (Note 11.b)	(11,250)	(13,956)	(16,007)	(19,858)
Share of profit of associates (Note 15)	253	232	360	330
<b>Group profit before income tax</b>	<b>42,069</b>	<b>42,668</b>	<b>59,859</b>	<b>60,711</b>

## Reconciliation of assets

	31 December 2012	31 December 2011	31 December 2012	31 December 2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Segment operating assets</b>	<b>2,268,592</b>	<b>2,113,593</b>	<b>3,227,916</b>	<b>3,007,372</b>
Investments in associates (Note 15)	4,948	4,696	7,040	6,681
Held-to-maturity financial assets (Note 21 a)	20,134	15,670	28,649	22,296
Current financial assets	42	45,105	60	64,179
Other assets and assets held for sale	8,149	63	11,594	90
Cash and cash equivalents (Note 18)	170,425	108,877	242,493	154,918
<b>Group operating assets</b>	<b>2,472,290</b>	<b>2,288,004</b>	<b>3,517,752</b>	<b>3,255,536</b>

## Reconciliation of liabilities

	31 December 2012	31 December 2011	31 December 2012	31 December 2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Segment operating liabilities</b>	<b>219,536</b>	<b>192,283</b>	<b>312,372</b>	<b>273,594</b>
Deferred income tax liabilities (Note 12)	187,822	172,425	267,246	245,339
Current corporate income tax liabilities	1,892	1,024	2,692	1,457
Borrowings (Note 21 b)	595,235	513,334	846,943	730,408
Derivative financial instruments (Note 21 c)	24,699	23,763	35,143	33,812
Trade and other payables	32,596	33,599	46,381	47,807
<b>Group operating liabilities</b>	<b>1,061,780</b>	<b>936,428</b>	<b>1,510,777</b>	<b>1,332,417</b>

## Geographical information on segments

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Revenue from external customers</b>				
Baltics	726,698	672,523	1,033,998	956,914
Scandinavian countries	24,340	9,244	34,633	13,153
<b>TOTAL revenue</b>	<b>751,038</b>	<b>681,767</b>	<b>1,068,631</b>	<b>970,067</b>

Non-current assets are located in the Group's country of domicile – Latvia and consist of property, plant and equipment, investment properties and intangible assets.

Revenue from one customer in 2012 amounted to LVL 80,543 thousand or EUR 114,602 thousand (2011: LVL 60,362 thousand or EUR 85,887 thousand) arising from sales by the generation and supply segment.

## 6. REVENUE

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Electricity and electricity services	600,511	593,092	854,450	843,894
Heat sales	90,548	69,233	128,838	98,510
Lease and management of transmission system assets*	36,323	-	51,683	-
Other revenue	23,656	19,442	33,660	27,663
<b>TOTAL revenue</b>	<b>751,038</b>	<b>681,767</b>	<b>1,068,631</b>	<b>970,067</b>

\* As of 2nd January of the 2012, according to EU Directive 2009/72/EC Augstsprieguma tīkls AS was sold to Ministry of Finance of the Republic of Latvia. Till the sale of Augstsprieguma tīkls AS revenue from lease and management of transmission system assets was consolidated as Group intragroup transactions.

## 7. OTHER INCOME

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Gain/(loss) from sale of assets held for sale and PPE	190	(68)	271	(97)
Gain from sale of current assets and other income	3,522	2 943	5,011	4,187
Income on redemption of held-to-maturity financial assets	227	611	323	870
<b>TOTAL other income:</b>	<b>3,939</b>	<b>3,486</b>	<b>5,605</b>	<b>4,960</b>

## 8. RAW MATERIALS AND CONSUMABLES USED

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Electricity:</b>				
Purchased electricity	258,212	242,293	367,403	344,752
Fair value (income)/loss on electricity swaps (Note 21 c, III)	(1,525)	7,759	(2,170)	11,040
Electricity transmission services costs*	52,262	-	74,362	-
	<b>308,949</b>	<b>250,052</b>	<b>439,595</b>	<b>355,792</b>
Fuel expense	140,052	127,673	199,276	181,662
Fair value (income) / loss on CO <sub>2</sub> emission allowances forward contracts (Note 21 c, IV)	(4,598)	1,155	(6,542)	1,643
Raw materials, spare parts and maintenance costs	31,125	29,312	44,287	41,708
<b>TOTAL raw materials and consumables used:</b>	<b>475,528</b>	<b>408,192</b>	<b>676,616</b>	<b>580,805</b>

\* As of 2nd January of the 2012, according to EU Directive 2009/72/EC Augstsprieguma tīkls AS was sold to Ministry of Finance of the Republic of Latvia. Till the sale of Augstsprieguma tīkls AS transmission services costs were consolidated as Group intragroup transactions.



## 9. PERSONNEL EXPENSES

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Wages and salaries	48,644	45,896	69,215	65,305
Expenditure of employment termination	1,140	2,028	1,623	2,885
Pension costs – defined contribution plan	2,175	2,102	3,094	2,991
State social insurance contributions and other benefits defined in the Collective Agreement	12,193	11,546	17,348	16,428
<b>TOTAL personnel expenses, including remuneration to the management</b>	<b>64,152</b>	<b>61,572</b>	<b>91,280</b>	<b>87,609</b>
<b>Including remuneration to the management*</b>				
Wages and salaries	745	710	1,060	1,010
Expenditure of employment termination	5	9	7	13
Pension costs – defined contribution plan	28	26	40	37
State social insurance contributions and other benefits defined in the Collective Agreement	182	181	259	258
<b>TOTAL remuneration to the management</b>	<b>960</b>	<b>926</b>	<b>1,366</b>	<b>1,318</b>
			2012	2011
Number of employees at the end of the year			4,457	4,490
Average number of employees during the year			4,453	4,518

\*remuneration to the management includes remuneration to the members of the Management Boards and Supervisory body of the Group entities.

## 10. OTHER OPERATING EXPENSES

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Selling expenses and customer service costs	13,377	5,843	19,034	8,314
Information technology maintenance expenses	2,457	2,192	3,496	3,119
Transportation expenses	5,435	5,608	7,734	7,979
Environment protection and work safety expenses	3,291	3,181	4,683	4,526
Rent, maintenance and utilities costs	3,719	3,944	5,292	5,612
Telecommunications expenses	1,451	1,437	2,065	2,045
Electric power transit and capacity services costs	2,489	3,750	3,541	5,336
Loss from disposal of property, plant and equipment	2,426	1,583	3,451	2,252
Real estate tax	712	704	1,013	1,002
Public utilities regulation fee	682	80	970	114
Other expenses	7,475	7,275	10,636	10,351
<b>TOTAL other operating expenses:</b>	<b>43,514</b>	<b>35,597</b>	<b>61,915</b>	<b>50,650</b>

## 11. FINANCE INCOME AND COSTS

### Finance income

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Interest income on bank accounts and deposits	1,405	2,776	1,999	3,950
Interest income from held-to-maturity financial assets	1,097	689	1,561	981
Fair value gain on forward foreign currencies exchange contracts (Note 21 c, V)	-	105	-	149
Fair value gain on issued guarantees (Note 26)	136	166	193	236
Net gain from currency exchange rate fluctuations	841	-	1,197	-
<b>TOTAL finance income:</b>	<b>3,479</b>	<b>3,736</b>	<b>4,950</b>	<b>5,316</b>

## Finance costs

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Interest expense on borrowings	10,145	12,025	14,435	17,110
Interest expense on interest rate swaps	4,863	4,065	6,919	5,784
Other finance costs	121	64	172	91
Fair value loss on interest rate swaps (Note 21 c, II)	283	641	403	912
Fair value loss on forward foreign currencies exchange contracts (Note 21 c, V)	105	-	149	-
Net foreign exchange losses	-	748	-	1,065
Capitalised borrowing costs and currency translation differences	(4,267)	(3,587)	(6,071)	(5,104)
<b>TOTAL finance costs:</b>	<b>11,250</b>	<b>13,956</b>	<b>16,007</b>	<b>19,858</b>

## 12. INCOME TAX

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Current tax	10,156	13 730	14,450	19,537
Deferred tax	(3,828)	(14 294)	(5,447)	(20,339)
<b>TOTAL income tax:</b>	<b>6,328</b>	<b>(564)</b>	<b>9,003</b>	<b>(802)</b>

The tax on the Group's profit before tax differs from the theoretical amount that would arise if using the tax rate applicable to profits of the Group as follows:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Profit before tax</b>	<b>42,069</b>	<b>42,668</b>	<b>59,859</b>	<b>60,711</b>
Corporate income tax at the statutory rate 15%	6,310	6,400	8,979	9,106
Expense deductible for tax purpose	305	662	433	942
Impairment of receivables	1,674	262	2,382	373
Tax deductions for donations	(175)	(13)	(249)	(18)
Losses that reduce taxable income	(178)	(1,058)	(254)	(1,505)
Tax incentives for new technological equipment	(1,608)	(6,817)	(2,288)	(9,700)
<b>TOTAL income tax:</b>	<b>6,328</b>	<b>(564)</b>	<b>9,003</b>	<b>(802)</b>

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax

assets against current tax liabilities and when the deferred income taxes relate to the same taxation authority. The offset

amounts are as follows:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Deferred income tax liabilities:</b>				
- Deferred tax liabilities to be payable after more than 1 year	188,816	172,087	268,661	244,858
- Deferred tax liabilities to be payable within 1 year	2,706	4,636	3,850	6,596
<b>Deferred income tax assets:</b>				
- Deferred tax assets to be recovered after more than 1 year	(1,658)	(1,819)	(2,359)	(2,588)
- Deferred tax assets to be recovered within 1 year	(2,042)	(2,479)	(2,906)	(3,527)
<b>TOTAL deferred income tax liabilities, net</b>	<b>187,822</b>	<b>172,425</b>	<b>267,246</b>	<b>245,339</b>

## The movement on the deferred income tax accounts

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>172,425</b>	<b>186,710</b>	<b>245,339</b>	<b>265,664</b>
Income credited to the Consolidated Income Statement	(3,828)	(14,294)	(5,447)	(20,339)
Attributable to non-current assets revaluation reserve in equity (Note 20)	19,225	(81)	27,354	(115)
Attributable to discontinuing operations	-	90	-	129
<b>Deferred tax liabilities at the end of the year</b>	<b>187,822</b>	<b>172,425</b>	<b>267,246</b>	<b>245,339</b>

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values

for financial reporting and tax purposes:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Deferred tax liabilities</b>				
<b>At the beginning of the year</b>	<b>173,352</b>	<b>189,434</b>	<b>246,658</b>	<b>269,540</b>
Income credited to the Consolidated Income Statement	(1,084)	(15,897)	(1,543)	(22,619)
Attributable to discontinuing operations	30	(104)	43	(148)
Attributable to non-current assets revaluation reserve in equity (Note 20)	19,225	(81)	27,354	(115)
<b>At the end of the year</b>	<b>191,523</b>	<b>173,352</b>	<b>272,512</b>	<b>246,658</b>
<b>Deferred tax assets</b>				
<b>At the beginning of the year</b>	<b>(957)</b>	<b>(2,724)</b>	<b>(1,362)</b>	<b>(3,876)</b>
Income credited / expense charged to the Consolidated Income Statement	(2,744)	1,603	(3,904)	2,281
Attributable to discontinuing operations	-	164	-	233
<b>At the end of the year</b>	<b>(3,701)</b>	<b>(957)</b>	<b>(5,266)</b>	<b>(1,362)</b>

## 13. INTANGIBLE ASSETS

### a) Intangible assets

	Licenses	Software	Assets under construction	TOTAL	Licenses	Software	Assets under construction	TOTAL
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>At 31 December 2010</b>								
Cost	1,750	18,793	80	20,623	2,490	26,740	114	29,344
Accumulated amortisation	(567)	(12,578)	-	(13,145)	(807)	(17,897)	-	(18,704)
<b>Net book amount</b>	<b>1,183</b>	<b>6,215</b>	<b>80</b>	<b>7,478</b>	<b>1,683</b>	<b>8,843</b>	<b>114</b>	<b>10,640</b>
<b>Year ended 31 December 2011</b>								
Additions	-	1,290	417	1,707	-	1,836	593	2,429
Disposals	(148)	-	-	(148)	(211)	-	-	(211)
Amortisation charge	-	(2,436)	-	(2,436)	-	(3,466)	-	(3,466)
<b>Closing net book amount</b>	<b>1,035</b>	<b>5,069</b>	<b>497</b>	<b>6,601</b>	<b>1,473</b>	<b>7,212</b>	<b>707</b>	<b>9,392</b>
<b>At 31 December 2011</b>								
Cost	1,750	19,940	497	22,187	2,490	28,372	707	31,569
Accumulated amortisation	(715)	(14,871)	-	(15,586)	(1,017)	(21,160)	-	(22,177)
<b>Net book amount</b>	<b>1,035</b>	<b>5,069</b>	<b>497</b>	<b>6,601</b>	<b>1,473</b>	<b>7,212</b>	<b>707</b>	<b>9,392</b>
<b>Year ended 31 December 2012</b>								
Additions	-	1,042	681	1,723	-	1,483	969	2,452
Disposals	(148)	(7)	-	(155)	(211)	(10)	-	(221)
Amortisation charge	-	(2,365)	-	(2,365)	-	(3,365)	-	(3,365)
<b>Closing net book amount</b>	<b>887</b>	<b>3,739</b>	<b>1,178</b>	<b>5,804</b>	<b>1,262</b>	<b>5,320</b>	<b>1,676</b>	<b>8,258</b>
<b>At 31 December 2012</b>								
Cost	1,750	20,571	1,178	23,499	2,490	29,270	1,676	33,436
Accumulated amortisation	(863)	(16,832)	-	(17,695)	(1,228)	(23,950)	-	(25,178)
<b>Net book amount</b>	<b>887</b>	<b>3,739</b>	<b>1,178</b>	<b>5,804</b>	<b>1,262</b>	<b>5,320</b>	<b>1,676</b>	<b>8,258</b>

*b) Greenhouse gas emission allowances*

	2012	2011
	Number of allowances	Number of allowances
<b>At the beginning of the year</b>	<b>552,559</b>	<b>483,309</b>
Allowances allocated free of charge	3,099,482	1,107,445
Purchased allowances	562,188	255,746
Used allowances	(953,367)	(1,184,626)
Sales of allowances	(70,000)	(109,315)
<b>At the end of the year</b>	<b>3,190,862</b>	<b>552,559</b>

Allowances are allocated free of charge in accordance with the law „On Pollution” and Directives of the Ministry of Environmental Protection and Regional Development and are recognised at zero cost.

During the reporting period ended 31 December 2012 the number of allowances in the Group received from the Government free of charge was 3,099,482 (31/12/2011: 1,107,445). Therefore their carrying amount as at 31 December 2012 was nil (31/12/2011: nil).

The fair value of greenhouse gas emission allowances as at 31 December 2012 was LVL 15,025 thousand or EUR 21,379 thousand (31/12/2011: LVL 3,037 thousand

or EUR 4,321 thousand). For estimation of the fair value of allowances were used closing market prices of NASDAQ OMX Commodities exchange on the last trade date (28 December 2012) – 6.7 EUR/t (30/12/2011: 7.82 EUR/t).

In 24 October 2012 in accordance with Directive No. 51 of the Ministry of Environmental Protection and Regional Development „For additional allocation of gas emission allowances for Latvenergo AS thermal plant TEC-2 in period from 2009 until 2012” all allowances for four-year period are received and allocated.

European Union Allowances (EUA) must be used until the end of 2020.

As at 31 December 2012 the number of allowances in the Group purchased was 562,188 (31/12/2011: 255,746). Allowances are purchased under CO<sub>2</sub> emissions allowances forward contracts (Note 21 c, IV). Purchase costs of allowances in amount of LVL 7,293 thousand or EUR 10,377 thousand (2011: LVL 1,507 thousand or EUR 2,144 thousand) are included in the Consolidated Income Statement position 'Fuel expense' (Note 8). All purchased allowances during the 2012 are used therefore carrying amount at the end of the year was nil (31/12/2011: nil).



## 14. PROPERTY, PLANT AND EQUIPMENT

### a) Property, plant and equipment

LVL	Revalued buildings and facilities				Non-revalued buildings and facilities	Land and buildings, TOTAL	Revalued technology equipment, machinery				Technology equipment and machinery, TOTAL
	Daugava hydropower plants' buildings and facilities	Transmission system buildings and facilities	Distribution system buildings and facilities				Daugava hydropower plants' technology equipment, machinery	Transmission system technology equipment, machinery	Distribution system technology equipment, machinery	Non-revalued technology equipment, machinery	
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
<b>At 31 December 2010</b>											
Cost or valuation	1,041,991	305,217	1,261,427	224,187	<b>2,832,822</b>	156,685	252,433	468,911	216,984	<b>1,095,013</b>	
Accumulated depreciation and impairment	(586,615)	(190,892)	(678,335)	(50,807)	<b>(1,506,649)</b>	(111,154)	(134,176)	(249,581)	(107,031)	<b>(601,942)</b>	
<b>Net book amount</b>	<b>455,376</b>	<b>114,325</b>	<b>583,092</b>	<b>173,380</b>	<b>1,326,173</b>	<b>45,531</b>	<b>118,257</b>	<b>219,330</b>	<b>109,953</b>	<b>493,071</b>	
<b>Year ended 31 December 2011</b>											
Additions	2,957	1,863	30,127	6,896	<b>41,843</b>	2,886	3,197	11,456	5,678	<b>23,217</b>	
Transfers	-	-	-	(60)	<b>(60)</b>	-	-	-	53	<b>53</b>	
Disposals	-	(148)	(315)	(796)	<b>(1 259)</b>	-	(58)	(525)	(16)	<b>(599)</b>	
Impairment charge	-	-	-	414	<b>414</b>	-	-	-	(11,899)	<b>(11,899)</b>	
Depreciation	(9,284)	(6,169)	(36,503)	(6,228)	<b>(58,184)</b>	(10,056)	(9,671)	(13,869)	(11,906)	<b>(45,502)</b>	
<b>Closing net book amount</b>	<b>449,049</b>	<b>109,871</b>	<b>576,401</b>	<b>173,606</b>	<b>1,308,927</b>	<b>38,361</b>	<b>111,725</b>	<b>216,392</b>	<b>91,863</b>	<b>458,341</b>	
<b>At 31 December 2011</b>											
Cost or valuation	1,041,813	306,387	1,290,528	230,442	<b>2,869,170</b>	158,771	252,794	478,154	220,049	<b>1,109,768</b>	
Accumulated depreciation and impairment	(592,764)	(196,516)	(714,127)	(56,836)	<b>(1,560,243)</b>	(120,410)	(141,069)	(261,762)	(128,186)	<b>(651,427)</b>	
<b>Net book amount</b>	<b>449,049</b>	<b>109,871</b>	<b>576,401</b>	<b>173,606</b>	<b>1,308,927</b>	<b>38,361</b>	<b>111,725</b>	<b>216,392</b>	<b>91,863</b>	<b>458,341</b>	
<b>Year ended 31 December 2012</b>											
PPE revaluation	12,633	2,017	2,065	-	<b>16,715</b>	51,294	8,363	10,067	-	<b>69,724</b>	
Additions	4,044	4,087	34,474	12,297	<b>54,902</b>	2,633	13,354	14,552	6,853	<b>37,392</b>	
Transfers	1,419	-	-	(1,331)	<b>88</b>	(928)	-	-	932	<b>4</b>	
Disposals	(7)	(129)	(1,054)	(338)	<b>(1,528)</b>	(19)	(101)	(847)	(41)	<b>(1,008)</b>	
Reclassified to investment property	-	-	-	(1,116)	<b>(1,116)</b>	-	-	-	-	<b>-</b>	
Impairment charge	-	-	-	361	<b>361</b>	-	-	-	(3,114)	<b>(3,114)</b>	
Depreciation	(10,981)	(7,279)	(38,312)	(6,950)	<b>(63,522)</b>	(7,060)	(7,768)	(13,931)	(16,062)	<b>(44,821)</b>	
<b>Closing net book amount</b>	<b>456,157</b>	<b>108,567</b>	<b>573,574</b>	<b>176,529</b>	<b>1,314,827</b>	<b>84,281</b>	<b>125,573</b>	<b>226,233</b>	<b>80,431</b>	<b>516,518</b>	
<b>At 31 December 2012</b>											
Cost or valuation	1,051,763	316,974	1,337,675	237,629	<b>2,944,041</b>	227,803	280,095	490,773	226,193	<b>1,224,864</b>	
Accumulated depreciation and impairment	(595,606)	(208,407)	(764,101)	(61,100)	<b>(1,629,214)</b>	(143,522)	(154,522)	(264,540)	(145,762)	<b>(708,346)</b>	
<b>Net book amount</b>	<b>456,157</b>	<b>108,567</b>	<b>573,574</b>	<b>176,529</b>	<b>1,314,827</b>	<b>84,281</b>	<b>125,573</b>	<b>226,233</b>	<b>80,431</b>	<b>516,518</b>	

LVL	Revalued other property, plant and equipment			Non-revalued other PPE	Other PPE, TOTAL	Assets under construction	Property, plant and equipment, TOTAL
	Daugava hydropower plants' other PPE	Transmission system other PPE	Distribution system other PPE				
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000
<b>At 31 December 2010</b>							
Cost or valuation	7,477	3,309	4,135	81,629	96,550	89,193	4,113,578
Accumulated depreciation and impairment	(3,366)	(2,628)	(2,726)	(62,355)	(71,075)	(4,720)	(2,184,386)
<b>Net book amount</b>	<b>4,111</b>	<b>681</b>	<b>1,409</b>	<b>19,274</b>	<b>25,475</b>	<b>84,473</b>	<b>1,929,192</b>
<b>Year ended 31 December 2011</b>							
Additions	-	154	307	7,175	7,636	124,320	197,016
Transfers	-	-	-	7	7	-	-
Disposals	-	-	-	(11)	(11)	(37)	(1,906)
Impairment charge	-	-	-	-	-	(277)	(11,762)
Depreciation	(309)	(551)	(273)	(8,219)	(9,352)	-	(113,038)
<b>Closing net book amount</b>	<b>3,802</b>	<b>284</b>	<b>1,443</b>	<b>18,226</b>	<b>23,755</b>	<b>208,479</b>	<b>1,999,502</b>
<b>At 31 December 2011</b>							
Cost or valuation	7,477	3,318	4,359	81,648	96,802	213,475	4,289,215
Accumulated depreciation and impairment	(3,675)	(3,034)	(2,916)	(63,422)	(73,047)	(4,996)	(2,289,713)
<b>Net book amount</b>	<b>3,802</b>	<b>284</b>	<b>1,443</b>	<b>18,226</b>	<b>23,755</b>	<b>208,479</b>	<b>1,999,502</b>
<b>Year ended 31 December 2012</b>							
PPE revaluation	540	625	679	-	1,844	-	88,283
Additions	21	1,631	826	5,897	8,375	83,331	184,000
Transfers	281	-	-	(373)	(92)	-	-
Disposals	-	(1)	(36)	(21)	(58)	(167)	(2,761)
Reclassified to investment property	-	-	-	-	-	-	(1,116)
Impairment charge	-	-	-	-	-	191	(2,562)
Depreciation	(459)	(799)	(582)	(7,086)	(8,926)	-	(117,269)
<b>Closing net book amount</b>	<b>4,185</b>	<b>1,740</b>	<b>2,330</b>	<b>16,643</b>	<b>24,898</b>	<b>291,834</b>	<b>2,148,077</b>
<b>At 31 December 2012</b>							
Cost or valuation	9,598	5,502	6,004	78,609	99,713	296,705	4,565,323
Accumulated depreciation and impairment	(5,413)	(3,762)	(3,674)	(61,966)	(74,815)	(4,871)	(2,417,246)
<b>Net book amount</b>	<b>4,185</b>	<b>1,740</b>	<b>2,330</b>	<b>16,643</b>	<b>24,898</b>	<b>291,834</b>	<b>2,148,077</b>

EUR	Revalued buildings and facilities			Non-revalued buildings and facilities	Land and buildings, TOTAL	Revalued technology equipment, machinery			Non-revalued technology equipment, machinery	Technology equipment and machinery, TOTAL
	Daugava hydropower plants' buildings and facilities	Transmission system buildings and facilities	Distribution system buildings and facilities			Daugava hydropower plants' technology equipment, machinery	Transmission system technology equipment, machinery	Distribution system technology equipment, machinery		
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>At 31 December 2010</b>										
Cost or valuation	1,482,620	434,285	1,794,849	318,989	<b>4,030,743</b>	222,943	359,180	667,200	308,740	<b>1,558,063</b>
Accumulated depreciation and impairment	(834,678)	(271,615)	(965,184)	(72,292)	<b>(2,143,769)</b>	(158,158)	(190,915)	(355,122)	(152,291)	<b>(856,486)</b>
<b>Net book amount</b>	<b>647,942</b>	<b>162,670</b>	<b>829,665</b>	<b>246,697</b>	<b>1,886,974</b>	<b>64,785</b>	<b>168,265</b>	<b>312,078</b>	<b>156,449</b>	<b>701,577</b>
<b>Year ended 31 December 2011</b>										
Additions	4,207	2,651	42,867	9,812	<b>59,537</b>	4,106	4,549	16,301	8,079	<b>33,035</b>
Transfers	-	-	-	(85)	<b>(85)</b>	-	-	-	75	<b>75</b>
Disposals	-	(211)	(448)	(1,133)	<b>(1,792)</b>	-	(83)	(747)	(22)	<b>(852)</b>
Impairment charge	-	-	-	589	<b>589</b>	-	-	-	(16,931)	<b>(16,931)</b>
Depreciation	(13,210)	(8,778)	(51,939)	(8,861)	<b>(82,788)</b>	(14,308)	(13,761)	(19,734)	(16,941)	<b>(64,744)</b>
<b>Closing net book amount</b>	<b>638,939</b>	<b>156,332</b>	<b>820,145</b>	<b>247,019</b>	<b>1,862,435</b>	<b>54,583</b>	<b>158,970</b>	<b>307,898</b>	<b>130,709</b>	<b>652,160</b>
<b>At 31 December 2011</b>										
Cost or valuation	1,482,366	435,949	1,836,256	327,889	<b>4,082,460</b>	225,911	359,693	680,352	313,102	<b>1,579,058</b>
Accumulated depreciation and impairment	(843,427)	(279,617)	(1,016,111)	(80,870)	<b>(2,220,025)</b>	(171,328)	(200,723)	(372,454)	(182,392)	<b>(926,897)</b>
<b>Net book amount</b>	<b>638,939</b>	<b>156,332</b>	<b>820,145</b>	<b>247,019</b>	<b>1,862,435</b>	<b>54,583</b>	<b>158,970</b>	<b>307,898</b>	<b>130,709</b>	<b>652,160</b>
<b>Year ended 31 December 2012</b>										
PPE revaluation	17,975	2,870	2,939	-	<b>23,784</b>	72,985	11,900	14,324	-	<b>99,209</b>
Additions	5,754	5,815	49,051	17,497	<b>78,117</b>	3,746	19,001	20,724	9,751	<b>53,204</b>
Transfers	2,019	-	-	(1,894)	<b>125</b>	(1,320)	-	-	1,326	<b>6</b>
Disposals	(10)	(183)	(1,500)	(481)	<b>(2,174)</b>	(27)	(144)	(1,205)	(58)	<b>(1,434)</b>
Reclassified to investment property	-	-	-	(1,588)	<b>(1,588)</b>	-	-	-	-	<b>-</b>
Impairment charge	-	-	-	514	<b>514</b>	-	-	-	(4,431)	<b>(4,431)</b>
Depreciation	(15,624)	(10,357)	(54,513)	(9,889)	<b>(90,383)</b>	(10,046)	(11,053)	(19,822)	(22,854)	<b>(63,775)</b>
<b>Closing net book amount</b>	<b>649,053</b>	<b>154,477</b>	<b>816,122</b>	<b>251,178</b>	<b>1,870,830</b>	<b>119,921</b>	<b>178,674</b>	<b>321,901</b>	<b>114,443</b>	<b>734,939</b>
<b>At 31 December 2012</b>										
Cost or valuation	1,496,524	451,013	1,903,340	338,116	<b>4,188,993</b>	324,134	398,539	698,307	321,844	<b>1,742,824</b>
Accumulated depreciation and impairment	(847,471)	(296,536)	(1,087,218)	(86,938)	<b>(2,318,163)</b>	(204,213)	(219,865)	(376,406)	(207,401)	<b>(1,007,885)</b>
<b>Net book amount</b>	<b>649,053</b>	<b>154,477</b>	<b>816,122</b>	<b>251,178</b>	<b>1,870,830</b>	<b>119,921</b>	<b>178,674</b>	<b>321,901</b>	<b>114,443</b>	<b>734,939</b>

EUR	Revalued other property, plant and equipment			Non-revalued other PPE	Other PPE, TOTAL	Assets under construction	Property, plant and equipment, TOTAL
	Daugava hydropower plants' other PPE	Transmission system other PPE	Distribution system other PPE				
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>At 31 December 2010</b>							
Cost or valuation	10,639	4,708	5,884	116,148	137,379	126,910	5,853,095
Accumulated depreciation and impairment	(4,790)	(3,739)	(3,879)	(88,723)	(101,131)	(6,716)	(3,108,102)
<b>Net book amount</b>	<b>5,849</b>	<b>969</b>	<b>2,005</b>	<b>27,425</b>	<b>36,248</b>	<b>120,194</b>	<b>2,744,993</b>
<b>Year ended 31 December 2011</b>							
Additions	-	219	437	10,209	10,865	176,892	280,329
Transfers	-	-	-	10	10	-	-
Disposals	-	-	-	(16)	(16)	(53)	(2,713)
Impairment charge	-	-	-	-	-	(394)	(16,736)
Depreciation	(439)	(784)	(389)	(11,694)	(13,306)	-	(160,838)
<b>Closing net book amount</b>	<b>5,410</b>	<b>404</b>	<b>2,053</b>	<b>25,934</b>	<b>33,801</b>	<b>296,639</b>	<b>2,845,035</b>
<b>At 31 December 2011</b>							
Cost or valuation	10,639	4,721	6,202	116,175	137,737	303,747	6,103,002
Accumulated depreciation and impairment	(5,229)	(4,317)	(4,149)	(90,241)	(103,936)	(7,109)	(3,257,967)
<b>Net book amount</b>	<b>5,410</b>	<b>404</b>	<b>2,053</b>	<b>25,934</b>	<b>33,801</b>	<b>296,639</b>	<b>2,845,035</b>
<b>Year ended 31 December 2012</b>							
PPE revaluation	768	889	966	-	2,623	-	125,616
Additions	30	2,321	1,176	8,391	11,918	118,569	261,808
Transfers	400	-	-	(531)	(131)	-	-
Disposals	-	(1)	(51)	(30)	(82)	(238)	(3,928)
Reclassified to investment property	-	-	-	-	-	-	(1,588)
Impairment charge	-	-	-	-	-	272	(3,645)
Depreciation	(653)	(1,137)	(828)	(10,083)	(12,701)	-	(166,859)
<b>Closing net book amount</b>	<b>5,955</b>	<b>2,476</b>	<b>3,316</b>	<b>23,681</b>	<b>35,428</b>	<b>415,242</b>	<b>3,056,439</b>
<b>At 31 December 2012</b>							
Cost or valuation	13,657	7,829	8,543	111,851	141,880	422,173	6,495,870
Accumulated depreciation and impairment	(7,702)	(5,353)	(5,227)	(88,170)	(106,452)	(6,931)	(3,439,431)
<b>Net book amount</b>	<b>5,955</b>	<b>2,476</b>	<b>3,316</b>	<b>23,681</b>	<b>35,428</b>	<b>415,242</b>	<b>3,056,439</b>

Impairment charge is included in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

In 2012 the Group has capitalised borrowing costs and currency translation differences in amount of LVL 4,267 thousand or EUR 6,071 thousand (2011: LVL 3,587

thousand or EUR 5,104 thousand). Rate of capitalised borrowing costs was of 1.98% (2011: 2.26%).

## Property, plant and equipment revaluation

As at 1 January 2011 transmission system assets and as at 1 September 2011 distribution system assets were evaluated for property investment in subsidiaries share capital (Latvijas elektriskie tīkli AS and Sadales tīkls AS respectively). Latvenergo AS revalued assets of Daugava hydropower plants as at 1 January 2012. Valuation have been done by independent certified valuers by applying the cost model, which provides, that the assets value comprises replacement or renewal costs of similar asset at the date of revaluation

less the accumulated depreciation and impairment losses. To determine original cost replacement value of the revalued asset is used current acquisition or purchase cost.

As at the end of the reporting period carrying value of the Daugava hydropower plants, transmission system assets and distribution system assets approximates its fair value. In 2012 the increase in revalued Daugava hydropower plants in amount of LVL 64,436 thousand or EUR 91,684, net of deferred tax, was charged to non-current assets revaluation reserve under

the comprehensive income and the increase in the amount of LVL 31 thousand or EUR 44 thousand, that has been previously charged to expenses, in the Consolidated Income Statement under Increase of non-current assets value due revaluation'.

The carrying amounts of revalued property, plant and equipment of Daugava hydropower plants, transmission and distribution system assets at revalued amounts and their cost basis are as follows:

	Revalued property, plant and equipment categories				Revalued property, plant and equipment categories			
	Buildings and facilities	Technology equipment and machinery	Other property, plant and equipment	TOTAL	Buildings and facilities	Technology equipment and machinery	Other property, plant and equipment	TOTAL
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>AT REVALUED AMOUNTS</b>								
<b>At 31 December 2011</b>								
Revalued	2,638,728	889,719	15,154	<b>3,543,601</b>	3,754,572	1,265,956	21,562	<b>5,042,090</b>
Accumulated depreciation	(1,503,407)	(523,241)	(9,625)	<b>(2,036,273)</b>	(2,139,155)	(744,505)	(13,695)	<b>(2,897,355)</b>
<b>Revalued net book amount</b>	<b>1,135,321</b>	<b>366,478</b>	<b>5,529</b>	<b>1,507,328</b>	<b>1,615,417</b>	<b>521,451</b>	<b>7,867</b>	<b>2,144,735</b>
<b>At 31 December 2012</b>								
Revalued	2,706,412	998,671	21,104	<b>3,726,187</b>	3,850,877	1,420,981	30,028	<b>5,301,886</b>
Accumulated depreciation	(1,568,114)	(562,584)	(12,849)	<b>(2,143,547)</b>	(2,231,225)	(800,485)	(18,282)	<b>(3,049,992)</b>
<b>Revalued net book amount</b>	<b>1,138,298</b>	<b>436,087</b>	<b>8,255</b>	<b>1,582,640</b>	<b>1,619,652</b>	<b>620,496</b>	<b>11,746</b>	<b>2,251,894</b>
<b>AT AMOUNTS STATED ON HISTORICAL COST BASIS</b>								
<b>At 31 December 2011</b>								
Cost	530,900	396,426	13,740	<b>941,066</b>	755,403	564,063	19,550	<b>1,339,016</b>
Accumulated depreciation	(165,019)	(197,067)	(11,045)	<b>(373,131)</b>	(234,801)	(280,401)	(15,716)	<b>(530,918)</b>
<b>Net book amount</b>	<b>365,881</b>	<b>199,359</b>	<b>2,695</b>	<b>567,935</b>	<b>520,602</b>	<b>283,662</b>	<b>3,835</b>	<b>808,099</b>
<b>At 31 December 2012</b>								
Cost	572,106	420,410	14,861	<b>1,007,377</b>	814,033	598,190	21,145	<b>1,433,368</b>
Accumulated depreciation	(222,471)	(229,186)	(12,063)	<b>(463,720)</b>	(316,548)	(326,102)	(17,164)	<b>(659,814)</b>
<b>Net book amount</b>	<b>349,635</b>	<b>191,224</b>	<b>2,798</b>	<b>543,657</b>	<b>497,485</b>	<b>272,088</b>	<b>3,981</b>	<b>773,554</b>

### b) Impairment

Impairment review performed in accordance with IAS 36 Impairment of Assets resulted in an impairment charge on technological equipment and machinery of the Riga TEC-2 combined heat and power plant (carried in non-revalued technology equipment and machinery) based on value in use calculations. The accumulated impairment as at 31

December 2012 amounted to LVL 53,495 thousand or EUR 76,117 thousand (31/12/2011: LVL 50,381 thousand or 71,686 thousand). The cash-generating unit is defined as the assets of Riga TEC-2 plant. Additional impairment is due to Riga TEC-2 technological equipment and machinery planned to be partly discontinued starting in 2013. Nominal

pre-tax discount rate used to determine value in use of cash-generating unit by discounting cash flows is 7.4% (2011: 8.4%).

For sensitivity analysis see Note 4 a, II.

## 15. INVESTMENTS IN ASSOCIATES AND OTHER INVESTMENTS

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>4,696</b>	<b>4,464</b>	<b>6,681</b>	<b>6,351</b>
Share of profit in Nordic Energy Link AS	253	232	360	330
Disposal of investment in Pirmais Slēgtais Pensiju Fonds AS	(1)	-	(1)	-
<b>At the end of the year</b>	<b>4,948</b>	<b>4,696</b>	<b>7,040</b>	<b>6,681</b>

The table below discloses the Group's share of profit from investments in significant associates and summarised

financial information on the amounts of assets, liabilities and net sales of these entities.

	Assets	Liabilities	Net sales	Share of profit	Assets	Liabilities	Net sales	Share of profit
	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>As of 31 December 2011</b>								
Nordic Energy Link AS *	60,063	41,399	9,706	232	85,462	58,905	13,810	330
	<b>60,063</b>	<b>41,399</b>	<b>9,706</b>	<b>232</b>	<b>85,462</b>	<b>58,905</b>	<b>13,810</b>	<b>330</b>
<b>As of 31 December 2012</b>								
Nordic Energy Link AS *	56,893	37,218	9,801	252	80,951	52,956	13,946	360
	<b>56,893</b>	<b>37,218</b>	<b>9,801</b>	<b>252</b>	<b>80,951</b>	<b>52,956</b>	<b>13,946</b>	<b>360</b>

\* Un-audited financial data of associate for financial year ending 31 December 2012 and comparative figures for financial year ending 31 December 2011.

### Participating interest in subsidiaries and associates:

Name	Country of incorporation	Business activity held	Interest held, %	
			31/12/2012	31/12/2011
<b>Subsidiaries:</b>				
Latvijas elektriskie tīkli AS	Latvia	Management of transmission system assets	100%	100%
Sadales tīkls AS	Latvia	Electricity distribution	100%	100%
Elektrum Eesti OÜ	Estonia	Electricity supply	100%	100%
Elektrum Latvija SIA	Latvia	Electricity supply	100%	-
Elektrum Lietuva UAB	Lithuania	Electricity supply	100%	100%
Liepājas enerģija SIA	Latvia	Thermal energy generation and sales in Liepāja city, electricity generation	51%	51%
<b>Associates:</b>				
Nordic Energy Link AS	Estonia	Electricity transmission	25%	25%
Pirmais Slēgtais Pensiju Fonds AS	Latvia	Management of pension plans	48.15%	50%

The Group owns 48.15% of the shares of the closed pension fund Pirmais Slēgtais Pensiju Fonds AS.

However, the Group is only a nominal shareholder as all risks and benefits arising from associate's activities will accrue to the Group's employees who are members of the pension fund. Therefore, investment in Pirmais Slēgtais Pensiju Fonds

AS is valued at cost and not consolidated.

## 16. INVENTORIES

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Raw materials and spare parts	14,196	12 532	20 199	17 831
Other inventories	4,192	4 159	5 965	5 919
Allowance for raw materials, spare parts, technological fuel	(2,784)	(2 742)	(3 961)	(3 902)
<b>KOPĀ krājumi</b>	<b>15,604</b>	<b>13 949</b>	<b>22 203</b>	<b>19 848</b>

Changes in the allowance for raw materials and spare parts are included in the Consolidated Income Statement position 'Raw materials and consumables used'.

### Movement on the allowance for raw materials, spare parts and technological fuel:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>2 742</b>	<b>2 459</b>	<b>3 902</b>	<b>3 499</b>
Inventories written off	(48)	(44)	(69)	(63)
Charged to the Consolidated Income Statement	90	327	128	466
<b>At the end of the year</b>	<b>2 784</b>	<b>2 742</b>	<b>3 961</b>	<b>3 902</b>

## 17. TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES

### a) Trade receivables, net

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Receivables</b>				
- Electricity customers	64,637	66,101	91,971	94,053
- Heating customers	19,140	12,324	27,234	17,536
- Other trade receivables	14,450	5,101	20,560	7,258
	<b>98,227</b>	<b>83,526</b>	<b>139,765</b>	<b>118,847</b>
<b>Provision for impairment of receivables</b>				
- Electricity customers	(18,894)	(8,320)	(26,884)	(11,838)
- Heating customers	(295)	(292)	(420)	(416)
- Other trade receivables	(1,217)	(1,105)	(1,732)	(1,572)
	<b>(20,406)</b>	<b>(9,717)</b>	<b>(29,036)</b>	<b>(13,826)</b>
<b>Receivables, net</b>				
- Electricity customers	45,743	57,781	65,087	82,215
- Heating customers	18,845	12,032	26,814	17,120
- Other trade receivables	13,233	3,996	18,828	5,686
	<b>77,821</b>	<b>73,809</b>	<b>110,729</b>	<b>105,021</b>

There is no significant concentration of credit risk with respect to trade receivables, as the Group has a large number of customers.



Electricity receivables grouped by past due days and calculated impairment loss:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Electricity receivables:</b>				
Fully performing receivables	37,974	44,151	54,033	62,821
Receivables past due but not impaired:				
- Receivables past due by 1-45 days	4,140	4,826	5,891	6,867
Impaired receivables:				
- Receivables past due by 46-90 days	507	702	721	999
- Receivables past due by 91-180 days	691	909	983	1,293
- Receivables past due by more than 181 day	9,376	7,034	13,341	10,008
- Individually impaired receivables with scheduled payments	11,949	8,479	17,002	12,065
	<b>64,637</b>	<b>66,101</b>	<b>91,971</b>	<b>94,053</b>
<b>Provision for impaired electricity receivables:</b>				
- Receivables past due by 46-90 days	(253)	(351)	(360)	(499)
- Receivables past due by 91-180 days	(518)	(683)	(737)	(972)
- Receivables past due by more than 181 day	(9,376)	(7,034)	(13,341)	(10,008)
- Individually impaired receivables with scheduled payments	(8,747)	(252)	(12,446)	(359)
	<b>(18,894)</b>	<b>(8,320)</b>	<b>(26,884)</b>	<b>(11,838)</b>
<b>Electricity receivables, net</b>				
Fully performing receivables	37,974	44,151	54,033	62,821
Receivables past due but not impaired:				
- Receivables past due by 1-45 days	4,140	4,826	5,891	6,867
Net impaired receivables:				
- Receivables past due by 46-90 days	254	351	361	499
- Receivables past due by 91-180 days	173	226	246	322
- Individually impaired receivables with scheduled payments	3,202	8,227	4,556	11,706
	<b>45,743</b>	<b>57,781</b>	<b>65,087</b>	<b>82,215</b>

### Heating and other receivables grouped by past due days and calculated impairment loss:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Heating and other trade receivables:</b>				
Fully performing receivables	31,367	15,697	44,631	22,335
Receivables past due but not impaired:				
- Receivables past due by 1-30 days	656	258	933	367
Impaired receivables:				
- Receivables past due by 31-90 days	96	142	137	202
- Receivables past due by more than 91 day	1,471	1,328	2,093	1,890
	<b>33,590</b>	<b>17,425</b>	<b>47,794</b>	<b>24,794</b>
<b>Provision for impaired heating and other trade receivables:</b>				
- Receivables past due by 31-90 days	(41)	(69)	(59)	(98)
- Receivables past due by more than 91 day	(1,471)	(1,328)	(2,093)	(1,890)
	<b>(1,512)</b>	<b>(1,397)</b>	<b>(2,152)</b>	<b>(1,988)</b>
<b>Heating and other trade receivables, net</b>				
Fully performing receivables	31,367	15,697	44,631	22,335
Receivables past due but not impaired:				
- Receivables past due by 1-30 days	656	258	933	367
Net impaired receivables:				
- Receivables past due by 31-90 days	55	73	78	104
	<b>32,078</b>	<b>16,028</b>	<b>45,642</b>	<b>22,806</b>

The Group's Management has estimated provisions for impairment of receivables on the basis of aging of trade receivables and by evaluating liquidity and history of previous payments of each significant debtor (see point 2.11).

The carrying amount of trade receivables, less provision for impairment, is assumed to approximate their fair values.

The Group's Management assumptions and methodology for estimation of recoverable amount of trade receivables and evaluation of impairment risk are described in Note 4 b.



## Receivables credit quality:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Fully performing electricity receivables:</b>				
- customers with no overdue receivables	30,054	36,908	42,763	52,515
- customers with overdue receivables	7,920	7,243	11,270	10,306
	<b>37,974</b>	<b>44,151</b>	<b>54,033</b>	<b>62,821</b>
<b>Fully performing heating and other receivables:</b>				
- customers with no overdue receivables	30,529	15,209	43,439	21,641
- customers with overdue receivables	838	488	1,192	694
<b>TOTAL fully performing trade receivables</b>	<b>31,367</b>	<b>15,697</b>	<b>44,631</b>	<b>22,335</b>

The basis for estimating the credit quality of fully performing trade receivables not due yet and not written down are

internal ratings by reference to earlier credit behaviour of clients.

## Movements in allowances for impairment of trade receivables are as follows:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>9,717</b>	<b>8,218</b>	<b>13,825</b>	<b>11,692</b>
Receivables written off during the year as uncollectible	(203)	(575)	(289)	(818)
Allowance for impaired receivables	10,892	2,074	15,500	2,951
<b>At the end of the year</b>	<b>20,406</b>	<b>9,717</b>	<b>29,036</b>	<b>13,825</b>

The charge and release of allowance for impaired trade receivables due to delayed payments have been recorded in

the Consolidated Income Statement position 'Other operating expenses' as selling expenses and customer services costs (Note 10).

### *b) Other current receivables*

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Accrued income	7,574	6,986	10,777	9,940
Pre-tax and overpaid taxes	12,944	9,029	18,417	12,847
Deferred expenses	609	571	866	812
Other current financial receivables	119	609	169	867
Other current non-financial receivables	2,846	416	4,050	592
	<b>24,092</b>	<b>17,611</b>	<b>34,279</b>	<b>25,058</b>

None of the receivables are secured with pledges or otherwise. The carrying amounts of other receivables are assumed to approximate their fair values.

## 18. CASH AND CASH EQUIVALENTS

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Cash at bank	25,316	77,969	36 021	110 940
Short-term bank deposits	145,109	30,908	206 472	43 978
<b>TOTAL cash and cash equivalents</b>	<b>170,425</b>	<b>108,877</b>	<b>242 493</b>	<b>154 918</b>

Cash at bank balances earns daily interest mostly based on floating interbank deposit rates. Short-term deposits are placed for different periods between several days and three

months depending on the immediate cash needs of the Group and cash flow forecasts. During 2012 the average annual effective interest rate earned on short-term cash deposits was 1.05% (2011: 1.53%). See also Note 3.1.b.

The carrying amounts of cash and cash equivalents are assumed to be approximate to their fair values.

## 19. SHARE CAPITAL

As at 31 December 2012, the registered share capital of the Parent Company is LVL 904,605 thousand or EUR 1,287,137 thousand (31/12/2011: LVL 325,862 thousand or EUR 463,660 thousand) and consists of 904,605 thousand ordinary shares (31/12/2011: 325,862 thousand) with the nominal value of LVL 1 per share (31/12/2011: LVL 1 per share). All shares are fully paid up.

In September 2012, in accordance with the Decision of the Management Board No. 170/35 dated 14 August 2012 „On increase in the Share Capital and change of statutes of Latvenergo AS”, share capital was increased by LVL 577,990

thousand or EUR 822,406 thousand, investing positive surplus between equity attributable to equity holders of the Parent Company and amount comprised by share capital and non-distributable reserves. Increase in the share capital was approved by the Parent Company's Shareholders meeting on 22 August 2012 and registered with the Commercial Register of Latvia on 21 September 2012.

In November 2012, in accordance with the Cabinet of Ministers Directive No. 486 dated 16 October 2012: „On the Investment of the State's property units in the Share Capital of Latvenergo AS”, real estate in the amount of LVL 753

thousand or EUR 1,071 thousand was invested in the Parent Company's share capital (2011: real estate in the amount of LVL 2,318 thousand or EUR 3,298 thousand). The value of real estate was determined by independent certified valuation experts applying amortised cost model, based on construction or acquisition costs of similar assets. Increase in the share capital was approved by the Parent Company's Shareholders' meeting on 9 November 2012 and registered with the Commercial Register of Latvia on 25 November 2012.

## 20. RESERVES AND DIVIDENDS

As at 31 December 2012, the Group's reserves in the amount of LVL 452,685 thousand or EUR 644,113 thousand (31/12/2011: LVL 976,921 thousand or EUR 1,390,033 thousand) consist of the property, plant and

equipment revaluation reserve, hedge reserve, currency translation reserve and other reserves. The Group cannot distribute the property, plant and equipment revaluation, currency translation and hedge reserves. Other reserves are

maintained with the aim to maintain stability in the operations of the Group entities. Other reserves can be distributed by a resolution of the shareholders.

	Non-current assets revaluation reserve	Hedge reserve	Trans-lation	Other reserves	TOTAL	Non-current assets revaluation reserve	Hedge reserve	Trans-lation	Other reserves	TOTAL
	LVL'000	LVL'000	LVL'000	LVL'000	LVL'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
<b>As at 31 December 2010</b>	<b>976,180</b>	<b>(3,912)</b>	<b>1</b>	<b>9</b>	<b>972,278</b>	<b>1,388,979</b>	<b>(5,566)</b>	<b>1</b>	<b>13</b>	<b>1,383,427</b>
Transfer from previous year profit	-	-	-	10,257	10,257	-	-	-	14,594	14,594
Disposal of non-current assets revaluation reserve	(1,362)	-	-	-	(1,362)	(1,938)	-	-	-	(1,938)
Deferred tax related to non-current assets revaluation reserve (Note 12)	81	-	-	-	81	115	-	-	-	115
Currency translation differences	-	-	2	-	2	-	-	3	-	3
Loss from fair value changes in derivative financial instruments (Note 21 c, l)	-	(4,335)	-	-	(4,335)	-	(6,168)	-	-	(6,168)
<b>As at 31 December 2011</b>	<b>974,899</b>	<b>(8,247)</b>	<b>3</b>	<b>10,266</b>	<b>976,921</b>	<b>1,387,156</b>	<b>(11,734)</b>	<b>4</b>	<b>14,607</b>	<b>1,390,033</b>
Previous year profit	-	-	-	(10,257)	(10,257)	-	-	-	(14,594)	(14,594)
Investment in share capital (Note 19)	(577,990)	-	-	-	(577,990)	(822,406)	-	-	-	(822,406)
Non-current assets revaluation reserve* (Note 14 a)	87,794	-	-	-	87,794	124,920	-	-	-	124,920
Disposal of non-current assets revaluation reserve	(568)	-	-	-	(568)	(809)	-	-	-	(809)
Adjusted disposal of non-current assets revaluation reserve	828	-	-	-	828	1,178	-	-	-	1,178
Deferred tax related to non-current assets revaluation reserve (Note 12)	(19,225)	-	-	-	(19,225)	(27,354)	-	-	-	(27,354)
Currency translation differences	-	-	65	-	65	-	-	93	-	93
Loss from fair value changes in derivative financial instruments (Note 21 c, l)	-	(4,883)	-	-	(4,883)	-	(6,948)	-	-	(6,948)
<b>As at 31 December 2012</b>	<b>465,738</b>	<b>(13,130)</b>	<b>68</b>	<b>9</b>	<b>452,685</b>	<b>662,685</b>	<b>(18,682)</b>	<b>97</b>	<b>13</b>	<b>644,113</b>

\* includes increase in revalued Daugava hydropower plants in amount of LVL 64,467 thousand or EUR 91,728 and increase in revalued transmission and distribution assets in amount of LVL 23,327 thousand or EUR 33,192 thousand, net of deferred tax

The dividends paid in 2012 were LVL 39,000 thousand or EUR 56,773 thousand (LVL 0.044 or EUR 0.063 per share) and in 2011 - LVL 35,000 thousand or EUR 49,801 thousand (LVL 0.107 or EUR 0.153 per share). The

distribution of net profit for the 2012 is subject to a resolution of the Parent Company's Shareholders meeting.

## 21. FINANCIAL ASSETS AND LIABILITIES

### a) Held-to-maturity financial assets

There were no gains or losses realised on the disposal of held-to-maturity financial assets in 2012 (2011: nil). All held-to-maturity financial assets are denominated in the LVL.

The maximum exposure to credit risk at the reporting date is the carrying amount of held-to-maturity financial assets.

As at 31 December 2012 the entire Group's held-to-maturity financial assets were State Treasury bonds with 5 year and 10 year maturity, which were purchased with the purpose to

invest liquidity reserve in the low risk financial instruments with higher yield. The outstanding amortised value of held-to-maturity financial assets is assumed to approximate their fair values.

### Held to-maturity financial assets carrying amount:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Held-to-maturity financial assets:				
- current	-	44,714	-	63,622
- non-current	20,134	15,670	28,649	22,296
<b>TOTAL held-to-maturity financial assets</b>	<b>20,134</b>	<b>60,384</b>	<b>28,649</b>	<b>85,918</b>

### b) Borrowings

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Non-current borrowings from financial institutions	506,797	462,888	721,107	658,630
Issued debt securities (bonds)	14,033	-	19,967	-
<b>TOTAL non-current borrowings</b>	<b>520,830</b>	<b>462,888</b>	<b>741,074</b>	<b>658,630</b>
Current portion of non-current borrowings from financial institutions	73,208	48,226	104,165	68,619
Accrued interest on non-current borrowings	1,197	2,220	1,704	3,159
<b>TOTAL current borrowings</b>	<b>74,405</b>	<b>50,446</b>	<b>105,869</b>	<b>71,778</b>
<b>TOTAL borrowings</b>	<b>595,235</b>	<b>513,334</b>	<b>846,943</b>	<b>730,408</b>

### Movement in borrowings:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>513,334</b>	<b>545,607</b>	<b>730,408</b>	<b>776,329</b>
Borrowings received	116,947	4,357	166,401	6,199
Borrowings repaid	(48,056)	(36,936)	(68,378)	(52,555)
Change in accrued interest on borrowings	(1,023)	306	(1,455)	435
Issued debt securities (bonds)	14,033	-	19,967	-
<b>At the end of the year</b>	<b>595,235</b>	<b>513,334</b>	<b>846,943</b>	<b>730,408</b>

### Borrowings by categories of lenders:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Foreign investment banks	338,617	316,860	481,808	450,851
Foreign commercial banks	31,704	36,038	45,110	51,277
Financial institutions registered in the Republic of Latvia	210,881	160,436	300,058	228,280
Issued debt securities (bonds)	14,033	-	19,967	-
<b>TOTAL borrowings</b>	<b>595,235</b>	<b>513,334</b>	<b>846,943</b>	<b>730,408</b>

## Borrowings by maturity:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Fixed rate non-current and current borrowings:</b>				
- < 1 year (current portion of non-current borrowings)	297	291	422	414
- 1- 5 years	14,736	984	20,967	1,400
- > 5 years	-	-	-	-
<b>TOTAL fixed rate borrowings</b>	<b>15,033</b>	<b>1,275</b>	<b>21,389</b>	<b>1,814</b>
<b>Floating rate non-current and current borrowings:</b>				
- < 1 year (current portion of non-current borrowings)	74,108	50,155	105,447	71,364
- 1- 5 years	352,162	341,189	501,082	485,468
- > 5 years	153,932	120,715	219,025	171,762
<b>TOTAL floating rate borrowings</b>	<b>580,202</b>	<b>512,059</b>	<b>825,554</b>	<b>728,594</b>
<b>TOTAL borrowings</b>	<b>595,235</b>	<b>513,334</b>	<b>846,943</b>	<b>730,408</b>

## Borrowings by pricing period (considering the effect of derivative financial instruments):

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
- < 1 year	321,707	270,560	457,748	384,972
- 1- 5 years	210,275	186,550	299,195	265,437
- > 5 years	63,253	56,224	90,000	79,999
<b>TOTAL borrowings:</b>	<b>595,235</b>	<b>513,334</b>	<b>846,943</b>	<b>730,408</b>

At 31 December 2012 and at 31 December 2011 the Group had none of their borrowings denominated in other currencies than Euro.

The fair value of current and non-current borrowings with floating rates equals their carrying amount, as their actual floating interest rates approximate the market price of similar financial instruments available to the Group, and the effect of fair value revaluation is not significant. The fair value of current and non-current borrowings with fixed rates (excluding the effect of derivative financial instruments) exceeds their carrying amounts by LVL 79.35 thousand or EUR 112.9 thousand (2011: LVL 26.2 thousand or EUR 37.3 thousand). The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by the Group's credit risk margin. The average interest rate for discounting cash flows of non-current borrowings was 2.356% (2011: 5.185%).

### *I) Pledges*

The Group's assets are not pledged to secure the borrowings, except the pledge assets of Liepājas Enerģija SIA of maximum secured claims in the amount of LVL 21.2 million or EUR 30.2 million (31/12/2011: LVL 14.8 million or EUR 21.1 million) to secure its current and non-current borrowings. There has been pledged the property, plant and equipment in the net book amount of LVL 17.8 million or EUR 25.3 million and the claims on the receivables accounts in the amount of LVL 3.4 million or EUR 4.8 million (31/12/2011: LVL 12.8 million or EUR 18.2 million and LVL 2.0 million or EUR 2.8 million, respectively).

### *II) Un-drawn borrowing facilities*

As at 31 December 2012 the undrawn portion of committed non-current credit facilities amounts to LVL 145.7 million or EUR 207.3 million (31/12/2011: LVL 257.5 million or EUR 366.4 million).

At 31 December 2012 the Group had available LVL 23.6 million or EUR 33.6 million (31/12/2011: LVL 23.6 million or EUR 33.6 million) of undrawn committed short-term borrowing facilities in respect of which all conditions precedent had been met.

### *III) Weighted average effective interest rate*

During the reporting year the weighted average effective interest rate (including interest rate swaps) on non-current borrowings was 2.87% (2011: 3.03%), weighted average effective interest rate for current borrowings was 1.08% (2011: 2.44%). At 31 December 2012 interest rates for non-current borrowings in Euro were 3 and 6 month EURIBOR+0.74% (31/12/2011: +0.45%). At 31 December 2012 seventeen interest rate swap agreements were concluded by the Group for the total notional amount of LVL 269.1 million or EUR 382.8 million (31/12/2011: fifteen interest rate swap agreements in amount of LVL 241.5 million or EUR 343.6 million) and the interest rate was fixed for the periods from 6 to 10 years.

#### M) Bonds issued

In December 2012 Latvenergo AS has carried out a bond issued in the nominal amount of EUR 20 million under Latvenergo AS LVL 50 million (or its equivalent in EUR)

programme for the issuance of bonds. The annual coupon rate is 2.8% and the maturity date is 15 December 2017. At the end of period the issued debt securities (bonds) is measured at amortised cost.

#### c) Derivative financial instruments

##### 1) Outstanding fair values of derivatives and their classification

In the table below outstanding fair values of derivatives are disclosed as follows:

	31/12/2012		31/12/2011		31/12/2012		31/12/2011	
	LVL'000		LVL'000		EUR'000		EUR'000	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate swaps (Note 21 c, II)	-	16,735	-	11,819	-	23,812	-	16,817
Electricity swaps (Note 21 c, III)	(4,195)	7,964	(2,060)	7,347	(5,969)	11,331	(2,931)	10,454
CO <sub>2</sub> emissions allowances forward contracts (Note 21 c, IV)	-	-	-	4,597	-	-	-	6,541
Forward foreign currencies exchange contracts (Note 21 c, V)	(42)	-	(390)	-	(60)	-	(555)	-
<b>TOTAL outstanding fair values of derivatives:</b>	<b>(4,237)</b>	<b>24,699</b>	<b>(2,450)</b>	<b>23,763</b>	<b>(6,029)</b>	<b>35,143</b>	<b>(3,486)</b>	<b>33,812</b>

##### (Gains) / losses on fair value changes as a result of realised hedge agreements:

	31/12/2012		31/12/2011		31/12/2012		31/12/2011	
	LVL'000		LVL'000		EUR'000		EUR'000	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Non-current	-	12,555	-	10,629	-	17,864	-	15,124
Current	(4,237)	12,144	(2,450)	13,134	(6,029)	17,279	(3,486)	18,688
<b>TOTAL fair values of derivative financial instruments</b>	<b>(4,237)</b>	<b>24,699</b>	<b>(2,450)</b>	<b>23,763</b>	<b>(6,029)</b>	<b>35,143</b>	<b>(3,486)</b>	<b>33,812</b>

	2012		2011		2012		2011	
	LVL'000		LVL'000		EUR'000		EUR'000	
<b>Included in the Consolidated Income Statement</b>								
Interest rate swaps (Note 11)		283		641		403		912
Electricity swaps (Note 8)		(1,525)		7,759		(2,170)		11,040
CO <sub>2</sub> emissions allowances forward contracts (Note 8)		(4,598)		1,155		(6,542)		1,643
Forward foreign currencies exchange contracts (Note 11)		105		(105)		149		(149)
		<b>(5,735)</b>		<b>9,450</b>		<b>(8,160)</b>		<b>13,446</b>
<b>Included in other comprehensive income</b>								
Interest rate swaps (Note 20)		4,633		4,135		6,592		5,884
Electricity (Note 20)		7		(79)		10		(113)
Forward foreign currencies exchange contracts (Note 20)		243		279		346		397
		<b>4,883</b>		<b>4,335</b>		<b>6,948</b>		<b>6,168</b>

According to amendments to IAS 1 a financial liability or asset that is not held for trading purposes should be presented as current or non-current on the basis of its settlement date.

Derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months

after the end of the reporting period have been classified as non-current assets or liabilities.

II) *Interest rate swaps*

As at 31 December 2012 the Group had seventeen interest rate swap agreements with total notional amount of LVL 269.1 million or EUR 382.8 million (31/12/2011: LVL 241.5 million or EUR 343.6 million). Interest rate swaps are concluded with 6 to 10 year maturities and hedged floating

rates are 3 and 6 month EURIBOR. As at 31 December 2012 fixed interest rates vary from 1.548% to 4.4925% (31/12/2011: from 2.3835% to 4.4925%).

Fourteen of all outstanding interest rate swap agreements (2011: 12 agreements) are designated to comply with hedge accounting and were re-measured prospectively

and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. It was established that they are fully effective and therefore there is no ineffective portion to be recognised within profit or loss in the Consolidated Income Statement.

**In the table below fair value changes of interest rate swaps are disclosed:**

	2012		2011		2012		2011	
	LVL'000		LVL'000		EUR'000		EUR'000	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
<b>Outstanding fair value at the beginning of the year</b>	-	11,819	(1,011)	8,054	-	16,817	(1,439)	11,460
Included in the Consolidated Income Statement, net (Note 11)	-	283	-	641	-	403	-	912
Included in other comprehensive income (Note 20)	-	4,633	1,011	3,124	-	6,592	1,439	4,445
<b>Outstanding fair value at the end of the year</b>	-	16,735	-	11,819	-	23,812	-	16,817

The main interest rate hedging criteria stated in the Financial Risk Management policy is to ensure average fixed rate duration from 2 to 4 years and fixed rate portion at more than 35% of borrowings. As at 31 December 2012 46% (31/12/2011: 47%) of the Group's borrowings had fixed interest rates (taking into account the effect from the interest rate swaps), and average remaining time to interest re-pricing was 2.0 years (2011: 2.13 years).

III) *Electricity swaps*

As at 31 December 2012 the Group has entered into 137 (31/12/2011: 125) electricity swap contracts with total

outstanding volume of 4,180,372 MWh (31/12/2011: 4,418,243 MWh) and notional value of LVL 129.3 million or EUR 184 million (2011: LVL 139.2 million or EUR 198 million). Electricity swaps are signed for the maturities from one month to one year during the period from 1 January 2013 to 31 December 2014.

Electricity swap contracts are agreed for hedging purposes through financial counterparties and by using the Nordic energy exchange Nord Pool Spot pricing. All purchased swap contracts were contracts with fixed amount of electricity and price in Euros.

As at 31 December 2012 29 (31/12/2011: 57) electricity swap contracts are designated to comply with hedge accounting treatment and were re-measured prospectively and retrospectively to test whether they are effective within the hedging period. All contracts are designed as cash flow hedges. As there was no ineffectiveness to be recorded through profit or loss in the Consolidated Income Statement, then fair value gains or losses are recognised in the hedging reserve in 'Other comprehensive income' (Note 20).

**In the table below fair value changes of electricity swaps are disclosed:**

	2012		2011		2012		2011	
	LVL'000		LVL'000		EUR'000		EUR'000	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Outstanding fair value at the beginning of the year	(2,060)	7,347	(2,393)	-	(2,931)	10,453	(3,405)	-
Included in the Consolidated Income Statement (Note 8)	-	(1,525)	2,393	5,366	-	(2,170)	3,405	7,635
Included in other comprehensive income (Note 20)	(2,135)	2,142	(2,060)	1,981	(3,038)	3,048	(2,931)	2,818
<b>Outstanding fair value at the end of the year</b>	<b>(4,195)</b>	<b>7,964</b>	<b>(2,060)</b>	<b>7,347</b>	<b>(5,969)</b>	<b>11,331</b>	<b>(2,931)</b>	<b>10,453</b>



*M) CO<sub>2</sub> emissions allowances forward contracts*

As at 31 December 2012 the Group has no outstanding contracts of CO<sub>2</sub> emission allowances purchase or sale (31/12/2011: 24).

As at 31 December 2012 total amount of allocated and procured CO<sub>2</sub> emission allowances for the allocation period till the end of 2012 is sufficient to offset emissions. Over the European Union Emissions Trading System Phase II the Parent Company has used the allowed option to procure and offset 10% of allocated European Union Allowances (EUA) with cheaper Certified Emission Reductions (CER).

In 2012 CO<sub>2</sub> emission allowances forward contracts fair value changes are included in the Consolidated Income Statement in the amount of LVL 4,598 thousand or EUR 6,542 thousand (Note 8) (31/12/2011: LVL 1,155 thousand or EUR 1,643 thousand).

In the table below fair value changes of CO<sub>2</sub> emission allowances forward contracts are disclosed:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
	Liabilities	Liabilities	Liabilities	Liabilities
<b>Outstanding fair value at the beginning of the year</b>	<b>4,598</b>	<b>3,443</b>	<b>6,542</b>	<b>4,899</b>
Included in the Consolidated Income Statement (Note 8)	(4,598)	1,155	(6,542)	1,643
<b>Outstanding fair value at the end of the year</b>	<b>-</b>	<b>4,598</b>	<b>-</b>	<b>6,542</b>

*V) Forward foreign currencies exchange contracts*

As at 31 December 2012 the Group has entered into EUR/ USD forward foreign currencies exchange contracts. The notional principal amount of the outstanding forward foreign currencies exchange contracts as at 31 December 2012 were USD 3.2 million or LVL 1.7 million (31/12/2011: USD 9.4 million or LVL 5.1 million). As at 31 December 2012 the Group has no outstanding LVL/EUR forward foreign currencies exchange contracts (31/12/2011: EUR 42.0 million or LVL 29.5 million – the notional principal amount of contracts).

The hedged highly probable forecasted USD currency transactions are expected to occur at various dates during the next 9 months. Fair value gains and losses on EUR/ USD forward foreign currencies exchange contracts as at 31 December 2012 are recognised in the hedging reserve in 'Other comprehensive income' (Note 20) as they qualify under IAS 39 requirements of hedge accounting.

All outstanding EUR/USD forward foreign currencies exchange contracts at 31 December 2012 were designed as cash flow hedges for USD transactions of Riga TEC-2 combined heat and power plant second power generation unit reconstruction contract. As at the date of conclusion of these contracts it was not possible to use LVL/USD forward foreign currencies exchange contracts due to limited

maturities and availability, then instead the EUR/USD forward foreign currencies exchange contracts were used to employ the existing peg between Latvian Lats and Euros.

There was no ineffectiveness to be recorded through profit or loss in the Consolidated Income Statement from EUR/ USD forward foreign currencies exchange contracts. The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in the Consolidated Statement of Financial Position.

In 2012 LVL/EUR forward foreign currencies exchange contracts fair value gains and losses are recognised through profit or loss in the Consolidated Income Statement (Note 11).

In the table below fair value changes of forward foreign currencies exchange contracts are disclosed:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
	Assets	Assets	Assets	Assets
<b>Outstanding fair value at the beginning of the year</b>	<b>(390)</b>	<b>(564)</b>	<b>(554)</b>	<b>(802)</b>
Included in the Consolidated Income Statement (Note 11)	105	(105)	149	(149)
Included in other comprehensive income (Note 20)	243	279	346	397
<b>Outstanding fair value at the end of the year</b>	<b>(42)</b>	<b>(390)</b>	<b>(59)</b>	<b>(554)</b>

## 22. PROVISIONS

### a) Provisions for post-employment benefits

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>7,734</b>	<b>7,321</b>	<b>11,004</b>	<b>10,417</b>
Current service cost	308	283	438	403
Interest cost	442	422	629	600
Post-employment benefits paid	(985)	(353)	(1,401)	(503)
Losses as a result of changes in actuarial assumptions	261	61	372	87
<b>At the end of the year</b>	<b>7,760</b>	<b>7,734</b>	<b>11,042</b>	<b>11,004</b>

Total charged/credited provisions are included in the Consolidated Income Statement position 'Personnel

expenses' within state social insurance contributions and other benefits defined in the Collective agreement (see Note 9):

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>7,734</b>	<b>7,321</b>	<b>11,004</b>	<b>10,417</b>
Charged to the Consolidated Income Statement	26	413	38	587
<b>At the end of the year</b>	<b>7,760</b>	<b>7,734</b>	<b>11,042</b>	<b>11,004</b>

Discount rate used for discounting benefit obligations was 5.7% (2011: 6.15%), considering the market yields on government bonds at the end of the reporting year. The Group's Collective Agreement provides indexation of

employees' wages at least at the level of inflation. Long-term inflation determined at the level of 3% (2011: 3%) when calculating long-term post-employment benefits.

In calculation of these liabilities also the probability, determined on the basis of previous experience, of retirement in different employees' aging groups was also considered.

### b) Environmental provisions

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>1,783</b>	<b>1,376</b>	<b>2,537</b>	<b>1,958</b>
Charged to the Consolidated Income Statement	965	407	1,373	579
<b>At the end of the year</b>	<b>2,748</b>	<b>1,783</b>	<b>3,910</b>	<b>2,537</b>

The environmental provision in the amount of LVL 2,748 thousand or EUR 3,910 thousand (2011: LVL 1,783 thousand or EUR 2,537 thousand) represents the estimated cost of cleaning up Riga TEC-1 combined heat and power plant ash-fields in accordance with the requests made by the

regional Environmental Authority of Riga and feasibility study on this project in the amount of LVL 1,000 thousand or EUR 1,423 thousand (2011: LVL 1,028 thousand or EUR 1,463 thousand) and SIA „Liepājas Enerģija” provision for the environmental recovery measures in the amount of LVL 1,748

thousand or EUR 2,487 thousand (2011: LVL 755 thousand or EUR 1,074 thousand). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau).

## 23. OTHER LIABILITIES AND DEFERRED INCOME

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Deferred non-current income from connection fees	92,777	87,181	132,010	124,048
Deferred income on financing from European Union funds	12,338	7,252	17,555	10,318
Deferred income from plant and equipment received free of charge	310	366	442	521
Other non-financial liabilities	-	16	-	23
<b>TOTAL other liabilities and deferred income:</b>	<b>105,425</b>	<b>94,815</b>	<b>150,007</b>	<b>134,910</b>

### Movement in deferred connection fees (non-current and current part):

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>At the beginning of the year</b>	<b>92,277</b>	<b>87,901</b>	<b>131,298</b>	<b>125,072</b>
Received fees	6,787	9,753	9,657	13,877
Credited to the Consolidated Income Statement	(6,206)	(5,377)	(8,830)	(7,651)
<b>At the end of the year</b>	<b>92,858</b>	<b>92,277</b>	<b>132,125</b>	<b>131,298</b>



## 24. TRADE AND OTHER PAYABLES

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>Financial liabilities:</b>				
Payables for materials and services	69,994	56,672	99,592	80,637
Payables for electricity	19,784	14,962	28,150	21,289
Accrued expenses	7,128	5,621	10,142	7,998
Other financial current payables	884	906	1,258	1,289
<b>TOTAL financial liabilities</b>	<b>97,790</b>	<b>78,161</b>	<b>139,142</b>	<b>111,213</b>
<b>Non-financial liabilities:</b>				
Value added tax payable	11,554	14,305	16,440	20,354
State social security contributions and other taxes	5,608	6,482	7,979	9,223
Advances received	8,731	8,701	12,423	12,380
Deferred income from connection fees	6,379	5,095	9,077	7,250
Deferred income on financing from EU funds:				
The European Energy Development Program – 330 kV „Kurzeme Ring”	3,030	5,947	4,311	8,462
The EU Cohesion Fund – reconstruction of SIA „Liepājas Enerģija” heating network	315	151	449	215
The EU Regional Development Fund – woodchip boiler house construction in Kegums	12	12	17	17
Other non-financial current payables	2,580	2,360	3,671	3,358
<b>TOTAL non-financial liabilities</b>	<b>38,209</b>	<b>43,053</b>	<b>54,367</b>	<b>61,259</b>
<b>TOTAL trade and other current payables:</b>	<b>135,999</b>	<b>121,214</b>	<b>193,509</b>	<b>172,472</b>

The carrying amounts of trade and other payables are assumed to approximate their fair values.

## 25. 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, key management personnel of the

Group and Supervisory body – Audit committee, as well as companies over which the Group entities has significant influence.

The following transactions were carried out with related parties:

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>a) Sales of goods:</b>				
- Associates (electricity sales)	2,856	2,448	4,064	3,483
- Government-related entities (heat and electricity sales)	97,419	60,356	138,615	85,879
	<b>100,275</b>	<b>62,804</b>	<b>142,679</b>	<b>89,362</b>
<b>b) Sales of services:</b>				
- Associates	-	626	-	891
- Government-related entities	43,543	6	61,956	8
	<b>43,543</b>	<b>632</b>	<b>61,956</b>	<b>899</b>
<b>c) Purchases of goods:</b>				
- Associates (electricity purchases)	824	407	1,172	579
- Government-related entities (heat and electricity purchases)	18,065	9,254	25,704	13,167
	<b>18,889</b>	<b>9,661</b>	<b>26,876</b>	<b>13,746</b>
<b>d) Purchases of services:</b>				
- Associates	2,148	2,277	3,057	3,240
- Government-related entities	52,282	211	74,391	300
	<b>54,430</b>	<b>2,488</b>	<b>77,448</b>	<b>3,540</b>

Balances at the end of the year arising from sales/purchases:

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>a) Trade receivables from related parties:</b>				
- Associates	267	432	380	615
- Government-related entities	21,087	10,082	30,004	14,345
	<b>21,354</b>	<b>10,514</b>	<b>30,384</b>	<b>14,960</b>
<b>b) Trade payables to related parties:</b>				
- Associates	493	351	701	499
- Government-related entities	8,378	1,203	11,921	1,712
	<b>8,871</b>	<b>1,554</b>	<b>12,622</b>	<b>2,211</b>

The Group has not incurred write-offs of trade payables and receivables from transactions with related parties, as all debts are recoverable.

Receivables and payables with related parties are current balances for services and goods. None of the amounts at the end of the reporting year are secured.

Remuneration to the key management personnel that is defined as Members of the Management Boards of the Group entities and Supervisory body is disclosed in Note 9.

## 26. ISSUED GUARANTEES

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
Outstanding issued guarantees by the Group to guarantee obligations to third parties:				
<b>Guarantee on behalf of Nordic Energy Link AS</b>	<b>8,994</b>	<b>9,922</b>	<b>12,797</b>	<b>14,118</b>

Guarantee on behalf of Nordic Energy Link AS was provided for receiving long-term loan facility. As at 31 December 2012 the outstanding amount of the issued guarantee on behalf of Nordic Energy Link AS (validity term – 15 December 2014) is LVL 8,994 thousand or EUR 12,797 (31/12/2011: LVL 9,922 thousand or EUR 14,118 thousand).

The fair value of guarantee is LVL 199.9 thousand or EUR 284.4 thousand (31/12/2011: LVL 335.6 thousand or EUR 477.5 thousand). The fair value calculations are based on the estimated amount of service fee receivable discounted

at EUR swap rates increased by the Group's credit risk margin. During 2012 the average interest rate for discounting cash flow was 2.23% (2011: 4.55%).

## 27. CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As at 31 December 2012 the Group had commitments amounting to LVL 197.4 million or EUR 280.9 million (31/12/2011: LVL 344.8 million or EUR 490.6 million) for capital expenditure contracted but not delivered at the end of the reporting period.

During the ordinary course of business the Group may become a party to legal proceedings and disputes, including claims in relation to actions of regulatory and supervisory institutions. Currently the Company is invited as a third party to the Administrative Court, questioning the legitimacy of

the action of the Public Utilities Commission not to object to the latest end user tariff increase. On 25 June 2012, the Administrative Regional court finished a review of complaints on the electricity tariff and carried out a judgement repealing such tariff as of the day it has been approved. Following the submission of cassation complaints, on 31 January 2013, the Senate of the Supreme Court set aside and forwarded the matter to be adjudicated de novo in the Administrative Regional court, stating that (i) the Administrative Regional court had incorrectly defined the object of the case and

thus the finding to repeal the decision of the regulatory body would not result in repealing of tariffs, (ii) the Company as the third party has no obligation to compensate the damages to the electricity users and (iii) obligation to compensate the damages to the electricity users lies on the regulatory body as a respondent. The Administrative Regional court will start review of the case on 16 May 2013. It is important to note that until a final and non-appealable judgement is announced, the Company is applying present tariffs that are in force as from 1 April 2011.

## 28. EVENTS AFTER THE REPORTING PERIOD

On 30 January 2013 Latvenergo AS realised additional issue of bonds in the amount of EUR 30,000,000 under the first series of bonds and on 21 March 2013 implemented successful placement of notes in the amount of EUR 20,000,000 under the first series of notes. Upon admission of the additionally issued bonds to the regulated market the bonds will be consolidated and form a single series with the EUR 20,000,000 bonds issued on 19 December 2012, thus forming the series of bonds in the total amount of EUR 70,000,000.

On 19 April 2013 the Shareholders Meeting of Latvenergo AS decided to increase the aggregate principal amount of the notes to be issued under the Programme from 50 million lats or its equivalent in euro to 85 million lats or its equivalent in euro with book-entry within AS Latvian Central Depository and listing on AS NASDAQ OMX Riga. Accordingly, Latvenergo AS plans to supplement the Base Prospectus of the Programme for the issuance of notes that was originally approved by the Management Board on 23 November 2012

and registered with the Latvian Financial and Capital Market Commission on 28 November 2012.

There have been no significant events subsequent to the end of the reporting year that might have a material effect on the Group's Consolidated Financial Statements for the year ended 31 December 2012.

## 29. DISCONTINUED OPERATIONS

Following the regulation No. 635 of the Cabinet of Ministers of Latvia dated 5 December 2011 „On purchase of shares and the shareholder of Augstsprieguma tīkls AS” and according to the agreement „On purchase of shares” dated 30 December 2011 the investments in subsidiary undertaking Augstsprieguma tīkls AS is disposed of. As at 31 December 2011 investment in Augstsprieguma tīkls AS has been estimated in recoverable amount and therefore has not any effect to the Group's Consolidated Income Statement when the sales transaction was completed on January 2012. Augstsprieguma tīkls AS was engaged in provision of the

electricity transmission services within the Group.

The Group retained its transmission assets, but lease them out to Augstsprieguma tīkls AS who continue providing electricity transmission services with those assets.

Accordingly, the Group continue purchasing transmission services from this entity, and lease its assets and provide other necessary services to the entity necessary to the latter for providing these services. In 2012 such transactions represented as external transactions, while in 2011 such transactions were represented as intra-group transactions

and were therefore eliminated: purchase of transmission services in the amount of LVL 57,740 thousand or EUR 82,157 thousand (costs are disclosed in Note 8), lease of transmission assets in the amount of LVL 22,813 thousand or EUR 32,460 thousand, and sales of electricity and other services in the amount of LVL 32,096 thousand or EUR 45,668 thousand (revenue is disclosed in Note 6). Discontinued operations segment operating profit for the year 2011 amounted to LVL 2,123 thousand or EUR 3,021 thousand and net profit to LVL 546 thousand or EUR 777 thousand.

## 30. FINANCIAL INFORMATION ON THE PARENT COMPANY

Financial information disclosed on the Parent Company includes the primary separate Financial Statements of the Parent Company, the disclosure of which is required by the Accounting Act of Latvia. The primary Financial Statements of the Parent Company have been prepared using the same

accounting policies that have been used in the preparation of the Consolidated Financial Statements. Investments in subsidiaries are reported at cost less any impairment charge in the separate Financial Statements of the Parent Company.

### Income Statement

	2012	2011	2012	2011
	LVL'000	LVL'000	EUR'000	EUR'000
Revenue	657,457	700,914	935,477	997,311
Other income	2,015	3,222	2,867	4,585
Income on transfer of operating segment	-	577,989	-	822,404
Raw materials and consumables used	(345,183)	(325,818)	(491,151)	(463,597)
Personnel expense	(22,135)	(21,454)	(31,495)	(30,526)
Depreciation, amortisation and impairment of intangible assets and property, plant and equipment	(52,102)	(100,559)	(74,134)	(143,083)
Other operating expenses	(203,357)	(169,171)	(289,351)	(240,708)
<b>Operating profit</b>	<b>36,695</b>	<b>665,123</b>	<b>52,213</b>	<b>946,386</b>
Income from investments in subsidiaries	3,449	725	4,907	1,032
Finance income	8,799	5,706	12,520	8,118
Finance costs	(11,417)	(13,885)	(16,245)	(19,757)
<b>Profit before tax</b>	<b>37,526</b>	<b>657,669</b>	<b>53,395</b>	<b>935,779</b>
Income tax	(6,345)	295	(9,028)	420
<b>Profit for the year</b>	<b>31,181</b>	<b>657,964</b>	<b>44,367</b>	<b>936,199</b>

## Statement of Financial Position

	31/12/2012	31/12/2011	31/12/2012	31/12/2011
	LVL'000	LVL'000	EUR'000	EUR'000
<b>ASSETS</b>				
Intangible assets	8,664	8,065	12,328	11,476
Property, plant and equipment	1,055,757	952,048	1,502,207	1,354,643
Investment property	896	-	1,275	-
Financial investment	845,375	884,391	1,202,861	1,258,375
<b>TOTAL non-current assets</b>	<b>1,910,692</b>	<b>1,844,504</b>	<b>2,718,671</b>	<b>2,624,494</b>
Inventories	4,691	4,697	6,675	6,683
Trade and other receivables	178,337	145,251	253,750	206,675
Derivative financial instruments	4,237	2,450	6,029	3,486
Held-to-maturity assets	-	44,714	-	63,622
Cash and cash equivalents	163,437	101,841	232,550	144,907
<b>TOTAL current assets</b>	<b>350,702</b>	<b>298,953</b>	<b>499,004</b>	<b>425,373</b>
<b>TOTAL ASSETS</b>	<b>2,261,394</b>	<b>2,143,457</b>	<b>3,217,675</b>	<b>3,049,867</b>
<b>EQUITY</b>				
Share capital	904,605	325,862	1,287,137	463,660
Non-current assets revaluation reserve	466,275	411,959	663,449	586,165
Hedge reserve	(13,130)	(8,247)	(18,682)	(11,734)
Other reserves	50,172	9,562	71,389	13,606
Retained earnings	31,181	657,964	44,367	936,199
<b>TOTAL equity</b>	<b>1,439,103</b>	<b>1,397,100</b>	<b>2,047,660</b>	<b>1,987,896</b>
<b>LIABILITIES</b>				
Provisions	3,802	3,918	5,410	5,575
Borrowings	509,736	454,783	725,289	647,098
Deferred income tax liabilities	83,423	74,896	118,700	106,567
Derivative financial instruments	12,555	10,629	17,864	15,124
Other non-current liabilities	535	3,933	761	5,596
<b>TOTAL non-current liabilities</b>	<b>610,051</b>	<b>548,159</b>	<b>868,024</b>	<b>779,960</b>
Borrowings	78,003	60,642	110,988	86,286
Trade and other payables	86,763	97,220	123,454	138,332
Derivative financial instruments	12,344	13,470	17,564	19,166
Other current liabilities	35,130	26,866	49,985	38,227
<b>TOTAL current liabilities</b>	<b>212,240</b>	<b>198,198</b>	<b>301,991</b>	<b>282,011</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>2,261,394</b>	<b>2,143,457</b>	<b>3,217,674</b>	<b>3,049,867</b>

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**INDEPENDENT AUDITORS' REPORT**

To the shareholder of AS Latvenergo

**Report on the financial statements**

We have audited the accompanying consolidated financial statements of AS Latvenergo and its subsidiaries (the "Group"), set out on pages 84 through 144 of the accompanying 2012 Consolidated Annual Report, which comprise the consolidated statement of financial position as at 31 December 2012, and consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

**Management's responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable

assurance about whether the financial statements are free from material misstatement.

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

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

**Opinion**

In our opinion, the consolidated financial statements give a true and fair view of the financial position of AS Latvenergo and its subsidiaries as of 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

**Report on other legal and regulatory requirements**

Furthermore, we have read the management report for the year ended 31 December 2012 (set out on pages 82 through 83 of the accompanying 2012 Consolidated Annual Report) and have not noted any material inconsistencies between the financial information included in it and the consolidated financial statements for the year ended 31 December 2012.

We have assured ourselves that the Group has prepared the corporate management report for the year 2012 and verified information presented in the report according to requirements listed in the section 56.1 first paragraph clauses 3, 4, 6, 8 and 9 and the section 56.2 second paragraph clause 5 in the Law on Financial Instruments Market of Republic of Latvia.

SIA Ernst & Young Baltic  
Licence No. 17

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

Rīga,  
23 April 2013