

**BASE PROSPECTUS**  
**23 November 2012**

**AS Latvenergo**

**LVL 50,000,000**  
**or its equivalent in EUR**

**Programme for the issuance of Notes**

The prospectus relating to a series of Notes issued under the Programme consists of this Base Prospectus and the Final Terms

Arranger of the Programme:



**AS SEB banka**

NEITHER THIS BASE PROSPECTUS NOR ANY FINAL TERMS DOES CONSTITUTE AN OFFER TO SELL OR A SOLICITATION OF AN OFFER TO BUY THE NOTES IN ANY JURISDICTION TO ANY PERSON TO WHOM IT IS UNLAWFUL TO MAKE SUCH AN OFFER OR SOLICITATION IN SUCH JURISDICTION.

## INFORMATION CONCERNING THE BASE PROSPECTUS

### General

In this base prospectus (the “**Base Prospectus**”), any reference to the “**Company**” or the “**Issuer**” means AS Latvenergo and the “**Group**” means AS Latvenergo together with its consolidated subsidiaries. In this Base Prospectus the “**Arranger of the Programme**” and the “**Issuing Agent**” refers to AS SEB banka.

In this Base Prospectus, unless otherwise specified, references to a “**Member State**” are references to a Member State of the European Economic Area, references to “**€**”, “**EUR**” or “**euro**” are to the single currency introduced at the start of the third stage of the European Economic and Monetary Union pursuant, and as defined in Article 2 of the Council Regulation (EC) No.974/98 of 3 May 1998 on the introduction of the euro, as amended, and references to “**LVL**”, “**Ls**” or “**lats**” are to the lawful currency for the time being of the Republic of Latvia. The Bank of Latvia’s foreign exchange rate for euro since 1 January 2005 has been fixed at LVL 0.702804 = EUR 1.00.

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 and 2011 respectively and the unaudited consolidated interim report of the Group for the six month periods ended 30 June 2011 and 30 June 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).

This Base Prospectus has been prepared by the Issuer in accordance with the Financial Instruments Market Law of Latvia and Commission Regulation (EC) No. 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses, as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements. The Issuer will, as deemed necessary, supplement the Base Prospectus with updated information pursuant to the Financial Instruments Market Law of Latvia.

This Base Prospectus has been registered with the Latvian Financial and Capital Market Commission and has been validly notified to the Bank of Lithuania (*Lietuvos Bankas*) and the Estonian Financial Supervision Authority (*Finantsinspeksioon*).

The Latvian Financial and Capital Market Commission has approved this Base Prospectus, but is not liable for the correctness of the information presented therein. The Base Prospectus has been prepared in English and translated into Latvian. In case of any discrepancies between the Base Prospectus in English and the Latvian translation of the Base Prospectus, the Base Prospectus version in English shall prevail.

This Base Prospectus should be read and construed together with any supplement hereto and with any other documents attached herein and, in relation to any series of notes (the “**Series of Notes**”), with the final terms of the relevant Series of Notes (the “**Final Terms**”).

No person has been authorised by the Issuer, the Arranger of the Programme or the Issuing Agent to give any information or to make any representation not contained in or not consistent with this Base Prospectus or any information supplied by the Issuer or such other information as is in the public domain and, if given or

made, such information or representation should not be relied upon as having been authorised by the Issuer, the Arranger of the Programme or the Issuing Agent.

No representation or warranty, express or implied, is made by the Arranger of the Programme and the Issuing Agent as to the contents of this Base Prospectus, and nothing contained in this Base Prospectus is, or shall be relied upon as, a promise or representation by the Arranger of the Programme or the Issuing Agent in this respect, whether as to the past or the future. The Arranger of the Programme and the Issuing Agent assumes no responsibility for the accuracy or completeness of the information and, accordingly, disclaims to the fullest extent permitted by applicable law, any and all liability which it might otherwise be found to have in respect of this Base Prospectus or any such statement.

The information contained herein is current as of the date of this Base Prospectus. Neither the delivery of this Base Prospectus, nor the offer, sale or delivery of the Notes shall, under any circumstances, create any implication that there has been no adverse changes occurred or events have happened, which may or could result in an adverse effect on the Group's business, financial condition or results of operations and/or the market price of the Notes. Nothing contained in this Base Prospectus constitutes, or shall be relied upon as, a promise or representation by the Issuer, the Arranger of the Programme or the Issuing Agent as to the future.

### **Notice to Investors and Restrictions on Distribution**

In making an investment decision, prospective investors must rely on their own analysis on the advantages and risks relating to the investment decision. No person has been authorised to provide any information or to make any representation other than as contained in this Base Prospectus. If given or made, such information or representation must not be relied upon as having been authorised by the Issuer. The delivery or display of this Base Prospectus shall not under any circumstances, create any implication that the information contained in the Base Prospectus is correct as of any time subsequent to the date hereof or that the operations of the Issuer have not since changed.

The distribution of this Base Prospectus and any Final Terms and the offering, sale and delivery of the Notes in certain countries is restricted by law. Any person residing outside the Republic of Latvia, the Republic of Lithuania and the Republic of Estonia may receive this Base Prospectus only within the limits of applicable special provisions or restrictions. The Issuer requires persons into whose possession this Base Prospectus or any Final Terms comes to inform themselves of and observe all such restrictions. This Base Prospectus and any Final Terms may not be distributed or published 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. Neither this Base Prospectus nor any Final Terms constitute an offer to sell or a solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The Issuer, the Arranger of the Programme, the Issuing Agent or their representatives or advisers do not accept any legal responsibility whatsoever for any such violations, whether or not a prospective investor is aware of such restrictions. The Notes have not been and will not be registered in accordance with the U.S. Securities Act of 1933 (the "**Securities Act**") or under the securities laws of any state of the United States of America and accordingly, they may not be offered, sold, resold, granted, delivered, allotted, taken up, transferred or renounced, directly or indirectly, in or into the United States of America, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and any securities laws of any state of the United States of America.

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## 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 Latvenego.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| 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, Riga, 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 2012.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| B.5, B14 | If the issuer is part of a group, a description of the group and the issuer's position within the group. If the issuer is dependent upon other | <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> <li>- Elektrum Lietuva UAB (100 per cent) incorporated in Lithuania; and</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |

entities within the group, this must be clearly stated

- 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 and 2011 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 and 2011 and as of, and for each of the six month periods ended 30 June 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<br>31 December<br>2010 | Year ended<br>31 December<br>2011 | Six months ended<br>30 June<br>2011 | Six months ended<br>30 June<br>2012 |
|-----------------------------------------------------------------|---------|-----------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|
|                                                                 |         | <i>Audited</i>                    | <i>Audited</i>                    | <i>Unaudited</i>                    | <i>Unaudited</i>                    |
| <b>Financial Highlights</b>                                     |         |                                   |                                   |                                     |                                     |
| Revenue                                                         | LVL'000 | 567,386                           | 681,767                           | 350,782                             | 389,174                             |
| Including electricity sales                                     | LVL'000 | 470,663                           | 583,428                           | 295,448                             | 298,772                             |
| Heat sales                                                      | LVL'000 | 71,863                            | 69,233                            | 40,736                              | 51,675                              |
| EBITDA                                                          | LVL'000 | 207,240                           | 180,729                           | 122,793                             | 112,439                             |
| EBITDA margin                                                   |         | 37%                               | 27%                               | 35%                                 | 29%                                 |
| Operating profit                                                | LVL'000 | 61,826                            | 53,345                            | 51,557                              | 54,388                              |
| Operating margin                                                |         | 11%                               | 8%                                | 15%                                 | 14%                                 |
| Net profit                                                      | LVL'000 | 44,325                            | 43,778                            | 39,412                              | 42,354                              |
| Net profit margin                                               |         | 8%                                | 6%                                | 11%                                 | 11%                                 |
| Return on assets (ROA)                                          |         | 2.2%                              | 1.9%                              | 1.3%                                | 2.0%                                |
| Return on equity (ROE)                                          |         | 4.0%                              | 3.2%                              | 2.2%                                | 3.5%                                |
| Non-current assets at the end of the period                     | LVL'000 | 1,942,231                         | 2,026,594                         | 1,962,428                           | 2,082,771                           |
| Total assets at the end of the period                           | LVL'000 | 2,279,266                         | 2,288,004                         | 2,278,358                           | 2,339,344                           |
| Total equity at the end of the period                           | LVL'000 | 1,344,748                         | 1,351,576                         | 1,351,606                           | 1,350,248                           |
| Borrowings from financial institutions at the end of the period | LVL'000 | 545,607                           | 513,334                           | 529,338                             | 550,781                             |
| Cash flows from operating activities                            | LVL'000 | 160,563                           | 180,399                           | 115,343                             | 124,613                             |
| Capital expenditure                                             | LVL'000 | 127,539                           | 198,723                           | 83,884                              | 110,758                             |
| Net debt at the end of the period                               | LVL'000 | 311,342                           | 404,458                           | 347,284                             | 400,526                             |
| Net debt/EBITDA ratio                                           |         | 1.5                               | 2.3                               | 1.6                                 | 2.2                                 |
| <b>Operating Highlights</b>                                     |         |                                   |                                   |                                     |                                     |
| Retail electricity sales                                        | GWh     | 7,620                             | 8,980                             | 4,589                               | 4,307                               |
| Electricity produced in power plants                            | GWh     | 5,869                             | 5,285                             | 3,565                               | 3,001                               |
| Total amount of purchased electricity                           | GWh     | 3,028                             | 4,466                             | 1,565                               | 1,887                               |
| Including purchased electricity from independent producers      | GWh     | 693                               | 759                               | 436                                 | 459                                 |
| The rest amount of purchased electricity                        | GWh     | 2,335                             | 3,707                             | 1,129                               | 1,428                               |
| Aggregate heat sales                                            | GWh     | 2,928                             | 2,524                             | 1,572                               | 1,570                               |
| Number of employees at the end of the period                    |         | 4,517                             | 4,490                             | 4,525                               | 4,443                               |
| Moody's credit rating of the Issuer                             |         | Baa3 (stable)                     | Baa3 (stable)                     | Baa3 (stable)                       | Baa3 (stable)                       |

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                                                         | <p>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 2011.</p> <p>There has been no material adverse change in the Issuer's or the Group's financial or trading position since 30 June 2012.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| 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                                                                                                             | <p>The Group divides its operations into three main operating segments – generation and supply, distribution system services and management of transmission system assets.</p> <p><i>The generation and supply business segment</i> comprises the Group's electricity and heat generation operations, which is 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.</p> <p><i>The operations of the distribution system services business segment</i> relates to the provision of electricity distribution services in Latvia and are managed by the Issuer's subsidiary AS Sadales tīkls, the largest distribution system operator in Latvia. In 2011 distribution assets 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.</p> <p>The Issuer's subsidiary AS Latvijas elektriskie tīkli represents the third business segment – <i>management of transmission system assets</i> in Latvia. 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 assets are leased to the transmission system operator.</p> |
| B.16 | To the extent known to the issuer, state whether the issuer is directly or indirectly owned or controlled and by whom and describe the nature of such control. | The Issuer is incorporated as a public limited company ( <i>akciju sabiedrība</i> ) 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.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 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                               | <p>The Issuer is rated Baa3 with a stable outlook by Moody's Investors Service. The rating and outlook was reaffirmed on 11 July 2012.</p> <p>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.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

***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                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <p>Unsecured Notes with an aggregate nominal value up to LVL 50,000,000 or its equivalent in EUR.</p> <p>The Notes are dematerialized debt securities in bearer form.</p> <p>The identification numbers (ISIN codes) for each Series of Notes will be provided in the Final Terms.</p> <p><b>Issue specific summary:</b><br/>Number of Series of Notes: [●]</p> <p>ISIN Code: [●]</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| C.2      | Currency of the securities issue                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <p>LVL or EUR.</p> <p><b>Issue specific summary:</b><br/>The currency of the Notes: [●]</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| C.5      | A description of any restrictions on the free transferability of the securities                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | <p>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.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| C.8, C.9 | <p>A description of the rights attached to the securities including</p> <ul style="list-style-type: none"> <li>• ranking</li> <li>• limitations to those rights</li> <li>• the nominal interest rate</li> <li>• the date from which interest becomes payable and the due dates for interest</li> <li>• where the rate is not fixed, description of the underlying on which it is based</li> <li>• maturity date and arrangements for the amortisation of the loan, including the repayment procedures</li> <li>• an indication of yield</li> <li>• name of representative of debt security holders</li> </ul> | <p><b>Ranking</b><br/>The Notes constitute direct, unsecured and unguaranteed obligations of the Issuer, ranking <i>pari passu</i> 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.</p> <p><b>Issue Price</b><br/>The Notes may be issued at their nominal amount or at a discount or a premium to their nominal amount.</p> <p><b>Interest rate</b><br/>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.</p> <p>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.</p> <p><b>Issue specific summary:</b><br/>Interest Payment Date: [●] each year</p> <p><b>Indication of Yield</b><br/>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.</p> |

**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

Not applicable. The Notes have no derivative component in the interest payment.

under the circumstances when the risks are most evident

- 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.
- 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.

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

- 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

### **The Arranger of the Programme and Issuing Agent**

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).

### **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. |

## **RISK FACTORS**

*Prospective investors are advised to carefully consider the risk factors and other information provided in this Base Prospectus. Investing in the Notes involves certain risks including but not limited to the following risks described herein.*

*The Issuer believes that if one or more of the risk factors described herein realises, it may have a negative effect on the Issuer's business operations, financial position and/or business results and, thereby, the Issuer's ability to fulfil its obligations under the Notes, as well as the market price and value of the Notes. If these risks were to lead to a decline in the market price of the Notes, prospective investors may lose all or part of their investment.*

*The risks and uncertainties described hereafter are the risks which the Issuer has deemed material, however, they are not the only factors affecting the Issuer's activities, therefore the Issuer does not represent that the statements below regarding the risks of acquiring and/or holding any Notes are exhaustive. Also other factors and uncertainties than those mentioned herein, which are currently unknown or deemed immaterial, may negatively affect the Issuer's business operations, financial position and/or business results and, thereby, the Issuer's ability to fulfil its obligations under the Notes, as well as the market price and value of the Notes.*

*The below description of the risk factors does not reflect the probability of the respective risk's realisation or their order of importance. Most of these risk factors are contingencies which may or may not occur and the Issuer is not in a position to assess or express a view on the likelihood of any such contingency occurring.*

*All investors should make their own evaluations of the risks associated with an investment in the Notes and should consult with their own professional advisers if they consider it necessary.*

### **Risks Related to Macroeconomic Conditions**

#### ***Exposures of business results to macroeconomic developments***

The ongoing market liberalization in Latvia, Lithuania and Estonia, further Group's expansion into neighbouring energy markets, as well as its integration into international business processes creates growing exposures of the Group's business and financial results to macroeconomic developments. The Group's business is influenced by electricity price trends in local and Nordic markets, commodities prices (including, but not limited to, natural gas, oil), consumer behaviour and electricity demand in the Baltic States, and other indices that may reflect local and global macroeconomic trends and have a material adverse effect on the Group's business and financial position.

#### ***Turmoil in the global financial markets***

The length of the current turmoil in the global financial markets and the downturn in the world economy are difficult to predict. The Group has a strong balance sheet and operates in a relatively non-cyclical or late-cyclical industry. However, a 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.

The maturity schedule of the Group's loan portfolio is relatively evenly distributed over several years, and the refinancing is expected to be made using uncommitted open-market debt financing transactions and bank loans, alongside the Group's free cash flow. In addition, the Group has committed lines of credit with the banks that may be utilised if the open-market refinancing conditions are inadequate. However, the cost of funding might be higher, should the financial turmoil and the downturn in the economy continue for a long time or become even more severe.

### **Risks Related to Business Operations**

#### ***State ownership***

The sole shareholder of the Company is the Republic of Latvia and the rights and duties of the shareholder are awarded to the Ministry of Economics of the Republic of Latvia.

The shareholder's supervision of the Group's business activities is considered as adequate allowing to manage the Group's business activities in a manner consistent with its business strategy. However, certain and substantial shareholder's decisions alternating the Group's strategic orientation or decisions in respect of dividend policy, capital structure and other relevant decisions could have a material adverse effect on general operations of the Group, as well as the Group's business and financial position.

### ***Regulated electricity and heat market***

Approximately two thirds of the Group's revenues currently are 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 2013, 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. As of 30 June 2012, market share obtained by the Group in Lithuania electricity market is 11 per cent and Estonian electricity market – 7 per cent. Currently, electricity markets of Lithuania and Estonia are partially open for competition and additional openings in both markets are expected. 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.

### ***Counterparty risks***

Counterparty risk is inherent into the core business activities, as well as other business activities the Group is engaged in. Counterparty risk may result in financial losses (including, but not limited to, revenues to be



received from customers, funds deposited at banks, money receivable under the Group's hedging agreements, partners in long term projects etc.) to the Group. Although, the Group monitors and manages its counterparty risks, occurrence of the mentioned counterparty risks may have adverse impact on the Group's business and financial position.

### ***Electricity market price risks***

The Group's generation portfolio does not meet the needs of the supply portfolio. Although, it has seasonal variations, throughout the year approximately two-thirds of the Group's electricity supply is subject to price volatility risks in electricity wholesale market. The Group uses hedging instruments to mitigate the effect of fluctuations in the electricity prices. If effective, hedging would be the best way to protect the Group against unfavourable changes in the electricity prices.

Due to the fact that organized electricity derivatives' market in the Baltic region is currently absent, availability of hedging instruments is limited. Therefore, the Group partly uses Nordic electricity derivatives for hedging purposes in the Baltic region (proxy hedge).

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.

### ***Political and regulatory risks***

The ability of the Group to attain short-term goals and long-term strategic targets is partially dependent on the legislative environment in markets where the Group operates and on social and politico-social decisions not only in Latvia, but also in EU and other countries. Subjects that may have material effect on the Group's business and financial position includes, but are not limited to, electricity market liberalization; development and application of principles of supporting or subsidizing certain energy market sectors; feed-in tariff policy for environment friendly generation sources; state regulations on technical, safety, environmental protection issues; decisions of certain market supervising institutions (such as the Public Utility Commission, the Competition Council, the State Revenue Service etc.) etc.

Although, the Group is managing risk by representing its interests through wide range of professional organizations and monitoring relevant regulatory environments, adverse political and regulatory decisions may increase operating costs of the business and thus alter the financial situation of the Group.

### ***Seasonality and long-term shifts in climate***

The Group's core business operations, particularly electricity generation in hydro power plants (the "HPPs") and combined heat and power plants (the "CHPPs"), are partially influenced by weather conditions. HPPs ability to actually generate electricity is dependent on the water inflow in the River Daugava, thus the total electricity generation volumes fluctuate annually. CHPPs are generally working in cogeneration mode, thus electricity generation at the CHPPs is largely dependent on thermal energy consumption which is affected by weather conditions, i.e. external air temperature, duration of the heating season. 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 affecting electricity generated in hydro power plants and/or number of working hours operated in effective cogeneration mode. Decrease of annual flow volume in the River Daugava below long-term average flow level and/or untypically mild weather conditions during autumn and winter months might result in reduced volume of annual electricity generation by the Group's power plants, exposing the Group to electricity procurement price risks and lower profitability margins. Long-term shifts in climate condition may result in more permanent changes in generation patterns thus creating adverse effect on the Group's business and financial position.

### ***Asset damage risks***

The Group's main assets include generation assets (including HPPs and CHPPs), electricity transmission and distribution assets, and other assets necessary for operations of the Group. The Group manages asset-related risks through implementation of maintenance, investment and prevention programmes, as well as by transferring risks to insurance market, where such insurance is commercially available. In certain circumstances adequate insurance cover might not be available, either as a result of the lack of relevant



insurance or excessive costs. In addition, insurance proceeds received may be inadequate to cover replacement costs of damaged assets, increased asset repair and maintenance costs, sequential financial losses due to business interruption, fines and liabilities to third parties incurred, and similar costs and expenses associated with such asset damages. The assets of the Group are exposed to the risks of loss or damage due to acts of terrorism; natural disasters (such as storms, fire, flooding, etc.); breakdown of equipment; structural damages and other risks of loss or damage of assets. These asset damage risks could have a material adverse effect on the Group's business and financial position.

### ***Litigation and disputes***

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.

There can be no assurance that the Group will not be a party to court and administrative proceedings in the future or that, with respect to its current proceedings, it will not be subject to fines, damages, penalties or other costs which could have a material adverse effect on the Group's business and financial position.

### ***Resource risks***

The Group's operations depend on consistent and commercially adequate resource supplies of natural gas needed for operation of CHPPs, supplies of electricity from power producers in Latvia and neighbouring countries etc. Risk factors associated to resource availability risks include non-availability of supplies due to technological accidents (including, but not limited to, accidents in natural gas supply networks, accidents in high voltage transmission system networks interconnecting Latvia electricity grid with the transmission system grids in neighbouring countries) and limitations on resource availability due to commercial, technological or other reasons. The risk that supplies may not be available, or may only be available on commercially unfavourable terms would affect the Group's profitability, which could adversely affect the Group's business and financial position.

Since natural gas is the main fuel source for electricity and heat generation in CHPPs and the incumbent gas supplier AS Latvijas Gāze currently has the exclusive rights of sale of natural gas and gas prices are subject to monthly revision, the Group is exposed to single supplier risks and gas price increase risks. The occurrence of such circumstances could weaken the Group's competitive position, expose to additional electricity import risks and adversely impact the Group's profitability and financial position.

### ***Risks associated with execution of investment projects***

During recent years the Group has commenced extensive capital investment programmes, aimed at upgrade of its generating facilities, as well as large scale investment programmes in the Group's transmission and distribution system assets. Following successful completion of the recent investment projects, namely reconstruction of the Riga 1<sup>st</sup> combined heat and power plant ("**Riga TEC-1**") (commissioned in 2005) and the Riga 2<sup>nd</sup> combined heat and power plant ("**Riga TEC-2**") first unit (commissioned in 2008), in 2010 the Group commenced project of reconstruction of Riga TEC-2 second unit. The completion of reconstruction project of Riga TEC-2 second unit is scheduled in 2013. The Group has no substantial information that may indicate on risks associated with potential delays or cost overruns within current investment projects. Nevertheless, the cost overruns and project delays or similar risks related to execution of current or future investment projects could have material adverse effect on the Group's business and financial position.

### ***Risks from potential participation in Visaginas Nuclear Power Plant project***

The Company as a potential investor is involved in negotiations of nuclear power plant construction project in Lithuania. The other potential investors in the project would be Visagino atominė elektrinė (Lithuania), Eesti Energia (Estonia) and Hitachi (Japan, strategic investor). Currently negotiations are ongoing as to host country guarantees in the project, EPC (engineering, procurement, construction) contract and other key matters in the project. The project shall be considered at its early stage and the Company has not undertaken any financial commitments regarding the project.

Before significant commitments in the project are undertaken, the parties would need to agree on many outstanding matters, including, but not limited to business plan of the project, legal environment, sharing of open risks and provision of other guarantees to the project. The project would be capital intensive and, if undertaken, additional solutions will need to be considered for meeting the Group's funding needs of this project.

If the Group does participate in the project, it is also likely to be exposed to a number of risks which could have a material adverse effect on the Group's business and financial position. Whilst the Group will not have day-to-day responsibility for the principal operations of the nuclear power plant, as a participant in the project, the Group may, nonetheless, still be exposed to 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.

In addition, changes to the regulatory regime in Lithuania and/or the EU could have a material impact on the Group's ability to participate in, or raise finance for, the project.

### ***Electricity distribution system investment risks***

The Group's electricity distribution system network has been established over a long period of time, it is aged and current distribution tariff does not correspond to the required capital investments in maintenance of the existing network. There is a risk that the quality of provided distribution services in some locations might not correspond to safety and service level requirements set in the legal acts. This in turn might lead to additional service interruptions, losses and damages causing the Group unplanned repair and maintenance costs, legal disputes, as well as reallocation of resources from other investments projects, potentially leading to a material adverse effect on financial position of the Group.

### ***Transmission system investments and EU financing risks***

The Company's subsidiary AS Latvijas elektriskie tīkli is an owner and manager of transmission system assets in Latvia. Operations and strategic decision making on asset maintenance and development is not within the control of the Group. The investment plans are prepared and approved by the transmission system operator AS Augstsprieguma tīkls, while asset construction and financing is managed within the Group. Part of the projects carried out is co-financed with EU funds.

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 existing value of the assets. As such, the value of the existing assets might decrease causing material adverse effect on financial position of the Group.

In addition, if EU would have objections in relation to their co-financed project execution, there is a risk that the Group would need to increase its financing share in the existing transmission system asset construction projects. That would in turn decrease the funds available for other investment projects or could result in increased debt levels and have material adverse effect on financial position of the Group.

### ***Sovereign debt crisis***

The escalation of Eurozone sovereign debt crisis could lead to systemic and structural changes in Eurozone, including but not limited to the reintroduction of national currencies in one or more Eurozone countries or, in extreme circumstances, unprecedented rates of inflation and collapse of the euro entirely. Occurrence of such risks could have a negative effect on existing contractual relations, including the Group's financing obligations to its banks and other third parties, all of which could have a significant negative impact on the Group's business and financial position.

### ***Environmental damage, health and safety risks***

The Group's core business activities such as generation, electricity distribution and the management of the electricity transmission assets include operations with certain assets, products, substances and processes that inherently have increased levels of riskiness, thus exposing the Group's personnel, third parties and natural environment to potential losses, damages or harm due to operational accidents or other sudden and unforeseen occurrences. Certain technology processes, including, but not limited to, operation of CHPPs and HPPs, operation of electricity transmission and distribution system assets and other processes, involve

materials, products or substances that are potentially dangerous or harmful in uncontrolled or catastrophic circumstances, such as fires, explosions, accidents or major failures of equipment or structures. The consequences of uncontrolled release of pollutants or other environmental damages, such as subsequent loss mitigation activities and clean up costs, environment pollution damages, fines, penalties and similar costs imposed in accordance with relevant legislation, third party claims and other losses could adversely affect the Group's business and financial position.

The Group has made substantial investments into technologies and processes, thus minimising the Group's actual impact on environment and minimising the risks of damages to environment. It must be considered that there is probability of new legislative incentives aimed at minimising the environmental impact which may impose additional costs on the Group.

The Group's personnel, as well as personnel of the Group's subcontractors are exposed to increased health and safety risks by operating certain assets of the Group. Notwithstanding that the Group has implemented wide array of activities and procedures aimed at mitigation of occupational health and safety risks, third party's or the Group's personnel's claims in relation to personal damages or harm caused at workplace may incur substantial costs to the Group, as well as negative publicity, causing material adverse effect on the Group.

## **Financial Risks**

### ***Foreign exchange risk***

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 (financial expenses, imported electricity, payment for capital expenditures) is in euro, but the main part of the Group's revenue is in lats. The Group does not have any substantial liabilities in any other foreign currency, except euro. The peg of lats to euro at the beginning of 2005 resulted in limited euro/lats currency risk. By increasing the Group's electricity export to the neighbouring countries, a partial hedge of foreign exchange exposure is provided. Estonia has joined euro zone, but Lithuania has fixed currency peg to euro. To ensure cash flow hedges for U.S. dollars transactions of Riga TEC-2 second power generation unit reconstruction contract, in 2010 the Group entered into euro/U.S. dollars forward foreign currencies exchange contracts. Although, lat is pegged to euro, any unfavourable fluctuations in lats/euro exchange rate due to exchange rate policies in the future may have material adverse impact on the Group's operations, prospects and financial results.

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

The existing Group's long term loan agreements generally have financial covenant clause with three ratios: debt service coverage ratio, capital ratio, total debt to EBITDA. 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.

### ***Interest rate risk***

The Group's interest rate risk mainly arises from long-term borrowings at variable rates. This exposes the Group to a risk that borrowing costs might increase significantly in the event that the relevant benchmark market interest rates rise. The Group's policy is to maintain at least 35 per cent of its borrowings as fixed interest rates borrowings (taking into account the effect of interest rate swaps) with duration between two to four years. Adverse interest rate fluctuations, if not hedged, may negatively impact the Group's operations, prospects and financial results.

### ***Liquidity risk***

Liquidity risk is the risk that the Group is unable to maintain a sufficient reserve of cash and cash equivalents that can be used to meet its payment obligations as they fall due.

The availability of liquidity for business activities and the ability to access long-term financing are necessary to enable the Group to implement its capital expenditure projects and its growing debt refinancing needs. Although, 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, a reduction in the Group's liquidity position may have a material adverse effect on its business and financial position.

### ***Downgrade of the Issuer's credit rating***

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 the transactions. The Issuer's credit rating may be downgraded if the credit rating of the Republic of Latvia is downgraded due to weak macroeconomic conditions or there is change of the support assumptions provided by the Republic of Latvia. Any adverse change in an applicable credit rating could also adversely affect the trading price of the Notes.

### ***Risks Related to the Notes***

The following risk factors are, among other things, material in order to assess the risks associated with the Notes. Words and expressions in this section shall have the same meaning as defined in the General Terms and Conditions of the Notes.

### ***The Notes may not be a suitable investment for all investors***

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. A potential investor should not invest in the Notes unless it has the expertise (either alone or with the relevant support from a financial advisor) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of such Notes and the impact this investment will have on the potential investor's overall investment portfolio. In particular, each potential investor should:

- (i) have the sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or referred to in this Base Prospectus, the Final Terms and documents attached to this Base Prospectus;
- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes;
- (iv) understand thoroughly the terms of the Notes and be familiar with the behavior of any relevant financial markets; and
- (v) be able to evaluate either alone or with the relevant support from a financial adviser possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risk.

### ***Possibility to forfeit interest and principle amount invested***

Should the Issuer become insolvent during the term of the Notes, an investor may forfeit interest payable on, and the principle amount of, the Notes in whole or in part. An investor is always solely responsible for the economic consequences of its investment decisions.

### ***No guarantee or security***

The Notes will not be obligations of anyone other than the Issuer and they will not be guaranteed. No one other than the Issuer will accept any liability whatsoever in respect of any failure by the Issuer to pay any amount due under the Notes.

The Notes are unsecured debt instruments and the Noteholders would be unsecured creditors in the event of the Issuer's insolvency.

### ***Claims cannot be enforced against the Issuer's key assets***

The Issuer holds a number of assets which under applicable laws of the Republic of Latvia can be owned only by the Issuer or its wholly-owned subsidiaries. As a consequence, such assets are not transferable to any other party except for the Issuer or its subsidiaries. Section 20.<sup>1</sup> (2) of the Energy Law (*Enerģētikas likums*) lists the following non-transferable assets: (i) the Pļaviņas, Ķegums and Rīga hydropower plants on the River Daugava; (ii) the Rīga TEC-1 and Rīga TEC-2; and (iii) electricity transmission grid and distribution grid, telecommunication grid and equipment owned by the Issuer. Because of their non-transferable nature, no claims, either on the ground of the Notes or otherwise, can be enforced against these assets. Furthermore, in case of the Issuer's insolvency these assets will not be used for settling the creditors' claims.

### ***Adverse change in the financial condition or prospects of the Issuer***

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, such adverse change may result in a reduced probability that the Noteholders will receive the prompt and full payment, when due, for principal and interest and/or any other amounts and items payable to the Noteholders pursuant to the General Terms and Conditions of the Notes from time to time.

### ***An active market for the Notes may not develop***

The Notes constitute a new issue of securities by the Issuer. Prior to admission to trading on the regulated market, there is no public market for the Notes.

Although application(s) will be made for the Notes to be admitted to trading on NASDAQ OMX Rīga stock exchange, there is no assurance that such application(s) will be accepted and the Notes will be admitted to trading. In addition, admission to trading the Notes on a regulated market will not guarantee that a liquid public market for the Notes will develop or, if such market develops, that it will be maintained, and neither the Issuer, nor the Arranger of the Programme or the Issuing Agent is under any obligation to maintain such market. If an active market for the Notes does not develop or is not maintained, it may result in a material decline in the market price of the Notes, and the liquidity of the Notes may be adversely affected. In addition, the liquidity and the market price of the Notes can be expected to vary with changes in market and economic conditions, the financial condition and the prospects of the Issuer, as well as many other factors that generally influence the market price for securities. Accordingly, due to such factors the Notes may trade at a discount to the price at which the Noteholders purchased the Notes. Therefore, investors may not be able to sell their Notes at all or at a price that will provide them with a yield comparable to similar financial instruments that are traded on a developed and functioning secondary market. Further, if additional and competing financial instruments are introduced on the markets, this may also result in a material decline in the market price and value of the Notes.

### ***Fixed interest rate and inflation***

The Notes will bear interest on their outstanding principal at a fixed interest rate. A holder of a security with a fixed interest rate is exposed to the risk that the price of such security could fall as a result of changes in the market interest rate. Market interest rates follow the changes in general economic conditions, and are affected by, among many other things, demand and supply for money, liquidity, inflation rate, economic growth, central banks' benchmark rates, implied future rates, and changes and expectations related thereto.



While the nominal compensation rate of a security with a fixed interest rate is fixed during the term of such security or during a certain period of time, current interest rates on capital markets (market interest rates) typically change continuously. In case market interest rates increase, the market price of such a security typically falls, until the yield of such security is approximately equal to the market interest rates. If market interest rates fall, the price of a security with a fixed interest rate typically increases, until the yield of such a security is approximately equal to market interest rates. Consequently, the Noteholders should be aware that movements of market interest rates may result in a material decline in the market price of the Notes and can result in losses for the Noteholders if they sell the Notes. Further, the past performance of the Notes is not an indication of their future performance.

Also inflation may result in a decline of the market price of the Notes. Inflation decreases the purchasing power of a currency unit and respectively the received interest.

***Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes***

The Issuer will pay principal and interest on the Notes either in LVL or EUR (depending on the currency of the respective Series of Notes). This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **"Investor's Currency"**) other than LVL or EUR. These include the risk that exchange rates may significantly change (including changes due to devaluation of the LVL or EUR or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the LVL or EUR would decrease the Investor's Currency-equivalent: (i) yield on the Notes; (ii) value of the principal payable on the Notes; and (iii) market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect the applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal at all. In addition, investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

***Credit ratings may not reflect all risks***

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, or other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

***No assurance on change of laws or practices***

The Notes are governed by the laws of the Republic of Latvia, as in force from time to time. Latvian laws (including but not limited to tax laws) and regulations governing the Notes may change during the validity of the Notes, and new judicial decisions can be given and administrative practices may take place. No assurance can be given as to the impact of any such possible change of laws or regulations, or new judicial decision or administrative practice taking place after the date of this Base Prospectus. Hence, such change may have a material adverse effect on the Issuer's business, financial condition, results of operations and/or future prospects and, thereby, the Issuer's ability to fulfil its obligations under the Notes, taxation of the Notes, as well as the market price and value of the Notes. Such event may also result in material financial losses or damage to the Noteholders.

***Legal investment considerations may restrict certain investments***

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: (i) the Notes are legal investments for the investor; (ii) the Notes can be used as collateral for various types of borrowings; and (iii) other restrictions apply to its purchase or pledge of any Notes.



***The Notes do not contain covenants governing the Issuer's operations and do not limit its ability to merge, effect asset sales or otherwise effect significant transactions that may have a material adverse effect on the Notes and the Noteholders***

The Notes do not contain provisions designed to protect the Noteholders from a reduction in the creditworthiness of the Issuer. In particular, the General Terms and Conditions of the Notes do not, except for the Change of Control and Events of Default conditions (see Clause 16 and Clause 18 of the General Terms and Conditions of the Notes), restrict the Issuer's ability to increase or decrease its share capital, to enter into a merger, asset sale or other significant transaction that could materially alter its existence, jurisdiction of organization or regulatory regime and/or its composition and business. In the event that the Issuer enters into such a transaction, Noteholders could be materially adversely affected. Furthermore, the Change of Control condition does not restrict the current shareholder of the Issuer from disposing any or all of their shareholdings, in case the law, which at the date of this Base Prospectus restricts privatisation or alienation of the shares of the Issuer, is changed.

***No voting rights***

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.

***Amendments to the Notes bind all Noteholders***

The General Terms and Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind 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. This may incur financial losses, among other things, to all Noteholders, including such Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

***No limitation on issuing additional debt***

The Issuer is not prohibited from issuing further debt. If the Issuer incurs significant additional debt ranking equally with the Notes, it will 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 since: (i) it is a question of a contractual arrangement only being binding upon the parties to such contractual arrangement; (ii) there is no specific legislation in Latvia providing beneficiaries of negative pledge undertakings or covenants with a preferred position vis-a-vis the claims of third parties; and (iii) no registry or public record exists in Latvia through which negative pledge undertakings or covenants could be filed to obtain a preferred position. Should the Issuer breach its obligations under such undertakings and covenants and create a security interest in favour of a third party, such third party would obtain a valid and enforceable security interest over the pledged asset.

## PARTY RESPONSIBLE FOR THE BASE PROSPECTUS

### Party Responsible for the Base Prospectus

AS Latvenergo

Registration number: 40003032949

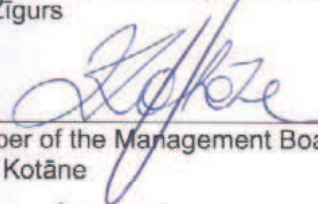
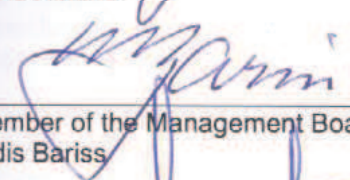
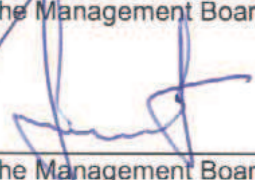
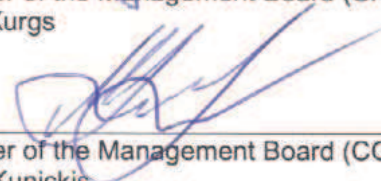
Legal address: Pulkveža Brieža 12, Riga, LV-1230, Latvia

### Assurance of the Information Given in the Base Prospectus

The Company and its Management Board are responsible for the information contained in this Base Prospectus. The Company and its Management Board, having taken all reasonable care to ensure that such is the case, confirms that the information contained in the Base Prospectus is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import.

Riga, 23 November 2012

Management Board of AS Latvenergo:

  
Chairman of the Management Board (CEO)  
Āris Žigurs  
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

## **MANAGEMENT BOARD OF THE COMPANY, AUDITORS AND ADVISERS**

### **Management Board of the Company**

| <b>Name</b>    | <b>Position</b>                        |
|----------------|----------------------------------------|
| Āris Žīgurs    | Chairman of the Management Board (CEO) |
| Zane Kotāne    | Member of the Management Board (CFO)   |
| Uldis Bariss   | Member of the Management Board (CCO)   |
| Arnis Kurgs    | Member of the Management Board (CAO)   |
| Māris Kuņickis | Member of the Management Board (COO)   |

### **Company's Auditor during the financial years that ended 2010 and 2011**

PricewaterhouseCoopers SIA  
Registration number: 40003142793  
Legal address: Krišjāņa Valdemāra 19, Riga, LV-1010, Latvia  
Auditor in charge: Ilandra Lejiņa (number of certificate: 168)

### **Company's Auditor as of 13 June 2012**

ERNST & YOUNG BALTIC SIA  
Registration number: 40003593454  
Legal address: Muižas 1A, Riga, LV-1010, Latvia  
Auditor in charge: Diāna Krišjāne (number of certificate: 124)

### **Arranger of the Programme and Issuing Agent**

AS SEB banka  
Registration number: 40003151743  
Legal address: Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia

### **Legal Adviser to the Arranger of the Programme and Issuing Agent**

Attorneys at Law BORENIUS  
VAT payer's registration number: LV90001568767  
Legal Address: Lāčplēša 20A, Riga, LV-1011, Latvia

## **GENERAL INFORMATION**

### **Interests of Natural and Legal Persons Involved in the Issue/Offer**

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.

### **Use of Proceeds**

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.

### **Credit Ratings**

The Issuer is rated Baa3 with a stable outlook by Moody's Investors Service. The rating and outlook was reaffirmed on 11 July 2012.

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.

## OTHER INFORMATION

### Forward-Looking Statements

Some of the statements in this Base Prospectus, including statements under the sections “*Risks Related to Macroeconomic Conditions*”, “*Risks Related to Business Operations*”, and “*Financial Risks*” are based on the Company’s Management Board’s views and understanding of the Group and on the assumptions made based on the factors known to the Company’s Management Board as of the date of this Base Prospectus and thus can be forward-looking statements. Statements which include such words as “believe”, “anticipate”, “predict”, “expect”, “will”, “would”, “could”, “consider”, “likely”, “estimate” or “plan” and variations of such words or any other similar statements identify forward-looking statements.

These forward-looking statements involve known and unknown risks, uncertainties and other important factors, as a result of which the Group’s actual results, activities or achievements or the actual results, activities or achievements of a business segment of the Group may differ materially from the expressly or indirectly presented results, activities or achievements indicated in the forward-looking statements. Such risks, uncertainties and other important factors include, among others, general economic development, the Group’s need for financing, the Group’s indebtedness, the Group’s liquidity, the development of demand in the Group’s products and services, competition, as well as other matters described under the sections “*Risks Related to Macroeconomic Conditions*”, “*Risks Related to Business Operations*”, and “*Financial Risks*” and forward-looking statements described under the section “*Financial and Trend Information*”.

The sections “*Risks Related to Macroeconomic Conditions*”, “*Risks Related to Business Operations*”, and “*Financial Risks*” includes risks, uncertainties and other important factors, which may affect the Group’s business operations, financial position and/or business result. The risk factors described in the Base Prospectus do not necessarily include all risks and new risks may surface. If one or more of the risk factors described in this Base Prospectus or any other risk factors or uncertainties would materialise or any of the assumptions made would turn out to be erroneous, the Group’s actual business result and/or financial position may differ materially from that anticipated, believed, estimated or expected. It is not the Group’s intention, and it will not accept responsibility for updating any forward-looking statements contained in this Base Prospectus, unless required by applicable legislation.

### Figures Presented in the Base Prospectus

The figures set out in the financial statements and other figures presented in the Base Prospectus have mainly been rounded off. As a result, the sum of individual figures set out in the tables contained in this Base Prospectus may not always correspond accurately to the sums presented in these tables. In addition, certain percentages have been calculated based on exact figures and thus do not necessarily correspond to the percentages, which would have been the result, if the calculation would have been based on figures that have been rounded off.

### Availability of the Base Prospectus and Final Terms

The copies of the Base Prospectus and any Final Terms are available at the legal address of the Company at Pulkveža Brieža 12, Riga, LV-1230, Latvia and legal address of the Issuing Agent at Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia on weekdays within the limits of normal business hours upon request, and in electronic format on the Company’s website at [www.latvenergo.lv](http://www.latvenergo.lv).

### Third Party Information and Statement by Experts and Declarations of any Interest

This Base Prospectus contains auditor’s reports for 2010 and 2011. 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.

### Other Information on the Website are not part of the Base Prospectus

The Base Prospectus and the Final Terms, as well as documents attached to the Base Prospectus will be published on the Company’s website at [www.latvenergo.lv](http://www.latvenergo.lv). Other information presented on the above-

mentioned website or on any other website does not, however, form part of the Base Prospectus or the Final Terms.

### **Restrictions on Distribution of the Base Prospectus and the Final Terms**

The distribution of this Base Prospectus and any Final Terms and the offering, sale and delivery of the Notes in certain countries is restricted by law. Any person residing outside the Republic of Latvia, the Republic of Lithuania and the Republic of Estonia may receive this Base Prospectus only within the limits of applicable special provisions or restrictions. The Issuer requires persons into whose possession this Base Prospectus or any Final Terms comes to inform themselves of and observe all such restrictions. This Base Prospectus and any Final Terms may not be distributed or published 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. Neither this Base Prospectus nor any Final Terms constitute an offer to sell or a solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. The Issuer or its representatives do not accept any legal responsibility for any such violations, whether or not a prospective purchaser of the Notes is aware of such restrictions. The Notes have not been and will not be registered in accordance with the Securities Act or under the securities laws of any state of the United States of America and accordingly, they may not be offered, sold, resold, granted, delivered, allotted, taken up, transferred or renounced, directly or indirectly, in or into the United States of America, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and any securities laws of any state of the United States of America.

The issue of the Notes shall be governed by the laws of the Republic of Latvia. No action has been taken by the Issuer in any jurisdiction that would permit offering of the Notes other than in the Republic of Latvia, the Republic of Lithuania and the Republic of Estonia. Unless specifically otherwise stated in this Base Prospectus, the Notes may not be, directly or indirectly, 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, except for the exceptions to registration obligation allowed by the securities laws of the United States of America and its states, Australia, Canada, Hong Kong and Japan. The Base Prospectus and any Final Terms may not be delivered to any person in the above-mentioned countries. The Issuer, the Arranger of the Programme and the Issuing Agent requires persons into whose possession this Base Prospectus or any Final Terms comes to inform them of and observe all such restrictions. The Issuer, the Arranger of the Programme and the Issuing Agent do not have any legal responsibility whatsoever for such violations whether or not such restrictions were known to prospective investors. The Issuer, the Arranger of the Programme and the Issuing Agent reserves the right to, respectively, at its sole discretion reject subscription to the Notes, which the Issuer, the Arranger of the Programme and/or the Issuing Agent believes would cause the violation or breach of any law, rule or regulation for the time being in force.

### **Issuing Agent's Right to Invest**

The Issuer has agreed that the Issuing Agent has a right to invest in the Notes.

### **Governing Law**

The Base Prospectus and any Final Terms, as well as the issuance and/or offering of Notes in question at the time shall be governed by and construed in accordance with the laws of the Republic of Latvia. Any disputes relating to or arising from the above-mentioned will be settled solely by the courts of the Republic of Latvia of competent jurisdiction.



## GENERAL TERMS AND CONDITIONS OF THE NOTES

### Authorisation of the Shareholders Meeting of the Issuer

The shareholder of the Issuer has at its meeting on 13 June 2012 (Meeting minutes No.7, 3§) 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.

### Resolution of the Management Board

The Management Board of the Issuer has at its meeting on 23 November 2012 approved the Base Prospectus and the general terms and conditions of the notes (the “**General Terms and Conditions**”) to be issued under the programme (the “**Notes**”), which are as specified below.

### Arranger of the Programme and Issuing Agent

The Issuer has appointed AS SEB banka (registration number: 40003151743, legal address: Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia) as the Arranger of the Programme and as the Issuing Agent.

Indication of the material features of the agreement with the Issuing Agent, including the quotas, will be provided in the Final Terms of the respective Series of Notes.

#### 1. Principal Amount and Issuance of the Notes

The Issuer may issue the Notes up to an aggregate principal amount of LVL 50,000,000 (fifty 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.

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

The Notes will be offered for subscription for a minimum investment amount (the “**Minimum Investment Amount**”) which will be specified in the Final Terms of the respective Series of Notes.

The Notes will be offered for certain categories of institutional investors, which will be specified in the Final Terms of the respective Series of Notes, and retail investors.

#### 2. ISIN Code of the Notes

Before commencement of the offering of the respective Series of Notes, AS Latvian Central Depository (registration number: 40003242879, legal address: Valņu 1, Riga, LV-1050, Latvia) (the “**LCD**”) upon request of the Issuer will assign to the respective Series of Notes an ISIN code. For each Series of Notes there will be a separate ISIN code, which will be different from the ISIN code of the respective other Series of Notes.

In order to identify each new Series of Notes, the Final Terms shall also stipulate the serial number of the respective Series of Notes.

#### 3. Applicable Law

The issue of the Notes is governed by the laws of the Republic of Latvia:

- Law on State and Municipality Capital Shares and Capital Companies;
- Commercial Law;
- Financial Instruments Market Law;
- Regulations of LCD and NASDAQ OMX Riga;

as well as other applicable legal acts of the Republic of Latvia.

Any disputes relating to or arising in relation to the Notes will be settled solely by the courts of the Republic of Latvia of competent jurisdiction.

#### **4. Form of the Notes**

The Notes are freely transferable debt securities, which contain payment obligations of the Issuer towards the holders of the Notes (the “**Noteholders**”).

The Notes are dematerialized debt securities in bearer form which are disposable without any restrictions. 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.

According to the Financial Instruments Market Law the book-entry and accounting of the dematerialized securities in the Republic of Latvia, which will be admitted to trading in regulated market, shall be made by the LCD.

#### **5. Status and Security**

The Notes constitute direct, unsecured and unguaranteed obligations of the Issuer ranking *pari passu* without any preference among each other and with all other unsecured, unguaranteed and unsubordinated indebtedness of the Issuer, save for such obligations as may be preferred by mandatory provisions of law.

#### **6. Currency of the Notes**

The Notes will be issued in LVL or EUR. The currency of each Series of Notes shall be specified in the Final Terms.

#### **7. Issue Price**

The Notes may be issued at their nominal amount or at a discount or a premium to their nominal amount (the “**Issue Price**”). The Issue Price shall be determined by the Issuer according to Section “*Placement of the Notes*” of this Base Prospectus.

#### **8. Underwriting**

The issue of a Series of Notes will not be underwritten.

#### **9. Issue Date**

The issue date of each Series of Notes (the “**Issue Date**”) shall be specified in the Final Terms.

#### **10. Interest**

The Notes shall bear interest at fixed annual interest rate (the “**Annual Interest Rate**”) which shall be determined by the Issuer according to Section “*Placement of the Notes*” of this Base Prospectus.

The interest on the Notes will be paid annually on the dates specified in the Final Terms (“**Interest Payment Date**”) until the Maturity Date (as defined below) and will be calculated on the aggregate outstanding principal amount of the Notes of the respective 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 of the respective Series of Notes outstanding from time to time. The first interest period commences on the Issue Date and ends on the first Interest Payment Date (the “**First Interest Period**”). Each consecutive interest period begins from the previous Interest Payment Date and ends on the following Interest Payment Date. The last interest period ends on the Maturity Date (as defined below).

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.

When interest is required to be calculated in respect of a period of less than a full year other than in respect of the First Interest Period, it shall be calculated on the basis of (a) the actual number of days in the period from and including the date from which interest begins to accrue (the “**Accrual Date**”) to but excluding the date on which it falls due divided by (b) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date.

Interest on the Notes shall be paid in accordance with the LCD Rules No 8 “On payment of dividends, coupons, principal and other cash proceeds”. The Issuer will transfer all payable amounts to the LCD account on the Interest Payment Date. The LCD shall transfer all payable amounts received from the Issuer to the account holders (credit institutions and investment brokerage firms which are LCD participants) within 1 (one) Business Day according to the number of Notes on the LCD’s corresponding accounts of the account holders 8 (eight) Business Days prior to the Interest Payment Date. The account holders shall transfer the amounts payable to the Noteholders or the nominee holders, which will further transfer the respective amounts to the Noteholders.

Should any Interest Payment Date fall on a date which is not a Business Day, the payment of the interest due will be postponed to the next Business Day. The postponement of the payment date shall not have an impact on the amount payable.

“**Business Day**” means a day on which banks in Riga are open for general business.

## **11. Maturity and Principal Payment**

The Notes shall be repaid in full at their nominal amount on the date which will be specified in the Final Terms (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 accordance with Clause 16 (*Change of Control*) or 18 (*Events of Default*) below or in case the Noteholders’ Meeting, upon proposal of the Issuer, has decided that the Notes shall be redeemed prior to the Maturity Date.

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.

The principal of the Notes shall be paid in accordance with the LCD Rules No 8 “On payment of dividends, coupons, principal and other cash proceeds”. The Issuer will transfer all payable amounts to the LCD account on the Maturity Date. The LCD shall transfer all payable amounts received from the Issuer to the account holders (credit institutions and investment brokerage firms which are LCD participants) within 1 (one) Business Day. The account holders shall transfer the amounts payable to the Noteholders or the nominee holders, which will further transfer the respective amounts to the Noteholders.

Should the Maturity Date fall on a date which is not a Business Day, the payment of the amount due will be postponed to the next Business Day. The postponement of the payment date shall not have an impact on the amount payable.

## **12. Taxation**

All payments in respect of the Notes by the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (“**Taxes**”), unless the withholding or deduction of the Taxes is required by laws of the Republic of Latvia. In such case, the Issuer shall make such payment after the withholding or deduction has been made and shall account to the relevant authorities in accordance with the applicable laws for the amount so required to be withheld or deducted. The Issuer will not be obligated to make any additional compensation to the Noteholders in respect of such withholding or deduction.

### 13. Publication of the Final Terms

The Final Terms of each Series of Notes will be approved by the Management Board of the Issuer and before the offering of the respective Series of Notes commences the Final Terms:

- will be submitted to the Financial and Capital Market Commission, who will forward them to the Bank of Lithuania (*Lietuvos Bankas*), the Estonian Financial Supervision Authority (*Finantsinspeksioon*); and
- will be published on the Issuer's website [www.latvenergo.lv](http://www.latvenergo.lv) and will, is 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). The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

### 14. Estimated Expenses Charged to the Investors

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 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.

### 15. Admission to Trading

The Issuer will submit an application regarding inclusion of each Series of Notes in the official list of AS NASDAQ OMX Riga, registration number: 40003167049, legal address: Valņu 1, Riga, LV-1050, Latvia ("**NASDAQ OMX Riga**"). An application will be prepared according to the requirements of NASDAQ OMX Riga and will be submitted to NASDAQ OMX Riga not later than 3 (three) months after the Issue Date of respective Series of Notes.

The Issuer shall use its best efforts to ensure that the Notes remain listed in the official list of NASDAQ OMX Riga or, if such listing is not possible to obtain or maintain, listed or traded on another regulated market or market place. The Issuer shall, following a listing or admission to trading, take all reasonable actions on its part required as a result of such listing or trading of the Notes.

The Issuer will cover all costs which are related to the admission of the Notes to the relevant regulated market.

### 16. Change of Control

If, after the Issue Date, at any time, the Republic of Latvia ceases to own, directly or indirectly, at least 51 per cent of the issued share capital of the Issuer or ceases to have the power, directly or indirectly, to cast, or control the casting of, at least 51 per cent of the maximum number of votes that might be casted at a shareholders' meeting of the Issuer (the "**Change of Control**"), the Issuer immediately and without any delay after it becomes aware of the Change of Control shall notify the Noteholders in accordance with Clause 19 (*Notices*) about the occurrence of the Change of Control. Accordingly, on the Prepayment Date (as defined below) the Issuer shall prepay all Noteholders the principal amount of and the interest accrued on the Notes, but without any premium or penalty. Interest on the Notes accrues until the Prepayment Date (excluding the Prepayment Date).

"**Prepayment Date**" means the date falling 45 (forty-five) Business Days after the Issuer becomes aware of the occurrence of the Change of Control.

### 17. Negative Pledge

So long as any Note remains outstanding, the Issuer shall not, and shall procure that none of its Subsidiaries will create mortgage, pledge or any other security interest (each a "**Security Interest**"), other than a Permitted Security Interest, upon the whole or any part of its undertaking or assets, present or future, to secure their obligations in respect of any present or future Relevant Indebtedness, unless prior to or

simultaneously therewith the Issuer's obligations under the Notes are secured equally and rateably therewith.

Within the meaning of this Clause the "**Subsidiary**" means a company: (i) in which the Issuer holds a majority of the voting rights; or (ii) of which the Issuer is a shareholder or participant and has the right to appoint or remove a majority of the members of the Management Board; or (iii) of which the Issuer is a shareholder or participant and controls a majority of the voting rights, and includes any company which is a subsidiary of a Subsidiary of the Issuer.

Within the meaning of this Clause the "**Group**" means the Issuer and its Subsidiaries from time to time.

"**Permitted Security Interest**" means any Security Interest created over any asset of any company which becomes a member of the Group after the issue of the Notes where such Security Interest is created: (a) prior to the date on which the company becomes a member of the Group, provided that such Security Interest was not created in contemplation of the acquisition of such company; or (b) simultaneously with the acquisition of such company for the sole purpose of financing the acquisition of such company.

"**Relevant Indebtedness**" means any Indebtedness which is in the form of, or represented by, bonds, notes, debentures or other similar securities which are issued by the Issuer or any of its Subsidiaries and which are, or are capable of being, quoted, listed or ordinarily traded on any stock exchange or other established securities, but shall not include any Project Finance Indebtedness.

"**Indebtedness**" means any indebtedness (whether principal, premium, interest or other amounts) in respect of any borrowed money of the Issuer or any of its Subsidiaries (other than from the Issuer to any of its wholly-owned Subsidiaries and from any of the Issuer's wholly-owned Subsidiaries to the Issuer or to another wholly-owned Subsidiary).

"**Project Finance Indebtedness**" means any Indebtedness of the Project Company incurred to finance the ownership, acquisition, construction, development and/or operation of any specific assets within the energy sector or any Indebtedness of such Project Company incurred to refinance any of such aforementioned Indebtedness, where neither persons to whom such Indebtedness is owed nor any other persons shall have any recourse whatsoever to the Issuer or any of its Subsidiaries (other than the Project Company) for the repayment or payment of any sum relating to such Indebtedness.

"**Project Company**" means a company established or acquired by the Issuer or any of its Subsidiaries for the purpose of owning, constructing, developing, operating and/or financing of any specific assets within energy sector, provided that the respective purpose of the Project Company is specifically approved/designated by the Issuer.

## 18. Events of Default

If an Event of Default (as defined below) occurs, the Issuer immediately and without any delay shall notify the Noteholders in accordance with Clause 19 (*Notices*) about the occurrence of an Event of Default. Accordingly, on the 10<sup>th</sup> (tenth) Business Day after the occurrence of an Event of Default the Issuer shall prepay all Noteholders the outstanding principal amount of the Notes and the interest accrued on the Notes, but without any premium or penalty. Interest on the Notes accrues until the prepayment date (excluding the prepayment date).

Each of the following events shall constitute an event of default ("**Event of Default**"):

- (a) **Non-Payment:** Any amount of interest on or principal of the Notes has not been paid within 5 (five) Business Days from the relevant due date, unless the failure to pay is caused by a reason referred to in Clause 20 (*Force Majeure*).
- (b) **Breach of Other Obligations:** The Issuer fails to perform any its obligations pursuant to these General Terms and Conditions, or otherwise act in contravention of these General Terms and Conditions, except that the Issuer has rectified such situation within 20 (twenty) Business Days after the Issuer becomes or should have become aware of such failure to comply with these General Terms and Conditions.

- (c) **Disposal of Assets:** The Issuer or any of its Subsidiaries enters into a single transaction or a series of transactions (whether related or not) to sell, transfer or otherwise dispose of any asset to the Project Company, unless such disposal is made for a fair market value.
- (d) **Cross Default:** Any outstanding Indebtedness (including guarantees given by the Issuer) of the Issuer or any of its Material Subsidiaries (other than in respect of the Project Finance Indebtedness) in a minimum amount of EUR 10,000,000 (ten million euro) or its equivalent in any other currency, is accelerated prematurely because of default, howsoever described, or if any such Indebtedness is not paid or repaid on the due date thereof or within any applicable grace period after the due date, or if any security given by the Issuer for any such Indebtedness becomes enforceable by reason of default.
- (e) **Negative Pledge:** the Issuer does not comply with its obligations under Clause 17 (*Negative Pledge*).
- (f) **Cessation of Business:** The Issuer or/and any of its Material Subsidiaries cease to carry on its current business in its entirety or a substantial part thereof, other than: (i) pursuant to any sale, disposal, demerger, amalgamation, reorganization or restructuring or any cessation of business in each case on a solvent basis and within the Group, or (ii) for the purposes of, or pursuant to any terms approved by the Noteholders' Meeting, or (iii) in relation to a Material Subsidiary, if the cessation of the respective business (or substantial part thereof) of the Material Subsidiary is required by any specific EU regulations or laws of the Republic of Latvia or decisions of any regulatory authority in relation to the operation of the electricity markets and it does not materially affect the Issuer's ability to fulfil its obligations with regard to the Notes.
- (g) **Liquidation:** An effective resolution is passed for the liquidation of the Issuer or any of its Material Subsidiaries other than, in case of a Material Subsidiary: (i) pursuant to an amalgamation, reorganization or restructuring in each case within the Group, or (ii) for the purposes of, or pursuant to any terms approved by the Noteholders' Meeting.
- (h) **Insolvency:** (i) the Issuer or any of its Material Subsidiaries is declared insolvent or bankrupt by a court of competent jurisdictions or admits inability to pay its debts; (ii) the Issuer or any of its Material Subsidiaries enters into any arrangement with majority of its creditors by value in relation to restructuring of its debts or any meeting is convened to consider a proposal for such arrangement; or (iii) an application to initiate insolvency, restructuring (including procedures such as legal protection process (TAP) and out of court legal protection process (ATAP)) or administration of the Issuer or any of its Material Subsidiaries or any other proceedings for the settlement of the debt of the Issuer or of any of its Material Subsidiaries is submitted to the court by the Issuer or any of its Material Subsidiaries.

In case of the Issuer's liquidation or insolvency the Noteholders shall have a right to receive payment of the outstanding principal amount of the Notes and the interest accrued on the Notes according to the relevant laws governing liquidation or insolvency of the Issuer.

Within the meaning of this Clause "**Indebtedness**" shall have the meaning prescribed to it in Clause 17 (*Negative Pledge*).

Within the meaning of this Clause "**Project Finance Indebtedness**" shall have the meaning prescribed to it in Clause 17 (*Negative Pledge*).

Within the meaning of this Clause "**Project Company**" shall have the meaning prescribed to it in Clause 17 (*Negative Pledge*).

Within the meaning of this Clause "**Material Subsidiary**" means at any time any Subsidiary:

- (i) whose sales or total assets represent not less than ten 10 (ten) per cent of the consolidated sales or the consolidated total assets of the Group taken as a whole, all as calculated by reference to the then most recent audited financial statements of the Group; or
- (ii) to which is transferred the whole or substantially the whole of the sales or assets and undertakings of the Subsidiary which, immediately prior to such transfer, is a Material Subsidiary.



Within the meaning of this Clause “**Subsidiary**” shall have the meaning prescribed to it in Clause 17 (*Negative Pledge*).

Within the meaning of this Clause “**Group**” shall have the meaning prescribed to it in Clause 17 (*Negative Pledge*).

## **19. Notices**

Noteholders shall be advised of matters relating to the Notes by a notice published in English and Latvian in Central Storage of Regulated Information ([www.oricgs.lv](http://www.oricgs.lv)), on the Issuer’s website at [www.latvenergo.lv](http://www.latvenergo.lv) and, after the Notes are admitted to the regulated market, also on NASDAQ OMX Riga website. Any such notice shall be deemed to have been received by the Noteholders when published in the manner specified in this Clause 19.

## **20. Force Majeure**

The Issuer, the Arranger of the Programme, the Issuing Agent and the LCD shall be entitled to postpone the fulfilment of their obligations hereunder, in case the performance is not possible due to continuous existence of any of the following circumstances:

- (a) action of any authorities, war or threat of war, rebellion or civil unrest;
- (b) disturbances in postal, telephone or electronic communications which are due to circumstances beyond the reasonable control of the Issuer, the Arranger of the Programme, the Issuing Agent or the LCD and that materially affect operations of any of them;
- (c) any interruption of or delay in any functions or measures of the Issuer, the Arranger of the Programme, the Issuing Agent or the LCD as a result of fire or other similar disaster;
- (d) any industrial action, such as strike, lockout, boycott or blockade affecting materially the activities of the Issuer, the Arranger of the Programme, the Issuing Agent or the LCD even if it only affects part of the employees of any of them and whether any of them is involved therein or not; or
- (e) any other similar force majeure or hindrance which makes it unreasonably difficult to carry on the activities of the Issuer, the Arranger of the Programme, the Issuing Agent or the LCD.

In such case the fulfilment of the obligations may be postponed for the period of the existence of the respective circumstances and shall be resumed immediately after such circumstances cease to exist, provided that the Issuer, the Arranger of the Programme, the Issuing Agent and the LCD shall put all best efforts to limit the effect of the above referred circumstances and to resume the fulfilment of their obligations, as soon as possible.

## **21. Further Issues**

The Issuer may from time to time, without the consent of and notice to the Noteholders, create and issue further Notes having the same terms and conditions as such Series of Notes in all respects (or in all respects, except for the issue price and/or the minimum investment amount thereof) by increasing the issued and, if needed, also the maximum aggregate principal amount of the Notes of such Series of Notes or otherwise and whether such further Notes form a single series with such Series of Notes or not. For the avoidance of doubt, this Clause 21 shall not limit the Issuer's right to issue any other notes.

## **22. Purchases**

The Issuer or any of its Subsidiaries may at any time purchase the Notes in any manner and at any price in the secondary market. Such Notes may be held, resold or surrendered by the purchaser through the Issuer for cancellation. Notes held by or for the account of the Issuer or any of its Subsidiaries for their own account will not carry the right to vote at the Noteholders’ Meetings and will not be taken into account in determining how many Notes are outstanding for the purposes of these General Terms and Conditions.

### 23. Time Bar

In case any payment under the Notes has not been claimed by the respective Noteholder entitled to this payment within 10 (ten) years from the original due date thereof, the right to such payment shall be forfeited by the Noteholder and the Issuer shall be permanently free from such payment.

### 24. Representation of the Noteholders

Within the Programme described herewith, 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.

### 25. Noteholders' Meeting

- (a) The Issuer shall have a right to convene a meeting of the Noteholders or the Noteholders of the relevant Series of Notes, respectively, (the **"Noteholders' Meeting"**) or shall do so following a written request from the Noteholders who, on the day of the request, represent not less than one-tenth of the principal amount of the Notes outstanding or the principal amount of the Notes of the relevant Series of Notes outstanding, respectively, (excluding the Issuer and its Subsidiaries), to decide on amendments of these General Terms and Conditions, the Final Terms of the relevant Series of Notes or other matters that may significantly affect the interests of the Noteholders.
- (b) All expenses in relation to the convening and holding the Noteholders' Meeting shall be covered by the Issuer.
- (c) In case convening of the Noteholders' Meeting is initiated by the Noteholders, the Issuer shall be obliged to convene the Noteholders' Meeting not later than within 3 (three) months after receipt of the respective Noteholders' written request.
- (d) Notice of the Noteholders' Meeting shall be published in accordance with Clause 19 (*Notices*) no later than 10 (ten) Business Days prior to the meeting. Furthermore, the notice shall specify the time, place and agenda of the meeting, as well as any action required on the part of the Noteholder that will attend the meeting. No matters other than those referred to in the notice may be resolved at the Noteholders' Meeting.
- (e) Only those who, according to the register kept by LCD in respect of the Notes, were registered as the Noteholders on the 6<sup>th</sup> (sixth) Business Day prior to the Noteholders' Meeting or proxies authorised by such Noteholders, shall be entitled to vote at the meeting and shall be recorded in the list of Noteholders in the Noteholders' Meeting.
- (f) The Noteholders' Meeting shall be held in Riga, Latvia, and its chairman shall be the Issuer's representative appointed by the Issuer.
- (g) The Noteholders' Meeting shall constitute a quorum only if one or more Noteholders holding 50 (fifty) per cent in aggregate or more of the principal amount of the Notes outstanding or the principal amount of the relevant Series of Notes outstanding, respectively, are present in the meeting. If the Issuer and/or any of its Subsidiaries are the Noteholders, their principal amount of the Notes will be excluded when a quorum of the Noteholders' Meeting is calculated.
- (h) If, within 30 (thirty) minutes after the time specified for the start of the Noteholders' Meeting, a quorum is not present, any consideration of the matters to be dealt with at the meeting shall be adjourned for consideration at a meeting to be convened on a date not earlier than 14 (fourteen) calendar days and no later than 28 (twenty-eight) calendar days after the original meeting at a place to be determined by the Issuer. The adjourned Noteholders' Meeting shall constitute a quorum if one or more Noteholders holding 25 (twenty-five) per cent in aggregate or more of the principal amount of the Notes outstanding or the principal amount of the Notes of the relevant Series of Notes outstanding, respectively, are present. Only those who, according to the register kept by LCD in respect of the Notes, were registered as the Noteholders on the 6<sup>th</sup> (sixth) Business Day prior to the adjourned Noteholders' Meeting or proxies authorised by such Noteholders, shall be entitled to vote at the adjourned

Noteholders' Meeting and shall be recorded in the list of the Noteholders in the adjourned Noteholders' Meeting.

- (i) Notice of the adjourned Noteholders' Meeting shall be given in the same manner as notice of the original Noteholder's Meeting. The notice shall also state the requirements for the constitution of a quorum.
- (j) Voting rights of the Noteholders shall be determined according to the principal amount of the Notes held. The Issuer and any Subsidiary shall not hold voting rights at the Noteholders' Meeting.
- (k) The Noteholders' Meeting shall be held in English with translation into Latvian, unless the Noteholders present in the respective Noteholders' Meeting unanimously decide that the respective Noteholders' Meeting shall be held only in Latvian or English.
- (l) A representative of the Issuer and a person authorised to act for the Issuer may attend and speak at the Noteholders' Meeting.
- (m) Minutes of the Noteholders' Meeting shall be kept, recording the day and time of the meeting, attendees, their votes represented, matters discussed, results of voting, and resolutions which were adopted. The minutes shall be signed by the keeper of the minutes, which shall be appointed by the Noteholders' Meeting. The minutes shall be attested by the chairman of the Noteholders' Meeting, if the chairman is not the keeper of the minutes, as well as by one of the persons appointed by the Noteholders' Meeting to attest the minutes. The minutes shall be published in accordance with Clause 19 (*Notices*) after the Noteholders' Meeting as soon as possible and without any delay. New or amended General Terms and Conditions or Final Terms of the relevant Series of Notes, respectively (if applicable) shall be appended to the minutes. The minutes shall be stored in a secure manner by the Issuer.
- (n) The Noteholders' Meeting shall be organised by the chairman of the Noteholders' Meeting.
- (o) The Noteholders' Meeting is entitled to make the decisions that are binding on all Noteholders as follows:

consent of simple majority of the Noteholders present at the Noteholders' Meeting (subject to quorum requirements) is required to the following decisions:

- (i) agreement with the Issuer to change the terms and conditions of the Notes;
- (ii) granting of consent to the Issuer which is required according to this Base Prospectus;

however, consent of at least 75 (seventy-five) per cent of the aggregate principal amount of the outstanding Notes is required for the following decisions:

- (iii) agreement with the Issuer to change the law governing the Notes or jurisdiction;
- (iv) agreement with the Issuer to amend Clause 5 (*Status and Security*), Clause 15 (*Admission to Trading*), Clause 16 (*Change of Control*), Clause 17 (*Negative Pledge*) and Clause 18 (*Events of Default*);
- (v) agreement with the Issuer to amend the requirements for the constitution of a quorum at a Noteholders' Meeting;
- (vi) agreement with the Issuer to amend the majority requirements of the Noteholders' Meeting;
- (vii) agreement with the Issuer to amend this sub-clause (o);

and consent of at least 75 (seventy-five) per cent of the aggregate principal amount of the outstanding Notes of the respective Series of Notes is required for the following decisions:

- (viii) agreement with the Issuer to change the date, or the method of determining the date, for the payment of principal, interest or any other amount in respect of the relevant Series of Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the relevant Series of Notes or to change the method of calculating the amount of principal, interest or any other amount payable on any date in respect of the relevant Series of Notes;
  - (ix) agreement with the Issuer to change the currency of the relevant Series of Notes;
  - (x) agreement with the Issuer on any exchange or substitution of the relevant Series of Notes for, or the conversion of the relevant Series of Notes into, any other obligations or securities of the Issuer or any other person;
  - (xi) in connection with any exchange, substitution or conversion of the type referred to in paragraph (x) agreement with the Issuer to amend any of the provisions of the relevant Series of Notes describing circumstances in which the relevant Series of Notes may be redeemed or declared due and payable prior to their scheduled maturity.
- (p) Resolutions passed at the Noteholders Meeting shall be binding on all Noteholders irrespective of whether they have been present at the Noteholders' Meeting.
  - (q) The Issuer shall have a right to increase the aggregate principal amount of the Notes to be issued under the Programme without the consent of the Noteholders or the Noteholders' Meeting.
  - (r) The Issuer shall have a right to amend the technical procedures relating to the Notes in respect of payments or other similar matters without the consent of the Noteholders or the Noteholders' Meeting, if such amendments are not prejudicial to the interests of the Noteholders.

## PLACEMENT OF THE NOTES

### 1. Placement Account

Initially the Notes of the respective Series of Notes will be book-entered in the placement account of the Issuing Agent within LCD.

### 2. Placement Period

The placement period for each Series of Notes (the “**Placement Period**”) will be specified in the Final Terms.

### 3. Submission of Purchase Orders

The investors wishing to purchase the Notes shall submit their orders to acquire the Notes (the “**Purchase Orders**”) at any time during the Placement Period to the Issuing Agent and its sub-agents, which will be specified in the Final Terms of the relevant Series of Notes. The procedure of submission of the Purchase Orders will be specified in the Final Terms of the relevant Series of Notes.

### 4. Purchase Orders

Total amount of the Notes to be acquired and indicated in each Purchase Order shall be for at least Minimum Investment Amount.

The Purchase Order shall also indicate the lowest acceptable yield to maturity of the Notes (the “**Yield to Maturity**”) within the established Yield to Maturity Range (as defined below) (the “**Competitive Purchase Orders**”) or an acceptance to acquire the Notes at any Yield to Maturity within the established Yield to Maturity Range that shall be established by the Issuer in the manner provided in this Base Prospectus (the “**Non-competitive Purchase Orders**”). Yield to Maturity is the percentage rate of return paid if the Note is held to its Maturity Date, assuming that interest paid over the life of the Note is reinvested at the same rate.

Only valid Non-competitive Purchase Orders and Competitive Purchase Orders indicating Yield to Maturity that is less or equal to the Final Yield to Maturity (to be established as described below) shall be treated as qualifying Purchase Orders (the “**Qualifying Purchase Orders**”).

Purchase Orders by the same legal entity or person will be aggregated into one if all order parameters (except the purchase amount) are the same.

All Purchase Orders are binding and irrevocable commitment to acquire the allotted Notes, with the exceptions stated below.

### 5. Range of Yield to Maturity

An expected yield to maturity range (the “**Yield to Maturity Range**”) for the Series of Notes being offered will be specified in the Final Terms of respective Series of Notes. The Issuer has a right to amend the Yield to Maturity Range during the Placement Period and announce updated Yield to Maturity Range (the “**Updated Yield to Maturity Range**”).

The Updated Yield to Maturity Range 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). The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

Investors should follow the information on the aforementioned websites and have a right to modify or cancel their Purchase Orders if the Yield to Maturity Range has been updated, provided that such modification or cancellation of the Purchase Order is received by the Issuing Agent before the end of the Placement Period.

## 6. Invalid Purchase Orders

The Purchase Order shall not be considered valid and shall not be processed in case the purchase amount indicated in the Purchase Order is less than the Minimum Investment Amount, the Purchase Order was received after the Placement Period or the Yield to Maturity indicated in the Purchase Order is higher than the maximum value of the Yield to Maturity Range or the Updated Yield to Maturity Range, as the case may be, applicable at the end of the Placement Period. Nor the Issuer, neither the Issuing Agent has any obligation to inform investors about the fact that their Purchase Orders are invalid.

## 7. Allotment

On the next Business Day following the Placement Period the Issuer will decide whether to proceed with the offering of the respective Series of Notes or cancel the offering partly or completely. The offering of the respective Series of Notes shall be cancelled partly in case the aggregate principal amount of the respective Series of Notes together with the aggregate principal amount of other Series of Notes exceeds the total aggregate principal amount of the Notes to be issued under the Programme.

In case the offering of the respective Series of Notes is cancelled partly or completely, the Issuer will publish respective announcement on the Issuer's website [www.latvenergo.lv](http://www.latvenergo.lv) which 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 submit respective information to the Financial and Capital Market Commission. The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

In case the Issuer decides to proceed with the offering of the respective Series of Notes completely or partly, the following actions shall be taken on the next Business Day following the Placement Period:

### *(a) Establishment of the Final Yield to Maturity and Qualifying Purchase Orders*

The Issuer together with the Issuing Agent, on the basis of the submitted valid Purchase Orders and indicated Yield to Maturity, shall establish the final Yield to Maturity (the "**Final Yield to Maturity**") payable to the investors.

The Final Yield to Maturity shall be established according to the following procedure: the Purchase Orders with the lowest Yield to Maturity shall be fulfilled as first. Afterwards, the Purchase Orders with the next highest Yield to Maturity shall be fulfilled in ascending order. The procedure continues until the amount of the Purchase Orders fulfilled, including the Non-competitive Purchase Orders, reaches the aggregate principal amount of the respective Series of Notes. The Yield to Maturity at which the amount of the Purchase Orders fulfilled reached the actual amount of the respective Series of Notes shall be considered as the Final Yield to Maturity.

The Final Yield to Maturity shall be the same for all investors acquiring the Notes of the respective Series of Notes during the offering.

Based on the established Final Yield to Maturity the Issuer together with the Issuing Agent shall determine which Purchase Orders can be treated as Qualifying Purchase Orders, and the extent of their satisfaction.

### *(b) Determination of Annual Interest Rate and Issue Price*

The Annual Interest Rate shall be set by rounding down 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 following formula:

|                                                                         |                                                                                                                                                                                             |
|-------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| $P = \frac{C}{(1+Y)} + \frac{C}{(1+Y)^2} + \dots + \frac{C+N}{(1+Y)^n}$ | <p>P – Issue Price<br/>C – Annual Interest Rate multiplied by nominal amount of the Note;<br/>N – Nominal amount of the Note;<br/>Y – Final Yield to Maturity;<br/>n – Number of Years.</p> |
|-------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|



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

The Issuer has a right to establish the First Interest Period shorter as a calendar year. In such case the Issue Price of the Notes will be calculated according to the formula, which will be different from the formula provided above.

Therefore, for each Series of Notes the Issuer will provide in the Final Terms the formula for calculation of the Issue Price of the Notes.

*(c) Allotment of the Notes to the Investors*

Upon determination of the Annual Interest Rate and the Issue Price, the Issuer together with the Issuing Agent will establish the exact amount of the Notes to be allotted with respect to each Qualifying Purchase Order. The procedure of allotment of the Notes will be specified in the Final Terms of the relevant Series of Notes.

*(d) Announcement*

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. The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

*(e) Confirmations*

After completion of the allotment with respect to each Qualifying Purchase Order the Issuing Agent shall submit a trade confirmation (the "**Confirmation**") to each investor by way of fax or by e-mailing an electronic copy of the Confirmation. The Confirmation will evidence the extent of satisfaction or rejection of the Purchase Order submitted by the investor, the number of Notes allotted to the investor, the Issue Price and the amount (price) payable for the Notes, Annual Interest Rate and the Issuing Agent's current account to which the amount by the investor should be payable.

## **8. Payment**

Each investor undertakes by 11.00 a.m. on the Issue Date to pay the Issue Price of the allotted Notes in full to the Issuing Agent's current account specified in the Confirmation. If an irrevocable order to debit account of the investor is granted in the Purchase Order, the Issuing Agent will debit such account at 11.00 a.m. on the Issue Date without separate notice to or consent of the investor. All paid up Notes shall be treated as issued.

## **9. Transfer of the Notes**

On the Issue Date the Issuing Agent will submit to the LCD instructions to transfer the Notes of the investors who have acquired and paid for the Notes on the Issue Date from the placement account of the Issuing Agent to the accounts of the credit institutions or investment brokerage firms with which the investors have opened securities accounts. The credit institutions or investment brokerage firms will register the Notes in the securities accounts of the respective investors. The Notes which are not paid up shall be cancelled.

## **10. Information About the Results of the Placement**

Information about the results of the placement of each Series of Notes (amount of the Notes issued and aggregate principal amount of the respective Series of Notes) shall 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) within 10 (ten) Business Days after the Issue Date. The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

## FORM OF THE FINAL TERMS

**Final Terms dated [●]  
AS Latvenergo  
Issue of [●] Notes due [●]  
under the LVL 50,000,000 (or equivalent in EUR)  
Programme**

These Final Terms together with the General Terms and Conditions of the LVL 50,000,000 (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.

Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. However, a summary of the issue of the Notes is annexed to these Final Terms.

The Base Prospectus has been published on the Issuer's website [www.latvenergo.lv](http://www.latvenergo.lv).

- |     |                                                                                                    |                 |
|-----|----------------------------------------------------------------------------------------------------|-----------------|
| 1.  | Issuer:                                                                                            | AS Latvenergo   |
| 2.  | Serial number of Series of Notes:                                                                  | [●]             |
| 3.  | ISIN Code:                                                                                         | [●]             |
| 4.  | Aggregate principal amount:                                                                        | [●]             |
| 5.  | Currency of the Notes:                                                                             | [●]             |
| 6.  | Nominal amount of the Note:                                                                        | [●]             |
| 7.  | Issue Date:                                                                                        | [●]             |
| 8.  | Interest Payment Date:                                                                             | [●] each year   |
| 9.  | Maturity Date:                                                                                     | [●]             |
| 10. | Minimum Investment Amount:                                                                         | [●]             |
| 11. | Yield to Maturity Range*:                                                                          | from [●] to [●] |
| 12. | Placement Period:                                                                                  | [●]             |
| 13. | Procedure of submission of the Purchase Orders:                                                    | [●]             |
| 14. | Formula for calculation of the Issue Price:                                                        | [●]             |
| 15. | Indication of the material features of the agreement with the Issuing Agent, including the quotas: | [●]             |
| 16. | Sub-agents of the Issuing Agent:                                                                   | [●]             |
| 17. | Categories of investors to whom the Notes will be offered                                          | [●]             |
| 18. | Procedure of allotment of Notes:                                                                   | [●]             |

19. Rating: the Notes to be issued [are not/have been/are expected to be] rated [by:[•]]

\* The Issuer has a right to amend the Yield to Maturity Range during the Placement Period and announce the updated Yield to Maturity Range (the “Updated Yield to Maturity Range”). Updated Yield to Maturity Range 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). The Issuing Agent will for this purpose use reasonable endeavours to timely publish this information, but will not take any responsibility for the timeliness of the publishing.

Investors should follow the information on the aforementioned websites and have a right to modify or cancel their Purchase Orders if the Yield to Maturity Range has been updated, provided that such modification or cancellation of Purchase Order is received by the Issuing Agent before the end of the Placement Period.

These Final Terms have been approved by the Management Board of the Issuer at its meeting on [date] [month] [year].

Riga, [date] [month] [year]

Management Board of AS Latvenergo:

[•]

**Annex - Form of Issue Specific Summary**  
*(Issuer to annex form of issue specific summary to the Final Terms)*

## 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, Riga, LV-1230, Latvia                |
| Webpage:             | <a href="http://www.latvenergo.lv">www.latvenergo.lv</a> |
| 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 Riga hydropower plant (1974) on the River Daugava and Riga TEC-1 combined heat and power plant (1955) and Riga 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 2007 to 30 June 2012.

|                                                     |             | 2007  | 2008  | Year ended<br>31 December<br>2009<br>(Audited) | 2010  | 2011  | Six months ended<br>30 June<br>2011<br>(Unaudited) | 2012  |
|-----------------------------------------------------|-------------|-------|-------|------------------------------------------------|-------|-------|----------------------------------------------------|-------|
| <b>Key Financial data (the Group)</b>               |             |       |       |                                                |       |       |                                                    |       |
| Revenue                                             | LVL million | 362   | 476   | 501                                            | 567   | 682   | 351                                                | 389   |
| EBITDA <sup>1)</sup>                                | LVL million | 90    | 107   | 145                                            | 207   | 181   | 123                                                | 112   |
| Net profit                                          | LVL million | 8     | 7     | 20                                             | 44    | 44    | 39                                                 | 42    |
| Total assets at the end of the period               | LVL million | 1,316 | 1,681 | 1,699                                          | 2,279 | 2,288 | 2,278                                              | 2,339 |
| Total equity at the end of the period               | LVL million | 712   | 866   | 889                                            | 1,345 | 1,352 | 1,352                                              | 1,350 |
| Net Debt at the end of the period <sup>2)</sup>     | LVL million | 316   | 393   | 352                                            | 311   | 404   | 347                                                | 401   |
| Net debt/EBITDA ratio <sup>3)</sup>                 |             | 3.5   | 3.7   | 2.4                                            | 1.5   | 2.3   | 1.6                                                | 2.2   |
| <b>Electricity sales and generation (the Group)</b> |             |       |       |                                                |       |       |                                                    |       |
| Electricity supply                                  | GWh         | 7,518 | 7,461 | 6,659                                          | 7,620 | 8,980 | 4,589                                              | 4,307 |
| Generated electricity                               | GWh         | 4,128 | 4,567 | 4,871                                          | 5,869 | 5,285 | 3,565                                              | 3,001 |

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 from financial institutions 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 712 million in 2007 to LVL 1,352 million at the end of 2011. The capital structure of the Group has been stable, with equity to assets ratio ranging between 50 per cent and 60 per cent since 2007. 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 1000 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 2011, 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. The next step for market opening will be on 1 January 2013 when market will be fully open, including households, in Estonia and remaining legal entities in Lithuania will purchase electricity in open market. 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 business segment* comprises the Group's electricity and heat generation operations, which is 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 business segment* relates to the provision of distribution services in Latvia and are managed by the Company's subsidiary AS Sadales tīkls, the largest distribution system operator in Latvia. In 2011 distribution assets 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 Company's subsidiary AS Latvijas elektriskie tīkli represents the third business segment – *management of transmission system assets* in Latvia. 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 assets are leased to the transmission system operator.

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

For segment reporting purposes, the division into business 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 business segment of the Group, comprising approximately two-thirds of total revenues for the year 2011. 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 business segment revenues also include revenues from sales of heat produced at the Group's plants. The heat sales amounted to LVL 69 million in 2011, accounting for approximately 10 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 AS Rīgas Siltums 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 2372 MW, of which 34 per cent are generated by CHPPs and 65 per cent by HPPs. The total installed thermal energy capacity of the Group is 2042 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 the first half of 2012, the Group sold more electricity (808 GWh) outside of Latvia than it lost to competitors in Latvia (343 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. On 30 June 2012, almost 50 per

cent of the Baltic electricity market was still regulated, mainly representing the market segments for small and medium sized enterprises and households, whereas the electricity market for large and medium sized business customers is open for competition in all three Baltic States. As of 1 November 2012 the Latvian electricity market is open for all customer segments with the exception of the household segment. The Estonian electricity market is expected to be fully liberalised as from 1 January 2013. As a consequence, these changes will result in that the share of regulated market in the Baltics will decline to approximately 25 per cent as from 1 January 2013. In Latvia, it is expected that the electricity market for households will be opened in 2013, although no date is yet set. It is also expected that the Lithuanian electricity market will be fully open in 2015.

#### *Size of the market and competition*

As of 30 June 2012, the size of the Baltic electricity market was approximately 25 TWh. The largest market is Lithuania with 9.7 TWh, followed by the Estonian market with 7.9 TWh and the Latvian market with 7.2 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 a 91 per cent market share in the first half of 2012. The Group's market shares in Lithuania and Estonia was 11 per cent and 7 per cent respectively in the first half of 2012, respectively. The Group's main competitor in the Baltic market is Eesti Energia, holding approximately 28 to 30 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 opening of Estonian and Latvian household sector in 2013, 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 30 June 2012, the Company had 865 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.

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 0.1074 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.

The Group does not expect that electricity end user tariffs will be changed until the opening of the household segment in Latvia, scheduled for 2013.

### **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 during 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 April 2012, the fee is set at LVL 12.3 per MWh, and the next revision of the fee is planned for 1 April 2013. 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 90 per cent of the total electricity output in Latvia and about 70 per cent of the total thermal energy output in Riga.

The total electric capacity of generators installed at the Group's production facilities as at 30 June 2012 was 2372 MW, whereas the total heat generation capacity of installed thermal generation facilities was 2042 MW.

The Group's installed electrical capacity as per 30 June 2012:

|                      | (MW)        |
|----------------------|-------------|
| Daugava HPPs .....   | 1560        |
| Riga CHPPs .....     | 806         |
| Liepāja plants ..... | 4           |
| Small plants .....   | 2           |
| <b>Total</b> .....   | <b>2372</b> |

The Group's thermal energy capacity of installed generation facilities as per 30 June 2012:

|                      | (MW)        |
|----------------------|-------------|
| Riga CHPPs .....     | 1840        |
| Liepāja plants ..... | 198         |
| Small plants .....   | 4           |
| <b>Total</b> .....   | <b>2042</b> |

### *Generation at HPPs*

The Group's three largest HPPs – the *Pļaviņas*, *Kegums* and *Rīga* plants - are located on the River Daugava. In 2011, the respective HPPs produced 53 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 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 Kegums HPP* is the oldest on the River Daugava, built in 1936-1939 and restored in 1945-1947. Initial installed capacity was 72 MW. In 1979 three additional units were installed increasing the installed capacity to 264 MW.

*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 electric 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 electric capacity of Riga TEC-2 is 662 MW and its thermal capacity is 1347 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 198 MW, and its electric capacity is 4 MW. In 2010 SIA Liepājas enerģija resumed electricity generation after commissioning a CHPP unit with 4 MW electric capacity and 4 MW thermal energy capacity.

### **Distribution system services**

Distribution system services are performed by the Company's subsidiary AS Sadales tīkls, and the Group's revenues from distribution services accounted for approximately one-quarter of total Group revenues for the year 2011. 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 2011

was 93764 km, with 28488 transformers and 25678 transformer substations with a total installed capacity of 5917 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 1 million 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 is accounting for approximately 5 per cent of total Group revenues.

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 2011, the total length of electricity transmission lines equalled 5256 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 3200 MVA and a hundred and nineteen 110 kV substations with an aggregate installed transformer capacity of 4829 MVA. The latest 330 kV substation at Riga TEC-2 was constructed in 2008. Four 110 kV substations were built in the last five years: *Zunda, Zolitūde, Matīss and Liepājas Metalurģs*.

### Capital expenditures

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

|                      |                | 2007 | 2008 | 2009      | 2010 | 2011 | Six months<br>2012 |
|----------------------|----------------|------|------|-----------|------|------|--------------------|
|                      |                |      |      | (Audited) |      |      | (Unaudited)        |
| Capital expenditures | LVL<br>million | 222  | 197  | 105       | 128  | 199  | 111                |

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

The table below provides information as of 30 June 2012 on contractually committed capital expenditures of the Group for the financial years 2012, 2013 and 2014.



|                                                                     | Year ended 31 December |                       |             |
|---------------------------------------------------------------------|------------------------|-----------------------|-------------|
|                                                                     | 2012                   | 2013<br>(LVL million) | 2014        |
| Generation and sales.....                                           | 97.4                   | 35.6                  | 4.0         |
| Distribution system service.....                                    | 38.4                   | 31.3                  | 2.6         |
| Management of transmission assets.....                              | 24.0                   | 44.5                  | 5.9         |
| Corporate functions .....                                           | 6.8                    | 4.5                   | 3.0         |
| <b>Total committed.....</b>                                         | <b>166.5</b>           | <b>115.9</b>          | <b>15.5</b> |
| <b>Total committed excluding major projects <sup>(1)</sup>.....</b> | <b>67.8</b>            | <b>56.1</b>           | <b>10.6</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 225 million. As of 30 June 2012, the EPC work equalling LVL 214 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, 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 380 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 renovation and modernization of the 110 kV transmission line Milgravis-Bolderaja and the design and construction of the new 330 kV transmission cable line Riga TEC-1-Imanta are scheduled for completion at the beginning of 2013;
- (2) In the second step, the construction of the Grobina-Ventspils transmission line (as part of Latvia Western region transmission network reinforcement, which is also a part of the "Kurzeme Ring" project), the reconstruction of the existing 330 kV substation Grobina, the construction of the new 330 kV substation Ventspils, the renovation of the existing 110 kV double circuit transmission overhead lines and reinforcement with a new 330 kV line on the same poles are scheduled for completion by mid-2014;
- (3) The third step relates to the reinforcing of the existing 110 kV overhead line connection Ventspils–Dundaga–Tume–Riga line to a 330 kV overhead and is scheduled for completion by 2018.

As at 30 June 2012, the committed capital expenditures for the first and second stage of the project amounted to LVL 66 million and LVL 15 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 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. For the first half of 2012, cash flows from operating activities for the Group amounted to LVL 125 million, which similarly as during years 2009 through 2011 were sufficient to cover all capital investments for the respective period.

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

The Group's gross debt as of 30 June 2012 was LVL 549 million with the following debt maturity schedule:

|                |             | <b>2012</b>        |             |                  |                    |              |
|----------------|-------------|--------------------|-------------|------------------|--------------------|--------------|
|                |             | <b>Second half</b> | <b>2013</b> | <b>2014-2016</b> | <b>2017 - 2025</b> | <b>Total</b> |
| Debt repayment | LVL million | 23                 | 73          | 299              | 154                | 549          |

The table below provides information about the Group's borrowings by lender category as of 30 June 2012.

|                                                                   | <b>30 June 2012</b>   |
|-------------------------------------------------------------------|-----------------------|
|                                                                   | <i>(LVL millions)</i> |
| International investment banks .....                              | 300                   |
| International commercial banks .....                              | 34                    |
| Financial institutions registered in the Republic of Latvia ..... | 215                   |
| <b>Total</b> .....                                                | <b>549</b>            |

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

As of 30 June 2012 total long term committed credit lines available for the Group amounted to EUR 276 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. The weighted average interest rate of the Group's outstanding borrowings was 2.99 per cent (with the effect of the interest rate swaps) for the first half of 2012. The weighted average applicable margin as at 30 June 2012 was 0.667 per cent. As of 30 June 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 is expected to start its operations in December 2012; 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 controlling, 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 2013, followed by reinstatement of supervisory boards soon after.

### **Employees**

The Group had 4443 employees as at 30 June 2012, of whom 75 per cent were men and 25 per cent women. The average age of the employees was 44.3 years. The Group's staff turnover was less than 3 per cent in 2011.

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 shall consist of three members and at the date of this Base Prospectus the nomination of the members of the Audit Committee is in process. The Audit Committee shall be fully operational in 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 two financial years ended 31 December 2010 and 2011 respectively and the two interim periods ended 30 June 2011 and 30 June 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 and 2011 respectively and the unaudited consolidated interim report of the Group for the six month periods ended 30 June 2011 and 30 June 2012 respectively, each of which is attached to this Base Prospectus and forms an integral part of this Base Prospectus. Annual reports and interim reports of the Group are prepared according to International Financial Reporting Standards (IFRS).

|                                                                 |                 | Year ended<br>31 December<br>2010<br><i>Audited</i> | Year ended<br>31 December<br>2011<br><i>Audited</i> | Six months ended<br>30 June<br>2011<br><i>Unaudited</i> | Six months ended<br>30 June<br>2012<br><i>Unaudited</i> |
|-----------------------------------------------------------------|-----------------|-----------------------------------------------------|-----------------------------------------------------|---------------------------------------------------------|---------------------------------------------------------|
| <b>Financial Highlights</b>                                     |                 |                                                     |                                                     |                                                         |                                                         |
| Revenue                                                         | LVL<br>thousand | 567,386                                             | 681,767                                             | 350,782                                                 | 389,174                                                 |
| Including electricity sales                                     | LVL<br>thousand | 470,663                                             | 583,428                                             | 295,448                                                 | 298,772                                                 |
| Heat sales                                                      | LVL<br>thousand | 71,863                                              | 69,233                                              | 40,736                                                  | 51,675                                                  |
| EBITDA <sup>1)</sup>                                            | LVL<br>thousand | 207,240                                             | 180,729                                             | 122,793                                                 | 112,439                                                 |
| EBITDA margin <sup>2)</sup>                                     |                 | 37%                                                 | 27%                                                 | 35%                                                     | 29%                                                     |
| Operating profit <sup>3)</sup>                                  | LVL<br>thousand | 61,826                                              | 53,345                                              | 51,557                                                  | 54,388                                                  |
| Operating margin <sup>4)</sup>                                  |                 | 11%                                                 | 8%                                                  | 15%                                                     | 14%                                                     |
| Net profit                                                      | LVL<br>thousand | 44,325                                              | 43,778                                              | 39,412                                                  | 42,354                                                  |
| Net profit margin <sup>5)</sup>                                 |                 | 8%                                                  | 6%                                                  | 11%                                                     | 11%                                                     |
| Return on assets (ROA) <sup>6)</sup>                            |                 | 2.2%                                                | 1.9%                                                | 1.3%                                                    | 2.0%                                                    |
| Return on equity (ROE) <sup>7)</sup>                            |                 | 4.0%                                                | 3.2%                                                | 2.2%                                                    | 3.5%                                                    |
| Non-current assets at the end of the period                     | LVL<br>thousand | 1,942,231                                           | 2,026,594                                           | 1,962,428                                               | 2,082,771                                               |
| Total assets at the end of the period                           | LVL<br>thousand | 2,279,266                                           | 2,288,004                                           | 2,278,358                                               | 2,339,344                                               |
| Total equity at the end of the period                           | LVL<br>thousand | 1,344,748                                           | 1,351,576                                           | 1,351,606                                               | 1,350,248                                               |
| Borrowings from financial institutions at the end of the period | LVL<br>thousand | 545,607                                             | 513,334                                             | 529,338                                                 | 550,781                                                 |
| Cash flows from operating activities                            | LVL<br>thousand | 160,563                                             | 180,399                                             | 115,343                                                 | 124,613                                                 |
| Capital expenditure                                             | LVL<br>thousand | 127,539                                             | 198,723                                             | 83,884                                                  | 110,758                                                 |
| Net debt at the end of the period <sup>8)</sup>                 | LVL<br>thousand | 311,342                                             | 404,458                                             | 347,284                                                 | 400,526                                                 |
| Net debt/EBITDA ratio <sup>9)</sup>                             |                 | 1.5                                                 | 2.3                                                 | 1.6                                                     | 2.2                                                     |
| <b>Operating Highlights</b>                                     |                 |                                                     |                                                     |                                                         |                                                         |
| Retail electricity sales                                        | GWh             | 7,620                                               | 8,980                                               | 4,589                                                   | 4,307                                                   |
| Electricity produced in power plants                            | GWh             | 5,869                                               | 5,285                                               | 3,565                                                   | 3,001                                                   |
| Total amount of purchased electricity                           | GWh             | 3,028                                               | 4,466                                               | 1,565                                                   | 1,887                                                   |
| Including purchased electricity from independent producers      | GWh             | 693                                                 | 759                                                 | 436                                                     | 459                                                     |
| The rest amount of purchased electricity                        | GWh             | 2,335                                               | 3,707                                               | 1,129                                                   | 1,428                                                   |
| Aggregate heat sales                                            | GWh             | 2,928                                               | 2,524                                               | 1,572                                                   | 1,570                                                   |
| Number of employees at the end of the period                    |                 | 4,517                                               | 4,490                                               | 4,525                                                   | 4,443                                                   |

|                                     | Year ended<br>31 December<br>2010 | Year ended<br>31 December<br>2011 | Six months ended<br>30 June<br>2011 | Six months ended<br>30 June<br>2012 |
|-------------------------------------|-----------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|
| Moody's credit rating of the Issuer | Baa3 (stable)                     | 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 from financial institutions 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 2011 and 2010 (prepared according to IFRS) and unaudited consolidated interim reports as of and for the six month periods ended 30 June 2012 and 2011 (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. A court of cassation instance may render one of the following judgements: (i) to leave the judgement of the Administrative Regional court unvaried and to dismiss the complaints of the PUC and the Company, or (ii) to set aside the judgement of the Administrative Regional court in full or partially and forward the matter to be adjudicated *de novo* in the Administrative Regional court.

In case the cassation instance renders a judgement to leave the judgement of the Administrative Regional court unvaried and to dismiss the complaints of the PUC and the Company, the Company will have to conform to the judgement. In such case the Company will need to apply lower tariffs that were in force prior to the present tariffs. If the judgement repeals the present tariff as of the day of its approval, such lower tariffs will also need to be applied retrospectively from 1 April 2011.

Although the amount of the potential loss is subject to several variables outside the control of the Company, as of 30 June 2012 the Company estimated that the loss resulting from such decision might be about LVL 45 million. At the same time, the Company considers that the possibility for that the court of cassation instance will leave the judgement unvaried is low. Moreover, in case the judgment will not be varied, the Company might have an option to claim losses from the PUC as it is the supervising authority of the tariff decision, which is found unlawful and repealed by the court.

In case the judgement of the Administrative Regional court is set aside in full (or partially) and forwarded for adjudication *de novo*, the Company will continue the court procedures that might last for several years.

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.

#### *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 30 June 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 2011.

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 2012.

### **Future Outlook**

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

## **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. |

## **TAXATION**

The following is a general summary of certain tax consideration in the Republic of Latvia, the Republic of Estonia and the Republic of Lithuania in relation to the Notes. It is not exhaustive and does not purport to be a complete analysis of all tax consequences relating to the Notes, as well as does not take into account or discuss the tax implications of any country other than the Republic of Latvia, the Republic of Estonia and the Republic of Lithuania. The information provided in this section shall not be treated as legal or tax advice; and prospective investors are advised to consult their own tax advisors as to the tax consequences of the subscription, ownership and disposal of the Notes applicable to their particular circumstances.

This summary is based on the laws of Latvia, Estonia and Lithuania as in force on the date of this Base Prospectus and is subject to any change in law that may take effect after such date, provided that such changes could apply also retroactively.

### **The Republic of Latvia**

Latvia has entered into number of tax conventions on elimination of the double taxation, which may provide more favourable taxation regime. Therefore if there is a valid tax treaty with the country of a non-resident prospective investor, it should be also examined. The procedures for application of tax conventions are provided in the Republic of Latvia Cabinet Regulations No. 178 Procedures for Application of Tax Relief Determined in International Agreements for Prevention of Double Taxation and Tax Evasion.

#### ***Taxation of the Noteholders Individuals***

##### Resident Individuals

An individual will be considered as a resident of Latvia for taxation purposes:

- if the individual's permanent place of residence is in the Republic of Latvia, or
- if the individual stays in the Republic of Latvia 183 days or more within any 12-month period, starting or ending in the taxation year; or
- if the individual is a citizen of the Republic of Latvia employed abroad by the government of the Republic of Latvia.

In accordance with the Law on Personal Income Tax the interest income from the Notes for resident individuals will be subject to 10 per cent. withholding tax, deductible by the Issuer before the payment. Also the income from the alienation of the Notes will be subject to 10 per cent tax, but the tax would be payable by the individual him/herself.

##### Non-Resident Individuals

In accordance with the Law on Personal Income Tax the interest income from the Notes for non-resident individuals will be subject to 10 per cent withholding tax, deductible by the Issuer before the payment. The income from the alienation of the Notes will not be subject to tax in Latvia.

#### ***Taxation of the Noteholders Entities***

##### 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 legal acts. 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. Provided that if the Notes are listed on a regulated market of the European Union or the European Economic Area, then, until 31 December 2012, the gains realised from the sale of the Notes may be excluded from the taxpayer's annual taxable income in Latvia. However the respective exemption shall terminate as of 1 January 2013. But the Ministry of Finance has submitted to the Cabinet of Ministers a proposal for amendments to the Corporate Income Tax Law, providing that the gains realised from the sale of the Notes may be excluded from the taxpayer's annual taxable income also after 1 January 2013.

#### 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 Economic Area 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.

### **The Republic of Estonia**

#### ***Taxation of the Noteholders Individuals***

##### Resident Individuals

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 a citizen of Estonia employed abroad by the Estonian government.

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).

#### Non-Resident Individuals

Since the Issuer is a non-resident entity for Estonian taxation purposes, the income of the non-resident individual from the Notes (i.e. interest income and income from the transfer of the Notes) will not be subject to tax in Estonia.

#### ***Taxation of the Noteholders Entities***

##### Resident Entities

An entity will be considered as a resident of Estonia for tax purposes if it is established or registered in Estonia.

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.

According to the Estonian corporate income tax system the moment of taxation of corporate income (including income from the Notes, e.g. interest income, as well as gains) is postponed until the distribution of the profits. The system applies to resident entities and also permanent establishments of non-resident entities in Estonia.

All profit distributions (including dividends) are taxed at a rate of 21/79 of the net amount which is slightly over 26.6 per cent. (or 21 per cent. of the gross amount). This is the corporate income tax which is paid by the resident entity making the distribution.

##### Non-Resident Entities

Since the Issuer is a non-resident entity for Estonian taxation purposes, the income of the non-resident entity from the Notes (i.e. interest income and income from the transfer of the Notes) will not be subject to tax in Estonia.

#### **The Republic of Lithuania**

In accordance with the Law on Tax Administration of the Republic of Lithuania where any international treaties to which Lithuania is a party provide for the rules on taxation different from those of the relevant taxation legislation, and provided the international treaties have been ratified, enacted and enforceable in the Republic of Lithuania, the rules of such international treaties shall prevail. Lithuania and Latvia have entered into a tax convention on elimination of the double taxation, which provides more favourable taxation regime (effective from 1 January 1995). The rules for application of tax conventions are provided in the Law on Tax Administration of the Republic of Lithuania and in the Order No. 159 of the Head of State Tax Inspectorate under the Ministry of Finance dated 27 June 2001.

#### ***Taxation of the Noteholders Individuals***

##### Resident Individuals

Only permanent residents of Lithuania have an obligation to declare and to pay personal income tax from the foreign source income (if such income, eliminating the double taxation, is not exempt from the income tax).

An individual will be considered as a resident of Lithuania during the calendar year for taxation purposes if he/she meets at least one of the criteria laid out in paragraph 1 of Article 4 of the Law On Personal Income Tax of the Republic of Lithuania, i.e.:

- if the individual's permanent place of residence is in Lithuania during the calendar year;
- if the individual's place of personal, social or economic interests is in Lithuania rather than in a foreign country during the calendar year;
- if the individual is present in Lithuania for a period or periods in the aggregate of 183 days or more during the calendar year;
- if the individual is present in Lithuania for a period or periods in the aggregate of 280 days or more during successive calendar years and who stayed in Lithuania for a period or periods in the aggregate of 90 days or more in any of such periods (in such case a person is deemed to be a resident of Lithuania for both years of presence in Lithuania).

In accordance with the Law on Personal Income Tax of the Republic of Lithuania any interest generated by a resident of Lithuania from Notes where such redemption of the Notes commences not earlier than 366 days after the date of the issue of the Notes shall be exempted from personal income tax. Interest income of the residents of Lithuania generated from the Notes that are redeemed earlier than 366 days from the issue of Notes shall be taxed by a 15 percent rate personal income tax.

The resident of Lithuania shall be taxed at a rate of 15 percent on gains from disposal of the Notes. Gains from the disposal of the Notes that have been held continuously for at least 366 days are tax exempt as defined in the Law on Personal Income Tax of the Republic of Lithuania.

#### Non-Resident Individuals

Since the Issuer is a non-resident entity for Lithuanian taxation purposes, the income of the non-resident individual from the Notes (i.e. interest income and income from the transfer of the Notes) will not be subject to tax in Lithuania.

#### ***Taxation of the Noteholders Entities***

##### Resident Entities

An entity will be considered as a resident of Lithuania for tax purposes if it is established and registered in the Republic of Lithuania. This may also include permanent establishments of foreign entities in Lithuania.

In accordance with provisions of the Law on Corporate Income Tax of the Republic of Lithuania any income of a Lithuanian entity (legal person) from the Notes, including an interest, shall be considered as the taxable income of the entity. Having disposed of the Notes a Lithuanian entity shall recognize the gain (the difference between the Notes purchase and sale price). The income from the Notes interest and the gain from the disposal of the Notes shall be included into the overall taxable result of the Lithuanian entity that shall be subject to taxation in the manner set forth in the Law on Corporate Income Tax of the Republic of Lithuania.

##### Non-Resident Entities

Since the Issuer is a non-resident entity for Lithuanian taxation purposes, the income of the non-resident entity from the Notes (i.e. interest income and income from the transfer of the Notes) will not be subject to tax in Lithuania.

## **EU Savings Directive**

In accordance with the EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria may instead apply a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories, including Switzerland, have adopted similar measures (either provision of information or transitional withholding). The European Commission has proposed certain amendments to the EU Savings Directive, which, if implemented, may broaden the scope of the requirements described above.

## 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. In 2008 and 2010 affected by the global financial crisis Latvian growth turned into severe recession. A cumulative drop in GDP of 21.2 per cent was one of the biggest in Europe. Since 2010 a gradual pick up of economic activity is observed. Driven by export and sustained by domestic demand Latvia now is among fastest growing economies in the region. During the first half of the 2012 Latvia has been able to produce a respectable pace of growth of 5.9 per cent in annual rate. This was maintained both by retail sales and by the manufacturing, despite a slowdown in export growth. Solid increase in the activity of transport and communication and tourism was also noted. Construction continued to recover actively. GDP growth of 4.5 per cent in 2012 and 3.6 per cent in 2013 is expected.

| GDP, (%)        | 2007 | 2008 | 2009  | 2010 | 2011 | 2012* |
|-----------------|------|------|-------|------|------|-------|
| Latvia          | 9,6  | -3,3 | -17,7 | -0,9 | 5,5  | 4,5   |
| EU (27) average | 3,2  | 0,3  | -4,3  | 2,1  | 1,5  | 0,0   |

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 stabilized. It will continue to be subject to global processes, which signals new challenges for prices of food and energy that may swiftly show up in inflation.

| Inflation, HICP, average, (%) | 2007 | 2008 | 2009 | 2010 | 2011 | 2012* |
|-------------------------------|------|------|------|------|------|-------|
| Latvia                        | 10,1 | 15,3 | 3,3  | -1,2 | 4,2  | 2,5   |
| EU (27) average               | 2,4  | 3,7  | 1,0  | 2,1  | 3,1  |       |

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 16.1 per cent in the second quarter 2012.

| Unemployment, % | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------------|------|------|------|------|------|
| Latvia          | 6,0  | 7,5  | 16,9 | 18,7 | 16,2 |

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 9.7 per cent of GDP to 3.4 per cent of GDP. Proceeding prudently 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 2006 and 2010, compared to the average of the 27 EU Member States, as determined by Eurostat.

| Government surplus/(-)deficit as<br>percentage of GDP | 2007 | 2008 | 2009 | 2010 | 2011 |
|-------------------------------------------------------|------|------|------|------|------|
| Latvia                                                | 0.4  | -4.2 | -9.8 | -8.1 | -3.4 |
| EU (27) average                                       | -0.9 | -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 42.2 per cent of GDP in 2011. 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.

| Government gross debt as a<br>percentage of GDP | 2007 | 2008 | 2009 | 2010 | 2011 |
|-------------------------------------------------|------|------|------|------|------|
| Latvia                                          | 9.0  | 19.8 | 36.7 | 44.5 | 42.2 |
| EU (27) average                                 | 59.0 | 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. Latvian export of goods at current prices increased by 28.1 per cent in 2011 year-on-year and reached 6 billion lats. In January-July 2012, export of goods continued to increase rapidly (at current prices by 11 per cent, year-on-year). Import of goods in 2011 increased at the same pace as export. In total in 2011, import of goods at current prices increased by 28.3 per cent year-on-year. In seven month of 2012, import of goods has increased at current prices by 14 per cent, compared with January-July 2011. In January-July 2012, export volume growth has been observed in all commodity groups, except for export group of vehicles. More than 1/3 of all export growth has been provided by the export of agricultural and food products. Considerable increase is observed also for the export of metal and its products as well as export of machinery, which contribution in the total export growth is accordingly 20 per cent and 16 per cent. Export to the EU countries in January-July 2012, increased by 7 per cent, compared to the according period of last year. Biggest contribution to this growth were provided by the export increase of agricultural and food products as well as machinery products. Export to CIS countries increased even more rapidly by 16 per cent. More than a half of all export increase was provided by the export increase of agricultural and food products. In January-July 2012, compared to the seven months of 2011, export volumes to Estonia increased by 8 per cent but to Lithuania slightly decreased -1 per cent. Agricultural and food products as well as machinery and chemical products comprise the large part of export to Lithuania and Estonia.

## 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 8.5 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 -2.2 per cent of the GDP in 2011. A moderate current account deficit is likely to persist in 2012 and will gradually increase in years to come.

| <b>Current account, % of GDP</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Latvia                           | -22,4       | -13,1       | 8,6         | 2,9         | -2,2        |

*Source: The Bank of Latvia*

## **DOCUMENTS ON DISPLAY**

Copies of the following documents during validity of this Base Prospectus are available on the Company's webpage [www.latvenergo.lv](http://www.latvenergo.lv) and at the legal address of the Company at Pulkveža Brieža 12, Riga, Latvia on weekdays within the limits of normal business hours:

- (a) Articles of Association of the Company;
- (b) Latvenergo Consolidated Annual Report for the financial year ended 31 December 2011 (prepared according to IFRS);
- (c) Latvenergo Consolidated Annual Report for the financial year ended 31 December 2010 (prepared according to IFRS); and
- (d) Latvenergo Interim Condensed Consolidated Financial Statements for the period ended 30 June 2012 (unaudited; prepared according to IFRS).

## DEFINITIONS

|                                     |                                                                                                                                                                                                                                                                |
|-------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Accrual Date</b>                 | shall have the meaning assigned to it in Clause 10 of the General Terms and Conditions                                                                                                                                                                         |
| <b>Annual Interest Rate</b>         | shall mean the fixed annual interest rate                                                                                                                                                                                                                      |
| <b>Arranger of the Programme</b>    | shall mean AS SEB banka (registration number: 40003151743, legal address: Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia)                                                                                                                |
| <b>Base Prospectus</b>              | shall mean this Base Prospectus                                                                                                                                                                                                                                |
| <b>Business Day</b>                 | shall mean a day on which banks in Riga are open for general business                                                                                                                                                                                          |
| <b>Change of Control</b>            | shall have the meaning assigned to it in Clause 16 of the General Terms and Conditions                                                                                                                                                                         |
| <b>CHPPs</b>                        | shall mean combined heat and power plants                                                                                                                                                                                                                      |
| <b>Company or Issuer</b>            | shall mean AS Latvenergo (registration number 40003032949 and its registered address is Pulkveža Brieža 12, Riga, LV-1230)                                                                                                                                     |
| <b>Competitive Purchase Orders</b>  | Shall have the meaning assigned to in Clause 4 of the Section Placement of the Notes                                                                                                                                                                           |
| <b>Confirmation</b>                 | shall have the meaning assigned to in Clause 7 of the Section Placement of the Notes                                                                                                                                                                           |
| <b>Elements</b>                     | shall mean disclosure requirements, as described in the Summary                                                                                                                                                                                                |
| <b>EUR, euro or €</b>               | shall mean the single currency introduced at the start of the third stage of the European Economic and Monetary Union pursuant, and as defined in Article 2 of the Council Regulation (EC) No.974/98 of 3 May 1998 on the introduction of the euro, as amended |
| <b>EURELECTRIC</b>                  | shall mean the Union of the Electricity Industry of Europe                                                                                                                                                                                                     |
| <b>Event of Default</b>             | shall have the meaning assigned to in Clause 18 of the General Terms and Conditions                                                                                                                                                                            |
| <b>Final Terms</b>                  | shall mean the final terms of the relevant Series of Notes                                                                                                                                                                                                     |
| <b>Final Yield to Maturity</b>      | Shall have the meaning assigned to in Clause 7 of the Section Placement of the Notes                                                                                                                                                                           |
| <b>First Interest Period</b>        | Shall have the meaning assigned to it in Clause 10 of the General Terms and Conditions                                                                                                                                                                         |
| <b>General Terms and Conditions</b> | shall mean the general terms and conditions of the notes                                                                                                                                                                                                       |
| <b>Group</b>                        | shall mean AS Latvenergo together with its consolidated subsidiaries                                                                                                                                                                                           |

|                                        |                                                                                                                                                                |
|----------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                        | or shall have the meaning assigned to in Clause 17 of the General Terms and Conditions, respectively                                                           |
| <b>HPPs</b>                            | shall mean the hydropower plants                                                                                                                               |
| <b>IFRS</b>                            | shall mean International Financial Reporting Standards                                                                                                         |
| <b>Indebtedness</b>                    | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                                                                            |
| <b>Interest Payment Date</b>           | shall mean the interest payment date specified in the Final Terms                                                                                              |
| <b>Investor's Currency</b>             | shall have the meaning assigned to under in risk factor <i>"Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes"</i> |
| <b>Issuing Agent</b>                   | shall mean AS SEB banka (registration number: 40003151743, legal address: Meistaru 1, Valdlauči, Ķekava parish, Ķekava region, LV-1076, Latvia)                |
| <b>Issue Date</b>                      | shall mean the issue date of each Series of Notes                                                                                                              |
| <b>Issue Price</b>                     | shall mean the issue price of the Notes                                                                                                                        |
| <b>Issuer</b>                          | shall mean AS Latvenergo (registration number 40003032949 and its registered address is Pulkveža Brieža 12, Riga, LV-1230)                                     |
| <b>LCD</b>                             | shall mean AS Latvian Central Depository (registration number: 40003242879, legal address: Valņu 1, Riga, LV-1050, Latvia)                                     |
| <b>LVL, lats or Ls</b>                 | shall mean the lawful currency for the time being of the Republic of Latvia                                                                                    |
| <b>Material Subsidiary</b>             | shall have the meaning assigned to in Clause 18 of the General Terms and Conditions                                                                            |
| <b>Maturity Date</b>                   | shall mean the date specified in the Final Terms on which the Notes shall be repaid in full at their nominal amount                                            |
| <b>Member State</b>                    | shall mean Member State of the European Economic Area                                                                                                          |
| <b>Minimum Investment Amount</b>       | shall mean the minimum investment amount for subscription of the Notes, as specified in the Final Terms                                                        |
| <b>NASDAQ OMX Riga</b>                 | shall mean AS NASDAQ OMX Riga (registration number: 40003167049, legal address: Valņu 1, Riga, LV-1050, Latvia)                                                |
| <b>Non-competitive Purchase Orders</b> | shall have the meaning assigned to in Clause 4 of the Section Placement of the Notes                                                                           |
| <b>Noteholders</b>                     | shall mean the holders of the Notes                                                                                                                            |
| <b>Noteholders Meeting</b>             | shall mean the meeting of the Noteholders or the Noteholders of the relevant Series of Notes                                                                   |
| <b>Notes</b>                           | shall mean the notes to be issued under the programme                                                                                                          |

|                                        |                                                                                                        |
|----------------------------------------|--------------------------------------------------------------------------------------------------------|
| <b>Placement Period</b>                | shall mean the placement period for each Series of Notes, as specified in the Final Terms              |
| <b>Permitted Security Interest</b>     | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>Prepayment Date</b>                 | shall have the meaning assigned to it in Clause 16 of the General Terms and Conditions                 |
| <b>Project Company</b>                 | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>Project Finance Indebtedness</b>    | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>PUC</b>                             | shall mean the Public Utilities Commission                                                             |
| <b>Purchase Orders</b>                 | shall mean orders of the investors to acquire the Notes                                                |
| <b>Qualifying Purchase Orders</b>      | shall have the meaning assigned to in Clause 4 of the Section Placement of the Notes                   |
| <b>Relevant Indebtedness</b>           | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>Riga TEC-1</b>                      | shall mean Riga 1 <sup>st</sup> combined heat and power plant                                          |
| <b>Riga TEC-2</b>                      | shall mean Riga 2 <sup>nd</sup> combined heat and power plant                                          |
| <b>Securities Act</b>                  | shall mean the U.S. Securities Act of 1933                                                             |
| <b>Security Interest</b>               | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>Series of Notes</b>                 | shall mean any series of notes                                                                         |
| <b>Subsidiary</b>                      | shall have the meaning assigned to in Clause 17 of the General Terms and Conditions                    |
| <b>Updated Yield to Maturity Range</b> | shall have the meaning assigned to in Clause 5 of the Section Placement of the Notes                   |
| <b>Yield to Maturity</b>               | shall have the meaning assigned to in Clause 4 of the Section Placement of the Notes                   |
| <b>Yield to Maturity Range</b>         | shall have the meaning assigned to in Clause 5 of the Section Placement of the Notes                   |
| <b>Taxes</b>                           | shall mean any present or future taxes, duties, assessments or governmental charges of whatever nature |

## CROSS-REFERENCE LIST

A cross-reference list below identifies the pages where each item of Annexes IV and V of the Commission Regulation (EC) No. 809/2004 can be found in the Base Prospectus.

|             | <b>Items of Annexes IV of the Commission Regulation (EC) No. 809/2004</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | <b>Page number</b> |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| <b>1.</b>   | <b>PERSONS RESPONSIBLE</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |                    |
| 1.1.        | All persons responsible for the information given in the Registration Document and, as the case may be, for certain parts of it, with, in the latter case, an indication of such parts. In the case of natural persons including members of the issuer's administrative, management or supervisory bodies indicate the name and function of the person; in case of legal persons indicate the name and registered office.                                                                                                                                                                                                                                                                                                  | 26                 |
| 1.2.        | A declaration by those responsible for the registration document that, having taken all reasonable care to ensure that such is the case the information contained in the registration document is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. As the case may be, declaration by those responsible for certain parts of the registration document that, having taken all reasonable care to ensure that such is the case, the information contained in the part of the registration document for which they are responsible is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. | 26                 |
| <b>2.</b>   | <b>STATUTORY AUDITORS</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                    |
| 2.1.        | Names and addresses of the issuer's auditors for the period covered by the historical financial information (together with their membership in a professional body).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 27                 |
| 2.2.        | If auditors have resigned, been removed or not been re-appointed during the period covered by the historical financial information, details if material.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | N/A                |
| <b>3.</b>   | <b>SELECTED FINANCIAL INFORMATION</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                    |
| 3.1.        | Selected historical financial information regarding the issuer, presented, for each financial year for the period covered by the historical financial information, and any subsequent interim financial period, in the same currency as the financial information. The selected historical financial information must provide key figures that summarise the financial condition of the issuer.                                                                                                                                                                                                                                                                                                                            | 62-63              |
| 3.2.        | If selected financial information for interim periods is provided, comparative data from the same period in the prior financial year must also be provided, except that the requirement for comparative balance sheet data is satisfied by presenting the year end balance sheet information.                                                                                                                                                                                                                                                                                                                                                                                                                              | 63-63              |
| <b>4.</b>   | <b>RISK FACTORS</b><br>Prominent disclosure of risk factors that may affect the issuer's ability to fulfil its obligations under the securities to investors in a section headed "Risk Factors".                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 16-25              |
| <b>5.</b>   | <b>INFORMATION ABOUT THE ISSUER</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                    |
| <b>5.1.</b> | <b><u>History and development of the Issuer:</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                    |
| 5.1.1.      | the legal and commercial name of the issuer;                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 47                 |
| 5.1.2.      | the place of registration of the issuer and its registration number;                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 47                 |
| 5.1.3.      | the date of incorporation and the length of life of the issuer, except where indefinite;                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 47                 |
| 5.1.4.      | the domicile and legal form of the issuer, the legislation under which the issuer operates, its country of incorporation, and the address and telephone number of its registered office (or principal place of business if different from its registered office);                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 47                 |
| 5.1.5.      | any recent events particular to the issuer which are to a material extent relevant to the evaluation of the issuer's solvency.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | N/A                |
| <b>5.2.</b> | <b><u>Investments</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                    |
| 5.2.1.      | A description of the principal investments made since the date of the last published financial statements.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 54                 |
| 5.2.2.      | Information concerning the issuer's principal future investments, on which its management bodies have already made firm commitments.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 54-56              |



|        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |       |
|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| 5.2.3. | Information regarding the anticipated sources of funds needed to fulfil commitments referred to in item 5.2.2.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 56    |
| 6.     | <b>BUSINESS OVERVIEW</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |       |
| 6.1.   | <b>Principal activities:</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |       |
| 6.1.1. | A description of the issuer's principal activities stating the main categories of products sold and/or services performed; and                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 50-54 |
| 6.1.2. | an indication of any significant new products and/or activities                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 50-54 |
| 6.2.   | <b>Principal markets</b><br>A brief description of the principal markets in which the issuer competes                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 50-54 |
| 6.3.   | The basis for any statements made by the issuer regarding its competitive position.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 51    |
| 7.     | <b>ORGANISATIONAL STRUCTURE</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |       |
| 7.1.   | If the issuer is part of a group, a brief description of the group and of the issuer's position within it.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 57    |
| 7.2.   | If the issuer is dependent upon other entities within the group, this must be clearly stated together with an explanation of this dependence.                                                                                                                                                                                                                                                                                                                                                                                                                                                    | N/A   |
| 8.     | <b>TREND INFORMATION</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |       |
| 8.1.   | Include 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. In the event that the issuer is unable to make such a statement, provide details of this material adverse change.                                                                                                                                                                                                                                                                                                           | 65    |
| 8.2.   | Information on any known trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the issuer's prospects for at least the current financial year.                                                                                                                                                                                                                                                                                                                                                                                           | 65    |
| 9.     | <b>PROFIT FORECASTS OR ESTIMATES</b><br>If an issuer chooses to include a profit forecast or a profit estimate, the registration document must contain the information items 9.1 and 9.2:                                                                                                                                                                                                                                                                                                                                                                                                        | N/A   |
| 9.1.   | A statement setting out the principal assumptions upon which the issuer has based its forecast, or estimate. There must be a clear distinction between assumptions about factors which the members of the administrative, management or supervisory bodies can influence and assumptions about factors which are exclusively outside the influence of the members of the administrative, management or supervisory bodies; the assumptions must be readily understandable by investors, be specific and precise and not relate to the general accuracy of the estimates underlying the forecast. | N/A   |
| 9.2.   | A report prepared by independent accountants or auditors must be included stating that in the opinion of the independent accountants or auditors the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.                                                                                                                                                                                                                                     | N/A   |
| 9.3.   | The profit forecast or estimate must be prepared on a basis comparable with the historical financial information.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | N/A   |
| 10.    | <b>ADMINISTRATIVE, MANAGEMENT, AND SUPERVISORY BODIES</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |       |
| 10.1.  | Names, business addresses and functions in the issuer of the following persons, and an indication of the principal activities performed by them outside the issuer where these are significant with respect to that issuer:<br>(a) members of the administrative, management or supervisory bodies;<br>(b) partners with unlimited liability, in the case of a limited partnership with a share capital.                                                                                                                                                                                         | 58-59 |
| 10.2.  | <b>Administrative, Management, and Supervisory bodies conflicts of interests</b><br>Potential conflicts of interests between any duties to the issuing entity of the persons referred to in item 10.1 and their private interests and or other duties must be clearly stated. In the event that there are no such conflicts, make a statement to that effect.                                                                                                                                                                                                                                    | 59    |
| 11.    | <b>BOARD PRACTICES</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |       |
| 11.1.  | Details relating to the issuer's audit committee, including the names of committee                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | 60    |

|         |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                   |
|---------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|
|         | members and a summary of the terms of reference under which the committee operates.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                   |
| 11.2.   | A statement as to whether or not the issuer complies with its country's of incorporation corporate governance regime(s). In the event that the issuer does not comply with such a regime a statement to that effect must be included together with an explanation regarding why the issuer does not comply with such regime.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 60                |
| 12.     | <b>MAJOR SHAREHOLDERS</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                   |
| 12.1.   | To the extent known to the issuer, state whether the issuer is directly or indirectly owned or controlled and by whom and describe the nature of such control, and describe the measures in place to ensure that such control is not abused.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 61                |
| 12.2.   | A description of any arrangements, known to the issuer, the operation of which may at a subsequent date result in a change in control of the issuer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | N/A               |
| 13.     | <b>FINANCIAL INFORMATION CONCERNING THE ISSUER'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                   |
| 13.1.   | <p>Historical Financial Information Audited historical financial information covering the latest 2 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year. Such financial information must be prepared according to Regulation (EC) No 1606/2002, or if not applicable to a Member States national accounting standards for issuers from the Community.</p> <p>The most recent year's historical financial information must be presented and prepared in a form consistent with that which will be adopted in the issuer's next published annual financial statements having regard to accounting standards and policies and legislation applicable to such annual financial statements.</p> <p>If the audited financial information is prepared according to national accounting standards, the financial information required under this heading must include at least:</p> <ul style="list-style-type: none"> <li>(a) balance sheet;</li> <li>(b) income statement;</li> <li>(c) cash flow statement; and</li> <li>(d) accounting policies and explanatory notes.</li> </ul> <p>The historical annual financial information must have been independently audited or reported on as to whether or not, for the purposes of the registration document, it gives a true and fair view, in accordance with auditing standards applicable in a Member State or an equivalent standard.</p> | 64,<br>Appendices |
| 13.2.   | <p><b><u>Financial statements</u></b></p> <p>If the issuer prepares both own and consolidated financial statements, include at least the consolidated financial statements in the registration document.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 64,<br>Appendices |
| 13.3.   | <b><u>Auditing of historical annual financial information</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                   |
| 13.3.1. | A statement that the historical financial information has been audited. If audit reports on the historical financial information have been refused by the statutory auditors or if they contain qualifications or disclaimers, such refusal or such qualifications or disclaimers must be reproduced in full and the reasons given.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 64,<br>Appendices |
| 13.3.2. | An indication of other information in the registration document which has been audited by the auditors.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | 64,<br>Appendices |
| 13.3.3. | Where financial data in the registration document is not extracted from the issuer's audited financial statements state the source of the data and state that the data is un-audited.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | N/A               |
| 13.4.   | <b><u>Age of latest financial information</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                   |
| 13.4.1. | The last year of audited financial information may not be older than 18 months from the date of the registration document.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 64,<br>Appendices |
| 13.5.   | <b><u>Interim and other financial information</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                   |

|         |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                |
|---------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|
| 13.5.1. | If the issuer has published quarterly or half yearly financial information since the date of its last audited financial statements, these must be included in the registration document. If the quarterly or half yearly financial information has been reviewed or audited the audit or review report must also be included. If the quarterly or half yearly financial information is un-audited or has not been reviewed state that fact.                                                                                                             | 64, Appendices |
| 13.5.2. | If the registration document is dated more than nine months after the end of the last audited financial year, it must contain interim financial information, covering at least the first six months of the financial year. If the interim financial information is un-audited state that fact. The interim financial information must include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the years end balance sheet. | 64, Appendices |
| 13.6.   | <b><u>Legal and arbitration proceedings</u></b><br>Information on any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the issuer is aware), during a period covering at least the previous 12 months which may have, or have had in the recent past, significant effects on the issuer and/or group's financial position or profitability, or provide an appropriate negative statement.                                                                                        | 64-65          |
| 13.7.   | <b><u>Significant change in the issuer's financial or trading position</u></b><br>A description of any significant change in the financial or trading position of the group which has occurred since the end of the last financial period for which either audited financial information or interim financial information have been published, or an appropriate negative statement.                                                                                                                                                                    | 65             |
| 14.     | <b>ADDITIONAL INFORMATION</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                |
| 14.1.   | <b><u>Share Capital</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |                |
| 14.1.1. | The amount of the issued capital, the number and classes of the shares of which it is composed with details of their principal characteristics, the part of the issued capital still to be paid up, with an indication of the number, or total nominal value, and the type of the shares not yet fully paid up, broken down where applicable according to the extent to which they have been paid up.                                                                                                                                                   | 66             |
| 14.2.   | <b><u>Memorandum and Articles of Association.</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                |
| 14.2.1. | The register and the entry number therein, if applicable, and a description of the issuer's objects and purposes and where they can be found in the memorandum and articles of association.                                                                                                                                                                                                                                                                                                                                                             | 66             |
| 15.     | <b>MATERIAL CONTRACTS</b><br>A brief summary of all material contracts that are not entered into in the ordinary course of the issuer's business, which could result in any group member being under an obligation or entitlement that is material to the issuer's ability to meet its obligation to security holders in respect of the securities being issued.                                                                                                                                                                                        | 66             |
| 16.     | <b>THIRD PARTY INFORMATION AND STATEMENT BY EXPERTS AND DECLARATIONS OF ANY INTEREST</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                |
| 16.1.   | Where a statement or report attributed to a person as an expert is included in the Registration Document, provide such person's name, business address, qualifications and material interest if any in the issuer. If the report has been produced at the issuer's request a statement to that effect that such statement or report is included, in the form and context in which it is included, with the consent of that person who has authorised the contents of that part of the Registration Document.                                            | 29             |
| 16.2.   | Where information has been sourced from a third party, provide a confirmation that this information has been accurately reproduced and that as far as the issuer is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. In addition, the issuer shall identify the source(s) of the information                                                                                                                           | 29             |
| 17.     | <b>DOCUMENTS ON DISPLAY</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 76             |

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|--|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
|  | <p>A statement that for the life of the registration document the following documents (or copies thereof), where applicable, may be inspected:</p> <ul style="list-style-type: none"> <li>(a) the memorandum and articles of association of the issuer;</li> <li>(b) all reports, letters, and other documents, historical financial information, valuations and statements prepared by any expert at the issuer's request any part of which is included or referred to in the registration document;</li> <li>(c) the historical financial information of the issuer or, in the case of a group, the historical financial information of the issuer and its subsidiary undertakings for each of the two financial years preceding the publication of the registration document. An indication of where the documents on display may be inspected, by physical or electronic means.</li> </ul> |  |
|--|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|

|      | <b>Items of Annexes V of the Commission Regulation (EC) No. 809/2004</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | <b>Page number</b> |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|
| 1.   | <b>PERSONS RESPONSIBLE</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                    |
| 1.1. | All persons responsible for the information given in the prospectus and, as the case may be, for certain parts of it, with, in the latter case, an indication of such parts. In the case of natural persons including members of the issuer's administrative, management or supervisory bodies indicate the name and function of the person; in case of legal persons indicate the name and registered office.                                                                                                                                                                                               | 26                 |
| 1.2. | A declaration by those responsible for the prospectus that, having taken all reasonable care to ensure that such is the case, the information contained in the prospectus is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. As the case may be, declaration by those responsible for certain parts of the prospectus that the information contained in the part of the prospectus for which they are responsible is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import. | 26                 |
| 2.   | <b>RISK FACTORS</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                    |
| 2.1. | Prominent disclosure of risk factors that are material to the securities being offered and/or admitted to trading in order to assess the market risk associated with these securities in a section headed "Risk Factors".                                                                                                                                                                                                                                                                                                                                                                                    | 16-25              |
| 3.   | <b>KEY INFORMATION</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                    |
| 3.1. | <b>Interest of natural and legal persons involved in the issue/offer</b><br>A description of any interest, including conflicting ones, that is material to the issue/offer, detailing the persons involved and the nature of the interest.                                                                                                                                                                                                                                                                                                                                                                   | 28                 |
| 3.2. | <b>Reasons for the offer and use of proceeds</b><br>Reasons for the offer if different from making profit and/or hedging certain risks. Where applicable, disclosure of the estimated total expenses of the issue/offer and the estimated net amount of the proceeds. These expenses and proceeds shall be broken into each principal intended use and presented by order of priority of such uses. If the issuer is aware that the anticipated proceeds will not be sufficient to fund all the proposed uses, state the amount and sources of other funds needed.                                           | 28                 |
| 4.   | <b>INFORMATION CONCERNING THE SECURITIES TO BE OFFERED/ADMITTED TO TRADING</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                    |
| 4.1. | A description of the type and the class of the securities being offered and/or admitted to trading, including the ISIN (International Security Identification Number) or other such security identification code.                                                                                                                                                                                                                                                                                                                                                                                            | 31-32              |
| 4.2. | Legislation under which the securities have been created.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 31                 |
| 4.3. | An indication of whether the securities are in registered form or bearer form and whether the securities are in certificated form or book-entry form. In the latter case, name and address of the entity in charge of keeping the records.                                                                                                                                                                                                                                                                                                                                                                   | 32                 |
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| 4.6. | A description of the rights attached to the securities, including any limitations of those rights, and procedure for the exercise of those rights.                                                                                                                                                                                                                                                                                                                                                                                                                                                           | 31-40              |

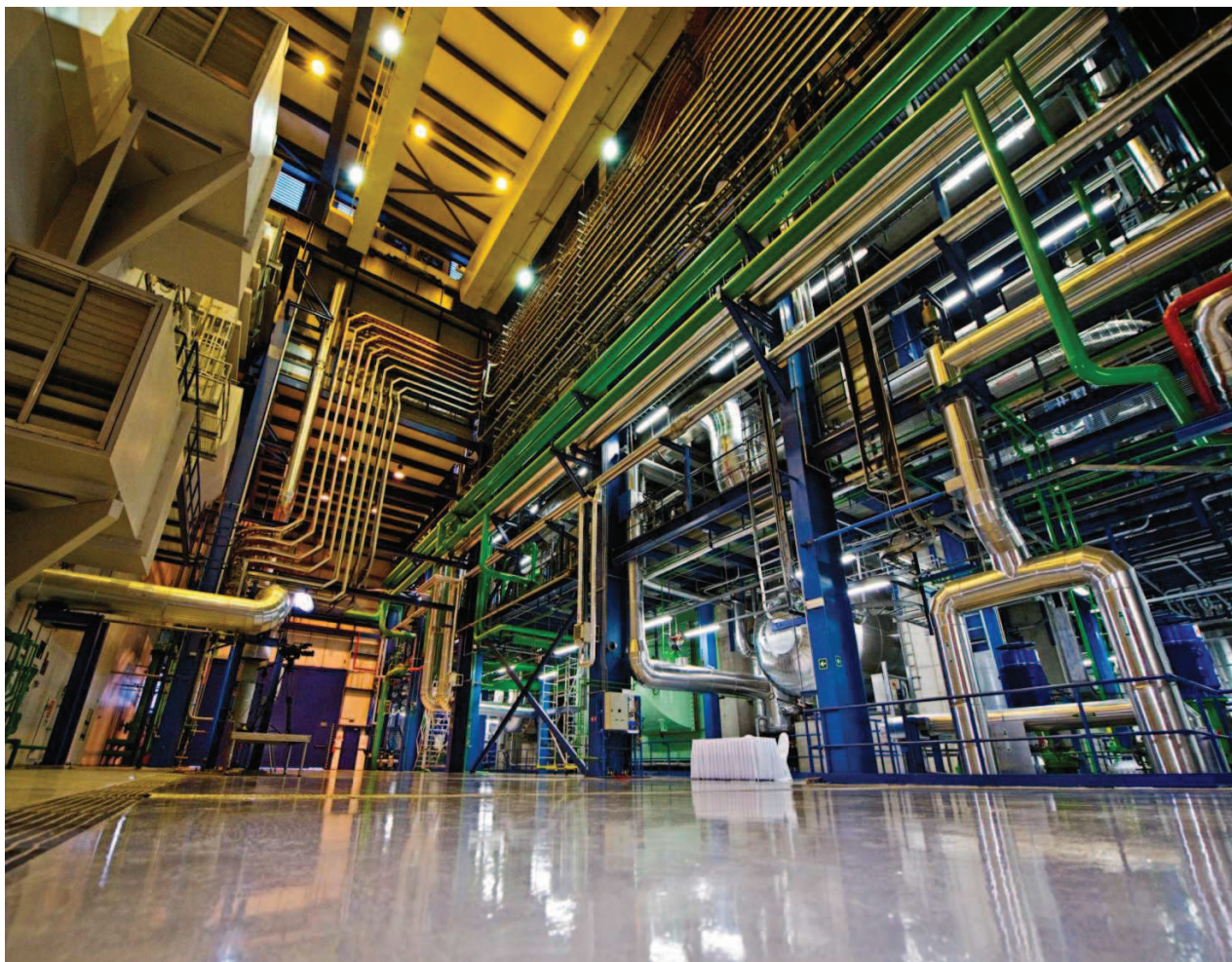
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|--------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|
| 4.7.   | <p>The nominal interest rate and provisions relating to interest payable.</p> <ul style="list-style-type: none"> <li>- The date from which interest becomes payable and the due dates for interest</li> <li>- The time limit on the validity of claims to interest and repayment of principal</li> </ul> <p>Where the rate is not fixed, description of the underlying on which it is based and of the method used to relate the two and an indication where information about the past and the further performance of the underlying and its volatility can be obtained.</p> <ul style="list-style-type: none"> <li>- A description of any market disruption or settlement disruption events that affect the underlying</li> <li>- Adjustment rules with relation to events concerning the underlying</li> <li>- Name of the calculation agent</li> </ul> <p>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.</p> | 32-33 |
| 4.8.   | Maturity date and arrangements for the amortization of the loan, including the repayment procedures. Where advance amortization is contemplated, on the initiative of the issuer or of the holder, it shall be described, stipulating amortization terms and conditions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 33    |
| 4.9.   | An indication of yield. Describe the method whereby that yield is calculated in summary form                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 41-43 |
| 4.10.  | Representation of debt security holders including an identification of the organisation representing the investors and provisions applying to such representation. Indication of where the public may have access to the contracts relating to these forms of representation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 38    |
| 4.11.  | In the case of new issues, a statement of the resolutions, authorisations and approvals by virtue of which the securities have been or will be created and/or issued.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | N/A   |
| 4.12.  | In the case of new issues, the expected issue date of the securities.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | N/A   |
| 4.13.  | A description of any restrictions on the free transferability of the securities.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 32    |
| 4.14.  | <p>In respect of the country of registered office of the issuer and the country(ies) where the offer being made or admission to trading is being sought:</p> <ul style="list-style-type: none"> <li>- Information on taxes on the income from the securities withheld at source;</li> <li>- Indication as to whether the issuer assumes responsibility for the withholding of taxes at the source.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 68-72 |
| 5.     | <b>TERMS AND CONDITIONS OF THE OFFER</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |       |
| 5.1.   | <b>Conditions, offer statistics, expected timetable and action required to apply for the offer</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |       |
| 5.1.1. | Conditions to which the offer is subject                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | N/A   |
| 5.1.2. | Total amount of the issue/offer; if the amount is not fixed, of the arrangements and time for announcing to the public the definitive amount of the offer.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | 31,43 |
| 5.1.3. | The time period, including any possible amendments, during which the offer will be open and description of the application process.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 41    |
| 5.1.4. | A description of the possibility to reduce subscriptions and the manner for refunding excess amount paid by applicants.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | 42    |
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| 5.1.7. | A full description of the manner and date in which results of the offer are to be made public.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 43    |
| 5.1.8. | The procedure for the exercise of any right of pre-emption, the negotiability of subscription rights and the treatment of subscription rights not exercised.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | N/A   |

|        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |     |
|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| 5.2.   | <b>Plan of distribution and allotment</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                        |     |
| 5.2.1. | The various categories of potential investors to which the securities are offered. If the offer is being made simultaneously in the markets of two or more countries and if a tranche has been or is being reserved for certain of these, indicate any such tranche.                                                                                                                                                                                                                             | 31  |
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| 5.3.1. | An indication of the expected price at which the securities will be offered or the method of determining the price and the process for its disclosure. Indicate the amount of any expenses and taxes specifically charged to the subscriber or purchaser.                                                                                                                                                                                                                                        | 42  |
| 5.4.   | <b>Placing and Underwriting</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |     |
| 5.4.1. | Name and address of the co-ordinator(s) of the global offer and of single parts of the offer and, to the extent known to the issuer or to the offeror, of the placers in the various countries where the offer takes place.                                                                                                                                                                                                                                                                      | 31  |
| 5.4.2. | Name and address of any paying agents and depository agents in each country.                                                                                                                                                                                                                                                                                                                                                                                                                     | N/A |
| 5.4.3. | Name and address of the entities agreeing to underwrite the issue on a firm commitment basis, and name and address of the entities agreeing to place the issue without a firm commitment or under "best efforts" arrangements. Indication of the material features of the agreements, including the quotas. Where not all of the issue is underwritten, a statement of the portion not covered. Indication of the overall amount of the underwriting commission and of the placing commission.   | 31  |
| 5.4.4. | When the underwriting agreement has been or will be reached.                                                                                                                                                                                                                                                                                                                                                                                                                                     | N/A |
| 6.     | <b>ADMISSION TO TRADING AND DEALING ARRANGEMENTS</b>                                                                                                                                                                                                                                                                                                                                                                                                                                             |     |
| 6.1.   | An 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. This circumstance must be mentioned, without creating the impression that the admission to trading will necessarily be approved. If known, give the earliest dates on which the securities will be admitted to trading.                 | 34  |
| 6.2.   | All the regulated markets or equivalent markets on which, to the knowledge of the issuer, securities of the same class of the securities to be offered or admitted to trading are already admitted to trading.                                                                                                                                                                                                                                                                                   | N/A |
| 6.3.   | Name and address of the entities which have a firm commitment to act as intermediaries in secondary trading, providing liquidity through bid and offer rates and description of the main terms of their commitment.                                                                                                                                                                                                                                                                              | N/A |
| 7.     | <b>ADDITIONAL INFORMATION</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |     |
| 7.1.   | If advisors connected with an issue are mentioned in the Securities Note, a statement of the capacity in which the advisors have acted.                                                                                                                                                                                                                                                                                                                                                          | 27  |
| 7.2.   | An indication of other information in the Securities Note which has been audited or reviewed by statutory auditors and where auditors have produced a report. Reproduction of the report or, with permission of the competent authority, a summary of the report.                                                                                                                                                                                                                                | N/A |
| 7.3.   | Where a statement or report attributed to a person as an expert is included in the Securities Note, provide such persons' name, business address, qualifications and material interest if any in the issuer. If the report has been produced at the issuer's request a statement to that effect that such statement or report is included, in the form and context in which it is included, with the consent of that person who has authorised the contents of that part of the Securities Note. | 29  |
| 7.4.   | Where information has been sourced from a third party, provide a confirmation that this information has been accurately reproduced and that as far as the issuer is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. In addition, identify the source(s) of the information.                                                                                    | 29  |



|      |                                                                                                                                                                                                                                                         |    |
|------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|
| 7.5. | Credit ratings assigned to an issuer or its debt securities at the request or with the cooperation of the issuer in the rating process. A brief explanation of the meaning of the ratings if this has previously been published by the rating provider. | 28 |
|------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|

## **APPENDICES**



## Latvenergo Consolidated Annual Report 2011

**PREPARED IN ACCORDANCE WITH  
THE INTERNATIONAL FINANCIAL REPORTING STANDARDS  
AS ADOPTED BY EU**

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## Key Figures

|                                                               |         | 2007        | 2008          | 2009            | 2010          | 2011          |
|---------------------------------------------------------------|---------|-------------|---------------|-----------------|---------------|---------------|
| Revenue                                                       | LVL'000 | 361,629     | 475,856       | 500,513         | 567,386       | 681,767       |
| Including electricity sales                                   | LVL'000 | 302,167     | 386,205       | 404,723         | 470,663       | 583,428       |
| Heat sales                                                    | LVL'000 | 49,751      | 72,887        | 71,403          | 71,863        | 69,233        |
| EBITDA <sup>1)</sup>                                          | LVL'000 | 89,819      | 107,052       | 144,885         | 207,240       | 180,729       |
| EBITDA margin <sup>2)</sup>                                   |         | 25%         | 22%           | 29%             | 37%           | 27%           |
| Operating profit <sup>3)</sup>                                | LVL'000 | 17,174      | 18,345        | 31,446          | 61,826        | 53,345        |
| Operating margin <sup>4)</sup>                                |         | 5%          | 4%            | 6%              | 11%           | 8%            |
| Net profit                                                    | LVL'000 | 7,507       | 7,328         | 19,556          | 44,325        | 43,778        |
| Dividends                                                     | LVL'000 | 2,123       | 13,001        | 20,230          | 35,000        | 39,900        |
| Net profit margin <sup>5)</sup>                               |         | 2%          | 2%            | 4%              | 8%            | 6%            |
| Return on assets (ROA) <sup>6)</sup>                          |         | 0.8%        | 0.5%          | 1.2%            | 2.2%          | 1.9%          |
| Return on equity (ROE) <sup>7)</sup>                          |         | 1.5%        | 0.9%          | 2.2%            | 4.0%          | 3.2%          |
| Non-current assets at the end of the year                     | LVL'000 | 1,201,742   | 1,475,618     | 1,462,114       | 1,942,231     | 2,026,594     |
| Total assets at the end of the year                           | LVL'000 | 1,315,958   | 1,680,567     | 1,699,491       | 2,279,266     | 2,288,004     |
| Total equity at the end of the year                           | LVL'000 | 711,671     | 866,331       | 889,440         | 1,344,748     | 1,351,576     |
| Borrowings from financial institutions at the end of the year | LVL'000 | 354,856     | 496,317       | 507,225         | 545,607       | 513,334       |
| Cash flows from operating activities                          | LVL'000 | 125,410     | 84,419        | 138,174         | 160,563       | 180,399       |
| Capital expenditure                                           | LVL'000 | 221,886     | 197,311       | 104,506         | 127,539       | 198,723       |
| Net debt <sup>8)</sup>                                        | LVL'000 | 315,682     | 392,767       | 352,287         | 311,342       | 404,458       |
| Net debt/EBITDA ratio                                         |         | 3.5         | 3.7           | 2.4             | 1.5           | 2.3           |
| Retail electricity sales                                      | GWh     | 7,518       | 7,461         | 6,659           | 7,620         | 8,980         |
| Electricity produced in power plants                          | GWh     | 4,128       | 4,567         | 4,871           | 5,869         | 5,285         |
| Total amount of purchased electricity                         | GWh     | 3,981       | 3,478         | 3,145           | 3,028         | 4,466         |
| Including purchased electricity from independent producers    | GWh     | 564         | 637           | 636             | 693           | 759           |
| The rest amount of purchased electricity                      | GWh     | 3,418       | 2,841         | 2,509           | 2,335         | 3,707         |
| Aggregate heat sales                                          | GWh     | 2,876       | 2,634         | 2,600           | 2,928         | 2,524         |
| Number of employees at the end of the year                    |         | 5,353       | 5,375         | 4,701           | 4,517         | 4,490         |
| Moody's credit rating of the Parent Company                   |         | A2 (stable) | A3 (negative) | Baa3 (negative) | Baa3 (stable) | Baa3 (stable) |

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

<sup>2)</sup> EBITDA margin – EBITDA / revenue

<sup>3)</sup> Operating profit – earnings before income tax, finance income and costs

<sup>4)</sup> Operating margin – operating profit / revenue

<sup>5)</sup> Net profit margin – net profit / revenue

<sup>6)</sup> 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)

<sup>7)</sup> 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)

<sup>8)</sup> Net debt – borrowings from financial institutions at the end of the year minus cash and cash equivalents at the end of the year

## Management Report

**In 2011 Latvenergo Group is the largest electricity retailer in the Baltics**

Latvenergo Group is the largest energy company in the Baltics - engaged in electricity and heat production as well as electricity trade. 2011 is the seventh reporting year for Latvenergo as a Group.

2011 Latvenergo Group's revenues are LVL 681.8 million, which is 20% more compared to 2010. Revenue growth was achieved mainly due to successful electricity retail market operations in the Baltics where the Group sold 8 980 GWh electricity - 18% more than in 2010 reaching the highest sales volume amount over the last years.

As a result of expansion of operations in Lithuania and Estonia in 2011 almost one fourth (13% in 2010) from the total Group's revenues are generated from operations outside Latvia. As a result of increase in sold electricity volumes, Latvenergo Group is the largest electricity retailer in the Baltic countries servicing one third of all Baltic clients.

The largest increase of electricity sold in 2011 is in Lithuania and Estonia where total sold volume amounts to 2 296 GWh, which exceeds 2010 results by more than 3 times (700 GWh), As a result our market share in Lithuania reached 18% (5% in 2010), while in Estonia - 7% (2% in 2010) from total consumption. Sold electricity volume in Latvia amounts to 6 685 GWh (6 920 GWh in 2010) covering 94% from total Latvian electricity consumption (95% in 2010).

In accordance to the provisions of Baltic Energy Market Interconnection Plan (BEMIP) which is also implemented in the local legislation of each Baltic country, electricity market liberalisation continued in 2011. Most substantial changes were introduced in Lithuania, where open market represents 56% of all electricity consumption (50% in Latvia, 30% in Estonia).

Latvenergo Group is actively pursuing market opening opportunities. During 2011 Latvenergo Group sold 5 330 GWh in unregulated Baltic electricity market, representing 47% from total market open to competition thus demonstrating successful operations in competitive environment.

**Latvenergo Group's share in the open Baltic electricity market is 47%**

In 2012 long term changes in the Baltic electricity market will continue including further price deregulation and joint electricity Exchange establishment in the Baltic countries. For 2012 Latvenergo Group has defined ambitious goals to strengthen position in the Baltics by considerably increasing number of clients. In 2012 new retail brand introduction and brand awareness activities are planned in addition to further deployment of on-line servicing and enhancement of billing options as well as preparations to enter Estonian small and medium enterprise and household market in 2013.

In 2011 Latvenergo Group's generated gross electricity volume amounted to 5 285 GWh in total or by 10% less than in 2010 when performance of Daugava hydro-power plants (hereinafter - Daugava HPP) was positively influenced by water throughput in the river Daugava.

**Latvenergo Group is the largest Baltic renewable electricity producer in 2011**

In 2011 Daugava HPP cascade delivered 2 823 GWh or 53% from total electricity produced by Latvenergo. As a result Latvenergo is the leading renewable electricity producer in the Baltics and one of the leaders of energy producers from renewable energy resources in whole Europe.

In addition to own produced electricity Latvenergo Group



purchased 4 466 GWh electricity in 2011 (3 028 GWh in 2010) in Latvia, including 759 GWh from Latvian producers within framework of mandatory procurement (693 GWh in 2010).

Latvenergo Group's profit for 2011 was LVL 43.8 million (LVL 44.3 million in 2010), and dividends payable – LVL 39.9 million (LVL 35.0 million in 2010). During 2011 capital investments amounted to LVL 198.7 million and 57% of investments related to Rīgas TEC-2 energy generation unit reconstruction project that will commence operations in 2013. With completion of Rīgas TEC-2 energy unit in 2013 Latvenergo Group will be the only electricity producer in the Baltics that has renewed all production facilities.

**All production facilities of Latvenergo Group will be renewed by 2013**

Future investments in generation assets will relate to diversification of generation capacities as well as improving efficiency for the usage of renewable resource. Latvenergo will continue capital investment program to improve efficiency of Daugava HPP generation capacity to utilize the river Daugava resource more efficiently. It is planned to complete Daugava HPP generation unit upgrade by 2022 and total capital investments for this program will exceed LVL 100 million. Similarly, Latvenergo will explore options to develop new generation capacities in whole Baltic region as a major step towards electricity sales expansion.

**Investments in the distribution network amounted to LVL 45.8 million in 2011**

Important Latvenergo Group's business segment is electricity distribution. Revenues from distribution services in 2011 are LVL 179.5 million (LVL 161.9 million in 2010), while capital investments for distribution grid reconstruction and development increased to LVL 45.8 million (LVL 26.2 million in 2010). With the aim to decrease electricity supply interruptions, in 2011 capital investment program was started to rebuild overhead lines into cables. With an objective to improve reliability of distribution network and its technical parameters (frequency of outages, voltage measurements, technical conditions of electricity lines etc.) in 2012 it is planned to further increase capital investments in distribution network.

By investing distribution assets owned by Latvenergo AS in the equity of Sadales tīkls AS at the value of LVL 803.4 million in 2011 establishment of the distribution system operator as required by the market liberalization was finalized.

According to amendments to Electricity market Law, related to requirements of the European Parliament and the Council Directive as of 13<sup>th</sup> July of the 2009<sup>th</sup> Directive 2009/72/EC transmission operator needs to be separated from electricity generation, distribution and sale. At the end of 2011 the shares of transmission operator Augstsprieguma tīkls AS were sold to Ministry of Finance (process finalized at the beginning of 2012) and Latvijas elektriskie tīkli AS was established as an owner of the transmission system assets. With this business transfer, transmission system assets amounting to LVL 240.1 million previously owned by Latvenergo were invested in Latvijas elektriskie tīkli AS, and employees required for provision of services related to transmission system assets were taken over from Augstsprieguma tīkls AS.

**Requirements of Directive 2009/72/EC on unbundling of transmission system operator are fully satisfied**

**Project Kurzemes Ring will improve security of electricity supply and ensure integration in Nordic market**

In 2011 Latvenergo Group invested LVL 15.1 million into the transmission network. The most significant strategic project is 330 kV network development project *Kurzemes Ring* that is part of the international electricity infrastructure development project – *NordBalt* including construction of interconnection to Sweden by 2018 to improve security of electricity supply for whole Baltics. Capital investments related to the project reached LVL 4.7 million



in 2011. Total project costs are estimated at LVL 140 million. Co-financing from EU Energy project for Economic recovery is received.

In 2011 Latvenergo Group's cash flows from the operating activities continued to improve and reached LVL 180.4 million (LVL 160.6 million in 2010). In overall cash flows from the operating activities for the last three years were sufficient to cover all capital investments for this period.

**Cash flows from operations improves while sustaining good liquidity and stable capital structure**

Latvenergo Group's loan and cash balance net value in 2011 was LVL 404.5 million (LVL 311.3 million for 2010). To optimize cash flow Latvenergo Group invested free cash flows in the state securities (LVL 60.4 million in 2011). Net debt ratio against earnings before taxes and depreciation (EBITDA) is 2.3 which according to financing practice considered as very good indicator.

Operations of Latvenergo Group are exposed to various risks. Most significant ones are financial risks, namely, foreign exchange rate risks, interest rate risks and price fluctuation risks. The main drivers of the Group's operations are price fluctuations in *NordPool* exchange, CO<sub>2</sub> emission allowance prices, EURIBOR rate and EUR exchange rate. According to the Group's risk management policies the Group is using derivative financial instruments to reduce open risk positions and limit impact on the Group's financial result due to changes in underlying market factors.

**Latvenergo is recognised as the most valuable company in Latvia**

In 2011 Latvenergo was recognised by Review of magazine *Kapitāls*, investment bankers firm IBS Prudentia and NASDAQ OMX Riga Stock exchange as the most valuable company in Latvia, similarly in 2012 review done by *Dienas Bizness* recognised Latvenergo as the third largest company by turnover in the Baltics and the largest Baltic energy company.

In 2011 seventeenth year in a row the knowledge quiz organized by Latvenergo Group eXperiments took place to facilitate in attractive way youth interest for physics, natural phenomena and safe electricity usage. In 2011 there were 220 teams participating from schools in Latvia.

Therefore we can conclude that successful operations of Latvenergo are result of targeted activities in the Baltic electricity market, well planned development of generation capacities and balanced grid development policy. We run our business by acknowledging of client needs, impact of our operations on environment, society and country. Successfully started development of Latvenergo Group will be continued in 2012.

### **Post balance sheet events**

In accordance with the provisions of the agreement signed on 30 December 2011 between Latvenergo AS and Ministry of the Finance, and based on Augstsprieguma tīkls AS Shareholder's register entry on 2 January 2012, from 2 January 2012 the sole shareholder of Augstsprieguma tīkls AS is Latvian State represented by Ministry of the Finance.

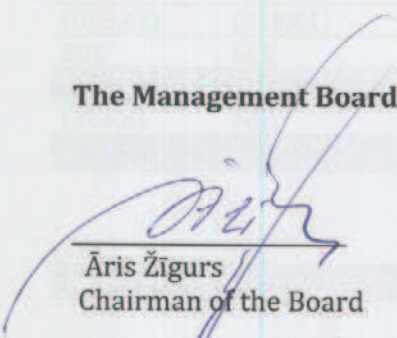
There are no other post balance sheet events that would materially affect the financial position of the Group as at 31 December 2011.

### Profit distribution

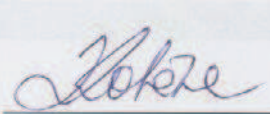
Fulfilling the requirements of the Law on state and municipality owned shares and companies, Regulations No. 1074 of the Cabinet of Ministers of Latvia dated 25 November 2010 On amendments of regulations No. 1471 dated 15 December 2009 On Procedure how the payable part of the profit for the use of the state's capital is determined and paid into the state's budget and the Law on state's budget for 2012, the Management Board of Latvenergo AS proposes to allocate LVL 39,900,000 to be paid out in dividends.

The distribution of profit for 2011 is subject to a resolution of Latvenergo AS Shareholders' meeting.

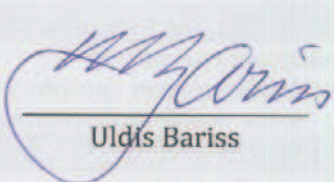
#### The Management Board of Latvenergo AS:



Āris Žigurs  
Chairman of the Board



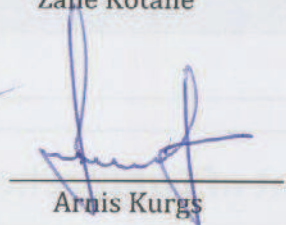
Zane Kotāne



Uldis Bariss



Māris Kuņickis



Arnis Kurģs

22 May 2012



## Consolidated Income Statement

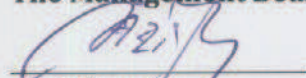
|                                                                                                  | Notes    | 2011<br>LVL'000 | 2010<br>LVL'000 |
|--------------------------------------------------------------------------------------------------|----------|-----------------|-----------------|
| Revenue                                                                                          | 5        | 681,767         | 567,386         |
| Other income                                                                                     | 6        | 4,175           | 2,674           |
| Raw materials and consumables used                                                               | 7        | (408,192)       | (273,590)       |
| Personnel expenses                                                                               | 8        | (61,572)        | (56,136)        |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | 12a, 13a | (127,384)       | (145,414)       |
| Other operating expenses                                                                         | 9        | (35,449)        | (33,094)        |
| <b>Operating profit</b>                                                                          |          | <b>53,345</b>   | <b>61,826</b>   |
| Finance income                                                                                   | 10       | 3,047           | 5,513           |
| Finance costs                                                                                    | 10       | (13,956)        | (16,530)        |
| Share of profit of associates                                                                    | 14       | 232             | 203             |
| <b>Profit before income tax</b>                                                                  |          | <b>42,668</b>   | <b>51,012</b>   |
| Income tax                                                                                       | 11       | 564             | (6,455)         |
| <b>Profit for the year from continuing operations</b>                                            |          | <b>43,232</b>   | <b>44,557</b>   |
| <b>Discontinued operations</b><br><b>(transmission system operator)</b>                          |          |                 |                 |
| Profit for the year from discontinued operations                                                 | 30       | 546             | (232)           |
| <b>Profit for the year</b>                                                                       |          | <b>43,778</b>   | <b>44,325</b>   |
| <b>Profit attributable to:</b>                                                                   |          |                 |                 |
| - Owners of the Parent Company                                                                   |          | 43,328          | 43,847          |
| - Non-controlling interest                                                                       |          | 450             | 478             |

## Consolidated Statement of Comprehensive Income

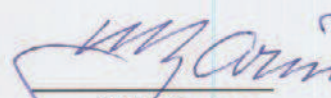
|                                                                   | Notes | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-------------------------------------------------------------------|-------|-----------------|-----------------|
| <b>Profit for the year</b>                                        |       | <b>43,778</b>   | <b>44,325</b>   |
| <b>Other comprehensive income:</b>                                |       |                 |                 |
| Gains on revaluation of property, plant and equipment             | 19    | 81              | 425,248         |
| (Losses)/gains on currency translation differences                | 19    | (14)            | 8               |
| Losses from change in hedge reserve                               | 19    | (4,335)         | (375)           |
| <b>Other comprehensive (loss)/income for the year, net of tax</b> |       | <b>(4,268)</b>  | <b>424,881</b>  |
| <b>Total comprehensive income for the year</b>                    |       | <b>39,510</b>   | <b>469,206</b>  |
| <b>Attributable to:</b>                                           |       |                 |                 |
| - Owners of the Parent Company                                    |       | 39,060          | 468,728         |
| - Non-controlling interest                                        |       | 450             | 478             |

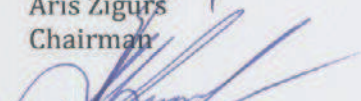
The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

  
Aris Žigurs  
Chairman

  
Zane Kotāne

  
Uldis Bariss

  
Maris Kuņickis

  
Arnis Kurgs

22 May 2012



## Consolidated Statement of Financial Position

|                                                            | Notes | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|------------------------------------------------------------|-------|-----------------------|-----------------------|
| <b>ASSETS</b>                                              |       |                       |                       |
| <b>Non-current assets</b>                                  |       |                       |                       |
| Intangible assets                                          | 12a   | 6,601                 | 7,478                 |
| Property, plant and equipment                              | 13a   | 1,999,502             | 1,928,810             |
| Investment property                                        | 13c   | -                     | 382                   |
| Investments in associates                                  | 14    | 4,696                 | 4,464                 |
| Other non-current receivables                              |       | 95                    | 172                   |
| Investments in held-to-maturity financial assets           | 28    | 15,670                | -                     |
| Deferred income tax assets                                 | 11    | 30                    | 925                   |
| <b>Total non-current assets</b>                            |       | <b>2,026,594</b>      | <b>1,942,231</b>      |
| <b>Current assets</b>                                      |       |                       |                       |
| Inventories                                                | 15    | 13,949                | 11,501                |
| Trade receivables                                          | 16a   | 73,809                | 63,031                |
| Other receivables                                          | 16b   | 17,611                | 21,882                |
| Derivative financial instruments                           | 24a   | 2,450                 | 3,968                 |
| Investments in held-to-maturity financial assets           | 28    | 44,714                | 2,387                 |
| Cash and cash equivalents                                  | 17    | 108,877               | 234,266               |
| <b>Total current assets</b>                                |       | <b>261,410</b>        | <b>337,035</b>        |
| <b>TOTAL ASSETS</b>                                        |       | <b>2,288,004</b>      | <b>2,279,266</b>      |
| <b>EQUITY</b>                                              |       |                       |                       |
| <b>Equity attributable to owners of the Parent Company</b> |       |                       |                       |
| Share capital                                              | 18    | 325,862               | 323,544               |
| Non-current assets revaluation reserve                     | 19    | 974,899               | 976,180               |
| Hedge reserve                                              | 19    | (8,247)               | (3,912)               |
| Other reserves                                             | 19    | 10,269                | 10                    |
| Retained earnings                                          |       | 45,773                | 46,356                |
|                                                            |       | <b>1,348,556</b>      | <b>1,342,178</b>      |
| <b>Non-controlling interest</b>                            |       | <b>3,020</b>          | <b>2,570</b>          |
| <b>Total equity</b>                                        |       | <b>1,351,576</b>      | <b>1,344,748</b>      |
| <b>LIABILITIES</b>                                         |       |                       |                       |
| <b>Non-current liabilities</b>                             |       |                       |                       |
| Borrowings                                                 | 20    | 462,888               | 506,756               |
| Deferred income tax liabilities                            | 11    | 172,425               | 187,635               |
| Provisions for post-employment benefits                    | 21a   | 7,734                 | 7,321                 |
| Environmental provisions                                   | 21b   | 1,783                 | 1,376                 |
| Derivative financial instruments                           | 24a   | 10,629                | 7,088                 |
| Other liabilities and deferred income                      | 22    | 94,815                | 94,889                |
| <b>Total non-current liabilities</b>                       |       | <b>750,274</b>        | <b>805,065</b>        |
| <b>Current liabilities</b>                                 |       |                       |                       |
| Trade and other payables                                   | 23    | 121,214               | 82,356                |
| Income tax payable                                         |       | 1,024                 | 3,336                 |
| Borrowings                                                 | 20    | 50,446                | 38,851                |
| Derivative financial instruments                           | 24a   | 13,134                | 4,408                 |
| Issued guarantees                                          | 26    | 336                   | 502                   |
| <b>Total current liabilities</b>                           |       | <b>186,154</b>        | <b>129,453</b>        |
| <b>TOTAL EQUITY AND LIABILITIES</b>                        |       | <b>2,288,004</b>      | <b>2,279,266</b>      |

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

Aris Žigurs  
Chairman

Māris Kuņickis

Zane Kotāne

Arnis Kurgs

Uldis Bariss

22 May 2012

## Consolidated Statement of Changes in Equity

|                                                                                                         | Notes         | Attributable to owners of the Parent Company |                |                   |                  | Non-controlling interest | TOTAL            |
|---------------------------------------------------------------------------------------------------------|---------------|----------------------------------------------|----------------|-------------------|------------------|--------------------------|------------------|
|                                                                                                         |               | Share capital                                | Reserves       | Retained earnings | Total            |                          |                  |
|                                                                                                         |               | LVL'000                                      | LVL'000        | LVL'000           | LVL'000          | LVL'000                  | LVL'000          |
| <b>As at 31 December 2009</b>                                                                           |               | <b>317,653</b>                               | <b>549,354</b> | <b>20,782</b>     | <b>887,789</b>   | <b>1,651</b>             | <b>889,440</b>   |
| Increase in share capital                                                                               | 18            | 5,891                                        | -              | -                 | 5,891            | -                        | 5,891            |
| Dividends for 2009                                                                                      | 19            | -                                            | -              | (20,230)          | (20,230)         | -                        | (20,230)         |
| Non-controlling interest arising on increase in subsidiary's share capital                              |               | -                                            | -              | -                 | -                | 441                      | 441              |
| <b>Total contributions by and distributions to owners of the company, recognised directly in equity</b> |               | <b>5,891</b>                                 | <b>-</b>       | <b>(20,230)</b>   | <b>(14,399)</b>  | <b>441</b>               | <b>(13,898)</b>  |
| Profit for the year                                                                                     |               | -                                            | -              | 43,847            | 43,847           | 478                      | 44,325           |
| <b>Other comprehensive income:</b>                                                                      |               |                                              |                |                   |                  |                          |                  |
| Change in hedge reserve                                                                                 | 19            | -                                            | (375)          | -                 | (375)            | -                        | (375)            |
| Currency translation differences                                                                        | 19            | -                                            | 8              | -                 | 8                | -                        | 8                |
| Revaluation of property, plant and equipment                                                            | 19            | -                                            | 425,248        | -                 | 425,248          | -                        | 425,248          |
| Disposal of revalued property, plant and equipment                                                      | 19            | -                                            | (1,957)        | 1,957             | -                | -                        | -                |
| <b>Total other comprehensive income for the year</b>                                                    |               | <b>-</b>                                     | <b>422,924</b> | <b>1,957</b>      | <b>424,881</b>   | <b>-</b>                 | <b>424,881</b>   |
| <b>Total comprehensive income for the year</b>                                                          |               | <b>-</b>                                     | <b>422,924</b> | <b>45,804</b>     | <b>468,728</b>   | <b>478</b>               | <b>469,206</b>   |
| <b>As at 31 December 2010</b>                                                                           | <b>18, 19</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> |
| Increase in share capital                                                                               | 18            | 2,318                                        | -              | -                 | 2,318            | -                        | 2,318            |
| Dividends for 2010                                                                                      | 19            | -                                            | -              | (35,000)          | (35,000)         | -                        | (35,000)         |
| Transfer to reserves                                                                                    |               | -                                            | 10,257         | (10,257)          | -                | -                        | -                |
| <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>  |
| Profit for the year                                                                                     |               | -                                            | -              | 43,328            | 43,328           | 450                      | 43,778           |
| <b>Other comprehensive income:</b>                                                                      |               |                                              |                |                   |                  |                          |                  |
| Change in hedge reserve                                                                                 | 19            | -                                            | (4,335)        | -                 | (4,335)          | -                        | (4,335)          |
| Currency translation differences                                                                        | 19            | -                                            | 2              | (16)              | (14)             | -                        | (14)             |
| Revaluation of property, plant and equipment                                                            | 19            | -                                            | 81             | -                 | 81               | -                        | 81               |
| Disposal of revalued property, plant and equipment                                                      | 19            | -                                            | (1,362)        | 1,362             | -                | -                        | -                |
| <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>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>As at 31 December 2011</b>                                                                           | <b>18, 19</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> |

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.



## Consolidated Statement of Cash Flows

|                                                                                 | Notes     | 2011<br>LVL'000  | 2010<br>LVL'000 |
|---------------------------------------------------------------------------------|-----------|------------------|-----------------|
| <b>Cash flows from operating activities</b>                                     |           |                  |                 |
| Profit before tax                                                               |           | 42,668           | 51,012          |
| <b>Adjustments for:</b>                                                         |           |                  |                 |
| - Amortisation and depreciation                                                 | 12a, 13a  | 115,622          | 119,056         |
| - Impairment of non-current assets                                              | 13        | 11,762           | 26,357          |
| - Loss from disposal of non-current assets                                      |           | 1,941            | 1,771           |
| - Discontinued operations<br>(transmission system operator)                     | 30        | 546              | (232)           |
| - Investments accounting at equity method                                       | 14        | (232)            | (203)           |
| - Interest expense                                                              | 10        | 16,091           | 14,383          |
| - Interest income                                                               | 10        | (2,776)          | (5,351)         |
| - Fair value losses / (gains) on derivative financial<br>instruments            | 7, 10     | 9,284            | (13,345)        |
| - Changes in provisions                                                         | 21        | (413)            | (152)           |
| - (Gains) / losses on currency translation differences                          | 10        | 748              | 1,142           |
| (Increase) / decrease in inventories                                            |           | (2,448)          | 1,542           |
| Increase in receivables                                                         |           | (5,218)          | (16,361)        |
| Increase in payables, accrued expense, deferred<br>income and other liabilities |           | 22,863           | 1,649           |
| <b>Cash generated from operations</b>                                           |           | <b>210,438</b>   | <b>181,268</b>  |
| Interest paid                                                                   |           | (15,424)         | (14,889)        |
| Interest received                                                               |           | 1,459            | 5,352           |
| Income tax paid                                                                 |           | (16,074)         | (11,168)        |
| <b>Net cash generated from operating activities</b>                             |           | <b>180,399</b>   | <b>160,563</b>  |
| <b>Cash flows from investing activities</b>                                     |           |                  |                 |
| Proceeds from sale of intangible assets and PPE                                 |           | -                | 301             |
| Purchase of intangible assets and PPE                                           |           | (182,301)        | (107,812)       |
| Proceeds on financing from EU funds                                             |           | 1,479            | 10,575          |
| Purchase of the state treasury bills                                            |           | (74,567)         | (2,387)         |
| Proceeds from redemption of the state treasury bills                            |           | 17,180           | -               |
| <b>Net cash used in investing activities</b>                                    |           | <b>(238,209)</b> | <b>(99,323)</b> |
| <b>Cash flows from financing activities</b>                                     |           |                  |                 |
| Proceeds from borrowings from credit institutions                               | 20        | 4,357            | 60,041          |
| Repayment of borrowings                                                         | 20        | (36,936)         | (22,164)        |
| Non-controlling interest's contribution to<br>subsidiaries' share capital       |           | -                | 441             |
| Dividends paid                                                                  |           | (35,000)         | (20,230)        |
| <b>Net cash (used in) / generated from financing<br/>activities</b>             |           | <b>(67,579)</b>  | <b>18,088</b>   |
| <b>Net (decrease) / increase in cash and cash<br/>equivalents</b>               |           |                  |                 |
|                                                                                 |           | <b>(125,389)</b> | <b>79,328</b>   |
| Cash and cash equivalents at the beginning of the year                          |           | 234,266          | 154,938         |
| <b>Cash and cash equivalents at the end of the year</b>                         | <b>17</b> | <b>108,877</b>   | <b>234,266</b>  |

In 2011 property investment was committed in the amount of LVL 2,318 thousand by real estate investment in the Parent Company's share capital (2010: LVL 5,891 thousand).

The notes on pages 12 to 60 are an integral part of these Consolidated Financial Statements.

# Notes to the Consolidated Financial Statements

## 1 CORPORATE INFORMATION

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.

2011 was the seventh reporting year with Latvenergo AS heading Latvenergo Group (hereinafter – the Group). The Group includes six subsidiaries:

|                               | <b>REGISTERED IN<br/>THE COMMERCIAL<br/>REGISTER</b> | <b>INTEREST<br/>HELD</b> | <b>BUSINESS ACTIVITY HELD</b>                                  |
|-------------------------------|------------------------------------------------------|--------------------------|----------------------------------------------------------------|
| Augstsprieguma tīkls AS       | 01.09.2005                                           | 100%                     | Electricity transmission                                       |
| Sadales tīkls AS              | 18.09.2006                                           | 100%                     | Electricity distribution                                       |
| Latvenergo Kaubandus OÜ       | 27.06.2007                                           | 100%                     | Electricity trade operations in Estonia                        |
| Latvenergo Prekyba UAB        | 07.01.2008                                           | 100%                     | Electricity trade operations in Lithuania                      |
| Latvijas elektriskie tīkli AS | 10.02.2011                                           | 100%                     | Operation and maintenance of transmission system assets        |
| Liepājas enerģija SIA         | 06.07.2005                                           | 51%                      | Thermal energy generation, transmission, distribution and sale |

The Parent Company's associate Nordic Energy Link AS carries out the functions of the operator of an interconnection power cable between Estonia and Finland.

The Parent Company's associate Pirmais Slēgtais Pensiju Fonds AS manages a defined-contribution corporate pension plan in Latvia.

Since 15 November 2010 until 14 August 2011, the Management Board of Latvenergo AS was comprised of the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Arnis Kurgs and Arnis Daugulis.

Reposing on Shareholder's resolution, Arnis Daugulis as at 14 August 2011 was excluded from the composition of the Management Board of Latvenergo AS, and since 15 August 2011 Zane Kotāne has been acting as a member of the Management Board of Latvenergo AS.

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), Zane Kotāne, Uldis Bariss, Māris Kuņickis and Arnis Kurgs.

The Consolidated Financial Statements for year 2011 include the financial information in respect of the Parent Company and its all subsidiaries (hereinafter – the Group) for the annual period ending 31 December 2011 and comparative information for annual period ending 31 December 2010.

Latvenergo AS Management Board has approved for issue the Consolidated Financial Statements on 22 May 2012. 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 thousand of Latvian Lats (LVL), unless stated otherwise.

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.

In these Consolidated Financial Statements the Group has performed reclassification of some lines of the Consolidated Statement of Cash Flows of 2010 – 'Proceeds on financing from EU funds' in amount of LVL 10,575 thousand and 'Purchase of the state treasury bills' in amount of LVL 2,387 thousand were reclassified from cash flows from financing activities to cash flows from investing activities. The Group also has performed reclassification of some lines of the Consolidated Income Statement of 2010 – revenue from compensation of electric energy price margin in amount of LVL 4,324 thousand were reclassified from 'Revenue' to 'Raw materials and consumables used' and fair value loss on derivative financial instruments in amount of LVL 1,220 thousand was reclassified from 'Finance costs' to 'Finance income' to present the gain in net amount.

### **Adoption of new and revised standards and interpretations**

Certain new IFRSs became effective for the Group from 1 January 2011.

- **IAS 24 (revised), Related party disclosures**

This revised standard removes the requirement for government related entities to disclose details of all transactions with the government and other government-related entities and it clarifies and simplifies the definition of a related party.

Certain new standards and interpretations have been published that will become effective for the accounting periods beginning on or after 1 January 2012.

- **Presentation of Items of Other Comprehensive Income – Amendment to IAS 1** (effective for annual periods beginning on or after 1 July 2012; not yet adopted by the EU)

The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

- **IFRS 9, Financial Instruments Part 1: Classification and Measurement** (effective for annual periods beginning on or after 1 January 2015; not yet endorsed by the EU)

IFRS 9 issued in November 2009 replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities, and in December 2011 to change its effective date and add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.

- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

- **IFRS 10, Consolidated financial statements** (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)

IFRS 10 replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the standard on its financial statements.

- **IFRS 12, Disclosures of interests in other entities** (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)

IFRS 12 applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose

information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including (i) significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, (ii) extended disclosures on share of non-controlling interests in group activities and cash flows, (iii) summarised financial information of subsidiaries with material non-controlling interests, and (iv) detailed disclosures of interests in unconsolidated structured entities. The Group is currently assessing the impact of the standard on its financial statements.

- **IFRS 13, 'Fair value measurement'** (effective for annual periods beginning on or after 1 January 2013; not yet endorsed by the EU)

IFRS 13 aims to improve consistency and reduce complexity by providing a revised definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Group is currently assessing the impact of the standard on its financial statements.

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.

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. 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 Group's presentation currency.

***(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).

***2.4. 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) Emission rights for greenhouse gases**

Emission rights for greenhouse gases (or allowances) are recognised at purchase cost. Emission rights received from the Government free of charge is recognised at zero cost. Emission rights are recognised at cost when the Group is able to exercise the control, as at 31 December 2011 the number of allowances in the Group received from the Government free of charge was 1,107,445 (31/12/2010: 1,107,445). Therefore their carrying amount as at 31 December 2011 was nil (31/12/2010: nil). 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'. As at 31 December 2011 the number of allowances in the Group purchased was 255,746 (31/12/2010: 280,000), see Note 12b. 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 2.18, 3.3. and Note 24. c).

**2.5. Property, plant and equipment**

All property, plant and equipment (PPE) are stated at historical cost or revalued amount (see Note 2.8) 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 recognized 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 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. 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:

| Type of property, plant and equipment                   | Estimated useful life, years |
|---------------------------------------------------------|------------------------------|
| Buildings and facilities, including                     |                              |
| • Hydropower plants, thermal power plants               | 15 – 80                      |
| • Electricity transmission lines                        | 30 – 50                      |
| • Electricity distribution lines                        | 20 – 30                      |
| Technology equipment and machinery, including           |                              |
| • Hydropower plants                                     | 3 – 12                       |
| • Thermal power plants                                  | 3 – 10                       |
| • Transmission and distribution machinery and equipment | 10                           |
| Other property, plant and equipment                     | 2 – 5                        |



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 (Note 2.7).

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.

## **2.6. 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.

## **2.7. 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.

## **2.8. 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 fixed asset groups are revalued regularly but not less frequently than every five years:

- Hydropower plants' buildings and plants,
- Hydropower plants' machinery and technology equipment,
- Other fixed assets of hydropower plants,
- Electricity transmission system engineering structure,
- Electricity transmission lines,
- Electrical equipment and other fixed assets of electricity transmission system,
- Electricity distribution system engineering structure,
- Electricity distribution lines,
- Electrical equipment and other fixed assets of electricity distribution system.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to the Consolidated Statement of Comprehensive Income 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 share capital or other reserves, or used for other purposes.

## **2.9. 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.

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:

- a) Inventories that haven't turned over during last 12 months are fully impaired,
- b) 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%,
- c) Inventories that haven't turned over during last 6 months are impaired in amount of 50%,
- d) 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%,
- e) Allowances are not calculated for the inventory of heating materials necessary to ensure uninterrupted operations of heat power plants,
- f) Allowances are not calculated for scrap metal obtained in the process of fixed assets' dismantling and are accounted at net realisable value.

## *2.10. 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 16 a). Individual impairment assessments are performed for the debtors if their debt balance exceeds LVL 500 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.

## *2.11. Cash and cash equivalents*

Cash and cash equivalents include cash in hand, at bank, and short-term deposits with original maturities of three months or less.

## **2.12. 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.

## **2.13. 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.

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.

## **2.14. Deferred income tax**

Income tax is calculated in accordance with applicable tax regulations and is based on the taxable income reported for the taxation period.

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.

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.

### **2.15. Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the Consolidated Income Statement over the period of the borrowings using the effective interest method.

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. 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.

### **2.16. 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.

### **2.17. Grants**

Property, plant and equipment received at nil consideration from other entities 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.

***2.18. 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 (Note 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 ongoing 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 with 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'.

***2.19. 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 corporate customers, business centres, network operators and households 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".

***2.20. Related parties***

The Parent Company is owned by the Latvian state. The Group's related parties are defined as companies in which the state has the control or significant influence, members of the Group companies Supervisory Board and the Management Board and key management personnel, their close relatives and companies in which they have a control or significant influence.

***2.21. 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. Non-current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

***2.22. Share capital***

The Group's share capital consists of ordinary shares.

***2.23. 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.

***2.24. 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 recognized 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.

***2.25. 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.

### **2.26 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.

## **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 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 provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate 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<br>receivables | Derivatives<br>used for<br>hedging | Financial<br>assets at<br>fair value<br>through<br>profit or<br>loss | Held-to-<br>maturity<br>assets |
|---------------------------------------------------------------------------|--------------------------|------------------------------------|----------------------------------------------------------------------|--------------------------------|
| <b>Assets as per statement of<br/>financial position as at 31/12/2011</b> | LVL'000                  | LVL'000                            | LVL'000                                                              | LVL'000                        |
| Derivative financial instruments (Note 24)                                | -                        | 2,345                              | 105                                                                  | -                              |
| Trade and other receivables (Note 16 a)                                   | 73,809                   | -                                  | -                                                                    | -                              |
| Other non-current receivables                                             | 95                       | -                                  | -                                                                    | -                              |
| Accrued income and other financial current<br>receivables (Note 16 b)     | 7,595                    | -                                  | -                                                                    | -                              |
| Investments in held-to-maturity financial assets<br>(Note 28)             | -                        | -                                  | -                                                                    | 60,384                         |
| Cash and cash equivalents (Note 17)                                       | 108,877                  | -                                  | -                                                                    | -                              |
|                                                                           | <b>190,376</b>           | <b>2,345</b>                       | <b>105</b>                                                           | <b>60,384</b>                  |

|                                                                           | Loans and<br>receivables | Derivatives<br>used for<br>hedging | Financial<br>assets at<br>fair value<br>through<br>profit or<br>loss | Held-to-<br>maturity<br>assets |
|---------------------------------------------------------------------------|--------------------------|------------------------------------|----------------------------------------------------------------------|--------------------------------|
| <b>Assets as per statement of<br/>financial position as at 31/12/2010</b> | LVL'000                  | LVL'000                            | LVL'000                                                              | LVL'000                        |
| Derivative financial instruments (Note 24)                                | -                        | 1,575                              | 2,393                                                                | -                              |
| Trade and other receivables (Note 16 a)                                   | 63,031                   | -                                  | -                                                                    | -                              |
| Other non-current receivables                                             | 172                      | -                                  | -                                                                    | -                              |
| Accrued income and other financial current<br>receivables (Note 16 b)     | 7,914                    | -                                  | -                                                                    | -                              |
| Investments in held-to-maturity financial assets<br>(Note 28)             | -                        | -                                  | -                                                                    | 2,387                          |
| Cash and cash equivalents (Note 17)                                       | 234,266                  | -                                  | -                                                                    | -                              |
|                                                                           | <b>305,383</b>           | <b>1,575</b>                       | <b>2,393</b>                                                         | <b>2,387</b>                   |

|                                                                                | Derivatives<br>used for<br>hedging | Other financial<br>liabilities at<br>amortised cost | Liabilities at<br>fair value<br>through the<br>profit or loss |
|--------------------------------------------------------------------------------|------------------------------------|-----------------------------------------------------|---------------------------------------------------------------|
| <b>Liabilities as per statement of financial position as<br/>at 31/12/2011</b> | LVL'000                            | LVL'000                                             | LVL'000                                                       |
| Borrowings (Note 20)                                                           | -                                  | 513,334                                             | -                                                             |
| Derivative financial instruments (Note 24)                                     | 10,592                             | -                                                   | 13,171                                                        |
| Issued guarantees (Note 26)                                                    | -                                  | -                                                   | 336                                                           |
| Trade and other payables (Note 23)                                             | -                                  | 78,161                                              | -                                                             |
|                                                                                | <b>10,592</b>                      | <b>591,495</b>                                      | <b>13,507</b>                                                 |

|                                                                                | Derivatives<br>used for<br>hedging | Other financial<br>liabilities at<br>amortised cost | Liabilities at<br>fair value<br>through the<br>profit or loss |
|--------------------------------------------------------------------------------|------------------------------------|-----------------------------------------------------|---------------------------------------------------------------|
| <b>Liabilities as per statement of financial position as<br/>at 31/12/2010</b> | LVL'000                            | LVL'000                                             | LVL'000                                                       |
| Borrowings (Note 20)                                                           | -                                  | 545,607                                             | -                                                             |
| Derivative financial instruments (Note 24)                                     | 5,487                              | -                                                   | 6,009                                                         |
| Issued guarantees (Note 26)                                                    | -                                  | -                                                   | 502                                                           |
| Trade and other payables (Note 23)                                             | -                                  | 51,934                                              | -                                                             |
|                                                                                | <b>5,487</b>                       | <b>597,541</b>                                      | <b>6,511</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 2011 the Group had none of their borrowings denominated in other currencies than the Euro (see Note 20).

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 do 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 2011 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 24e).

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 2011, 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 344 thousand higher or lower (2010: LVL 305 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 15 interest rate swap agreements with the total notional amount EUR 343.6 million or LVL 241.5 million (2010: 15 interest rate swap agreements in total amount of EUR 348.2 million or LVL 244.7 million) (see Note 24b).

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 2011 47% of the Group's borrowings (31/12/2010: 43.4%) had fixed interest rate (taking into account the effect of the interest rate swaps) and average fixed rate duration 2.13 years (2010: 2.3 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 2011, 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 1,261 thousand lower or higher (2010: LVL 1,341 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 2011, 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 4,112 thousand higher or lower (31/12/2010: LVL 4,286 thousand). Furthermore LVL 649 thousand (2010: LVL 795 thousand) would have been attributable to profit or loss and LVL 3,463 thousand (2010: LVL 3,491 thousand) to the Consolidated Statement of Changes in Equity 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 24 c) and CO<sub>2</sub> allowances (Note 24 d).

#### ***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 16).

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 17), trade and other receivables (Note 16), nominal amounts of issued guarantees (Note 26) and investments in held-to-maturity financial assets (Note 28).

**Assessment of maximum possible exposure to credit risk**

|                                         |             | <b>31/12/2011</b> | <b>31/12/2010</b> |
|-----------------------------------------|-------------|-------------------|-------------------|
|                                         | <b>Note</b> | <b>LVL'000</b>    | <b>LVL'000</b>    |
| Trade receivables                       | 16 a        | 73,809            | 63,031            |
| Accrued income                          | 16 b        | 6,986             | 7,522             |
| Other non-current financial receivables |             | 95                | 172               |
| Other current financial receivables     | 16 b        | 609               | 392               |
| Cash and cash equivalents               | 17          | 108,877           | 234,266           |
| Derivative financial instruments        | 24 a        | 2,450             | 3,968             |
| Held-to-maturity financial assets       | 28          | 60,384            | 2,387             |
|                                         |             | <b>253,210</b>    | <b>311,738</b>    |

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, 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 (see Note 16 a):

- 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:

|                                          | <b>31/12/2011</b> | <b>31/12/2010</b> |
|------------------------------------------|-------------------|-------------------|
|                                          | <b>LVL'000</b>    | <b>LVL'000</b>    |
| Investment level credit rating           | 96,499            | 202,767           |
| No or non-investment level credit rating | 12,378            | 31,499            |
|                                          | <b>108,877</b>    | <b>234,266</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 (see Note 20) and cash and cash equivalents (see Note 17).



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)**

| <b>31/12/2011</b>                | <b>Less than 1<br/>year<br/>LVL'000</b> | <b>Between<br/>1 and 2<br/>years<br/>LVL'000</b> | <b>Between<br/>3 and 5<br/>years<br/>LVL'000</b> | <b>Over<br/>5 years<br/>LVL'000</b> | <b>Total<br/>LVL'000</b> |
|----------------------------------|-----------------------------------------|--------------------------------------------------|--------------------------------------------------|-------------------------------------|--------------------------|
| Borrowings                       | 58,746                                  | 81,093                                           | 301,216                                          | 141,315                             | <b>582,370</b>           |
| Derivative financial instruments | 22,009                                  | 11,371                                           | 5,197                                            | 1,085                               | <b>39,662</b>            |
| Issued guarantees                | 9,922                                   | -                                                | -                                                | -                                   | <b>9,922</b>             |
| Trade and other payables*        | 78,161                                  | -                                                | -                                                | -                                   | <b>78,161</b>            |
|                                  | <b>168,838</b>                          | <b>92,464</b>                                    | <b>306,413</b>                                   | <b>142,400</b>                      | <b>710,115</b>           |

| <b>31/12/2010</b>                | <b>Less than 1<br/>year<br/>LVL'000</b> | <b>Between<br/>1 and 2<br/>years<br/>LVL'000</b> | <b>Between<br/>3 and 5<br/>years<br/>LVL'000</b> | <b>Over<br/>5 years<br/>LVL'000</b> | <b>Total<br/>LVL'000</b> |
|----------------------------------|-----------------------------------------|--------------------------------------------------|--------------------------------------------------|-------------------------------------|--------------------------|
| Borrowings                       | 46,723                                  | 63,804                                           | 339,721                                          | 200,414                             | <b>650,662</b>           |
| Derivative financial instruments | 7,772                                   | 8,350                                            | 9,456                                            | 2,310                               | <b>27,888</b>            |
| Issued guarantees                | 10,825                                  | -                                                | -                                                | -                                   | <b>10,825</b>            |
| Trade and other payables*        | 51,934                                  | -                                                | -                                                | -                                   | <b>51,934</b>            |
|                                  | <b>117,254</b>                          | <b>72,154</b>                                    | <b>349,177</b>                                   | <b>202,724</b>                      | <b>741,309</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 on 31 December 2011 and on 31 December 2010 was as follows:

|                                                   | 31/12/2011 | 31/12/2010 |
|---------------------------------------------------|------------|------------|
| Total equity (LVL'000)                            | 1,351,576  | 1,344,748  |
| Total assets (LVL'000)                            | 2,288,004  | 2,279,266  |
| Outstanding financial guarantees issued (LVL'000) | 9,922      | 10,825     |
| <b>Capital Ratio</b>                              | <b>59%</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 (see 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 price used for financial assets held by the Group is the current bid price, i.e. interest rates by respective term and currency.

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. Quoted market prices for similar instruments are used for long-term debt. Other techniques, such as 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. Those fair values are compared to counterparty's bank revaluation reports.

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.

The fair value of non-current borrowings with floating interest rates fixed by SWAP agreements for disclosure purposes is estimated by discounting their future contractual cash flows at the current market interest rates for similar financial instruments.

## **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*

#### *1) 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 2011, the net book amount of property, plant and equipment of the Group totalled LVL 1,999 million (31 December 2010: LVL 1,929 million), and the depreciation charge of continuing operations for the reporting period was LVL 113 million (2010: LVL 116.7 million) (Note 13a). If depreciation rates were changed by 10%, the annual depreciation charge would change by LVL 11.3 million (2010: LVL 11.7 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 percent point the current year's impairment charge on technological equipment would be by LVL 32.0 million higher or lower (2010: LVL 29.9 million). Impairment charges recognised during the current reporting year are disclosed in Note 13b.

## ***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 13 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 2.10). 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 16).

### ***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:

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- a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- b) 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),
- c) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

|                                                                     | 31/12/2011 | Level 1 | Level 2       | Level 3 | Total balance |
|---------------------------------------------------------------------|------------|---------|---------------|---------|---------------|
| <b>Assets</b>                                                       |            |         |               |         |               |
| <i>Financial assets at fair value through profit or loss:</i>       |            |         |               |         |               |
| - Forward foreign exchange contracts (Note 24 e)                    | -          |         | 105           | -       | 105           |
| Electricity trading derivatives used for hedging (Note 24 c)        | -          |         | 2,060         | -       | 2,060         |
| Forward foreign exchange contracts used for hedging (Note 24 e)     | -          |         | 285           | -       | 285           |
| <b>Total assets</b>                                                 | -          |         | <b>2,450</b>  | -       | <b>2,450</b>  |
| <b>Liabilities</b>                                                  |            |         |               |         |               |
| <i>Financial liabilities at fair value through profit or loss:</i>  |            |         |               |         |               |
| - Electricity trading derivatives (Note 24 c)                       | -          |         | 5,366         | -       | 5,366         |
| - CO <sub>2</sub> emission allowances forward contracts (Note 24 d) | -          |         | 4,597         | -       | 4,597         |
| - Interest rate derivatives (Note 24 b)                             | -          |         | 3,208         | -       | 3,208         |
| Electricity trading derivatives used for hedging (Note 24 c)        | -          |         | 1,981         | -       | 1,981         |
| Interest rate derivatives used for hedging (Note 24 b)              | -          |         | 8,611         | -       | 8,611         |
| <b>Total liabilities</b>                                            | -          |         | <b>23,763</b> | -       | <b>23,763</b> |

|                                                                     | 31/12/2010 | Level 1 | Level 2       | Level 3 | Total balance |
|---------------------------------------------------------------------|------------|---------|---------------|---------|---------------|
| <b>Assets</b>                                                       |            |         |               |         |               |
| <i>Financial assets at fair value through profit or loss:</i>       |            |         |               |         |               |
| - Electricity trading derivatives (Note 24 c)                       | -          |         | 2,393         | -       | 2,393         |
| Interest rate derivatives used for hedging (Note 24 b)              | -          |         | 1,011         | -       | 1,011         |
| Forward foreign exchange contracts used for hedging (Note 24 e)     | -          |         | 564           | -       | 564           |
| <b>Total assets</b>                                                 | -          |         | <b>3,968</b>  | -       | <b>3,968</b>  |
| <b>Liabilities</b>                                                  |            |         |               |         |               |
| <i>Financial liabilities at fair value through profit or loss:</i>  |            |         |               |         |               |
| - CO <sub>2</sub> emission allowances forward contracts (Note 24 d) | -          |         | 3,442         | -       | 3,442         |
| - Interest rate derivatives (Note 24 b)                             | -          |         | 2,567         | -       | 2,567         |
| Interest rate derivatives used for hedging (Note 24 b)              | -          |         | 5,487         | -       | 5,487         |
| <b>Total liabilities</b>                                            | -          |         | <b>11,496</b> | -       | <b>11,496</b> |

### 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 22). The estimated customer relationship period is based on the Management's estimate. In the reporting period the Group's received connection fees totalled LVL 9.8 million (2010: LVL 12.4 million), and to the Consolidated Income Statement credited LVL 5.4 million (2010: LVL 5.2 million). If the estimated customer relationship period is reduced/increased by 25%, the annual income from connection service fees would increase/decrease by LVL 1.4 million (2010: LVL 1.3 million).

**e) 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 24).

**5 REVENUE**

|                                          | 2011<br>LVL'000 | 2010<br>LVL'000 |
|------------------------------------------|-----------------|-----------------|
| Electricity sales                        | 583,428         | 470,663         |
| - including sales to corporate customers | 457,119         | 338,886         |
| - residential customers                  | 126,309         | 131,777         |
| Sales of network services                | 9,664           | 6,074           |
|                                          | <b>593,092</b>  | <b>476,737</b>  |
| Heat sales                               | 69,233          | 71,863          |
| Revenue from lease of assets             | 393             | 97              |
| Other services                           | 19,049          | 18,689          |
| <b>Total revenue:</b>                    | <b>681,767</b>  | <b>567,386</b>  |

**6 OTHER INCOME**

|                                                       | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-------------------------------------------------------|-----------------|-----------------|
| (Loss)/gain from sale of assets held for sale and PPE | (68)            | 221             |
| Gain from sale of current assets and other income     | 2 943           | 2,452           |
| Interest income on treasury bills                     | 1,300           | 1               |
| <b>Total other income:</b>                            | <b>4,175</b>    | <b>2,674</b>    |

**7 RAW MATERIALS AND CONSUMABLES USED**

|                                                                                                    | 2011<br>LVL'000 | 2010<br>LVL'000 |
|----------------------------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Electricity:</b>                                                                                |                 |                 |
| Imported from the Baltic countries                                                                 | 138,373         | 60,974          |
| Purchased from producers in Latvia                                                                 | 65,439          | 56,590          |
| Imported from other countries                                                                      | 38,481          | 24,025          |
| Fair value loss / (income) on electricity swaps<br>(Note 24 b)                                     | 7,759           | (12,651)        |
|                                                                                                    | <b>250,052</b>  | <b>128,938</b>  |
| Fuel expense                                                                                       | 127,673         | 121,335         |
| Fair value (income) / loss on CO <sub>2</sub> emission allowances forward<br>contracts (Note 24 c) | 1,155           | (532)           |
| Raw materials, spare parts and maintenance costs                                                   | 29,312          | 23,849          |
| <b>Total raw materials and consumables used:</b>                                                   | <b>408,192</b>  | <b>273,590</b>  |

## 8 PERSONNEL EXPENSES

|                                                                                             | 2011<br>LVL'000 | 2010<br>LVL'000 |
|---------------------------------------------------------------------------------------------|-----------------|-----------------|
| Wages and salaries                                                                          | 45,896          | 42,443          |
| Expenditure of employment termination                                                       | 2,028           | 1,055           |
| Pension costs – defined contribution plan                                                   | 2,102           | 1,991           |
| State social insurance contributions and other benefits defined in the Collective Agreement | 11,546          | 10,647          |
| <b>Total personnel expenses:</b>                                                            | <b>61,572</b>   | <b>56,136</b>   |

|                                                                                             | 2011<br>LVL'000 | 2010<br>LVL'000 |
|---------------------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Including remuneration to the management:</b>                                            |                 |                 |
| Wages and salaries                                                                          | 710             | 606             |
| Expenditure of employment termination                                                       | 9               | 8               |
| Pension costs – defined contribution plan                                                   | 26              | 31              |
| State social insurance contributions and other benefits defined in the Collective Agreement | 181             | 151             |
| <b>Total remuneration to the management:</b>                                                | <b>926</b>      | <b>796</b>      |

|                                             | 2011  | 2010  |
|---------------------------------------------|-------|-------|
| Number of employees at the end of the year  | 4,490 | 4,517 |
| Average number of employees during the year | 4,518 | 4,594 |

Remuneration to the management includes remuneration to the members of the Management Boards of the Group entities.

In accordance with the directions of the Cabinet of Ministers of Latvia No. 1199 dated 28 December 2010: "On distribution of the obligatory state social insurance contribution rate for 2011" 73% from the obligatory state social insurance contributions are used for financing the state fixed contribution pension scheme (2010: 65%).

## 9 OTHER OPERATING EXPENSES

|                                                     | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-----------------------------------------------------|-----------------|-----------------|
| Selling expenses and customer service costs         | 5,843           | 3,604           |
| Information technology maintenance expenses         | 2,192           | 2,206           |
| Transportation expenses                             | 5,608           | 4,558           |
| Environment protection and work safety expenses     | 3,181           | 2,599           |
| Rent, maintenance and utilities costs               | 3,944           | 4,627           |
| Electric power transit and capacity services costs  | 3,750           | 4,300           |
| Loss from disposal of property, plant and equipment | 1,583           | 1,969           |
| Real estate tax                                     | 704             | 756             |
| Telecommunications expenses                         | 1,437           | 1,754           |
| Public utilities regulation fee                     | 80              | 955             |
| Other expenses                                      | 7,127           | 5,766           |
| <b>Total other operating expenses:</b>              | <b>35,449</b>   | <b>33,094</b>   |



## 10 FINANCE INCOME AND COSTS

### *Finance income*

|                                                                              | 2011<br>LVL'000 | 2010<br>LVL'000 |
|------------------------------------------------------------------------------|-----------------|-----------------|
| Interest income on bank accounts and deposits                                | 2,776           | 5,351           |
| Fair value gain on interest rate swaps (Note 24 b)                           | -               | 21              |
| Fair value gain on forward foreign currencies exchange contracts (Note 24 e) | 105             | -               |
| Fair value gain on issued guarantees (Note 26)                               | 166             | 141             |
| <b>Total finance income:</b>                                                 | <b>3,047</b>    | <b>5,513</b>    |

### *Finance costs*

|                                                       | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-------------------------------------------------------|-----------------|-----------------|
| Interest expense on borrowings                        | 12,025          | 9,023           |
| Interest expense on interest rate swaps               | 4,065           | 5,360           |
| Other finance costs                                   | 64              | 1,671           |
| Fair value loss on interest rate swaps (Note 24 b)    | 641             | -               |
| Net foreign exchange losses                           | 748             | 1,142           |
| Capitalized interest expense and currency translation | (3,587)         | (666)           |
| <b>Total finance costs:</b>                           | <b>13,956</b>   | <b>16,530</b>   |

## 11 INCOME TAX

|                          | 2011<br>LVL'000 | 2010<br>LVL'000 |
|--------------------------|-----------------|-----------------|
| Current tax              | 13,730          | 11,551          |
| Deferred tax             | (14,294)        | (5,096)         |
| <b>Total income tax:</b> | <b>(564)</b>    | <b>6,455</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:

|                                                                       | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-----------------------------------------------------------------------|-----------------|-----------------|
| <b>Profit before tax</b>                                              | <b>42,668</b>   | <b>51,012</b>   |
| Corporate income tax at the statutory rate 15%                        | 6,400           | 7,652           |
| Gain on deferred income tax asset value                               | -               | (7)             |
| Expense not deductible for tax purpose                                | 1,058           | 915             |
| (Income)/loss not subject to tax                                      | (245)           | 830             |
| Gain on discontinuing operations                                      | (123)           | (35)            |
| Accelerated depreciation of newly constructed technological equipment | (7,654)         | (2,900)         |
| <b>Total income tax:</b>                                              | <b>(564)</b>    | <b>6,455</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:

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|                                                                   | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|-------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Deferred income tax liabilities:</b>                           |                       |                       |
| - Deferred tax liabilities to be recovered after more than 1 year | 172,087               | 185,124               |
| - Deferred tax liabilities to be recovered within 1 year          | 4,636                 | 4,310                 |
| <b>Deferred income tax assets:</b>                                |                       |                       |
| - Deferred tax assets to be recovered after more than 1 year      | (1,849)               | (1,811)               |
| - Deferred tax assets to be recovered within 1 year               | (2,479)               | (913)                 |
| <b>Total deferred income tax assets</b>                           | <b>(30)</b>           | <b>(925)</b>          |
| <b>Total deferred income tax liabilities</b>                      | <b>172,425</b>        | <b>187,635</b>        |

The movement on the deferred income tax accounts is as follows:

|                                                                            | 2011<br>LVL'000 | 2010<br>LVL'000 |
|----------------------------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                                        | <b>186,710</b>  | <b>117,108</b>  |
| Income credited to the Consolidated Income Statement                       | (14,294)        | (5,096)         |
| Attributable to non-current assets revaluation reserve in equity (Note 19) | (81)            | 74,698          |
| Attributable to discontinuing operations                                   | 60              | -               |
| <b>Deferred tax asset at the end of the year</b>                           | <b>(30)</b>     | <b>(925)</b>    |
| <b>Deferred tax liabilities at the end of the year</b>                     | <b>172,425</b>  | <b>187,635</b>  |

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

|                                                                  | 2011<br>LVL'000                     | 2010<br>LVL'000 |
|------------------------------------------------------------------|-------------------------------------|-----------------|
| <b>Deferred tax liabilities:</b>                                 |                                     |                 |
|                                                                  | <b>Accelerated tax depreciation</b> |                 |
| <b>At the beginning of the year</b>                              | <b>189,434</b>                      | <b>121,810</b>  |
| Income credited to the Consolidated Income Statement             | (15,897)                            | (7,074)         |
| Attributable to discontinuing operations                         | (104)                               | -               |
| Attributable to non-current assets revaluation reserve in equity | (81)                                | 74,698          |
| <b>At the end of the year</b>                                    | <b>173,352</b>                      | <b>189,434</b>  |
| <b>Deferred tax assets:</b>                                      |                                     |                 |
|                                                                  | <b>Accruals/provisions</b>          |                 |
| <b>At the beginning of the year</b>                              | <b>(2,724)</b>                      | <b>(4,702)</b>  |
| Expense charged to the Consolidated Income Statement             | 1,603                               | 1,978           |
| Attributable to discontinuing operations                         | 164                                 | -               |
| <b>At the end of the year</b>                                    | <b>(957)</b>                        | <b>(2,724)</b>  |

## 12 INTANGIBLE ASSETS

### 12 a) Intangible assets

|                                    | Licenses<br>LVL'000 | Software<br>LVL'000 | Assets under<br>construction<br>LVL'000 | Total<br>LVL'000 |
|------------------------------------|---------------------|---------------------|-----------------------------------------|------------------|
| <b>At 31 December 2009</b>         |                     |                     |                                         |                  |
| Cost                               | 1,750               | 17,206              | 33                                      | 18,989           |
| Accumulated amortisation           | (420)               | (10,377)            | -                                       | (10,797)         |
| <b>Net book amount</b>             | <b>1,330</b>        | <b>6,829</b>        | <b>33</b>                               | <b>8,192</b>     |
| <b>Year ended 31 December 2010</b> |                     |                     |                                         |                  |
| Opening net book amount            | 1,330               | 6,829               | 33                                      | 8,192            |
| Additions                          | -                   | 1,626               | 47                                      | 1,673            |
| Disposals                          | -                   | (1)                 | -                                       | (1)              |
| Amortisation charge                | (147)               | (2,239)             | -                                       | (2,386)          |
| <b>Closing net book amount</b>     | <b>1,183</b>        | <b>6,215</b>        | <b>80</b>                               | <b>7,478</b>     |
| <b>At 31 December 2010</b>         |                     |                     |                                         |                  |
| Cost                               | 1,750               | 18,793              | 80                                      | 20,623           |
| Accumulated amortisation           | (567)               | (12,578)            | -                                       | (13,145)         |
| <b>Net book amount</b>             | <b>1,183</b>        | <b>6,215</b>        | <b>80</b>                               | <b>7,478</b>     |
| <b>Year ended 31 December 2011</b> |                     |                     |                                         |                  |
| Opening net book amount            | 1,183               | 6,215               | 80                                      | 7,478            |
| Additions                          | -                   | 1,290               | 417                                     | 1,707            |
| Amortisation charge                | (148)               | (2,436)             | -                                       | (2,584)          |
| <b>Closing net book amount</b>     | <b>1,035</b>        | <b>5,069</b>        | <b>497</b>                              | <b>6,601</b>     |
| <b>At 31 December 2011</b>         |                     |                     |                                         |                  |
| Cost                               | 1,750               | 19,940              | 497                                     | 22,187           |
| Accumulated amortisation           | (715)               | (14,871)            | -                                       | (15,586)         |
| <b>Net book amount</b>             | <b>1,035</b>        | <b>5,069</b>        | <b>497</b>                              | <b>6,601</b>     |

### 12 b) Emission allowances:

|                                     | 2011<br>Number of<br>allowances | 2010<br>Number of<br>allowances |
|-------------------------------------|---------------------------------|---------------------------------|
| <b>At the beginning of the year</b> | <b>483,309</b>                  | <b>459,097</b>                  |
| Allocated allowances*               | 1,107,445                       | 1,107,445                       |
| Purchased allowances                | 255,746                         | 280,000                         |
| Used allowances                     | (1,184,626)                     | (1,268,233)                     |
| Sales of allowances                 | (109,315)                       | (95,000)                        |
| <b>At the end of the year</b>       | <b>552,559</b>                  | <b>483,309</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.

## 13 PROPERTY, PLANT AND EQUIPMENT

### 13 a) Property, plant and equipment

|                                         | Revalued buildings and facilities                   |                                               |                                               |                                       | Land and buildings, total | Revalued technology equipment, machinery                   |                                                      |                                                      |                                              | Technology equipment and machinery, total |
|-----------------------------------------|-----------------------------------------------------|-----------------------------------------------|-----------------------------------------------|---------------------------------------|---------------------------|------------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|----------------------------------------------|-------------------------------------------|
|                                         | Daugava hydropower plants' buildings and facilities | Trans-mission system buildings and facilities | Distri-bution system buildings and facilities | Non-revalued buildings and facilities |                           | Daugava hydropower plants' technology equipment, machinery | Trans-mission system technology equipment, machinery | Distri-bution 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                                   |
| <b>At 31 December 2009</b>              |                                                     |                                               |                                               |                                       |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Cost or valuation                       | 1,041,449                                           | 302,528                                       | 352,204                                       | 204,713                               | <b>1,900,894</b>          | 147,044                                                    | 250,075                                              | 166,099                                              | 209,029                                      | <b>772,247</b>                            |
| Accumulated depreciation and impairment | (577,363)                                           | (188,329)                                     | (102,335)                                     | (40,871)                              | <b>(908,898)</b>          | (101,694)                                                  | (126,038)                                            | (81,087)                                             | (77,136)                                     | <b>(385,955)</b>                          |
| <b>Net book amount</b>                  | <b>464,086</b>                                      | <b>114,199</b>                                | <b>249,869</b>                                | <b>163,842</b>                        | <b>991,996</b>            | <b>43,350</b>                                              | <b>124,037</b>                                       | <b>85,012</b>                                        | <b>131,893</b>                               | <b>386,292</b>                            |
| <b>Year ended 31 December 2010</b>      |                                                     |                                               |                                               |                                       |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Opening net book amount                 | 464,086                                             | 114,199                                       | 249,869                                       | 163,842                               | <b>991,996</b>            | 45,350                                                     | 124,037                                              | 85,012                                               | 131,893                                      | <b>386,292</b>                            |
| Revaluation of PPE                      | -                                                   | -                                             | 349,863                                       | -                                     | <b>349,863</b>            | -                                                          | -                                                    | 149,777                                              | -                                            | <b>149,777</b>                            |
| Additions                               | 542                                                 | 8,582                                         | 17,819                                        | 14,652                                | <b>41,595</b>             | 11,819                                                     | 4,495                                                | 8,766                                                | 8,239                                        | <b>33,319</b>                             |
| Transfers                               | -                                                   | (1,552)                                       | 4,501                                         | 1,995                                 | <b>4,944</b>              | -                                                          | -                                                    | (4,538)                                              | (242)                                        | <b>(4,780)</b>                            |
| Disposals                               | -                                                   | (700)                                         | (265)                                         | (175)                                 | <b>(1,140)</b>            | (78)                                                       | (406)                                                | (298)                                                | (5)                                          | <b>(787)</b>                              |
| Impairment charge*                      | -                                                   | -                                             | (2,276)                                       | (850)                                 | <b>(3,126)</b>            | -                                                          | -                                                    | (5,144)                                              | (17,223)                                     | <b>(22,367)</b>                           |
| Depreciation                            | (9,252)                                             | (6,204)                                       | (36,419)                                      | (6,466)                               | <b>(58,341)</b>           | (11,560)                                                   | (9,869)                                              | (14,245)                                             | (12,709)                                     | <b>(48,383)</b>                           |
| <b>Closing net book amount</b>          | <b>455,376</b>                                      | <b>114,325</b>                                | <b>583,092</b>                                | <b>172,998</b>                        | <b>1,325,791</b>          | <b>45,531</b>                                              | <b>118,257</b>                                       | <b>219,330</b>                                       | <b>109,953</b>                               | <b>493,071</b>                            |
| <b>At 31 December 2010</b>              |                                                     |                                               |                                               |                                       |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Cost or valuation                       | 1,041,991                                           | 305,217                                       | 1,261,427                                     | 223,733                               | <b>2,832,368</b>          | 156,685                                                    | 252,433                                              | 468,911                                              | 216,984                                      | <b>1,095,013</b>                          |
| Accumulated depreciation and impairment | (586,615)                                           | (190,892)                                     | (678,335)                                     | (50,735)                              | <b>(1,506,577)</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>172,998</b>                        | <b>1,325,791</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>      |                                                     |                                               |                                               |                                       |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Opening net book amount                 | 455,376                                             | 114,325                                       | 583,092                                       | 172,998                               | <b>1,325,791</b>          | 45,531                                                     | 118,257                                              | 219,330                                              | 109,953                                      | <b>493,071</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)                                         | (420)                                 | <b>(883)</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)                                      | (6,222)                               | <b>(58,178)</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                                     | 230,364                               | <b>2,869,092</b>          | 158,771                                                    | 252,794                                              | 478,154                                              | 220,049                                      | <b>1,109,768</b>                          |
| Accumulated depreciation and impairment | (592,764)                                           | (196,516)                                     | (714,127)                                     | (56,758)                              | <b>(1,560,165)</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>                            |

|                                         | Revalued other fixed assets                              |                                                   |                                                   | Non-revalued other fixed assets<br>LVL'000 | Other fixed assets, total<br>LVL'000 | Assets under construction<br>LVL'000 | Property, plant and equipment, total<br>LVL'000 |
|-----------------------------------------|----------------------------------------------------------|---------------------------------------------------|---------------------------------------------------|--------------------------------------------|--------------------------------------|--------------------------------------|-------------------------------------------------|
|                                         | Daugava hydropower plants' other fixed assets<br>LVL'000 | Transmission system other fixed assets<br>LVL'000 | Distribution system other fixed assets<br>LVL'000 |                                            |                                      |                                      |                                                 |
| <b>At 31 December 2009</b>              |                                                          |                                                   |                                                   |                                            |                                      |                                      |                                                 |
| Cost or valuation                       | 7,477                                                    | 3,299                                             | 2,065                                             | 84,864                                     | 97,705                               | 43,193                               | 2,814,039                                       |
| Accumulated depreciation and impairment | (3,053)                                                  | (2,066)                                           | (1,374)                                           | (60,652)                                   | (67,145)                             | (3,997)                              | (1,365,995)                                     |
| <b>Net book amount</b>                  | <b>4,424</b>                                             | <b>1,233</b>                                      | <b>691</b>                                        | <b>24,212</b>                              | <b>30,560</b>                        | <b>39,196</b>                        | <b>1,448,044</b>                                |
| <b>Year ended 31 December 2010</b>      |                                                          |                                                   |                                                   |                                            |                                      |                                      |                                                 |
| Opening net book amount                 | 4,424                                                    | 1,233                                             | 691                                               | 24,212                                     | 30,560                               | 39,196                               | 1,448,044                                       |
| Revaluation of PPE                      | -                                                        | -                                                 | 306                                               | -                                          | 306                                  | -                                    | 499,946                                         |
| Additions                               | -                                                        | 61                                                | 141                                               | 4,612                                      | 4,814                                | 46,138                               | 125,866                                         |
| Transfers                               | -                                                        | -                                                 | 521                                               | (632)                                      | (111)                                | -                                    | 53                                              |
| Disposals                               | -                                                        | (8)                                               | (1)                                               | (63)                                       | (72)                                 | (73)                                 | (2,072)                                         |
| Impairment charge*                      | -                                                        | -                                                 | (76)                                              | -                                          | (76)                                 | (788)                                | (26,357)                                        |
| Depreciation                            | (313)                                                    | (605)                                             | (173)                                             | (8,855)                                    | (9,946)                              | -                                    | (116,670)                                       |
| <b>Closing 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>1,928,810</b>                                |
| <b>At 31 December 2010</b>              |                                                          |                                                   |                                                   |                                            |                                      |                                      |                                                 |
| Cost or valuation                       | 7,477                                                    | 3,309                                             | 4,135                                             | 81,629                                     | 96,550                               | 89,193                               | 4,113,124                                       |
| Accumulated depreciation and impairment | (3,366)                                                  | (2,628)                                           | (2,726)                                           | (62,355)                                   | (71,075)                             | (4,720)                              | (2,184,314)                                     |
| <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>1,928,810</b>                                |
| <b>Year ended 31 December 2011</b>      |                                                          |                                                   |                                                   |                                            |                                      |                                      |                                                 |
| Opening net book amount                 | 4,111                                                    | 681                                               | 1,409                                             | 19,274                                     | 25,475                               | 84,473                               | 1,928,810                                       |
| Additions                               | -                                                        | 154                                               | 307                                               | 7,175                                      | 7,636                                | 124,320                              | 197,016                                         |
| Transfers                               | -                                                        | -                                                 | -                                                 | 7                                          | 7                                    | -                                    | -                                               |
| Disposals                               | -                                                        | -                                                 | -                                                 | (11)                                       | (11)                                 | (37)                                 | (1,530)                                         |
| Impairment charge*                      | -                                                        | -                                                 | -                                                 | -                                          | -                                    | (277)                                | (11,762)                                        |
| Depreciation                            | (309)                                                    | (551)                                             | (273)                                             | (8,219)                                    | (9,352)                              | -                                    | (113,032)                                       |
| <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                              | 4,289,137                                       |
| Accumulated depreciation and impairment | (3,675)                                                  | (3,034)                                           | (2,916)                                           | (63,422)                                   | (73,047)                             | (4,996)                              | (2,289,635)                                     |
| <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>                                |

\* Impairment charge is included in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

In 2011 the Group has capitalised borrowing expenses in amount of LVL 3,097 thousand (2010: LVL 666 thousand) at a rate of 2.26% (2010: 1.69%).

### Property, plant and equipment revaluation

Latvenergo AS revalued assets of Daugava hydropower plants as at 1 January 2007, transmission system assets as at 1 January 2008 and distribution system assets as at 1 January 2010. Valuation have been done by external certified valuers by applying the depreciated replacement 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. Construction or purchase costs of similar assets are used to estimate the renewal costs of the assets. As at 1 January 2011 transmission system assets and distribution system assets were evaluated for property investment in subsidiaries share capital (*Latvijas elektriskie tīkli AS* and *Sadales tīkls AS* respectively). As at the end of the reporting period carrying value of the hydropower plants, transmission system assets and distribution system assets approximates its fair value (in 2010 the increase in revalued distribution system assets' carrying amount of LVL 499,946 thousand, net of deferred tax, was charged to non-current assets revaluation reserve under the comprehensive income and the decrease in the carrying amount of assets, as a result of a distribution system assets revaluation in the amount of LVL 7,496 thousand in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment').

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 |                          |                                    |                    |                  |
|---------------------------------------------------|--------------------------|------------------------------------|--------------------|------------------|
|                                                   | Buildings and facilities | Technology equipment and machinery | Other fixed assets | Total            |
|                                                   | LVL'000                  | LVL'000                            | LVL'000            | LVL'000          |
| <b>At revalued amounts</b>                        |                          |                                    |                    |                  |
| <b>At 31 December 2010</b>                        |                          |                                    |                    |                  |
| Revalued                                          | 2,608,635                | 878,029                            | 14,921             | 3,501,585        |
| Accumulated depreciation                          | (1,455,842)              | (494,911)                          | (8,720)            | (1,959,473)      |
| <b>Revalued net book amount</b>                   | <b>1,152,793</b>         | <b>383,118</b>                     | <b>6,201</b>       | <b>1,542,112</b> |
| <b>At 31 December 2011</b>                        |                          |                                    |                    |                  |
| Revalued                                          | 2,638,728                | 889,719                            | 15,154             | 3,543,601        |
| Accumulated depreciation                          | (1,503,407)              | (523,241)                          | (9,625)            | (2,036,273)      |
| <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>At amounts stated on historical cost basis</b> |                          |                                    |                    |                  |
| <b>At 31 December 2010</b>                        |                          |                                    |                    |                  |
| Cost                                              | 496,062                  | 374,573                            | 10,951             | 881,586          |
| Accumulated depreciation                          | (153,748)                | (184,264)                          | (8,483)            | (346,495)        |
| <b>Net book amount</b>                            | <b>342,314</b>           | <b>190,309</b>                     | <b>2,468</b>       | <b>535,091</b>   |
| <b>At 31 December 2011</b>                        |                          |                                    |                    |                  |
| Cost                                              | 530,900                  | 396,426                            | 13,740             | 941,066          |
| Accumulated depreciation                          | (165,019)                | (197,067)                          | (11,045)           | (373,131)        |
| <b>Net book amount</b>                            | <b>365,881</b>           | <b>199,359</b>                     | <b>2,695</b>       | <b>567,935</b>   |

### 13 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 2011 amounted to LVL 50,381 thousand (31/12/2010: LVL 38,358 thousand). The cash-generating unit is defined as the assets of Riga TEC-2 plant. Additional impairment is due to Riga TEC-2 technological



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equipment and machinery planned to be partly discontinued after 2013. Nominal pre-tax discount rate for the future cash flows has diminished from 8.5% in 2010 to 8.4% in 2011. Impairment review was performed also for other assets that are not substantial in the context of these Consolidated Financial Statements. For sensitivity analysis see Note 4 a, II.

### 13 c) Investment properties (buildings):

| <b>Augstsprieguma<br/>tīkls AS buildings</b>  |  | LVL'000    |
|-----------------------------------------------|--|------------|
| <b>Year ended 31 December 2010</b>            |  |            |
| Opening net book amount                       |  | 436        |
| Reclassified to property, plant and equipment |  | (53)       |
| Depreciation                                  |  | (1)        |
| <b>Closing net book amount</b>                |  | <b>382</b> |
| <b>At 31 December 2010</b>                    |  |            |
| Cost                                          |  | 454        |
| Accumulated depreciation                      |  | (72)       |
| <b>Net book amount</b>                        |  | <b>382</b> |
| <b>Year ended 31 December 2011</b>            |  |            |
| Opening net book amount                       |  | 382        |
| Disposals                                     |  | (376)      |
| Depreciation                                  |  | (6)        |
| <b>Closing net book amount</b>                |  | <b>-</b>   |
| <b>At 31 December 2011</b>                    |  |            |
| Cost                                          |  | 78         |
| Accumulated depreciation                      |  | (78)       |
| <b>Net book amount</b>                        |  | <b>-</b>   |

## 14 INVESTMENTS IN ASSOCIATES AND OTHER INVESTMENTS

|                                     | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b> | <b>4,464</b>    | <b>4,261</b>    |
| Share of profit                     | 232             | 203             |
| <b>At the end of the year</b>       | <b>4,696</b>    | <b>4,464</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.

| Name                          | Assets<br>LVL'000 | Liabilities<br>LVL'000 | Net sales<br>LVL'000 | Share of<br>profit<br>LVL'000 |
|-------------------------------|-------------------|------------------------|----------------------|-------------------------------|
| <b>As of 31 December 2010</b> |                   |                        |                      |                               |
| Nordic Energy Link AS *       | 63,152            | 45,378                 | 10,504               | 203                           |
|                               | <b>63,152</b>     | <b>45,378</b>          | <b>10,504</b>        | <b>203</b>                    |
| <b>As of 31 December 2011</b> |                   |                        |                      |                               |
| Nordic Energy Link AS *       | 60,063            | 41,399                 | 9,706                | 232                           |
|                               | <b>60,063</b>     | <b>41,399</b>          | <b>9,706</b>         | <b>232</b>                    |

\* Audited financial data of associate for financial year ending 31 December 2011 and comparative figures for financial year ending 31 December 2010.

Participating interest in subsidiaries and associates:

| Name                              | Country of incorporation | Business activity held               | Interest held, % |      |
|-----------------------------------|--------------------------|--------------------------------------|------------------|------|
| 31/12/2011    31/12/2010          |                          |                                      |                  |      |
| <b>Subsidiaries:</b>              |                          |                                      |                  |      |
|                                   |                          | Transmission system assets operation |                  |      |
| Latvijas elektriskie tīkli AS     | Latvia                   |                                      | 100%             | -    |
| Augstsprieguma tīkls AS *         | Latvia                   | Transmission                         | -                | 100% |
| Sadales tīkls AS                  | Latvia                   | Distribution                         | 100%             | 100% |
| Latvenergo Kaubandus OÜ           | Estonia                  | Electricity trading                  | 100%             | 100% |
| Latvenergo Prekyba UAB            | Lithuania                | Electricity trading                  | 100%             | 100% |
| Liepājas enerģija SIA             | Latvia                   | Heating                              | 51%              | 51%  |
| <b>Associates:</b>                |                          |                                      |                  |      |
| Nordic Energy Link AS             | Estonia                  | Transmission                         | 25%              | 25%  |
| Pirmais Slēgtais Pensiju Fonds AS | Latvia                   | Management of pension plans          | 50%              | 50%  |

\* As at 31 December 2011 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 off (see Note 30)

The Group owns 50% 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.

## 15 INVENTORIES

|                                                              | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------------------------------------------|-----------------------|-----------------------|
| Raw materials and spare parts                                | 12,532                | 9,807                 |
| Technological fuel                                           | 4,143                 | 4,124                 |
| Advance payments for inventories                             | 16                    | 29                    |
| Allowance for raw materials, spare parts, technological fuel | (2,742)               | (2,459)               |
|                                                              | <b>13,949</b>         | <b>11,501</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:*

|                                              | 2011<br>LVL'000 | 2010<br>LVL'000 |
|----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>          | <b>2,459</b>    | <b>1,768</b>    |
| Inventories written off                      | (44)            | (1,026)         |
| Charged to the Consolidated Income Statement | 327             | 1,717           |
| <b>At the end of the year</b>                | <b>2,742</b>    | <b>2,459</b>    |

## 16 TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES

### 16 a) Trade receivables, net

|                                                | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|------------------------------------------------|-----------------------|-----------------------|
| <b>Receivables</b>                             |                       |                       |
| - Electricity customers                        | 66,101                | 48,494                |
| - Heating customers                            | 12,324                | 16,816                |
| - Other trade receivables                      | 5,101                 | 5,939                 |
|                                                | <b>83,526</b>         | <b>71,249</b>         |
| <b>Provision for impairment of receivables</b> |                       |                       |
| - Electricity customers                        | (8,320)               | (6,809)               |
| - Heating customers                            | (292)                 | (394)                 |
| - Other trade receivables                      | (1,105)               | (1,015)               |
|                                                | <b>(9,717)</b>        | <b>(8,218)</b>        |
| <b>Receivables, net</b>                        |                       |                       |
| - Electricity customers                        | 57,781                | 41,685                |
| - Heating customers                            | 12,032                | 16,422                |
| - Other trade receivables                      | 3,996                 | 4,924                 |
|                                                | <b>73,809</b>         | <b>63,031</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:

|                                                              | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------------------------------------------|-----------------------|-----------------------|
| <b>Electricity receivables:</b>                              |                       |                       |
| Fully performing receivables                                 | 44,151                | 37,870                |
| Receivables past due but not impaired:                       |                       |                       |
| - Receivables past due by 1-45 days                          | 4,826                 | 3,339                 |
| Impaired receivables:                                        |                       |                       |
| - Receivables past due by 46-90 days                         | 702                   | 602                   |
| - Receivables past due by 91-180 days                        | 909                   | 703                   |
| - Receivables past due by more than 181 day                  | 7,034                 | 5,980                 |
| - Individually impaired receivables with scheduled payments* | 8,479                 | -                     |
|                                                              | <b>66,101</b>         | <b>48,494</b>         |
| <b>Provision for impaired electricity receivables:</b>       |                       |                       |
| - Receivables past due by 46-90 days                         | (351)                 | (301)                 |
| - Receivables past due by 91-180 days                        | (683)                 | (528)                 |
| - Receivables past due by more than 181 day                  | (7,034)               | (5,980)               |
| - Individually impaired receivables with scheduled payments* | (252)                 | -                     |
|                                                              | <b>(8,320)</b>        | <b>(6,809)</b>        |
| <b>Electricity receivables, net</b>                          |                       |                       |
| Fully performing receivables                                 | 44,151                | 37,870                |
| Receivables past due but not impaired:                       |                       |                       |
| - Receivables past due by 1-45 days                          | 4,826                 | 3,339                 |
| Net impaired receivables:                                    |                       |                       |
| - Receivables past due by 46-90 days                         | 351                   | 301                   |
| - Receivables past due by 91-180 days                        | 226                   | 175                   |
| - Individually impaired receivables with scheduled payments* | 8,227                 | -                     |
|                                                              | <b>57,781</b>         | <b>41,685</b>         |

\* - individually impaired receivables are electricity receivables with debt amount exceeding LVL 500 thousand and with the agreement for gradual debt repayment; the required impairment level for individually impaired receivables is determined and based on the debtor's risk assessment and estimated probability of debtor's default (see Note 2.10)

*Heating and other receivables grouped by past due days and calculated impairment loss:*

|                                                                    | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Heating and other trade receivables:</b>                        |                       |                       |
| Fully performing receivables                                       | 15,697                | 20,820                |
| Receivables past due but not impaired:                             |                       |                       |
| - Receivables past due by 1-30 days                                | 258                   | 404                   |
| Impaired receivables:                                              |                       |                       |
| - Receivables past due by 31-90 days                               | 142                   | 242                   |
| - Receivables past due by more than 91 day                         | 1,328                 | 1,289                 |
|                                                                    | <b>17,425</b>         | <b>22,755</b>         |
| <b>Provision for impaired heating and other trade receivables:</b> |                       |                       |
| - Receivables past due by 31-90 days                               | (69)                  | (120)                 |
| - Receivables past due by more than 91 day                         | (1,328)               | (1,289)               |
|                                                                    | <b>(1,397)</b>        | <b>(1,409)</b>        |
| <b>Heating and other trade receivables, net</b>                    |                       |                       |
| Fully performing receivables                                       | 15,697                | 20,820                |
| Receivables past due but not impaired:                             |                       |                       |
| - Receivables past due by 1-30 days                                | 258                   | 404                   |
| Net impaired receivables:                                          |                       |                       |
| - Receivables past due by 31-90 days                               | 73                    | 122                   |
|                                                                    | <b>16,028</b>         | <b>21,346</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 Note 2.10). 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).

|                                                        | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------------------------------------|-----------------------|-----------------------|
| <b>Fully performing electricity receivables:</b>       |                       |                       |
| - customers with no overdue receivables                | 36,908                | 32,745                |
| - customers with overdue receivables                   | 7,243                 | 5,125                 |
|                                                        | <b>44,151</b>         | <b>37,870</b>         |
| <b>Fully performing heating and other receivables:</b> |                       |                       |
| - customers with no overdue receivables                | 15,209                | 17,627                |
| - customers with overdue receivables                   | 488                   | 3,193                 |
| <b>Total fully performing trade receivables</b>        | <b>15,697</b>         | <b>20,820</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:*

|                                                          | 2011<br>LVL'000 | 2010<br>LVL'000 |
|----------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                      | <b>8,218</b>    | <b>6,137</b>    |
| Receivables written off during the year as uncollectible | (575)           | (288)           |
| Allowance for impaired receivables                       | 2,074           | 2,369           |
| <b>At the end of the year</b>                            | <b>9,717</b>    | <b>8,218</b>    |

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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 9).

### 16 b) Other current receivables

|                                         | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|-----------------------------------------|-----------------------|-----------------------|
| Accrued income                          | 6,986                 | 7,522                 |
| Pre-tax and overpaid taxes              | 9,029                 | 13,520                |
| Deferred expenses                       | 571                   | 364                   |
| Other financial current receivables     | 609                   | 392                   |
| Other non-financial current receivables | 416                   | 84                    |
|                                         | <b>17,611</b>         | <b>21,882</b>         |

None of the receivables are secured with pledges or otherwise. The carrying amounts of other receivables are assumed to approximate their fair values.

## 17 CASH AND CASH EQUIVALENTS

|                          | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------|-----------------------|-----------------------|
| Cash at bank and on hand | 77,969                | 52,399                |
| Short-term bank deposits | 30,908                | 181,867               |
|                          | <b>108,877</b>        | <b>234,266</b>        |

Cash at bank 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 2011 the average annual effective interest rate earned on short-term cash deposits was 1.53% (2010: 3.49%). See also Note 3.1.b).

The carrying amounts of cash and cash equivalents are assumed to approximate their fair values.

## 18 SHARE CAPITAL

As at 31 December 2011, the registered share capital of the Parent Company is LVL 325,862 thousand (31/12/2010: 323,544 thousand) and consists of 325,862 thousand (31/12/2010: 323,544 thousand) ordinary shares with the nominal value of LVL 1 per share (31/12/2010: LVL 1 per share). All shares are fully paid up.

In November 2011, in accordance with the Cabinet of Ministers Directive No. 543 dated 20 October 2011: "On the Investment of the State's property units in the Share Capital of *Latvenergo AS*" and Directives No. 568 and No. 569 dated 2 November 2011: "On the Investment of the State's property units in the Share Capital of *Latvenergo AS*", real estate in the amount of LVL 2,318 thousand was invested in the Parent Company's share capital (2010: real estate in the amount of LVL 5,891 thousand). The value of real estate was determined by external certified valuation experts applying amortised cost model, based on purchase costs of similar assets. Increase in the share capital was approved by the Parent Company's Shareholders' meeting on 9 November 2011 and registered with the Commercial Register of Latvia on 14 November 2011.

## 19 RESERVES AND DIVIDENDS

As at 31 December 2011, the Group's reserves in the amount of LVL 976,921 thousand (31/12/2010: LVL 972,278 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<br>assets<br>revaluation<br>reserve<br>LVL'000 | Hedge<br>reserve<br>LVL'000 | Trans-<br>lation<br>LVL'000 | Other<br>reserves<br>LVL'000 | TOTAL<br>LVL'000 |
|------------------------------------------------------------------------------|------------------------------------------------------------|-----------------------------|-----------------------------|------------------------------|------------------|
| <b>As at 31 December 2009</b>                                                | <b>552,889</b>                                             | <b>(3,537)</b>              | <b>-</b>                    | <b>2</b>                     | <b>549,354</b>   |
| Revaluation of property, plant and equipment (PPE) (Note 13a)                | 499,946                                                    | -                           | -                           | -                            | 499,946          |
| Disposal of non-current assets revaluation reserve (Note 13a)                | (1,957)                                                    | -                           | -                           | -                            | (1,957)          |
| Deferred tax related to PPE revaluation reserve (Note 11)                    | (74,698)                                                   | -                           | -                           | -                            | (74,698)         |
| Currency translation differences                                             | -                                                          | -                           | 8                           | -                            | 8                |
| Loss from fair value changes in derivative financial instruments (Note 24 a) | -                                                          | (375)                       | -                           | -                            | (375)            |
| <b>As at 31 December 2010</b>                                                | <b>976,180</b>                                             | <b>(3,912)</b>              | <b>8</b>                    | <b>2</b>                     | <b>972,278</b>   |
| Transfer from previous year profit                                           | -                                                          | -                           | -                           | 10,257                       | 10,257           |
| Disposal of non-current assets revaluation reserve (Note 13a)                | (1,362)                                                    | -                           | -                           | -                            | (1,362)          |
| Deferred tax related to PPE revaluation reserve (Note 11)                    | 81                                                         | -                           | -                           | -                            | 81               |
| Currency translation differences                                             | -                                                          | -                           | 2                           | -                            | 2                |
| Loss from fair value changes in derivative financial instruments (Note 24 a) | -                                                          | (4,335)                     | -                           | -                            | (4,335)          |
| <b>As at 31 December 2011</b>                                                | <b>974,899</b>                                             | <b>(8,247)</b>              | <b>10</b>                   | <b>10,259</b>                | <b>976,921</b>   |

The dividends paid in 2011 were LVL 35,000 thousand (LVL 0.107 per share) and in 2010 - LVL 20,230 thousand (LVL 0.064 per share).

The distribution of net profit for the 2011 is subject to a resolution of the Parent Company's Shareholder's meeting.

## 20 BORROWINGS

|                                            | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|--------------------------------------------|-----------------------|-----------------------|
| <b>Non-current borrowings</b>              | <b>462,888</b>        | <b>506,756</b>        |
| Current portion of non-current borrowings  | 48,226                | 36,935                |
| Accrued interest on non-current borrowings | 2,220                 | 1,916                 |
| <b>Total current borrowings</b>            | <b>50,446</b>         | <b>38,851</b>         |
| <b>Total borrowings</b>                    | <b>513,334</b>        | <b>545,607</b>        |



**Movement in borrowings:**

|                                     | <b>2011</b>    | <b>2010</b>    |
|-------------------------------------|----------------|----------------|
|                                     | LVL'000        | LVL'000        |
| <b>At the beginning of the year</b> | <b>545,607</b> | <b>507,225</b> |
| Borrowings received                 | 4,357          | 60,041         |
| Borrowings repaid                   | (36,936)       | (22,164)       |
| Accrued interest on borrowings      | 306            | 505            |
| <b>At the end of the year</b>       | <b>513,334</b> | <b>545,607</b> |

**Borrowings by categories of lenders:**

|                                                             | <b>31/12/2011</b> | <b>31/12/2010</b> |
|-------------------------------------------------------------|-------------------|-------------------|
|                                                             | LVL'000           | LVL'000           |
| Foreign investment banks                                    | 316,860           | 334,517           |
| Foreign commercial banks                                    | 36,038            | 40,229            |
| Financial institutions registered in the Republic of Latvia | 160,436           | 170,861           |
| <b>Total borrowings</b>                                     | <b>513,334</b>    | <b>545,607</b>    |

**Borrowings by maturity:**

|                                                        | <b>31/12/2011</b> | <b>31/12/2010</b> |
|--------------------------------------------------------|-------------------|-------------------|
|                                                        | LVL'000           | LVL'000           |
| <b>Fixed rate non-current borrowings:</b>              |                   |                   |
| - < 1 year (current portion of non-current borrowings) | 291               | 292               |
| - 1- 5 years                                           | 984               | 1,124             |
| - > 5 years                                            | -                 | 141               |
| <b>Total fixed rate borrowings</b>                     | <b>1,275</b>      | <b>1,557</b>      |
| <b>Floating rate borrowings:</b>                       |                   |                   |
| - < 1 year (current portion of non-current borrowings) | 50,155            | 38,559            |
| - 1- 5 years                                           | 341,189           | 333,613           |
| - > 5 years                                            | 120,715           | 171,878           |
| <b>Total floating rate borrowings</b>                  | <b>512,059</b>    | <b>544,050</b>    |
| <b>Total borrowings</b>                                | <b>513,334</b>    | <b>545,607</b>    |

**Borrowings by pricing period (considering the effect of derivative financial instruments):**

|                          | <b>31/12/2011</b> | <b>31/12/2010</b> |
|--------------------------|-------------------|-------------------|
|                          | LVL'000           | LVL'000           |
| - < 1 year               | 270,560           | 309,836           |
| - 1- 5 years             | 186,550           | 185,029           |
| - > 5 years              | 56,224            | 50,742            |
| <b>Total borrowings:</b> | <b>513,334</b>    | <b>545,607</b>    |

At 31 December 2011 and at 31 December 2010 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 26.2 thousand (2010: LVL 143.68 thousand). The fair value calculations are based on discounted cash flows using

discount factor of respective EUR swap rates increased by average market margin. The average interest rate for discounting cash flows of non-current borrowings was 5.185% (2010: 2.99%).

#### *a) 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 14.8 million (31/12/2010: LVL 13.4 million) to secure its current and non-current borrowings. There has been pledged the property, plant and equipment in the amount of LVL 12.8 million and the claims on the receivables accounts in the amount of LVL 2.0 million (31/12/2010: LVL 10.7 million and LVL 2.7 million, respectively).

#### *b) Un-drawn borrowing facilities*

As at 31 December 2011 the undrawn portion of committed non-current credit facilities amounts to LVL 257.5 million (31/12/2010: LVL 253 million).

At 31 December 2011 the Group had available LVL 17.57 million (31/12/2010: LVL 17.57 million) of undrawn committed short-term borrowing facilities in respect of which all conditions precedent had been met.

#### *c) Weighted average effective interest rate*

During the reporting year the weighted average effective interest rate on non-current borrowings was 2.27% (2010: 1.70%), weighted average effective interest rate for current borrowings was 2.44% (2010: 1.949%). At 31 December 2011 interest rates for non-current borrowings in Euro were 3 and 6 month EURIBOR+0.451% (31/12/2010: +0.453%). At 31 December 2011 fifteen interest rate swap agreements were concluded by the Group for the total notional amount of EUR 343.6 million or LVL 241.5 million (31/12/2010: fifteen interest rate swap agreements EUR 348.2 million or LVL 244.7 million) and the interest rate was fixed for the periods from 3 to 10 years (see Note 24).

## **21 PROVISIONS**

### *21 a) Provisions for post-employment benefits*

|                                                                | <b>2011</b><br>LVL'000 | <b>2010</b><br>LVL'000 |
|----------------------------------------------------------------|------------------------|------------------------|
| <b>At the beginning of the year</b>                            | <b>7,321</b>           | <b>7,473</b>           |
| Current service cost                                           | 283                    | 309                    |
| Interest cost                                                  | 422                    | 360                    |
| Post-employment benefits paid                                  | (353)                  | (440)                  |
| Losses/(gains) as a result of changes in actuarial assumptions | 61                     | (381)                  |
| <b>At the end of the year</b>                                  | <b>7,734</b>           | <b>7,321</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 8):

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|                                                         | 2011<br>LVL'000 | 2010<br>LVL'000 |
|---------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                     | <b>7,321</b>    | <b>7,473</b>    |
| Charged/(credited) to the Consolidated Income Statement | 413             | (152)           |
| <b>At the end of the year</b>                           | <b>7,734</b>    | <b>7,321</b>    |

Discount rate used for discounting benefit obligations was 6.15% (2010: 5.53%), 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% (2010: 2.7%) 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.

### 21 b) Environmental provisions

|                                              | 2011<br>LVL'000 | 2010<br>LVL'000 |
|----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>          | <b>1,376</b>    | <b>1,376</b>    |
| Charged to the Consolidated Income Statement | 407             | -               |
| <b>At the end of the year</b>                | <b>1,783</b>    | <b>1,376</b>    |

The environmental provision in the amount of LVL 1,783 thousand (2010: LVL 1,376 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 1,028 thousand (2010: LVL 1,376 thousand) and SIA "Liepājas Energija" provision for the environmental recovery measures in the amount of LVL 755 thousand (2010: LVL 0). The amount of the provisions is calculated taking into account the construction cost index (data from the Central Statistical Bureau).

## 22 OTHER LIABILITIES AND DEFERRED INCOME

|                                                                                              | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|----------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| Deferred non-current income from connection fees                                             | 87,181                | 82,688                |
| Deferred income from plant and equipment received free of charge and financing from EU funds | 366                   | 234                   |
| Other non-financial liabilities                                                              | 7,268                 | 11,967                |
| <b>Total other liabilities and deferred income:</b>                                          | <b>94,815</b>         | <b>94,889</b>         |

### *Movement in deferred connection fees (non-current portion):*

|                                               | 2011<br>LVL'000 | 2010<br>LVL'000 |
|-----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>           | <b>87,901</b>   | <b>80,699</b>   |
| Received                                      | 9,753           | 12,415          |
| Credited to the Consolidated Income Statement | (5,377)         | (5,213)         |
| <b>At the end of the year</b>                 | <b>92,277</b>   | <b>87,901</b>   |

## 23 TRADE AND OTHER PAYABLES

|                                                     | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|-----------------------------------------------------|-----------------------|-----------------------|
| <b>Financial liabilities:</b>                       |                       |                       |
| Payables for materials and services                 | 56,672                | 30,034                |
| Payables for electricity                            | 14,962                | 15,169                |
| Accrued expenses                                    | 5,621                 | 6,274                 |
| Other financial current payables                    | 906                   | 457                   |
| <b>Total financial liabilities</b>                  | <b>78,161</b>         | <b>51,934</b>         |
| <b>Non-financial liabilities:</b>                   |                       |                       |
| Value added tax payable                             | 14,305                | 15,320                |
| State social security contributions and other taxes | 6,482                 | 2,467                 |
| Advances received                                   | 8,701                 | 5,702                 |
| Deferred income from connection fees                | 5,095                 | 5,213                 |
| Other non-financial current payables                | 8,470                 | 1,720                 |
| <b>Total non-financial liabilities</b>              | <b>43,053</b>         | <b>30,422</b>         |
| <b>Total trade and other current payables:</b>      | <b>121,214</b>        | <b>82,356</b>         |

The carrying amounts of trade and other payables are assumed to approximate their fair values.

## 24 DERIVATIVE FINANCIAL INSTRUMENTS

### 24 a) Outstanding fair values of derivatives and their classification

In the table below outstanding fair values of derivatives are disclosed as follows:

|                                                        |       | 31/12/2011<br>LVL'000 |               | 31/12/2010<br>LVL'000 |               |
|--------------------------------------------------------|-------|-----------------------|---------------|-----------------------|---------------|
|                                                        | Note  | Assets                | Liabilities   | Assets                | Liabilities   |
| Interest rate swaps                                    | 24 b) | -                     | 11,819        | (1,011)               | 8,054         |
| Electricity swaps                                      | 24 c) | (2,060)               | 7,347         | (2,393)               | -             |
| CO <sub>2</sub> emissions allowances forward contracts | 24 d) | -                     | 4,597         | -                     | 3,442         |
| Forward foreign currencies exchange contracts          | 24 e) | (390)                 | -             | (564)                 | -             |
| <b>Total outstanding fair values of derivatives:</b>   |       | <b>(2,450)</b>        | <b>23,763</b> | <b>(3,968)</b>        | <b>11,496</b> |

|               | 31/12/2011<br>LVL'000 |               | 31/12/2010<br>LVL'000 |               |
|---------------|-----------------------|---------------|-----------------------|---------------|
|               | Assets                | Liabilities   | Assets                | Liabilities   |
| Non-current   | -                     | 10,629        | -                     | 7,088         |
| Current       | (2,450)               | 13,134        | (3,968)               | 4,408         |
| <b>Total:</b> | <b>(2,450)</b>        | <b>23,763</b> | <b>(3,968)</b>        | <b>11,496</b> |

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In the table below are disclosed (gains) / losses on fair value changes as a result of realized hedge agreements:

|                                                                     | Note | Included in the Consolidated Income Statement |                 | Included in other comprehensive income |            | Included in accrued liabilities |            |
|---------------------------------------------------------------------|------|-----------------------------------------------|-----------------|----------------------------------------|------------|---------------------------------|------------|
|                                                                     |      | 2011                                          | 2010            | 2011                                   | 2010       | 2011                            | 2010       |
| Interest rate swaps – hedging derivatives                           | 19   | -                                             | -               | 4,135                                  | 939        | -                               | -          |
| Interest rate swaps – trading derivatives                           | 10   | 641                                           | (21)            | -                                      | -          | -                               | -          |
| Electricity swaps – hedging derivatives                             | 19   | -                                             | -               | (79)                                   | -          | -                               | -          |
| Electricity swaps – trading derivatives                             | 7    | 7,759                                         | (12,651)        | -                                      | -          | -                               | -          |
| CO <sub>2</sub> emissions allowances forward contracts              | 7    | 1,155                                         | (532)           | -                                      | -          | -                               | 608        |
| Forward foreign currencies exchange contracts – hedging derivatives | 19   | -                                             | -               | 279                                    | (564)      | -                               | -          |
| Forward foreign currencies exchange contracts – trading derivatives | 10   | (105)                                         | -               | -                                      | -          | -                               | -          |
| <b>Total:</b>                                                       |      | <b>9,450</b>                                  | <b>(13,204)</b> | <b>4,335</b>                           | <b>375</b> | <b>-</b>                        | <b>608</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. The Group implemented the above-mentioned amendments to *IAS 1* in the Consolidated Financial Statements from 2008. 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.

### 24 b) Interest rate swaps

As at 31 December 2011 the Group had fifteen interest rate swap agreements with total notional amount of EUR 343.6 million or LVL 241.5 million (31/12/2010: EUR 348.2 million or LVL 244.7 million). Interest rate swaps are agreed with 3 to 10 year maturities and hedged floating rates are 3 and 6 month EURIBOR. At 31 December 2011 fixed interest rates vary from 2.3835% to 4.4925% (31/12/2010: from 2.3835% to 4.4925%).

Twelve of all outstanding interest rate swap 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 recognized within profit or loss in the Consolidated Income Statement.

In the table below fair value changes of interest rate swaps are disclosed:

|                                                              | 2011           |               | 2010           |              |
|--------------------------------------------------------------|----------------|---------------|----------------|--------------|
|                                                              | LVL'000        |               | LVL'000        |              |
|                                                              | Assets         | Liabilities   | Assets         | Liabilities  |
| <b>Outstanding fair value at the beginning of the year</b>   | <b>(1,011)</b> | <b>8,054</b>  | <b>(145)</b>   | <b>6,270</b> |
| Included in the Consolidated Income Statement, net (Note 10) | -              | 641           | -              | (21)         |
| Included in other comprehensive income (Note 19)             | 1,011          | 3,124         | (866)          | 1,805        |
| <b>Outstanding fair value at the end of the year</b>         | <b>-</b>       | <b>11,819</b> | <b>(1,011)</b> | <b>8,054</b> |

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 2011 47% (31/12/2010: 43.4%) 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 2.13 years (2010: 2.3 years).

#### *24 c) Electricity swaps*

As at 31 December 2011 the Group has entered into 125 (31/12/2010: 85) electricity swap contracts with total outstanding volume of 4 418 243 MWh (31/12/2010: 3 007 701 MWh) and notional value of EUR 198 million or LVL 139.2 million (2010: EUR 152 million or LVL 106.8 million). Electricity swaps are signed for the maturities from one month to one year during the period from 1 January 2012 to 31 December 2014.

Electricity swap contracts are agreed through financial counterparties and by using the Nordic energy exchange *Nord Pool Spot* pricing according to the Group's Financial Risk Management Policy for hedging purposes. All purchased swap contracts were contracts with fixed amount of electricity and price in Euros.

As at 31 December 2011 57 (31/12/2010: 0) 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 recognized in the hedging reserve in 'Other comprehensive income' (Note 19).

In the table below fair value changes of electricity swaps are disclosed:

|                                                            | 2011<br>LVL'000 |              | 2010<br>LVL'000 |               |
|------------------------------------------------------------|-----------------|--------------|-----------------|---------------|
|                                                            | Assets          | Liabilities  | Assets          | Liabilities   |
| <b>Outstanding fair value at the beginning of the year</b> | <b>(2,393)</b>  | <b>-</b>     | <b>-</b>        | <b>10,258</b> |
| Included in the Consolidated Income Statement (Note 7)     | 2,393           | 5,366        | (2,393)         | (10,258)      |
| Included in other comprehensive income (Note 19)           | (2,060)         | 1,981        | -               | -             |
| <b>Outstanding fair value at the end of the year</b>       | <b>(2,060)</b>  | <b>7,347</b> | <b>(2,393)</b>  | <b>-</b>      |

#### *24 d) CO<sub>2</sub> emissions allowances forward contracts*

As at 31 December 2011 the Group has entered into 24 forward contracts of CO<sub>2</sub> emission allowances purchase or sale (31/12/2010: 25) which included 9 purchase contracts of European Union Allowances, hereinafter – EUAs (31/12/2010: 9), 13 purchase contracts of Certified Emission Reductions, hereinafter – CERs (31/12/2010: 12) and 2 sale contracts of CERs (31/12/2010: 4), with the total fair value of EUR 9.6 million or LVL 6.7 million (31/12/2010: EUR 9.4 million or LVL 6.6 million).

As at 31 December 2011 total amount of allocated and procured CO<sub>2</sub> emission allowances for the current allocation period till the end of 2012 is sufficient to offset expected emissions. Over the European Union Emissions Trading System Phase II the Parent Company has fully used the allowed option to procure and offset 10% of allocated EUAs with cheaper CERs. As a result of EUAs and CERs purchase and sale contracts measurement at fair value as at 31 December 2011, the Group has recognised the liabilities in the amount of EUR 5,816 thousand or LVL 4,088 thousand (31/12/2010: EUR 3,612 thousand or LVL 2,538 thousand) for EUAs contracts and EUR 726 thousand or LVL 510 thousand (31/12/2010: EUR 1,286 thousand or LVL 904 thousand) for CERs contracts.



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In 2011 CO<sub>2</sub> emissions allowances forward contracts fair value changes are included in the Consolidated Income Statement in the amount of EUR 1,645 thousand or LVL 1,155 thousand (see Note 7) (31/12/2010: EUR 757 thousand or LVL 532 thousand).

In the table below fair value changes of CO<sub>2</sub> emission allowances forward contracts are disclosed:

|                                                            | 2011<br>LVL'000 | 2010<br>LVL'000 |
|------------------------------------------------------------|-----------------|-----------------|
|                                                            | Liabilities     | Liabilities     |
| <b>Outstanding fair value at the beginning of the year</b> | <b>3,442</b>    | <b>3,366</b>    |
| Included in accrued liabilities                            | -               | 608             |
| Included in the Consolidated Income Statement (Note 7)     | 1,155           | (532)           |
| <b>Outstanding fair value at the end of the year</b>       | <b>4,597</b>    | <b>3,442</b>    |

### 24 e) Forward foreign currencies exchange contracts

As at 31 December 2011 the Group has entered into EUR/USD and LVL/EUR forward foreign currencies exchange contracts. The notional principal amounts of the outstanding forward foreign currencies exchange contracts as at 31 December 2011 were USD 9.4 million or LVL 5.1 million (31/12/2010: USD 35.8 million or LVL 19.2 million) EUR/USD currency pair and EUR 42.0 million or LVL 29.5 million (31/12/2010: 0) LVL/EUR currency pair.

The hedged highly probable forecasted USD currency transactions are expected to occur at various dates during the next 21 months. Fair value gains and losses on EUR/USD forward foreign currencies exchange contracts as at 31 December 2011 are recognized in the hedging reserve in 'Other comprehensive income' (Note 19) as they qualify under IAS 39 requirements of hedge accounting.

All outstanding EUR/USD forward foreign currencies exchange contracts at 31 December 2011 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 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.

Agreed LVL/EUR forward foreign currencies exchange contracts will be settled at various dates during the next 4 months. Fair value gains and losses on LVL/EUR forward foreign currencies exchange contracts as at 31 December 2011 are recognized through profit or loss in the Consolidated Income Statement (Note 10).

In the table below fair value changes of forward foreign currencies exchange contracts are disclosed:

|                                                            | 2011<br>LVL'000 | 2010<br>LVL'000 |
|------------------------------------------------------------|-----------------|-----------------|
|                                                            | Assets          | Assets          |
| <b>Outstanding fair value at the beginning of the year</b> | <b>(564)</b>    | <b>-</b>        |
| Included in the Consolidated Income Statement (Note 10)    | (105)           | -               |
| Included in other comprehensive income (Note 19)           | 279             | (564)           |
| <b>Outstanding fair value at the end of the year</b>       | <b>(390)</b>    | <b>(564)</b>    |

## 25 RELATED PARTY TRANSACTIONS

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state. Related parties, other than subsidiaries and associates, are those companies in which the State exercises control or has significant influence.

The following transactions were carried out with related parties:

|                                                                   | 2011<br>LVL'000               | 2010<br>LVL'000               |
|-------------------------------------------------------------------|-------------------------------|-------------------------------|
| <b>a) Sales of goods:</b>                                         |                               |                               |
| - Associates (electricity sales)                                  | 2,448                         | 103                           |
| - Other related parties (heat sales)                              | 59,363                        | 60,536                        |
| <b>Total sales of goods to related parties:</b>                   | <b>61,811</b>                 | <b>60,639</b>                 |
| <b>b) Sales of services:</b>                                      |                               |                               |
| - Associates                                                      | 626                           | 13,659                        |
| - Other related parties                                           | 682                           | 800                           |
| <b>Total sales of services to related parties:</b>                | <b>1,308</b>                  | <b>14,459</b>                 |
| <b>c) Purchases of goods:</b>                                     |                               |                               |
| - Associates (electricity purchases)                              | 407                           | 335                           |
| - Other related parties (heat purchases)                          | 10,037                        | 10,723                        |
| <b>Total purchases of goods from related parties:</b>             | <b>10,444</b>                 | <b>11,058</b>                 |
| <b>d) Purchases of services:</b>                                  |                               |                               |
| - Associates                                                      | 2,277                         | 3,090                         |
| - Other related parties                                           | 1,493                         | 1,655                         |
| <b>Total purchases of services from related parties:</b>          | <b>3,770</b>                  | <b>4,745</b>                  |
|                                                                   | <b>31/12/2011<br/>LVL'000</b> | <b>31/12/2010<br/>LVL'000</b> |
| <b>e) Balances at the end of the year arising from sales:</b>     |                               |                               |
| <b>Trade receivables from:</b>                                    |                               |                               |
| - Associates                                                      | 432                           | 28                            |
| - Other related parties                                           | 10,000                        | 13,699                        |
| <b>Total trade receivables from related parties:</b>              | <b>10,432</b>                 | <b>13,727</b>                 |
| <b>f) Balances at the end of the year arising from purchases:</b> |                               |                               |
| <b>Trade payables to:</b>                                         |                               |                               |
| - Associates                                                      | 309                           | 138                           |
| - Other related parties                                           | 1,530                         | 2,013                         |
| <b>Total trade payables to related parties:</b>                   | <b>1,839</b>                  | <b>2,151</b>                  |
| <b>g) Accrued liabilities due to related party transactions:</b>  |                               |                               |
| - Other related parties                                           | 68                            | 78                            |
|                                                                   | <b>68</b>                     | <b>78</b>                     |

The Group has not created any provisions or incurred write-offs from transactions with related parties, as all debts are recoverable.

The transactions disclosed above do not include sales of electricity in the ordinary course of business of the Group due to a very large volume of those transactions and the fact that these transactions are performed at tariffs regulated by the Latvian Regulatory authority (Public Utilities Commission) applicable to other similar customers.

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 is disclosed in Note 8.

## 26 ISSUED GUARANTEES

|                                                                                                    | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|----------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Outstanding issued guarantees by the Group to guarantee obligations to third parties:</b>       |                       |                       |
| Guarantee on behalf of <i>Nordic Energy Link AS</i>                                                | 9,922                 | 10,825                |
| <b>Total outstanding issued guarantees by the Group to guarantee obligations to third parties:</b> | <b>9,922</b>          | <b>10,825</b>         |

Guarantee on behalf of *Nordic Energy Link AS* was provided for receiving long-term loan facility. The outstanding amount of the issued guarantee on behalf of *Nordic Energy Link AS* (validity term – December 15, 2014) is LVL 9,922 thousand (31/12/2010: LVL 10,825 thousand). The fair value of guarantee is LVL 335.6 thousand (31/12/2010: LVL 502 thousand). The fair value calculations are based on the estimated amount of service fee receivable discounted at EUR swap rates increased by average market margin of loans with respective maturities. During 2011 the average interest rate for discounting cash flow was 4.55% (2010: 2.57%).

## 27 CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2011 the Parent Company had commitments amounting to LVL 323.9 million (31/12/2010: LVL 221.7 million) for capital expenditure contracted but not delivered at the end of the reporting period.

The tax authorities may at any time inspect the books and records within 3 years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The Group's and the Parent Company's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

## 28 HELD-TO-MATURITY FINANCIAL ASSETS

There were no gains or losses realized on the disposal of held-to-maturity financial assets in 2011 (2010: 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 2011 the entire Group's held-to-maturity financial assets were State Treasury bills with 6 months and 12 months maturity, and the 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 are assumed to approximate their fair values.

|                                   | 2011<br>LVL'000 |             | 2010<br>LVL'000 |             |
|-----------------------------------|-----------------|-------------|-----------------|-------------|
| Outstanding amortised value:      | Current         | Non-current | Current         | Non-current |
| Held-to-maturity financial assets | 44,714          | 15,670      | 2,387           | -           |

## 29 EVENTS AFTER THE REPORTING PERIOD

Following to the Share Purchase Agreement concluded 30 December 2011 between Latvenergo AS and Republic of Latvia in person of Ministry of Finance and according to the entry in the Shareholders' Register of Augstsprieguma tīkls AS, dated 2 January 2012, since 2 January 2012 Augstsprieguma tīkls AS has been fully owned by Republic of Latvia in person of Ministry of Finance.

There have been no other 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 2011.

## 30 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 off. 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 will lease them out to *Augstsprieguma tīkls AS* who will continue providing electricity transmission services with those assets. Accordingly, the Group will continue purchasing transmission services from this entity, and will lease its assets and provide other necessary services to the entity necessary to the latter for providing these services. In 2011, such transactions represented intra-group transactions and were therefore eliminated; the major transactions comprised: purchase of transmission services in the amount of LVL 57,740 thousand, lease of transmission assets in the amount of LVL 22,813 thousand, and sales of electricity and other services in the amount of LVL 32,096 thousand.

Financial information disclosed below on discontinued operations includes result, net assets and cash flows of discontinued transmission business segment:

### Income Statement

|                                    | 2011<br>LVL'000 | 2010<br>LVL'000 |
|------------------------------------|-----------------|-----------------|
| Revenue                            | 3,804           | 2,980           |
| Other income                       | 342             | 43              |
| Raw materials and consumables used | (520)           | (279)           |
| Personnel expense                  | (1,751)         | (1,557)         |
| Other operating expenses           | (1,058)         | (1,419)         |
| <b>Operating profit / (loss)</b>   | <b>817</b>      | <b>(232)</b>    |
| <b>Profit / (loss) before tax</b>  | <b>817</b>      | <b>(232)</b>    |
| Income tax                         | (271)           | -               |
| <b>Profit for the year</b>         | <b>546</b>      | <b>(232)</b>    |

*Assets and liabilities of discontinued operations*

|                                              | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|----------------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                                |                       |                       |
| Current assets                               | 1,826                 | 662                   |
| <b>TOTAL:</b>                                | <b>1,826</b>          | <b>662</b>            |
| <b>LIABILITIES</b>                           |                       |                       |
| Provisions                                   | 127                   | 96                    |
| Trade payables and other current liabilities | 3,004                 | 1,619                 |
| <b>TOTAL:</b>                                | <b>3,131</b>          | <b>1,715</b>          |

*Cash flows of discontinued operations*

In 2011 operating cash flows of the discontinued transmission business segment amounts to LVL 998 thousand and investing cash outflows amounts to LVL 9 thousand.

## 31 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*

|                                                                                                  | 2011<br>LVL'000 | 2010<br>LVL'000 |
|--------------------------------------------------------------------------------------------------|-----------------|-----------------|
| Revenue                                                                                          | 700,914         | 650 374         |
| Other income                                                                                     | 2,327           | 2 322           |
| Income on transfer of operating segment                                                          | 577,989         | -               |
| Raw materials and consumables used                                                               | (325,818)       | (241 331)       |
| Personnel expense                                                                                | (21,454)        | (19,400)        |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | (101,140)       | (142,867)       |
| Other operating expenses                                                                         | (168,995)       | (189,165)       |
| <b>Operating profit</b>                                                                          | <b>663,823</b>  | <b>59,933</b>   |
| Income from investments in subsidiaries                                                          | 725             | -               |
| Finance costs, net                                                                               | (6,879)         | (10,929)        |
| <b>Profit before tax</b>                                                                         | <b>657,669</b>  | <b>49,004</b>   |
| Income tax                                                                                       | 295             | (6,399)         |
| <b>Profit for the year</b>                                                                       | <b>657,964</b>  | <b>42,605</b>   |

Statement of Financial Position

|                                        | 31/12/2011<br>LVL'000 | 31/12/2010<br>LVL'000 |
|----------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                          |                       |                       |
| Intangible assets                      | 8,065                 | 7,452                 |
| Property, plant and equipment          | 952,048               | 1,915,907             |
| Financial investment                   | 884,390               | 6,487                 |
| <b>Total non-current assets</b>        | <b>1,844,503</b>      | <b>1,929,846</b>      |
| Inventories                            | 4,697                 | 4,779                 |
| Receivables                            | 145,251               | 99,886                |
| Derivative financial instruments       | 2,450                 | 3,968                 |
| Held-to-maturity assets                | 44,715                | 2,387                 |
| Cash and cash equivalents              | 101,841               | 229,457               |
| <b>Total current assets</b>            | <b>298,954</b>        | <b>340,477</b>        |
| <b>TOTAL ASSETS</b>                    | <b>2,143,457</b>      | <b>2,270,323</b>      |
| <b>EQUITY</b>                          |                       |                       |
| Share capital                          | 325,862               | 323,544               |
| Non-current assets revaluation reserve | 411,959               | 978,137               |
| Hedge reserve                          | (8,246)               | (3,912)               |
| Other reserves                         | 9,562                 | -                     |
| Retained earnings                      | 657,964               | 42,605                |
| <b>Total equity</b>                    | <b>1,397,101</b>      | <b>1,340,374</b>      |
| <b>LIABILITIES</b>                     |                       |                       |
| Provisions                             | 3,918                 | 4,014                 |
| Borrowings                             | 454,783               | 500,127               |
| Deferred income tax liabilities        | 74,896                | 187,635               |
| Derivative financial instruments       | 10,629                | 7,088                 |
| Other non-current liabilities          | 3,932                 | 92,448                |
| <b>Total non-current liabilities</b>   | <b>548,158</b>        | <b>791,312</b>        |
| Borrowings                             | 60,642                | 40,232                |
| Trade and other payables               | 97,220                | 65,270                |
| Derivative financial instruments       | 13,470                | 4,910                 |
| Other current liabilities              | 26,866                | 28,225                |
| <b>Total current liabilities</b>       | <b>198,198</b>        | <b>138,637</b>        |
| <b>TOTAL EQUITY AND LIABILITIES</b>    | <b>2,143,457</b>      | <b>2,270,323</b>      |

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Translation from Latvian original\*

## **INDEPENDENT AUDITOR'S REPORT**

### **To the Shareholder of Latvenergo AS**

### **Report on the Consolidated Financial Statements**

We have audited the accompanying financial statements of Latvenergo AS and its subsidiaries ("the Group"), set out on pages 8 to 60 of the accompanying annual report which comprise the consolidated statement of financial position as of 31 December 2011 and the consolidated income statement and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

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

Management is responsible for the preparation and fair presentation of these consolidated 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.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

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### *Opinion*

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2011, 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**

We have read the Management Report for 2011 set out on pages 4 to 7 of the accompanying annual report for 2011 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the consolidated financial statements for 2011.

PricewaterhouseCoopers SIA  
Certified audit company  
Licence No. 5

A handwritten signature in blue ink, appearing to read "Ilandra Lejiņa".

Ilandra Lejiņa  
Certified auditor in charge  
Certificate No. 168

Member of the Board

Riga, Latvia  
22 May 2012

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



## **Latvenergo AS**

### **Consolidated Annual Report 2010**

**PREPARED IN ACCORDANCE WITH  
THE INTERNATIONAL FINANCIAL REPORTING STANDARDS  
AS ADOPTED BY EU**

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## Key Figures

|                                                               |         | 2006        | 2007        | 2008          | 2009            | 2010          |
|---------------------------------------------------------------|---------|-------------|-------------|---------------|-----------------|---------------|
| Revenue                                                       | LVL'000 | 292,132     | 361,629     | 475,856       | 500,513         | 574,690       |
| Including electricity sales                                   | LVL'000 | 235,219     | 302,167     | 386,205       | 404,723         | 475,411       |
| Heat sales                                                    | LVL'000 | 37,298      | 49,751      | 72,887        | 71,403          | 71,863        |
| EBITDA <sup>1)</sup>                                          | LVL'000 | 81,132      | 89,819      | 107,052       | 144,885         | 207,007       |
| EBITDA margin <sup>2)</sup>                                   |         | 28%         | 25%         | 22%           | 29%             | 36%           |
| Operating profit                                              | LVL'000 | 31,318      | 17,174      | 18,345        | 31,446          | 61,593        |
| Operating margin <sup>3)</sup>                                |         | 11%         | 5%          | 4%            | 6%              | 11%           |
| Net profit                                                    | LVL'000 | 24,034      | 7,507       | 7,328         | 19,556          | 44,325        |
| Dividends                                                     | LVL'000 | 6,505       | 2,123       | 13,001        | 20,230          | 35,000        |
| Net profit margin <sup>4)</sup>                               |         | 8%          | 2%          | 2%            | 4%              | 8%            |
| Return on assets (ROA) <sup>5)</sup>                          |         | 4,0%        | 0,8%        | 0,5%          | 1,2%            | 2,2%          |
| Return on equity (ROE) <sup>6)</sup>                          |         | 8,3%        | 1,5%        | 0,9%          | 2,2%            | 4,0%          |
| Non-current assets at the end of the year                     | LVL'000 | 572,885     | 1,201,742   | 1,475,618     | 1,462,114       | 1,942,231     |
| Total assets at the end of the year                           | LVL'000 | 649,092     | 1,315,958   | 1,680,567     | 1,699,491       | 2,279,266     |
| Total equity at the end of the year                           | LVL'000 | 298,333     | 711,671     | 866,331       | 889,440         | 1,344,748     |
| Borrowings from financial institutions at the end of the year | LVL'000 | 237,784     | 354,856     | 496,317       | 507,225         | 545,607       |
| Cash flow from operating activities                           | LVL'000 | 70,916      | 125,410     | 84,419        | 138,174         | 160,563       |
| Capital expenditure                                           | LVL'000 | 124,016     | 221,886     | 197,311       | 104,506         | 127,539       |
| Aggregate electricity sales to customers                      | GWh     | 6,294       | 6,704       | 6,655         | 5,884           | 6,889         |
| Electricity produced in power plants                          | GWh     | 4,424       | 4,127       | 4,567         | 4,871           | 5,869         |
| Total amount of purchased electricity                         | GWh     | 3,196       | 3,981       | 3,478         | 3,132           | 2,494         |
| Including purchased electricity from independent producers    | GWh     | 386         | 564         | 637           | 636             | 693           |
| Imported electricity                                          | GWh     | 2,810       | 3,417       | 2,841         | 2,496           | 1,801         |
| Aggregate heat sales                                          | GWh     | 2,959       | 2,871       | 2,629         | 2,594           | 2,922         |
| Number of employees at the end of the year                    |         | 5,441       | 5,353       | 5,375         | 4,701           | 4,517         |
| Moody's credit rating of the Parent Company                   |         | A2 (stable) | A2 (stable) | A3 (negative) | Baa3 (negative) | Baa3 (stable) |

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

<sup>2)</sup> EBITDA margin – EBITDA / revenue

<sup>3)</sup> Operating margin – operating profit / revenue

<sup>4)</sup> Net profit margin – net profit / revenue

<sup>5)</sup> 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)

<sup>6)</sup> 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)

## **Management Report**

### *Aspect of activity*

The public limited company Latvenergo or Latvenergo AS (hereinafter – the Parent Company) is an energy power supply enterprise engaged in generation and sale of electricity and thermal energy, electricity trade, as well as provision of IT and telecommunication services. Latvenergo AS is one of the largest corporate entities in Latvia.

2010 was the sixth reporting year with Latvenergo AS heading a corporate group. Latvenergo Group also includes six subsidiaries: Augstsprieguma tīkls AS, Sadales tīkls AS, Latvenergo Kaubandus OÜ, Latvenergo Prekyba UAB, Latvijas elektriskie tīkli AS and Liepājas enerģija SIA.

Augstsprieguma tīkls AS is a 100% subsidiary of Latvenergo AS. Since 1 September 2005 it performs the functions of the Latvian electricity transmission system operator (the respective license from the Public Utilities Commission is dated 8 June 2005).

Sadales tīkls AS, another 100% subsidiary of Latvenergo AS, has been formed on 1 September 2006 and registered in the Commercial Register of Latvia on 18 September 2006. Since 1 July 2007, it performs the functions of the Latvian electricity distribution system operator (under the license issued by the Public Utilities Commission on 21 February 2007).

Latvenergo Kaubandus OÜ, 100% subsidiary of Latvenergo AS, has been formed on 20 June 2007 and registered in the Commercial Register of Estonia on 27 June 2007. Under the license issued by the Estonian regulatory authority on 31 July 2007, Latvenergo Kaubandus OÜ performs electricity-trading activities in Estonia according to signed trade agreements from 1 August 2007.

Latvenergo Prekyba UAB, fully owned by Latvenergo AS, has been established on 20 December 2007 and registered in the Register of Legal Persons of Lithuania on 7 January 2008. Under the license issued by the Lithuanian regulatory authority, Latvenergo Prekyba UAB performs from 1 September 2009 electric energy import and export activities in Lithuania.

Latvijas elektriskie tīkli AS, 100% subsidiary of Latvenergo AS has been registered in the Commercial Register of Latvia on 10 February 2011. Since 1 April 2011 it provides electricity transmission system assets management functions.

Liepājas enerģija SIA, with Latvenergo AS having the controlling interest of 51%, was registered in the Commercial Register of Latvia on 6 July 2005. Since 1 November 2005, it renders district-heating supply services in Liepāja (thermal energy generation, transmission, distribution and trade license issued by the Municipal Public Service Regulator of Liepāja on 21 October 2005).

### *Financial results*

In 2010, the consolidated net sales of Latvenergo Group reached LVL 574.7 million exceeding the year 2009 result by LVL 74.2 million or 15%. Increase was achieved mainly by successful retail sales and wholesale electricity market operations.

The retail electricity sales to the electricity market clients in the Baltic States increased by LVL 46.6 million, including LVL 25.4 million growth of the sales to the Latvian electricity market clients and LVL 21.2 million – to the market clients in Estonia and Lithuania, where since 1 January 2010 and 1 April 2010 respectively electricity markets were liberalized. Currently, Lithuania has liberalized approximately 40% of its electricity market, and Estonia – 30%. The market share of Latvenergo Group of 95% has been retained in Latvia, but in the Baltic States it has reached 29%.



## **Management Report (continued)**

### ***Financial results (continued)***

In 2010, revenue from wholesale and export of electricity and its services increased by LVL 23.8 million and reached LVL 55.0 million. Major electricity export was to NordPool and BaltPool electric power exchanges. The electricity sales from the export to NordPool electric power exchange increased by LVL 11.8 million and reached LVL 20.4 million, while from the export to BaltPool electric power exchange, where trade operations were commenced on 1 January 2010, reached LVL 11.4 million. The growth of the wholesale electricity sales was facilitated by increased electricity market prices in the region and low outside temperatures during heating season, that provided opportunity to raise electricity generation at Riga's thermal power plants.

The Group's consolidated net profit for the year 2010 was LVL 44.3 million; it is LVL 24.8 million more than in 2009 (LVL 19.5 million). The consolidated net profit was positively affected by successful retail and wholesale market trade operations, selling electricity produced at Latvenergo Group's power plants. Conversely, the consolidated net profit was negatively affected by incurred losses of the subsidiaries providing distribution and transmission services in amount of LVL 6.8 million. In 2010, Sadales tīkls AS reported a net loss of LVL 5.2 million, but Augstsprieguma tīkls AS – LVL 1.6 million.

In 2010, Latvenergo Group's aggregate electricity sales amounted to 6,889 GWh (in Estonia and Lithuania – to 700 GWh), that is by 1,004 GWh or 17% more than in 2009. Heat sales amounted to 2,922 GWh in 2010 and were by 328 GWh or 13% more than in 2009.

5,869 GWh of electricity were produced in the power plants of Latvenergo Group in 2010, that is by 998 GWh or 20% more than in 2009. The increase in electricity produced was primarily impacted by greater electricity generation at Riga's thermal power plants. Difference between electricity produced and electricity consumed by Group's clients was purchased at an electric power exchange or bought from independent producers. The total amount of Latvenergo Group's purchased electricity in 2010 decreased to 2,495 GWh (2009: 3,132 GWh). In 2010 Latvenergo Group purchased electricity from independent producers in amount of 693 GWh (2009: 636 GWh).

In 2010, capital expenditures of Latvenergo Group totalled LVL 127.5 million. The major Group's capital expenditures were invested into the power generation plants totalled LVL 76.7 million or 60%. The capital expenditures into the reconstruction and development of distribution system totalled LVL 26.2 million, but into the transmission system - LVL 7.4 million. In 2010, the major capital expenditures in amount of LVL 66.4 million were made for the project of reconstruction of Riga's CHPP-2 (Combined Heat and Power Plant second power generation unit).

At the end of 2010, the value of non-current assets of Latvenergo Group was LVL 1,942.2 million, which is by LVL 480.1 million or 33% more than at the end of previous year. Increase in the value of non-current assets was caused by revaluation of distribution system assets. As a result of revaluation of distribution system assets all the most significant positions of non-current assets of Latvenergo Group are revalued at the end of 2010.

The total Group's non-current and current borrowings from financial institutions increased by LVL 38.4 million and reached LVL 545.6 million at the end of 2010 (2009: LVL 507.2 million). The value of cash and cash equivalents of Latvenergo Group, at the end of 2010, reached LVL 234.3 million, which is by LVL 79.4 million more than at the end of previous year. The borrowings from financial institutions were raised to provide funding for commenced capital expenditure projects.

## **Management Report (continued)**

### *Financial results (continued)*

At the end of 2010, the total equity of Latvenergo Group was LVL 1,344.7 million, which is by LVL 455.3 million more than at the end of the year 2009. Relevant increase in the equity was caused by the revaluation reserve results of the revaluation of distribution system assets. The total equity composes 59% of the total assets at the end of 2010.

### *Group's strategic development*

New long-term strategy of Latvenergo Group has been started to design. It will focus on long-term value enhancement and profitable growth. Latvenergo Group and the Parent Company had defined six strategic goals for the time period 2011-2016:

- Increase the value of Latvenergo Group and the Parent Company in long-term by ensuring competitive return on investment,
- Ensure aligned positioning in all three Baltic markets as domestic, environmentally friendly electricity retailer,
- Develop diversified and environmentally friendly energy generation portfolio,
- Ensure optimal operations and high competitiveness in comparison to similar companies,
- Achieve customer centric approach in fulfilling client expectations in economically viable way,
- Acknowledge Latvenergo Group as socially responsible group.

2010 was the year of Latvenergo Group expansion to gradually opening electricity markets in Estonia and Lithuania and goal for 2011 is to reach 10% of the market share in these markets. Latvia is a way ahead to other Baltic countries because the major electricity consumers have an obligation to buy electricity in open market already since May 2008.

According to strategic intention Latvenergo Group plans to act in all three Baltic markets as domestic actor. Such ambition requires development of sales structure, client servicing systems and supporting infrastructure. Project was started in 2010 and full implementation is expected by 2013.

Preparation to introduce 3<sup>rd</sup> energy package were carried out in 2010 by splitting TSO (transmission system operator) in a separate legal entity. This effort shall be completed in 2011.

In 17 June 2009 prime ministers of Baltic Sea countries along with President of European Commission signed a Memorandum of Understanding confirming the BEMIP (Baltic Energy Market Integration Plan), which foresees also the opening of the retail electricity markets in Estonia and Lithuania. Latvenergo Group is actively participating in BEMIP implementation in areas of market liberalization and establishing new interconnections.

Strategic goals also include modernization of electricity generation capacity and participation in Baltic joint assessment and implementation of new generation capacities.

During the 2011 Latvenergo Group will continue the renovation and modernization programs for electricity generation system. During the year 2010 Latvenergo Group has continued the renovation and modernization of its power plant's system and also ongoing investment programs for electricity generation. Riga TEC - 2 CHPP second power generation unit modernizations has been started.

Latvenergo Group will also carry on improvement of Daugava's hydroelectric constructions safety.

## **Management Report (continued)**

### ***Group's strategic development (continued)***

The investments in transmission and distribution system assets have continued within available funding to provide customers with new connections and additional power and to comply with safety standards and licensing requirements. At the same time customer-servicing efficiency has been increased.

In TSO area Kurzemes ring investment project, that has been started and in the middle of year 2010, EU financial contribution from EEPR (European Economic Recovery Plan) program has been finally confirmed. Kurzemes ring investment program is a part of BEMIP and it is planned to finalize the program by 2018-2020. In 2010 *Environmental impact assessment* has been started and the first investments have been made.

Latvenergo Group in accordance with approved strategy of 2008-2010 and goals for 2010 has continued to investigate new generation capacity feasibility in Latvia and Baltics in areas of renewable energy and cogeneration.

To increase Latvenergo Group's and the Parent Company's competitiveness, further optimization of support functions and increase of efficiency is continued; also new niche business opportunities with environmentally friendly potential are assessed.

### ***Financial risk management***

The Group faces various financial risks, mostly credit risk, liquidity risk, currency and interest rate risk, as well as risk of fair value fluctuation of financial assets and liabilities. The Parent Company's management strives to minimize possible negative influence of financial risks on the Group's or the Parent Company's financial position by executing regular credit risk analysis and control, as well as regular customer credit control activities. The Group follow prudent liquidity risk control to assure appropriate and sufficient availability of funds to meet its obligations.

### ***Financial instruments***

The major financial instruments of the Group are non-current and current borrowings from financial institutions, trade receivables and payables, derivative financial instruments (interest rate swaps, electricity swaps, CO<sub>2</sub> emissions allowances forward contracts) and cash. The main objective of borrowings is to finance the Group's operating activities and investments in property, plant and equipment.

### ***Management of the Parent Company***

Since 16 November 2006 until 22 June 2010, the Management Board of Latvenergo AS was comprised of the following members: Kārlis Miķelsons (Chairman), Uldis Bariss, Arnis Daugulis, Arnis Kurgs and Aigars Melko.

Reposing on Shareholder's resolution, Kārlis Miķelsons (Chairman) and Aigars Melko were removed from the composition of the Management Board of Latvenergo AS since 22 June 2010, and the Management Board since 22 June 2010 until 1 November 2010 was comprised of the following members: Uldis Bariss (Chairman), Arnis Daugulis and Arnis Kurgs.

Since 1 November 2010 Māris Kuņickis has been acting as a member of the Management Board of Latvenergo AS and until 15 November it was comprised of the following members: Uldis Bariss (Chairman), Māris Kuņickis, Arnis Daugulis and Arnis Kurgs.

Since 15 November 2010 as a Chairman of the Management Board of Latvenergo AS has been appointed Āris Žīgurs and since 15 November 2010 until the date of signing off this Annual



## Management Report (continued)

### Management of the Parent Company (continued)

Report, the Management Board of Latvenergo AS includes the following members: Āris Žīgurs (Chairman), Uldis Bariss, Māris Kuņickis, Arnis Daugulis and Arnis Kurgs.

### Events after the reporting period

On 10 February 2011 Latvijas elektriskie tīkli AS – 100% subsidiary of Latvenergo AS has been registered in the Commercial Register of Latvia.

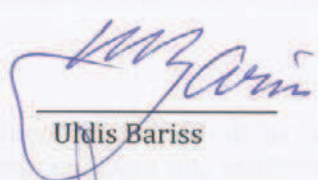
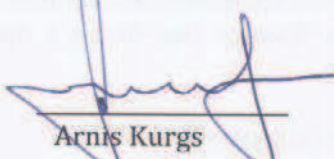
After the reporting period, there have been no events that would materially affect the financial position of the Group as at 31 December 2010.

### 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 2011" the Management Board of Latvenergo AS proposes to allocate LVL 35,000,000 to be paid out in dividends and to reinvest the remaining profit portion of LVL 9,562,097 as share capital of the Parent Company.

The distribution of profit for 2010 is subject to a resolution of Latvenergo AS Shareholders' meeting.

The Management Board of Latvenergo AS:

|                                                                                                                         |                                                                                                              |                                                                                                                 |
|-------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------|
| <br>_____<br>Āris Žīgurs<br>Chairman | <br>_____<br>Uldis Bariss | <br>_____<br>Māris Kuņickis |
| <br>_____<br>Arnis Daugulis          | <br>_____<br>Arnis Kurgs  |                                                                                                                 |

24 May 2011



## Consolidated Income Statement

|                                                                                                  | Notes    | 2010<br>LVL'000 | 2009<br>LVL'000 |
|--------------------------------------------------------------------------------------------------|----------|-----------------|-----------------|
| Revenue                                                                                          | 5        | 574,690         | 500,513         |
| Other income                                                                                     | 6        | 2,716           | 6,281           |
| Raw materials and consumables used                                                               | 7        | (278,193)       | (261,681)       |
| Personnel expenses                                                                               | 8        | (57,693)        | (60,601)        |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | 12a, 13a | (145,414)       | (113,439)       |
| Other operating expenses                                                                         | 9        | (34,513)        | (39,627)        |
| <b>Operating profit</b>                                                                          |          | <b>61,593</b>   | <b>31,446</b>   |
| Finance income                                                                                   | 10a      | 6,734           | 10,769          |
| Finance costs                                                                                    | 10b      | (17,750)        | (18,243)        |
| Share of profit of associates                                                                    | 14       | 203             | 198             |
| <b>Profit before income tax</b>                                                                  |          | <b>50,780</b>   | <b>24,170</b>   |
| Income tax                                                                                       | 11       | (6,455)         | (4,614)         |
| <b>Profit for the year</b>                                                                       |          | <b>44,325</b>   | <b>19,556</b>   |
| <b>Attributable to:</b>                                                                          |          |                 |                 |
| - Owners of the Parent Company                                                                   |          | 43,847          | 19,370          |
| - Non-controlling interest                                                                       |          | 478             | 186             |

## Consolidated Statement of Comprehensive Income

|                                                                | Notes | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------------------------|-------|-----------------|-----------------|
| <b>Profit for the year</b>                                     |       | <b>44,325</b>   | <b>19,556</b>   |
| <b>Other comprehensive income:</b>                             |       |                 |                 |
| Gains/(losses) on revaluation of property, plant and equipment | 19    | 423,291         | (1,445)         |
| Disposal of property, plant and equipment revaluation reserve  | 19    | 1,957           | 1,701           |
| Currency translation differences                               |       | 8               | -               |
| Gains/(losses) from change in hedge reserve                    | 19    | (375)           | 9,403           |
| <b>Other comprehensive income for the year, net of tax</b>     |       | <b>424,881</b>  | <b>9,659</b>    |
| <b>Total comprehensive income for the year</b>                 |       | <b>469,206</b>  | <b>29,215</b>   |
| <b>Attributable to:</b>                                        |       |                 |                 |
| - Owners of the Parent Company                                 |       | 468,728         | 29,029          |
| - Non-controlling interest                                     |       | 478             | 186             |

The notes on pages 13 to 62 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

Āris Žīgurs  
Chairman

Arnis Daugulis

Uldis Bariss

Arnis Kurgs

Māris Kuņickis



## Consolidated Statement of Financial Position

|                                                            | Notes | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|------------------------------------------------------------|-------|-----------------------|-----------------------|
| <b>ASSETS</b>                                              |       |                       |                       |
| <b>Non-current assets</b>                                  |       |                       |                       |
| Intangible assets                                          | 12a   | 7,478                 | 8,192                 |
| Property, plant and equipment                              | 13a   | 1,928,810             | 1,448,044             |
| Investment property                                        | 13c   | 382                   | 436                   |
| Investments in associates                                  | 14    | 4,464                 | 4,261                 |
| Other non-current receivables                              |       | 172                   | 249                   |
| Deferred income tax assets                                 | 11    | 925                   | 932                   |
| <b>Total non-current assets</b>                            |       | <b>1,942,231</b>      | <b>1,462,114</b>      |
| <b>Current assets</b>                                      |       |                       |                       |
| Inventories                                                | 15    | 11,501                | 13,043                |
| Trade receivables                                          | 16a   | 63,031                | 48,963                |
| Income tax prepayment                                      |       | -                     | 775                   |
| Other receivables                                          | 16b   | 21,882                | 19,513                |
| Derivative financial instruments                           | 24e   | 3,968                 | 145                   |
| Investments in held-to-maturity financial assets           | 28    | 2,387                 | -                     |
| Cash and cash equivalents                                  | 17    | 234,266               | 154,938               |
| <b>Total current assets</b>                                |       | <b>337,035</b>        | <b>237,377</b>        |
| <b>TOTAL ASSETS</b>                                        |       | <b>2,279,266</b>      | <b>1,699,491</b>      |
| <b>EQUITY</b>                                              |       |                       |                       |
| <b>Equity attributable to owners of the Parent Company</b> |       |                       |                       |
| Share capital                                              | 18    | 323,544               | 317,653               |
| Non-current assets revaluation reserve                     | 19    | 976,180               | 552,889               |
| Hedge reserve                                              | 19    | (3,912)               | (3,537)               |
| Other reserves                                             | 19    | 10                    | 2                     |
| Retained earnings                                          |       | 46,356                | 20,782                |
|                                                            |       | <b>1,342,178</b>      | <b>887,789</b>        |
| <b>Non-controlling interest</b>                            |       | <b>2,570</b>          | <b>1,651</b>          |
| <b>Total equity</b>                                        |       | <b>1,344,748</b>      | <b>889,440</b>        |
| <b>LIABILITIES</b>                                         |       |                       |                       |
| <b>Non-current liabilities</b>                             |       |                       |                       |
| Borrowings                                                 | 20    | 506,756               | 483,652               |
| Deferred income tax liabilities                            | 11    | 187,635               | 118,040               |
| Provisions for post-employment benefits                    | 21a   | 7,321                 | 7,473                 |
| Environmental provisions                                   | 21b   | 1,376                 | 1,376                 |
| Derivative financial instruments                           | 24e   | 7,088                 | 10,135                |
| Other liabilities and deferred income                      | 22    | 94,889                | 78,445                |
| <b>Total non-current liabilities</b>                       |       | <b>805,065</b>        | <b>699,121</b>        |
| <b>Current liabilities</b>                                 |       |                       |                       |
| Trade and other payables                                   | 23    | 82,356                | 73,226                |
| Income tax payable                                         |       | 3,336                 | 3,729                 |
| Borrowings                                                 | 20    | 38,851                | 23,573                |
| Derivative financial instruments                           | 24e   | 4,910                 | 10,402                |
| <b>Total current liabilities</b>                           |       | <b>129,453</b>        | <b>110,930</b>        |
| <b>TOTAL EQUITY AND LIABILITIES</b>                        |       | <b>2,279,266</b>      | <b>1,699,491</b>      |

The notes on pages 13 to 62 are an integral part of these Consolidated Financial Statements.

The Management Board of Latvenergo AS:

Aris Žigurs  
Chairman

Arnis Daugulis

Uldis Bariss

Arnis Kungs

Māris Kuņickis



## Consolidated Statement of Changes in Equity

|                                                                            | Notes         | Attributable to owners of the Parent Company |                |                   |                  | Non-controlling interest | TOTAL            |
|----------------------------------------------------------------------------|---------------|----------------------------------------------|----------------|-------------------|------------------|--------------------------|------------------|
|                                                                            |               | Share capital                                | Reserves       | Retained earnings | Total            |                          |                  |
|                                                                            |               | LVL'000                                      | LVL'000        | LVL'000           | LVL'000          | LVL'000                  | LVL'000          |
| <b>As at 31 December 2008</b>                                              |               | <b>311,150</b>                               | <b>545,212</b> | <b>8,896</b>      | <b>865,258</b>   | <b>1,073</b>             | <b>866,331</b>   |
| Increase in share capital                                                  | 18            | 6,503                                        | -              | -                 | 6,503            | -                        | 6,503            |
| Adjustment of prior period                                                 |               | -                                            | (3,816)        | 3,816             | -                | -                        | -                |
| Dividends for 2008                                                         | 19            | -                                            | -              | (13,001)          | (13,001)         | -                        | (13,001)         |
| Non-controlling interest arising on increase in subsidiary's share capital |               | -                                            | -              | -                 | -                | 392                      | 392              |
| <b>Income/(loss) recognized directly in equity:</b>                        |               |                                              |                |                   |                  |                          |                  |
| Change in hedge reserve                                                    | 19            | -                                            | 9,403          | -                 | 9,403            | -                        | 9,403            |
| Revaluation of property, plant and equipment                               | 19            | -                                            | (1,445)        | 1,701             | 256              | -                        | 256              |
| <b>Total income recognized directly in equity for the year</b>             |               | <b>-</b>                                     | <b>7,958</b>   | <b>1,701</b>      | <b>9,659</b>     | <b>-</b>                 | <b>9,659</b>     |
| Profit for the year                                                        |               | -                                            | -              | 19,370            | 19,370           | 186                      | 19,556           |
| <b>Total comprehensive income for the year</b>                             |               | <b>-</b>                                     | <b>7,958</b>   | <b>21,071</b>     | <b>29,029</b>    | <b>186</b>               | <b>29,215</b>    |
| <b>As at 31 December 2009</b>                                              | <b>18, 19</b> | <b>317,653</b>                               | <b>549,354</b> | <b>20,782</b>     | <b>887,789</b>   | <b>1,651</b>             | <b>889,440</b>   |
| Increase in share capital                                                  | 18            | 5,891                                        | -              | -                 | 5,891            | -                        | 5,891            |
| Dividends for 2009                                                         | 19            | -                                            | -              | (20,230)          | (20,230)         | -                        | (20,230)         |
| Non-controlling interest arising on increase in subsidiary's share capital |               | -                                            | -              | -                 | -                | 441                      | 441              |
| <b>Income/(loss) recognized directly in equity:</b>                        |               |                                              |                |                   |                  |                          |                  |
| Change in hedge reserve                                                    | 19            | -                                            | (375)          | -                 | (375)            | -                        | (375)            |
| Currency translation differences                                           | 19            | -                                            | 8              | -                 | 8                | -                        | 8                |
| Revaluation of property, plant and equipment                               | 19            | -                                            | 423,291        | 1,957             | 425,248          | -                        | 425,248          |
| <b>Total income recognized directly in equity for the year</b>             |               | <b>-</b>                                     | <b>422,924</b> | <b>1,957</b>      | <b>424,881</b>   | <b>-</b>                 | <b>424,881</b>   |
| Profit for the year                                                        |               | -                                            | -              | 43,847            | 43,847           | 478                      | 44,325           |
| <b>Total comprehensive income for the year</b>                             |               | <b>-</b>                                     | <b>422,924</b> | <b>45,804</b>     | <b>468,728</b>   | <b>478</b>               | <b>469,206</b>   |
| <b>As at 31 December 2010</b>                                              | <b>18, 19</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> |

The notes on pages 13 to 62 are an integral part of these Consolidated Financial Statements.

## Consolidated Statement of Cash Flows

|                                                                                           | Notes     | 2010<br>LVL'000  | 2009<br>LVL'000 |
|-------------------------------------------------------------------------------------------|-----------|------------------|-----------------|
| <b>Cash flows from operating activities</b>                                               |           |                  |                 |
| Profit before tax                                                                         |           | 50,780           | 24,170          |
| <b>Adjustments for:</b>                                                                   |           |                  |                 |
| - Amortisation and depreciation                                                           | 12a, 13a  | 119,056          | 94,091          |
| - Impairment of non-current assets                                                        | 13        | 26,357           | 19,348          |
| - Loss from disposal of non-current assets                                                |           | 1,771            | 3,623           |
| - Investments accounting at equity method                                                 | 14        | (203)            | (198)           |
| - Interest expense                                                                        | 10b       | 14,383           | 16,423          |
| - Interest income                                                                         | 10a       | (5,351)          | (9,822)         |
| - Fair value (gains) / losses on derivative financial instruments                         | 7, 10     | (13,345)         | 9,894           |
| - Changes in provisions                                                                   | 21        | (152)            | (2,630)         |
| - Losses on currency translation differences                                              | 10b       | 1,142            | 357             |
| Decrease in inventories                                                                   |           | 1,542            | 6,084           |
| (Increase) / decrease in receivables                                                      |           | (16,361)         | 11,419          |
| Increase / (decrease) in payables, accrued expense, deferred income and other liabilities |           | 1,649            | (26,941)        |
| <b>Cash generated from operations</b>                                                     |           | <b>181,268</b>   | <b>145,818</b>  |
| Interest paid                                                                             |           | (14,889)         | (16,118)        |
| Interest received                                                                         |           | 5,352            | 9,822           |
| Income tax paid                                                                           |           | (11,168)         | (1,348)         |
| <b>Net cash generated from operating activities</b>                                       |           | <b>160,563</b>   | <b>138,174</b>  |
| <b>Cash flows from investing activities</b>                                               |           |                  |                 |
| Proceeds from sale of intangible assets and PPE                                           |           | 301              | 847             |
| Purchase of intangible assets and PPE                                                     |           | (107,812)        | (91,449)        |
| <b>Net cash used in investing activities</b>                                              |           | <b>(107,511)</b> | <b>(90,602)</b> |
| <b>Cash flows from financing activities</b>                                               |           |                  |                 |
| Proceeds on financing from EU funds                                                       |           | 10,575           | 1,050           |
| Purchase of state treasury bills                                                          | 28        | (2,387)          | -               |
| Proceeds on borrowings from credit institutions                                           | 20        | 60,041           | 35,140          |
| Repayment of borrowings                                                                   | 20        | (22,164)         | (21,658)        |
| Non-controlling interest's contribution to subsidiaries' share capital                    |           | 441              | 392             |
| Dividends paid                                                                            |           | (20,230)         | (11,108)        |
| <b>Net cash generated from financing activities</b>                                       |           | <b>26,276</b>    | <b>3,816</b>    |
| <b>Net increase in cash and cash equivalents</b>                                          |           | <b>79,328</b>    | <b>51,388</b>   |
| Cash and cash equivalents at the beginning of the year                                    |           | 154,938          | 103,550         |
| <b>Cash and cash equivalents at the end of the year</b>                                   | <b>17</b> | <b>234,266</b>   | <b>154,938</b>  |

The notes on pages 13 to 62 are an integral part of these Consolidated Financial Statements.

# Notes to the Consolidated Financial Statements

## 1 CORPORATE INFORMATION

All of the shares of public limited company Latvenergo or Latvenergo AS 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 Consolidated Financial Statements for year 2010 include the financial information in respect of the Parent Company and its all subsidiaries (hereinafter – the Group) for the annual period ending 31 December 2010 and comparative information for annual period ending 31 December 2009.

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.

The Group also includes six subsidiaries: Augstsprieguma tīkls AS, Sadales tīkls AS, Latvijas elektriskie tīkli AS, Latvenergo Kaubandus OÜ, Latvenergo Prekyba UAB and Liepājas enerģija SIA.

Subsidiary Augstsprieguma tīkls AS performs the functions of the Latvian electricity transmission system operator.

Subsidiary Sadales tīkls AS performs the functions of the Latvian electricity distribution system operator.

Subsidiary Latvijas elektriskie tīkli AS provides the functions of electricity transmission system assets operation, management and maintenance.

Latvenergo Kaubandus OÜ has been formed on 20 June 2007. It renders electricity-trading services in Estonia and has concluded cross-border deals.

Latvenergo Prekyba UAB has been established on 20 December 2007. It renders electricity-trading services in Lithuania and has concluded cross-border deals.

Liepājas enerģija SIA renders district-heating supply services in Liepāja (thermal energy generation, transmission, distribution and trade).

The Parent Company's associate Nordic Energy Link AS carries out the functions of the operator of an interconnection power cable between Estonia and Finland.

The Parent Company's associate Pirmais Slēgtais Pensiju Fonds AS manages a defined-contribution corporate pension plan in Latvia.

Latvenergo AS Management Board has approved for issue the Consolidated Financial Statements on 24 May 2011. 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 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, available-for-sale financial assets, and 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 thousand of Latvian Lats (LVL), unless stated otherwise.

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.

#### **2.1.1. Adoption of new and revised standards and interpretations**

##### **(a) Amendments to standards relevant and adopted by the Group for the current accounting period**

The certain new or revised standards and interpretations of International Financial Reporting Standards (IFRS) and amendments to International Accounting Standards (IAS) became effective for the Group from accounting periods beginning on 1 January 2010:

##### *Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009*

The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The amendments haven't a significant effect on these Consolidated Financial Statements.

##### *IAS 27, Consolidated and Separate Financial Statements, revised in January 2008*

The revised IAS 27 requires the Group to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the previous standard required the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how the Group should measure any gain or loss arising on the loss of control of a subsidiary. At the

date when control is lost, any investment retained in the former subsidiary has to be measured at its fair value. The amended standard has no impact on these Consolidated Financial Statements, as none of the non-controlling interests have a deficit balance, there have been no transactions whereby an interest in an entity is retained after the loss of control of that entity, and there have been no transactions with non-controlling interests.

*Eligible Hedged Items - Amendment to IAS 39*

The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment did not have an impact on these Consolidated Financial Statements.

*Improvements to International Financial Reporting Standards, issued in April 2009*

In April 2009, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to *IFRS*. The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of *IFRS 2*; clarification of disclosure requirements set by *IFRS 5* and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under *IFRS 8* only if such amounts are regularly provided to the chief operating decision maker; amending *IAS 1* to allow classification of certain liabilities settled by the Parent Company's own equity instruments as non-current; changing *IAS 7* such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under *IAS 17* even without transfer of ownership of the land at the end of the lease; providing additional guidance in *IAS 18* for determining whether the Parent Company acts as a principal or an agent; clarification in *IAS 36* that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing *IAS 38* regarding measurement of fair value of intangible assets acquired in a business combination; amending *IAS 39* (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending *IFRIC 9* to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in *IFRIC 16* that hedging instruments may not be held by the foreign operation that itself is being hedged. The improvements to *IFRS* did not have a material impact on these Consolidated Financial Statements.

**(b) Interpretations and amendments to standards adopted for the current accounting period but not relevant to the Group's operations**

The certain new or revised standards and *IFRIC* interpretations that became effective for accounting periods beginning on 1 January 2010, but that is not relevant to the Group's operations, has been published or amended:

*IFRIC 12, Service Concession Arrangements*

The interpretation contains guidance on applying the existing standards by service providers in public-to-private service concession arrangements. Application of *IFRIC 12* did not have any impact on the Group's Consolidated Financial Statements because it is not subject to any service concession arrangements.

*IFRIC 15, Agreements for the Construction of Real Estate*

The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of *IAS 11* or *IAS 18*. It also provides criteria for determining when entities should recognize revenue on such transactions. The amendment did not have any material impact on these Consolidated Financial Statements.

*IFRIC 16, Hedges of a Net Investment in a Foreign Operation*

The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The *IFRIC* allows the hedging instrument to be held by the Parent Company or entities within the Group except the foreign operation that it is being hedged. The interpretation also clarifies how the currency translation gain or loss reclassified from other comprehensive income to profit or loss is calculated on disposal of the hedged foreign operation. The Group applies *IAS 39* to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in *IFRIC 16*. *IFRIC 16* did not have an impact on these Consolidated Financial Statements.

*IFRIC 17, Distributions of Non-Cash Assets to Owners*

The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. The Group should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets is recognised in profit or loss for the year when the entity settles the dividend payable. *IFRIC 17* did not have an impact on these Consolidated Financial Statements.

*IFRIC 18, Transfers of Assets from Customers*

The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. The Group has assessed the impact of *IFRIC 18* on the recognition of connection fees and determined that the existing accounting policy is in compliance with the principles of *IFRIC 18*, because the revenue from connection fees is recognised as income on a straight line basis over the estimated customer relationship period, and so the interpretation does not have any impact on these Consolidated Financial Statements.

*IFRS 3, Business Combinations, revised in January 2008*

The revised *IFRS 3* allows entities to choose to measure non-controlling interests using the existing *IFRS 3* method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised *IFRS 3* is more detailed in providing guidance on the application of the purchase method to business combinations. The requirements to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer has to re-measure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. Acquisition-related costs are accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer has to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date are recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised *IFRS 3* brings into its scope business combinations involving also mutual entities and business combinations achieved by



contract alone. The revised *IFRS 3* did not have a material impact on these Consolidated Financial Statements.

*Amendment to IFRS 5, Non-current Assets Held for Sale and Discontinued Operations (and consequential amendments to IFRS 1)*

This amendment to *IFRS 5* is part of the *IASB's* annual improvements project published in May 2008. The amendment clarifies that the Parent Company committed to a sale plan involving loss of control of a subsidiary would classify the subsidiary's assets and liabilities as held for sale. The revised guidance should be applied prospectively from the date at which the Parent Company first applied *IFRS 5*. The amendment did not have a material impact on these Consolidated Financial Statements.

*IFRS 1, First-time Adoption of International Financial Reporting Standards, revised in December 2008*

The revised *IFRS 1* retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group assessed that the revised standard did not have any effect on these Consolidated Financial Statements.

*Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2*

The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in *IFRIC 8* and *IFRIC 11*, which are withdrawn. The amendments expand on the guidance given in *IFRIC 11* to address plans that were previously not considered in the interpretation. The amendments also clarify the defined terms in the Appendix to the standard. The amendments did not have a material impact on these Consolidated Financial Statements.

*Additional Exemptions for First-time Adopters - Amendments to IFRS 1*

The amendments provide an additional exemption for measurement of oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with *IFRIC 4, 'Determining Whether an Arrangement Contains a Lease'* when the application of their national accounting requirements produced the same result. The amendments did not have any impact on these Consolidated Financial Statements.

**(c) Standards, interpretations and amendments to standards relevant but not early adopted by the Group**

The certain new and revised *IAS*, *IFRS* and *IFRIC* interpretations that are mandatory for accounting periods beginning on or after 1 January 2011, but that have not been early adopted by the Group:

*Classification of Rights Issues - Amendment to IAS 32, issued in October 2009*

The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives. The Group does not expect the amendment to have any material effect on its Consolidated Financial Statements.

*Amendment to IAS 24, Related Party Disclosures, issued in November 2009*

The amended standard simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The Group is currently assessing the impact of the amended standard on disclosures in its Consolidated Financial Statements.

*Prepayments of a Minimum Funding Requirement - Amendment to IFRIC 14*

This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of *IFRIC 14* related to voluntary pension prepayments when there is a minimum funding requirement. The Group is currently assessing the impact of the amended interpretation on its Consolidated Financial Statements.

*IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments*

This *IFRIC* clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the profit and loss account based on the fair value of the equity instruments compared to the carrying amount of the debt. The Group does not expect *IFRIC 19* to have any material effect on its Consolidated Financial Statements.

*Limited exemption from comparative IFRS 7 disclosures for first-time adopters - Amendment to IFRS 1*

Existing IFRS preparers were granted relief from presenting comparative information for the new disclosures required by the March 2009 amendments to *IFRS 7 'Financial Instruments: Disclosures'*. This amendment to *IFRS 1* provides first-time adopters with the same transition provisions as included in the amendment to *IFRS 7*. The Group does not expect the amendment to have any effect on its Consolidated Financial Statements.

**2.1.2. New or revised standards and interpretations not yet adopted by the Group**

**(a) Interpretations and amendments to existing standards that are not yet effective but relevant for the Group's operations**

*IFRS 9, Financial Instruments Part 1: Classification and Measurement (effective for annual periods beginning on or after 1 January 2013; not yet adopted by the EU)*

*IFRS 9* issued in November 2009 replaces those parts of *IAS 39* relating to the classification and measurement of financial assets. *IFRS 9* was further amended in October 2010 to address the classification and measurement of financial liabilities. Key features are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other

comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated as at fair value through profit or loss in other comprehensive income.

The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

*Disclosures - Transfers of Financial Assets - Amendments to IFRS 7 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU)*

The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party yet remain on the entity's statement of financial position. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Group is currently assessing the impact of the amended standard on disclosures in its Consolidated Financial Statements.

*Deferred Tax: Recovery of Underlying Assets - Amendment to IAS 12 (effective for annual periods beginning on or after 1 January 2012; not yet adopted by the EU)*

The amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. The Group is currently assessing the impact of the amended standard on its Consolidated Financial Statements.

*Improvements to International Financial Reporting Standards, issued in May 2010 (effective dates vary standard by standard, most improvements are effective for annual periods beginning on or after 1 January 2011; the improvements have not yet been adopted by the EU)*

The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on acquiree's share-based payment arrangements that were not replaced or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets

that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date and not the amount obtained during the reporting period; *IAS 1* was amended to clarify that the components of the statement of changes in equity include profit or loss, other comprehensive income, total comprehensive income and transactions with owners and that an analysis of other comprehensive income by item may be presented in the notes; *IAS 27* was amended by clarifying the transition rules for amendments to *IAS 21, 28* and *31* made by the revised *IAS 27* (as amended in January 2008); *IAS 34* was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and *IFRIC 13* was amended to clarify measurement of fair value of award credits. The Group is considering implications of the improvements to *IFRS* on its Consolidated Financial Statements.

**(b) Interpretations and amendments to existing standards that are not yet effective and not relevant for the Group's operations**

*Severe hyperinflation and removal of fixed dates for first-time adopters - Amendment to IFRS 1 (effective for annual periods beginning on or after 1 July 2011; not yet adopted by the EU)*

The amendments will provide relief for first-time adopters of *IFRSs* from having to reconstruct transactions that occurred before their date of transition to *IFRSs*, and guidance for entities emerging from severe hyperinflation either to resume presenting *IFRS* financial statements or to present *IFRS* financial statements for the first time. The Group does not expect the amendments to have any material effect on its Consolidated Financial Statements.

The International Financial Reporting Standard for Small and Medium-sized Entities (issued in July 2009) is a self-contained standard, tailored to the needs and capabilities of smaller businesses.

Many of the principles of full *IFRS* for recognising and measuring assets, liabilities, income and expense have been simplified, and the number of required disclosures have been simplified and significantly reduced.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's Consolidated Financial Statements.

**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.

The purchase 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 Parent Company's 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, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of

the Parent Company's share of the identifiable net assets of the subsidiary acquired is recorded as goodwill. If the costs of acquisition are less than the fair value of net assets of the subsidiary acquired, the difference is recognised directly 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 reserves is recognized in reserves. 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.

Investments in associates in the Consolidated Financial Statements are accounted at cost less impairment, if any.

***2.3. 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 Group's functional and presentation currency.

***(b) Transactions and balances***

All transactions denominated in foreign currencies are translated into Latvian Lats at the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Latvian Lats 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).

***2.4. Intangible assets***

***(a) Trademarks and licenses***

Trademarks and licenses are shown at historical cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licenses 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) Emission rights for greenhouse gases***

Emission rights (or allowances) are recognized at cost when the Group is able to exercise the control. As at 31 December 2010 number of allowances in the Group received from the Government free of charge was 1,107,445 (31/12/2009: 1,107,445). Therefore their carrying amount as at 31 December 2010 was nil (31/12/2009: nil). In case the quantity of emitted greenhouse gases exceeds the quantity of greenhouse gas emission allowances allocated by the state free of charge, the allowances additionally purchased are recognised using the market price of greenhouse gas emission allowances at the reporting period. As at 31 December 2010 the number of allowances in the Group purchased was 280,000 (31/12/2009: 230,000), see Note 12. b). The forward agreements for purchase or sale of emission allowances for trade rather than for own use in the Group are defined as derivatives (see points 2.18, 3.3. and Note 24. c).

***2.5. Property, plant and equipment***

All property, plant and equipment (PPE) are stated at historical cost or revalued amount (see Note 2.8) less accumulated depreciation and accumulated impairment loss.

The cost comprises of 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 recognized 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 borrowings.



If an item of PPE consists of components with different useful lives, these components are depreciated as separate items. 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:

| Type of property, plant and equipment     | Estimated useful life, years |
|-------------------------------------------|------------------------------|
| Buildings and structures:                 |                              |
| • Hydropower plants, thermal power plants | 15 – 80                      |
| • Electricity transmission lines          | 30 – 50                      |
| • Electricity distribution lines          | 20 – 30                      |
| Machinery and equipment:                  |                              |
| • Hydropower plants                       | 3 – 12                       |
| • Thermal power plants                    | 3 – 10                       |
| • Transformer stations                    | 10                           |
| Other fixed assets                        | 2 – 5                        |

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 (Note 2.7).

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.

## **2.6. 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.

## **2.7. Impairment of non-financial assets**

Assets that are subject to 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 recognized in the Consolidated Income Statement within amortisation, depreciation and impairment charge expenses.

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 management for maximum period of 10 years. Assets are reviewed for possible reversal of the impairment at each reporting date. Revenue from the reversal of this impairment is recognised in the Consolidated Income Statement.

## **2.8. Assets revaluation**

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 fixed asset groups are revalued regularly but not less frequently than every five years:

- Hydropower plants' buildings and plants,
- Hydropower plants' machinery and technology equipment,
- Other fixed assets of hydropower plants,
- Electricity transmission system engineering structure,
- Electricity transmission lines,
- Electrical equipment and other fixed assets of electricity transmission system,
- Electricity distribution system engineering structure,
- Electricity distribution lines,
- Electrical equipment and other fixed assets of electricity distribution system.

Increase in the carrying amount arising on revaluation net of deferred tax is credited to "Non-current investments revaluation reserve" in shareholders' equity. Decreases that offset previous increases of the same asset are charged 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.

Non-current assets 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 share capital or other reserves, or used for other purposes.

## **2.9. 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.

During the reporting year at least at each month has been performed revaluation of the inventories with purpose to identify obsolescent and damaged inventories. Provisions for an impairment loss are recognized for those inventories.

The following basic principles are used in determining impairment losses for idle and obsolescent inventories:

- a) Inventories that haven't turned over during last 12 months are fully impaired,
- b) 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%,
- c) Inventories that haven't turned over during last 6 months are impaired in amount of 50%,
- d) 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%,
- e) The provisions are not calculated for the inventory of heating materials necessary to ensure uninterrupted operations of heat power plants,
- f) Provisions are not calculated for scrap metal obtained in the process of fixed assets' dismantling and are accounted at recoverable value.

## **2.10. Trade 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.

A provision for impairment of doubtful debts is calculated on the basis of trade receivables aging according to estimates defined by the Group entities and the Parent Company's management, which are revised at least once a year. Provisions for electricity trade receivables are calculated for debts overdue 45 days, and, if the debt is overdue more than 181 days, provisions are established at 100%. For other trade receivables provisions are calculated for debts overdue 31 day, and, if the date of payment is overdue more than 91 days, provisions are established at 100% (see Note 16 a).

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.

## **2.11. Cash and cash equivalents**

Cash and cash equivalents include cash in hand, at bank, and short-term deposits with original maturities of three months or less.

## **2.12. 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.

## **2.13. 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 participations of the Group companies accounting 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.

Independent qualified actuaries value these obligations annually. The expected costs of those benefits are accrued over the period of employment using the same accounting methodology as used for defined benefit pension plans.

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 reporting period less accrued costs or revenue referring to employment relationships until the change of benefit conditions. The defined benefit obligation is calculated annually using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows with sufficient regularity. The Group uses the projected unit credit method to measure the present value of its defined benefit obligations and related current and past service costs. This method sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the Group's total post-employment obligations. The Group also uses unbiased and mutually compatible actuarial assumptions about demographic variables and financial variables (including future increases in salaries and certain changes in benefits).

The Group's net total of current service cost, interest cost, actuarial gains and losses arising from changes in assumptions, past service costs, and the effect of any settlements is recognized as expense or income in the Consolidated Income Statement. Gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of 10% of the defined benefit obligation are charged or credited to the Consolidated Income Statement. Past-service costs are recognised in the Consolidated Income Statement using linear method over the employees' expected average remaining working lives until benefits are guaranteed. If benefits are guaranteed promptly after establishment or changes of defined benefit plan, the Group immediately recognizes past-service costs in the Consolidated Income Statement.

## **2.14. Deferred income tax**

Income tax is calculated in accordance with Latvian tax regulations and is based on the taxable income reported for the taxation period.

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.

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.

## **2.15. Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the Consolidated Income Statement over the period of the borrowings using the effective interest method.

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. The Group capitalises the borrowing costs arising on financing of new capital investments by adopting the requirements of IAS 23 *Borrowing costs* starting from 1 January 2008.

## **2.16. 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.

## **2.17. Grants**

Property, plant and equipment received at nil consideration from other entities 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.

## **2.18. 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 (Note 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 either:

- (a) Hedges of a particular risk associated with a recognised liability or highly probable forecast transactions denominated in foreign currency (cash flow hedge),
- (b) Derivatives at fair value through profit or loss and 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 ongoing 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 values of derivative instruments used for hedging purposes are disclosed in Note 24. Movements on the hedging reserve in shareholders' equity are shown in Note 19. The fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the hedged item is more than 12 months and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. 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 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 position "Raw materials and consumables used" (see Note 7) and "Finance income/costs" (Note 10a and Note 10b), respectively.

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) Derivatives at fair value through profit or loss and accounted for at fair value through profit or loss***

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any of these derivative instruments are recognised immediately in the Consolidated Income Statement within "Finance income" or "Finance costs".

***2.19. 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 shown at net value excluding 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 sales value of 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.

***(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) Interest income***

Interest income is recognized using the effective interest method. Interest income is recorded in the Consolidated Income Statement as "Finance income".

## ***2.20. Related parties***

The Parent Company is owned by the Latvian state. The Parent Company's related parties are defined as companies in which the state has the control or significant influence, members of the Supervisory Board and the Management Board and key management personnel, their close relatives and companies in which they have a control or significant influence.

## ***2.21. 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. Non-current assets held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

## ***2.22. Share capital***

The Group's share capital consists of ordinary shares.

## ***2.23. 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.

## ***2.24. 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 supply of goods or services or for administrative purposes, or sale in the ordinary course of business. The investment properties are initially recognized and subsequently measured at acquisition cost net of accumulated depreciation and impairment losses. The applied depreciation rates are similar to those set for respective fixed asset categories.

## ***2.25. Held-to-maturity investments***

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. At 31 December 2010, if the class of held-to-maturity investments had been tainted with all other variables held constant, the fair value would have not increase neither decrease significantly.

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.

### **3 FINANCIAL RISK MANAGEMENT**

#### ***3.1 Financial risk factors***

The Group's activities expose them 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 has carried out by the Parent Company's Treasury department (the Group Treasury) according to 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 provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

#### ***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 2010 the Group had none of their borrowings denominated in other currencies than the Euro (see Note 20).

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.

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 2010 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 24d).

The Parent Company has certain investments in associates and subsidiaries outside Latvia (Estonia and Lithuania), whose are exposed to foreign currency risk. 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.

The Group's internal financing is organized on mutual loan bases, which occasionally creates receivable balances to the benefit of the Parent Company. Such loans issued have floating interest rates based on market rates; therefore the internal Group loans have some impact on profit or loss of the Parent Company.

However, during 2010, 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 305 thousand higher or lower (2009: LVL 259.3 thousand).

The Group's cash flow interest rate risk mainly arises from long-term borrowings at variable rates. They expose the Group to 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 rate borrowings (taking into account the effect of interest rate swaps) with duration in between 2-4 years. To hedge cash flow risk, the Group has entered into 15 interest rate swap agreements with the notional amount EUR 348.2 million or LVL 244.7 million (2009: 15 interest rate swap agreements in amount of EUR 341 million or LVL 239.7 million) (see Note 24a).

As at 31 December 2010 43.4% of the Group's borrowings (31/12/2009: 42.2%) had fixed interest rate (considering the interest rate swaps) and average fixed rate duration 2.3 years (2009: 2.4 years).

The Group analyses their 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. 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 2010, if interest rates on Euro denominated borrowings 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 1,341 thousand lower or higher (2009: LVL 1,403 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 2010, 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 4,286 thousand higher or lower (31/12/2009: LVL 4,091 thousand). Furthermore LVL 795 thousand (2009: LVL 1,020 thousand) would have been attributable to profit or loss and LVL 3,491 thousand (2009: LVL 3,071 thousand) to the Consolidated Statement of Changes in Equity 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. To hedge the risk the Parent Company has purchased electricity swap contracts that are used to hedge the risk related to changes in the price of electricity (Note 24 b).

**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 counterpart or group of counterparts having similar characteristics. Impairment loss has been deducted from accounts receivable (Note 16).

Advance payments subject to substantial credit risk have been secured by bank guarantees.

The maximum credit risk exposure related to financial assets comprises of carrying amounts of cash and cash equivalents (see table below and Note 17), trade and other receivables (Note 16) and nominal amounts of issued guarantees (Note 26).

**Assessment of max possible exposure to credit risk**

|                                  | Note | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|----------------------------------|------|-----------------------|-----------------------|
| Trade receivables                | 16 a | 63,031                | 48,963                |
| Deferred expenses                | 16 b | 364                   | 624                   |
| Other receivables                | 16 b | 483                   | 412                   |
| Cash and cash equivalents        | 17   | 234,266               | 154,938               |
| Derivative financial instruments | 24 e | 3,968                 | 145                   |
|                                  |      | <b>302,112</b>        | <b>205,082</b>        |

For banks and financial institutions, 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 counterpart, 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. 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 reporting period:

|                                          | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|------------------------------------------|-----------------------|-----------------------|
| Investment level credit rating           | 202,767               | 143,729               |
| No or non investment level credit rating | 31,499                | 11,209                |
|                                          | <b>234,266</b>        | <b>154,938</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 (see Note 20) and cash and cash equivalents (see Note 17).

The table below analyses the Group's financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the Consolidated Statement of Financial Position to the contractual maturity date. 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 reporting period.

#### *Liquidity analysis (contractual undiscounted cash flows):*

| 31/12/2010                       | Less than 1<br>year<br>LVL'000 | Between<br>1 and 2<br>years<br>LVL'000 | Between<br>3 and 5<br>years<br>LVL'000 | Over<br>5 years<br>LVL'000 | Total<br>LVL'000 |
|----------------------------------|--------------------------------|----------------------------------------|----------------------------------------|----------------------------|------------------|
| Borrowings                       | 46,723                         | 63,804                                 | 339,721                                | 200,414                    | 650,662          |
| Derivative financial instruments | 7,772                          | 8,350                                  | 9,456                                  | 2,310                      | 27,888           |
| Trade and other payables*        | 71,441                         | -                                      | -                                      | -                          | 71,441           |
|                                  | 125,936                        | 72,154                                 | 349,177                                | 202,724                    | 749,991          |

| 31/12/2009                       | Less than 1<br>year<br>LVL'000 | Between<br>1 and 2<br>years<br>LVL'000 | Between<br>3 and 5<br>years<br>LVL'000 | Over<br>5 years<br>LVL'000 | Total<br>LVL'000 |
|----------------------------------|--------------------------------|----------------------------------------|----------------------------------------|----------------------------|------------------|
| Borrowings                       | 31,060                         | 43,465                                 | 209,722                                | 265,622                    | 549,869          |
| Derivative financial instruments | 10,447                         | 9,221                                  | 11,922                                 | 3,201                      | 34,791           |
| Trade and other payables*        | 67,385                         | -                                      | -                                      | -                          | 67,385           |
|                                  | 108,892                        | 52,686                                 | 221,644                                | 268,823                    | 652,045          |

\* Excluding advances received, deferred income and other non-current 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.



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This ratio is calculated by dividing the sum of equity and subordinated debt 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 on 31 December 2010 and on 31 December 2009 was as follows:

|                                                   | 31/12/2010 | 31/12/2009 |
|---------------------------------------------------|------------|------------|
| Total equity (LVL'000)                            | 1,344,748  | 889,440    |
| Total assets (LVL'000)                            | 2,279,266  | 1,699,491  |
| Outstanding financial guarantees issued (LVL'000) | 10,825     | 11,733     |
| <b>Capital Ratio</b>                              | <b>59%</b> | <b>52%</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.

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 price used for financial assets held by the Group is the current bid price, i.e. interest rates by respective term and currency.

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. Quoted market prices for similar instruments are used for long-term debt. Other techniques, such as 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. Those fair values are compared to counterparty bank revaluation reports. 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.

The fair value of non-current borrowings with fixed interest rates (considering the effect of derivative financial instruments) for disclosure purposes is estimated by discounting their future contractual cash flows at the current market interest rates for similar financial instruments.

## **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 live***

The Group makes estimates concerning the expected useful lives and residual values of property, plant and equipment. These are reviewed at each end of reporting period and are based on the past experience as well as industry practice.

***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 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 market and other essential factors have an impact on decreasing of revalued values. If discount rate used for the purposes of impairment charge calculation would be lower or higher by one percent point current year's impairment charge on technological equipment would be by 76% higher or lower (2009: 64%). Impairment charges recognised during the current reporting year are disclosed in Note 13 b.

***III) Fair valuation***

External, certified valuers have performed revaluation of the Group's property, plant and equipment by applying the amortised 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, amortised replacement value was determined for each asset. Amortised replacement value is calculated as land's instant market value at its current use, increased by the replacement value of existing buildings and refinements on the said land plot and decreased by the depreciation expenses and other impairment losses. If there is no any recognizable market value due to specific nature of property, plant and equipment and rare occurrence of sales transactions of those assets (except for sales in the Group), then these units should be valued at replacement fair value. Fair value of property, plant and equipment is calculated on the basis of their current use. Results of revaluation are described in Note 13 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 2.10). 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 16).

**c) Fair value estimation for financial instruments**

Effective 1 January 2009, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the Consolidated Statement of Financial Position at fair value and disclosed fair value measurements by level of the following fair value measurement hierarchy:

- a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1),
- b) 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),
- c) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following tables present the Group's assets and liabilities that are measured at fair value:

|                                                                     | 31/12/2010   | Level<br>1   | Level<br>2 | Level<br>3 | Total<br>balance |
|---------------------------------------------------------------------|--------------|--------------|------------|------------|------------------|
| <b>Assets:</b>                                                      |              |              |            |            |                  |
| Electricity trading derivatives (Note 24 b)                         | 2,393        | -            | -          | -          | <b>2,393</b>     |
| Interest rate derivatives used for hedging (Note 24 a)              | -            | 1,011        | -          | -          | <b>1,011</b>     |
| Forward foreign exchange contracts used for hedging (Note 24 d)     | -            | 564          | -          | -          | <b>564</b>       |
| <b>Total assets</b>                                                 | <b>2,393</b> | <b>1,575</b> | <b>-</b>   | <b>-</b>   | <b>3,968</b>     |
| <b>Liabilities</b>                                                  |              |              |            |            |                  |
| <i>Financial liabilities at fair value through profit or loss:</i>  |              |              |            |            |                  |
| - CO <sub>2</sub> emission allowances forward contracts (Note 24 c) | 3,442        | -            | -          | -          | <b>3,442</b>     |
| Interest rate derivatives used for hedging (Note 24 a)              | -            | 8,054        | -          | -          | <b>8,054</b>     |
| <b>Total liabilities</b>                                            | <b>3,442</b> | <b>8,054</b> | <b>-</b>   | <b>-</b>   | <b>11,496</b>    |

|                                                                     | 31/12/2009    | Level<br>1   | Level<br>2 | Level<br>3 | Total<br>balance |
|---------------------------------------------------------------------|---------------|--------------|------------|------------|------------------|
| <b>Assets:</b>                                                      |               |              |            |            |                  |
| Interest rate derivatives used for hedging (Note 24 a)              | -             | 145          | -          | -          | <b>145</b>       |
| <b>Total assets</b>                                                 | <b>-</b>      | <b>145</b>   | <b>-</b>   | <b>-</b>   | <b>145</b>       |
| <b>Liabilities</b>                                                  |               |              |            |            |                  |
| <i>Financial liabilities at fair value through profit or loss:</i>  |               |              |            |            |                  |
| - Electricity trading derivatives (Note 24 b)                       | 10,258        | -            | -          | -          | <b>10,258</b>    |
| - CO <sub>2</sub> emission allowances forward contracts (Note 24 c) | 3,366         | -            | -          | -          | <b>3,366</b>     |
| Interest rate derivatives used for hedging (Note 24 a)              | -             | 6,270        | -          | -          | <b>6,270</b>     |
| <b>Total liabilities</b>                                            | <b>13,624</b> | <b>6,270</b> | <b>-</b>   | <b>-</b>   | <b>19,894</b>    |

The fair value of financial instruments traded in active markets is based on quoted market prices at the preparation date of the statement of financial position. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the group is the current bid price. These instruments are included in Level 1.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as

possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- a) Quoted market prices or dealer quotes for similar instruments,
- b) The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves,
- c) The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value,
- d) Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

Changes in assumptions about these factors could affect reported fair value of financial instruments (Note 24).

#### *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 22). The estimated customer relationship period is based on the Management's estimate. In the reporting period the Group's received connection fees totalled LVL 12.4 million (2009: LVL 16 million), and to the Consolidated Income Statement credited LVL 5.2 million (2009: LVL 4.4 million). If the estimated customer relationship period is reduced/increased by 25%, the annual income from connection service fees would increase/decrease by LVL 1.3 million (2009: LVL 0.9 million).

#### *e) 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, the total gain/loss from the changes in the fair value are recognized in the Consolidated Income Statement (Note 24).

## **5 REVENUE**

|                                        | <b>2010</b>    | <b>2009</b>    |
|----------------------------------------|----------------|----------------|
|                                        | <b>LVL'000</b> | <b>LVL'000</b> |
| <b>Electricity sales:</b>              |                |                |
| Corporate customers                    | 343,634        | 278,907        |
| Residential customers                  | 131,777        | 125,816        |
|                                        | <b>475,411</b> | <b>404,723</b> |
| Transmission and distribution services | 7,932          | 8,238          |
| Heat sales                             | 71,863         | 71,403         |
| Revenue from assets lease              | 110            | 508            |
| Other services                         | 19,374         | 15,641         |
| <b>Total revenue:</b>                  | <b>574,690</b> | <b>500,513</b> |

## 6 OTHER INCOME

|                                                   | 2010<br>LVL'000 | 2009<br>LVL'000 |
|---------------------------------------------------|-----------------|-----------------|
| Gain from sale of assets held for sale and PPE    | 264             | 415             |
| Gain from sale of current assets and other income | 2,452           | 5,866           |
| <b>Total other income:</b>                        | <b>2,716</b>    | <b>6,281</b>    |

## 7 RAW MATERIALS AND CONSUMABLES USED

|                                                                                                    | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Electricity:</b>                                                                                |                 |                 |
| Imported from the Baltic countries                                                                 | 65,298          | 50,214          |
| Purchased from producers in Latvia                                                                 | 56,590          | 66,652          |
| Imported from other countries                                                                      | 24,025          | 6,877           |
| Fair value (income) / loss on electricity swaps<br>(Note 24 b)                                     | (12,651)        | 4,915           |
|                                                                                                    | <b>133,262</b>  | <b>128,658</b>  |
| Fuel expense                                                                                       | 121,335         | 105,061         |
| Fair value (income) / loss on CO <sub>2</sub> emission allowances<br>forward contracts (Note 24 c) | (532)           | 3,366           |
| Raw materials, spare parts and maintenance costs                                                   | 24,128          | 24,596          |
| <b>Total raw materials and consumables used:</b>                                                   | <b>278,193</b>  | <b>261,681</b>  |

## 8 PERSONNEL EXPENSES

|                                                                                                | 2010<br>LVL'000 | 2009<br>LVL'000 |
|------------------------------------------------------------------------------------------------|-----------------|-----------------|
| Wages and salaries                                                                             | 43,621          | 44,247          |
| Expenditure of employment termination                                                          | 1,084           | 3,216           |
| Pension costs – defined contribution plan                                                      | 2,046           | 2,026           |
| State social insurance contributions and other benefits<br>defined in the Collective Agreement | 10,942          | 11,112          |
| <b>Total personnel expenses:</b>                                                               | <b>57,693</b>   | <b>60,601</b>   |

|                                                                                                | 2010<br>LVL'000 | 2009<br>LVL'000 |
|------------------------------------------------------------------------------------------------|-----------------|-----------------|
| <b>Including remuneration to the management:</b>                                               |                 |                 |
| Wages and salaries                                                                             | 606             | 743             |
| Expenditure of employment termination                                                          | 8               | -               |
| Pension costs – defined contribution plan                                                      | 31              | 37              |
| State social insurance contributions and other benefits<br>defined in the Collective Agreement | 151             | 180             |
| <b>Total remuneration to the management:</b>                                                   | <b>796</b>      | <b>960</b>      |

|                                             | 2010  | 2009  |
|---------------------------------------------|-------|-------|
| Number of employees at the end of the year  | 4,513 | 4,701 |
| Average number of employees during the year | 4,594 | 4,969 |

Remuneration to the management includes remuneration to the members of the Management Boards of the Group entities.

In accordance with the directions of the Cabinet of Ministers of Latvia No. 1577 "On distribution of the obligatory state social insurance contribution rate for 2010" 65% from the obligatory state social insurance contributions are used for financing the state fixed contribution pension scheme (2009: 69%).

## 9 OTHER OPERATING EXPENSES

|                                                     | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-----------------------------------------------------|-----------------|-----------------|
| Selling expenses and customer service costs         | 3,604           | 8,824           |
| Information technology maintenance expenses         | 2,206           | 2,313           |
| Transportation expenses                             | 4,758           | 4,796           |
| Environment protection and work safety expenses     | 2,679           | 2,563           |
| Rent, maintenance and utilities costs               | 4,879           | 5,545           |
| Electric power transit and capacity services costs  | 4,604           | 3,122           |
| Loss from disposal of property, plant and equipment | 1,969           | 2,125           |
| Real estate tax                                     | 780             | 657             |
| Telecommunications expenses                         | 1,764           | 1,832           |
| Public utilities regulation fee                     | 1,017           | 1,016           |
| Other expenses                                      | 6,253           | 6,834           |
| <b>Total other operating expenses:</b>              | <b>34,513</b>   | <b>39,627</b>   |

## 10 FINANCE INCOME AND COSTS

### 10 a) Finance income

|                                                                 | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-----------------------------------------------------------------|-----------------|-----------------|
| Interest income on bank accounts, deposits and loans            | 5,351           | 9,768           |
| Interest income on derivative financial instruments             | -               | 54              |
| Fair value gain on derivative financial instruments (Note 24 a) | 1,241           | 947             |
| Fair value gain on issued guarantees (Note 26)                  | 141             | -               |
| Interest income on treasury bills                               | 1               | -               |
| <b>Total finance income:</b>                                    | <b>6,734</b>    | <b>10,769</b>   |

### 10 b) Finance costs

|                                                                 | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-----------------------------------------------------------------|-----------------|-----------------|
| Interest cost on borrowings                                     | 9,023           | 13,684          |
| Interest cost on derivative financial instruments               | 5,360           | 2,739           |
| Management commission on bank borrowings                        | 1,671           | 157             |
| Fair value loss on derivative financial instruments (Note 24 a) | 1,220           | 2,171           |
| Fair value loss on issued guarantees (Note 26)                  | -               | 389             |
| Net foreign exchange losses                                     | 1,142           | 357             |
| Capitalized interest cost*                                      | (666)           | (1,254)         |
| <b>Total finance costs:</b>                                     | <b>17,750</b>   | <b>18,243</b>   |

\* See Note 2.15.



## 11 INCOME TAX

|                          | 2010<br>LVL'000 | 2009<br>LVL'000 |
|--------------------------|-----------------|-----------------|
| Current tax              | 11,551          | 4,682           |
| Deferred tax             | (5,096)         | (68)            |
| <b>Total income tax:</b> | <b>6,455</b>    | <b>4,614</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:

|                                                                       | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-----------------------------------------------------------------------|-----------------|-----------------|
| <b>Profit before tax</b>                                              | <b>50,780</b>   | <b>24,170</b>   |
| Corporate income tax at the statutory rate 15%                        | 7,617           | 3,625           |
| Loss in PPE value from revaluation                                    | 1,124           | -               |
| Gain on deferred income tax asset value                               | (7)             | (391)           |
| Expense not deductible for tax purpose                                | 915             | 4,568           |
| Income not subject to tax                                             | (294)           | (256)           |
| Accelerated depreciation of newly constructed technological equipment | (2,900)         | (2,932)         |
| <b>Total income tax:</b>                                              | <b>6,455</b>    | <b>4,614</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:

|  | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|--|-----------------------|-----------------------|
|--|-----------------------|-----------------------|

### *Deferred income tax liabilities:*

|                                                                   |         |         |
|-------------------------------------------------------------------|---------|---------|
| - Deferred tax liabilities to be recovered after more than 1 year | 185,124 | 116,037 |
| - Deferred tax liabilities to be recovered within 1 year          | 4,310   | 5,773   |

### *Deferred income tax assets:*

|                                                              |                |                |
|--------------------------------------------------------------|----------------|----------------|
| - Deferred tax assets to be recovered after more than 1 year | (1,811)        | (2,544)        |
| - Deferred tax assets to be recovered within 1 year          | (913)          | (2,158)        |
| <b>Total deferred income tax assets</b>                      | <b>(925)</b>   | <b>(932)</b>   |
| <b>Total deferred income tax liabilities</b>                 | <b>187,635</b> | <b>118,040</b> |

The movement on the deferred income tax accounts is as follows:

|                                                                            | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                                        | <b>117,108</b>  | <b>117,432</b>  |
| Income credited to the Consolidated Income Statement                       | (5,096)         | (68)            |
| Attributable to non-current assets revaluation reserve in equity (Note 19) | 74,698          | (256)           |
| <b>Deferred tax asset at the end of the year</b>                           | <b>(925)</b>    | <b>(932)</b>    |
| <b>Deferred tax liabilities at the end of the year</b>                     | <b>187,635</b>  | <b>118,040</b>  |

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Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

|                                                                              | 2010<br>LVL'000                     | 2009<br>LVL'000 |
|------------------------------------------------------------------------------|-------------------------------------|-----------------|
| <i>Deferred tax liabilities:</i>                                             |                                     |                 |
|                                                                              | <b>Accelerated tax depreciation</b> |                 |
| <b>At the beginning of the year</b>                                          | <b>121,810</b>                      | <b>122,573</b>  |
| Income credited to the Consolidated Income Statement                         | (7,074)                             | (507)           |
| Attributable to non-current assets revaluation reserve in equity             | 74,698                              | (256)           |
| <b>At the end of the year</b>                                                | <b>189,434</b>                      | <b>121,810</b>  |
| <i>Deferred tax assets:</i>                                                  |                                     |                 |
|                                                                              | <b>Accruals/provisions</b>          |                 |
| <b>At the beginning of the year</b>                                          | <b>(4,702)</b>                      | <b>(5,141)</b>  |
| (Income) / expense (credited) / charged to the Consolidated Income Statement | 1,978                               | 439             |
| <b>At the end of the year</b>                                                | <b>(2,724)</b>                      | <b>(4,702)</b>  |

## 12 INTANGIBLE ASSETS

### 12 a) Intangible assets

|                                    | Licenses<br>LVL'000 | Software<br>LVL'000 | Emission<br>allowances<br>LVL'000 | Assets under<br>construction<br>and advances<br>LVL'000 | Total<br>LVL'000 |
|------------------------------------|---------------------|---------------------|-----------------------------------|---------------------------------------------------------|------------------|
| <b>Year ended 31 December 2009</b> |                     |                     |                                   |                                                         |                  |
| Opening net book amount            | 1,479               | 7,879               | 1,914                             | 33                                                      | 11,305           |
| Additions                          | -                   | 950                 | -                                 | -                                                       | 950              |
| Disposals                          | -                   | -                   | (1,914)                           | -                                                       | (1,914)          |
| Amortisation charge                | (149)               | (2,000)             | -                                 | -                                                       | (2,149)          |
| <b>Closing net book amount</b>     | <b>1,330</b>        | <b>6,829</b>        | <b>-</b>                          | <b>33</b>                                               | <b>8,192</b>     |
| <b>At 31 December 2009</b>         |                     |                     |                                   |                                                         |                  |
| Cost                               | 1,750               | 17,206              | -                                 | 33                                                      | 18,989           |
| Accumulated amortisation           | (420)               | (10,377)            | -                                 | -                                                       | (10,797)         |
| <b>Net book amount</b>             | <b>1,330</b>        | <b>6,829</b>        | <b>-</b>                          | <b>33</b>                                               | <b>8,192</b>     |
| <b>Year ended 31 December 2010</b> |                     |                     |                                   |                                                         |                  |
| Opening net book amount            | 1,330               | 6,829               | -                                 | 33                                                      | 8,192            |
| Additions                          | -                   | 1,626               | -                                 | 47                                                      | 1,673            |
| Disposals                          | -                   | (1)                 | -                                 | -                                                       | (1)              |
| Amortisation charge                | (147)               | (2,239)             | -                                 | -                                                       | (2,386)          |
| <b>Closing net book amount</b>     | <b>1,183</b>        | <b>6,215</b>        | <b>-</b>                          | <b>80</b>                                               | <b>7,478</b>     |
| <b>At 31 December 2010</b>         |                     |                     |                                   |                                                         |                  |
| Cost                               | 1,750               | 18,793              | -                                 | 80                                                      | 20,623           |
| Accumulated amortisation           | (567)               | (12,578)            | -                                 | -                                                       | (13,145)         |
| <b>Net book amount</b>             | <b>1,183</b>        | <b>6,215</b>        | <b>-</b>                          | <b>80</b>                                               | <b>7,478</b>     |

**12 b) Emission allowances:**

|                                     | <b>2010</b>          | <b>2009</b>          |
|-------------------------------------|----------------------|----------------------|
|                                     | Number of allowances | Number of allowances |
| <b>At the beginning of the year</b> | <b>459,095</b>       | <b>311,983</b>       |
| Allocated allowances*               | 1,107,445            | 1,107,445            |
| Purchased allowances                | 280,000              | 230,000              |
| Used allowances                     | (1,268,233)          | (1,015,333)          |
| Sales of allowances                 | (95,000)             | (175,000)            |
| <b>At the end of the year</b>       | <b>483,307</b>       | <b>459,095</b>       |

\*Allowances are allocated free of charge in accordance with the law "On Pollution" and Directives of the Ministry of Environment.

## 13 PROPERTY, PLANT AND EQUIPMENT

### 13 a) Property, plant and equipment

|                                         | Revalued property, plant and equipment        |                                         |                                         |                                 | Land and buildings, total | Revalued property, plant and equipment                     |                                                      |                                                      |                                              | Technology equipment and machinery, total |
|-----------------------------------------|-----------------------------------------------|-----------------------------------------|-----------------------------------------|---------------------------------|---------------------------|------------------------------------------------------------|------------------------------------------------------|------------------------------------------------------|----------------------------------------------|-------------------------------------------|
|                                         | Daugava hydropower plants' land and buildings | Trans-mission system land and buildings | Distri-bution system land and buildings | Non-revalued land and buildings |                           | Daugava hydropower plants' technology equipment, machinery | Trans-mission system technology equipment, machinery | Distri-bution 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                                   |
| <b>Year ended 31 December 2009</b>      |                                               |                                         |                                         |                                 |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Opening net book amount                 | 471,855                                       | 116,346                                 | 227,537                                 | 154,010                         | <b>969,748</b>            | 44,275                                                     | 113,864                                              | 82,037                                               | 159,749                                      | <b>399,925</b>                            |
| Additions                               | 1,471                                         | 5,059                                   | 34,089                                  | 15,644                          | <b>56,263</b>             | 13,117                                                     | 20,040                                               | 16,585                                               | 2,694                                        | <b>52,436</b>                             |
| Transfers                               | -                                             | -                                       | 24                                      | 314                             | <b>338</b>                | -                                                          | -                                                    | (96)                                                 | (535)                                        | <b>(631)</b>                              |
| Disposals                               | -                                             | (1,130)                                 | (18)                                    | (386)                           | <b>(1,534)</b>            | (53)                                                       | (618)                                                | (82)                                                 | (3)                                          | <b>(756)</b>                              |
| Impairment charge*                      | -                                             | -                                       | -                                       | -                               | -                         | -                                                          | -                                                    | -                                                    | (15,908)                                     | <b>(15,908)</b>                           |
| Depreciation                            | (9,240)                                       | (6,076)                                 | (11,763)                                | (5,740)                         | <b>(32,819)</b>           | (11,989)                                                   | (9,249)                                              | (13,432)                                             | (14,104)                                     | <b>(48,774)</b>                           |
| <b>Closing net book amount</b>          | <b>464,086</b>                                | <b>114,199</b>                          | <b>249,869</b>                          | <b>163,842</b>                  | <b>991,996</b>            | <b>45,350</b>                                              | <b>124,037</b>                                       | <b>85,012</b>                                        | <b>131,893</b>                               | <b>386,292</b>                            |
| <b>At 31 December 2009</b>              |                                               |                                         |                                         |                                 |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Cost or valuation                       | 1,041,449                                     | 302,528                                 | 352,204                                 | 204,713                         | <b>1,900,894</b>          | 147,044                                                    | 250,075                                              | 166,099                                              | 209,029                                      | <b>772,247</b>                            |
| Accumulated depreciation and impairment | (577,363)                                     | (188,329)                               | (102,335)                               | (40,871)                        | <b>(908,898)</b>          | (101,694)                                                  | (126,038)                                            | (81,087)                                             | (77,136)                                     | <b>(385,955)</b>                          |
| <b>Net book amount</b>                  | <b>464,086</b>                                | <b>114,199</b>                          | <b>249,869</b>                          | <b>163,842</b>                  | <b>991,996</b>            | <b>45,350</b>                                              | <b>124,037</b>                                       | <b>85,012</b>                                        | <b>131,893</b>                               | <b>386,292</b>                            |
| <b>Year ended 31 December 2010</b>      |                                               |                                         |                                         |                                 |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Opening net book amount                 | 464,086                                       | 114,199                                 | 249,869                                 | 163,842                         | <b>991,996</b>            | 45,350                                                     | 124,037                                              | 85,012                                               | 131,893                                      | <b>386,292</b>                            |
| Revaluation of PPE                      | -                                             | -                                       | 349,863                                 | -                               | <b>349,863</b>            | -                                                          | -                                                    | 149,777                                              | -                                            | <b>149,777</b>                            |
| Additions                               | 542                                           | 8,582                                   | 17,819                                  | 14,652                          | <b>41,595</b>             | 11,819                                                     | 4,495                                                | 8,766                                                | 8,239                                        | <b>33,319</b>                             |
| Transfers                               | -                                             | (1,552)                                 | 4,501                                   | 1,995                           | <b>4,944</b>              | -                                                          | -                                                    | (4,538)                                              | (242)                                        | <b>(4,780)</b>                            |
| Disposals                               | -                                             | (700)                                   | (265)                                   | (175)                           | <b>(1,140)</b>            | (78)                                                       | (406)                                                | (298)                                                | (5)                                          | <b>(787)</b>                              |
| Impairment charge*                      | -                                             | -                                       | (2,276)                                 | (850)                           | <b>(3,126)</b>            | -                                                          | -                                                    | (5,144)                                              | (17,223)                                     | <b>(22,367)</b>                           |
| Depreciation                            | (9,252)                                       | (6,204)                                 | (36,419)                                | (6,466)                         | <b>(58,341)</b>           | (11,560)                                                   | (9,869)                                              | (14,245)                                             | (12,709)                                     | <b>(48,383)</b>                           |
| <b>Closing net book amount</b>          | <b>455,376</b>                                | <b>114,325</b>                          | <b>583,092</b>                          | <b>172,998</b>                  | <b>1,325,791</b>          | <b>45,531</b>                                              | <b>118,257</b>                                       | <b>219,330</b>                                       | <b>109,953</b>                               | <b>493,071</b>                            |
| <b>At 31 December 2010</b>              |                                               |                                         |                                         |                                 |                           |                                                            |                                                      |                                                      |                                              |                                           |
| Cost or valuation                       | 1,041,991                                     | 305,217                                 | 1,261,427                               | 223,733                         | <b>2,832,368</b>          | 156,685                                                    | 252,433                                              | 468,911                                              | 216,984                                      | <b>1,095,013</b>                          |
| Accumulated depreciation and impairment | (586,615)                                     | (190,892)                               | (678,335)                               | (50,735)                        | <b>(1,506,577)</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>172,998</b>                  | <b>1,325,791</b>          | <b>45,531</b>                                              | <b>118,257</b>                                       | <b>219,330</b>                                       | <b>109,953</b>                               | <b>493,071</b>                            |

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|                                         | Revalued property, plant and equipment                   |                                                   |                                                   |  | Non-revalued other fixed assets | Other fixed assets, total | Assets under construction and advances | Property, plant and equipment, total |
|-----------------------------------------|----------------------------------------------------------|---------------------------------------------------|---------------------------------------------------|--|---------------------------------|---------------------------|----------------------------------------|--------------------------------------|
|                                         | Daugava hydropower plants' other fixed assets<br>LVL'000 | Transmission system other fixed assets<br>LVL'000 | Distribution system other fixed assets<br>LVL'000 |  |                                 |                           |                                        |                                      |
| <b>Year ended 31 December 2009</b>      |                                                          |                                                   |                                                   |  | LVL'000                         | LVL'000                   | LVL'000                                | LVL'000                              |
| Opening net book amount                 | 4,738                                                    | 1,811                                             | 823                                               |  | 26,491                          | 33,863                    | 54,428                                 | 1,457,964                            |
| Additions                               | -                                                        | 96                                                | 150                                               |  | 6,276                           | 6,522                     | (11,665)                               | 103,556                              |
| Transfers                               | -                                                        | -                                                 | -                                                 |  | 576                             | 576                       | -                                      | 283                                  |
| Disposals                               | -                                                        | (23)                                              | -                                                 |  | (49)                            | (72)                      | (127)                                  | (2,489)                              |
| Impairment charge*                      | -                                                        | -                                                 | -                                                 |  | -                               | -                         | (3,440)                                | (19,348)                             |
| Depreciation                            | (314)                                                    | (651)                                             | (282)                                             |  | (9,082)                         | (10,329)                  | -                                      | (91,922)                             |
| <b>Closing net book amount</b>          | <b>4,424</b>                                             | <b>1,233</b>                                      | <b>691</b>                                        |  | <b>24,212</b>                   | <b>30,560</b>             | <b>39,196</b>                          | <b>1,448,044</b>                     |
| <b>At 31 December 2009</b>              |                                                          |                                                   |                                                   |  |                                 |                           |                                        |                                      |
| Cost or valuation                       | 7,477                                                    | 3,299                                             | 2,065                                             |  | 84,864                          | 97,705                    | 43,193                                 | 2,814,039                            |
| Accumulated depreciation and impairment | (3,053)                                                  | (2,066)                                           | (1,374)                                           |  | (60,652)                        | (67,145)                  | (3,997)                                | (1,365,995)                          |
| <b>Net book amount</b>                  | <b>4,424</b>                                             | <b>1,233</b>                                      | <b>691</b>                                        |  | <b>24,212</b>                   | <b>30,560</b>             | <b>39,196</b>                          | <b>1,448,044</b>                     |
| <b>Year ended 31 December 2010</b>      |                                                          |                                                   |                                                   |  |                                 |                           |                                        |                                      |
| Opening net book amount                 | 4,424                                                    | 1,233                                             | 691                                               |  | 24,212                          | 30,560                    | 39,196                                 | 1,448,044                            |
| Revaluation of PPE                      | -                                                        | -                                                 | 306                                               |  | -                               | 306                       | -                                      | 499,946                              |
| Additions                               | -                                                        | 61                                                | 141                                               |  | 4,612                           | 4,814                     | 46,138                                 | 125,866                              |
| Transfers                               | -                                                        | -                                                 | 521                                               |  | (632)                           | (111)                     | -                                      | 53                                   |
| Disposals                               | -                                                        | (8)                                               | (1)                                               |  | (63)                            | (72)                      | (73)                                   | (2,072)                              |
| Impairment charge*                      | -                                                        | -                                                 | (76)                                              |  | -                               | (76)                      | (788)                                  | (26,357)                             |
| Depreciation                            | (313)                                                    | (605)                                             | (173)                                             |  | (8,855)                         | (9,946)                   | -                                      | (116,670)                            |
| <b>Closing 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>1,928,810</b>                     |
| <b>At 31 December 2010</b>              |                                                          |                                                   |                                                   |  |                                 |                           |                                        |                                      |
| Cost or valuation                       | 7,477                                                    | 3,309                                             | 4,135                                             |  | 81,629                          | 96,550                    | 89,193                                 | 4,113,124                            |
| Accumulated depreciation and impairment | (3,366)                                                  | (2,628)                                           | (2,726)                                           |  | (62,355)                        | (71,075)                  | (4,720)                                | (2,184,314)                          |
| <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>1,928,810</b>                     |

\* Impairment charge is included in the Consolidated Income Statement under 'Depreciation, amortisation and impairment of intangible assets and property, plant and equipment'.

Latvenergo AS revalued assets of Daugava hydropower plants as at 1 January 2007 and transmission system assets were leased to subsidiary *Augstsprieguma tīkls AS* at 1 January 2008. As at 1 January 2010 distribution system assets leased to subsidiary *Sadales tīkls AS*. Valuation have been revalued by external certified valuers by applying the depreciated replacement cost model, which provides, that the assets value comprises replacement or renewal costs of similar asset at the date of revaluation and less the accrued total depreciation. Instant construction and purchase costs of similar assets are used to state the renewal costs of those assets as conjunctive valuation basis. In 2010 the increase in revalued distribution system assets' carrying amount of LVL 499,946 thousand, net off deferred tax, was charged to non-current assets revaluation reserve under the Parent Company's equity (2009: decrease in amount of LVL 1,701 thousand). The decrease in the carrying amount of assets, as a result of a distribution system assets revaluation, in the amount of LVL 7,496 thousand was recognised in the Consolidated Income Statement under "Depreciation, amortisation and impairment of intangible assets and property, plant and equipment" (2009: LVL 0).

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 |                                  |                                                  |                                  |                  |
|---------------------------------------------------|----------------------------------|--------------------------------------------------|----------------------------------|------------------|
|                                                   | Land and<br>buildings<br>LVL'000 | Technology<br>equipment,<br>machinery<br>LVL'000 | Other fixed<br>assets<br>LVL'000 | Total<br>LVL'000 |
| <b>At revalued amounts</b>                        |                                  |                                                  |                                  |                  |
| <b>At 31 December 2009</b>                        |                                  |                                                  |                                  |                  |
| Revalued cost                                     | 1,696,181                        | 563,218                                          | 12,841                           | 2,272,240        |
| Accumulated depreciation                          | (868,027)                        | (308,819)                                        | (6,493)                          | (1,183,339)      |
| <b>Revalued net book amount</b>                   | <b>828,154</b>                   | <b>254,399</b>                                   | <b>6,348</b>                     | <b>1,088,901</b> |
| <b>At 31 December 2010</b>                        |                                  |                                                  |                                  |                  |
| Revalued cost                                     | 2,614,632                        | 880,603                                          | 12,605                           | 3,507,840        |
| Accumulated depreciation                          | (1,459,457)                      | (495,588)                                        | (6,926)                          | (1,961,971)      |
| <b>Revalued net book amount</b>                   | <b>1,155,175</b>                 | <b>385,015</b>                                   | <b>5,679</b>                     | <b>1,545,869</b> |
| <b>At amounts stated on historical cost basis</b> |                                  |                                                  |                                  |                  |
| <b>At 31 December 2009</b>                        |                                  |                                                  |                                  |                  |
| Cost                                              | 469,595                          | 351,197                                          | 10,815                           | 831,607          |
| Accumulated depreciation                          | (143,757)                        | (170,558)                                        | (8,026)                          | (322,341)        |
| <b>Net book amount</b>                            | <b>325,838</b>                   | <b>180,639</b>                                   | <b>2,789</b>                     | <b>509,266</b>   |
| <b>At 31 December 2010</b>                        |                                  |                                                  |                                  |                  |
| Cost                                              | 496,062                          | 374,573                                          | 10,951                           | 881,586          |
| Accumulated depreciation                          | (153,748)                        | (184,264)                                        | (8,483)                          | (346,495)        |
| <b>Net book amount</b>                            | <b>342,314</b>                   | <b>190,309</b>                                   | <b>2,468</b>                     | <b>535,091</b>   |

### 13 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 based on value in use calculations. The accumulated impairment as at 31 December 2010 is in the amount of LVL 38,358 thousand (31/12/2009: LVL 21,259 thousand). The cash-generating unit is defined as the assets of TEC-2 plant. Additional impairment is due to TEC-2 technological equipment and machinery planned to be partly discontinued after 2013, specification of heat demand forecasts and new additional legislation regulations for excise tax application to natural gas used in generation of electricity. Nominal pre-tax discount rate for the future cash flows has diminished from 11.1% in 2009 to 8.5% in 2010, which is caused by decreased state credit risk factor.



13 c) Investment properties (buildings):

|                                               | Augstsprieguma<br>tīkls AS buildings<br>LVL'000 | Liepājas Enerģija<br>SIA buildings<br>LVL'000 | Total<br>LVL'000 |
|-----------------------------------------------|-------------------------------------------------|-----------------------------------------------|------------------|
| <b>Year ended 31 December 2009</b>            |                                                 |                                               |                  |
| Opening net book amount                       | 456                                             | 283                                           | 739              |
| Reclassified to property, plant and equipment | -                                               | (283)                                         | (283)            |
| Depreciation                                  | (20)                                            | -                                             | (20)             |
| <b>Closing net book amount</b>                | <b>436</b>                                      | <b>-</b>                                      | <b>436</b>       |
| <b>At 31 December 2009</b>                    |                                                 |                                               |                  |
| Costs                                         | 507                                             | -                                             | 507              |
| Accumulated depreciation                      | (71)                                            | -                                             | (71)             |
| <b>Net book amount</b>                        | <b>436</b>                                      | <b>-</b>                                      | <b>436</b>       |
| <b>Year ended 31 December 2010</b>            |                                                 |                                               |                  |
| Opening net book amount                       | 436                                             | -                                             | 436              |
| Reclassified to property, plant and equipment | (53)                                            | -                                             | (53)             |
| Depreciation                                  | (1)                                             | -                                             | (1)              |
| <b>Closing net book amount</b>                | <b>382</b>                                      | <b>-</b>                                      | <b>382</b>       |
| <b>At 31 December 2010</b>                    |                                                 |                                               |                  |
| Costs                                         | 454                                             | -                                             | 454              |
| Accumulated depreciation                      | (72)                                            | -                                             | (72)             |
| <b>Net book amount</b>                        | <b>382</b>                                      | <b>-</b>                                      | <b>382</b>       |

## 14 INVESTMENTS IN ASSOCIATES AND OTHER FINANCIAL INVESTMENT

|                                     | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b> | <b>4,261</b>    | <b>4,063</b>    |
| Share of profit                     | 203             | 198             |
| <b>At the end of the year</b>       | <b>4,464</b>    | <b>4,261</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.

| Name                          | Assets<br>LVL'000 | Liabilities<br>LVL'000 | Net sales<br>LVL'000 | Share of<br>profit<br>LVL'000 |
|-------------------------------|-------------------|------------------------|----------------------|-------------------------------|
| <b>As of 31 December 2009</b> |                   |                        |                      |                               |
| Nordic Energy Link AS         | 67,955            | 50,931                 | 12,492               | 198                           |
|                               | <b>67,955</b>     | <b>50,931</b>          | <b>12,492</b>        | <b>198</b>                    |
| <b>As of 31 December 2010</b> |                   |                        |                      |                               |
| Nordic Energy Link AS*        | 63,105            | 45,368                 | 10,500               | 203                           |
|                               | <b>63,105</b>     | <b>45,368</b>          | <b>10,500</b>        | <b>203</b>                    |

\* Unaudited financial data (financial year of associate ends on 31 December 2010)

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The Parent Company's participating interest in subsidiaries and associates:

| Name                              | Country of incorporation | Business activity held      | Interest held, % |            |
|-----------------------------------|--------------------------|-----------------------------|------------------|------------|
|                                   |                          |                             | 31/12/2010       | 31/12/2009 |
| <b>Subsidiaries:</b>              |                          |                             |                  |            |
| Augstsprieguma tīkls AS           | Latvia                   | Transmission                | 100%             | 100%       |
| Sadales tīkls AS                  | Latvia                   | Distribution                | 100%             | 100%       |
| Latvenergo Kaubandus OŪ           | Estonia                  | Electricity trading         | 100%             | 100%       |
| Latvenergo Prekyba UAB            | Lithuania                | Electricity trading         | 100%             | 100%       |
| Liepājas enerģija SIA             | Latvia                   | Heating                     | 51%              | 51%        |
| <b>Associates:</b>                |                          |                             |                  |            |
| Nordic Energy Link AS             | Estonia                  | Transmission                | 25%              | 25%        |
| Pirmais Slēgtais Pensiju Fonds AS | Latvia                   | Management of pension plans | 50%              | 50%        |

The Group owns 50% of the shares in *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 plan. Therefore, investment in *Pirmais Slēgtais Pensiju Fonds AS* is valued at cost.

## 15 INVENTORIES

|                                                              | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|--------------------------------------------------------------|-----------------------|-----------------------|
| Raw materials and spare parts                                | 9,807                 | 11,001                |
| Technological fuel                                           | 4,124                 | 3,731                 |
| Advance payments for inventories                             | 29                    | 79                    |
| Provision for raw materials, spare parts, technological fuel | (2,459)               | (1,768)               |
|                                                              | <b>11,501</b>         | <b>13,043</b>         |

Changes in the provision for raw materials and spare parts are included in the Consolidated Income Statement classification "Raw materials and consumables used".

### *Movement on the provision for raw materials, spare parts and technological fuel:*

|                                              | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>          | <b>1,768</b>    | <b>1,414</b>    |
| Inventories written off                      | (1,026)         | (791)           |
| Charged to the Consolidated Income Statement | 1,717           | 1,145           |
| <b>At the end of the year</b>                | <b>2,459</b>    | <b>1,768</b>    |

## 16 TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES

### 16 a) Trade receivables, net

|                                                | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|------------------------------------------------|-----------------------|-----------------------|
| <b>Receivables</b>                             |                       |                       |
| - Electricity customers                        | 48,494                | 39,894                |
| - Heating customers                            | 16,816                | 10,865                |
| - Other trade receivables                      | 5,939                 | 4,341                 |
|                                                | <b>71,249</b>         | <b>55,100</b>         |
| <b>Provision for impairment of receivables</b> |                       |                       |
| - Electricity customers                        | (6,809)               | (5,003)               |
| - Heating customers                            | (394)                 | (345)                 |
| - Other trade receivables                      | (1,015)               | (789)                 |
|                                                | <b>(8,218)</b>        | <b>(6,137)</b>        |
| <b>Receivables, net</b>                        |                       |                       |
| - Electricity customers                        | 41,685                | 34,891                |
| - Heating customers                            | 16,422                | 10,520                |
| - Other trade receivables                      | 4,924                 | 3,552                 |
|                                                | <b>63,031</b>         | <b>48,963</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 overdue days and calculated impairment loss:

|                                                        | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|--------------------------------------------------------|-----------------------|-----------------------|
| <b>Electricity receivables:</b>                        |                       |                       |
| Fully performing receivables                           | 37,870                | 30,487                |
| Overdue receivables but not impaired:                  |                       |                       |
| - Receivables overdue by 1-45 days                     | 3,339                 | 3,636                 |
| Impaired receivables:                                  |                       |                       |
| - Receivables overdue by 46-90 days                    | 602                   | 945                   |
| - Receivables overdue by 91-180 days                   | 703                   | 1,180                 |
| - Receivables overdue by more than 181 day             | 5,980                 | 3,646                 |
|                                                        | <b>48,494</b>         | <b>39,894</b>         |
| <b>Provision for impaired electricity receivables:</b> |                       |                       |
| - Receivables overdue by 46-90 days                    | (301)                 | (472)                 |
| - Receivables overdue by 91-180 days                   | (528)                 | (885)                 |
| - Receivables overdue by more than 181 day             | (5,980)               | (3,646)               |
|                                                        | <b>(6,809)</b>        | <b>(5,003)</b>        |
| <b>Electricity receivables, net</b>                    |                       |                       |
| Fully performing receivables                           | 37,870                | 30,487                |
| Net overdue receivables but not impaired:              |                       |                       |
| - Receivables overdue by 1-45 days                     | 3,339                 | 3,636                 |
| Net impaired receivables:                              |                       |                       |
| - Receivables overdue by 46-90 days                    | 301                   | 473                   |
| - Receivables overdue by 91-180 days                   | 175                   | 295                   |
|                                                        | <b>41,685</b>         | <b>34,891</b>         |

*Heating and other receivables grouped by overdue days and calculated impairment loss:*

|                                                                                          | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| <b>Heating and other trade receivables:</b>                                              |                       |                       |
| Fully performing receivables                                                             | 20,820                | 13,685                |
| Overdue receivables but not impaired:                                                    |                       |                       |
| - Receivables overdue by 1-30 days                                                       | 404                   | 308                   |
| Impaired receivables:                                                                    |                       |                       |
| - Receivables overdue by 31-90 days                                                      | 242                   | 152                   |
| - Receivables overdue by more than 91 day                                                | 1,289                 | 1,061                 |
|                                                                                          | <b>22,755</b>         | <b>15,206</b>         |
| <b>Provision for overdue heating and other trade receivables classified as doubtful:</b> |                       |                       |
| - Receivables overdue by 31-90 days                                                      | (120)                 | (73)                  |
| - Receivables overdue by more than 91 day                                                | (1,289)               | (1,061)               |
|                                                                                          | <b>(1,409)</b>        | <b>(1,134)</b>        |
| <b>Heating and other trade receivables, net</b>                                          |                       |                       |
| Fully performing receivables                                                             | 20,820                | 13,685                |
| Net overdue receivables but not impaired:                                                |                       |                       |
| - Receivables overdue by 1-30 days                                                       | 404                   | 308                   |
| Net impaired receivables:                                                                |                       |                       |
| - Receivables overdue by 31-90 days                                                      | 122                   | 79                    |
|                                                                                          | <b>21,346</b>         | <b>14,072</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 Note 2.10). 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).

*Movements on provision for impairment of trade receivables are as follows:*

|                                                          | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                      | <b>6,137</b>    | <b>2,773</b>    |
| Receivables written off during the year as uncollectible | (288)           | (203)           |
| Provision for impaired receivables                       | 2,369           | 3,567           |
| <b>At the end of the year</b>                            | <b>8,218</b>    | <b>6,137</b>    |

The creation and release of provision for impaired trade receivables have been included in the Consolidated Income Statement classification "Other operating expenses" as sales and customer services costs (Note 9).

**16 b) Other current receivables**

|                            | <b>31/12/2010</b> | <b>31/12/2009</b> |
|----------------------------|-------------------|-------------------|
|                            | <b>LVL'000</b>    | <b>LVL'000</b>    |
| Accrued income             | 7,522             | 7,344             |
| Pre-tax and overpaid taxes | 13,513            | 11,133            |
| Deferred expenses          | 364               | 624               |
| Other receivables          | 483               | 412               |
|                            | <b>21,882</b>     | <b>19,513</b>     |

None of the receivables are secured with pledges or otherwise. The carrying amounts of trade receivables and other receivables are assumed to approximate their fair values.

**17 CASH AND CASH EQUIVALENTS**

|                          | <b>31/12/2010</b> | <b>31/12/2009</b> |
|--------------------------|-------------------|-------------------|
|                          | <b>LVL'000</b>    | <b>LVL'000</b>    |
| Cash at bank and on hand | 52,399            | 46,455            |
| Short-term bank deposits | 181,867           | 108,483           |
|                          | <b>234,266</b>    | <b>154,938</b>    |

Cash at bank 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 2010 the average annual effective interest rate earned on short-term cash deposits was 3.49% (2009: 11.43%). See also Note 3.1.b).

The carrying amounts of cash and cash equivalents are assumed to approximate their fair values.

**18 SHARE CAPITAL**

The registered share capital of the Parent Company is LVL 323,544 thousand (2009: 317,653 thousand) and consists of 323,544 thousand (2009: 317,653 thousand) ordinary shares with the nominal value of LVL 1 per share (2009: LVL 1 per share). All shares are fully paid up.

In 2010, in accordance with the Cabinet of Ministers Directive No. 496 dated 23 July 2009: "On the Investment of the State's property units in the Share Capital of *Latvenergo AS*", Directive No. 519 dated 3 August 2009: "On the granting of authorization to the Investment of the Salaspil's electric power supply unit in the Share Capital of *Latvenergo AS*", and Directive No. 815 dated 30 November 2009: "On the Investment of the State's land property units in the Share Capital of *Latvenergo AS*", real estate in the amount of LVL 5,891 thousand was invested in the Parent Company's share capital. The real estate value was determined by external certified valuers applying cost model, based on purchase costs of similar assets. Increase in the share capital was approved by the Parent Company's Shareholders' meeting on 5 February 2010 and registered with the Commercial Register of Latvia on 18 February 2010.

## 19 RESERVES AND DIVIDENDS

As at 31 December 2010, the Group's reserves in the amount of LVL 972,278 thousand (31/12/2009: LVL 549,354 thousand) consist of the property, plant and equipment revaluation reserve, hedge reserve and other reserves. The Group cannot distribute the property, plant and equipment revaluation and hedge reserves. Other reserves are maintained with the aim to maintain stability in the operations of the Group entities. Other reserves of prior accounting periods were restated with the deferred tax asset adjustment relating to the previously estimated and recognised received investment credit for corporate income tax purposes.

|                                                                                        | Non-current<br>assets<br>revaluation<br>reserve<br>LVL'000 | Hedge<br>reserve<br>LVL'000 | Trans-<br>lation<br>LVL'000 | Other<br>reserves<br>LVL'000 | TOTAL<br>LVL'000 |
|----------------------------------------------------------------------------------------|------------------------------------------------------------|-----------------------------|-----------------------------|------------------------------|------------------|
| <b>As at 31 December 2008</b>                                                          | <b>554,334</b>                                             | <b>(12,940)</b>             | <b>-</b>                    | <b>3,818</b>                 | <b>545,212</b>   |
| Transfer from previous year<br>profit                                                  | -                                                          | -                           | -                           | 2                            | 2                |
| Restated error of prior period                                                         | -                                                          | -                           | -                           | (3,818)                      | (3,818)          |
| Disposal of non-current assets<br>revaluation reserve (Note 13a)                       | (1,701)                                                    | -                           | -                           | -                            | (1,701)          |
| Deferred tax related to PPE<br>revaluation reserve (Note 11)                           | 256                                                        | -                           | -                           | -                            | 256              |
| Gains from fair value changes in<br>derivative financial instruments<br>(Note 24 a, b) | -                                                          | 9,403                       | -                           | -                            | 9,403            |
| <b>As at 31 December 2009</b>                                                          | <b>552,889</b>                                             | <b>(3,537)</b>              | <b>-</b>                    | <b>2</b>                     | <b>549,354</b>   |
| Currency translation differences                                                       | -                                                          | -                           | 8                           | -                            | 8                |
| Revaluation of property, plant<br>and equipment (PPE) (Note 13a)                       | 499,946                                                    | -                           | -                           | -                            | 499,946          |
| Disposal of non-current assets<br>revaluation reserve (Note 13a)                       | (1,957)                                                    | -                           | -                           | -                            | (1,957)          |
| Deferred tax related to PPE<br>revaluation reserve (Note 11)                           | (74,698)                                                   | -                           | -                           | -                            | (74,698)         |
| Loss from fair value changes in<br>derivative financial instruments<br>(Note 24 a, d)  | -                                                          | (375)                       | -                           | -                            | (375)            |
| <b>As at 31 December 2010</b>                                                          | <b>976,180</b>                                             | <b>(3,912)</b>              | <b>8</b>                    | <b>2</b>                     | <b>972,278</b>   |

The dividends paid in 2010 were LVL 20,230 thousand (LVL 0.064 per share) and in 2009 - LVL 13,001 thousand (LVL 0.041 per share).

The distribution of net profit for the 2010 is subject to a resolution of the Parent Company's Shareholder's meeting.

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 2011" the Management Board of Latvenergo AS proposes to allocate LVL 35,000,000 as dividends and to reinvest the remaining profit portion of LVL 9,562,097 as share capital of the Parent Company.



## 20 BORROWINGS

|                                                       | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|-------------------------------------------------------|-----------------------|-----------------------|
| <b>Non-current borrowings (excl. current portion)</b> | <b>506,756</b>        | <b>483,652</b>        |
| Current portion of non-current borrowings             | 36,935                | 21,906                |
| Accrued interest on non-current borrowings            | 1,916                 | 1,410                 |
| Current borrowings                                    | -                     | 257                   |
| <b>Total current borrowings</b>                       | <b>38,851</b>         | <b>23,573</b>         |
| <b>Total borrowings</b>                               | <b>545,607</b>        | <b>507,225</b>        |

### Movement in borrowings:

|                                  | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------|-----------------|-----------------|
| <b>Balance as of 1 January</b>   | <b>507,225</b>  | <b>496,317</b>  |
| Borrowings received              | 60,041          | 35,140          |
| Borrowing repaid                 | (22,164)        | (21,658)        |
| Accrued interest on borrowings   | 505             | (2,574)         |
| <b>Balance as of 31 December</b> | <b>545,607</b>  | <b>507,225</b>  |

### Borrowings by categories of lenders:

|                                                             | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|-------------------------------------------------------------|-----------------------|-----------------------|
| Foreign investment banks                                    | 334,517               | 311,332               |
| Foreign commercial banks                                    | 40,229                | 42,760                |
| Financial institutions registered in the Republic of Latvia | 170,861               | 153,133               |
| <b>Total borrowings:</b>                                    | <b>545,607</b>        | <b>507,225</b>        |

### Borrowings by maturity:

|                                                        | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|--------------------------------------------------------|-----------------------|-----------------------|
| <b>Fixed rate non-current borrowings:</b>              |                       |                       |
| - < 1 year                                             | 292                   | 713                   |
| - 1- 5 years                                           | 1,124                 | 1,123                 |
| - > 5 years                                            | 141                   | 422                   |
| <b>Total fixed rate non-current borrowings:</b>        | <b>1,557</b>          | <b>2,258</b>          |
| <b>Floating rate borrowings:</b>                       |                       |                       |
| - < 1 year (current borrowings)                        | -                     | 257                   |
| - < 1 year (current portion of non-current borrowings) | 38,559                | 22,605                |
| - 1- 5 years                                           | 333,613               | 227,875               |
| - > 5 years                                            | 171,878               | 254,230               |
| <b>Total floating rate borrowings:</b>                 | <b>544,050</b>        | <b>504,967</b>        |
| <b>Total borrowings:</b>                               | <b>545,607</b>        | <b>507,225</b>        |

**Borrowings by pricing period (considering the effect of derivative financial instruments):**

|                          | <b>31/12/2010</b> | <b>31/12/2009</b> |
|--------------------------|-------------------|-------------------|
|                          | <b>LVL'000</b>    | <b>LVL'000</b>    |
| - < 1 year               | 309,836           | 293,854           |
| - 1– 5 years             | 185,029           | 76,957            |
| - > 5 years              | 50,742            | 136,414           |
| <b>Total borrowings:</b> | <b>545,607</b>    | <b>507,225</b>    |

At 31 December 2010 and at 31 December 2009 the Group had none of their borrowings denominated in other currencies than the 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 143.68 thousand (2009: 83 thousand). The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by average market margin. The average interest rate for discounting cash flows of non-current borrowings was at 2.99% level (2009: 4.85%).

***a) 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 33.5 million (2009: LVL 20.3 million) to secure its current and non-current borrowings.

***b) Un-drawn borrowing facilities***

As at 31 December 2010 the undrawn portion of committed non-current credit facilities amounts to LVL 253 million (31/12/2009: LVL 140.6 million).

At 31 December 2010 the Group had available LVL 17.57 million (31/12/2009: LVL 20.5 million) of undrawn committed short-term borrowing facilities in respect of which all conditions precedent had been met.

***c) Weighted average effective interest rate***

During the reporting year the weighted average effective interest rate on non-current borrowings was 1.70% (2009: 2.75%), weighted average effective interest rate for current borrowings was 1.949% (2009: 1.894%). At 31 December 2010 the interest rates for the non-current borrowings in Euro were 3 and 6 month EURIBOR +0.453% (31/12/2009: +0.536%). At 31 December 2010 fifteen interest rate swap agreements were concluded for the notional amount of EUR 348.2 million or LVL 244.7 million (31/12/2009: EUR 341 million or LVL 239.7 million) and the interest rate was fixed for the periods from 3 to 10 years (see Note 24).

## 21 PROVISIONS

### 21 a) Provisions for post-employment benefits

|                                                       | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-------------------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>                   | <b>7,473</b>    | <b>10,103</b>   |
| Current service cost                                  | 309             | 1,368           |
| Interest cost                                         | 360             | 326             |
| Post-employment benefits paid                         | (440)           | (2,117)         |
| Gains as a result of changes in actuarial assumptions | (381)           | (2,207)         |
| <b>At the end of the year</b>                         | <b>7,321</b>    | <b>7,473</b>    |

Total charge is included in the Consolidated Income Statement classification "Personnel expenses" (see Note 8):

|                                              | 2010<br>LVL'000 | 2009<br>LVL'000 |
|----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>          | <b>7,473</b>    | <b>10,103</b>   |
| Charged to the Consolidated Income Statement | (152)           | (2,630)         |
| <b>At the end of the year</b>                | <b>7,321</b>    | <b>7,473</b>    |

Discount rate used for discounting benefit obligations was 5.53% (2009: 6.75%), considering the market yields on government bonds at the end of the reporting period. 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 2.7% (2009: 4%) 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.

### 21 b) Environmental provisions

|                                     | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b> | <b>1,376</b>    | <b>1,376</b>    |
| <b>At the end of the year</b>       | <b>1,376</b>    | <b>1,376</b>    |

The environmental provision in the amount of LVL 1,376 thousand (2009: LVL 1,376 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. The amount of the provision is calculated taking into account the construction cost index (data from the Central Statistical Bureau). The changes in construction costs in 2010 were not significant for revaluation of the provision.

## 22 OTHER LIABILITIES AND DEFERRED INCOME

|                                                                                              | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|----------------------------------------------------------------------------------------------|-----------------------|-----------------------|
| Deferred non-current income from connection fees                                             | 82,688                | 76,296                |
| Deferred income from plant and equipment received free of charge and financing from EU funds | 234                   | 948                   |
| Other liabilities                                                                            | 11,967                | 1,201                 |
| <b>Total other liabilities and deferred income:</b>                                          | <b>94,889</b>         | <b>78,445</b>         |

### *Movement in deferred connection fees (non-current and current portion):*

|                                               | 2010<br>LVL'000 | 2009<br>LVL'000 |
|-----------------------------------------------|-----------------|-----------------|
| <b>At the beginning of the year</b>           | <b>80,699</b>   | <b>69,010</b>   |
| Received                                      | 12,415          | 16,092          |
| Credited to the Consolidated Income Statement | (5,213)         | (4,403)         |
| <b>At the end of the year</b>                 | <b>87,901</b>   | <b>80,699</b>   |

## 23 TRADE AND OTHER PAYABLES

|                                                     | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|-----------------------------------------------------|-----------------------|-----------------------|
| Payables for materials and services                 | 30,034                | 21,080                |
| Payables for electricity                            | 15,169                | 8,571                 |
| Accrued tax liabilities for revenue                 | 15,320                | 14,073                |
| State social security contributions and other taxes | 2,467                 | 4,494                 |
| Advances received                                   | 5,702                 | 7,967                 |
| Deferred income from connection fees                | 5,213                 | 4,403                 |
| Accrued expenses                                    | 6,274                 | 10,399                |
| Other current payables                              | 2,177                 | 2,239                 |
| <b>Total trade and other current payables:</b>      | <b>82,356</b>         | <b>73,226</b>         |

The carrying amounts of trade and other payables are assumed to approximate their fair values.

## 24 DERIVATIVE FINANCIAL INSTRUMENTS

### *a) Interest rate swaps*

The notional amounts of the outstanding interest rate swap contracts at 31 December 2010 were EUR 348.2 million or LVL 244.7 million (31/12/2009: EUR 341 million or LVL 239.7 million). Interest rate swaps are agreed with 3 to 10 year maturities and hedged floating rates are 3 and 6 month EURIBOR. At 31 December 2010 fixed interest rates vary from 2.3835% to 4.493% (31/12/2009: from 2.3835% to 4.493%).

The Parent Company has signed eleven interest rate swap agreements that are designated to comply with hedge accounting and were re-measured prospectively and retrospectively to test whether they are effective within the hedging period. It was established that they are fully effective and therefore there is no ineffective portion to be recognized within profit or loss in the Consolidated Income Statement.

In the table below fair value changes of interest rate swaps are disclosed:

|                                                                            | 2010           |              | 2009         |              |
|----------------------------------------------------------------------------|----------------|--------------|--------------|--------------|
|                                                                            | LVL'000        |              | LVL'000      |              |
|                                                                            | Assets         | Liabilities  | Assets       | Liabilities  |
| <b>Outstanding fair value at the beginning of the year</b>                 | <b>(145)</b>   | <b>6,270</b> | <b>(43)</b>  | <b>3,125</b> |
| Included in the Consolidated Income Statement, net (Note 10a and Note 10b) | -              | (21)         | 43           | 1,181        |
| Included in Equity (Note 19)                                               | (866)          | 1,805        | (145)        | 1,964        |
| <b>Outstanding fair value at the end of the year</b>                       | <b>(1,011)</b> | <b>8,054</b> | <b>(145)</b> | <b>6,270</b> |

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 2010 43.4% (31/12/2009: 42.2%) of the Group's borrowings had fixed interest rates (considering the interest rate swaps), and average remaining time to interest re-pricing was 2.3 years (2009: 2.4 years).

### ***b) Electricity swaps***

As at 31 December 2010 the Parent Company has agreed 85 (31/12/2009: 39) electricity swap contracts with total outstanding volume of 3 007 701 MWh (31/12/2009: 1 866 336 MWh) and value of EUR 152 million or LVL 106.8 million (2009: EUR 96.7 million or LVL 68 million). Electricity swaps are signed for the maturities from one month to one year starting from 1 January 2010 to 31 December 2012.

Electricity swap contracts are agreed through financial counterparties and by using the Nordic energy exchange *NordPool* pricing either to lock in favourable price movements or according to the Group's Financial Risk Management Policy for hedging purposes. All purchased swap contracts were contracts with fixed amount of electricity and price in Euros. Electricity swaps that were designated to comply with hedge accounting treatment were re-measured prospectively and retrospectively to test whether they are effective within the hedging period, see Note 3.1. It was established that due falling consumption and increase of overdue electricity receivables they were ineffective according to hedge accounting treatment and therefore were recognized within profit or loss in Consolidated Income Statement (Note 7). As all purchased swaps did not hedge open positions any more, then they were effectively closed through concluding opposite electricity swaps, except ones related to year 2012.

The Parent Company also used favourable price movements in the *NordPool* by fixing selling price for flood energy of April 2011. As at 31 December 2010 all electricity swaps were recognized within profit or loss in Consolidated Income Statement.

In the table below fair value changes of electricity swaps are disclosed:

|                                                            | 2010           |               | 2009     |               |
|------------------------------------------------------------|----------------|---------------|----------|---------------|
|                                                            | LVL'000        |               | LVL'000  |               |
|                                                            | Assets         | Liabilities   | Assets   | Liabilities   |
| <b>Outstanding fair value at the beginning of the year</b> | <b>-</b>       | <b>10,258</b> | <b>-</b> | <b>16,565</b> |
| Included in the Consolidated Income Statement (Note 7)     | (2,393)        | (10,258)      | -        | 4,915         |
| Included in Equity (Note 19)                               | -              | -             | -        | (11,222)      |
| <b>Outstanding fair value at the end of the year</b>       | <b>(2,393)</b> | <b>-</b>      | <b>-</b> | <b>10,258</b> |

*c) CO<sub>2</sub> emissions allowances forward contracts*

As at 31 December 2010 the Parent Company has agreed 25 forward contracts of CO<sub>2</sub> emission allowances purchase or sale (31/12/2009: 31) which included 9 purchase contracts of European Union Allowances, hereinafter – EUAs (31/12/2009: 9), 12 purchase contracts of Certified Emission Reductions, hereinafter – CERs (31/12/2009: 19) and 4 sale contracts of CERs (31/12/2009: 3). The total value of agreed contracts was EUR 9.4 million or LVL 6.6 million (31/12/2009: EUR 12.4 million or LVL 8.7 million).

As at 31 December 2010 total amount of allocated and procured CO<sub>2</sub> emission allowances for the current allocation period till the end of 2012 is sufficient to offset expected emissions. The Parent Company plans to procure and offset about 0.5 million tons of CO<sub>2</sub> emission with cheaper CERs in the current allocation period. At 31 December 2010 EUAs were recognized as derivative financial instruments, and the fair value of EUAs was negative in the amount of EUR 3 612 thousand or LVL 2 538 thousand (31/12/2009: EUR 3,816 thousand or LVL 2,682 thousand).

As at 31 December 2010 CO<sub>2</sub> emissions allowances forward contracts fair value changes are included in the Consolidated Income Statement in the amount of EUR 757 thousand or LVL 532 thousand (see Note 7) (31/12/2009: EUR 4,789 thousand or LVL 3,366 thousand).

In the table below fair value changes of CO<sub>2</sub> emission allowances forward contracts are disclosed:

|                                                            | <b>2010</b>        | <b>2009</b>        |
|------------------------------------------------------------|--------------------|--------------------|
|                                                            | <b>LVL'000</b>     | <b>LVL'000</b>     |
|                                                            | <b>Liabilities</b> | <b>Liabilities</b> |
| <b>Outstanding fair value at the beginning of the year</b> | <b>3,366</b>       | <b>-</b>           |
| Included in accrued liabilities                            | 608                | -                  |
| Included in the Consolidated Income Statement (Note 7)     | (532)              | 3,366              |
| <b>Outstanding fair value at the end of the year</b>       | <b>3,442</b>       | <b>3,366</b>       |

*d) Forward foreign currencies exchange contracts*

The notional principal amounts of the outstanding EUR/USD forward foreign currencies exchange contracts as at 31 December 2010 were USD 38.5 million or LVL 19.2 million (2009: nil).

The hedged highly probable forecast transactions denominated in foreign currency are expected to occur at various dates during the next 33 months. Fair value gains and losses on forward foreign currencies exchange contracts as at 31 December 2010 are recognized in the hedging reserve in Equity (Note 19) as they qualify under IAS 39 requirements of hedge accounting.

All outstanding EUR/USD forward foreign currencies exchange contracts at 31 December 2010 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 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. The plus/minus 1% corridor within the EUR/LVL peg may create insignificant inefficiency of designed hedges, which then is recognized through profit or loss in Consolidated Income Statement.



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In the table below fair value changes of forward foreign currencies exchange contracts are disclosed:

|                                                            | 2010<br>LVL'000 |             | 2009<br>LVL'000 |             |
|------------------------------------------------------------|-----------------|-------------|-----------------|-------------|
|                                                            | Assets          | Liabilities | Assets          | Liabilities |
| <b>Outstanding fair value at the beginning of the year</b> | -               | -           | -               | -           |
| Included in Equity (Note 19)                               | (564)           | -           | -               | -           |
| <b>Outstanding fair value at the end of the year</b>       | <b>(564)</b>    | -           | -               | -           |

There was no ineffectiveness to be recorded through profit or loss in Consolidated Income Statement from forward foreign currencies exchange contracts. The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in Consolidated Statement of Financial Position.

### *e) Classification of fair values of derivatives*

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. The Group implemented the above-mentioned amendments to IAS 1 in the Consolidated Financial Statements for 2008. Derivatives that have a maturity of more than twelve months and have been expected to hold for more than twelve months after the end of the reporting period were classified as non-current assets or liabilities.

|                                               | 2010<br>LVL'000 |             | 2009<br>LVL'000 |             |
|-----------------------------------------------|-----------------|-------------|-----------------|-------------|
| <b>Outstanding fair value of derivatives:</b> | Current         | Non-current | Current         | Non-current |
| Assets                                        | 3,968           | -           | 145             | -           |
| Liabilities*                                  | 4,910           | 7,088       | 10,402          | 10,135      |

\* incl. fair value of guarantees (Note 26)

## 25 RELATED PARTY TRANSACTIONS

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state. Related parties, other than subsidiaries and associates, are those companies in which the State exercises control or has significant influence.

The following transactions were carried out with related parties:

|                                                  | 2010<br>LVL'000 | 2009<br>LVL'000 |
|--------------------------------------------------|-----------------|-----------------|
| <b><i>a) Sales of goods and services:</i></b>    |                 |                 |
| - Associates                                     | 13,762          | 213             |
| - Other entities under common control            | 61,336          | 60,472          |
| <b>Total sales to related parties:</b>           | <b>75,098</b>   | <b>60,685</b>   |
| <b><i>b) Purchase of goods and services:</i></b> |                 |                 |
| - Associates                                     | 3,425           | 2,324           |
| - Other entities under common control            | 12,378          | 11,725          |
| <b>Total purchases from related parties:</b>     | <b>15,803</b>   | <b>14,049</b>   |

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|  | 31/12/2010 | 31/12/2009 |
|--|------------|------------|
|  | LVL'000    | LVL'000    |

*c) Balances at the end of year arising from sale of goods/services:*

**Trade receivables from:**

|                                                      |               |              |
|------------------------------------------------------|---------------|--------------|
| - Associates                                         | 28            | -            |
| - Other entities under common control                | 13,699        | 8,599        |
| <b>Total trade receivables from related parties:</b> | <b>13,727</b> | <b>8,599</b> |

*d) Balances at the end of year arising from purchase of goods/services:*

**Trade payables to:**

|                                                 |              |              |
|-------------------------------------------------|--------------|--------------|
| - Associates                                    | 138          | 12           |
| - Other entities under common control           | 2,013        | 1,070        |
| <b>Total trade payables to related parties:</b> | <b>2,151</b> | <b>1,082</b> |

*e) Accrued liabilities due to related party transactions:*

|                                       |           |           |
|---------------------------------------|-----------|-----------|
| - Other entities under common control | 78        | 61        |
|                                       | <b>78</b> | <b>61</b> |

The Group has not created any provisions or incurred write-offs from transactions with related parties, as all debts are recoverable.

The transactions disclosed above do not include sales of electricity in the ordinary course of business of the Group due to a very large volume of those transactions and the fact that these transactions are performed at tariffs regulated by the Latvian Regulatory authority (Public Utilities Commission) applicable to other similar customers.

Receivables and payables with related parties are current balances for services and goods. None of the amounts at the end of reporting period are secured.

Remuneration to the Members of the Management Boards of the Group entities is disclosed in Note 8.

## 26 ISSUED GUARANTEES

|  | 2010    | 2009    |
|--|---------|---------|
|  | LVL'000 | LVL'000 |

**Issued guarantees by the Group to guarantee obligations to third parties:**

|                                                                                        |               |               |
|----------------------------------------------------------------------------------------|---------------|---------------|
| Guarantee on behalf of Nordic Energy Link AS                                           | 10,825        | 11,733        |
| <b>Total issued guarantees by the Group to guarantee obligations to third parties:</b> | <b>10,825</b> | <b>11,733</b> |

Guarantee on behalf of *Nordic Energy Link AS* was provided for receiving long-term loan facility. The fair value of guarantee on behalf of *Nordic Energy Link AS* (validity term – December 15, 2014) exceeds its carrying amount by LVL 502 thousand (2009: LVL 643 thousand). The fair value calculations are based on discounted cash flows using discount factor of respective EUR swap rates increased by average market margin of loans with respective maturities. During 2010 the average interest rate for discounting cash flow was 2.57% (2009: 4.25%).

## 27 CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As of 31 December 2010 the Parent Company had commitments amounting to LVL 221.7 million (31/12/2009: LVL 76.5 million) for capital expenditure contracted but not delivered at the end of the reporting period.

The tax authorities may at any time inspect the books and records within 3 years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The Group's and the Parent Company's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

## 28 HELD-TO-MATURITY FINANCIAL ASSETS

Held-to-maturity financial assets are non-derivative financial assets 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.

No financial assets measured at amortised cost were reclassified during 2010 (2009: nil). There were no gains or losses realized on the disposal of held-to-maturity financial assets in 2010 (2009: nil), as all the financial assets were disposed of at their redemption date. All held-to-maturity financial assets are denominated in the LVL currency. The maximum exposure to credit risk at the reporting date is the carrying amount of held-to-maturity financial assets.

As at 31 December 2010 all the Group's held-to-maturity financial assets were State Treasury bills with six months maturity purchased with the purpose to invest liquidity reserve in the low risk financial instruments with higher yield.

|                                                             | 2010<br>LVL'000 |             | 2009<br>LVL'000 |             |
|-------------------------------------------------------------|-----------------|-------------|-----------------|-------------|
| Outstanding amortised value:                                | Current         | Non-current | Current         | Non-current |
| Held-to-maturity financial assets<br>(State Treasury Bills) | 2,387           | -           | -               | -           |

## 29 EVENTS AFTER THE REPORTING PERIOD

On 10 February 2011 Latvijas elektriskie tīkli AS – 100% subsidiary of Latvenergo AS has been registered in the Commercial Register of Latvia, and since 1 April 2011 it provides electricity transmission system assets management functions.

There have been no other 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 2010.

### 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.

#### 30 a) Income Statement

|                                                                                                  | 2010<br>LVL'000 | 2009<br>LVL'000 |
|--------------------------------------------------------------------------------------------------|-----------------|-----------------|
| Revenue                                                                                          | 655,247         | 609,750         |
| Other income                                                                                     | 2,322           | 6,054           |
| Raw materials and consumables used                                                               | (246,204)       | (250,210)       |
| Personnel expense                                                                                | (19,400)        | (19,396)        |
| Depreciation, amortisation and impairment of intangible assets and property, plant and equipment | (142,867)       | (112,034)       |
| Other operating expenses                                                                         | (189,165)       | (204,421)       |
| <b>Operating profit</b>                                                                          | <b>59,933</b>   | <b>29,743</b>   |
| Finance costs, net                                                                               | (10,929)        | (6,991)         |
| <b>Profit before tax</b>                                                                         | <b>49,004</b>   | <b>22,752</b>   |
| Income tax                                                                                       | (6,399)         | (4,223)         |
| <b>Profit for the year</b>                                                                       | <b>42,605</b>   | <b>18,529</b>   |

#### 30 b) Statement of Financial Position

|                                        | 31/12/2010<br>LVL'000 | 31/12/2009<br>LVL'000 |
|----------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                          |                       |                       |
| Non-current assets                     | 1,929,846             | 1,459,655             |
| Current assets                         | 340,477               | 234,618               |
| <b>TOTAL ASSETS</b>                    | <b>2,270,323</b>      | <b>1,694,273</b>      |
| <b>EQUITY</b>                          |                       |                       |
| Share capital                          | 323,544               | 317,653               |
| Non-current assets revaluation reserve | 978,137               | 554,590               |
| Hedge reserve                          | (3,912)               | (3,537)               |
| Retained earnings                      | 42,605                | 18,529                |
| <b>Total equity</b>                    | <b>1,340,374</b>      | <b>887,235</b>        |
| <b>LIABILITIES</b>                     |                       |                       |
| Non-current liabilities                | 791,312               | 688,982               |
| Current liabilities                    | 138,637               | 118,056               |
| <b>TOTAL EQUITY AND LIABILITIES</b>    | <b>2,270,323</b>      | <b>1,694,273</b>      |





Translation from Latvian original\*

## **INDEPENDENT AUDITOR'S REPORT**

### **To the Shareholder of Latvenergo AS**

### **Report on the Consolidated Financial Statements**

We have audited the accompanying financial statements on pages 9 to 62 of Latvenergo AS and its subsidiaries ("the Group") which comprise the consolidated statement of financial position as of 31 December 2010 and the consolidated income statement and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

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

Management is responsible for the preparation and fair presentation of these consolidated 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.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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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 the Group as of 31 December 2010, 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**

We have read the Management Report set out on pages 4 to 8 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the consolidated financial statements for 2010.

PricewaterhouseCoopers SIA  
Certified audit company  
Licence No. 5

A handwritten signature in blue ink, appearing to read "Ahmed Abu Sharkh".

Ahmed Abu Sharkh  
Chairman of the Board

A handwritten signature in blue ink, appearing to read "Ilandra Lejina".

Ilandra Lejina  
Certified auditor in charge  
Certificate No. 168  
Member of the Board

Riga, Latvia  
24 May 2011

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





# **Latvenergo Interim Condensed Consolidated Financial Statements for the period ending 30 June 2012**

**UNAUDITED**  
**PREPARED IN ACCORDANCE WITH**  
**THE INTERNATIONAL FINANCIAL REPORTING STANDARDS**  
**AS ADOPTED BY EU**

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## **Management Report**

Results for the first six months of 2012 continued to show growth in operations of the Group. Revenues for half year in 2012 were 11% higher than for the same period in 2011, and reached 389 million Lats. Operating profit increased by 6% compared to the same period year ago, and the profit for the period amounted to 42 million Lats, which is 8% increase from prior year.

The Group has also continued its investment project in all areas of operations – generation, transmission assets and distribution networks. Capital investments for the first six months in 2012 amount to 111 million Lats, which also impact 2% overall asset growth since December 2011.

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. Latvenergo and Public Utility Commission (PUC) have submitted appeals to the court judgement. In case the cassation instance renders a judgement to leave the judgement of the Administrative Regional court unvaried and to dismiss the complaints of the PUC and the Company, the Company will have to conform to the judgement. In such case the Company will need to apply lower tariffs that were in force prior to the present tariffs. If the judgement repeals the present tariff as of the day of its approval, such lower tariffs will also need to be applied retrospectively from 1 April 2011. Although the amount of the potential loss is subject to several variables outside the control of the Company, as of 30 June 2012 the Company estimated that the loss resulting from such decision might be about 45 million Lats. Due to uncertainties related to ongoing litigation, there are no transactions recorded in relation to this litigation in these Interim Condensed Consolidated Financial Statements.

### **Post interim period events**

In order to implement the requirements of well-functioning internal electricity market prescribed in the Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, the major changes in the electricity retail market have been in place since May 2008. To facilitate the liquidity of internal market, the regulated electricity market share was gradually reduced by abolishing the regulated end-user tariffs. In August 2012, decision was passed on additional market opening in Latvia. From 1 November 2012 only the household customers in Latvia are allowed to stay with public trader, all legal entities are obliged to acquire electricity in open market.

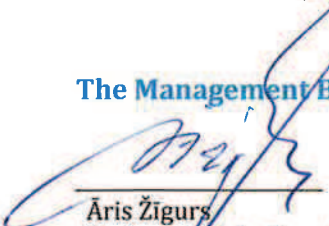
On 21 September 2012, as a result of capitalisation of retained earnings, share capital increase amounting to 578.0 million Lats was registered in the Commercial Register of the Republic of Latvia. At the date of approving these Interim Condensed Consolidated Financial Statements, the registered share capital of the Company amounts to 903.8 million Lats.

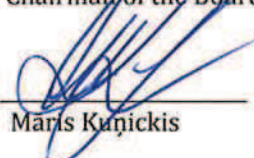
There are no other post interim period events that would materially affect the financial position of the Group as at 30 June 2012.

### **Dividends**

On 8 June 2012, the Shareholders' meeting passed resolution on distribution of the profit for 2011. The meeting decided that LVL 39,900,000 shall be paid out in dividends. The dividends were fully paid in July 2012.

**The Management Board of Latvenergo AS:**

  
Āris Žīgurs  
Chairman of the Board

  
Māris Kuņickis

  
Zane Kotāne

  
Arnis Kurgs

  
Uldis Bariss

20 November 2012



## Condensed Consolidated Income Statement

|                                            | Notes | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011          |
|--------------------------------------------|-------|-----------------------|-----------------------|---------------|
|                                            |       | LVL'000               | LVL'000               | LVL'000       |
| Revenue                                    | 4     | 389,174               | 350,782               | 681,767       |
| Other income                               |       | 2,313                 | 1,816                 | 4,175         |
| Materials, consumables and supplies        | 5     | (204,107)             | (181,370)             | (408,192)     |
| Personnel expenses                         |       | (31,685)              | (30,666)              | (61,572)      |
| Depreciation, amortisation and impairment  |       | (58,051)              | (71,236)              | (127,384)     |
| Other operating expenses                   |       | (43,256)              | (17,769)              | (35,449)      |
| <b>Operating profit</b>                    |       | <b>54,388</b>         | <b>51,557</b>         | <b>53,345</b> |
| Finance income                             |       | 1,394                 | 2,289                 | 3,047         |
| Finance costs                              |       | (5,717)               | (7,447)               | (13,956)      |
| Share of profit of an associate            |       | 114                   | 68                    | 232           |
| <b>Profit before income tax</b>            |       | <b>50,179</b>         | <b>46,467</b>         | <b>42,668</b> |
| Income tax                                 | 6     | (7,825)               | (6,224)               | 564           |
| Profit/(loss) from discontinued operations |       | -                     | (831)                 | 546           |
| <b>Profit for the period</b>               |       | <b>42,354</b>         | <b>39,412</b>         | <b>43,778</b> |

## Condensed Consolidated Statement of Comprehensive Income

|                                                    | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011           |
|----------------------------------------------------|-----------------------|-----------------------|----------------|
|                                                    | LVL'000               | LVL'000               | LVL'000        |
| <b>Net profit</b>                                  | <b>42,354</b>         | <b>39,412</b>         | <b>43,778</b>  |
| <b>Other comprehensive (loss)/income:</b>          |                       |                       |                |
| Gains on revaluation of PPE                        | 367                   | 35                    | 81             |
| (Losses)/gains on currency translation differences | (43)                  | 3                     | (14)           |
| (Losses)/gains from change in hedge reserve        | (2,201)               | 2,408                 | (4,335)        |
| <b>Other comprehensive (loss)/income</b>           | <b>(1,877)</b>        | <b>2,446</b>          | <b>(4,268)</b> |
| <b>Total comprehensive income for the period</b>   | <b>40,477</b>         | <b>41,858</b>         | <b>39,510</b>  |

The Management Board of Latvenergo AS:

Aris Žigurs  
Chairman

Māris Kunickis

Zane Kotāne

Arnis Kurgs

Uldis Bariss

## Condensed Consolidated Statement of Financial Position

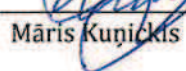
|                                                           | Notes | 30 June<br>2012  | 31 December<br>2011 | 30 June<br>2011  |
|-----------------------------------------------------------|-------|------------------|---------------------|------------------|
|                                                           |       | LVL'000          | LVL'000             | LVL'000          |
| <b>ASSETS</b>                                             |       |                  |                     |                  |
| <b>Non-current assets</b>                                 |       |                  |                     |                  |
| Intangible assets and PPE                                 | 7     | 2,058,351        | 2,006,103           | 1,948,899        |
| Investments in associates and other financial investments |       | 4,809            | 4,696               | 4,532            |
| Held-to-maturity financial assets                         |       | 19,547           | 15,670              | 7,986            |
| Deferred income tax assets                                |       | -                | 30                  | 900              |
| Other non-current assets                                  |       | 64               | 95                  | 111              |
| <b>Total non-current assets:</b>                          |       | <b>2,082,771</b> | <b>2,026,594</b>    | <b>1,962,428</b> |
| <b>Current assets</b>                                     |       |                  |                     |                  |
| Inventories                                               | 8     | 16,412           | 13,949              | 12,775           |
| Trade and other receivables                               | 9     | 73,256           | 91,420              | 72,915           |
| Derivative financial instruments                          |       | 5,086            | 2,450               | 1,944            |
| Held-to-maturity financial assets                         |       | 11,564           | 44,714              | 46,242           |
| Cash and cash equivalents                                 | 10    | 150,255          | 108,877             | 182,054          |
| <b>Total current assets:</b>                              |       | <b>256,573</b>   | <b>261,410</b>      | <b>315,930</b>   |
| <b>TOTAL ASSETS</b>                                       |       | <b>2,339,344</b> | <b>2,288,004</b>    | <b>2,278,358</b> |
| <b>EQUITY</b>                                             |       |                  |                     |                  |
| Share capital                                             |       | 325,862          | 325,862             | 323,544          |
| Non-current assets revaluation reserve                    |       | 973,646          | 974,899             | 975,979          |
| Hedge reserve                                             |       | (10,447)         | (8,247)             | (1,504)          |
| Other reserves                                            |       | 23,224           | 10,269              | 9,909            |
|                                                           |       | 986,423          | 976,921             | 984,384          |
| Retained earnings                                         |       | 34,546           | 45,773              | 40,425           |
| Non-controlling interest                                  |       | 3,417            | 3,020               | 3,253            |
| <b>Total equity:</b>                                      |       | <b>1,350,248</b> | <b>1,351,576</b>    | <b>1,351,606</b> |
| <b>LIABILITIES</b>                                        |       |                  |                     |                  |
| <b>Non-current liabilities</b>                            |       |                  |                     |                  |
| Borrowings                                                | 11    | 490,878          | 462,888             | 485,951          |
| Deferred income tax liabilities                           |       | 169,819          | 172,425             | 182,599          |
| Provisions                                                | 12    | 9,601            | 9,517               | 8,965            |
| Derivative financial instruments                          |       | 12,277           | 10,629              | 5,576            |
| Other liabilities and deferred income                     |       | 107,088          | 94,815              | 95,096           |
| <b>Total non-current liabilities:</b>                     |       | <b>789,663</b>   | <b>750,274</b>      | <b>778,187</b>   |
| <b>Current liabilities</b>                                |       |                  |                     |                  |
| Borrowings                                                | 11    | 59,903           | 50,446              | 43,387           |
| Derivative financial instruments                          |       | 17,124           | 13,134              | 3,054            |
| Trade and other current liabilities, deferred income      |       | 122,406          | 122,574             | 102,124          |
| <b>Total current liabilities:</b>                         |       | <b>199,433</b>   | <b>186,154</b>      | <b>148,565</b>   |
| <b>Total liabilities:</b>                                 |       | <b>989,096</b>   | <b>936,428</b>      | <b>926,752</b>   |
| <b>TOTAL EQUITY AND LIABILITIES</b>                       |       | <b>2,339,344</b> | <b>2,288,004</b>    | <b>2,278,358</b> |

The Management Board of Latvenergo AS:

  
 Āris Žigurs  
 Chairman

  
 Zane Kotāne

  
 Uldis Bariss

  
 Māris Kuņickis

  
 Arnis Kurgs

## Condensed Consolidated Statement of Changes in Equity

|                                                             | Attributable to owners of the Parent Company |                |                      | Non-<br>control-<br>ling<br>interest | TOTAL        |                  |
|-------------------------------------------------------------|----------------------------------------------|----------------|----------------------|--------------------------------------|--------------|------------------|
|                                                             | Share<br>capital                             | Reserves       | Retained<br>earnings |                                      |              | Total            |
|                                                             | LVL'000                                      | LVL'000        | LVL'000              | LVL'000                              | LVL'000      | LVL'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> |
| Dividends for 2010                                          | -                                            | -              | (35,000)             | (35,000)                             | -            | (35,000)         |
| Transfer to reserves                                        | -                                            | 9,907          | (9,907)              | -                                    | -            | -                |
| Profit for the period                                       | -                                            | -              | 38,729               | 38,729                               | 683          | 39,412           |
| Other comprehensive income<br>for the period                | -                                            | 2,199          | 247                  | 2,446                                | -            | 2,446            |
| <b>Total comprehensive<br/>income for the period</b>        | <b>-</b>                                     | <b>2,199</b>   | <b>38,976</b>        | <b>41,175</b>                        | <b>683</b>   | <b>41,858</b>    |
| <b>As at 30 June 2011</b>                                   | <b>323,544</b>                               | <b>984,384</b> | <b>40,425</b>        | <b>1,348,353</b>                     | <b>3,253</b> | <b>1,351,606</b> |
| Increase in share capital                                   | 2,318                                        | -              | -                    | 2,318                                | -            | 2,318            |
| Transfer to reserves                                        | -                                            | 350            | (350)                | -                                    | -            | -                |
| Profit/(loss) for the period                                | -                                            | -              | 4,599                | 4,599                                | (233)        | 4,366            |
| Other comprehensive<br>income/(loss) for the period         | -                                            | (7,813)        | 1,099                | (6,714)                              | -            | (6,714)          |
| <b>Total comprehensive<br/>income/(loss) for the period</b> | <b>-</b>                                     | <b>(7,813)</b> | <b>5,698</b>         | <b>(2,115)</b>                       | <b>(233)</b> | <b>(2,348)</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> |
| Dividends for 2011                                          | -                                            | -              | (39,900)             | (39,900)                             | -            | (39,900)         |
| Transfer to reserves                                        | -                                            | 12,992         | (12,992)             | -                                    | -            | -                |
| Disposal of revalued PPE                                    | -                                            | (1,619)        | (286)                | (1,905)                              | -            | (1,905)          |
| Profit for the period                                       | -                                            | -              | 41,957               | 41,957                               | 397          | 42,354           |
| Other comprehensive loss for<br>the period                  | -                                            | (1,871)        | (6)                  | (1,877)                              | -            | (1,877)          |
| <b>Total comprehensive<br/>income/(loss) for the period</b> | <b>-</b>                                     | <b>(1,871)</b> | <b>41,951</b>        | <b>40,080</b>                        | <b>397</b>   | <b>40,477</b>    |
| <b>As at 30 June 2012</b>                                   | <b>325,862</b>                               | <b>986,423</b> | <b>34,546</b>        | <b>1,346,831</b>                     | <b>3,417</b> | <b>1,350,248</b> |



## Condensed Consolidated Statement of Cash Flows

|                                                                                         | Notes     | 01.01.-<br>30.06.2012<br>LVL'000 | 01.01.-<br>30.06.2011<br>LVL'000 | 2011<br>LVL'000  |
|-----------------------------------------------------------------------------------------|-----------|----------------------------------|----------------------------------|------------------|
| <b>Cash flows from operating activities</b>                                             |           |                                  |                                  |                  |
| Profit before tax                                                                       |           | 50,179                           | 46,467                           | 42,668           |
| <b>Adjustments for:</b>                                                                 |           |                                  |                                  |                  |
| - Amortisation, depreciation, impairment loss of non-current assets                     |           | 59,496                           | 71,498                           | 129,325          |
| - Discontinued operations                                                               |           | -                                | (831)                            | 546              |
| - Net financial adjustments                                                             |           | 3,418                            | 6,383                            | 22,599           |
| - Other adjustments                                                                     |           | 327                              | 152                              | 103              |
| Decrease/(increase) in current assets                                                   |           | 15,319                           | 10,813                           | (7,666)          |
| Increase/(decrease) in payables, accrued expense, deferred income and other liabilities |           | 4,126                            | (10,759)                         | 22,863           |
| <b>Cash generated from operations</b>                                                   |           | <b>132,865</b>                   | <b>123,723</b>                   | <b>210,438</b>   |
| Net interest paid                                                                       |           | (1,111)                          | (4,273)                          | (13,965)         |
| Income tax paid                                                                         |           | (7,141)                          | (4,107)                          | (16,074)         |
| <b>Net cash generated from operating activities</b>                                     |           | <b>124,613</b>                   | <b>115,343</b>                   | <b>180,399</b>   |
| <b>Cash flows from investing activities</b>                                             |           |                                  |                                  |                  |
| Purchase of intangible assets and PPE                                                   |           | (110,981)                        | (63,938)                         | (182,301)        |
| Proceeds on financing from EU funds                                                     |           | 198                              | -                                | 1,479            |
| Net investments in held-to-maturity assets                                              |           | 29,400                           | (52,226)                         | (57,387)         |
| <b>Net cash used in investing activities</b>                                            |           | <b>(81,383)</b>                  | <b>(116,164)</b>                 | <b>(238,209)</b> |
| <b>Cash flows from financing activities</b>                                             |           |                                  |                                  |                  |
| Proceeds on borrowings from credit institutions                                         | 11        | 63,260                           | 1,686                            | 4,357            |
| Repayment of borrowings                                                                 | 11        | (25,212)                         | (18,077)                         | (36,936)         |
| Dividends paid                                                                          |           | (39,900)                         | (35,000)                         | (35,000)         |
| <b>Net cash used in financing activities</b>                                            |           | <b>(1,852)</b>                   | <b>(51,391)</b>                  | <b>(67,579)</b>  |
| <b>Net increase/(decrease) in cash and cash equivalents</b>                             |           | <b>41,378</b>                    | <b>(52,212)</b>                  | <b>(125,389)</b> |
| Cash and cash equivalents at the beginning of the year                                  | 10        | 108,877                          | 234,266                          | 234,266          |
| <b>Cash and cash equivalents at the end of the period</b>                               | <b>10</b> | <b>150,255</b>                   | <b>182,054</b>                   | <b>108,877</b>   |

## **Notes to the Interim Condensed Consolidated Financial Statements**

### **1. CORPORATE INFORMATION**

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 Economics of Republic of Latvia. 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 supply of electrical power and heat 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:

|                                                               | <b>REGISTERED IN THE<br/>COMMERCIAL REGISTER</b> | <b>INTEREST<br/>HELD</b> | <b>BUSINESS ACTIVITY HELD</b>                                  |
|---------------------------------------------------------------|--------------------------------------------------|--------------------------|----------------------------------------------------------------|
| Augstsprieguma tīkls AS                                       | 01.09.2005 -1.01.2012                            | 100%                     | Electricity transmission                                       |
| Sadales tīkls AS                                              | 18.09.2006                                       | 100%                     | Electricity distribution                                       |
| Elektrum Eesti OÜ (previous name – Latvenergo Kaubandus OÜ)   | 27.06.2007                                       | 100%                     | Electricity sales in Estonia                                   |
| Elektrum Lietuva UAB (previous name – Latvenergo Prekyba UAB) | 07.01.2008                                       | 100%                     | Electricity sales in Lithuania                                 |
| Latvijas elektriskie tīkli AS                                 | 10.02.2011                                       | 100%                     | Operation and maintenance of transmission system assets        |
| Liepājas enerģija SIA                                         | 06.07.2005                                       | 51%                      | Thermal energy generation, transmission, distribution and sale |

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 Interim Condensed Consolidated Financial Statements for the period ending 30 June 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 2011 and comparative information for period ending 30 June 2011.

Latvenergo AS Shareholder's meeting has approved for issue the Consolidated Financial Statements on 1 June 2012.

The Interim Condensed Consolidated Financial Statements of the Latvenergo Group for the six months ended 30 June 2012 were authorised by the Management Board on 20 November 2012.

### **2. ACCOUNTING POLICIES**

The Interim Condensed Consolidated Financial Statements of the Latvenergo Group for the six months ended 30 June 2012 have been prepared in accordance with IAS 34 *Interim Financial Reporting*.

The Interim Condensed Consolidated Financial Statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Latvenergo Group Consolidated Financial Statements for the year ended 31 December 2011.

## ***Interim Condensed Consolidated Financial Statements – 30.06.2012***

The Interim Condensed Consolidated Financial Statements principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all reporting periods presented, unless otherwise stated. Where it is necessary, comparatives are reclassified.

The Interim Condensed 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 disclosed in accounting policies presented in the Latvenergo Group Consolidated Financial Statements of 2011.

The accounting policies are consistent with those applied in the Latvenergo Group Consolidated Financial Statements of 2011.

All amounts shown in these Interim Condensed Consolidated Financial Statements are presented in thousands of Latvian Lats (LVL), unless stated otherwise.

### ***Adoption of new standards and interpretations***

The accounting policies adopted in the preparation of the Interim Condensed Consolidated Financial Statements are consistent with those followed in the preparation of the Latvenergo Group Consolidated Financial Statements for the year ended 31 December 2011, except for the adoption of new standards and interpretations as of January 2012, noted below:

#### *IAS 12 Income Taxes (Amendment) – Deferred Taxes: Recovery of Underlying Assets*

The amendment clarified the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revolution model in IAS 16 should always be measured on a sale basis. The amendment is effective for annual periods beginning on or after 1 January 2012 and has been no effect on the Group's financial position, performance or its disclosures.

#### *IFRS 1 First-Time Adoption of International Financial Reporting Standards (Amendment) – Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters*

The IASB provided guidance on how an entity should resume presenting IFRS financial statements when its functional currency ceases to be subject to hyperinflation. The amendment is effective for annual periods beginning on or after 1 July 2011. The amendment had no impact to the Group.

#### *IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements*

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after 1 July 2011. The Group does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

### **3. FINANCIAL RISK MANAGEMENT**

#### ***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 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 provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, and credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

#### ***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 30 June 2012 the Group had none of their borrowings denominated in other currencies than the Euro.

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.

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.

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

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



## ***Interim Condensed Consolidated Financial Statements – 30.06.2012***

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.

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

### ***III) Price risk***

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

The most significant price risk is related to purchase of electricity 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 and CO<sub>2</sub> allowances.

### ***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.

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

No credit limits were exceeded during the reporting period, and the Group entities' management does not expect any losses from non-performance by these counterparties.

### ***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 and cash and cash equivalents.

### ***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.

## ***Interim Condensed Consolidated Financial Statements – 30.06.2012***

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.

### ***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.

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 price used for financial assets held by the Group is the current bid price, i.e. interest rates by respective term and currency.

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. Quoted market prices for similar instruments are used for long-term debt. Other techniques, such as 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. Those fair values are compared to counterparty's bank revaluation reports.

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.

The fair value of non-current borrowings with floating interest rates fixed by SWAP agreements for disclosure purposes is estimated by discounting their future contractual cash flows at the current market interest rates for similar financial instruments.

## **4. REVENUE**

|                                          | <b>01.01.-<br/>30.06.2012</b> | <b>01.01.-<br/>30.06.2011</b> | <b>2011</b>    |
|------------------------------------------|-------------------------------|-------------------------------|----------------|
|                                          | LVL'000                       | LVL'000                       | LVL'000        |
| <b>Electricity sales:</b>                | 298,772                       | 295,448                       | 583,428        |
| - including sales to corporate customers | 228,178                       | 229,917                       | 457,119        |
| - residential customers                  | 70,594                        | 65,531                        | 126,309        |
| Sales of network services                | 10,294                        | 3,768                         | 9,664          |
|                                          | <b>309,066</b>                | <b>299,216</b>                | <b>593,092</b> |
| Heat sales                               | 51,675                        | 40,736                        | 69,233         |
| Revenue from lease of assets             | 11,175                        | 197                           | 393            |
| Other services                           | 17,258                        | 10,633                        | 19,049         |
| <b>Total revenue:</b>                    | <b>389,174</b>                | <b>350,782</b>                | <b>681,767</b> |



**Interim Condensed Consolidated Financial Statements – 30.06.2012**

**5. MATERIALS, CONSUMABLES AND SUPPLIES**

|                                                                                   | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011           |
|-----------------------------------------------------------------------------------|-----------------------|-----------------------|----------------|
|                                                                                   | LVL'000               | LVL'000               | LVL'000        |
| <b>Electricity purchases:</b>                                                     |                       |                       |                |
| Imported from the Baltic countries                                                | 44,293                | 60,143                | 138,373        |
| Purchased from producers in Latvia                                                | 54,535                | 32,703                | 65,439         |
| Imported from other countries                                                     | 15,602                | 5,980                 | 38,481         |
| Fair value loss/(income) on electricity swaps                                     | (175)                 | 2,261                 | 7,759          |
|                                                                                   | <b>114,255</b>        | <b>101,087</b>        | <b>250,052</b> |
| Fuel expense                                                                      | 75,785                | 67,991                | 127,673        |
| Fair value (income)/loss on CO <sub>2</sub> emission allowances forward contracts | (226)                 | -                     | 1,155          |
| Raw materials, spare parts and maintenance costs                                  | 14,293                | 12,292                | 29,312         |
| <b>Total materials, consumables and supplies:</b>                                 | <b>204,107</b>        | <b>181,370</b>        | <b>408,192</b> |

**6. INCOME TAX**

|                          | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011         |
|--------------------------|-----------------------|-----------------------|--------------|
|                          | LVL'000               | LVL'000               | LVL'000      |
| Current tax              | 10,064                | 11,346                | 13,730       |
| Deferred tax             | (2,239)               | (5,122)               | (14,294)     |
| <b>Total income tax:</b> | <b>7,825</b>          | <b>6,224</b>          | <b>(564)</b> |

**7. INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT**

|                                                       | Intan-<br>gible<br>assets | Land,<br>buildings<br>and<br>facilities | Technology<br>equipment<br>and<br>machinery | Other<br>fixed<br>assets | Assets<br>under<br>con-<br>struction | TOTAL            |
|-------------------------------------------------------|---------------------------|-----------------------------------------|---------------------------------------------|--------------------------|--------------------------------------|------------------|
|                                                       | LVL'000                   | LVL'000                                 | LVL'000                                     | LVL'000                  | LVL'000                              | LVL'000          |
| <b>At 30 June 2011</b>                                |                           |                                         |                                             |                          |                                      |                  |
| Cost or valuation                                     | 20,659                    | 2,843,327                               | 1,105,344                                   | 96,158                   | 158,652                              | 4,224,140        |
| Accumulated amortisation, depreciation and impairment | (14,332)                  | (1,539,257)                             | (644,031)                                   | (72,850)                 | (4,771)                              | (2,275,241)      |
| <b>Net book amount:</b>                               | <b>6,327</b>              | <b>1,304,070</b>                        | <b>461,313</b>                              | <b>23,308</b>            | <b>153,881</b>                       | <b>1,948,899</b> |
| <b>At 31 December 2011</b>                            |                           |                                         |                                             |                          |                                      |                  |
| Cost or valuation                                     | 22,187                    | 2,869,092                               | 1,109,768                                   | 96,802                   | 213,475                              | 4,311,324        |
| Accumulated amortisation, depreciation and impairment | (15,586)                  | (1,560,165)                             | (651,427)                                   | (73,047)                 | (4,996)                              | (2,305,221)      |
| <b>Net book amount:</b>                               | <b>6,601</b>              | <b>1,308,927</b>                        | <b>458,341</b>                              | <b>23,755</b>            | <b>208,479</b>                       | <b>2,006,103</b> |
| <b>At 30 June 2012</b>                                |                           |                                         |                                             |                          |                                      |                  |
| Cost or valuation                                     | 22,250                    | 2,904,912                               | 1,113,929                                   | 95,441                   | 303,357                              | 4,439,889        |
| Accumulated amortisation, depreciation and impairment | (16,900)                  | (1,614,270)                             | (671,742)                                   | (73,650)                 | (4,976)                              | (2,381,538)      |
| <b>Net book amount:</b>                               | <b>5,350</b>              | <b>1,290,642</b>                        | <b>442,187</b>                              | <b>21,791</b>            | <b>298,381</b>                       | <b>2,058,351</b> |

## **8. INVENTORIES**

|                                                                 | <b>30 June<br/>2012</b> | <b>31 December<br/>2011</b> | <b>30 June<br/>2011</b> |
|-----------------------------------------------------------------|-------------------------|-----------------------------|-------------------------|
|                                                                 | LVL'000                 | LVL'000                     | LVL'000                 |
| Raw materials and spare parts                                   | 14,933                  | 12,532                      | 11,267                  |
| Technological fuel                                              | 4,143                   | 4,143                       | 4,118                   |
| Advance payments for inventories                                | 50                      | 16                          | 37                      |
| Allowance for raw materials, spare parts,<br>technological fuel | (2,714)                 | (2,742)                     | (2,647)                 |
| <b>Total inventories:</b>                                       | <b>16,412</b>           | <b>13,949</b>               | <b>12,775</b>           |

***Movement on the allowance for raw materials, spare parts and technological fuel:***

|                                              | <b>01.01.-<br/>30.06.2012</b> | <b>01.01.-<br/>30.06.2011</b> | <b>2011</b>  |
|----------------------------------------------|-------------------------------|-------------------------------|--------------|
|                                              | LVL'000                       | LVL'000                       | LVL'000      |
| <b>At the beginning of the period</b>        | <b>2,742</b>                  | <b>2,459</b>                  | <b>2,459</b> |
| Charged to the Consolidated Income Statement | (28)                          | 188                           | 283          |
| <b>At the end of the period</b>              | <b>2,714</b>                  | <b>2,647</b>                  | <b>2,742</b> |

## **9. TRADE RECEIVABLES AND OTHER CURRENT RECEIVABLES**

***Trade receivables, net***

|                           | <b>30 June<br/>2012</b> | <b>31 December<br/>2011</b> | <b>30 June<br/>2011</b> |
|---------------------------|-------------------------|-----------------------------|-------------------------|
|                           | LVL'000                 | LVL'000                     | LVL'000                 |
| <b>Receivables:</b>       |                         |                             |                         |
| - Electricity customers   | 53,183                  | 66,101                      | 55,020                  |
| - Heating customers       | 4,350                   | 12,324                      | 3,879                   |
| - Other trade receivables | 13,533                  | 5,101                       | 5,406                   |
|                           | <b>71,066</b>           | <b>83,526</b>               | <b>64,305</b>           |

**Provision for impairment of receivables:**

|                           |                 |                |                 |
|---------------------------|-----------------|----------------|-----------------|
| - Electricity customers   | (9,731)         | (8,320)        | (9,349)         |
| - Heating customers       | (561)           | (292)          | (732)           |
| - Other trade receivables | (1,206)         | (1,105)        | (1,211)         |
|                           | <b>(11,498)</b> | <b>(9,717)</b> | <b>(11,292)</b> |

**Receivables, net:**

|                           |               |               |               |
|---------------------------|---------------|---------------|---------------|
| - Electricity customers   | 43,452        | 57,781        | 45,671        |
| - Heating customers       | 3,789         | 12,032        | 3,147         |
| - Other trade receivables | 12,327        | 3,996         | 4,195         |
|                           | <b>59,568</b> | <b>73,809</b> | <b>53,013</b> |

## Interim Condensed Consolidated Financial Statements – 30.06.2012

**Movements in allowances for impairment of trade receivables are as follows:**

|                                                          | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011         |
|----------------------------------------------------------|-----------------------|-----------------------|--------------|
|                                                          | LVL'000               | LVL'000               | LVL'000      |
| <b>At the beginning of the period</b>                    | <b>9,717</b>          | <b>8,218</b>          | <b>8,218</b> |
| Receivables written off during the year as uncollectible | (79)                  | (105)                 | (575)        |
| Allowance for impaired receivables                       | 1,860                 | 3,179                 | 2,074        |
| <b>At the end of the period</b>                          | <b>11,498</b>         | <b>11,292</b>         | <b>9,717</b> |

### **Other current receivables**

|                                   | 30 June<br>2012 | 31 December<br>2011 | 30 June<br>2011 |
|-----------------------------------|-----------------|---------------------|-----------------|
|                                   | LVL'000         | LVL'000             | LVL'000         |
| <b>Other current receivables:</b> | <b>13,688</b>   | <b>17,611</b>       | <b>19,902</b>   |

## **10. CASH AND CASH EQUIVALENTS**

|                                         | 30 June<br>2012 | 31 December<br>2011 | 30 June<br>2011 |
|-----------------------------------------|-----------------|---------------------|-----------------|
|                                         | LVL'000         | LVL'000             | LVL'000         |
| Cash at bank and on hand                | 88,698          | 77,969              | 74,038          |
| Short-term bank deposits                | 61,557          | 30,908              | 108,016         |
| <b>Total cash and cash equivalents:</b> | <b>150,255</b>  | <b>108,877</b>      | <b>182,054</b>  |

## **11. BORROWINGS**

|                                                | 30 June<br>2012 | 31 December<br>2011 | 30 June<br>2011 |
|------------------------------------------------|-----------------|---------------------|-----------------|
|                                                | LVL'000         | LVL'000             | LVL'000         |
| Non-current borrowings (excl. current portion) | 490,878         | 462,888             | 485,951         |
| Current portion of non-current borrowings      | 58,275          | 48,226              | 41,351          |
| Accrued interest on non-current borrowings     | 1,628           | 2,220               | 2,036           |
| <b>Total current borrowings:</b>               | <b>59,903</b>   | <b>50,446</b>       | <b>43,387</b>   |
| <b>Total borrowings:</b>                       | <b>550,781</b>  | <b>513,334</b>      | <b>529,338</b>  |

**Movement in borrowings:**

|                                       | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011           |
|---------------------------------------|-----------------------|-----------------------|----------------|
|                                       | LVL'000               | LVL'000               | LVL'000        |
| <b>At the beginning of the period</b> | <b>513,334</b>        | <b>545,607</b>        | <b>545,607</b> |
| Borrowings received                   | 63,260                | 1,686                 | 4,357          |
| Borrowing repaid                      | (25,212)              | (18,077)              | (36,936)       |
| Accrued interest on borrowings        | (601)                 | 122                   | 306            |
| <b>At the end of the period</b>       | <b>550,781</b>        | <b>529,338</b>        | <b>513,334</b> |

## **Interim Condensed Consolidated Financial Statements – 30.06.2012**

### **12. PROVISIONS**

#### ***Provisions for post-employment benefits***

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 :

|                                              | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011         |
|----------------------------------------------|-----------------------|-----------------------|--------------|
|                                              | LVL'000               | LVL'000               | LVL'000      |
| <b>At the beginning of the period</b>        | <b>7,734</b>          | <b>7,321</b>          | <b>7,321</b> |
| Charged to the Consolidated Income Statement | 98                    | 268                   | 413          |
| <b>At the end of the period</b>              | <b>7,832</b>          | <b>7,589</b>          | <b>7,734</b> |

#### ***Environmental provisions***

|                                                         | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011         |
|---------------------------------------------------------|-----------------------|-----------------------|--------------|
|                                                         | LVL'000               | LVL'000               | LVL'000      |
| <b>At the beginning of the period</b>                   | <b>1,783</b>          | <b>1,376</b>          | <b>1,376</b> |
| Charged/(credited) to the Consolidated Income Statement | (14)                  | -                     | 407          |
| <b>At the end of the period</b>                         | <b>1,769</b>          | <b>1,376</b>          | <b>1,783</b> |

### **13. RELATED PARTY TRANSACTIONS**

The Parent Company and, indirectly, the other Group entities are controlled by the Latvian state.

Related parties are subsidiaries and associates, and those companies in which the Parent Company has participating interest.

#### ***The following transactions were carried out with related parties:***

|                                              | 01.01.-<br>30.06.2012 | 01.01.-<br>30.06.2011 | 2011          |
|----------------------------------------------|-----------------------|-----------------------|---------------|
|                                              | LVL'000               | LVL'000               | LVL'000       |
| Sales of goods                               | 46,577                | 36,543                | 61,811        |
| Sales of services                            | 466                   | 194                   | 1,308         |
| <b>Total sales to related parties:</b>       | <b>47,043</b>         | <b>36,737</b>         | <b>63,119</b> |
| Purchases of goods                           | 4,256                 | 6,265                 | 10,444        |
| Purchased of services                        | 785                   | 1,242                 | 3,770         |
| <b>Total purchases from related parties:</b> | <b>5,041</b>          | <b>7,507</b>          | <b>14,214</b> |

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**Balances at the end of the year arising from sales:**

|                                                       | <b>30 June<br/>2012</b> | <b>31 December<br/>2011</b> | <b>30 June<br/>2011</b> |
|-------------------------------------------------------|-------------------------|-----------------------------|-------------------------|
|                                                       | LVL'000                 | LVL'000                     | LVL'000                 |
| Trade receivables from related parties                | 3,203                   | 10,432                      | 2,508                   |
| Trade payables to related parties                     | 922                     | 1,839                       | 828                     |
| Accrued liabilities due to related party transactions | 40                      | 68                          | 77                      |

The Group has not created any provisions or incurred write-offs from transactions with related parties, as all debts are recoverable.

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