Joint Stock Company

Conexus Baltic Grid

Annual report 2018

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

Translated from Latvian

RIGA 2019

CONTENTS

Information on the Company

Joint stock company (JSC) “Conexus Baltic Grid” (hereinafter –the Company, Conexus) is the unified natural gas transmission and storage operator in Latvia managing one of the most modern natural gas storage facilities in Europe – Inčukalns underground gas storage (hereinafter – Inčukalns UGS, storage) and the main natural gas transmission system directly connecting the Latvian natural gas market with Lithuania, Estonia and NW region of Russia.

Conexus offers the natural gas transmission and storage services in accordance with the tariffs set by the Public Utilities Commission (hereinafter PUC, the Regulator).

Conexus is an independent and competitive company with high quality services providing development opportunities both to customers and employees.

VISION (Who do we want to be?)	MISSION (Why do we exist?)	VALUES (What is important to us?)
To become the most reliable energy source in the region	To promote sustainable energy market in the region, offering reliable operation of natural gas transmission and storage system.	Secure operation of the system Professional and united team Flexibility and openness through competent solutions Sustainable development

Medium-term (2019-2023) key goals of Conexus are related to three areas: **Market development, provision of infrastructure and operational development.** The Company’s strategic goals are set in accordance with Conexus values, vision and mission – **to promote sustainable energy market in the region, offering reliable operation of natural gas transmission and storage system.**

STRATEGIC GOALS

1 Development of regional natural gas market to achieve sustainable operation of Inčukalns UGS in market conditions	2 Provide safe, accessible and marked-based infrastructure	3 Implement sustainable management of the working capacity of internal and external resources

In addition to its strategic goals, Conexus has identified three developmental aspirations that spread across all medium-term activities planned. These aspirations add to the strategic goals, facilitate their implementation and are determined as follows:

DIGItisation	CONEXUS – ENERGY PROVIDER	COOPERATION WITH OTHER REGIONAL TSOs
Conexus will focus on modernisation and development of technologies as well as centralised asset, personnel and financial management and implementation of effective resource management	To become the most reliable energy source in the region and gradually introduce services not only for natural gas users, but also for electricity users.	In the medium term, Conexus plans to facilitate cooperation with other TSOs in the region by coordinating operational cooperation and introducing a periodic benchmarking system with other regional TSOs

Company	Joint Stock Company Conexus Baltic Grid
Registration number	40203041605
Registration date and place	2 January 2017, Riga
Address	Aristida Briāna iela 6 Riga, LV 1001 Latvia www.conexus.lv
Largest shareholders	AS „Augstsprieguma tīkls" (34.36 %) PAS „Gazprom" (34,10 %) Marguerite Gas I S.à r.l. (29.06 %)
Reporting period	01 January 2018 – 31 December 2018

The Council

Term of office as of 3 January 2018

Kaspars Āboliņš	Chairman of the Council
Viljams Pīrsons	Deputy Chairman of the Council
Ilze Bērziņa	Member of the Council
Sanita Greize	Member of the Council
Ilmārs Šņucins	Member of the Council
Gijoms Rivrons	Member of the Council
Franks Zīberts	Member of the Council (until 31 March 2018)
Martins Sičelkovs	Member of the Council (since 27 April 2018)

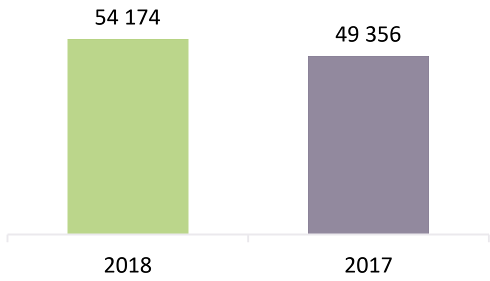
The Board

Term of office as of 31 December 2017

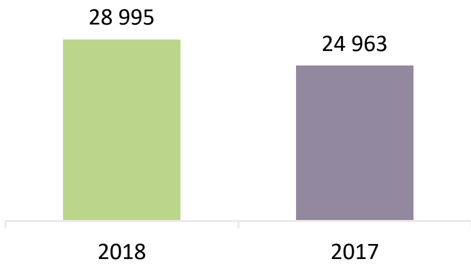
Zane Kotāne	Chairperson of the Board
Gints Freibergs	Member of the Board
Mārtiņš Gode	Member of the Board

Key performance indicators

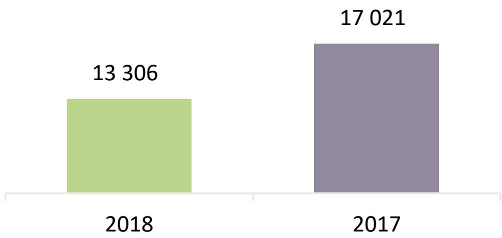
Net sales



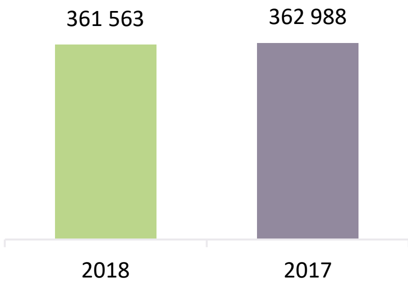
EBITDA



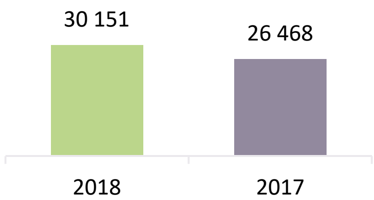
Net profit



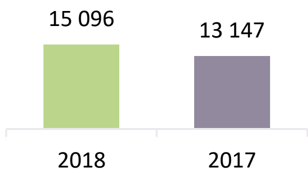
Assets



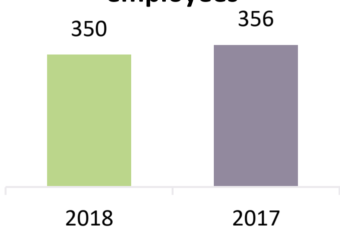
Transmitted natural gas
thous. MWh



Natural gas for consumption in Latvia
thous. MWh



Average number of employees

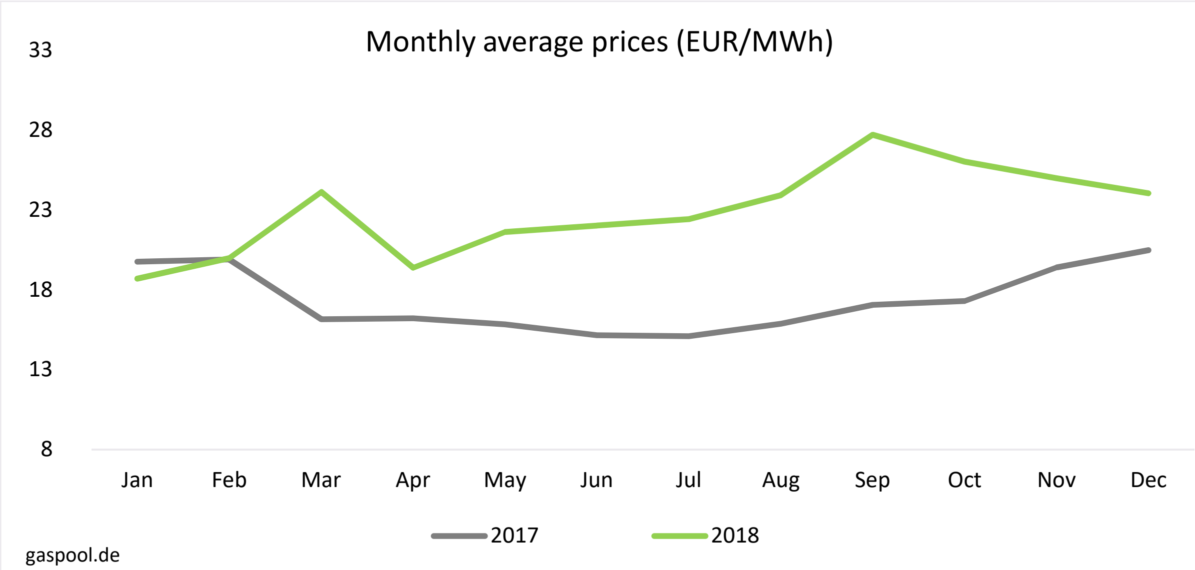


Management Report

Summary

Last year was an active period for the gas market of Latvia, as the major challenges for market participants were to assess and successfully adapt to the operation of the open natural gas market. For the second year, Conexus operates as a unified natural gas transmission and storage operator, ensuring uninterrupted supply of natural gas and transmitting the flows for the needs of Latvia, Lithuania, Estonia and Russia, and the results achieved support the Company's decisions.

2018 clearly shows that gas consumers are significantly affected by regional events and global trends, as last year saw an increase in energy prices affecting consumption volumes. The hot and dry weather in Latvia and Scandinavian countries prevented hydroelectric power plants from producing the required amount of electricity, which contributed to the increase in natural gas consumption and prices.



In 2018, considering the expected changes in the regional natural gas market, the Company approved a medium-term strategy, setting out the development for the market, infrastructure provision and developing internal processes as priorities for the following years. Digitisation, cooperation with other regional transmission system operators have been identified as the topics supplementing the objectives, which are going to contribute to achieving the performance. The Company is committed and full of ideas regarding the future development of the regional natural gas market, and actively participates in the historic establishment process of a single Baltic and Finnish natural gas market. This will be an important step in the development of the gas supply infrastructure in the region, promoting market stability and strengthening energy independence.

The volume of gas transferred in 2018 reached 30 151 GWh, an increase of 13.9% compared to the previous year. During the reporting period, the volume of gas transferred for the needs of Latvian users increased by 14.8%, amounting to 79% of total transmitted flows.

Key performance indicators	2018 / 31.12.2018	2017 / 31.12.2017
Transmitted natural gas, thous. MWh	30 151	26 468
Active natural gas at Inčukalns NGS, thous. MWh	10 026	11 806
Natural gas for consumption in Latvia, thous. MWh	15 096	13 147
Total length of main gas pipelines, km	1 188	1 188
Number of employees: Average	350	356

All revenues of Conexus are derived from regulated services, applying the tariffs established by the Regulator. During the reporting period, the Company's operating result is profit of EUR 13 306 thousand, net turnover is by 10% higher than during the prior year, reaching EUR 54 174 thous.

Key financial indicators	2018 / 31.12.2018	2017 / 31.12.2017
	EUR'000	EUR'000
Net sales	54 174	49 356
EBITDA	28 995	24 963
EBITDA, %	54%	51%
Net profit	13 306	17 021
Net profitability, %	25%	34%
Assets attributable to operating segments	343 495	345 102
Cash and cash equivalents	18 068	17 886
Total assets	361 563	362 988
Regulated asset base	324 396	283 480

Results of segment operations

The company has two operational segments: gas transmission (includes the transportation of natural gas via high pressure pipelines to supply it to storage, other countries, distribution system) and gas storage (gas storage at Inčukalns UGS). The information included in the operating segments is consistent with the information used by the chief decision making officer.

The transmission segment generates revenue from both natural gas consumption in Latvia and from international transportations of natural gas. The revenue of the transmission segment during the reporting period was EUR 33.9 million and EBITDA reached EUR 16.2 million, representing 55.7% of the Company's total EBITDA. Profit of the transmission segment amounted to EUR 6.6 million. Transmission segment is the largest by the amount of assets. At the end of 2018, assets of the segment amounted to EUR 181.2 million and comprised 52.8% of the total assets of the Company.

Gas transmission	2018 / 31.12.2018	2017 / 31.12.2017
	EUR'000	EUR'000
Net sales	**33 885**	**25 146**
EBITDA	16 160	11 141
Segment net profit	**6 631**	**4 493**
Segment assets	181 240	182 900
Depreciation and amortization	9 406	10 936
Acquisition of fixed and intangible assets	6 829	7 594
Regulated asset base	173 772	180 864

Result of the storage segment for the reporting period was revenue of EUR 20.3 million, ensuring EBITDA of EUR 12.8 million and profit of EUR 6.7 million. At the end of 2018, assets of the segment amounted EUR 162.3 million and comprised 47.2% of the total assets of the Company.

Gas storage	**2018 / 31.12.2018**	**2017 / 31.12.2017**
	EUR'000	EUR'000
Net sales	**20 290**	**24 210**
EBITDA	12 835	13 822
Segment net profit	**6 675**	**12 528**
Segment assets	162 255	162 202
Depreciation and amortization	6 093	7 608
Acquisition of fixed and intangible assets	7 081	9 366
Regulated asset base	150 624	102 616

Main activities

Establishment of a single natural gas market

In order to fulfil the agreement of 5 December 2014 between the Prime Ministers of the Baltic States and Finland with the aim to harmonise the implementation of network codes and the establishment of a single regional natural gas market as of 2020, it is necessary to reorganise the gas market of Estonia, Latvia and Lithuania (as well as Finland) by establishing unified rules for the functioning of the regional gas market.

Currently, when using transmission systems for crossing the territory of any country, it is necessary to pay tariffs approved in each country. To reduce the administrative burden on wholesale market activities, ensure a larger and more liquid market, and to prevent discrimination regarding natural gas supply routes and promote tariff transparency and predictability, in 2018, the Baltic States and Finland were actively working on the establishment of a single natural gas market, which could become the first single market region of this kind in the European Union. The single market is customer-oriented, providing digital and effective market communication. Along with the compensation mechanism, a single IT platform is being developed, which will facilitate the operation of any natural gas trader in the single market.

- The single natural gas market is a single entry/exit tariff zone for the transmission of natural gas, cancelling the different tariff payments when crossing the territorial borders of each country.
- The single market for natural gas is expected to become operational from 1 January 2020, and the single balancing zone of Estonia and Latvia will also become operational during that period.
- On 8 October 2018, in Tallinn, the Estonian, Latvian and Finnish gas transmission system operators signed a Memorandum of Understanding on the matters to be solved, to integrate natural gas markets of Latvia, Estonia and Finland. The signed Memorandum of Understanding provides for the possibility for other countries to join the initiative, thereby extending the area of the integrated market.

The Regulator certifies Conexus as an independent transmission and storage system operator

On 28 September Public Utilities Commission (PUC) adopted the final decision under which the unified natural gas transmission and storage system operator JSC “Conexus Baltic Grid” was certified at the same time prescribing the provision that must be fulfilled to 1 January 2020.

- On 25 July 2018, the European Commission rendered the opinion on the draft decision on certification of JSC “Conexus Baltic Grid” prepared by the Regulator. In its opinion the

European Commission states that agrees to PUC's conclusion that shareholding of PAS "Gazprom" and Marguerite Fund is not compliant with the requirements of Gas Directive article 9;

- PUC assigns JSC "Conexus Baltic Grid" to ensure till 1 January 2020 that the energy supply merchant engaged in the trade of natural gas cannot directly or indirectly control JSC "Conexus Baltic Grid" and the direct or indirect operation of financial institutions and merchants established specifically for this purpose fail to cause a conflict of interest between JSC "Conexus Baltic Grid" and energy supply merchant that is engaged in the manufacture or trade of natural gas or electricity;
- JSC "Conexus Baltic Grid" is obliged, once in two months from the day of adopting the decision, inform PUC on the process of implementation of the conditions and further planned activities by submitting a written report and substantiating documents.
- In November 2018, Conexus submitted an application to the Administrative Court to cancel the decision of PUC on certification of the operator in part regarding the provision established. The provisions by the PUC set out in the Regulator's decision are essentially addressed to shareholders, and Conexus, as a company, cannot legally influence the behaviour of the shareholder.

EU financing granted for the development of Inčukalns Underground Storage

The European Commission has approved the granting of co-financing of 50% for the development project of the unified natural gas transmission and storage system operator JSC "Conexus Baltic Grid", which intends to significantly enhance the operational safety of the technical infrastructure and equipment of Inčukalns Underground Gas Storage (Inčukalns UGS). The total investment in the project is 88 million, which will be invested in the storage by 2025. The other 50% of the project's investment is planned to be financed from borrowed resources.

In total, during six years investments will be allocated to the three directions intended for the modernization of the storage – modernization of surface infrastructure, gas well repairs, modernisation of the existing gas pumping equipment, as well as the purchase of a new compressor, the installation of which will ignite one of the most significant infrastructure development projects of Inčukalns UGS. The overall aim of the project is to increase the operation of storage so that Inčukalns Underground Gas Storage can maintain the functionality after increase of pressure in Baltic transmission system. The main benefit from implementation of the project is the ability to reduce the dependence of natural gas removal capacity from the volume of natural gas reserves in UGS.

Tariffs

Storage

On 26 April 2018, the Regulator approved new tariffs for the natural gas storage service, offering three new basic products to the users – products of grouped capacity, a market product, a virtual counterflow products. It is very important that the tariff review cycle is set at 3 years, which will allow the storage operator to notify the market participants in advance on the expected seasonal tariffs without a full tariff review procedure. The decision by the Regulator stipulates the obligation to inform market participants about the expected seasonal tariffs by 1 February. Also, the decision by the Regulator enables market participants to take part in the development of services necessary for the market and to suggest the operator to create an offer for long-term storage products, which will be available to all market participants after coordination with the PUC.

- On 14 December 2018, the PUC approved the storage service tariff values as part of the current tariff reporting cycle for the 2019/2020 annual storage cycle. 2019 begins with the approved natural gas storage service tariffs, which stand for significant changes in the planning order for the current natural gas injection season. Tariffs approved in due time will contribute to the development and safety of the natural gas market, and facilitate the entry of large and global market players by using Inčukalns UGS and thus strengthening the regional role of the storage.

- Due to timely approved natural gas storage tariffs, natural gas reservations for 2019/2020 injection season will begin much earlier – on 15 January instead of May, as has been the case so far. It will allow the traders to plan in advance the necessary natural gas flows and volumes for storage in Inčukalns UGS. Since the opening of the natural gas market, market processes and the necessary regulation regarding individual positions still adapt to the real conditions, and issues with timely approval of natural gas storage tariffs were one of the obstacles.

As natural gas is a complex product that requires precise long-term planning, market regulation must be subject to industry requirements and specificities. Such term as ‘immediate supply of natural gas’ for storage does not exist in this industry and, when the traders lack information regarding storage costs for too long, an alternative solution is very often found. Therefore it is a great pleasure that finally there has been a certain turning point and the new tariffs have been timely approved. This is also an important signal for international market participants, by clearly stating that they can count on Inčukalns natural gas storage and include it in their current season plans.

Timely preparation for the new natural gas injection season is also a matter of stability and security of natural gas supply in Latvia, as timely planned activities may increase the injection of Inčukalns UGS, which, in turn, will increase the availability of energy resources.

Timely approved tariffs are one of the steps for changes necessary regarding the operation of national strategic infrastructure object – Inčukalns UGS. Last year we began discussing the implementation of a storage model appropriate to the Latvian market situation, and we will continue the discussion this year, because at the moment, after the opening of the natural gas market, the traders are not obliged to use Inčukalns UGS for the storage of natural gas, and the storage is not able to cover all infrastructure costs related to its operation. Without reforms, it may pose risks to the security and stability of natural gas supply in the near future.

Transmission

On 18 June 2018, the Regulator approved new tariffs for the natural gas transmission system service, which become effective:

- On 18 July 2018 - for annual, quarterly, daily and current day products;
- 1 August 2018 – for monthly products.

On 30 July 2018, the Administrative Regional Court accepted the application from Conexus and instituted an administrative proceeding regarding the confirmed draft transmission tariff. In its application the Company asks to cancel partially the adopted tariff decision and include all actual costs incurred in heating season 2017/2018 regarding the provision of transmission system pressure that allowed Conexus to ensure the uninterrupted supply to Latvian market prescribed in the Licence and Energy Law. PUC has failed to recognize the costs in full in the tariff’s method and transmission tariff decision, in the result the actual costs of transmission operator amounting to 3 million EUR are not foreseen to be covered from the service tariffs.

On 22 October 2018, the Company submitted a new draft transmission tariffs to the PUC. Compared to the effective tariff, the proposed draft transmission system service tariff provides for an increase in costs related to the amendments by the Cabinet of 18 May 2018 to Regulation No 312 of 19 April 2011, ‘Procedures for Supply to Energy Users and Fuel Sales during the announced Energy Crisis and in the event of national threat’, resulting in, as described below, increase in costs to the Company related to auctions. The Regulator confirmed the rate of return on capital or profit norm in the field of natural gas of 4.22% that is lower than the one determined in the previous year.

The Company ensures the necessary capacity for transfer of natural gas from the storage

- On 18 May 2018, Cabinet of Minister adopted amendments in Regulations No. 312 “Procedures for the Supply of Energy Users and Sale of Heating Fuel During Declared Energy Crisis and in Case of Endangerment to the State” of 19 April 2011, on the base of which a transmission system operator shall ensure that from end of natural gas pumping season till March 1 of the following year such amount of active natural gas in Inčukalns underground gas storage that is not less than 3160 thous. MWh (300 million m^3.
- In 2018, the company organized 4 auctions to ensure, during the energy crisis, the required daily capacity for removal from Inčukalns Underground Storage, for provision of Latvian natural gas supply: open, market-based procedures, with the aim to select third parties (storage users) to enter into contractual agreements on ensuring natural gas availability in the transmission system interconnection with storage by injecting and storing natural gas in IUGS to the amount and within the time limits specified by the transmission system operator, in return for consideration.

Subsequent events

On 14 February 2019, the Company signed an agreement with Elering (Estonia) and Gasum Oy (Finland) on the implementation of inter transmission system operators compensation mechanism amongst the operators, which by 2020 will allow to establish Finnish, Estonian and Latvian gas market with a unified tariff zone for the transportation of gas.

The Board’s suggestion regarding profit distribution

- Dividends calculated for shareholders amount to EUR 11 935 827.
- Dividends calculated per share (EUR/share) EUR 0.30.
- Profit of 2018 to be transferred to retained earnings.
- Dividends to be distributed from the retained earnings of 2017.

Statement of the Management Responsibility

The management board of the Company is responsible for the preparation of the financial statements of the Company.

The financial statements for the year ending on 31 December 2018, have been prepared in accordance with the International Financial Reporting Standards adopted by the European Union and provide a true and fair view of the Company’s assets, liabilities, financial position and operational results.

The financial statements were approved by the Board on 6 March 2019 and they are signed by:

Zane Kotāne Chairperson of the Board	Gints Freibergs Member of the Board	Mārtiņš Gode Member of the Board

Financial statements

PROFIT AND LOSS STATEMENT

	Note	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017 Adjusted
		EUR'000	EUR'000
Revenue	1	54 174	49 356
Other income	2	2 459	1 430
Materials and services	3	(13 331)	(12 382)
Personnel expenses	4	(9 551)	(9 393)
Depreciation, amortisation and impairment of property, plant and equipment	7, 8	(15 500)	(18 544)
Other operating expenses	5	(4 757)	(4 047)
Operating profit		**13 494**	**6 420**
Financial expenses, net		(188)	(225)
Profit before taxes		**13 306**	**6 195**
Corporate income tax	6	-	10 826
Profit for the period		**13 306**	**17 021**

STATEMENT OF OTHER COMPREHENSIVE INCOME

	Note	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
		EUR'000	EUR'000
Profit for the period		13 306	17 021
Deferred income tax		-	18 757
Remeasurement of post-employment benefits due to changes in actuary's assumptions	14	(32)	593
Total net income recognised as other comprehensive income		(32)	19 350
Total comprehensive income for the period		**13 274**	**36 371**

The accompanying notes on pages 17 to 42 form an integral part of these financial statements.

Zane Kotāne
Chairperson of the Board

Gints Freibergs
Member of the Board

Mārtiņš Gode
Member of the Board

BALANCE SHEET

	Note	31.12.2018	31.12.2017
ASSETS		EUR'000	EUR'000
Non-current assets			
Intangible assets	7	990	1 038
Property, plant and equipment	8	331 681	333 883
Non-current prepaid costs	9	1 411	1 513
Total non-current assets:		**334 082**	**336 434**
Current assets			
Inventories	10	2 182	2 277
Advances for inventories		1	12
Trade receivables		6 859	5 959
Other current assets	11	371	420
Cash and cash equivalents		18 068	17 886
Total current assets:		**27 481**	**26 554**
TOTAL ASSETS:		**361 563**	**362 988**

The accompanying notes on pages 17 to 42 form an integral part of these financial statements.

Zane Kotāne
Chairperson of the Board

Gints Freibergs
Member of the Board

Mārtiņš Gode
Member of the Board

BALANCE SHEET (continued)

	Note	31.12.2018	31.12.2017
LIABILITIES AND SHAREHOLDERS' EQUITY		EUR'000	EUR'000
Shareholders' equity:			
Share capital	18	39 786	39 786
Treasury shares	18	(38)	(39)
Reserves	12	146 914	153 004
Retained earnings		123 104	117 666
Total shareholders' equity:		**309 766**	**310 417**
Non-current liabilities			
Deferred income	13	7 800	8 068
Employee benefit obligations	14	1 061	1 040
Borrowings	15	25 375	28 875
Total non-current liabilities:		**34 236**	**37 983**
Current liabilities			
Borrowings	15	3 500	3 500
Trade payables		3 666	2 814
Corporate income tax	6, 19	-	1 103
Other liabilities	16	8 510	6 707
Provisions	17	1 421	-
Deferred income	13	302	327
Advances from customers		162	137
Total current liabilities:		**17 561**	**14 588**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY:		**361 563**	**362 988**

The accompanying notes on pages 17 to 42 form an integral part of these financial statements.

Zane Kotāne Chairperson of the Board	Gints Freibergs Member of the Board	Mārtiņš Gode Member of the Board

STATEMENT OF CHANGES IN EQUITY

	Share capital	Treasury shares	Reserves	Retained earnings	Total
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
As at 4 January 2017	-	-	-	-	-
Received as a result of reorganization	39 786	-	234 299	-	274 085
Decrease of the revaluation reserve	-	-	(100 645)	100 645	-
Acquisition of treasury shares	-	(39)	-	-	(39)
Other comprehensive income:					
Other comprehensive income	-	-	19 350	-	19 350
Profit for the year				17 021	17 021
Total other comprehensive income:	-	-	*19 350*	*17 021*	*36 371*
31 December 2017	**39 786**	**(39)**	**153 004**	**117 666**	**310 417**
As at 1 January 2018	39 786	(39)	153 004	117 666	310 417
Dividends	-	-	-	(13 926)	(13 926)
Decrease of the revaluation reserve	-	-	(6 058)	6 058	-
Change in value of treasury shares	-	1	-	-	1
Other comprehensive income:					
Other comprehensive income	-	-	(32)	-	(32)
Profit for the year				13 306	13 306
Total other comprehensive income:	-	-	*(32)*	*13 306*	*13 274*
31 December 2018	**39 786**	**(38)**	**146 914**	**123 104**	**309 766**

The accompanying notes on pages 17 to 42 form an integral part of these financial statements.

Zane Kotāne Chairperson of the Board	Gints Freibergs Member of the Board	Mārtiņš Gode Member of the Board

STATEMENT OF CASH FLOW

	Note	04.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017 Adjustments
Cash flows from operating activities		EUR'000	EUR'000
Profit before corporate income tax		**13 306**	**6 195**
Adjustments for:			
- depreciation	8	15 118	17 881
- amortization of intangible assets	7	382	663
- loss on disposal of property, plant and equipment		461	(181)
- provisions		1 421	-
- participation in the transnational cross-border project	9	101	100
- amortisation of EU grants	13	(418)	(267)
- interest on loans		188	206
Change in operating assets and liabilities net of effects of reorganisation:			
- (increase) in debtors		(850)	(7 298)
- (increase)/decrease in advances for inventories		11	(12)
- (increase)/decrease in inventories		268	(61)
- (increase)/decrease in creditors		2 602	9 329
Corporate income tax paid		(1 110)	-
Net cash flow from operating activities		**31 480**	**26 555**
Cash flow from investing activities			
Purchase of property, plant and equipment		(13 545)	(16 587)
Purchase of intangible assets		(364)	(373)
Proceeds from sale of property, plant and equipment		25	517
Participation in the transnational cross-border project	9	-	(1 713)
Net cash flow from investing activities		**(13 884)**	**(18 156)**
Cash flow from financing activities			
Interest paid		(188)	(206)
Repayment of borrowings		(3 500)	(2 625)
Cash received on reorganisation		-	12 297
EU grants received	13	125	60
Acquisition of treasury shares	18	-	(39)
Dividends paid		(13 851)	-
Net cash flow from financing activities		**(17 414)**	**9 487**
Net cash flow		**182**	**17 886**
Cash and cash equivalents at the beginning of the reporting period		**17 886**	**-**
Cash and cash equivalents at the end of the reporting period		**18 068**	**17 886**

The accompanying notes on pages 17 to 42 form an integral part of these financial statements.

Zane Kotāne Chairperson of the Board	Gints Freibergs Member of the Board	Mārtiņš Gode Member of the Board

NOTES TO THE FINANCIAL STATEMENTS

NOTES TO THE STATEMENT OF PROFIT OR LOSS

1. Revenue

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017 Adjusted
	EUR'000	EUR'000
Revenue from transmission services	33 885	25 146
Revenue from storage services	20 289	24 210
	54 174	**49 356**

All revenue is generated in Latvia.

2. Other income

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017 Adjusted
	EUR'000	EUR'000
Net result from balancing	1 988	789
Income from EU financing (see Note 13)	418	268
Other income	53	190
Net gain on disposal of property, plant and equipment	-	183
	2 459	**1 430**

3. Materials and services

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017 Adjusted
	EUR'000	EUR'000
Natural gas	1 007	3 771
Materials	1 032	1 334
Maintenance of transmission and storage infrastructure	10 786	6 849
Maintenance of transport and machinery	187	176
Maintenance of IT infrastructure	319	252
	13 331	**12 382**

4. Personnel expenses

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
	EUR'000	EUR'000
Salary	7 337	7 271
State social insurance contributions	1 751	1 672
Life, health and pension insurance	438	412
Other personnel costs	25	38
	9 551	**9 393**
Including for members of the Council and the Board		
- Salary	564	1 013
- State social insurance contributions	122	201
- Life, health and pension insurance	36	100
- Other personnel costs	9	9
	731	**1 323**
Average number of employees	**350**	**356**

5. Other operating expenses

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
	EUR'000	EUR'000
Premises and territory maintenance and other services	1 378	1 326
Office and other administrative costs	1 626	1 517
Taxes and duties	1 292	1 204
Net loss on disposal of property, plant and equipment	461	-
	4 757	**4 047**

6. Corporate income tax

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
	EUR'000	EUR'000
Corporate income tax	-	(1 103)
De-recognition of deferred tax liabilities	-	11 929
	-	**10 826**

Corporate income tax from theoretically distributed profit in the financial statements for 2018 is disclosed under other operating income.

Notes to the balance sheet

7. Intangible assets

Intangible assets	31.12.2018	31.12.2017
	EUR'000	EUR'000
Cost		
Beginning of period	5 712	-
Received as a result of reorganization	-	5 352
Additions	364	373
Reclassified from fixed assets	4	-
Disposals	(121)	(13)
End of period	**5 959**	**5 712**
Amortization		
Beginning of period	4 674	-
Received as a result of reorganization	-	4 017
Amortization for the reporting period	382	663
Disposals	(87)	(6)
End of period	**4 969**	**4 674**
Net book value as at the end of the period	**990**	**1 038**

The intangible assets as at 31.12.2018 include fully depreciated intangible assets with a total cost of EUR 3 340 thousand (as at 31.12.2017: 2 843 thousand EUR). Most of intangible assets of the company represent software for operations of operating segments.

8. Property, plant and equipment

	Land and buildings	Machinery and equipment	Other fixed assets	Spare parts emergency reserve	Assets under construction	TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Cost or revalued amount						
04.01.2017	**-**	**-**	**-**	**-**	**-**	**-**
Reorganisation	635 266	105 659	4 331	-	12 419	757 675
Additions	-	-	-	-	16 587	16 587
Reclassified	4 830	5 630	588	1 608	(9 717)	2 939
Disposals	(716)	(630)	(110)	-	-	(1 456)
Transferred	7	(720)	713	-	-	-
31.12.2017	**639 387**	**109 939**	**5 522**	**1 608**	**19 289**	**775 745**
Depreciation						
04.01.2017	**-**	**-**	**-**	**-**	**-**	**-**
Reorganization	366 126	55 994	2 988	-	-	425 108
Calculated	11 786	5 704	391	-	-	17 881
Revalued		(10)				(10)
Disposals	(526)	(499)	(92)	-	-	(1 117)
Transferred	7	(362)	355	-		-
31.12.2017	**377 393**	**60 827**	**3 642**	**-**	**-**	**441 862**
Net book value as at 31.12.2017	**261 994**	**49 112**	**1 880**	**1 608**	**19 289**	**333 883**

Property, plant and equipment (continued)

	Land and buildings	Machinery and equipment	Other fixed assets	Spare parts emergency reserve	Assets under construction	TOTAL
	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000	EUR'000
Cost or revalued amount						
31.12.2017	**639 387**	**109 939**	**5 522**	**1 608**	**19 289**	**775 745**
Additions	-	195	265	-	13 085	13 545
Reclassified	12 668	11 335	534	-	(24 537)	-
Disposals	(1 416)	(767)	(90)	-	-	(2 273)
Transferred	-	-	-	(173)	(4)	(177)
31.12.2018	**650 639**	**120 702**	**6 231**	**1 435**	**7 833**	**786 840**
31.12.2017	**377 393**	**60 827**	**3 642**	**-**	**-**	**441 862**
Calculated	10 856	3 767	495	-	-	15 118
Disposals	(1 120)	(613)	(88)	-	-	(1 821)
31.12.2018	**387 129**	**63 981**	**4 049**	**-**	**-**	**455 159**
Balance as at 31.12.2018	**263 510**	**56 721**	**2 182**	**1 435**	**7 833**	**331 681**

Property, plant and equipment as at 31.12.2018 include fully depreciated assets with a total cost of EUR 13,418 thousand (as at 31.12.2017: 8 016 thousand EUR).

Cadastre value of real estate amounts to EUR 64 404 thousand.

The latest revaluation of the buildings, structures, machinery was carried out in 2016, before the reorganisation of JSC "Latvijas Gāze". The balances of revalued assets were transferred to the Company as a result of reorganisation, at prior amounts. The revaluation was performed by an independent external expert using the depreciated replacement cost method.

The following table summarises values of the revalued assets as if they were carried at the historical cost. Also, refer to Note 21.

Cost	31.12.2018	31.12.2017
	EUR'000	EUR'000
Buildings and structures	131 293	130 882
Machinery and equipment	51 889	43 677

9. Prepaid expenses

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Opening balance	1 613	-
Payment made	-	1 713
Amortised in the profit or loss	(101)	(100)
Transferred to future periods	**1 512**	**1 613**
incl. current part (see Note 11)	*101*	*100*
non-current term	*1411*	*1 513*

In accordance with the Regulator's Decision No 97 (prot. No 16, p.4) "On the distribution of investment costs for the common interest project "Klaipedos - Kiemenai pipeline capacity increase in Lithuania "", a payment was made to AB Amber Grid.

Prepaid expenses were transferred to costs during the repayment of investments.

10. Inventories

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Materials and spare parts	1 699	1 366
Natural gas	552	980
Write-off of inventory value to net realisable value	(69)	(69)
	2 182	**2 277**

Write-off of inventory value to net realisable value	**01.01.2018 - 31.12.2018**	**04.01.2017 -31.12.2017**
	EUR'000	EUR'000
Write-offs at the beginning of the period	69	
Overtaken as a result of reorganization	-	86
Decrease included in profit or loss	-	(17)
Write-offs at the end of period	**69**	**69**

11. Other current assets

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Prepaid expenses related to the participation in the transnational cross-border project (see Note 9)	101	100
Other prepaid expenses	199	145
Other financial assets	71	175
	371	**420**

12. Reserves

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Property, plant and equipment revaluation reserve	121 909	127 967
Post-employment benefit revaluation reserve	358	390
Reorganisation reserve	24 647	24 647
	146 914	**153 004**

Movement in revaluation reserves	PPE revaluation reserve	Post-employment benefit revaluation reserve
	EUR'000	EUR'000
Opening balance (04.01.2017)	-	-
Overtaken as a result of reorganization	209 855	(203)
Reassessment of actuarial assumptions	-	593
Disposed revalued assets	(56)	-
Transfer of depreciation of revaluation surplus (transferred in reorganisation) to retained earnings	(75 432)	-
Transfer of depreciation of revaluation surplus charged for the period to retained earnings	(6 400)	-
Balance as at 31.12.2017	**127 967**	**390**
Overtaken as a result of reorganization	-	-
Reassessment of actuarial assumptions		(32)
Disposed revalued assets	(162)	-
Transfer of depreciation of revaluation surplus (transferred in reorganisation) to retained earnings	(5 896)	-
Transfer of depreciation of revaluation surplus charged for the period to retained earnings	-	-
Balance as at 31.12.2018	**121 909**	**358**

Revaluation reserve cannot be distributed in dividends nor can it be capitalised.

13. Deferred income

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Non-current part	7 800	8 068
Current part	302	327
	8 102	**8 395**

Movement of deferred income	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
	EUR'000	EUR'000
Opening balance	8 395	-
Overtaken as a result of reorganization	-	8 602
EU funds received	125	60
Transferred to revenue for the period (see Note 2)	(418)	(267)
Transferred to future periods	**8 102**	**8 395**

According to EC Decision C(2010) 5554 of 13 August 2008 concerning the granting of financial aid for gas and electricity interconnections in the field of Regulation (EC) No 663/2009, JSC "Latvijas Gāze" received a financing of 50% up to a maximum of EUR 10 million for the realisation of measures No EEPR-2009-INTg-RF-LV-LT SI2.566527 'Reconstruction of 15 wells in Inčukalns underground gas storage' and SI2.566531 'Reconstruction of underwater passage over the Daugava River and construction of a new pipeline maintenance facility". Objects were put into operation in 2011. The unused part of funding was used for the reconstruction of two other wells. The last payment from the EC was received in 2013. In 2018, funding received from the EC for the development of sustainable strategy and model for Inčukalns Underground Gas Storage amounted to EUR 90 thousand, while EUR 35 thousand was received from the EC for the Enhancement of Latvia-Lithuania Interconnection Project.

14. Employee benefit obligations

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Post-employment benefit liabilities	963	927
Other employment benefits	98	113
	1 061	**1 040**

	01.01.2018 - 31.12.2018	04.01.2017 - 31.12.2017
Obligations at the beginning of the reporting period	1 040	-
Overtaken as a result of reorganization	-	1 539
Recognised in profit or loss	82	154
Paid	(93)	(60)
Revaluations due to changes in actuarial assumptions - in equity	32	(593)
Obligations at the end of the reporting period	**1 061**	**1 040**

Employee benefit obligations (continued)

Assumptions used in the calculations of obligations	31.12.2018	31.12.2017	Liabilities transferred as a result of reorganization
Discount rate, %	1.2%	0.205%	0.24%
Employee rotation rate, %	3.48%	3.09%	3.40%
Employee retirement age, years	64.9	63	62.75
Wage growth, %	3.00%	3.00%	4.00%
Contribution into private pension fund, %	5.00%	5.00%	5.00%
Compulsory social security contributions (employees), %	24.09%	23.59%	23.59%
Compulsory social security contributions (retired), %	21.31%	20.57%	19.90%

Assumptions used in the calculations of obligations	Changes in assumptions	Impact on obligations due to changes in assumptions	31.12.2018	31.12.2017
Discount rate	+0.5%	Savings reduced by	-4.29%	4.91%
Employee rotation rate	+0.5%	Savings reduced by	-4.70%	0.16%
Employee retirement age	+1 year	Savings reduced by	-5.34%	1.94%
Wage growth	+0.5%	Savings increased by	4.41%	4.70%
Contribution into private pension fund	+0.5%	Savings increased by	0.39%	0.39%
Compulsory social security contributions	+0.5%	Savings increased by	0.39%	0.39%

Assumptions used in the calculations of obligations	Changes in assumptions	Impact on obligations due to changes in assumptions	31.12.2018	31.12.2017
Discount rate	-0.5%	Savings increased by	4.70%	5.41%
Employee rotation rate	-0.5%	Savings increased by	5.13%	0.16%
Employee retirement age	-1 year	Savings increased by	5.04%	1.29%
Wage growth	-0.5%	Savings reduced by	-4.06%	4.32%
Contribution into private pension fund	-0.5%	Savings reduced by	-0.39%	0.39%
Social contributions	-0.5%	Savings reduced by	-0.39%	0.39%

15. Borrowings

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Borrowings from credit institutions – non-current part	25 375	28 875
Borrowings from credit institutions – current part	3 500	3 500
	28 875	**32 375**

The Company has a valid loan agreement with OP Corporate Bank plc, Latvian branch with maturity on 30 November 2021. The loan has an interest rate of 0.605 plus 6M EURIBOR. The loan is not secured by collateral.

16. Other liabilities

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Accrued costs for non-received invoices	5 194	4 040
Accrued bonuses	1 338	772
Value added tax	756	339
Accrued vacation costs	437	515
Salaries	301	281
Social insurance contributions	203	382
Personal income tax	103	231
Corporate income tax from theoretically distributed profit	36	-
Dividends undistributed from prior years	74	-
Other non-current liabilities	41	85
Natural resource tax	27	62
	8 510	**6 707**
incl. financial liabilities	*5 194*	*4 040*

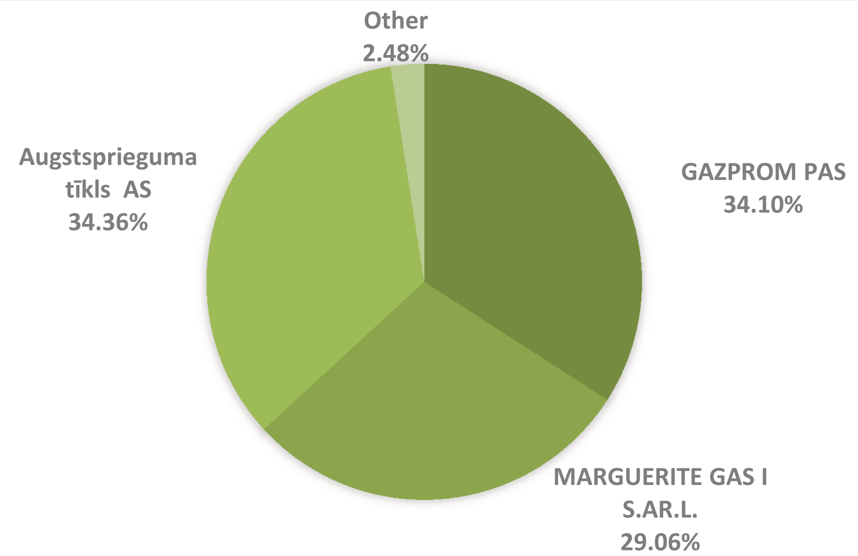
17. Provisions

	31.12.2018	31.12.2017
	EUR'000	EUR'000
Provisions to maintain minimum amount of natural gas in the pipelines	1 421	-
	1 421	**-**

Provisions relate to for the purchase of natural gas needed to cover losses on collecting level and for the balancing of transmission system.

18. Share capital

Conexus is a closed-end joint stock company with 100% registered shares. The total number of shares is 39,786,089, with a nominal value of EUR 1.00. The total number of shareholders exceeds 4.8 thousand. 97.52% of the total number of shares belong to the three largest shareholders.



The Company redeemed shares amounting to EUR 39 thousand in accordance with the provisions laid down in Article 353 (1), (2), (3) of the Commercial Code, from the shareholders who voted against the approval of the statues on 22 December 2016 at the constituent meeting of the JSC "Conexus Baltic Grid".

19. Taxes

	Balance 31.12.2017	**Calculated**	**Paid**	**Liabilities 31.12.2018**
	EUR'000	EUR'000	EUR'000	EUR'000
Corporate income tax	1 103	-	(1 103)	-
Corporate income tax from theoretically distributed profit	-	43	(7)	36
Value added tax	339	7 455	(7 038)	756
Social insurance contributions	382	2 444	(2 623)	203
Personal income tax	231	1 276	(1 404)	103
Natural resource tax	62	182	(217)	27
Real estate tax	-	960	(960)	-
	2 117	**12 360**	**(13 352)**	**1 125**

20. Related party transactions

No individual entity exercises control over the Company. The Company has following transactions with entities disclosed below, which own or owned more than 20% of the shares that deemed to provide a significant influence over the Company.

Income or expenses	**31.12.2018**	**31.12.2017**
	EUR'000	EUR'000
Income and provision of services		
PJSC "Gazprom"	-	26
	-	**26**
Expenses on purchase of services from the companies controlled by related companies		
Companies controlled by PJSC "Gazprom"	279	85
	279	**85**

Related parties payables and receivables	**31.12.2018**	**31.12.2017**
	EUR'000	EUR'000
Due to related parties		
Companies controlled by PJSC "Gazprom"	64	20
	64	**20**

21. Other issues

Capital commitments

The Company has planned to spend 14 673 thousand EUR for capital expenditures for property, plant and equipment and intangible assets in the subsequent year, including:

- contracted for, but not yet delivered: 3,437 thousand EUR

- authorised, but not yet contracted for: 14,236 thousand EUR

Events after the balance sheet date

No significant subsequent events have occurred since the last day of the reporting period that would materially influence the Company's financial statements as at 31 December 2018.

Remuneration to the certified auditors' company

Remuneration to the certified auditors' company	**01.01.2018 - 31.12.2018**	**04.01.2017 - 31.12.2017**
	EUR'000	EUR'000
Statutory audit	13	32
Agreed upon procedures with regard to reorganisation balance sheet	-	7
	13	**39**

22. Financial risk management and fair value

The principles and guidelines for general management of financial risks are set out in the Company's financial risk management policy. Financial risk management is ensured by the board member responsible for the financial area and by the Planning and Analysis Division.

The Company has contingent liabilities due to litigation against PUC regarding the certification of the company.

Conexus is exposed to the following financial risks: capital risk, interest rate risk, currency risk, credit risk and liquidity risk.

The financial assets of JSC "Conexus Baltic Grid" include trade and other receivables, cash and cash equivalents. Financial liabilities include borrowings, debts to suppliers and other creditors. The amount of financial assets and liabilities is summarized in the table below:

Financial assets and liabilities	**31.12.2018**	**31.12.2017**
	EUR'000	EUR'000
Trade receivables	6 859	5 959
Other receivables	71	175
Cash and cash equivalents	18 068	17 886
Financial assets (loans and receivables)	**24 998**	**24 020**
Borrowing	28 875	32 375
Trade payables	3 666	2 814
Other payables	5 194	4 040
Financial liabilities (other financial liabilities)	**37 735**	**39 229**

Liquidity risk

Liquidity risk is associated with ability of the Company to settle its obligations within agreed terms. JSC "Conexus Baltic Grid" follows prudent liquidity risk management when estimated annual, quarterly and monthly cash flows to ensure appropriate amount of funds necessary for operating activities. If necessary, JSC "Conexus Baltic Grid" can leverage short-term credit lines if needed. The liquidity reserves of the Company are made of the Company's own cash and cash equivalents and credit lines provided by credit institutions.

Term analysis of financial liabilities based on their contractual cash flows:

31.12.2018	**Carrying amount EUR'000**	**Contractual cash flows EUR'000**	**1 to 3 months EUR'000**	**3 months – 1 year EUR'000**	**1 - 5 years EUR'000**
Loans	28 875	29 301	918	2 749	25 634
Other loans	8 860	8 860	8 860	-	-
Financial liabilities	**37 735**	**38 161**	**9 778**	**2 749**	**25 634**

31.12.2017	Carrying amount EUR'000	Contractual cash flows EUR'000	1 to 3 months EUR'000	3 months – 1 year EUR'000	1 - 5 years EUR'000
Loans	32 375	32 988	923	2 764	29 301
Other loans	6 854	6 854	6 854	-	-
Financial liabilities	**39 229**	**39 842**	**7 777**	**2 764**	**29 301**

Market risk

Interest rate risk

The interest rate risk arises from the use of borrowed cash resources to ensure liquidity. JSC "Conexus Baltic Grid" uses general borrowing to finance its operations.

The Company is exposed to interest rate risk as the borrowing has variable interest rates. The Company's financial risk management policy stipulates that the interest rate of the largest portion of the borrowing s variable.

As all financial assets and liabilities are accounted for at the amortised cost, the Company is not exposed to the fair value interest rate risk.

Credit risk

JSC "Conexus Baltic Grid" is exposed to credit risk, i.e., in case the counterparty fails to fulfil its contractual obligations, losses will incur. Credit risk is derived from cash and cash equivalents and from overdue accounts receivable.

To restrict credit risk, JSC "Conexus Baltic Grid" uses security deposits. Credit risk management is conducted by the Commercial Division under the supervision of the Chairman of the Board. Credit risk is related to the largest customers of JSC "Conexus Baltic Grid".

As at 31.12.2018 and 31.12.2017 the Company was not subject to significant credit risk related to its customers as there were no overdue debts and all trade receivables were collected during January 2019.

The credit risk associated with cash and cash equivalents is managed by the Planning and Analysis Division. Credit risk regarding financial resources with credit institutions is balanced by placing them with at least two credit institutions.

All credit institutions with which the Company is cooperating or plans to cooperate are assessed on the basis of credit rating established by an international credit rating agency – of at least A- or A3. Based on such assessment, outstanding cash and cash equivalents can be summarised as follows (grouped by long-term rating):

Bank	**Rating**	**31.12.2018**	**31.12.2017**
		EUR'000	EUR'000
Swedbank	Aa3	18 009	17 836
Citadele banka	Ba2	50	50
SEB banka	Aa2**	9	-
Financial assets		**18 068**	**17 886**

* The Moody's rating for parent company Swedbank AB, such rating is not available for Swedbank AS.

** Credit rating for Skandinavska Enskilda Banken (SEB).

Due to the low interest rates, on 31 December 2018 and 2017, cash and cash equivalents consisted only of current account balances with credit institutions.

Capital Risk management

The Company's objectives when managing capital risk are to safeguard the Company's ability to continue as a going concern, maintain an optimal structure to reduce the cost of capital. The Company performs management of the capital, based on proportion of borrowed capital against total capital. Adequacy ratio of the shareholders' equity is calculated as the ratio of Conexus's total liabilities to its total capital. Liabilities include all long term and short-term liabilities, but total capital includes all liabilities of the Company and equity. This indicator is used to evaluate structure of the capital of the Company, as well as its solvency. Strategy of the company is to ensure that the mentioned proportion does not exceed 50%. As at 31.12.2018 the proportion of borrowed capital to total capital was as follows:

	31.12.2018	**31.12.2017**
	EUR'000	**EUR'000**
Total liabilities	51 797	52 571
(Cash and cash equivalents)	(18 068)	(17 886)
(Deferred income - EU grants)	(8 102)	(8 395)
Net total liabilities	25 627	26 310
Total equity and liabilities	361 563	362 988
Borrowed capital proportion to total capital	7.09%	7.25%

Currency risk

The Conexus policy is focused on operating transactions, assets or liabilities in the functional currency of the Company, which is the euro. Foreign currency risk is considered to be low. The Company does not hold any balances in foreign currencies.

Fair value

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources. In case of unobservable inputs, the valuation method reflects the Company's market assumptions. This hierarchy requires the use of observable market data when available. The Company considers relevant and observable market prices in its revaluation, where possible.

The objective of the fair value measurement, even in inactive markets, is to arrive at the price at which an orderly transaction would take place between market participants to sell the asset or transfer the liability at the measurement date under current market conditions. In order to arrive at the fair value of a financial instrument different methods are used: quoted prices, valuation techniques incorporating observable data and valuation techniques based on internal models. These valuation methods are divided according to the fair value hierarchy in Level 1, Level 2 and Level 3. The level in the fair value hierarchy within which the fair value of a financial instrument is categorized shall be determined on the basis of the lowest level input that is significant to the fair value in its entirety.

The classification of financial instruments in the fair value hierarchy is a two-step process:

1. Classifying each input used to determine the fair value into one of the three levels;

2. Classifying the entire financial instrument based on the lowest level input that is significant to the fair value in its entirety.

Quoted market prices – Level 1
Valuations in Level 1 are determined by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted prices are readily available and the prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques and observable inputs – Level 2
Valuation techniques in Level 2 are models where all significant inputs are observable for the asset or liability, either directly or indirectly. Inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (that is, as price) or indirectly (that is, derived from prices).

Valuation technique using significant unobservable inputs – Level 3
A valuation technique that incorporates significant inputs that are not based on observable market data (unobservable inputs) is classified in Level 3. Unobservable inputs are those not readily available in an active market due to non-liquid market or complexity of the product. Level 3 inputs are generally determined based on observable inputs of a similar nature, historic observations on the level of the input or analytical techniques.

The following financial assets and liabilities are included in Level 3.

	31.12.2018	**31.12.2017**
	EUR'000	**EUR'000**
Assets:		
Property, plant and equipment	319 191	310 081
Trade receivables	6 859	5 959
Other receivables	71	175
Cash and cash equivalents	18 068	17 886
Liabilities:		
Borrowings	28 875	32 375
Trade payables	3 666	2 814
Other payables	5 194	4 040

Assets and liabilities for which fair value is disclosed
The carrying amount of liquid and short-term financial instruments (with maturity below 3 months), for example, cash and cash equivalents, short-term trade payables and trade receivables, corresponds to their fair value.

The carrying amount of borrowings from credit institutions is evaluated by discounting future cash flows and applying market interest rate. As interest rates applied on borrowings from credit institutions, are mainly floating and do not significantly differ from market rates, and the risk margin applicable to the Company has not changed significantly, the fair value of long-term liabilities approximates their net book value.

Assets measured at fair value

The Company's buildings, structures, including gas pipeline infrastructure, machinery and equipment are reported at revalued amounts which approximate their fair value.

The last revaluation was performed in 2016 while the relevant assets were still the part of JSC "Latvijas Gāze". Considering the unique nature and use of the assets, revaluation was based on Level 3 data, meaning that the data are not freely observable for relevant type of assets. This was a repeated revaluation, and the data level of used assumptions was not changed.

The revaluation was performed by an external expert using the amortised replacement cost method. According to this method, initial value of assets is determined according to the prices, requirements and applied materials at the time of the valuation. Key assumptions during revaluation process are associated with the materials cost and the cost of the average construction prices at the time of revaluation. For determination of values, data available to the Company about similar constructions of facilities in recent years is being used. A significant section of the revaluation consists of revaluation of underground gas pipelines. The total length of pipeline transmission system is 1,188 km. In case of an increase in the average construction cost in the country or significantly increase the cost of materials, asset value will increase. If the cost of construction or materials decreases the value of the assets will decrease accordingly.

Parallel to the initial value, accumulated depreciation is determined, taking into account the following key factors: the asset's physical, functional and technical depreciation. If revalued assets are used in a substantially different way, or they are functionally obsolete, revalued asset value may decrease significantly.

The management has assessed the level of pipeline and general construction prices during 2017 and 2018, and has not identified significant changes as compared to 2016 when the revaluation was made. In the absence of other significant changes, the management concluded that the carrying amount of revalued property, plant and equipment does not differ materially from the amount which would be determined using fair value at the end of the reporting period.

23. Accounting Policies

Basis of preparation

Conexus financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union. These financial statements cover the period 1 January 2018 to 31 December 2018.

These financial statement have been approved by the Management Board on 6 March 2019 and will be approved by the shareholders of the Company. Shareholders have the power to reject the financial statements prepared and issued by the Company and the right to request that new financial statements be issued.

Financial statements are prepared on a going concern assumption. Assets and liabilities in the financial statements are measured on the historical cost basis, property, plant and equipment are measured at fair value. The cash flow statement has been prepared in accordance with the indirect method. Statement of financial position is entitled "Balance Sheet". Financial indicators in the financial statement of JSC "Conexus Baltic Grid" are reported in thousands of the euro, unless otherwise stated.

In preparing financial statements of JSC "Conexus Baltic Grid" in accordance with IFRS, balances of financial statements items are measured possibly accurately, based on management information on current events and activities, in line with the assumptions and estimates.

Conexus financial statements have been prepared in accordance with IFRS since 4 January 2017, when the Company was created as a result of the reorganisation, unbundling the natural gas transmission and storage activities from JSC "Latvijas Gāze".

The basic accounting and accounting valuation principles set out in this section have been applied consistently throughout the reporting period.

Adoption of new and revised standards and interpretations

The following new and amended IFRS and their interpretations have become effective in 2018:

IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2018). The standard was adopted as of 1 January 2018, adjusting the Company's accounting policies accordingly. This standard will not have significant impact on the Company's financial statements, as described below.

IFRS 15 – Revenue from Contracts with customers (effective for annual periods beginning on or after 1 January 2018) and amendments to IFRS 15 – Revenue from Contracts with customers (effective for annual periods beginning on or after 1 January 2018). The amended standard was adopted as of 1 January 2018, adjusting the Company's accounting policies accordingly. This standard will not have significant impact on the Company's financial statements, as described below.

A number of new standards and interpretations are published and are effective for annual periods beginning on or after 1 January 2019 or have not been adopted in the EU:

IFRS 16 Lease – (Effective for annual periods beginning on or after 1 January 2019).

Annual improvements to IFRS in 2016 Improvements include changes to 3 standards, including IFRS 1 First time adoption of IFRS are effective for reporting periods beginning on or after 1 January 2018; not yet adopted in the EU).

IFRIC 22 Foreign Currency Transaction and Advance Consideration (Effective for annual periods beginning on or after 1 January 2018, not yet adopted in the EU).

Annual improvements to IFRS in 2017 (effective for annual periods beginning on or after 1 January 2019; not yet adopted in the EU). These improvements include changes to 4 standards, including IAS 23 Borrowing costs.

The management of JSC "Conexus Baltic Grid" has elected not to adopt these standards, revisions and interpretations in advance of their effective dates, also, the Company anticipates that the adoption of all other standards, revisions and interpretations will have no material impact on the financial statements of the Company in the period of application.

IFRS 16 supersedes IAS 17 Leases and related interpretations. The Standard eliminates the current dual accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases.

Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals.

The new Standard introduces a number of limited scope exceptions for lessees which include:

- leases with a lease term of 12 months or less and containing no purchase options, and
- leases where the underlying asset has a low value ('small-ticket' leases).

Lessor accounting shall remain largely unaffected by the introduction of the new Standard and the distinction between operating and finance leases will be retained.

The new standard, when initially applied, is likely to result in the Company having to recognise in its balance sheet assets and liabilities relating to operating leases for which the Company acts as a lessee. Considering the operating lease commitments the Company currently has (land rent agreements), the quantitative impact of the new Standard will be to recognise additional asset and liability on balance sheet from the 1 January 2019. The precise effect has not been estimated yet; however, it is not expected to be material and will fall into the range of EUR 300-400 thousand.

Intangible assets

Recognised as intangible assets are identifiable non-monetary assets without physical substance that are used for the provision of services or for operating purposes. Intangible assets of JSC "Conexus Baltic Grid" mainly consist of so ware licenses and patents.

Amortisation of intangible assets is calculated on a straight-line basis over its estimated useful life. The average useful life of intangible assets is 5 years.

Property, plant and equipment

Property, plant and equipment are tangible assets held for using in more than one period in supply of goods and in providing services or for operating purposes. Company`s main fixed asset groups are buildings and structures, transmission gas pipelines and associated machinery and equipment, as well as structures, equipment and machinery of Inčukalns underground gas storage facility.

The Company's buildings and constructions and equipment and machinery are stated at revalued amount. Revaluation shall be made with sufficient regularity to ensure the carrying amount does not materially differ from that which would be determined using fair value at the end of the reporting period. All other property, plant and equipment groups (including land, cushion gas, line fill and emergency reserve of spare parts) are stated at historical cost.

An asset is recognized when there is a high probability that future economic benefits associated with this asset will be received and the cost of an asset can be measured reliably. In the financial statements, property, plant and equipment are stated net of accumulated depreciation and write-offs of impairment.

Assets in the process of construction, assembly or installation, but not yet ready for the intended use or are classified under Assets under construction. Subsequent costs are included in the asset's carrying amount based on asset recognition criteria. Current repair and maintenance costs are charged to the profit or loss statement as incurred.

Revaluation gain is included in Reserves under equity. Revaluation reserve is reduced if the revalued asset is disposed of, eliminated or an increase in value is no longer warranted according to the management's assessment. Revaluation surplus of written-off PPEs is transferred to the retained earnings under equity. During the useful life of the revalued within each reporting period, part of the revaluation reserve calculated as the difference between depreciation of the carrying amount of the revalued asset and depreciation of the from the initial cost value are recognised as accumulated profits under equity.

From the date when the asset is ready for its intended use, it is depreciated and its value is gradually written off during useful life up to the estimated residual value. No depreciation is calculated on land, prepayments for fixed assets, assets under construction, emergency reserve of spare parts as well as cushion gas and line fill.

Property, plant and equipment are subject to depreciation on a straight-line basis over the following useful lives:

Type of fixed assets	Estimated useful life in years
Buildings	20-100
Engineering structures	20-60
Equipment and machinery	5-30
Other fixed assets	3-10

In the event that the book value of an asset is higher than its recoverable amount, the value of the respective PPE is immediate written down to its recoverable amount.

Gains or losses on disposals are determined by calculating the carrying amount of PPE and proceeds from the sale of PPE. On disposal of revalued asset, the amount included in the revaluation reserve is transferred to retained earnings under equity.

Non-current prepaid costs

Classified as non-current prepaid expenses are balances of payment made by JSC “Conexus Baltic Grid”, which, by economic substance, relate to future periods more than one year after the balance sheet date.

Non-current prepaid expenses are subjected to amortisation and they are gradually recognized in the profit or loss based on their economic substance. Those prepaid expenses are disclosed under current assets that will be amortised during 12 months under profit or loss, and the remaining balance – within non-current assets.

Inventories

Inventories are stated at the lower of cost or net realizable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to complete the stock and the sale.

The cost of natural gas, materials and spare parts is determined using the weighted average method. Inventories expenses are recognised in profit or loss when they have been consumed.

Provisions are made for impairment of obsolete, slow-moving or damaged inventories. The amount of provisioning is included in the profit or loss for the period. The required amount of provisions are reviewed periodically, at least on an annual basis.

Cash and cash equivalents

Cash and cash equivalents comprise balances of current accounts and demand deposits at banks, as well as short term, highly liquid investments with initial maturity of up to 90 days that are readily convertible to cash and are not subject to significant risk of changes in value.

Other financial assets

The Company adopted IFRS 9 in 2018. IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the guidance in IAS 39, Financial Instruments: Recognition and Measurement, that relates to the classification and measurement of financial instruments.

Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit and loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different.

A financial asset is measured at amortized cost if the following two conditions are met:

- the assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding.

The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss (ECL)' model, which means that a loss event will no longer need to occur before an impairment allowance is recognised. The new impairment model will apply to financial assets measured at amortized cost or FVOCI, except for investments in equity instruments, and to contract assets.

Under IFRS 9, loss allowances are measured on either of the following bases:

- 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and
- Lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument.

The Company took advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Any potential differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 should have been recognized in retained earnings and reserves as at 1 January 2018. However, there was no impact from IFRS 9 adoption as noted below and therefore no adjustment to reserves were made as at 1 January 2018. Likewise, no substantial additional disclosures required by IFRS 9 were deemed necessary in the Company circumstances.

Initial recognition and measurement

Company's financial assets include trade and other receivables and cash and cash equivalents. Similarly to the past practice all financial assets held by the Company are classified as loans and receivables at amortized cost under IFRS 9. The Company determines the classification of its financial assets at initial recognition. All financial assets held by the Company are recognised initially at fair value plus directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognised on the trade date, i.e., the date that the Company commits to purchase or sell the asset.

Subsequent measurement

After initial measurement, financial assets are subsequently measured at amortised cost using the effective interest rate method (EIR), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR.

Derecognition

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when rights to receive cash flows from the asset have expired.

Impairment of financial assets

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. Allowances for ECL are determined on the basis of customers' ability to pay, considering historical information about payment patterns, doubtful debts, customer creditworthiness and prevailing economic conditions. Estimates made are updated if the debtor's ability to pay changes. The Company has adopted a loss rate based on past due day status for its trade debtors and contract assets. The effect of implementing ECLs is trivial due to the nature of the Company's financial assets. Current receivables the Company holds are of short term nature and from customers with no past loss events. Likewise, given the short term nature the impact on cash and cash equivalents is assessed as not significant. Therefore, no significant additional disclosures included in financial statements as allowed under IAS 1.31.

Financial liabilities

For financial liabilities, IFRS 9 brings no changes to classification and measurement except for liabilities designated at fair value through profit or loss whereby the changes in own credit risks are recognised in other comprehensive income.

Initial recognition and measurement

The Company's financial liabilities include trade and other payables, interest bearing loans and other liabilities.

Financial liabilities within the scope of IFRS 9 are classified as financial liabilities at amortised cost. The Company determines the classification of its financial liabilities at initial recognition.

All financial liabilities are recognised initially at fair value plus directly attributable transaction costs.

Subsequent measurement

After initial recognition, trade and other payables, interest bearing loans and other liabilities are subsequently measured at amortised cost using the effective interest rate method. Gains and losses are recognised in the statement of profit and loss when the liabilities are derecognised as well as through the effective interest rate method (EIR) amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. The EIR amortisation is included in finance cost in the statement of profit and loss.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of profit and loss.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

Dividends

Dividends are recognized as a liability in the period in which the dividends are approved by the Company's shareholders.

Provisions

Provisions for obligations are recognised when due to past events the Company has a present legal or constructive obligation and it is probable that an outflow of resources will be required to settle the obligation. Provisions are recognised if the amount can be reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value according to the management best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The required provisions are periodically reviewed, but not less than once a year.

Currency unit and revaluation of foreign currency

The items in the financial statements are expressed in Euro, which is the functional currency of the economic activity environment of JSC “Conexus Baltic Grid” and official currency in the Republic of Latvia.

All transactions in foreign currencies are translated into euro at the exchange rate of the European Central Bank on the day of the relevant transactions. All monetary assets and liabilities denominated in foreign currencies are revalued to EUR according to the exchange rate on the last day of the reporting year. Gains or losses from the revaluation of foreign currencies are recognized in the profit and loss statement of the respective period.

Employee benefits

JSC “Conexus Baltic Grid” recognises provisions for employee benefits where contractually obliged or where there is a past practice that has created a constructive obligation.

Social insurance and pension contributions

The Company pays social security insurance contributions for state pension fund in compliance with the Latvian legislation. The Company also pays contributions to an external fixed-contribution private pension plan. The Conexus will have no legal or constructive obligations to pay further contributions if the statutory fund cannot settle their liabilities towards the Conexus employees. The social insurance and pension contributions are recognised as an expense on an accrual basis and are included within personnel costs.

Post-employment and other employee benefits

Under the Collective Agreement, the Company provides certain benefits upon termination of employment and over the rest of life to employees whose employment conditions meet certain criteria. The amount of benefit liability is calculated based on the current salary level and the number of employees who are entitled or may become entitled to receive those payments, as well as based on actuarial assumptions. The benefit obligation is calculated once per year.

The present value of the benefit obligation is determined by discounting the estimated future cash outflows using the market rates on government bonds. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income within equity in the period in which they arise.

Taxes

As of 1 January 2018, the new Law on Enterprise Income Tax of the Republic of Latvia came into effect, setting out a conceptually new regime for paying taxes. As of the date, the tax rate increased to 20% instead of the previous tax rate 15% as well as the taxation period is one month instead of a year and the taxable base includes:

- distributed profit (dividends calculated, payments equivalent to dividends, conditional dividends) and
- conditionally distributed profit (non-operating expenses, doubtful debts, increased interest payments, loans to related parties, decrease of income or exceeded expenses which are incurred by entering transactions at prices other than those on the market that should be calculated using the methodology determined by the Cabinet of Ministers, benefits bestowed by the non-resident upon its staff or board (council members) regardless of whether the receiving party is a resident or a non-resident, if they relate to the operation of a permanent establishment in Latvia, liquidation quota).

Grants

Grants received to cover capital investments are initially recognised in deferred income which is gradually recognised as revenue over the useful life of the fixed assets received or acquired using grants. Grants received to cover expenses are recognised in the same period when the related expenses have arisen, if all the conditions of receiving the grant are met. The Company has received grants from the EU as co-financing of capital investments.

Revenue

IFRS 15, which was adopted by the Company in 2018, deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Entity adopts a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) a Company transfers control of goods or services to a customer at the amount to which the Company expects to be entitled. Depending on whether certain criteria are met, revenue is recognised:

- over time, in a manner that depicts the Company's performance; or
- at a point in time, when control of the goods or services is transferred to the customer.

Additionally, it is provided that an asset will be recognised for the incremental costs of obtaining a contract with a customer if they are expected to be recovered.

IFRS 15 also establishes the principles that a Company shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.

The standard replaces IAS 18 "Revenue" and IAS 11 "Construction contracts" and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2018 and early application is permitted. The Company applied IFRS 15 on a modified retrospective basis from 1 January 2018. In accordance with the transitional provision of IFRS 15, the cumulative effect of initially applying the new revenue standard is recognized as an adjustment to the opening balance of accumulated loss as at 1 January 2018. The comparative information is not restated and continues to be reported under the accounting standards in effect for those periods.

The internal revenue recognition policies for the different types of contracts with customers have been analysed, identifying the performance obligations, the determination of the calendar of satisfaction of these obligations, transaction price and allocation thereof, in order to identify possible differences with respect to the revenue recognition model under the new standard. No significant differences between them have been detected. IFRS 15 requires the recognition of an asset for incremental costs incurred in obtaining such contracts with customers and which are expected to be recovered. The current practices applied by Conexus imply that there are no contract costs to be capitalized.

Revenues derived from contracts with customers must be recognised based on compliance with performance obligations with customers. Revenue reflects the transfer of goods or services to customers at an amount that reflects the consideration to which Conexus expects to be entitled in exchange for such goods or services. Based on this recognition model, sales are recognised when services are rendered to the customer and have been accepted by the customer, even if they have not been invoiced, and it is probable that the economic benefits associated with the transaction will flow to the Company. The specific accounting policies for the Company's main types of revenue are explained below.

Revenue from transmission services

The transmission service is considered to be one performance obligation under IFRS 15. Transmission capacity product sales are regulated services provided by JSC "Conexus Baltic Grid" to the transmission system users at approved dates. Short-term (quarterly, monthly, daily and current day's capacity) and long-term transmission capacity (annual capacity) products are offered. Revenue from transmission capacity trade products, which, in its essence mean the provision of the transmission infrastructure and according to the chosen product, does not change over time for each capacity unit, is recognised in the profit or loss account for each reporting month in proportion to the period of the transmission capacity product reserved by the user.

Net Income from balancing

JSC "Conexus Baltic Grid" maintains information on the quantity of natural gas entered in the transmission system and exited from it by the transmission system users and calculates the imbalance. The amount of daily imbalance is the difference between the entry and exit. In the event of a negative imbalance for the user of the transmission system, the amount of imbalance charge is calculated for each such day, by multiplying the calculated quantity with the sale price of natural gas, published in specified order, for the daily balancing purposes. Revenues from the provision of balancing services are recognized for each reporting month when the transmission system user experiences an imbalance that has caused a deficit of natural gas in the transmission system.

Where market participants cause imbalance and where Conexus does not have sufficient gas resources available to ensure a proper operation of the gas transmission system, Conexus shall buy respective quantities of balancing gas. Also, refer to Note 17.

Net income from balancing is disclosed under Other income at net value (less expenses for periods when balance is positive).

Revenue from storage

The storage service is considered to be one performance obligation under IFRS 15. JSC Conexus Baltic Grid provides Inčukalns underground gas storage capacity services at approved storage tariffs to the users of the storage who have reserved natural gas storage capacity during the storage season. Revenue from the sale of storage capacity which according to the nature of the service means ensuring the infrastructure of IUGS and does not change during the storage season, is recognised for each reporting month according to the storage tariffs and in proportion to the remaining months the end of storage season.

Interest income

Interest income is recognised using the effective interest rate method. Interest income on term deposits is classified as Other income. Interest on cash balances is classified as Finance income.

Income from fines

Contractual penalties and late payment fines are recognised when it is certain that the Company will receive economic benefits, i.e., recognition usually coincides with the receipt of penalty.

Other income

Other income from services is recognized when services are provided. Other income from sale of materials is recognised when the buyer has accepted them.

Significant estimates and judgements

The financial statements are prepared in accordance with IFRS, using significant management estimates and judgements. Judgements and accounting estimates affect the amounts of assets and liabilities at the balance sheet date and the amount of income and expenses for the reporting period. It should be noted that actual results may differ from the estimates and assumptions for the outcome of future events.

The management has determined the following areas of financial statements requiring significant estimates or judgements: estimation of the frequency of revaluation of property, plant and equipment, determining the replacement value of property, plant and equipment subject to revaluation and estimation of the remaining useful life of property, plant and equipment.

Useful lives of property, plant and equipment

Amortisation of intangible assets and depreciation of property, plant and equipment are determined on the basis of approved useful lives, based on prior experience and industry practices. During revaluation process, the remaining useful live of revalued asset is estimated and usually – prolonged as compared to the previous estimate, as a result of technological improvements. This is compliant with the existing industry practice.

Revaluation of property, plant and equipment

JSC “Conexus Baltic Grid” accounting policy provides for a periodic revaluation of property, plant and equipment if the purchase price and average construction costs have changed significantly. The replacement value of revalued fixed assets is determined independently by certified appraisers in accordance with the valuation standards for real estate.

The latest revaluation of the buildings, structures, machinery was done in 2016, before the reorganisation of JSC “Latvijas Gāze”. The balances of revalued assets were transferred to the Company as a result of reorganisation, at predecessor carrying amounts. The management estimates that the carrying amount of PPE revalued on 31.12.2018 does not significantly differ from their fair value.

Employee benefit liabilities

The Management's best estimates on the amount of employee benefit liabilities are based upon an assessment of the key financial and demographic assumptions with periodic advice from the actuaries.

The rate used to discount the liabilities of the scheme reflects the average profit rate of government bonds with initial maturity of 5Y and more, determined during the last two issues (source: State Treasury). Inflation rate is determined by reference to the data by the Central Statistics Bureau for the

12 months of the respective year, and reflects average consumer price change in %, as compared to the prior period.

Mortality assumptions are set upon actuarial advice in accordance with statistics published in 2015 (Central Statistics Bureau).

Financial statements were prepared by:

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