JOINT STOCK COMPANY "LATVIJAS VALSTS MEŽI"

(UNIFIED REGISTRATION NUMBER 40003466281)

ANNUAL REPORT 2011

(12th accounting year)

PREPARED IN ACCORDANCE WITH

THE ANNUAL ACCOUNTS LAW OF THE REPUBLIC OF LATVIA

Riga, 2012

General Information

Name of the enterprise	Latvijas valsts meži
Legal status	Joint stock company
Registration number, place and date	40003466281 Riga, 28 October 1999 Re-registration in the Commercial Register 1 November 2004
Registered office	Kristapa iela 30 Riga, Latvia, LV-1046
Full name and address of the Shareholder	Ministry of Agriculture of the Republic of Latvia (100%) 2 Republikas laukums Riga, Latvia, LV-1981
Stockholder's representative	Arvīds Ozols
Responsible official of the Ministry of Agriculture	Jānis Birģelis
Members of the Board	Roberts Strīpnieks – Chairman of the Board
	Kārlis Boldiševics (until 09.12. 2011)
	Andrejs Brūvelis (until 09.12. 2011)
	Gints Bumbieris
	Arnis Melnis
	Aivars Tiesnesis (until 09.12. 2011)
	Edvīns Zakovics (until 18. 03. 2011)
Subsidiary company	SIA Jaunmoku pils (100%)
	Tume Municipality, Tukums Region, Latvia, LV-3139
Associated company	SIA Meža un koksnes produktu pētniecības un attīstības institūts [Forest and Wood Products Research and Development Institute] (40%)

	Dobeles iela 41, Jelgava, Latvia, LV-3001	
Accounting year	1 January 2011 – 31 December 2011	
Auditors	Iveta Vimba Sworn Auditor of the Republic of Latvia Certificate No. 153	Ernst & Young Baltic Ltd. Kronvalda bulvāris 3-5, Rīga Latvia, LV – 1010 Licence No.17

Report of the management

10 May 2011

Type of activity

The purpose of the activities of the joint stock company "Latvijas valsts meži" (hereinafter referred to as - LVM or the Company) is administration of the state-owned forest property and management of the public forest ensuring the preservation and increase of its value and generation of revenue for its owner – the state.

The stockholder of LVM is the state represented by the Ministry of Agriculture of Republic of Latvia. The Company's governing bodies are the General Meeting and the Board. The highest decision-making body is the General Meeting representing the stockholder: the Ministry of Agriculture. The highest executive body of LVM is the Board. As at 31 December 2011, the LVM Management Board consisted of 4 members: the Chairman of the Board and three Members of the Board.

LVM administers and manages 1.62 million hectares of land of the Republic of Latvia, including 1.59 million hectares of forest land, out of which 1.40 million ha is forest. In accordance with the LVM strategy confirmed in 2010, nature protection is the main objective in management of 0.31 million hectares. But the goal for managing of 0.074 million hectares is recreation and environment exploration. The economic activity with the objective to produce high-value wood is planned in 1.3 million hectares of land.

Activity of the Enterprise in the reporting year

Total revenues in 2011 by 27.4 million lats exceed the planned ones, including the revenues from sale of timber exceed the figures planned into the budget by 24.1 million lats. The overachieving of revenues is significantly influenced by a higher average sale price of round timber assortments. The revenues from sale of timber have been impacted also by delivery of timber through storehouses in ports, which was launched in 2009. In 2011, through ports 285 vessels were shipped, including 32

vessels with chips. Less than the budgeted are the revenues from standing trees which were affected by the lack of interest of contractors of long-term contracts on logging. The total costs by 17.4 million lats exceed the budgeted. This increase in costs was materially affected by LVL 12.1 million costs of writing off bad debt (non-accessible funds in Latvijas Krājbanka). In 2011, the costs of preparation and transport of round timber assortments also exceed the planned ones, mainly due to the intensive development of snow breakers in the first half of the year, higher prices for logging services and greater transport distance.

	Budget mln LVL	**Actual implementation Mln LVL**
Revenue, of which from	**190.35**	**217.73**
sales of roundwood assortments	158.85	185.30
sales of standing trees	25.24	22.73
sales of wood chips for energy production	2.85	2.97
sales of seeds and forest planting stock	1.32	1.68
land lease and sales of the earth entrails	0.67	0.90
lease of the hunting grounds	0.45	0.44
recreation and hunting services	0.55	0.47
other revenue*	0.01	2.01
interest income	0.41	1.23
Total costs:	**138.66**	**155.74**
production costs, *including accumulation for non-accessible funds in Latvijas Krājbanka*		12.2
administration costs	2.31	2.34
Real estate tax	**2.00**	**2.29**
Profits before tax	**49.69**	**59.70**
Company income tax	7.45	8.72
Profits after tax	**42.24**	**50.98**

* The difference between various revenues and costs that are not directly linked with the Company's business activities

The Joint-stock Company "Latvijas valsts meži" in 2011 has completely fulfilled its obligations towards the owner, i.e., the State, by paying the payment envisaged in the Law "On the State Budget for 2011" in the amount of 51.7 million lats (dividends out of the 2010 profit in the amount of 51.7 million lats) and all the taxes applicable to LVM (34.7 million lats).

Report of the management (continuation)

In accordance with the basic principles approved by the owner of the Enterprise, LVM during the reporting year for various objectives has donated 4 million lats.

Operations plan	Unit	Business operations plan	Actual implementation
Sales of standing trees	mln m3	1.56	1.37

Sales of roundwood assortments	mln m3	5.50	5.45
Sales of energy chips	mln loose m3	0.43	0.42
Forest regeneration	thou ha	16.7	17.8
Forest (young stand) tending	thou ha	31.0	31.6
Forest inventory	thou ha	268.5	2.5
Registration of land in the Land Register	thou ha	254.0	255.5
Forest road construction	km	401	376

In the second half of 2011, the timber market situation changed and pulpwood customers experienced problems with its implementation, which has affected the sale volume of round timber assortments during the reference period. In the areas of long-term logging contracts the whole planned volume was also not implemented. In December 2011, the decision was made to extend the felling terms of 2011 for the contractors of long-term contracts on logging to June 2012.

For forest management the average target model developed in this plan has been used, and the relevant forest regeneration and tending works have been carried out. In 2011 the forest has been regenerated in the area of 11.7 thousand hectares with the tree species, regeneration types and technologies and in accordance with volume necessary in nature envisaged in the plan of forest capital management. Young forest stands have been tended in 31.6 thousand hectares with the periodicity and intensity provided for in the above-said plan.

Forest inventory has been carried out in the agreed term. At the end of the reporting period the works have been accepted for the contract of 2010 in the North Latgale Forestry on the forest inventory in the area of 2.5 thousand hectares. In the areas specified by the contracts of 2011 rural works and partial data processing have been performed - by the end of the year, the data of inventory of 11.4 thousand ha have been received. The budgeted forest inventory works are expected to be adopted in 2012, when all the data for 2011 will be submitted and recorded in the State Register of Forests.

In 2011, 376 km of forest roads were launched into operation, including 235 km of roads that were reconstructed and 141 km that were constructed anew. The above-said roads are comprised into the balance-sheet of the Enterprise, and 17.7 million lats were invested in their construction. The total length of the objects being under construction is 529 km.

The total surveyed and registered in the Land Register area to be managed by LVN is 989.4 thousand hectares, including 255.5 thousand hectares recorded in 2011.

The most significant public relations projects and events of LVM in 2011:

- The informative film “Mežs cilvēkiem” (Forest for men) has been completed. The film is about the state forest management, and it has already attracted lots of positive feedback from the forest industry people and other spectators;
- In collaboration with the Office of the President *Vislatvijas Lielā talka* (the Big Cleanup Over All Latvia) and in collaboration with the Ministry of

Agriculture the conference “Meža nozare 20 gados” (Forest sector in 20 years of independence) were organized;

- *Mammadaba* embassy was opened in Riga within the framework of the project *Mammadaba*. The event lasted for 2 weeks and attracted more than 8000 visitors;
- Within the framework of the project “Izzini mežu” (Learning about Forest) 12 professional educational field trips for school youngsters, Forest Olympiad and the participation of Latvia in the European forest Olympiad, the teachers’ summer camp and winter courses, as well as in collaboration with the Forest Faculty of the Latvia University of Agriculture the participation in the exhibition “Skola 2011” (School 2011) were organized;
- Within the framework of the project *Skābeklis* (Oxygen) project planting of one year old trees was organized. It was attended by more than 300 participants.

Report of the management (continuation)

Development of the Enterprise

The Project for Changes was concluded, within the framework of which in 2011 the screening of all the LVM corporate governance functions, changes in the structure and process improvement were carried out.

The network of High Conservation Value Forest (HCVF) was created, the identification methodology of the biologically valuable forest stands and the EU protected habitats, including swamp forests, was developed, and their inventory in the areas of High Conservation Value Forest (HCVF), where in 2013 economic activities are planned, was launched.

Sustainable forest management certification and timber flow certification have been obtained - PEFC certification in all the LVM 8 regions and FSC certification in the North Kurzeme, West Vidzeme, Zemgale and Mid-Daugava regions.

An audit of supervision for Certificate ISO 9001 for production and sale of forest seedlings has been made.

In order to support a stable, predictable and transparent cooperation in the creation of new knowledge and implementation in forestry practice, LVM has concluded with the Forest Faculty of the Latvia University of Agriculture and the Latvian State Forest Research Institute "Silava" the memorandum of cooperation in scientific research.

In accordance with the priorities of scientific research defined in the LVM strategy, LVM has carried out such studies:

- Adaptation of forestry to climate changes;
- Research of limiting factors of the spread of root rot;
- Evaluation of the achievement of the objectives in the selection cutting areas;
- Reduced tire pressure on the low load carrying capacity roads;

- Innovations to improve the effectiveness of transport, the development of the study program;
- Creation of the tool for making of decision on use of forest roads;
- Forest Tree Breeding studies of genetically high-quality forest reproductive material selection.
- Studies of forest trees selection for selection of genetically high quality forest reproductive material;
- development of the research programme for the impact of forestry operations on the greenhouse-effect gases emissions and CO2 attraction;
- The development of methodological support for the reduction of the environmental impact of the forest management and for the development of the appropriate forest environmental monitoring system;
- Determination of course of growing and increment of forest stands, using the re-measured forest statistical inventory data;
- Research on determination of tree trunk form and forecasts of assortments yield.

Participation in international processes

To support the activities of the European State-owned Forest Managing Entities (EUSTAFOR), the Enterprise has participated in the extraordinary General Assembly of the Association in which the articles of the Association were specified and the changes of the Association management were made. The consultations about the Association's position in the development of the European forest strategy took place. Participation in the EUSTAFOR working panel on the management of Natura 2000 territories has been started.

Management of financial risks

LVM carries out its economic activity pursuant to the long-term development plan, using the monetary means at the disposal of the Enterprise.
Financial management at the Enterprise is effected in centralised manner, and the liquidity completely ensures the fulfilment of all obligations towards the cooperation partners and the State. Taking into account that nearly all revenues (more than 99%) according to the sale market is in lats or euro, the impact of currency risk on the financial indicators of the Enterprise is minimal.

The monetary means accrued by the Enterprise are placed in low-risk financial instruments – deposits of credit institutions and money market fund of JSC “SEB banka”, where the discharge of the fund shares is made at the request by the Enterprise with the aim to earn stable revenues.

Circumstances and events after the end of the reporting year

In the period since the last day of the reporting period till signature of this Report, there have not been any other noteworthy events that would significantly influence the financial condition of the Enterprise as of 31 December 2011.

Report of the management (continuation)

The most important intents for implementation in entrepreneurial activity in 2012:

To obtain FSC certification in the South Kurzeme, East Vidzeme, North Latgale and South Latgale regions, as well as to ensure the presence of sustainable forest management and timber flow certification (FSC, PEFC) in all the regions.

To improve the accuracy of the data and to promote the use of geospatial information in the production processes.

To promote introduction of new, higher value added products and services, looking for opportunities to be engaged in energy production using woody biomass.

To prepare and undertake the project on the promotion of the use of wood as a material. To increase the number of people involved in the forest environmental education projects and the campaign *Don't litter the forest!*

To start new and finalise the started research and development projects in the planned volume and terms. This includes further exploration of the effectiveness of alternative methods of protection against weevil damage.

To prepare the training plan of contract partners according to the production requirements. To introduce a competency-based approach to the company processes (assessment and collection of results the company's competence assessment and collection of results of the Enterprise's competencies, as well as the preparation of the staff training plan in accordance with the competency-based approach.

Distribution of Profits Recommended by the Board

Distributable profits	LVL
Reserves	50 975 809
Recommended distribution of profits:	
Calculate dividends to stockholders	51 600 000
Retained profits	5 375 809

The Board recommends channelling the retained profits in the amount of LVL 5 375 809 into increasing the equity capital and fulfilling the concluded commitments for completion of construction of forest infrastructure facilities in accordance with the enterprise strategy.

Roberts Strīpnieks
Chairman of the Board

Profit and Loss Account

	Note	2011 LVL	2010 LVL
Net sales	3	214 724 758	215 966 157
Cost of sales	4	(135 961 160)	(119 307 522)
Gross profit		**78 763 598**	**96 658 635**
Selling expenses	5	(676 197)	(1 525 980)
Administrative expenses	6	(4 346 938)	(3 311 886)
Other operating income	7	509 670	952 505
Other operating expenses	8	(16 115 874)	(4 122 185)
Other interest income and similar income	9	2 491 527	3 005 916
Interest expenses and similar costs	10	(83 137)	(351)
Profit before taxes		**60 542 649**	**91 656 654**
Corporate income tax	11	(8 721 034)	(11 257 688)
Change in deferred tax	11	1 503 313	(57 595)
Other taxes	27	(2 349 119)	(2 021 844)
Net profit for the accounting year		**50 975 809**	**78 319 527**

The notes form an integral part of these financial statements.

Roberts Strīpnieks
Chairman of the Board

Balance Sheet

ASSETS

LONG-TERM INVESTMENTS	No te	31.12.2011 **LVL**	31.12.2010 **LVL**
Intangible assets			
Concessions, patents, licenses, trade marks and similar rights	13	397 592	449 254
TOTAL		**397 592**	**449 254**
Fixed assets			
Land, buildings and structures	14	134 792 883	120 925 362
Equipment and machinery	14	1 974 187	2 585 682
Other fixed assets	14	1 894 231	1 433 520
Payments on account for fixed assets and fixed assets in the course of construction	14	7 226 208	5 289 084
Payments on account for fixed assets		2 656 926	641 821
TOTAL		**148 544 435**	**130 875 469**
Biological assets	**15**	**3 993 053**	**3 622 651**
Long-term financial investments			
Participation in capital of affiliated	16	1 139 200	1 139 200

companies			
Participation in capital of associated companies	16	398 400	317 826
Loans to affiliated companies	17, 28		105 000
Other securities	21	180 000	-
Deferred tax assets	11	114 949	-
TOTAL		**1 937 549**	**1 562 026**
TOTAL LONG-TERM INVESTMENTS		**154 872 629**	**136 509 400**
CURRENT ASSETS			
Stocks			
Raw materials, basic materials and consumables		372 641	362 758
Finished products and goods for sale	18	13 189 753	12 016 576
Advance payments for goods		1 527	63 457
Draft animals		184	184
TOTAL		**13 564 105**	**12 442 975**
Accounts receivable			
Accounts receivable from buyers and customers	19	12 512 953	14 331 412
Accounts receivable from affiliated companies	17, 28	42 541	41 266
Other accounts receivable	20	10 626 318	3 237 696
Prepaid expenses		203 315	218 640
TOTAL		**23 385 127**	**17 829 014**
Securities and participation in capital			
Other securities and investments	21	57 401 928	77 817 881
TOTAL		**57 401 928**	**77 817 881**
Cash and cash equivalents	22	**4 976 383**	**9 618 639**
TOTAL CURRENT ASSETS		**99 327 543**	**117 708 509**
TOTAL ASSETS		**254 200 172**	**254 217 909**

The notes form an integral part of these financial statements

Roberts Strīpnieks
Chairman of the Board

Balance Sheet

LIABILITIES

	Note	31.12.2011 **LVL**	31.12.2010 **LVL**
EQUITY			

Share capital	23	172 094 523	151 468 445
Reserves:		6 000 000	
Retained profits			
retained profits brought forward from previous years			
retained profits of the current reporting year		50 975 809	78 319 527
TOTAL EQUITY		**229 070 332**	**229 787 972**
PROVISIONS			
Other provisions	24	12 875 554	12 576 653
TOTAL PROVISIONS		12 875 554	12 576 653
ACCOUNTS PAYABLE			
Long-term accounts payable			
Deferred tax liabilities	12	-	1 388 364
Other accounts payable		12 745	12 745
TOTAL		**12 745**	**1 401 109**
Short-term accounts payable			
Prepayments received from purchasers		171 109	29 040
Accounts payable to suppliers and contractors		8 280 570	6 278 069
Accounts payable to affiliated companies	28	297	3 386
Accounts payable to associated companies	28	1791	1 204
Taxes and social insurance payments	27	803 346	1 486 205
Other accounts payable	25	577 789	1 319 380
Accrued obligations	26	2 406 639	1 334 891
TOTAL		**12 241 541**	**10 452 175**
TOTAL ACCOUNTS PAYABLE		**12 254 286**	**11 853 284**
TOTAL LIABILITIES		**254 200 172**	**254 217 909**

The notes form an integral part of these financial statements.

Roberts Strīpnieks
Chairman of the Board