

APPROVED

by the Order No 1K-150 of 13 April 2018 (redacted by Order No 1K-50 of 17 February 2021) of the Minister of Finance of the Republic of Lithuania

**LETTER**  
**ON THE OBJECTIVES PURSUED AND THE EXPECTATIONS SET BY THE STATE**  
**THAT ARE RELATED TO THE ACTIVITIES OF UAB IGNITIS GRUPĖ GROUP OF**  
**COMPANIES**

This letter presents the expectations of the State, the shareholder of AB Ignitis Grupė (hereinafter – the Company), which is represented by the Ministry of Finance of the Republic of Lithuania, regarding the activities, priorities, principles of activities and objectives of AB Ignitis Grupė group of energy companies (hereinafter – the Group).

**Activities**

The activities of the Group include electricity and gas distribution, generation and development of green energy, management of flexible electricity generation facilities, electricity and gas supply, development of energy-smart solutions, and other commercial activities. Activities of the Group which are of strategic importance to the State: management of the strategic infrastructures of the Lithuanian energy system and carrying out the projects of strategic importance according to the National Energy Independence Strategy<sup>1</sup>.

The general principles of corporate governance for the Group are set out in the Description of Corporate Governance Guidelines for the State-Owned Energy Group approved by the Minister of Finance of the Republic of Lithuania<sup>2</sup>.

The Company, which is the Parent Company of the Group, is responsible for the transparent management and coordination of the Group activities, increasing efficiency in order to provide competitive services to the customers and in ensuring a socially responsible increase of long-term value for the State.

**Priorities of the activities, principles and goals**

The activities of the Group must be related to sustainable and socially responsible development by further developing a modern, international, competitive Group. The shareholder expects for a consistent and purposeful growth of the Group to increase Group and State competitiveness by modernizing the energy infrastructure and developing new energy competencies.

Given the strategic impact on the Lithuanian energy system, by its activities the Group contributes to the implementation of the goals of the National Energy Independence Strategy and integrates them in its long-term and short-term priorities of the activities, and focuses on the National Energy Independence Strategy goals which are directly related to the activities and goals of the Group:

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<sup>1</sup> Resolution No XIII-1288 of the Seimas of the Republic of Lithuania of 21 June 2018 on the Amendment of the Resolution No XI-2133 of the Seimas of the Republic of Lithuania of 26 June 2012 on the Approval of the National energy independence strategy.

<sup>2</sup> Order No 1K-205 of the Minister of Finance of the Republic of Lithuania of 7 June 2013 on the approval of the description of the corporate governance guidelines of the state-owned energy company group.

- increasing reliability and development of electricity distribution network;
- development of green energy and sustainable bioenergy in order to increase electricity generation in Lithuania because currently only slightly more than one third of total Lithuanian electricity consumption demand, which increases as the gross domestic product grows, is generated;
- smart energy development by developing digital energy networks and smart meters to help save energy;
- synchronization with a reliable and continental European energy system to ensure Lithuania's energy system independence;
- development and implementation of energy innovations in the region as well as development of prosumers and of electric vehicles solutions, promoting sustainable energy use, etc.

The expectations of the activities of the Group are formulated taking into account the strategic importance of the assets used in the activities of the Group to ensure the stability of the Lithuanian energy system. The aim is also to implement the innovative and modern, contemporary solutions that meet the needs of the local and global market, which would ensure the integration of the global and regional energy changes into the Lithuanian energy system. The Group must ensure the continuity of its activities and the consistency of development of projects of heat and power generation from renewable energy sources, which contribute to reducing global greenhouse gas emissions by creating new business models, developing innovative energy solutions and expanding in the region.

### **Expectations of the Group strategic priorities**

1. To ensure the increase in reliability and development of the electricity distribution network
2. To ensure a reliable and flexible Lithuanian energy system and its development, by contributing to the implementation of changes in the energy sector in Lithuania and in the region
3. To expand green generation by contributing to Lithuania's and regional commitments to increase electricity generation from renewable energy sources.
4. To develop innovative solutions and to actively seek new opportunities for profitable development of activities.
5. To ensure sustainable development of the activities of the Group:
  - to follow the principles of environmental, social and good corporate governance practice (including the criteria of transparency of activities of the state-owned companies);
  - to contribute to achieving the sustainable development goals of the United Nations (hereinafter - the Sustainable Development) by giving priority to the Sustainable Development goals which are affected by the activities of the Group the most;
  - to consistently reduce the effect of greenhouse gas emissions.

### **Expectations by priority activities**

#### *Networks*

Priority is given to ensuring the resistance of the electricity and gas distribution network to externalities, efficient distribution of electricity and gas and to implementation of changes in the energy sector as well as increasing electricity generation from renewable energy sources. Therefore, the Group must continue to invest in Lithuanian electricity and gas distribution networks in order to modernize the asset of strategic importance, to digitize the electricity distribution network by implementing the smart meter installation programme, which will create conditions for increasing efficiency, flexibility, market

competitiveness, encourage to create new services, which will benefit every consumer. It also must aim to consistently improve the quality indicators of distribution networks. A special attention must be given to customer service quality improvement.

#### *Green generation*

Priority is given to the targeted, sustainable and profitable development of green generation. The Group should continue to look for ways to increase electricity generation and should invest in electricity generation from renewable energy sources both in Lithuania and abroad (both in countries where the Group already operates and in countries where changes in the energy sector are beginning to be implemented through transition to the development of renewable energy sources). The main green generation technologies in which the Group should invest include wind, solar energy, biofuels and waste. In order to absorb new technologies, the Group is recommended to cooperate with partners which have experience in implementing this type of investment. The development of green generation must be carried out in accordance with the principles of financial discipline – return on projects must be consistent with the risk taken and the project debt level should be in line with the market practice. To maximize returns on projects and to use financial resources efficiently, the asset rotation strategy, which is common in the energy sector, under which part of the projects is sold to financial investors, is recommended to be considered.

#### *Flexible generation*

Priority is given to ensuring a reliable and flexible Lithuanian energy system by providing reserve and system services. The Group must contribute towards achieving the objectives set out in the National Energy Independence Strategy by developing new and/or rehauling electricity generation capacities by: a) generating electricity and participating in the electricity trade market; b) providing system services; c) ensuring the service of isolated regime of electricity system; d) participating in the implementation of capacity assurance mechanism according to the demand provided by the Lithuanian electricity distribution operator. New flexible electricity generation capacities can be developed if market conditions allow to do so, and the development meets the return expectations posed. Conventional electricity generation facilities that are worn-out and unfit for reserve or system services must also be decommissioned and dismantled. The Group must contribute to successful synchronization of the Baltic energy system with the continental European electricity grid system and carry out the necessary preparatory works in order to adapt effectively to the continuously changing market of system services.

#### *Customers and Solutions*

Priority is given to the development of innovative energy solutions that create added value and to the implementation thereof by contributing to the development of the energy sector, to electricity and gas supply and trade and to ensuring their development in the region. Innovative solutions should be developed together with the partners, by contributing to environmental objectives and by striving to help the consumers to become energy smart. The Group must also contribute proactively to the energy community development in Lithuania by creating an opportunity for consumers to actively participate in the energy market by providing system flexibility services, generating, storing or selling electricity made by themselves from renewable energy sources, motivating consumers to change their consumption habits, reacting to changes in electricity market in real time and encouraging consumers to become co-owners of remote renewables powerplants.

The Group must aim to reduce the designated supply costs of liquefied natural gas terminal, which are compensated by the Lithuanian natural gas system users and/or consumers and implement rational measures to increase the efficiency of the designated supplier of the liquefied natural gas terminal, which

would ensure the smallest negative impact to the price of natural gas. The Group must also aim to increase the volume of natural gas supply to Lithuania and the region based on economically advantageous prices by utilising the development opportunities provided by the gas connection between Lithuania and Poland (GIPL) which will start operating in 2022.

## **Financial expectations**

### *Dividends*

The Company's dividend policy was determined in the Resolution No 963 of the Republic of Lithuania "On dividends paid by AB Ignitis Grupė" of 2 September 2020 directed at the increase of dividend value. The dividends paid for the financial year of 2020 should be at least 85m euros, the increase in dividends for every consecutive year should be at least 3%. The dividend policy of the Group has to be established in accordance with the Resolutions of the Government of the Republic of Lithuania.

### *Structure of the capital*

The Company has to maintain a high investment credit rating (BBB and higher), and the net debt of the Group in the medium and long term should not exceed amount of 5-year annual earnings before interest, tax, depreciation and amortization (EBITDA).

### *Return on equity*

In implementing the Group Strategy, the Company must ensure the return on equity (ROE) set by the Government of the Republic of Lithuania, which, in the period of 2019–2021, is set not less than 6.6 percent. When investing outside Lithuania, the risks associated with the investment should be adequately assessed and an appropriate return on capital should be ensured.

### *Long-term goals*

The long-term goals set for the Company have to be linked to the Group Strategy.

In order to motivate key executives to aim for sustainable and long-term goals of the Company and create additional incentives for the employees of the Group companies and ensure the implementation of the strategy and long-term goals of the Group companies, the Group must apply Share Allocation Rules of the Company, which are approved by the General Meeting of Shareholders.

The General Meeting of Shareholders of the Company should determine the following essential conditions for allocating shares:

- measure, by which the shares would be allocated (free of charge and/or partly free of charge);
- retention period, after which the shares can be allocated;
- cases, when key executives lose all their rights to shares according to option agreements;
- the high limit of share allocation, which cannot be exceeded when offering key executives of the Group to acquire shares;
- the principles of determining share price in order to determine the highest number of offered shares.

The long-term goals set for key executives must align with the long-term goals of the Company and good international practices. The goals should include and be oriented towards increasing the efficiency in the regulated activities, increasing shareholder returns and return on equity, development of green generation as well as improving environmental, social and good corporate governance practices.

Shares can be allocated to key executives only if the green generation results are growing significantly faster than the results of regulated monopoly activities<sup>3</sup> or the regulated monopoly activities comprise less than half of the Company's adjusted EBITDA (detailed by determining objectives or in the Share Allocation Rules of the Company).

### **Non-financial expectations**

#### *Good environmental, social responsibility and corporate governance practice*

Criterion for environmental, social responsibility and good governance practice must be integrated into the long-term business objectives of the Group, the commitment to reduce net carbon emissions to zero by 2050 must be also implemented consistently, and its implementation must be monitored, and there must be contribution to the implementation of the Sustainable Development Goals, which are most affected by the activities of the Group.

The Group must maintain the level of maturity of corporate governance and the highest corporate governance level index which is granted subject to the evaluation by the Governance Coordination Centre. The Group must continue to follow the requirements of the Organization for Economic Co-operation and Development (OECD), and of stock exchanges on which it is listed, as well as good governance practices of international companies, thus showing an example to follow by other state-owned companies. The Group must apply in all its activities the highest standards of transparency and the principles of depoliticised activities.

The Group must continue to refine the activities, to eliminate non-core activities altogether and must continue to increase efficiency of both the core functions and of the service and support functions.

#### *Implementation of innovation and digitization programmes in energy*

The Group must contribute to the promotion of innovation in Lithuanian energy sector. The Company must also actively implement energy innovations, new technologies and pilot projects including the use of National Energy Regulatory Council mechanism to promote innovations as well as to contribute to implementation of action plan measures for strengthening the Lithuanian energy innovation ecosystem, which includes involvement of state-owned companies. There should be a close cooperation with the local and international business and science, a potential should be created for the export of innovative energy products and services.

Excluding the investments in energy generation capacity and infrastructure development, which allow to ensure the effective energy sector activity, state's economic competitiveness, supply of quality services, the Group should continue its digitization programme and investing in start-ups which develop new services in energy sector. It should also invest in further development of functional possibilities of Data Hub platforms by installing open data model, creating production, supply and consumption database of the Lithuanian market, which is accessible to all market participants. While implementing energy efficiency solutions, the Group would reduce the customers' costs on electricity and, thus, would increase their competitiveness in the internal and international markets.

### **Accountability**

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<sup>3</sup> Regulated monopoly activities include network, public distribution, designated supply and system services activities which are not auctioned.

It is appropriate for the Supervisory Board, which is the supervisory body of the Company and of the Group, to maintain the existing practice, and to submit to the shareholders periodically, on a quarterly basis, a summary report of the Group activities.

The shareholder hopes that the management and supervisory bodies of the Group will continue good corporate governance practices and will carry out once a year evaluation of their activities and will also agree on further steps to improve the functioning of these management and supervisory bodies.

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