



# Networks regulation update

20 October 2021



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# Regulatory Methodology update



# Overview

## Sustainable regulatory framework maintained

### A What happened and why?

1. Regulator<sup>1</sup> announced proposed changes to **electricity distribution Price Cap Methodology**<sup>2</sup>
2. Key change: **RAB calculation method changed** from LRAIC to similar to historical cost model
3. Regulator aimed **to avoid differences between LRAIC RAB and Historical cost RAB**
4. Public consultation was announced

*Changes are not related to the retail tariff increase mitigation (e.g. unlike Spain)*

### B What did we do?

1. Actively participated in public consultation and **direct dialogue with the Regulator**
2. **Involved key stakeholders** (ministries of Energy and Finance, EBRD, etc.) to provide an outside view
3. Worked to find the **right balance between Regulator's goals and sustainability of the regulatory framework**

### C Outcome

1. **Agreed with the Regulator on a sustainable regulatory framework**
2. Sustainability ensured through the **newly established additional tariff component**, which offsets change in RAB calculation method



# 2022 vs 2021 EBITDA impact

## Impact from regulatory Methodology update

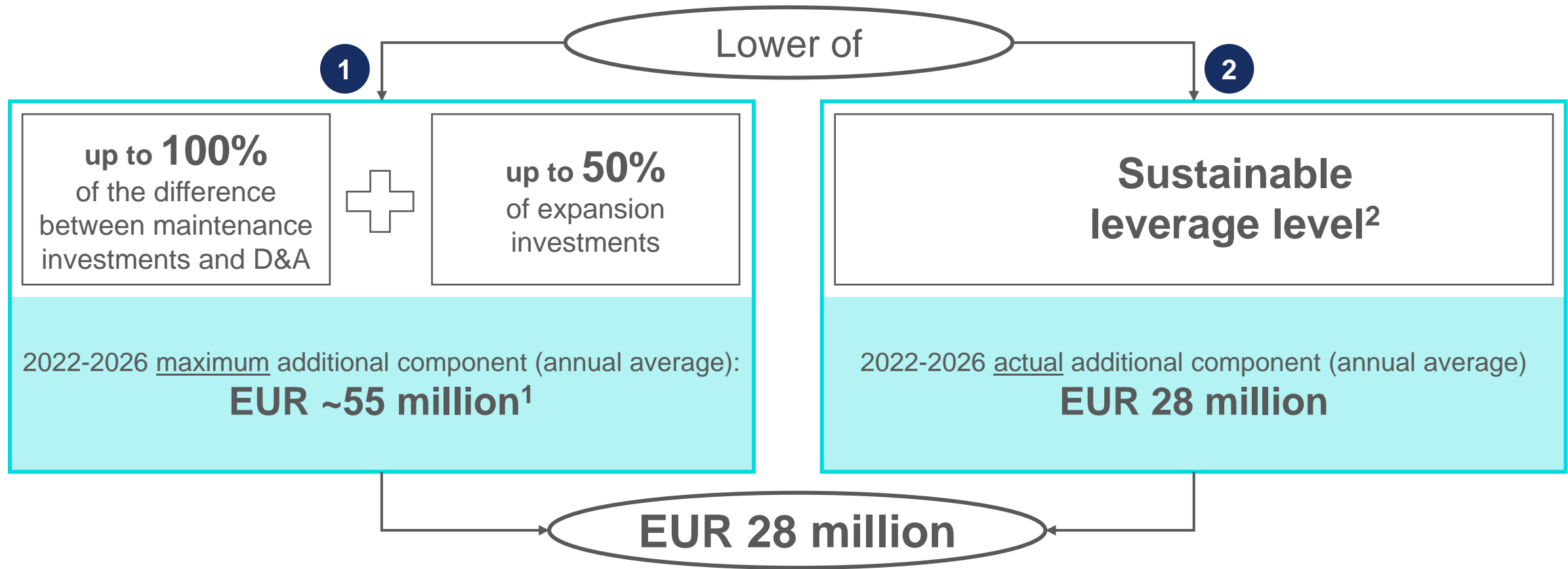
EURm	2021	2022	Difference
WACC	5.34%	4.16%	(1.18%)
RAB <b>N</b>	1,414	1,097	(317)
<b>EBITDA impact:</b>			
RAB * WACC	76	46	(30)
WACC effect	-	-	(17)
RAB effect	-	-	(13)
Depreciation	82	59	(24)
Additional tariff component <b>N</b>	-	28	28
<b>Total impact on Adjusted EBITDA<sup>1</sup></b>	<b>158</b>	<b>132</b>	<b>(26)</b>
<b>Total impact on Adjusted EBITDA<sup>1</sup> without WACC effect</b>	<b>158</b>	<b>149</b>	<b>(9)</b>

WACC effect was already known before the Methodology update

New additional tariff component significantly offsets lower RAB and depreciation effects



# Additional tariff component calculation principles



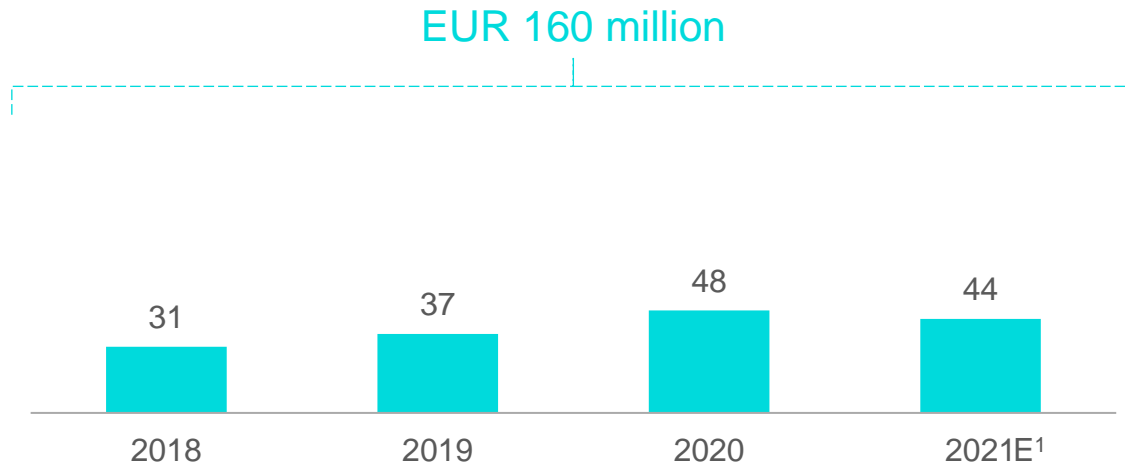
- Additional tariff component introduced to maintain ESO financial capacity to carry out 10-year investment plan
- Additional tariff component can be changed only if: (i) 10-year investment plan changes or (ii) it is not used for its purpose



# Correction for 2018-2021

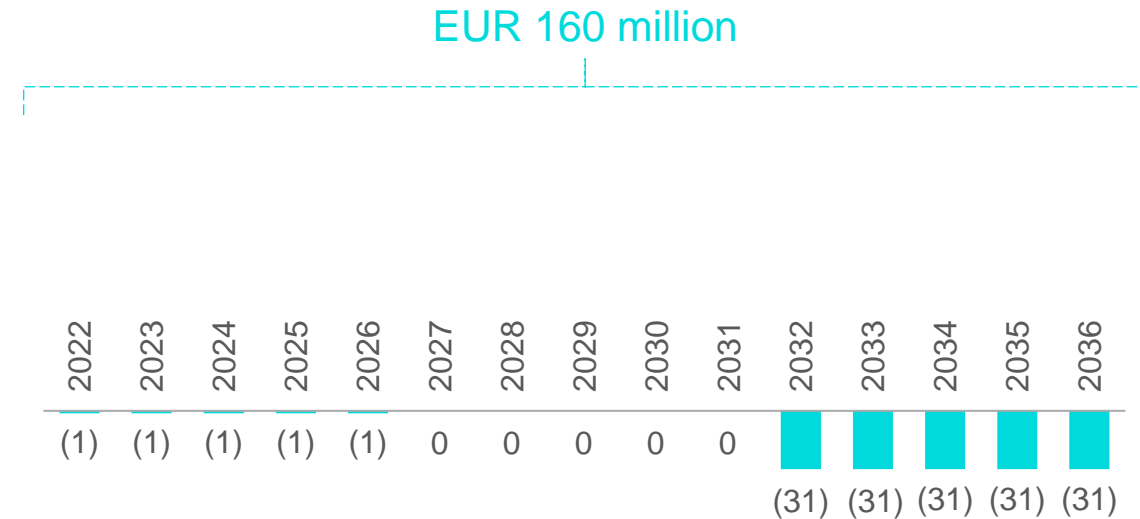
## Repayment of recalculated ROI and D&A for 2018-2021

### LRAIC1 correction for 2018-2021 EURm



- **EUR 160 million to be returned related to 2018-2021**
- ROI and D&A for 2018-2021 was recalculated based on actual historical investments (instead of LRAIC1 model)

### LRAIC1 correction for 2018-2021 return schedule EURm



- **96% of EUR 160 million to be returned over 2032-2036**
- Return schedule could be amended based on ESO sustainable leverage level<sup>2</sup>





# Additional tariff component offsets negative impacts



# Impact to the Group



# Impact to the Group

## **Guidance:** **no changes**

Adjusted EBITDA of  
EUR 300-310 million  
for 2021

## **Dividend policy:** **no changes**

Committed to a  
minimum annual  
growth of 3%

## **Strategic Plan 2021-2024:** **no changes**

- Adjusted EBITDA of  
EUR 350-390 million  
for 2024
- Investments over  
2021-2024  
unaffected

# Q&A

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# Annexes



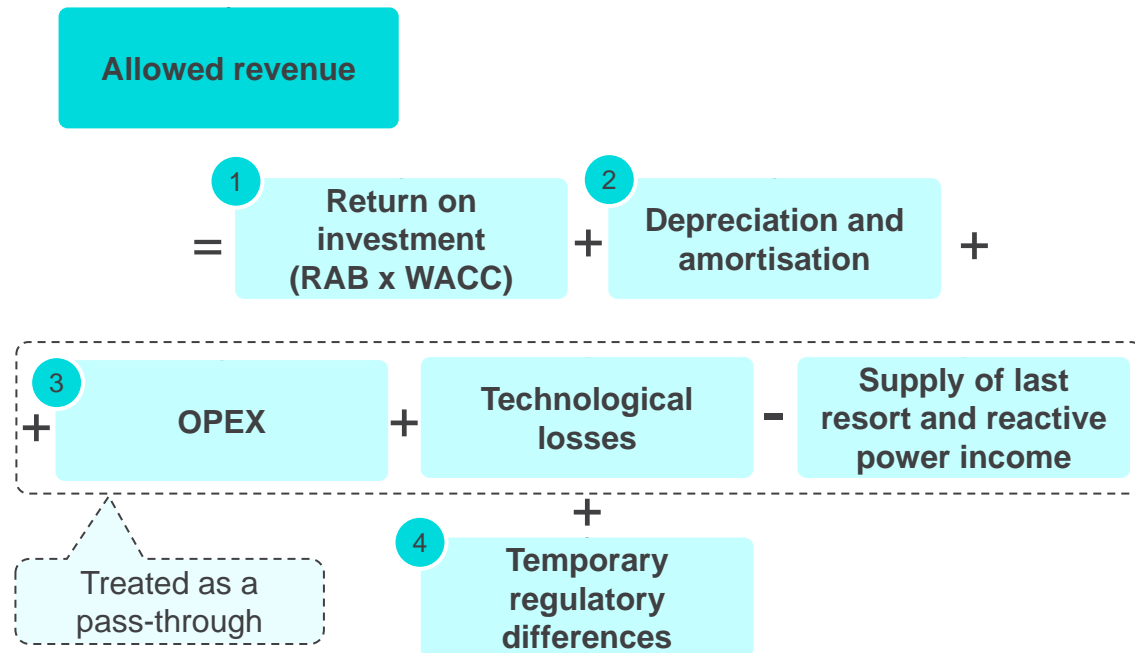


# Networks operating model



Largest Network in the Baltics, with a natural monopoly in both electricity and gas distribution servicing **>99.3%<sup>1</sup> of the Lithuanian market**

## Allowed revenue cap



## Regulated WACC & regulatory periods

Approved WACC												
Electricity ⚡						Gas 🔥						
2020: 5.28%						2020: 3.84%						
2021: 5.34%						2021: 3.90%						
2022: 4.16%						2022: 3.98%						
'16	'17	'18	'19	'20	'21	'22	'23	'24	'25	'26	'27	'28
2016–2021 Current regulatory period						2022–2026 New regulatory period						
						2019–2023 Current regulatory period			2024–2028 New regulatory period			



# Networks regulated WACC inputs



Parameter	Electricity 2022	Gas 2022
Risk free rate	1.42%	2.32%
Equity risk premium	5.00%	4.43%
Levered beta	0.779	0.720
D/(D+E)	50%	60%
Cost of debt	2.07%	2.30%
Corporate income tax	15%	15%
<b>WACC (pre-tax)</b>	<b>4.16%</b>	<b>3.98%</b>

## Old methodology

Based on market – the average Lithuanian government bond yields at issue of the last 10 years with a maturity not less than 3,468 days

Based on market - the sum of the equity risk premium of the country with the developed capital market (the US) and the additional market risk premium of Lithuania

Average levered beta in the sector of the European Union member states based on CEER report<sup>1</sup>

Fixed at 60%

Based on actual ESO cost of debt plus a premium of a half difference between actual ESO cost of debt and non-financial corporates average cost of debt. Annually updated

Corporate income tax rate in Lithuania

## New methodology

No changes

Fixed at 5.0%

Average unlevered beta in the sector of the European Union member states based on CEER report<sup>1</sup> and levered using 50/50 debt to equity ratio and 15% income tax rate

Fixed at 50%

Based on actual ESO cost of debt plus a premium of a difference between actual ESO cost of debt and the same sector average cost of debt. Annually updated

No changes

Applies only starting the new regulatory periods



2022



2024

# Glossary

#	Number
%	Per cent
<b>Adjusted EBITDA</b>	EBITDA after eliminating items, which are non-recurring, and/or non-cash, and/or related to other periods, and/or non-related to the main activities of the Group, and after adding back items, which better reflect the result of the current period
<b>D&amp;A</b>	Depreciation and amortization
<b>D/EBITDA or Net debt / Adjusted EBITDA</b>	Leverage ratio, which shows the Group's ability to repay its debt from the profit earned
<b>E</b>	Estimate
<b>ESO</b>	AB „Energijos skirstymo operatorius“
<b>etc.</b>	et cetera
<b>EURm</b>	million EUR
<b>GHG</b>	Greenhouse Gas
<b>Ignitis Group</b>	Group companies of AB „Ignitis Group“
<b>Installed capacity</b>	Where all assets have been completed and have passed a final test

<b>Investments</b>	Acquisition of property, plant and equipment and intangible assets, acquisition of shareholdings
<b>LRAIC</b>	Long-run average incremental cost
<b>New connection points and upgrades</b>	Number of new customers connected to the network and capacity upgrades of the existing connection points
<b>OPEX</b>	Operating expenses
<b>RAB</b>	Regulated asset base
<b>RAB</b>	Regulated asset base
<b>Regulator or NERC</b>	National Energy Regulatory Council
<b>ROI</b>	Return on Investment
<b>SN</b>	Side note
<b>vs.</b>	versus
<b>WACC</b>	Weighted average cost of capital



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