

02-03-2017 Nr. 12000-408

CONFIRMATION OF RESPONSIBLE PERSONS

Following Article 22 of the Law on Securities of the Republic of Lithuania and the Rules on Preparation and Submission of Periodic and Additional Information of the Bank of Lithuania, we, Dalia Andrulionienė, Chief Executive Officer of AB Energijos skirstymo operatorius and, Augustas Dragūnas, Director of Finance and Administration division, and Jelena Mordienė, Head of Reporting Division of Verslo Aptarnavimo Centras UAB acting under Order No IS17-20 of 22 February 2017, hereby do confirm that, to the best of our knowledge AB „Energijos skirstymo operatorius“ financial statements for the financial year 2016 are prepared in accordance with International Financial Reporting Standards as adopted by the European Union and give a true and fair view of the assets, liabilities, financial position, profit or loss and cash flow of AB „Energijos skirstymo operatorius“, and that the review of activities and business development as well as the condition of AB „Energijos skirstymo operatorius“ together with the description of the principle risks and uncertainties it faces has been described correctly in the AB „Energijos skirstymo operatorius“ Report of 2016.

AB Energijos skirstymo operatorius
Chief Executive Officer



Dalia Andrulionienė

AB Energijos skirstymo operatorius
Director of Finance and
Administration division



Augustas Dragūnas

Verslo Aptarnavimo Centras UAB
Head of Reporting Division, acting
under Order No IS17-20 of 22 February
2017



Jelena Mordienė

2016

ENERGIJOS SKIRSTYMO OPERATORIUS AB

FINANCIAL STATEMENTS OF THE COMPANY FOR THE YEAR 2016, PREPARED
ACCORDING TO THE INTERNATIONAL FINANCIAL REPORTING STANDARDS
AS ADOPTED BY THE EUROPEAN UNION, ANNUAL REPORT AND THE
INDEPENDENT AUDITOR'S REPORT



Translation note:

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

CONTENTS

FINANCIAL STATEMENTS

Independent auditor's report	3-8
Statement of financial position	9
Statement of profit or loss and other comprehensive income	10
Statement of changes in equity	11
Statement of cash flows	12
Notes to the financial statements	13-47
Annual report	48-134

The financial statements were approved on 2 March 2017 by Energijos Skirstymo Operatorius AB Chief Executive Officer, Director of Finance and Administration Service and Head or Reporting Division of Verslo Aptarnavimo Centras UAB (acting under Order No IS17-20 of 22 February 2017):



Dalia Andrulionienė
Energijos Skirstymo Operatorius AB,
Chief Executive Officer



Augustas Dragūnas
Energijos Skirstymo Operatorius AB,
Director of Finance and Administration
Service



Jėlena Mordienė
Verslo Aptarnavimo Centras, UAB
Head or Reporting Division acting under
Order No IS17-20 of 22 February 2017



Independent auditor's report

To the shareholders of Energijos Skirstymo Operatorius AB

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Energijos Skirstymo Operatorius AB ("the Company") as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

What we have audited

The Company's financial statements comprise:

- the statement of financial position as at 31 December 2016;
- the statement of profit or loss and other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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

Independence

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the Law on Audit of the Republic of Lithuania that are relevant to our audit of the financial statements in the Republic of Lithuania. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the Law on Audit of the Republic of Lithuania.



Our audit approach

Overview

Materiality	Overall materiality: EUR 5,645 thousand which represents 5% of profit before tax adjusted as explained in section <i>Materiality</i> below
Key audit matters	Event –driven • Presentation of the Company’s financial statements Recurring • Value of property, plant and equipment

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, if any, both individually and in aggregate on the financial statements as a whole.

Overall materiality	EUR 5,645 thousand
How we determined it	Overall materiality represents 5% of profit before tax adjusted for one-off impairment of financial asset which arose in 2015 on disposal of a subsidiary



Rationale for the materiality benchmark applied

We chose profit before tax adjusted for one-off items as the benchmark because, in our view, it is the generally accepted measure and it is the measure against which the performance of the company is most commonly assessed. This one-off item is non-recurring in nature. We chose 5%, which is within the range of acceptable quantitative materiality thresholds.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above EUR 282 thousand, as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<i>Key audit matter</i>	<i>How our audit addressed the key audit matter</i>
Presentation of the Company's financial statements (refer to notes 1, 2.5, 3, and 32) The Company was established following the reorganisation of LESTO AB and Lietuvos Dujos AB by way of merger. The Company took over all the assets, rights and obligations of LESTO AB and Lietuvos Dujos AB. The moment of take-over was 31 December 2015, 24:00. The merger is a transaction under common control and the management has elected to account for this transaction at the carrying values of assets and liabilities from separate financial statements of both companies having eliminated intercompany transactions and balances as disclosed. The comparatives were presented as if this structure was in place for all presented periods. Both LESTO AB and Lietuvos Dujos AB prepared separate financial statements as at 31 December 2015 in accordance with IFRS as adopted by EU but had different accounting policies for property, plant and equipment (classes related to electricity and gas networks) and for customer connection fee revenue.	In assessing the appropriateness of disclosure and presentation of comparative information, and the selected accounting policies we performed the following: • reconciled comparative information against audited financial statements of LESTO AB and Lietuvos Dujos AB for the year ended 31 December 2015, reviewed eliminations of intercompany transactions and balances, and evaluated the grouping of transactions and balances; • considered whether presentation of comparative information is relevant to economic decision making needs of users and reliable; • considered the reasons presented by the Company in support for selected accounting policy for recognition of revenue from electricity and gas connection fees and analysed whether the elected policy provides information that is relevant for the decision-making needs of the users of the financial statements; and • assessed whether the assets of LESTO AB and Lietuvos Dujos AB were classified properly, and whether they were measured in compliance with the selected accounting policies.



The Company's management had to assess accounting policies of LESTO AB and Lietuvos Dujos AB and to select the accounting policies to be adopted by the Company. Also, the Company's management had to provide the disclosure about the merger and present comparative figures in an understandable and informative manner. This is a complex and important accounting matter and was given special audit attention.

We concluded that the disclosure of the merger transaction and presentation of the comparative information was appropriate and the selected accounting policies were relevant and reliable.

Value of property, plant and equipment (refer to notes 3 and 4)

Property, plant and equipment is the most significant item of assets on the statement of financial position. Electricity distribution network and other assets are accounted for by the management at revalued amount (net book value of EUR 860,532 thousand), whereas gas distribution network is accounted for at cost less depreciation and impairment (net book value of EUR 160,009 thousand).

For assets carried at revalued amount, management has assessed whether the carrying amount does not differ materially from that which would be determined using fair value. For assets carried at cost less depreciation and impairment, management has considered whether indications for further impairment or reversal exist.

Management has identified cash generating units as the electricity and gas business segments, and forecasted expected cash flows for each unit. Based on the model, management has determined that fair values and recoverable values of cash generating units are higher than net book values as at 31 December 2016. Having concluded that no significant changes in electricity and gas related regulatory environment incurred compared to prior period, and that the identified deviation in value is lower than 5%, management assessed the increase in fair value as not material and did not account for this increase in the financial statements.

Assessment of values of property, plant and equipment is an area of significant management judgements, and they are, therefore, given special audit attention.

We obtained, understood and evaluated management's process for the assessment of the fair value of property, plant and equipment.

We discussed with management whether significant changes in electricity and gas legal environment incurred in 2016, that would have material impact on the Company's future cash flows and asset value. We examined changes in regulatory environment with reference to the latest decisions of the National Commission for Energy Control and Prices, including the regulated rate of return.

Also, we obtained the cash flow models used by management to monitor the value of assets employed in electricity and gas businesses. We checked the models and ensured that they are mathematically accurate and that the results are accurately compared to the carrying values of assets; we discussed with management key assumptions, where appropriate traced them to external or Company internal information and assessed sensitivity of the cash flow models to changes in selected assumptions.

Our work gave us sufficient audit evidence to conclude that management's judgement not to change the carrying values of property, plant and equipment is supportable and appropriate in light of the evidence obtained.



Other information

Management is responsible for the other information. The other information comprises the annual report (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.



- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and have communicated with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The certified auditor on the audit resulting in this independent auditor's report is Vytenis Lazauskas.

On behalf of PricewaterhouseCoopers UAB

A blue ink signature of Rimvydas Jogėla, consisting of a large, stylized 'R' followed by a cursive signature.

Rimvydas Jogėla
General Manager

Vilnius, Republic of Lithuania
2 March 2017

A blue ink signature of Vytenis Lazauskas, consisting of a stylized 'V' followed by a cursive signature.

Vytenis Lazauskas
Auditor's Certificate No.000536

STATEMENT OF FINANCIAL POSITION

As at 31 December 2016

All amounts in EUR thousands unless otherwise stated

STATEMENT OF FINANCIAL POSITION

	Note	31 Dec 2016	31 Dec 2015
ASSETS			
Non-current assets			
Property, plant, and equipment	4	1,020,541	921,797
Intangible assets	5	3,573	3,612
Prepayments for non-current assets		4	1,267
Investments in associates	6	2,346	2,018
Deferred income tax assets		-	1,978
Other non-current financial assets	7	5,836	10,633
		1,032,300	941,305
Current assets			
Inventories	8	1,731	2,544
Trade and other receivables	9	62,182	100,817
Prepayments, deferred expenses and accrued revenue	10	6,311	5,497
Prepaid income tax		-	1,604
Cash and cash equivalents	11	10,662	26,961
		80,886	137,423
Total assets		1,113,186	1,078,728
EQUITY AND LIABILITIES			
Equity			
Authorised share capital	12	259,443	259,443
Revaluation reserve	13	49,864	55,520
Legal reserve	13	25,910	25,910
Retained earnings		287,978	232,940
Total equity		623,195	573,813
LIABILITIES			
Non-current liabilities			
Borrowings	15	161,650	147,576
Deferred income tax liabilities	16	6,955	2,505
Deferred revenue	17	113,543	117,569
Grants and subsidies	18	20,477	21,384
Long-term employee benefits		2,949	2,487
Other non-current liabilities		3	51
		305,577	291,572
Current liabilities			
Borrowings	15	57,431	99,409
Trade and other payables	19	87,924	89,871
Advance amounts received, accrued liabilities and deferred revenue	20	32,080	23,941
Income tax payable		6,979	122
		184,414	213,343
Total liabilities		489,991	504,915
Total equity and liabilities		1,113,186	1,078,728

The accompanying notes form an integral part of these financial statements.

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Note	2016	2015
Revenue	21	645,545	631,872
Other income		4,518	5,994
Purchases of electricity and related services		(384,634)	(373,848)
Purchase (expenses) of natural gas and transmission services		(3,560)	(3,803)
Depreciation and amortisation		(46,028)	(43,848)
Employee benefits and related social security contributions	22	(47,131)	(56,090)
Repair and maintenance expenses		(18,484)	(25,649)
Transport costs		(4,540)	(4,775)
Telecommunications and IT services		(7,711)	(8,409)
Rent and utilities		(4,130)	(2,586)
Impairment and write-off expenses	23	(9,300)	(3,006)
Other expenses	24	(16,559)	(13,798)
Operating profit		107,986	102,054
Finance income	25	1,335	1,057
Finance costs	25	(2,224)	(2,563)
Finance costs – net		(889)	(1,506)
Share of profit of associates and joint ventures	6	328	(12)
Gain on disposal of investment in the joint venture		-	32
Profit before income tax		107,425	100,568
Income tax	16	(14,923)	(15,090)
Net profit for the period		92,502	85,478
Other comprehensive income (expenses)			
Items that will not be reclassified to profit or loss:			
Gain (loss) on revaluation of non-current assets	4	-	521
Effect of deferred income tax		-	(78)
Other comprehensive income (expenses)		-	443
Total comprehensive income for the period		92,502	85,921
Weighted average number of shares		894,630,333	894,630,333
Basic and diluted earnings per share (in EUR) attributable to owners of the Company		0.103	0.096

The accompanying notes form an integral part of these financial statements.

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
STATEMENT OF CHANGES IN EQUITY
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

STATEMENT OF CHANGES IN EQUITY

	Note	Authorised share capital	Revaluation reserve	Legal reserve	Retained earnings	Total equity
Balance at 1 January 2015		259,103	65,996	25,910	208,701	559,710
Comprehensive income						
Net profit for the period		-	-	-	85,478	85,478
Gain on revaluation of non-current assets, net of deferred income tax		-	443	-	-	443
Total comprehensive income for the period		-	443	-	85,478	85,921
Transfers to retained earnings (transfer of depreciation, net of deferred income tax)		-	(10,919)	-	10,919	-
Dividends	14	-	-	-	(72,162)	(72,162)
Result of the conversion of the nominal value of shares to the euro		340	-	-	-	340
Other transfers		-	-	-	4	4
Balance at 31 December 2015		259,443	55,520	25,910	232,940	573,813
Balance at 1 January 2016		259,443	55,520	25,910	232,940	573,813
Comprehensive income						
Net profit for the period		-	-	-	92,502	92,502
Total comprehensive income for the period		-	-	-	92,502	92,502
Transfers to retained earnings (transfer of depreciation, net of deferred income tax)		-	(5,656)	-	5,656	-
Dividends	14	-	-	-	(43,120)	(43,120)
Balance at 31 December 2016		259,443	49,864	25,910	287,978	623,195

The accompanying notes form an integral part of these financial statements.

STATEMENT OF CASH FLOWS

for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

STATEMENT OF CASH FLOWS

	Note	2016	2015
Cash flows from operating activities			
Net profit for the period		92,502	85,478
Adjustments for:			
Income tax expenses	16	14,923	15,090
Depreciation and amortisation	4,5	47,358	45,215
Amortisation of grants	18	(1,330)	(1,367)
Share of (profit) of associates and joint ventures	6	(328)	(12)
(Gain)/loss on disposal and write-off of assets		3,545	2,398
Loss on disposal of investments in subsidiaries and joint ventures		-	44
Increase in fair value of investment property		-	(49)
Revaluation of non-current assets and reversal of impairment		-	(184)
Impairment of available-for-sale financial assets		5,560	-
Finance (income)	25	(1,335)	(1,057)
Finance costs	25	2,224	2,563
Changes in working capital:			
Trade and other receivables		15,744	4,943
Inventories, prepayments, deferred expenses and accrued revenue		(1,116)	(221)
Trade and other payables, advance amounts received, accrued expenses and deferred revenue		2,433	(4,692)
Cash generated from operations		180,180	148,149
Income tax paid		(36)	(9,765)
Net cash flows generated from operating activities		180,144	138,384
Cash flows from investing activities			
Purchase of property, plant and equipment, intangible assets and investment property		(147,571)	(147,571)
Proceeds from sale of property, plant and equipment and investment property		-	6,229
Disposal of subsidiaries		24,444	24,428
(Acquisition) of investment in associates		-	(474)
Disposal of investments in joint ventures		-	131
Grants received		424	8,494
Loans (granted)		(25,146)	-
Loans repayments received		23,845	96
Dividends received		58	-
Interest received		152	224
Net cash flows used in investing activities		(123,794)	(86,132)
Cash flows from financing activities			
Proceeds from borrowings		71,500	133,500
Repayments of borrowings		(78,279)	(116,912)
Dividends paid to the Company's shareholders		(43,008)	(72,003)
Interest paid		(1,737)	(2,051)
Net cash flows used in financing activities		(51,524)	(57,466)
Net increase (decrease) in cash and cash equivalents		4,826	(5,214)
Cash and cash equivalents (including the overdraft balance) at the beginning of the period	11	5,836	11,050
Cash and cash equivalents (including the overdraft balance) at the end of the period	11	10,662	5,836

The accompanying notes form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1 General information

Energijos Skirstymo Operatorius AB ("the Company") is a public limited liability company registered in the Republic of Lithuania. The Company was registered with the Register of Legal Entities on 11 December 2015. The Company started its activities with effect from 1 January 2016. The shares of the Company have been listed on the main list of NASDAQ OMX Vilnius Stock Exchange since 17 January 2016. The address of its registered office is as follows:

Agonų g. 24,
 LT-03212 Vilnius,
 Lithuania.

The Company was established following the reorganisation of LESTO AB and Lietuvos Dujos AB by way of merger. Under the terms and conditions of the reorganisation approved by the decisions of the extraordinary general meetings of shareholders of LESTO AB and Lietuvos Dujos AB dated 3 December 2015, a transfer-acceptance statement was signed on 31 December 2015, on the basis of which the Company took over all the assets, rights and obligations of LESTO AB and Lietuvos Dujos AB. The moment of the take-over of assets, rights and obligations by the Company was 31 December 2015, 24:00.

For the purpose of the financial statements comparative figures for the year ended 31 December 2015 have been prepared by combining the data of the financial statements of LESTO AB and Lietuvos Dujos AB and having eliminated intercompany transactions and balances thereon as disclosed in Note 32. The term "the Company" used in these financial statements when presenting data for the year ended 31 December 2015 means the merged companies LESTO AB and Lietuvos Dujos AB.

The Company's core lines of business include electricity supply and distribution, and natural gas distribution.

As at 31 December 2016 and 31 December 2015, the Company's shareholder structure was as follows:

	At 31 December 2016		At 31 December 2015			
	Energijos Skirstymo Operatorius AB		LESTO AB		Lietuvos Dujos AB	
	Number of shares held	Ownership interest	Number of shares held	Ownership interest	Number of shares held	Ownership interest
Lietuvos Energija UAB	849,743,761	94.98%	570,066,682	94.39%	280,930,066	96.64%
Other shareholders	44,886,572	5.02%	33,877,911	5.61%	9,755,674	3.36%
Total	894,630,333	100%	603,944,593	100%	290,685,740	100%

As at 31 December 2016, Lietuvos Energija, UAB was the parent of the Company. Lietuvos Energija, UAB is wholly owned by the Lithuanian Government represented by the Lithuanian Ministry of Finance.

In calculating the proportion of an exchange of the shares of LESTO AB and Lietuvos Dujos AB for the shares of Energijos Skirstymo Operatorius AB, the values of the companies' shares were used. The shares of LESTO AB and Lietuvos Dujos AB have been exchanged for the shares of Energijos Skirstymo Operatorius AB under the approved reorganisation terms and conditions in the following proportions:

- 1.09206846 shares of Energijos Skirstymo Operatorius AB in return for 1 share of LESTO AB;
- 0.80871354 share of Energijos Skirstymo Operatorius AB in return for 1 share of Lietuvos Dujos AB;

All the shares of the Company with the nominal value of EUR 0.29 each are ordinary registered shares.

As at 31 December 2016, the Company had no subsidiaries. On 31 March 2015, LESTO AB sold ordinary registered shares of subsidiary Elektros Tinklo Paslaugos UAB and on 27 April 2015 it sold ordinary registered shares of subsidiary NT Valdovs UAB. As at 31 December 2015, Lietuvos Dujos AB had no subsidiaries.

As at 31 December 2016 and 31 December 2015, the Company's investments in associates were as follows:

Associate	Country	Year of acquisition	Company's ownership interest (%)		Profile of activities
			At 31 December 2016	At 31 December 2015	
Technologijų ir Inovacijų Centras UAB	Lithuania	2013	29.01%	29.01%	Information technology and telecommunication, and other services to the shareholders
Verslo Aptarnavimo Centras UAB	Lithuania	2014	22.25%	22.25%	Customer service, public procurement organisation and performance, accounting and personnel administration services

As at 31 December 2016, the Company had 2,677 (31 December 2015: 3,149) employees. Decline in the number of employees was caused by the implemented restructuring that allowed reducing the number of staff. Moreover, from 1 January 2016, the Company's customer service functions (management and development of customer service channels, management of customer requests, bookkeeping and collection of payments, management of trade receivables, transmission of notifications to customers, drafting and administration of contracts, performance of other support customer service functions) and with effect from 31 October 2016 the Company's functions related to legal services were transferred to Verslo Aptarnavimo Centras UAB. The total of 240 employees changed working place to Verslo Aptarnavimo Centras UAB from 1 January 2016.

Regulation of the Company's activities

The Company's activities are regulated by the Lithuanian Law on Energy, the Lithuanian Law on Electricity, the Lithuanian Law on Natural Gas and other regulatory legislation.

The Company carries out the following licensed activities:

- electricity distribution;
- public supply of electricity;
- distribution of natural gas.

The licences are issued and licensed activities are controlled by the National Control Commission for Prices and Energy (hereinafter "the Commission").

The Commission sets the price caps for the services of electricity distribution, public supply of electricity and natural gas distribution.

1. The setting of price caps in the electricity sector

The price caps of electricity distribution, public supply services are established according to the Methodology for the Determination of the Price Caps of Electricity Transmission, Distribution and Public Supply Services ("the Methodology") approved by Resolution No O3-3 of 15 January 2015 of the Commission.

The price caps of electricity distribution and public supply services are established for the regulatory period of 5 years (the 2016–2020 regulatory period is currently applicable to the electricity sector) and they can be adjusted not more than twice per year if substantial changes in one or several factors, based on which the price caps were determined, occur, including a substantial change in the scope of services, inflation, taxes and other objective (outside the control of the market participant) factors.

On 14 October 2016, the Commission established the price caps for the electricity distribution services for the year 2017 as follows:

- electricity distribution services via medium voltage networks – 0.830 euro ct/kWh (excl. VAT) (2016: 1.000 euro ct/kWh (excl. VAT));
- electricity distribution services via low voltage networks – 1.655 euro ct/kWh (excl. VAT) (2016: 1.766 euro ct/kWh (excl. VAT)).

On 14 October 2016, the Commission established the price caps for the electricity public supply services for the year 2017 as follows:

- public electricity supply services – 0.143 euro ct/kWh (excl. VAT) (2016: 0.165 euro ct/kWh (excl. VAT));

On 16 December 2016, the Commission established the public price cap of 7.102 euro ct/kWh (excl. VAT) to household customers who receive electricity via medium voltage network for 2017 (second half of 2016: 7.499 euro ct/kWh (excl. VAT)), and the public price cap of 9.088 euro ct/kWh (excl. VAT) to household customers who receive electricity via low voltage network for 2017 (second half of 2016: 9.530 euro ct/kWh (excl. VAT)).

2. The setting of price caps in the natural gas sector

The pricing of the natural gas distribution service is regulated by the Commission according to the *Procedure for determining regulated prices in natural gas sector* approved by Resolution No O3-367 of 13 September 2013 of the Commission.

The price cap of natural gas distribution service is established for the regulatory period of 5 years (the 2014–2018 regulatory period is currently applicable to the natural gas sector) and it can be adjusted once per year if there is a change in the inflation level, prices of imported (transported into the country) natural gas, taxes, natural gas quantity for the regulated service, requirements of regulatory legislation, also when the investments agreed with the Commission have been implemented by the natural gas companies or when those companies deviate from the indicators determined under the *Procedure for Determining Regulated Prices in Natural Gas Sector* approved by Resolution No O3-367 of 13 September 2013 of the Commission.

On 31 October 2016, the Commission established the price cap for the natural gas distribution service for the year 2017 as follows:

- natural gas distribution service – 7.25 euro ct/MWh (excl. VAT) (2016: 7.92 euro ct/MWh (excl. VAT)).

Approval of financial statements

The Company's management approved these financial statements on 2 March 2017. The Company's shareholders have a statutory right to approve or not to approve these financial statements and to require the preparation of a new set of financial statements.

2 Accounting policies

The accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2.1 Basis of preparation

These financial statements have been prepared under the historical cost convention, as modified by property, plant and equipment measured at revalued amount and certain financial assets measured at fair value.

All amounts in these financial statements are presented in the euros and they have been rounded to the nearest thousand (in thousand EUR), unless otherwise stated

The Company's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU).

The Company's financial year coincides with the calendar year.

Accounting policies applied in the preparation of these financial statements are consistent with those applied in the previous financial year, except for as follows:

a) Adoption of new and (or) amended IFRS and interpretations of the International Financial Reporting Interpretations Committee (IFRIC)

IFRSs and their amendments adopted by the Company for the first time in the financial year ended 31 December 2016 are as follows:

Annual improvements to IFRSs 2012 (effective for the annual periods beginning on or after 1 February 2015). The improvements consist of changes to seven standards.

IFRS 2 was amended to clarify the definition of a 'vesting condition' and to define separately 'performance condition' and 'service condition'. The amendment is effective for share-based payment transactions for which the grant date is on or after 1 July 2014.

IFRS 3 was amended to clarify that (1) an obligation to pay contingent consideration which meets the definition of a financial instrument is classified as a financial liability or as equity, on the basis of the definitions in IAS 32, and (2) all non-equity contingent consideration, both financial and non-financial, is measured at fair value at each reporting date, with changes in fair value recognised in profit and loss. Amendments to IFRS 3 are effective for business combinations where the acquisition date is on or after 1 July 2014.

IFRS 8 was amended to require (1) disclosure of the judgements made by management in aggregating operating segments, including a description of the segments which have been aggregated and the economic indicators which have been assessed in determining that the aggregated segments share similar economic characteristics, and (2) a reconciliation of segment assets to the entity's assets when segment assets are reported.

The basis for conclusions on IFRS 13 was amended to clarify that deletion of certain paragraphs in IAS 39 upon publishing of IFRS 13 was not made with an intention to remove the ability to measure short-term receivables and payables at invoice amount where the impact of discounting is immaterial.

IAS 16 and IAS 38 were amended to clarify how the gross carrying amount and the accumulated depreciation are treated where an entity uses the revaluation model.

IAS 24 was amended to include, as a related party, an entity that provides key management personnel services to the reporting entity or to the parent of the reporting entity ('the management entity'), and to require to disclose the amounts charged to the reporting entity by the management entity for services provided. There was no impact for The Company of the amendments on its financial statements.

Clarification of acceptable methods of depreciation and amortisation – Amendments to IAS 16 and IAS 38 (effective for annual periods beginning on or after 1 January 2016). In this amendment, the IASB has clarified that the use of revenue-based methods to calculate the depreciation of an asset is not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The Company calculates depreciation and amortization on the straight line basis, therefore this amendment had no impact.

Equity method in separate financial statements – Amendments to IAS 27 (effective for annual periods beginning on or after 1 January 2016). The amendments will allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. The Company don't have subsidiaries and its reports are not considered to be the separate, so this amendment is not relevant to the company's investments in associates. The Company has no subsidiaries and its financial statements are not separate financial statements, therefore this amendment is not applicable for the accounting of Company's investments in associates.

Annual improvements to IFRSs 2014 (effective for the annual periods beginning on or after 1 January 2016). The amendments impact 4 standards. IFRS 5 was amended to clarify that change in the manner of disposal (reclassification from 'held for sale' to 'held for distribution' or vice versa) does not constitute a change to a plan of sale or distribution, and does not have to be accounted for as such. The amendment to IFRS 7 adds guidance to help management determine whether the terms of an arrangement to service a financial asset which has been transferred constitute continuing involvement, for the purposes of disclosures required by IFRS 7. The amendment also clarifies that the offsetting disclosures of IFRS 7 are not specifically required for all interim periods, unless required by IAS 34.

Disclosure initiative – Amendments to IAS 1 (effective for annual periods beginning on or after 1 January 2016). The Standard was amended to clarify the concept of materiality and explains that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, even if the IFRS contains a list of specific requirements or describes them as minimum requirements. The Standard also provides new guidance on subtotals in financial statements, in particular, such subtotals (a) should be comprised of line items made up of amounts recognised and measured in accordance with IFRS; (b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable; (c) be consistent from period to period; and (d) not be displayed with more prominence than the subtotals and totals required by IFRS standards. The Company has reassessed presentation of financial statements considering these amendments.

Improvements are effective for annual periods beginning on or after 1 January 2016.

b) New, amended standards and interpretations that are not yet effective

Other new standards, amendments to standards and interpretations effective for the annual periods beginning on or after 01 January 2017, yet not applied in preparing these financial statements are as follows:

IFRS 9, Financial instruments: Classification and measurement (effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

- Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).
- Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.
- Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
- IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.
- Hedge accounting requirements were amended to align accounting more closely with risk management. The standard provides entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 and continuing to apply IAS 39 to all hedges because the standard currently does not address accounting for macro hedging.

IFRS 15, Revenue from contracts with customers (effective for annual periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

IFRS 14, Regulatory deferral accounts (effective for annual periods beginning on or after 1 January 2016; not yet adopted by the EU). IFRS 14 permits first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt IFRS. However, to enhance comparability with entities that already apply IFRS and do not recognise such amounts, the standard requires that the effect of rate regulation must be presented separately from other items. An entity that already presents IFRS financial statements is not eligible to apply the standard.

IFRS 16, Leases (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

Recognition of deferred tax assets for unrealised losses - Amendments to IAS 12 (effective for annual periods beginning on or after 1 January 2017; not yet adopted by the EU). The amendment has clarified the requirements on recognition of deferred tax assets for unrealised losses on debt instruments. The entity will have to recognise deferred tax asset for unrealised losses that arise as a result of discounting cash flows of debt instruments at market interest rates, even if it expects to hold the instrument to maturity and no tax will be payable upon collecting the principal amount. The economic benefit embodied in the deferred tax asset arises from the ability of the holder of the debt instrument to achieve future gains (unwinding of the effects of discounting) without paying taxes on those gains.

Disclosure initiative – Amendments to IAS 7 (effective for annual periods beginning on or after 1 January 2017; not yet adopted by the EU). The amended IAS 7 will require disclosure of a reconciliation of movements in liabilities arising from financing activities.

Revenue from contracts with customers - Amendments to IFRS 15 (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard.

Share-based payments – Amendments to IFRS 2 (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The amendments mean that non-market vesting conditions will impact measurement of cash-settled share-based payment transactions in the same manner as equity-settled awards. The amendments also clarify classification of a transaction with a net settlement feature in which the entity withholds a specified portion of the equity instruments, that would otherwise be issued to the counterparty upon exercise (or vesting), in return for settling the counterparty's tax obligation that is associated with the share-based payment. Such arrangements will be classified as equity-settled in their entirety. Finally, the amendments also clarify accounting for cash-settled share based payments that are modified to

become equity-settled, as follows (a) the share-based payment is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification; (b) the liability is derecognised upon the modification, (c) the equity-settled share-based payment is recognised to the extent that the services have been rendered up to the modification date, and (d) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Applying IFRS 9 Financial instruments with IFRS 4 Insurance contracts – Amendments to IFRS 4 (effective, depending on the approach, for annual periods beginning on or after 1 January 2018 for entities that choose to apply temporary exemption option, or when the entity first applies IFRS 9 for entities that choose to apply overlay approach; not yet adopted by the EU). The amendments address concerns arising from implementing the new financial instruments standard, IFRS 9, before implementing the replacement standard that IASB is developing for IFRS 4. These concerns include temporary volatility in reported results. The amendments introduce two approaches. (1) The amended standard will give all companies that issue insurance contracts the option to recognise in other comprehensive income, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts standard is issued ('overlay approach'). In addition, the amended standard will give companies whose activities are predominantly connected with insurance an optional temporary exemption from applying IFRS 9 until 2021. The entities that defer the application of IFRS 9 will continue to apply the existing financial instruments standard – IAS 39. The amendments to IFRS 4 supplement existing options in the standard that can already be used to address the temporary volatility.

Annual improvements to IFRSs 2014–2016 cycle (effective for annual periods beginning on or after 1 January 2017 (changes to IFRS 12) or 2018 (changes to IFRS 1 and IAS 28)); not yet adopted by the EU).

The improvements impact three standards. The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10–B16, apply to an entity's interests in other entities that are classified as held for sale or discontinued operations in accordance with IFRS 5. IFRS 1 was amended to delete some of the short-term exemptions from IFRSs after those short-term exemptions have served their intended purpose. The amendments to IAS 28 clarify that venture capital organisations or similar entities have an investment-by-investment choice for measuring investees at fair value. Additionally, the amendment clarifies that if an investor that is not an investment entity has an associate or joint venture that is an investment entity, the investor can choose on an investment-by-investment basis to retain or reverse the fair value measurements used by that investment entity associate or joint venture when applying the equity method.

Transfers of investment property – Amendments to IAS 40 (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The amendment clarified that to transfer to, or from, investment properties there must be a change in use. This change must be supported by evidence; a change in intention, in isolation, is not enough to support a transfer.

IFRIC 22, Foreign currency transactions and advance consideration (effective for annual periods beginning on or after 1 January 2018; not yet adopted by the EU). The interpretation applies where an entity either pays or receives consideration in advance for foreign currency-denominated contracts. The interpretation clarifies that the date of transaction, i.e. the date when the exchange rate is determined, is the date on which the entity initially recognises the non-monetary asset or liability from advance consideration. However, the entity needs to apply judgement in determining whether the prepayment is monetary or non-monetary asset or liability based on guidance in IAS 21, IAS 32 and the Conceptual Framework.

Other standards and their improvements are not expected to have significant impact on the Company.

2.2 Investments in associates

Investments in associates over which the Company has a significant influence are accounted for using the equity method, except for the cases when the investment is acquired and held solely for the purpose of selling it in the near future (not later than within 12 months from the date of acquisition) and the management is engaged in active search for buyers..

Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

The Company's share of post-acquisition profit or loss is recognised in profit or loss, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Company's share of losses in an associate equals or exceeds its interest in the associate, including all unsecured receivables, the Company does not recognise further losses, unless it has assumed obligations or made payments on behalf of the associate.

At each reporting date the Company reviews investments in associates to assess whether there is objective evidence that investments in associates may be impaired. If such indications exist, the Company calculates the amount of impairment, which is equal to the difference between the replacement cost and the carrying amount of the associate, and recognises this amount under the line item 'Share of profit (loss) of associates' in the statement of comprehensive income.

2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Board that makes strategic decisions.

According to the management, the Company has two operating segments, i.e. supply and distribution of electric power and distribution of gas. The Company has a single geographical segment – Republic of Lithuania. The chief operating decision-maker monitors the results with reference to the financial reports that have been prepared using the same accounting policies as those used for the preparation of the financial statements in accordance with IFRS, i.e. information on profit or loss, including the reported amounts of revenue and expenses, assets and liabilities.

2.4 Intangible assets

(a) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (3 years).

(b) Other intangible assets

Intangible assets expected to provide economic benefits to the Company in future periods are stated at acquisition cost, less any accumulated amortisation and impairment losses. Amortisation is calculated on the straight-line method over estimated useful lives of 3 to 4 years.

2.5 Property, plant and equipment

Property, plant and equipment is shown at revalued amount based on periodic valuations by external independent valuers, less subsequent accumulated depreciation and impairment, except for gas distribution pipelines and their equipment, gas technological equipment and structures that are accounted for under the cost method. Valuations are performed with sufficient regularity to ensure that the carrying amount does not differ materially from the value that would have been established based on the fair value at the balance sheet date. Any accumulated depreciation and impairment at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

Categories of property, plant and equipment measured using the cost method are recorded at cost less accumulated depreciation and accumulated impairment losses.

The initial value of property, plant and equipment comprises acquisition cost including not refundable acquisition taxes and all directly attributable costs associated with the preparation for its intended use..

Increases in the carrying amount arising on revaluation of property, plant and equipment are credited to other comprehensive income and shown as revaluation reserve in shareholders' equity. Decreases arising on subsequent revaluation that offset previous increases of the same asset are charged in other comprehensive income and debited against revaluation reserve directly in equity; all other decreases are charged to profit or loss. Increases in the carrying amount that offset previous decreases are recognised in profit or loss. All other increases in the carrying amount arising on revaluations of property, plant and equipment are recognised in other comprehensive income and credited to revaluation reserve directly in equity. Each year the difference between depreciation based on the revalued amount of the asset charged to profit or loss, and depreciation based on the asset's original cost is transferred from revaluation reserve to retained earnings taking into account the effect of deferred income tax.

Depreciation of property, plant and equipment is calculated using the straight-line method to write off the revalued amount of asset to its residual value over the following estimated useful lives:

Buildings	15 - 60 years
Whereof:	
Engineering constructions	50 years
35-110 kV transformer substation constructions	35 years
6-10 kV electricity distribution constructions	35 years
10/0.4 kV transformer constructions	35 years
Communication and operation system constructions	15-25 years
Structures, equipment and electricity networks	5-50 years
Whereof:	
35-110 kV transformer substation equipment (excl. constructions)	30 years
6-10 kV distribution equipment (excl. constructions)	30 years
10/0.4 kV capacity transformers	30 years
35 kV cables and lines	40-45 years
0.4-10 kV cables and lines	15-40 years
35-110 kV capacity transformers	40 years
Communication and operation system equipment (excl. constructions)	5-45 years
Hydrotechnical structures and equipment	50-75 years
Gas distribution pipelines and their equipment	13-55 years
Gas technological equipment and structures	18-36 years
Other property, plant and equipment	3-50 years

The residual values and useful lives of property, plant and equipment are reviewed regularly and adjusted, if appropriate, according to the procedure established at the Company.

When assets are written off or otherwise disposed, the acquisition cost and related depreciation charges are not further recognised in the financial statements, and gain or loss on such disposal is recognised in profit or loss. Gain or loss on disposal of property, plant and equipment is determined as the difference between proceeds and the net book value of assets disposed. Upon disposal of revalued asset, the corresponding amount included in revaluation reserve is transferred to retained earnings (deficit).

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repair and maintenance costs are recognised in profit or loss in the period when such costs are incurred.

Construction in progress is reclassified to corresponding categories of property, plant and equipment when it is completed and ready for the intended use.

Borrowing costs directly attributable to the acquisition, construction or production of assets, which are assets that necessarily take a substantial period of time (longer than 1 year) to get ready for their intended use, are added to the cost of those assets.

2.6 Financial assets

Financial assets are classified the Company as financial assets at fair value through profit or loss, held-to-maturity investments, loans granted and receivables, and available-for-sale financial assets. Regular purchases and sales of financial assets are recognised on the trade date. Financial assets are initially recognised at fair value plus transaction costs, except for the financial assets at fair value through profit or loss.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets.

Loans and receivables are initially recognised at cost (the fair value of consideration) and subsequently carried at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss in the statement of profit or loss and other comprehensive income when these assets are derecognised, impaired or amortised.

Impairment loss is recognised when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the amount receivable is impaired. The carrying amount of the asset is reduced, and the amount of the loss is recognised in profit or loss within other expenses. When an amount receivable is uncollectible, it is written off against the allowance account for amounts receivable. Subsequent recoveries of amounts previously written off are credited against 'other expenses' in the statement of profit or loss and other comprehensive income.

(b) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Available-for-sale financial assets are those intended to be held for an indefinite period of time.

Available-for-sale financial assets are initially recognised at fair value plus transaction costs and subsequently remeasured at fair value. Unrealised gains and losses, arising from changes in the fair value are recognised in other comprehensive income, except for impairment losses and foreign exchange gains or losses. When such financial assets are derecognised, the cumulative revaluation result previously recognised in other comprehensive income is recognised in profit or loss in the statement of comprehensive income.

Financial assets are derecognised when the contractual rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all risks and rewards of ownership.

2.7 Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of the remaining amount of natural gas is established using the weighted average and the cost of all other inventories is estimated using the FIFO method. Acquisition cost of inventories includes purchase price and related taxes (other than those subsequently recovered by the Company from tax authorities), transportation, handling and other costs directly associated with acquisition of inventories. The acquisition cost excludes borrowing costs.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated selling expenses.

2.8 Non-current assets held for sale

Non-current assets are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

2.9 Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks and other short-term highly liquid investments with maturities up to 3 months.

For the purpose of the statement of cash flows, cash and cash equivalents comprise cash on hand, deposits held in settlement bank accounts, and other short-term highly liquid investments with maturities up to 3 months, and bank overdrafts. In the statement of financial position, bank overdrafts are included in current borrowings.

2.10 Trade receivables

Trade payables are accrued when the other party has performed its obligations under the contract, and are initially recognised at fair value and subsequently estimated at amortised cost using the effective interest rate method.

2.11 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds and the redemption value is recognised in profit or loss in the statement of comprehensive income over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 month after the balance sheet date.

Borrowing costs that are attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time (longer than 1 year) to get ready for its intended use, are capitalised as part of the cost of that asset. Other borrowing costs are recognised as expenses when incurred.

2.12 Income tax

Income tax expense for the period comprises current tax and deferred tax.

(a) Income tax

Current income tax assets and liabilities are recognised to the extent their recovery from or payment to tax authorities is probable. Income tax is determined using the tax rates (and laws) that have been enacted by the date of the statements of financial position. The standard income tax rate in Lithuania was 15% in 2016 (2015: 15%).

(b) Deferred income tax

Deferred income tax is accounted for using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are recognised on all temporary differences that will increase the taxable profit in future, whereas deferred tax assets are recognised to the extent it is probable that they will reduce the taxable profit in future. However, deferred tax assets and liabilities are not recognised if the temporary differences arise from initial recognition of goodwill (or negative goodwill); or if they arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax assets are reviewed at each date of the statement of financial position and if it is not probable that the Company will generate sufficient taxable profit to realise these assets, they are reduced to an amount which is likely to reduce the taxable profit in future. Deferred income tax assets and liabilities are estimated using the tax rate that has been applied when calculating income tax for the year when the related temporary differences are to be realised or settled.

Deferred tax assets and liabilities are offset only where they relate to income tax assessed by the same fiscal authority or where there is a right to offset current tax assets and current tax liabilities.

(c) Current tax and deferred tax

Current tax and deferred tax are recognised as income and expenses and included in net profit or loss for the period, except to the extent that they relate to the amounts recognised in other comprehensive income and relate to transactions or events that are recognised directly in equity in the same or the next period.

2.13 Employee benefits

(a) Social security contributions

The Company pays social security contributions to the state Social Security Fund (the Fund) on behalf of its employees based on the defined contribution plan in accordance with the local legal requirements. A defined contribution plan is a plan under which the Company pays fixed contributions into the Fund and will have no legal or constructive obligations to pay further contributions if the Fund does not hold sufficient assets to pay all employees benefits relating to employee service in the current and prior period. Social security contributions are recognised as expenses on an accrual basis and are included in payroll expenses.

(b) Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan and agreements signed with employees without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are recognised at present value discounted using market interest rate.

(c) Pension benefits to employees of retirement age

Each employee of retirement age who terminates his/her employment with the Company upon retirement is entitled to receive a payment equal to 2 monthly salaries as stipulated in the Lithuanian laws. A liability for such pension benefits is recognised in the statement of comprehensive income and it reflects the present value of these earned benefits at the date of the statement of financial position. The aforementioned non-current liability for pension benefits to employees at the date of the statement of financial position is determined with reference to actuary valuations using the projected relative unit method. The present value of the defined non-current liability for pension benefits to employees is determined by discounting the estimated future cash flows using the effective interest rates as set for government debentures denominated in a currency in which the benefits will be paid to employees and that have maturity term similar to that of the related liability.

2.14 Grants

Asset-related grants

Government grants are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions. Government grants relating to purchase of property, plant and equipment are included in non-current liabilities in the statement of financial position and are recognised in the profit or loss account in the statement of profit or loss and other comprehensive income on a straight-line basis over the expected lives of the related assets.

On revaluation of non-current assets, the grants related to non-current assets, for which impairment was recognised and reported in profit or loss, are partly written off.

Income-related grants

Government grants received as a compensation for costs or unearned income for current or previous reporting period, and all grants other than those related to assets, are considered as grants related to income. The income-related grants are recognised as used in parts to the extent of the expenses incurred during the reporting period or unearned income to be compensated by that grant. These grants are presented in the statement of comprehensive income, less related expenses.

2.15 *Operating lease*

(a) Operating lease – where the Company is a lessee

Lease is recognised as operating lease, when all the risks and rewards of ownership of the leased item remain with the lessor. Operating lease payments are recognised as expenses in the statement of profit or loss and other comprehensive income on a straight-line basis over the lease term.

(b) Operating lease – where the Company is a lessor

Lease is recognised as operating lease, when the lessor retains all the rewards and risks of ownership of the leased item. Payments received under operating leases are recognised as income on a straight-line basis over the lease term.

2.16 *Provisions*

Provisions are recognised when the Company has a legal obligation or irrevocable commitment as a result of the event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Company expects that provision amount in part or in full will be compensated, e.g. by insurance, compensation to be received is recorded as a separate asset, but only when it is virtually certain. Expenses related to provisions are recorded in profit or loss in the statement of profit or loss and other comprehensive income, net of compensation receivable. If the effect of the time value of money is material, the amount of provision is discounted using the effective pre-tax discount rate set based on the interest rates for the period and taking into account specific risks associated with the provision as appropriate. Where discounting is used, the increase in the provision due to the passage of time is recognised as finance costs.

2.17 *Revenue recognition*

Revenue of the Company comprises the fair value of the consideration received or receivable for goods and services sold in the ordinary course of business. Revenue is shown net of value-added tax, returns, rebates and discounts.

Revenue is recognised when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the Company and when specific criteria have been met for each of the Company's activities, as described below.

(a) Revenue from sale of electricity

Revenue from sale of electricity to private customers is recognised in the period upon supply of electricity and receipt of payment for electricity supplied. At the end of each reporting period, revenue is accrued to account for electricity supplied but not paid yet.

Revenue from sale of electricity to business customers is recognised upon sale of electricity based on the actual consumption of electricity which is determined according to the readings of electricity meters.

Revenue from sale of electricity is regulated.

(b) Revenue from distribution of natural gas

Revenue from non-household customers for the distribution of natural gas is recognised on a monthly basis referring to the readings of measuring devices provided by users or if users did not provide the readings of measuring devices, referring to the quantities of gas calculated according to the approved methodology for the calculation of quantities of natural gas (an accrual basis).

Revenue from household customers is recognised on a monthly basis referring to the quantities of gas calculated according to the approved methodology for the calculation of quantities of natural gas, i.e. the calculation of revenue takes into account mismatches between quantities of gas declared by household customers and quantities of gas used by them (an accrual basis). Revenue from household consumers do not form a significant part of the gas revenues.

(c) Revenue from new customer connection to the electricity network

Fees received after 1 July 2009 for the connection of new customers, producers and for the dislocation or reconstruction of electricity network objects or facilities upon the request of the customer, producer or any other entity, are recognised as revenue upon connection.

The above-mentioned fees received before 1 July 2009 were initially recognised as accrued deferred revenue and subsequently recognised as revenue on a proportionate basis over the useful life of the newly created property, plant and equipment concerned. The related costs comprising the acquisition cost of property, plant and equipment and other costs were capitalised and are depreciated over the estimated useful life of the assets capitalised.

(d) Revenue from new customer connection to the Company's natural gas distribution network

Payments made by users for the connection to the Company's gas system are recorded as deferred revenue in the statement of financial position and recognised as revenue over the depreciation period of the capitalised property, plant and equipment concerned. Such revenue is shown in the line item 'Sales revenue' in the statement of comprehensive income.

(e) Revenue from sale of services

Revenue from sale of services is recognised during the period in which the services have been rendered with reference to the stage of completion of the specific transaction which is determined as a percentage of services actually rendered as compared to the total services to be rendered.

(f) Revenue from sale of goods

Revenue from sale of goods is recognised when all the risks relating to loss of or damage to goods have been transferred to the Company's buyer in accordance with the standard sale terms and conditions (INCOTERMS) agreed with the buyer, the amount of revenue can be measured reliably, and the collection of the related receivable amounts is certain.

(g) Interest income

Interest income is recognised on accrual basis (using the effective interest rate method). Interest received is recorded in profit or loss in the statement of profit or loss and other comprehensive income as finance income.

(h) Dividend income

Dividend income is recognised when the right to receive payment is established.

2.18 Impairment of assets

(a) Financial assets

At each reporting date the Company assesses whether there is an indication that financial assets may be impaired. A financial asset is deemed to be impaired if there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial assets. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. For financial assets carried at amortised cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows, estimated using the original effective interest rate.

The carrying amount of the financial asset is directly reduced by the amount of estimated impairment loss, except for trade receivables, for which impairment is recorded through allowance account. Impaired trade receivables are written-off when they are identified as irrecoverable.

If subsequent to the reporting date the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed and recognised in the statement of comprehensive income to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date that would have been determined had no impairment loss been recognised for the asset in prior years.

(b) Non-financial assets

The Company's non-financial assets are assessed for impairment when events and circumstances indicate that the value of assets may not be recoverable. Where the carrying amount of an asset exceeds its recoverable amount, impairment loss is accounted for in profit or loss. The recoverable amount is the higher of an asset's fair value, less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The previously recognised impairment loss is reversed when there are indications that recognised loss on impairment of an asset no longer exists or has reduced significantly. Reversal is accounted for in profit or loss under the same item as impairment loss.

2.19 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

2.20 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to the shareholders by the weighted average number of ordinary registered shares in issue during the period. Where the number of shares changes without causing a change in the economic resources, the weighted average number of ordinary registered shares is adjusted in proportion to the change in the number of shares as if such change happened at the beginning of the previous reporting period presented. The Company has no dilutive instruments, therefore, basic and diluted earnings per share do not differ.

2.21 Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements but disclosed when an inflow of income or economic benefits is probable.

2.22 *Events after the end of the reporting period*

All subsequent events after the end of the reporting period (adjusting events) are accounted for in the financial statements if they relate to the reporting period and have significant impact on the financial statements. All subsequent events that are significant but not adjusting events are disclosed in notes to the financial statements.

2.23 *Inter-company offsetting*

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

2.24 *Regulated activities*

The National Control Commission for Prices and Energy regulates the Company's level of profitability by approving the prices of services for the next year. The level of prices depends on expected costs of the next year, expected volume of services provided, the variance between profit earned during the prior periods and the regulated amount of profit and other matters.

Actual costs incurred by the Company during the year may differ from budgeted costs at the time of the approval of prices and the actual volume of services may differ from the expected volume. As a result, the Company's actual profit may deviate from the regulated level and the difference will affect the prices of future services.

The Company does not recognise regulatory assets or liabilities that would be used to adjust the current year profit in order to arrive at the regulated level of profit, if this difference is recovered / returned in the course of service provision in future.

3 Critical accounting estimates

The preparation of financial statements according to International Financial Reporting Standards requires the Company to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and costs and contingencies.

The areas where estimates are significant to the financial statements are presented below.

Disposal of NT Valdos, UAB

On 27 April 2015, LESTO AB sold to Lietuvos Energija UAB 1,692,666 ordinary registered shares of NT Valdos UAB representing 57.30% of the share capital of NT Valdos UAB. The Agreement on Sale of Shares stipulates that the sale price comprises the basic sale price and the premium to the basic sale price, which will be paid by 31 March 2019. The amount of the price premium depends on the amount of the normalised EBITDA to be achieved by NT Valdos UAB in 2018. The Company accounted for the sale price premium at the highest value as at 31 December 2015 under the line item 'Other non-current financial assets' in the statement of financial position, because, in management's view, the maximum financial covenants set forth in the Agreement on Sale of Shares will be met. As at 31 December 2016, the Company recognised impairment in respect of the sale price (Notes 7, 9), because, in management's view, risk exists that the financial covenants set forth in the Agreement on Sale of Shares will not be met in full. For the purpose to determine the level of normalized EBITDA in 2018, the Company has considered actual operating results of NT Valdos, UAB in 2016, plans for 2017 and forecasts of Lithuanian GDP.

Revaluation and impairment of property, plant and equipment

At the reporting date of 31 December 2016, the Company's assets were tested for impairment using the discounted cash flow method. Discounted cash flows were calculated in accordance with the legal acts and methodologies regulating the activities of gas, electricity distribution and supply activity, effective as at 31 December 2016.

The test included the cash flow forecasts until 2071 for the natural gas operating segment as the gas distribution activity is regulated on the basis of the regulated base of property, plant and equipment, which mostly consists of assets with long useful life (55 years); a continuous cash flow has been estimated beyond the year 2071. The assessment of the fair value of property, plant and equipment used in the electricity operating segment as at 31 December 2016 included the cash flow forecasts until 2056 as the distribution activity is regulated on the basis of the regulated base of property, plant and equipment, which mostly consists of assets with long useful life (40 years) – electricity lines. The Company has determined, that fair value of property, plant and equipment of electricity and natural gas operating segments (which is also recoverable amount for property, plant and equipment accounted at cost) differs from book value of this property not more than 5 percent. In the opinion of the management this difference is not material, therefore the Company's management decided that no adjustments for fair value and recoverable amounts will be made.

New customer connection fees

Fees paid by customers received after 1 July 2009 for the connection of new customers, producers to the Company's electricity networks and for the dislocation or reconstruction of electricity network objects or facilities upon the request of the customer, producer or any other entity, are recognised as revenue upon connection.

The above-mentioned fees received before 1 July 2009 were initially recognised as deferred revenue and subsequently recognised as revenue on a proportionate basis over the useful life of the related newly created property, plant and equipment. The related costs comprising the acquisition cost of property, plant and equipment and other costs were capitalised and are depreciated over the estimated useful life of the assets capitalised.

Payments made by customers for the connection to the Company's gas system are recorded as accrued deferred revenue in the statement of financial position and recognised as revenue over the useful life of the capitalised property, plant and equipment concerned. Such revenue is shown in the line item 'Sales revenue' in the statement of comprehensive income.

Accounting methods applied to account for fees paid by new customers for the connection to the electricity and gas system differ depending on the pricing of these services:

- the fee for the connection to the electricity network is determined on the basis of fees and methodologies approved by the Lithuanian legal acts and regulatory authorities; the service is deemed to be provided upon the connection of the customer to the electricity network;
- the fee for the connection of non-household customers to the gas system is determined on the basis of fees and methodologies approved by the Lithuanian legal acts and regulatory authorities, however, the connection agreement of the customer who connects a new natural gas system stipulates a minimum quantity of gas to be transported via a non-household customer or new natural gas system and the minimum capacities which ensure that the new customer or new natural gas system connected does not increase the price cap for the existing customers, as well as the procedure for calculating a fee for the minimum quantities of gas to be transported by a non-household customer or natural gas system and for the minimum capacities and the periodicity of payments if a new customer connecting a new natural gas system transports lower quantities or orders lower capacities than those specified in the new customer connection agreement. When approving the connection fees for household natural gas customers, the National Control Commission for Prices and Energy assesses the 20-year return on investments allocated for the connection of new natural gas household customers and their impact on the price cap of the natural gas distribution system (investments should not exceed the current price cap) under the same principle as used for non-household natural gas customers, yet not on an individual level of a customer, but by establishing an overall connection fee. In this case the service provided to the non-household and household customer is continuous in nature, related to contractual obligations and future consumption, and therefore revenue is split over the depreciation period of property, plant and equipment concerned.

Accounting for electricity meters

Until 1 January 2016, LESTO AB classified electricity meters as inventories. The Company's management assessed that electricity meters are used for a long period of time, they are controlled by the Company and reviewed individually, their acquisition cost can be measured reliably and therefore management decided to reclassify electricity meters to property, plant and equipment and apply a tax depreciation period of 8 years. This change is treated as a change in an accounting estimate, therefore with effect from 1 January 2016, electricity and gas meters are classified within the property, plant and equipment category 'Other property, plant and equipment'.

Accrued revenue

Revenue received from private customers is recognised based on payments received, therefore at the end of each reporting period the amount of revenue earned but not yet paid by private customers is estimated and accrued by management. Accrued revenue is estimated as 1/3 of payments for electricity received in December. Such estimate is based on the Company's historical experience and average settlement term for electricity supplied to private customers. Management has estimated that the majority of private customers declare and pay for electricity consumed on approx. the 20th day of the month, while electricity is supplied for a full month (30 or 31 days). Consequently, the volume of electricity used over the remaining 10 days is proportionally estimated based on the total volume of electricity supplied to the electricity supply network during the month (an actually known variable) and the total volume of electricity declared by private customers during December and multiplying the difference by the average rate per 1 kWh (Note 10).

Impairment losses of amounts receivable

Impairment losses of amounts receivable were determined based on management's estimates on recoverability and timing relating to the amounts that will not be collectable according to the original terms of receivables. Recoverability rate depends on economic situation and actions taken to recover significantly overdue amounts receivable.

The Company's amounts receivable are assessed to determine their value and impairment collectively in a group of similar receivables. In case of collectively assessed receivables for impairment, the Company takes into account historical statistics on loss events in the category of similar amounts receivable. The Company reviews annually whether the provisioning rates used for collectively assessed receivables are in line with the historical data of impairment of receivables and approves the provisioning rates for collectively assessed receivables for the upcoming year. Based on the Company's estimates, receivables not past due are also assessed, the recovery of a certain percentage of which is not probable in the future. For further details, see Note 9.

Usage of overdeclared electricity

Starting from the beginning of 2015 and 2016, the Company reduced electricity prices, however, a part of private customers declared higher volume of electricity than they actually used. The Company estimated the overdeclared amount. In 2015 and 2016, the estimated difference was recognised within advance amounts received (Note 20).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

4 Property, plant and equipment

Movement on the Company's property, plant and equipment account were as follows:

	Land	Buildings	Structures and machinery	Gas distribution pipelines	Gas technological equipment and structures	Motor vehicles	Computer hardware and other communication equipment	Other PP&E	Construction in progress	Total
At 31 December 2014										
Cost	79	34,694	650,303	267,821	8,712	3,195	4,135	11,427	11,732	992,098
Accumulated depreciation	-	(28)	(2,960)	(68,883)	(3,436)	(20)	(2,987)	(21)	-	(78,335)
Impairment	-	-	-	(57,059)	(665)	-	-	-	-	(57,724)
Net book amount at 1 January 2015	79	34,666	647,343	141,879	4,611	3,175	1,148	11,406	11,732	856,039
Additions	-	167	436	15	-	780	37	111	126,898	128,444
Disposals	-	(13,617)	(471)	-	-	(73)	(70)	(423)	(21)	(14,675)
Revaluation	-	705	-	-	-	-	-	-	-	705
Write-offs	-	(14)	(2,586)	(2)	(2)	-	(2)	(14)	(43)	(2,663)
Reclassifications between groups, transferred to intangible assets, inventories, assets held for sale	-	(747)	109,517	9,018	515	23	8,034	(3,863)	(124,995)	(2,498)
Depreciation charge	-	(2,699)	(31,327)	(4,244)	(457)	(1,388)	(1,670)	(1,770)	-	(43,555)
Net book amount at 31 December 2015	79	18,461	722,912	146,666	4,667	2,517	7,477	5,447	13,571	921,797
At 31 December 2015										
Cost	79	20,364	756,315	276,809	9,187	3,836	11,527	6,980	13,571	1,098,668
Accumulated depreciation	-	(1,903)	(33,403)	(76,571)	(3,875)	(1,319)	(4,050)	(1,533)	-	(122,654)
Impairment	-	-	-	(53,572)	(645)	-	-	-	-	(54,217)
Net book amount at 1 January 2016	79	18,461	722,912	146,666	4,667	2,517	7,477	5,447	13,571	921,797
Additions	-	106	554	7	-	1,247	326	462	143,927	146,629
Disposals	-	(1)	(169)	-	-	-	(16)	-	-	(186)
Write-offs	-	(8)	(3,333)	(13)	(1)	-	(4)	(1)	-	(3,360)
Reclassifications between groups	-	687	114,039	12,887	1,225	-	743	1,876	(131,457)	-
Reclassification to/from inventories	-	-	-	-	-	-	-	-	775	775
Depreciation charge	-	(1,915)	(33,598)	(4,823)	(606)	(997)	(1,642)	(1,533)	-	(45,114)
Net book amount at 31 December 2016	79	17,330	800,405	154,724	5,285	2,767	6,884	6,251	26,816	1,020,541
At 31 December 2016										
Cost	79	21,084	866,233	228,998	9,728	5,070	12,481	9,314	26,816	1,179,803
Accumulated depreciation	-	(3,754)	(65,828)	(23,969)	(3,836)	(2,303)	(5,597)	(3,063)	-	(159,262)
Impairment	-	-	-	(50,305)	(607)	-	-	-	-	(50,912)
Net book amount at 31 December 2016	79	17,330	800,405	154,724	5,285	2,767	6,884	6,251	26,816	1,020,541

The Company's property, plant and equipment is stated at revalued amount, except for gas distribution pipelines and gas technological equipment and structures which are stated using a cost method.

Structures and machinery comprise objects related to electricity distribution.

4 Property, plant and equipment (continued)

Assessment of the fair and recoverable values of the Company's property plant and equipment in 2016

At least once a year the Company assesses whether there is any indication that the carrying amount of property, plant and equipment recorded at acquisition cost could be impaired and whether the carrying amount of property, plant and equipment recorded at the revalued amount does not differ materially from their fair value. The Company performs the impairment test and revaluation of assets, if such indications are found.

At the reporting date of 31 December 2016, the Company used the discounted cash flow method to assess the values of the assets. Discounted cash flows were calculated in accordance with the following legal acts and methodologies regulating the activities of natural gas and electricity distribution, public supply and guaranteed supply of electricity in force as at the 31 December 2016 reporting date:

- *Methodology of Setting Price Ceilings of Electricity Transmission, Distribution and Public Supply Services and Public Energy Price Ceilings* ("the Electricity Methodology") approved by the Commission's Resolution No O3-3 of 15 January 2015 and subsequent amendments;
- *Description of Requirements for Accounting Separation and Cost Allocation of Electric Power Sector Companies and Requirements Related to Accounting Separation* ("the Electricity Description") approved by the Commission's Resolution No O3-507 of 18 September 2015 and subsequent amendments;
- *Methodology of Setting the Rate of Return on Investments* ("the WACC Methodology") approved by the Commission's Resolution No O3-510 of 22 September 2015 and subsequent amendments;
- *Methodology of Setting Regulated Prices in the Natural Gas Sector* ("the Gas Methodology") approved by the Commission's Resolution No O3-367 of 13 September 2013 and subsequent amendments;
- *Description of Requirements for Accounting Separation and Cost Allocation of Natural Gas Sector Companies and Requirements Related to Accounting Separation* ("the Gas Description") approved by the Commission's Resolution No O3-112 of 18 July 2013 and subsequent amendments.

According to Company's management, the Company has two cash generating units – electricity supply and distribution (hereinafter – the Electricity Business Segment) and gas distribution (hereinafter – the Gas Business Segment), therefore the revaluations of segment-attributed assets were conducted separately for each segment.

Revaluation of property, plant and equipment attributed to the Electricity Business Segment in 2016

The Electricity Business Segment consists of property, plant and equipment recorded at the revalued amount. The fair value assessment was performed by forecasting cash flows until 2056, as the distribution activity is regulated in accordance with the regulated asset base, which mainly includes assets with a long period (40 years) of operation, i.e. electricity lines. The main assumptions used in the cash flow forecast were as follows:

In setting the price cap of the electricity distribution service for 2017 in the Certificate of 14 October 2016, the Commission approved the rate of return on investments equal to 4.94% for this period. This rate is used to determine return on investments for the period of 2017–2020. The rate of return on investments of 4.32% is applied for the entire remaining cash flow forecast period (as calculated according to the calculation data, which is publicly available on the Commission's website);

A pre-tax discount rate of 5.53% was used for discounting cash flows;

The Company's operating expenses for 2017–2025 are planned under the Company's approved long-term plans. Starting from 2026, changes are planned referring to expected changes in the average annual consumer price index and remuneration prevailing during valuation;

A part of operating expenses incurred by the Company is not included in the regulated prices of the distribution and supply activity in accordance with the provisions of the Electricity Description;

It is estimated that in different regulatory periods additional profit will be earned as a result of the planned performance efficiency of the Company (such a possibility is established in the Methodology);

Investments are shown for the period of 2017–2020 under the Company's approved strategy, for the period of 2021–2025 under the approved ten-year investment plan. Starting from 2026, investments are reduced proportionately assuming that all items of technological assets that are currently depreciated or become depreciated over the period until 2055 will be recovered until 2055;

The cost of capital (return on investments and depreciation of non-current assets) is calculated and included, when determining the prices of the distribution services for other regulatory periods, in accordance with the long-run average incremental cost (LRAIC) model approved by the Commission ("the Model") and in view of paragraph 7 of the Electricity Methodology;

Possible favourable cash flows from ongoing legal disputes were not included in the assessment by the Company;

Having assessed all above-mentioned assumptions and having performed the fair value assessment, the Company has identified that the carrying amount of property, plant and equipment attributed to the Electricity Business Segment (EUR 849 million) as at the reporting date of 31 December 2016 would increase immaterially (up to 5%). Consequently, the Company's management decided not to make adjustments to the fair value of the assets.

Sensitivity analysis. Based on the provisions set forth in paragraph 93 of IFRS 13, in 2016 the Company performed the sensitivity analysis on the impairment test in respect of changes in unobservable inputs using the following scenarios:

Sensitivity analysis scenario I. The establishment of the level of revenue from 2021 by the Commission and the application of a 10% lower rate of return on investments, i.e. equal to 3.89%, would result in the Company's revenue being lower by EUR 347 million over the forecast period and the fair value of property, plant and equipment would decrease down to EUR 757 million.

Sensitivity analysis scenario II: As a result of change in the current regulatory environment and the possibilities to generate additional profit due to the Company's operational efficiency repealed by the Commission, the fair value of the Company's property, plant and equipment would decrease down to EUR 832 million.

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

Revaluation of property, plant and equipment attributed to the Gas Business Segment in 2016

Property, plant and equipment of gas business segment comprises property, plant and equipment stated at acquisition cost and revalued amount, i.e. gas distribution pipelines and their equipment, technological gas equipment and structures that are stated using the cost method and the remaining assets are recorded at the revalued amount. The recoverable and fair values of these assets were assessed by forecasting cash flows until 2076, because the gas distribution activity is regulated with reference to the regulated asset base, which mainly consists of assets with long-term useful life, e.g. gas distribution pipelines (55 years). The main assumptions used in the cash flow forecast were as follows:

In setting the price cap of the gas distribution service for 2014–2018, the Commission approved the rate of return on investments equal to 7.09% for this period. This rate is used to determine the return on investments for the forecast cash flow period of 2016–2018. Starting from 2019 the rate of return on investments of 4.32% is applied for the entire remaining cash flow forecast period (a new regulatory period) (as calculated according to the calculation data, which is publicly available on the Commission's website);

A pre-tax discount rate of 5.53% was used for discounting cash flows;

The Company's operating expenses for 2017–2025 are planned under the Company's approved long-term plans. Starting from 2026, changes are planned referring to expected changes in the average annual consumer price index and remuneration prevailing during valuation;

A part of operating expenses incurred by the Company is not included in the regulated prices of the distribution and supply activity in accordance with the provisions of the Gas Description;

It is estimated that in different regulatory periods additional profit will be earned as a result of the planned performance efficiency of the Company (such a possibility is established in the Methodology);

Investments are shown for the period of 2017–2020 under the Company's approved strategy, for the period of 2021–2025 under the approved ten-year investment plan. Starting from 2026 and until 2071 will remain at the level of 2025.

Having assessed all above-mentioned assumptions and having performed the fair value assessment, the Company has identified that the carrying amount of property, plant and equipment attributed to the Gas Business Segment (EUR 171 million) as at the reporting date of 31 December 2016 would increase immaterially (up to 5%). Consequently, the Company's management decided not to make adjustments to the fair and recoverable values of the assets.

Sensitivity analysis. Based on the provisions set forth in paragraph 93 of IFRS 13, in 2016 the Company performed the sensitivity analysis on the impairment test in respect of changes in unobservable inputs using the following scenarios:

Sensitivity analysis scenario I. The establishment of the level of the Company's Gas Business Segment revenue from 2019 by the Commission and the application of a 10% lower rate of return on investments, i.e. equal to 3.89%, would result in the Company's Gas Business Segment revenue being lower by EUR 46 million over the forecast period and the fair value property, plant and equipment would decrease down to EUR 159 million.

Sensitivity analysis scenario II. As a result of change in the current regulatory environment and the possibilities to generate additional profit due to the Company's operational efficiency repealed by the Commission, the fair value of the Company's Gas Business Segment property, plant and equipment would remain unchanged and would amount to EUR 171 million.

The distribution of the fair value of the Company's property, plant and equipment as at 31 December 2016.

Company	Level 1	Level 2	Level 3	Total
	Quoted prices in active markets	Other directly or indirectly observable inputs	Unobservable inputs	
Land	-	-	79	79
Buildings	-	-	17,330	17,330
Structures and machinery	-	452	799,953	800,405
Motor vehicles	-	1,039	1,687	2,726
Other PP&E, computer hardware and other communication equipment	-	-	13,135	13,135
Construction in progress	-	-	26,816	26,816
Fair value at 31 December 2016	-	1,491	859,000	860,491

If no revaluation had been carried out for PP&E, the net book values of the Company's PP&E would have been as follows as at 31 December 2016 and 2015:

Company	Land	Buildings	Structures and machinery	Motor vehicles	Computer, communication hardware, other office equipment	Other PP&E	Construction in progress	Total
At 31 December 2016	109	34,976	958,370	2,919	12,382	6,329	26,816	1,041,901
At 31 December 2015	109	39,690	890,593	2,555	14,116	5,588	12,308	964,959

Revaluation of the Company's property plant and equipment in 2015

At the reporting date of 31 December 2015, the Company used the discounted cash flow method to assess whether the carrying amount of its property, plant and equipment does not materially differ from fair value. Discounted cash flows were calculated in accordance with the legal acts and methodologies regulating the distribution and supply activities in force as at the 31 December 2015 reporting date.

Having assessed all assumptions and having performed the assets' fair value test, the Company has identified that the carrying amount of property, plant and equipment does not materially differ from its fair value.

The assets attributable to the Company's Electricity Business Segment (AB "Lesto") previously was revalued as at 31 December, 2014. The fair value was determined with reference to AB "Lesto" PP&E valuation report by UAB „Ernst & Young Baltic“. The fair value of assets was determined using the income and cost approach. The revaluation of the buildings and related structures attributable to the Company's Gas Business Segment previously was conducted as at 31 December, 2015. The fair value was based on the value determined by independent property valuers "Korporacija Matinkai", UAB and "Ober-Haus", UAB real estate. The valuation was performed using the market approach.

The table below presents the results of the revaluation performed in 2015.

2015	Recognised in other comprehensive income as revaluation reserve	Recognised as (expenses)/reduction of expenses	Total
Buildings	521	184	705
Total	521	184	705

Information on the distribution of the fair value of the Company's revalued property, plant and equipment by hierarchy level is presented below. The fair value hierarchy:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices);
- Level 3 – inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The distribution of the fair value of the Company's property, plant and equipment by hierarchy level is as follows as at 31 December 2015:

Company	Level 1	Level 2	Level 3	Total
	Quoted prices in active markets	Other directly or indirectly observable inputs	Unobservable inputs	
Land	-	-	79	79
Buildings	-	228	18,233	18,461
Structures and machinery	-	15	722,897	722,912
Motor vehicles	-	1,734	783	2,517
Other PP&E, computer hardware and other communication equipment*	-	-	12,387	12,387
Construction in progress**	-	-	12,297	12,297
Fair value at 31 December 2015	-	1,977	766,676	768,653

*Until 1 January 2016, Lietuvos Dujos AB accounted for computer, communication hardware and other office equipment (with the net book amount equal to EUR 537 thousand as at 31 December 2015) and construction in progress (with the net book amount equal to EUR 1,274 thousand as at 31 December 2015) at acquisition cost and therefore it did not disclose information on the fair value distribution in its separate financial statements for the year ended 31 December 2015. Based on the assessment of the Company's management the carrying amount of this property, plant and equipment approximates its fair value, therefore it was attributed to Level 3 of the fair value hierarchy in preparing the financial statements for the year 2016

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

5 Intangible assets

	Patents and licences	Computer software	Other intangible assets	Projects in progress	Total
At 31 December 2014					
Cost	1,141	7,117	221	177	8,656
Accumulated amortisation	(806)	(4,496)	(178)	-	(5,480)
Net book amount at 1 January 2015	335	2,621	43	177	3,176
Additions	86	114	44	1,943	2,187
Write-offs	-	(91)	-	-	(91)
Reclassification between groups, to/from PP&E	-	1,305	11	(1,316)	-
Amortisation charge	(156)	(1,483)	(21)	-	(1,660)
Net book amount at 31 December 2015	265	2,466	77	804	3,612
At 31 December 2015					
Cost	1,164	8,008	226	804	10,202
Accumulated amortisation	(899)	(5,542)	(149)	-	(6,590)
Net book amount at 1 January 2016	265	2,466	77	804	3,612
Additions	-	7	60	2,138	2,205
Reclassification between groups, to/from PP&E	1,023	1,109	(66)	(2,066)	-
Amortisation charge	(143)	(2,061)	(40)	-	(2,244)
Net book amount at 31 December 2016	1,145	1,521	31	876	3,573
At 31 December 2016					
Cost	1,333	9,835	290	876	12,334
Accumulated amortisation	(188)	(8,314)	(259)	-	(8,761)
Net book amount at 31 December 2016	1,145	1,521	31	876	3,573

6 Investments in joint ventures and associates

Investments in associates

Movements on the account of investments in associates in 2016 and 2015 were as follows:

	2016	2015
Carrying amount at 1 January	2,018	1,374
Acquisition of significant influence in associates	-	632
Profit (loss) from investments in associates	328	12
Carrying amount at 31 December	2,346	2,018

The condensed statements of financial position and the condensed statements of comprehensive income of the associates for the year 2016 (unaudited data) and the year 2015 (audited data) are presented below.

Condensed statement of financial position	Technologijų ir Inovacijų Centras UAB		Verslo Aptarnavimo Centras UAB	
	2016	2015	2016	2015
Current assets and liabilities				
Cash and cash equivalents	298	862	527	379
Other current assets	2,681	3,535	1,916	688
Total current assets	2,979	4,397	2,443	1,067
Other current liabilities	(3,221)	(2,936)	(1,795)	(638)
Total current liabilities	(3,221)	(2,936)	(1,795)	(638)
Non-current assets and liabilities				
Property, plant, and equipment	6,153	5,263	1	1
Other non-current assets	1,019	-	71	34
Total non-current assets	7,172	5,263	72	35
Other non-current liabilities	(47)	(39)	-	-
Total non-current liabilities	(47)	(39)	-	-
Net assets	6,883	6,685	720	464

Condensed statement of comprehensive income	Technologijų ir Inovacijų Centras UAB		Verslo Aptarnavimo Centras UAB	
	2016	2015	2016	2015
Revenue	14,500	14,362	9,724	3,826
Profit before income tax	311	531	312	53
Income tax benefit/(expenses)	87	(74)	(56)	12
Profit after income tax	398	457	256	65
Other comprehensive income	-	-	-	-
Total comprehensive income for the year	398	457	256	65
Dividends received from the associate	-	-	-	-

Condensed financial information	Technologijų ir Inovacijų Centras UAB		Verslo Aptarnavimo Centras UAB	
	2016	2015	2016	2015
Net assets at the beginning of the period (1 January)	6,685	5,731	464	367
Formation/cancellation of authorised share capital, changes in reserves	-	497	-	32
Dividends	(200)	-	-	-
Profit (loss) for the period	398	457	256	65
Other comprehensive income	-	-	-	-
Net assets at the end of the period (31 December)	6,883	6,685	720	464
Ownership interest	29%	29%	22%	22%
Investment in the associate	1,877	1,877	129	129
Carrying amount	2,188	1,898	158	120

Investments in joint ventures

On 6 November 2015, under the agreement on the purchase and sale of shares the Company transferred to Amber Grid AB all its shares of joint venture GET Baltic UAB, which represent 34% of the authorised share capital of GET Baltic UAB. The shares were sold for the market share price established by the independent property valuer amounting to EUR 130,832.

Movements in investments in joint ventures are summarised below.

2015	
Carrying amount at 1 January	123
Disposal of joint ventures	(99)
Gain/(loss) on investments in joint ventures	(24)
Carrying amount at 31 December	-

Gain on the disposal of the joint venture was calculated as follows:

2015	
Proceeds from disposal	131
Carrying amount of investment in the associate	(99)
Gain on disposal of investment in the joint venture	32

7 Other non-current financial assets

Other non-current financial assets consist of the non-current portion of mortgage loans granted to private individuals for a period of 25 years and available-for-sale financial assets:

	2016	2015
Non-current portion of mortgage loans granted	340	419
Available-for-sale financial assets	5,306	10,214
Other non-current receivables	190	-
Total	5,836	10,633

Available-for-sale financial assets consists of a part of the amount payable by Lietuvos Energija UAB for the premium to the basic sale price established for the shares of NT Valdos UAB, which is to be settled after 31 March 2019. The amount of the price premium depends on the amount by which the normalised EBITDA of NT Valdos UAB in 2018 will exceed the limit specified in the agreement. The fair value of the price premium is attributed to Level 3 in the fair value hierarchy.

On 31 December 2016, the Company's management reviewed the assessment of the amount of the sale price premium and determined that the fair value of the price premium for shares was equal to EUR 5,306 thousand as at 31 December. Impairment of EUR 5,560 thousand was presented in the line item 'Impairment and write-off expenses' in the statement of comprehensive income. The result of the discounting of the price premium equal to EUR 652 thousand was presented in the line item 'Income from financing activities'.

The mortgage loans are repayable in instalments till 2027. These loans are secured over residential housing property. In 2016, the current portion of these loans amounted to EUR 74 thousand (2015: EUR 82 thousand) and was accounted for under trade and other receivables (Note 9). These loans were issued at a fixed interest rate ranging from 0.1% to 1%.

	2016 m.	2015 m.
Fair value of mortgage loans granted	520	635
Carrying amount of mortgage loans granted	414	500

The fair value of mortgage loans was estimated based on discounted cash flows at a rate of 1.68% (31 December 2015: 1.78%). The discount rate corresponds to the interest rate on loans granted to non-financial entities and households as published by the Bank of Lithuania. The fair value of mortgage loans is within Level 3 of the fair value hierarchy. The weighted average effective interest rate used by the Company for discounting of mortgage loans was 7.82% as at 31 December 2016 (2015: 7.74%). The fair value of finance lease receivables does not significantly differ from the carrying amount.

8 Inventories

	2016	2015
Raw materials and spare parts	1,186	1,296
Electricity meters	-	775
Fuel	47	137
Other	543	374
Less: write-down allowance for inventories	(45)	(38)
Total	1,731	2,544

As disclosed in Note 3, with effect from 2016 the Company records electricity meters as property, plant and equipment and therefore electricity meters included in inventories as at 31 December 2015 were reclassified to property, plant and equipment (Note 4).

Movements in the inventory write-down allowance account in 2016 and in 2015 were as follows:

	2016	2015
Inventory write-down at the beginning of the period	38	688
Increase in inventory write-down	29	16
Write-off/(reversal) of inventory write-down	(22)	(666)
Inventory write-down at the end of the period	45	38

9 Trade and other receivables

	2016	2015
Trade receivables for electricity	53,090	53,178
Receivables from users of the system (non-household customers) for distribution of natural gas	1,595	3,597
Other trade receivables	547	1,529
Short-term loans granted to related parties (<i>Cashpool</i>)	1,502	-
Amount receivable for disposal of NT Valdov	-	24,468
Trade and other receivables from related parties (Note 28)	11,954	24,672
Current portion of mortgage loans	77	82
Other receivables	647	1,684
Less: impairment allowance for doubtful receivables	(7,230)	(8,393)
Total	62,182	100,817

The fair values of trade and other receivables approximate their carrying amounts.

Impairment provision for trade receivables is recognised when it is probable that the debtor will enter bankruptcy, fails to fulfil obligations or the payment is overdue. Based on the Company's estimates, with effect from 2013, receivables not past due are also assessed, the recovery of a certain percentage of which is not probable in the future.

Current portions of mortgage loans are disclosed at a net present value and are not past due.

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

The Company's trade and other receivables that were not classified as doubtful:

	2016	2015
Not past due	52,604	92,612
Past due up to 1 month	2,035	2,083
Past due from 1 to 2 months	1,184	1,222
Past due over 2 months	4,783	4,818
Total	60,606	100,735

Trade receivables are non-interest bearing and are normally settled over the term of 25 to 35 days.

The Company's trade and other receivables that were impaired:

	2016	2015
Past due up to 3 months	554	802
Past due from 3 to 6 months	147	331
Past due from 6 to 12 months	605	729
Past due over 1 year	5,924	6,531
Total	7,230	8,393

Movements in the Company's impairment allowance account for trade and other receivables in 2016 and 2015 were as follows:

Balance at 1 January 2015	8,786
Impairment charge for the year	1,154
Write-offs	(1,537)
Reversal of unused amounts	(10)
Balance at 1 January 2016	8,393
Impairment charge for the year	1,349
Write-offs	(2,512)
Balance at 31 December 2016	7,230

10 Prepayments, deferred expenses and accrued revenue

	2016	2015
Accrued revenue from sales of electricity	4,992	5,143
Prepayments for services	982	239
Other prepayments, deferred expenses, other accrued revenue	337	115
Total	6,311	5,497

11 Cash and cash equivalents, and term deposits

Cash and cash equivalents

	2016	2015
Cash at bank	10,662	26,961
Total	10,662	26,961

Cash and cash equivalents include the following for the purpose of the cash flow statement:

	2016	2015
Cash and cash equivalents	10,662	26,961
Bank overdraft (Note 15)	-	(21,125)
Total	10,662	5,836

Presented below is the analysis of the credit quality of balances of cash and cash equivalents based on ratings established by the rating agency Moody's:

	2016	2015
Aa2	3004	-
Aa3	6,836	25,796
A1	-	-
A2	822	-
A3	-	1,165
Iš viso:	10,662	26,961

12 Share capital

As at 31 December 2016, the Company's authorised share capital was divided into 894,630,333 ordinary registered shares with a nominal value of EUR 0.29 each. All the shares have been fully paid. Information on the authorised share capital of LESTO AB and Lietuvos Dujos AB as at 31 December 2015 and reorganisation terms is presented in Note 1.

13 Reserves

Legal reserve

A legal reserve is a compulsory reserve under Lithuanian legislation. Annual transfers of not less than 5 per cent of net profit are required until the reserve reaches 10 per cent of the share capital. As at 31 December 2016 and 2015, the legal reserve amounted to EUR 25,910 thousand. The legal reserve can be used only to cover the Company's loss. When the legal reserve is used to cover the loss, the legal reserve is re-established from distributable profit in accordance with the procedure set in Article 59(5) of the Law on Companies.

Revaluation reserve

Revaluation reserve arises from revaluation of property, plant and equipment due to the value increase. This reserve cannot be used to cover losses.

	Revaluation reserve	Deferred income tax	Net of deferred income tax
Balance at 1 January 2015	77,642	(11,646)	65,996
Transfer of revaluation reserve to retained earnings during the year (depreciation, write-offs, disposals)	(12,846)	1,927	(10,919)
Increase in the reserve due to valuation of assets	521	(78)	443
Balance at 31 December 2015	65,317	(9,797)	55,520
Balance at 1 January 2016	65,317	(9,797)	55,520
Transfer of revaluation reserve to retained earnings during the year (depreciation, write-offs, disposals)	(6,654)	998	(5,656)
Balance at 31 December 2016	58,663	(8,799)	49,864

14 Dividends

Declared dividends per share:

	2016	2015
Declared dividends (in EUR thousand)	43.120	72.162
Weighted average number of shares (thousands)	894.630	894.630
Declared dividends per share (in EUR per share)	0,048	0,081

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

The ordinary general meeting of shareholders of Energijos Skirstymo Operatorius AB was held on 29 March 2016 where it was decided to approve the profit appropriation for July–December 2015 and to allocate EUR 0.0342 per share in dividends, in total EUR 30,596 thousand in dividends.

The ordinary general meeting of shareholders of Energijos Skirstymo Operatorius AB was held on 26 September 2016 where it was decided to approve the profit appropriation for January–June 2016 and to allocate EUR 0.014 per share in dividends, in total EUR 12,524 thousand in dividends.

The ordinary general meeting of shareholders of LESTO AB was held on 27 April 2015 where it was decided to approve the profit appropriation for the year 2014 and to allocate EUR 0.02 per share in dividends, in total EUR 12,079 thousand in dividends.

The ordinary general meeting of shareholders of Lietuvos Dujos AB was held on 27 April 2015 where it was decided to approve the profit appropriation for 2014 and to allocate EUR 0.0963 per share in dividends, in total EUR 27,993 thousand in dividends.

The extraordinary general meeting of shareholders of LESTO AB was held on 24 September 2015 where it was decided to allocate EUR 0.0360 per share in dividends to the Company's shareholders for the six-month period ended 30 June 2015, in total EUR 21,742 thousand in dividends.

The extraordinary general meeting of shareholders of Lietuvos Dujos AB was held on 24 September 2015 where it was decided to allocate dividends to the shareholders of Lietuvos Dujos AB for a period shorter than the financial year. Dividends amounting to EUR 0.0356 per share of Lietuvos Dujos AB were allocated to the shareholders, in total EUR 10,348 thousand in interim dividends.

15 Borrowings

	2016	2015
Non-current borrowings		
Borrowings from banks	161,650	147,576
Current borrowings		
Bank overdraft (Note 11)	-	21,125
Borrowings from banks	57,431	78,284
	57,431	99,409
Total borrowings	219,081	246,985

All borrowings of the Company bear variable interest rate with repricing period up to 6 months. No assets have been provided as collateral for borrowings.

Non-current borrowings by maturity:

	2016	2015
Between 1 and 2 years	87,150	39,926
Between 2 and 5 years	74,500	107,650
	161,650	147,576

The average interest rates (%) at the financial reporting date:

	2016	2015
Bank overdraft	0.55	0.61
Borrowings from banks	0.74	0.82

The Company has the following undrawn committed credit facilities expiring within or after one year:

	2016	2015
Committed credit facilities	60,000	79,337

16 Income tax

The Company's income tax expense/(income) for 2016 and 2015 comprised as follows:

	2016	2015
Current year income tax	8,496	8,930
Deferred income tax expenses	6,427	6,160
Total	14,923	15,090

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

The analysis of deferred income tax assets and deferred income tax liabilities is as follows:

	2016	2015
Deferred income tax assets:		
Deferred income tax assets to be realised after more than 12 months	4,684	13,829
Deferred income tax assets to be realised within 12 months	641	2,121
Total	5,325	15,950
Deferred income tax liabilities:		
Deferred income tax liabilities to be settled after more than 12 months	(9,472)	(14,424)
Deferred income tax liabilities to be settled within 12 months	(2,808)	(2,053)
Total	(12,280)	(16,477)

Deferred income tax assets and deferred income tax liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes relate to the same fiscal authority. The amounts offset are presented in the table below:

Deferred income tax assets	Revenue from connection of new customers	Impairment of assets	Revaluation of PP&E and differences due to different depreciation rates	Accrued expenses	Over-declared electricity	Tax loss carry-forward*	Unused investment relief	Total
At 1 January 2015	3,319	1,459	11,080	964	281	3,050	833	20,986
Income tax (expenses)/income recognised in profit or loss	(184)	(160)	(1,883)	(76)	(62)	(3,050)	379	(5,036)
At 31 December 2015	3,135	1,299	9,197	888	219	-	1,212	15,950
Income tax (expenses)/income recognised in profit or loss	(182)	(184)	(9,197)	144	6	-	(1,212)	(10,625)
At 31 December 2016	2,953	1,115	-	1,032	225	-	-	5,325

Deferred income tax liabilities	Revaluation of PP&E and differences due to different depreciation rates	Investment relief	Write-off of grants	Total
At 1 January 2015	(10,806)	(3,197)	(1,272)	(15,275)
Income tax (expenses)/income recognised in profit or loss	(1,620)	459	37	(1,124)
Recognised in other comprehensive income	(78)	-	-	(78)
At 1 January 2016	(12,504)	(2,738)	(1,235)	(16,477)
Income tax (expenses)/income recognised in profit or loss	3,745	413	39	4,197
At 31 December 2016	(8,759)	(2,325)	(1,196)	(12,280)

The amount of income tax expenses reported in the statement of profit or loss and other comprehensive income attributable to the operating result for the year can be reconciled against the amount of income tax expenses that would result from applying the statutory income tax rate of 15 per cent to profit before tax:

	2016	2015
Profit before income tax	107,425	100,568
Income tax calculated at a rate of 15% (2015: 15%)	16,114	15,085
Expenses not deductible for tax purposes	1,281	175
Income not subject to tax	(285)	(16)
Income tax relief for investments	(2,109)	(863)
Tax loss not carried forward	-	753
Adjustments of income tax in respect of prior years	11	14
Support, charity	(124)	(8)
Other	35	(50)
Total	14,923	15,090

17 Deferred revenue

	2016	2015
Deferred revenue from customer connection fees	113,258	117,272
Deferred revenue from public service obligations (PSO) services	285	297
Total	113,543	117,569

Deferred revenue from customer connection fees:

	2016	2015
Opening balance	121,624	124,619
Received during the year	1,972	2,136
Recognised as revenue in the statement of profit or loss and other comprehensive income	(5,169)	(5,131)
Closing balance	118,427	121,624

	2016	2015
Non-current portion	113,258	117,272
Current portion	5,169	4,352
Total	118,427	121,624

With effect from 1 July 2009, all revenue from the connection of new customers to electricity equipment and from the dislocation of electricity lines received from customers are recognised in the period during which works were performed. Before 1 July 2009, accrued revenue used to be recognised as revenue over the average useful life of property, plant and equipment concerned.

Payments made by users for the connection to the Company's gas system are recorded as deferred revenue and recognised as revenue over the average useful life of the capitalised property, plant and equipment concerned. Such revenue is shown in the line item 'Sales revenue' in the statement of comprehensive income.

18 Grants

Balance at 31 December 2014	12,944
Received	9,823
Reversed	(7)
Coverage of expenses incurred	(9)
Amortisation charge	(1,367)
Balance at 31 December 2015	21,384
Received	424
Coverage of expenses incurred	(18)
Reversed	17
Amortisation charge	(1,330)
Balance at 31 December 2016	20,477

Grants consist of funds received from the EU Funds for the purpose of acquisition and construction of structures and electricity networks and of property, plant and equipment received at no consideration from the Government of the Republic of Lithuania. In 2015, grants included assets, which are compensated from the PSO budget, created for the purpose of connecting to electricity networks electricity producers that use renewable energy sources.

Amortisation of grants is accounted for under the line item 'Depreciation and amortisation' in the statement of profit or loss and other comprehensive income. Depreciation charges of the related property, plant and equipment are reduced by the amount of amortisation of grants.

19 Trade and other payables

	2016	2015
Trade payables	41,307	40,506
Trade payables to related parties (Note 28)	40,081	38,965
Total trade payables	81,388	79,471
Taxes (other than income tax)	1,598	4,941
Employment-related liabilities	2,073	2,141
Other current liabilities	2,865	3,318
Total other amounts payable	6,536	10,400
Trade and other payables	87,924	89,871

Other payables amounting to EUR 3,671 thousand as at 31 December 2016 (31 December 2015: EUR 7,082 thousand) are not financial instruments.

Trade payables

The above financial liabilities have the following conditions:

- Trade payables are non-interest bearing and are normally settled within the term of 60 days.
- Other payables are non-interest bearing and have an average settlement term of 6 months.

20 Advance amounts received, accrued expenses and deferred revenue

	2016	2015
Accrued charges	7,253	6,456
Current portion of deferred revenue from connection of new customers	5,169	4,353
Current portion of other deferred revenue	12	12
Advance amounts received	19,646	13,120
	32,080	23,941

As at 31 December 2016 and 31 December 2015, advance amounts received comprised advances received for the connection of new customers, advances received for electricity, and overdeclared electricity effects amounting to EUR 1,503 thousand (2015: EUR 1,458 thousand) arising from overdeclared electricity by some private customers as compared to actual consumption.

21 Revenue

	2016	2015
Electricity sales and distribution	573,602	561,341
Natural gas distribution	57,260	54,078
Income from connection of new customers	14,683	16,453
Total	645,545	631,872

22 Employee benefits and related social security contributions

	2016	2015
Wages and salaries	33,763	41,032
Termination benefits	2,110	2,750
Social security contributions	11,087	12,555
Change in vacation accrual	134	(219)
Change in social security contributions on vacation accrual	37	(27)
Total	47,131	56,090

23 Impairment and write-off expenses

	2016	2015
Impairment of available-for-sale financial assets (Note 7)	5,560	-
Write-offs of non-current assets and construction in progress	3,569	2,754
Write-offs of amounts receivable (Note 9)	1,349	1,535
Impairment (reversal of impairment) of inventories and assets held for resale	7	(651)
Impairment (reversal of impairment) of non-current assets and construction in progress	-	(233)
Impairment (reversal of impairment) of amounts receivable	(1,186)	(399)
Total	9,300	3,006

24 Other expenses

	2016	2015
Customer service expenses*	6,725	2,012
Taxes (other than income tax)	3,424	3,443
Maintenance company expenses	2,754	2,243
Consultation services	782	1,117
Payments under the collective agreement and other additional payments	368	526
Personnel development, business trips	292	436
Public relations and marketing	258	866
Insurance, medical care services	157	70
Loss on disposal of subsidiaries	-	898
Other expenses	1,799	2,187
Total	16,559	13,798

* From 1 January 2016, the Company's customer service functions (management and development of customer service channels, management of customer requests, bookkeeping and collection of payments, management of trade receivables, transmission of notifications to customers, drafting and administration of contracts, performance of other support customer service functions) were transferred to Verslo Aptarnavimo Centras UAB. The total of 240 employees changed working place to Verslo Aptarnavimo Centras UAB from 1 January 2016.

25 Financing activities

	2016	2015
Finance income		
Late-payment interest on trade receivables	449	625
Interest income from credit institutions	4	20
Interest income on loans granted	172	248
Dividends income	58	-
Other finance income	652	164
Total	1,335	1,057
Finance costs		
(Interest) paid on loans	(1,739)	(2,047)
Foreign exchange (loss)	-	(229)
Other (costs)	(485)	(287)
Total	(2,224)	(2,563)

26 Basic and diluted earnings per share

Basic

Basic earnings per share are calculated by dividing the profit attributable to shareholders of the Company by the weighted average number of ordinary shares in issue during the year.

	2016	2015
Net profit/(loss) attributable to shareholders of the Company (in EUR thousands)	92,502	85,478
Weighted average number of shares (thousands)	894,630	894,630
Basic earnings/(loss) per share (in EUR per share)	0.103	0.096

Diluted

Diluted earnings/(loss) per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. As at 31 December 2016, the Company had no dilutive potential ordinary shares issued.

27 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as Board of Directors that makes strategic decisions.

According to the management, the Company has two operating segments, i.e. supply and distribution of electric power, and distribution of gas. The Company have a single geographical segment – Republic of Lithuania. The chief operating decision-maker monitors the results with reference to the financial reports that have been prepared using the same accounting policies as those used for the preparation of the financial statements in accordance with IFRS, i.e. information on profit or loss, including the reported amounts of income and expenses, assets and liabilities.

The table below presents the Company's information on segments for the year 2016:

2016	Electricity supply and distribution	Gas distribution	Total
Revenue	591,371	58,692	650,063
Expenses	(459,604)	(27,145)	(486,749)
EBITDA	131,767	31,547	163,314
Depreciation and amortisation	(38,634)	(7,394)	(46,028)
Impairment and write-off expenses	(9,208)	(92)	(9,300)
Operating profit	83,925	24,061	107,986
Finance income	1,138	197	1,335
Finance (costs)	(1,786)	(438)	(2,224)
Share of (profit) of associates	267	61	328
Profit before income tax	83,544	23,881	107,425
Income tax	(12,158)	(2,765)	(14,923)
Net profit for the period	71,387	21,116	92,502

The table below presents the Company's information on segments for the year 2015:

2015	Electricity supply and distribution	Gas distribution	Total
Revenue	581,632	56,234	637,866
Expenses	(456,743)	(32,215)	(488,958)
EBITDA	124,889	24,019	148,908
Depreciation and amortisation	(34,793)	(9,055)	(43,848)
Impairment and write-off expenses	(3,140)	134	(3,006)
Operating profit	86,956	15,098	102,054
Finance income	1,028	29	1,057
Finance (costs)	(2,411)	(152)	(2,563)
Share of (profit) of associates and joint ventures		(12)	(12)
Gain on disposal of investments in joint venture		32	32
Profit before income tax	85,573	14,995	100,568
Income tax	(12,967)	(2,123)	(15,090)
Net profit for the period	72,606	12,872	85,478

28 Related-party transactions

The Company's related parties are as follows:

- Lietuvos Energija, UAB (the main shareholder of the Company) and its subsidiaries and associates;
- Associates of the Company;
- Management of the Company including companies in which they hold executive positions or companies which are controlled by them or over which a significant influence is exercised;
- All companies which are owned by the state or over which the state exercises a significant influence (transactions with these companies are disclosed when they are material).

Purchase and sale of goods and services

The Company's transactions with related parties between January and December of 2016 and the balances arising on these transactions as at 31 December 2016 are presented below:

Related party	Amounts payable and accrued expenses	Amounts receivable and unbilled revenue	Purchases	Sales
Parent company Lietuvos Energija UAB	235	5,823	6,310	781
Associates of the Company	2,565	3	17,925	79
Other companies of Lietuvos Energija UAB group	7,797	9,027	82,403	48,414
Companies of EPSO – G UAB group	29,484	4,099	198,742	920
Total	40,081	18,952	305,380	50,194

Amounts receivable from Lietuvos Energija, UAB include non-current available for sale financial assets amounting to EUR 5.306 thousand (Note 7) and short-term loan EUR 517 thousand.

With the purpose to reduce costs of working capital financing, on 18 May 2016 the Company has concluded not terminated Lietuvos energija, UAB Group intercompany borrowing agreement, according to this agreement it can obtain short term loans from other Group companies. Borrowing limit set until 26 April 2017 is EUR 30,000 thousand. Intragroup borrowing transactions have to be concluded in accordance with market terms and with interest rates, which would be set in the market. Market interest rate is determined for the one year period and coincides with interest rates of commercial banks.

At 31 December 2016 the Company has lent EUR 1,502 thousand.

The company purchased the following goods and services from subsidiaries and associates: leases of assets, information technology and telecommunication services, organization and execution of tenders, accounting and personnel administration services, also construction, reconstruction and maintenance of electric equipment. The main share of purchases from Lietuvos energija UAB group companies belongs to purchase of electricity. Companies of Litgrid AB group provide electricity transmission services and public service offerings (PSO)

The Company's transactions with related parties between January and December of 2015 and the balances arising on these transactions as at 31 December 2015 are presented below:

Related party	Amounts payable and accrued expenses	Amounts receivable and unbilled revenue	Purchases	Sales	
				Goods and services	Disposal of subsidiaries and associates
Parent company Lietuvos Energija UAB	263	34,682	1,029	326	58,982
Associates	2,175	-	12,031	-	-
Companies of Lietuvos Energija UAB group	11,227	20,127	165,611	56,032	-
Companies of EPSO – G, UAB group	25,300	4,573	162,704	5,608	-
Total	38,965	59,382	341,375	61,966	58,982

Compensation to key management personnel

Company	2016	2015
Wages and salaries and other short-term benefits to management personnel	530	1,174
Whereof: termination benefits	-	300
Number of key management personnel	7	10

In 2016, management included the heads of administration and their deputies. Until 31 May 2016, management of Lietuvos Dujos AB included the head of administration and his/her deputies, directors of branches, the chief financier. With effect from 1 June 2015, management of Lietuvos Dujos AB includes the Board members. In 2015, management of LESTO included the heads of administration and their deputies.

29 Commitments and contingencies

Buyout of electricity equipment

In 2016, the Company executed a simplified procedure of the buyout of electricity objects (electricity networks) installed for common use using the funds of homestead owners in line with the deadlines stipulated in Resolution No 1257 of 31 August 2010 of the Lithuanian Government *On the establishment of deadlines for the buyout from cooperatives the electricity transmission and distribution lines, transformer substations, electric facilities and other equipment designated for the transmission and distribution of electricity and installed in the territory of homestead owners using the funds of such homestead owners*, i.e. by 1 July 2011 (had to be bought out until 1 July 2011).

In 2016, 7 units of electricity networks of common use for the value of EUR 2,356 thousand (2015: 4 units of electricity networks for the value of EUR 26 thousand) was bought out. During the period from the start date of the buyout process until 31 December 2016, 951 units of electricity networks of common use of homestead cooperatives for the value of EUR 3,461 thousand were bought out. As at 31 December 2016, 3 applications with requests to buyout equipment on concessionary terms remained unsettled with the value of EUR 20 thousand.

Capital expenditure commitments

In 2016, the Company's capital expenditure commitments assumed under the signed contracts as at the date of the financial statements but not accounted for in the financial statements amounted to EUR 26,907 thousand (31 December 2015: EUR 11,694 thousand).

Additionally received revenue

Based on Resolution No O3-308 of 14 October 2016 *On recalculating the price caps for electricity distribution services provided by Energijos Skirstymo Operatorius AB through medium and low voltage networks for the year 2017*, the Commission set the price cap for the distribution service for 2017 on the basis of Certificate No O5-258 of 13 October 2016 where it also stated that in the period from 2014–2015 the Company earned additional return on investments amounting to EUR 84,961.6 thousand which exceeded the level of profit permitted by the Commission. The Commission decided to adjust the price caps for the distribution services for 2017 by 1/3 of the 2014–2015 return on investments presented in excess of the level of profit permitted by the Commission. Consequently, the Commission established a level of the distribution service revenue for 2017, which was lower by EUR 28,320.5 thousand.

It was decided that the remaining amount of the 2014–2015 return on investments in excess of the level of profit permitted by the Commission will be reflected by adjusting the price caps of the electricity distribution services to be set for the Company for the upcoming year of the regulatory period, but not later than by the end of the regulatory period.

In the assessment of Management the Company has earned excess profit, its exact amount and impact on future tariffs will be known in later periods.

Rent

The Company has concluded rent agreements for premises and vehicles. Terms of rent do not include any restrictions on Company's operations, related to dividends, additional borrowing or other long-term rent. In 2016 Company's rent expenses amounted to EUR 8,670 thousand (2015 – EUR 7,361 thousand).

Litigations

On 14 July 2014, the Prosecution Service of the Republic of Lithuania filed an indictment to Vilnius City District Court whereby Lietuvos Dujos AB and its former employees were charged with allegedly causing damage in establishing the supply activity tariffs for domestic users. The investigation of the case at Vilnius City District Court was started on 13 August 2014. The Prosecutor General requested the court to impose a fine on Lietuvos Dujos AB amounting to 25,000 times the minimum monthly wage or EUR 950 thousand. Lietuvos Dujos AB objected to the charges and requirements of the Prosecution Service. On 27 February 2015, Vilnius City District Court passed an acquittal whereby it acquitted Lietuvos Dujos AB as it was not established that the acts attributed were made. On 18 March 2015, the Prosecutor General appealed against the acquittal. Having investigated the case the court of appeals passed a ruling on 12 December 2016 whereby the acquittal passed by the court of the first instance was left unchanged.

On 18 March 2015, Amilina AB filed a claim to respondent Lietuvos Dujų Tiekimas UAB regarding the amendment to the pricing rules (formulas for the calculation of the price of natural gas established in the agreements) established in the agreements on the natural gas supply dated 19 December 2012 and 6 December 2013 and the awarding of the overpayment for natural gas acquired. The initial claim amount was equal to EUR 1.266 million and consisted of the following two elements: the natural gas price overpayment amounting to EUR 1.254 million and interest amounting to EUR 13 thousand. On 27 July 2015, Amilina AB filed a revised claim by indicating Lietuvos Dujos AB as a second respondent being jointly and severally liable. On 11 April 2016, Amilina AB filed an application on the revision of the object of the claim by reducing the amount of the claim down to EUR 1.049 million (the overpayment for natural gas amounting to EUR 1.038 million and interest amounting to EUR 11 thousand). In the opinion of the Company, the claim is not substantiated, because neither the legal acts nor the agreements on the natural gas supply obliged Lietuvos Dujos AB and Lietuvos Dujų Tiekimas UAB to pay to Amilina AB any amounts due to the change in import prices of natural gas or recalculate the natural gas price in case such changes occur; Lietuvos Dujos AB has properly fulfilled its contractual obligations under the agreements. On 7 October 2016, the court of the first instance passed a ruling whereby the claim of Amilina AB was rejected. The claimant filed an appeal, the case is under investigation by the court of appeals.

On 23 January 2015, Vilniaus Energija UAB filed a claim to respondent Lietuvos Dujų Tiekimas UAB regarding the amendment to the pricing rules (formulas for the calculation of the price of natural gas established in the agreements) established in the agreements on the natural gas supply dated 28 December 2012 and 30 December 2013 and the awarding of the overpayment for natural gas acquired. The initial claim amounted to EUR 19.132 million. On 14 July 2015, Vilniaus Energija UAB filed a revised claim by indicating Lietuvos Dujos AB as a second respondent being jointly and severally liable. On 3 December 2015, Vilniaus Energija UAB filed an application on the revision of the object of the claim by reducing the amount of the claim down to EUR 15.235 million (the overpayment for natural gas amounting to EUR 15.200 million and interest amounting to EUR 35 thousand). On 21 January 2016, the court of the first instance passed the ruling whereby the claim of Vilniaus Energija UAB was rejected. On 19 February 2016, Vilniaus Energija UAB filed an appeal. On 17 November 2016, the court of appeals passed a ruling whereby the ruling of the court of the first instance was left unchanged, i.e. the claim was rejected.

On 25 March 2011, the Ministry of Energy of the Republic of Lithuania, which held 17.7% of the Company's shares by the right of trust at that date, filed a claim to Vilnius Regional Court in relation to investigation of the legal entity's operations, wherein Lietuvos Dujos AB, the Board Members of Lietuvos Dujos AB delegated by Gazprom OAO, and the Managing Director were indicated as the respondents. In its claim, the Lithuanian Ministry of Energy demanded initiation of investigation of operations of Lietuvos Dujos AB and application of relevant requirements set forth in the claim in case the results of investigation showed that operations of Lietuvos Dujos AB and/or the aforementioned Board Members and/or the Managing Director were inappropriate. During the investigation of the requirement of the Lithuanian Ministry of Energy to commence the investigation of operations of the Company, on 3 September 2012 Vilnius Regional Court ruled in favour of the claimant to initiate investigation of operations of Lietuvos Dujos AB. The Company objected to the ruling of the court of the first instance and filed an appeal against it to the Court of Appeal of Lithuania. The Court of Appeal of Lithuania left the ruling of Vilnius Regional Court unchanged. On 29 April 2013, Lietuvos Dujos AB appealed by cassation to the Lithuanian Supreme Court with request to annul the decision passed by the Lithuanian Court of Appeal on 21 February 2013, and not to proceed with the case or reject it. On 20 November 2013, the Lithuanian Supreme Court suspended a judgement until the final resolution of the civil case by the Lithuanian Supreme Court pertaining to recognition and enforcement of the decision passed by the Arbitration Institute of the Stockholm Chamber of Commerce (Kingdom of Sweden) (hereinafter "the Arbitration"). On 23 October 2015, the Lithuanian Supreme Court passed a ruling whereby it recognised and enforced the decision passed by the Arbitration Tribunal in the Republic of Lithuania and under the ruling of 28 October 2015 renewed the investigation of the case pertaining to the initiation of investigation of operations of the legal entity. On 7 December 2015, the Lithuanian Supreme Court received the request of the Lithuanian Ministry of Energy and Lietuvos Energija UAB for the inclusion of Lietuvos Energija UAB as a co-claimant and suspension of the investigation of the case until the passing of the ruling in the case investigated by the Arbitration Court of the Stockholm Chamber of Commerce, which is investigated on the basis of the claim of the Lithuanian Ministry of Energy against Gazprom OAO. On 20 January 2016, the Lithuanian Supreme Court passed a ruling whereby Lietuvos Energija UAB was included as co-claimant in the case and the request for the suspension of the case was rejected. The Lithuanian Ministry of Energy and Lietuvos Energija UAB filed a peace agreement to the court signed between the Lithuanian Ministry of Energy and Lietuvos Energija UAB, the claimants, and Energiijos Skirstymo Operatorius AB, the respondent, and the application on the waiver of the claim. On 30 March 2016, the Lithuanian Supreme Court passed a ruling whereby is accepted the waiver of the claim filed by the Lithuanian Ministry of Energy and Lietuvos Energija UAB, approved the peace agreement submitted and discontinued the civil case.

Vilniaus Energija UAB (the claimant) filed a claim to Vilnius Regional Court, whereby it requested to award damages of EUR 9.284 million from the respondent LESTO AB. The claimant insisted that it incurred losses of EUR 9.284 million because for the purpose of ensuring compliance with the Lithuanian Government Resolution No 1051 of 20 November 2013 and the provisions of agreement on purchase/sale of electricity signed with the claimant, in 2014 LESTO AB purchased only that volume of supported electricity, which was produced under the technical minimum mode at the thermal power plants owned by the claimant. The claimant noted that the legal acts stipulated a requirement whereby LESTO AB was obliged to purchase the maximum volume, and LESTO AB failed to comply with such requirement. In its claim, the claimant requested as follows: to recognise the provisions of the agreement on the purchase/sale of electricity signed between the claimant and the respondent on 30 December 2013 as void *ab initio*; to oblige the respondent to purchase the maximum volume of supported electricity in 2014 from the claimant, which was established for the claimant's two thermal power plants by the Lithuanian Government Resolution No 1051 of 20 November 2013; and to award damages of EUR 9.284 million from the respondent. The Company does not agree with the claimant's position, because the description of PSO services and other effective legal acts do not stipulate that the Company is obliged to purchase the total volume of electricity produced. On 11 January 2016, Vilnius Regional Court passed the ruling whereby it suspended the investigation of the case until the Commission establishes the price for the thermal power supplied by Vilniaus Energija UAB for the year 2016.

On November 2014 and January 2015, LESTO AB filed the complaints to Vilnius Regional Administrative Court requesting to annul the respective resolutions of the National Control Commission for Prices and Energy (the Commission), to oblige the Commission to eliminate the violations, and when determining the price caps for electricity distribution services provided by LESTO AB through medium and low voltage networks for the upcoming period to include the following items in the level of revenue used for the price cap calculation:

- difference of EUR 7.78 million for 2015 which occurred as result of the improper WACC amount applied by the Commission;
- difference of EUR 4.64 million for 2015, which occurred as result of the Commission's improper application of requirements set forth in legal acts in respect of allowable return on investment for LESTO AB;
- expenses of EUR 16.46 million which were identified as unsubstantiated during the audit conducted by the Commission, yet which are treated as attributable to regulated activity expenses by LESTO AB.

In its other claim LESTO AB requested to oblige the Commission to eliminate violations made which resulted in:

- lower revenue of LESTO AB from public electricity supply services for 2015 by EUR 862.78 thousand;
- lower electricity acquisition costs of LESTO AB for 2015 by EUR 311.63 thousand;

The Company disagrees with the approach used by the Commission in interpreting and applying effective laws and other legal acts when passing its resolutions. Due to the mentioned reasons, in the Company's opinion, the price caps for 2015 were calculated by unjustifiably decreasing revenue by the amount of EUR 30.04 million. In case the court passes the ruling in favour of the Company, the above-mentioned amounts would be included in the tariff of the upcoming year resulting in higher revenue and profit of the Company.

In December 2015 and January 2016, Vilnius Regional Administrative Court investigated the cases on their merits and passed the rulings whereby the claims were rejected in their entirety. The Company filed appeals against the court's rulings. The cases are under investigation by the court of appeals.

In February 2015, the Company filed the complaint to Vilnius Regional Administrative Court with request to annul the Commission's Resolution on the Establishment of Price Caps for Distribution Services of LESTO AB Via Medium and Low Voltage Networks for 2016-2020 and indicated that as a result of improper application of legislative requirements by the Commission which determine allowable return on investments and required regulated activity costs for LESTO AB, the amount of EUR 11.93 million was not included in the level of revenue used for the price cap calculations for 2016. In the period from the day on which the complaint was filed to the court, the Commission made substantial changes in the regulatory environment which directly affects the Claimant's position in this case and the requirements presented in the complaint. As a result of this changed regulatory environment (including the resolution against which the appeal was filed) the Company is no longer facing such legal and financial consequences which are indicated in the Company's complaint. Therefore, on 20 February 2016, the Company submitted a request to Vilnius Regional Administrative Court for the withdrawal of the complaint, on the basis of which the investigation of the case was terminated.

In July 2015, LESTO AB filed the complaint to Vilnius Regional Administrative Court with the request to annul the Commission's Resolution on the Violation of Terms and Conditions of the Regulated Activity by LESTO AB under which the violation made by LESTO AB in respect of the licensed activity was identified, i.e. LESTO AB unjustifiably allocated more costs to the regulated activities of electricity distribution and public supply than the amount that could have been actually allocated, and to recognise the imposed fine of EUR 300 thousand as ungrounded. The investigation of the case has been suspended until the ruling is passed in the administrative case where the Company disagrees with the results of the Commission's audit. In view of the ruling of Vilnius Regional Administrative Court, in its financial statements at 31 December 2015 the Company accounted for the mentioned fine by recognising expenses and a liability.

30 Capital risk management

Pursuant to the Lithuanian Law on Companies the authorised share capital of a public company must be not less than EUR 28.97 thousand and the shareholders' equity should not be lower than 50 per cent of the company's authorised share capital. As at 31 December 2016 and 31 December 2015, the Company complied with these requirements.

When financing its business activities, the Company follows an optimal capital structure management policy seeking to make sure that the equity ratio (equity to assets ratio) exceeds 40 per cent. For the purpose of capital management the Company's management define capital as shareholders' equity.

	2016	2015
Equity	623,195	573,813
Assets	1,113,186	1,078,728
Equity ratio (equity to assets ratio)	56%	53%

31 Financial risk management

Credit risk

Trade and other receivables are distributed among a large number of customers, therefore, there is no significant credit risk concentration. Credit risk or the risk of counterparties defaulting, is controlled by the application of credit terms and monitoring procedures

The Company does issue guarantees to secure the fulfilment of obligations of third parties. The maximum exposure to credit risk is represented by the carrying amount of each item of financial asset. Therefore, management believes that the maximum exposure to credit risk is equal to the amount of mortgage loans, loans, trade and other receivables and cash at bank less recognised impairment loss at the date of the statement of financial position.

Because of the specific nature of the Company's operations, no collateral is required from customers.

Pursuant to the Articles of Association, free liquid funds can be invested by the Company only in low-risk short-term (with the remaining maturity less than 549 calendar days) money market instruments and debts securities, i.e. term deposits, bonds, Government securities, of reliable financial institutions or entities that have been assigned a long-term credit rating not lower than "A-" according to the rating agency Fitch Ratings (or equivalent rating of other rating agencies). In exceptional circumstances, free liquid funds may be held with other financial institutions that act under the licence issued by the Bank of Lithuania, which entitles them to provide financial services. The Company is allowed to hold funds with such financial institutions the amount not exceeding the amount guaranteed under the Lithuanian Law on Insurance of Deposits and Liabilities to Investors.

The priority objective of investing activities is to ensure the security of funds and maximise return on investments in pursuance of this objective.

As at 31 December 2016, the maximum exposure to credit risk of the Company amounted to EUR 83,623 thousand (31 December 2015: EUR 119,511 thousand) as disclosed in section *Financial instruments by category* of this note.

Interest rate risk

All the Company's borrowings bear variable interest rate linked with EURIBOR and expose the Company to the interest rate risk.

The Company did not have any derivative financial instruments to hedge against interest rate risk.

The following table demonstrates the sensitivity of the Company's profit before tax to potential shift in interest rates, with all other variables held constant (by changing the interest rate). There is no impact on the Company's equity, except for impact on current year profit.

	Increase/ decrease, percentage points	Impact on profit before tax
2016	0.15	-330
EUR	-0.15	330
EUR		
2015		
EUR	0.01	-22
EUR	-0.01	22

Foreign exchange risk

All monetary assets and liabilities of the Company are denominated in the euro, therefore, the Company practically is not exposed to the foreign exchange rate risk.

Liquidity risk

The Company's policy is to maintain sufficient cash and cash equivalents or have available funding through adequate amounts of committed credit facilities to meet its commitments at a given date in accordance with its strategic plans. The Company's current liquidity (total current assets / total amounts payable within one year and current liabilities) and quick ratios ((total current assets – inventories) / total amounts payable within one year and current liabilities) as at 31 December 2016 were 0.44 and 0.43 (31 December 2015: 0.64 and 0.63), respectively.

As at 31 December 2016, the Company's current liabilities exceeded their current assets by EUR 103,528 thousand (31 December 2015: EUR 75,920 thousand). The Company's cash flows from operating activities were positive and in the year ended 31 December 2016 amounted to EUR 180,144 thousand (31 December 2015: EUR 138,384 thousand). During the year 2016, the Company's repayments of borrowings amounted to EUR 78,279 thousand (2015: EUR 116,912 thousand) and proceeds from additional borrowings amounted to EUR 71,500 thousand (2015: EUR 133,500 thousand). Based on estimates of the Company's management, cash flows from operating activities will be sufficient to settle its current liabilities.

The table below summarises the maturity profile of the Company's financial liabilities as at 31 December 2016 and 2015 based on contractual undiscounted payments.

Company	Up to 3 months	3 to 12 months	1 to 5 years	Total
Borrowings	14,759	44,138	162,937	221,834
Trade and other payables	84,253	-	3	84,256
At 31 December 2016	99,012	44,138	162,940	308,090
Borrowings	35,624	67,877	149,443	252,944
Trade and other payables	82,789	-	51	82,840
At 31 December 2015	118,413	67,877	149,494	335,784

Fair value

The Company's principal financial assets and liabilities not designated at fair value are trade receivables and other receivables, trade and other payables and non-current and current borrowings.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of a financial asset or financial liability is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

To improve consistency in and comparability of fair value measurements and related disclosures, a fair value hierarchy is established that categorises into three levels the inputs to valuation techniques used to measure fair value.

Level 1 inputs (the highest level of accuracy) are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability.

The carrying amount of the Company's financial assets and financial liabilities approximates their fair value, except for mortgage loans as disclosed in Note 7.

The fair value of borrowings is estimated based on discounted probable future cash flows using prevailing interest rates. The fair value of loans and other financial assets is estimated using market interest rates.

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

- The carrying amount of current trade receivables and other receivables, current trade and other payables and current borrowings approximates their fair value.

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

- b) The fair value of non-current borrowings is estimated based on the quoted market price for the same or similar loan or on the current rates available for debt with the same maturity profile. The fair value of non-current borrowings with variable interest rates approximates their carrying amounts.

Financial instruments by category

	Loans and receivables	Available-for-sale financial assets	Total
At 31 December 2016			
Other non-current financial assets (Note 7)	530	5,306	5,836
Trade and other receivables (Note 9)	62,133	-	62,133
Accrued revenue (Note 10)	4,992	-	4,992
Cash and cash equivalents (Note 11)	10,662	-	10,662
Total	78,317	5,306	83,623
At 31 December 2015			
Other non-current financial assets (Note 7)	419	10,214	10,633
Trade and other receivables (Note 9)	100,538	-	100,538
Accrued revenue (Note 10)	5,143	-	5,143
Cash and cash equivalents (Note 11)	26,961	-	26,961
Total	133,061	10,214	143,275

	Other financial liabilities measured at amortised cost	Liabilities measured at fair value through profit or loss	Total
At 31 December 2016			
Borrowings (Note 15)	219,081	-	219,081
Trade and other payables (Note 19)	84,253	-	84,253
Other liabilities	3	-	3
Total	303,337	-	303,337
At 31 December 2015			
Borrowings (Note 15)	246,985	-	246,985
Trade and other payables (Note 19)	82,789	-	82,789
Other liabilities	51	-	51
Total	329,825	-	329,825

32 Business combinations

Business combination (merger) between LESTO AB and Lietuvos Dujos AB was accounted for using the predecessor accounting. During the merger process of the companies (neither of the companies being merged gained control over another), the amounts of assets, liabilities, income and expenses of companies being merged for all the periods presented in the financial statements were combined.

The amounts reported in the Company's statement of financial position as at 31 December 2015 and statement of comprehensive income for the year 2015 are equal to the sum of the amounts presented in the respective financial statements of LESTO AB and Lietuvos Dujos AB, after having eliminated inter-company balances and turnovers:

Statement of financial position at 31 December 2015

	LESTO AB	Lietuvos Dujos AB	Elimination of inter-company balances (-)	Energijos Skirstymo Operatorius AB
ASSETS				
Non-current assets				
Property, plant, and equipment	761,071	160,726	-	921,797
Intangible assets	3,256	356	-	3,612
Prepayments for non-current assets	-	1,267	-	1,267
Investments in associates	1,374	644	-	2,018
Deferred income tax assets	-	1,978	-	1,978
Other non-current financial assets	10,633	-	-	10,633
	776,334	164,971	-	941,305
Current assets				
Inventories	2,078	466	-	2,544
Trade and other receivables	77,053	23,836	(72)	100,817
Prepayments, deferred expenses and accrued revenue	5,407	90	-	5,497
Prepaid income tax	1,604	-	-	1,604
Cash and cash equivalents	19,027	7,934	-	26,961
	105,169	32,326	(72)	137,423
Total assets	881,503	197,297	(72)	1,078,728
EQUITY AND LIABILITIES				
Equity				
Authorised share capital	175,144	84,299	-	259,443
Revaluation reserve	55,254	266	-	55,520
Legal reserve	17,491	8,419	-	25,910
Retained earnings	185,186	47,754	-	232,940
Total equity	433,075	140,738	-	573,813
LIABILITIES				
Non-current liabilities				
Borrowings	147,576	-	-	147,576
Deferred income tax liabilities	2,505	-	-	2,505
Deferred income	79,298	38,271	-	117,569
Grants and subsidies	17,146	4,238	-	21,384
Long-term employee benefits	1,331	1,156	-	2,487
Other non-current liabilities	51	-	-	51
	247,907	43,665	-	291,572
Current liabilities				
Borrowings	99,409	-	-	99,409
Trade and other payables	80,881	9,062	(72)	89,871
Advance amounts received, accrued liabilities and deferred revenue	20,231	3,710	-	23,941
Income tax payable	-	122	-	122
	200,521	12,894	(72)	213,343
Total liabilities	448,428	56,559	(72)	504,915
Total equity and liabilities	881,503	197,297	(72)	1,078,728

ENERGIJOS SKIRSTYMO OPERATORIUS AB, company code 304151376 Agonų g. 24, Vilnius, Lithuania
NOTES TO THE FINANCIAL STATEMENTS
for the year ended 31 December 2016

All amounts in EUR thousands unless otherwise stated

Statement of comprehensive income at 31 December 2015

	LESTO AB	Lietuvos Dujos AB	Elimination of inter-company balances	Energijos Skirstymo Operatorius AB
Revenue	577.148	54,856	(132)	631.872
Other income	4.635	1,586	(227)	5.994
Purchases of electricity and related services	(373,848)	-	-	(373,848)
Purchase (expenses) of natural gas and transmission services	-	(3,803)	-	(3,803)
Depreciation and amortisation	(34,793)	(9,055)	-	(43,848)
Employee benefits and related social security contributions	(36,707)	(19,383)	-	(56,090)
Repair and maintenance expenses	(23,281)	(2,390)	22	(25,649)
Transport costs	(4,156)	(620)	1	(4,775)
Telecommunications and IT services	(7,022)	(1,387)	-	(8,409)
Rent and utilities	(2,551)	(350)	315	(2,586)
Impairment and write-off expenses	(3,140)	134	-	(3,006)
Other expenses	(9,388)	(4,427)	17	(13,798)
Operating profit	86,897	15,161	(4)	102,054
Finance income	1,028	29	-	1,057
Finance costs	(2,411)	(152)	-	(2,563)
Finance costs – net	(1,383)	(123)	-	(1,506)
Share of (profit) of associates and joint ventures	-	(12)	-	(12)
Gain on disposal of investment in the joint venture	-	32	-	32
Profit before income tax	85,514	15,058	(4)	100,598
Income tax	(12,967)	(2,123)	-	(15,090)
Net profit for the period	72,547	12,935	(4)	85,478
Other comprehensive income	-	443	-	443
Total comprehensive income (loss) for the period	72,547	13,378	(4)	85,921

33 Events after the reporting period

On 28 February, 2017 the Company received a notification of resignation of Mr. Dalius Svetulevičius from the post of a member of the Company's Board. Pursuant to the Republic of Lithuania Law on Companies, the last day of term of office of Mr. Dalius Svetulevičius as Company's Board member will be 14 March 2017. In consideration with this and in accordance with the Articles of Association of the Company, the Supervisory Board has the right to recall the member of the Company's Board before this date.

On 27 January 2017, the Company and SEB Bankas AB signed the agreement for a long-term loan of EUR 77 million. The loan will be used to refinance the Company's financial liabilities and finance the working capital. The loan repayment term is 10 years and it is subject to a variable interest rate of 3 months EURIBOR.

During the sitting of the Company's Supervisory Council held on 20 January 2017 a decision was made to elect Ignas Pranskevičius to the position of the Company's Board member, who will be in charge of the provision and development of services, from the end of the sitting of the Company's Supervisory Council, which has elected him, until the expiry of the term of office of the current Board.

The National Control Commission for Prices and Energy changed the Company's energy activity licence No L2-GDS-09 by adding a new territory to the activity area defined in the annex to this licence, i.e. the territory of Tauragė region municipality. The mentioned modification of the energy activity licence entitles the Company to ensure the provision of natural gas distribution services in Tauragė region municipality.

2016

ENERGIJOS SKIRSTYMO
OPERATORIUS AB
ANNUAL REPORT

REPORT FOR A TWELVE-MONTH PERIOD ENDED 31 DECEMBER 2016



Group of energy
companies

www.le.lt



CONTENTS

ANNUAL REPORT

Key operating and financial indicators of the Company for the reporting period	51
CEO Foreword	52
Most significant events in the reporting period	53
Analysis of the financial and operating indicators	58
Factors affecting the Company's financial indicators	63
Information on the Company's authorised share capital and securities	73
Customer service, service assessment	77
Social responsibility	79
Company and its management bodies	82
Material events in the Company's activities	94
Annexes	97

Reporting period covered by the report

The report covers the period from January to December 2016.

Information on the availability of the report and the documents used in preparing the report, and on means of mass media in which the company's public reports are published

The report and the documents, on the basis of which it was prepared, are available at the head office of Energijos Skirstymo Operatorius AB, the Department of Communication (Aguonų St. 24, Vilnius, Room 535), on working days from Mondays through Thursdays 7:30–16:30, on Fridays 7:30–15:15. The report is also available on the website of Energijos Skirstymo Operatorius AB at www.eso.lt and the website of NASDAQ Vilnius stock exchange at www.nasdaqomxbaltic.com.

All public announcements, which are required to be published by Energijos Skirstymo Operatorius AB (hereinafter “ESO”, “the Company”) according to the effective legal acts of the Republic of Lithuania, are published on the Company's website (www.eso.lt) and the website of NASDAQ OMX Vilnius stock exchange (www.nasdaqomxbaltic.com).

Persons responsible for information provided in the report

Position	Full name	Telephone number
Chief Executive Officer	Dalia Andrulionienė	(8 5) 277 7524
Finance and Administration Service Director	Augustas Dragūnas	(8 5) 277 7524
Finance Department Director	Artūras Paipolas	(8 5) 277 7524

The report of ESO has been prepared according to the Law on Securities of the Republic of Lithuania, the Rules for the Preparation and Submission of the Periodic and Additional Information approved by Decision No 03-48 of 28 February 2013 (with subsequent amendments and supplements) of the Board of the Bank of Lithuania, other laws and legislation currently in force.

Report's signing date

The report was signed on 2 March 2017.

Regarding the comparability of financial results

This report presents the financial results of ESO for the twelve-month period of 2016, which are comparable with the combined data of the financial statements of LESTO AB (hereinafter “LESTO”) and public limited liability company Lietuvos Dujos (hereinafter “Lietuvos Dujos”) having eliminated intercompany transactions.

KEY OPERATING AND FINANCIAL INDICATORS OF THE COMPANY FOR THE REPORTING PERIOD

Key operating indicators of ESO

		2016	2015	Change	
				+/-	%
Operating indicators					
Distributed electricity via medium and low voltage networks	TWh	8.98	8.53	0.45	5.23
Public and guaranteed supply of electricity	TWh	3.15	3.12	0.03	0.84
Distributed volume of natural gas	TWh	7.39	6.83	0.56	8.3
Supply quality indicators of the network					
ELECTRICITY					
SAIDI, min. (with <i>force majeure</i>)		172.9	106.5	66.4	
SAIFI, units (with <i>force majeure</i>)		1.25	1.06	0.19	
GAS					
SAIDI, min. (with <i>force majeure</i>)		0.529	1.034	-0.505	
SAIFI, units (with <i>force majeure</i>)		0.006	0.007	-0.001	

Key financial indicators of ESO

		2016	2015	Change	
				+/-	%
Revenue	EUR '000	650.063	637.866	12.197	1.91
Purchase of electricity, gas and related services	EUR '000	388.194	377.651	10.543	2.79
Operating expenses (1)	EUR '000	98.555	111.307	-12.752	-11.46
EBITDA (2)	EUR '000	163.314	148.908	14.406	9.67
EBITDA margin (3)	%	25.12	23.34		
Net profit (loss)	EUR '000	92.502	85.478	7.024	8.22
		2016	2015	Change	
				+/-	%
Total assets	EUR '000	1.113.186	1.078.728	34.458	3.19
Equity	EUR '000	623.195	573.813	49.382	8.61
Borrowings	EUR '000	219.081	246.985	-27.904	-11.30
Borrowings, net (4)	EUR '000	208.419	220.024	-11.605	-5.27
Return on equity ratio (ROE) (5)	%	15.46	15.08*		
Return on assets (ROA) (6)	%	8.44	8.10*		
Equity ratio (7)	%	55.98	53.19		
Borrowings, net / 12-month EBITDA	times	1.28	1.48		
Borrowings, net / Equity	%	33.44	38.34		

(1) Operating expenses (OPEX) = operating expenses excluding costs attributable to purchase of electricity and related services, depreciation and amortisation, impairment and write-off expenses;

(2) EBITDA (earnings before results of financing activities, tax and depreciation and amortization) = profit (loss) before tax + expenses of financing activities - income from financing activities - dividends received + depreciation and amortisation + impairment expenses + write-off expenses;

(3) EBITDA margin = EBITDA / Revenue;

(4) Borrowings, net = borrowings - cash and cash equivalents - short-term investments and term deposits - a portion of non-current other financial assets representing investments in debt securities;

(5) Return on equity (ROE) = net profit (loss) for the reporting period / average of equity at the beginning and at the end of the reporting period;

(6) Return on assets (ROA) = net profit (loss) for the reporting period / average of assets at the beginning and at the end of the reporting period;

(7) Equity ratio = equity at the end of the period / total assets at the end of the period.

* For 2015 calculations: the data of the beginning of the reporting period (01 01 2015) is used by summing up AB "Lietuvos dujos" and AB LESTO balance sheet of 2015

CEO FOREWORD

Dear all,

First year of ESO operation has exceeded our own expectations. The concentration of two distribution operators - electricity and gas - in a single company has improved the quality of service, reduced operating expenses and prices for our customers. ESO operating costs, compared to LESTO and Lietuvos Dujos, in 2016 fell by 12%, which is almost 13 million EUR. This result exceeded our projections that were performed before the merger of two operators. We will continue to increase the efficiency further and seek new opportunities for operational synergies. The organization will raise the operational efficiency bar as of the beginning of 2017 the



Operational excellence program based on LEAN principles started; the entire company will engage into it. While saving the operating costs we can have a direct impact on the cost of services and create additional value for our customers. I am pleased that since 2017 the price for gas distribution service has declined for the first time in five years, while public price of electricity has fallen for the fourth year in a row.

The first year of ESO operation can also be referred as year of our gas network expansion – in autumn the company built a gas distribution pipeline in Taurage at end of the year we began operations in Druskininkai, later acquiring gas distribution network. In Kaunas, Vaisvydava area, we began the largest block of gasification project in the last decade. During 2016 we observed gas consumption revival: we have gained more than 10.000 new customers - more than during 2014 and 2015 combined.

We understand how important is to quickly and easily connect to our distribution network, so in 2016 we have been working very actively in order to offer more convenient and faster electricity and gas connection process. The average duration of electricity connection for new customers in 2016 decreased by 20 calendar days, from 78 to 58 days, for new gas distribution network customers – the connection time declined by almost 54 calendar days, from 216 to 162 days.

Last year we continued to increase investments in the electricity distribution network security and reliability. We laid more than 2.000 kilometres of underground electrical cables and continued to use smart network elements that will enhance network reliability and prevent power outages. Residents and business our services reflect in the customer satisfaction survey results. ESO customer satisfaction rate, calculated in accordance with international GCSI (Eng. Global Customer Satisfaction Index) methodology in 2016 totalled 79 points and was 9 points higher than the European energy companies GCSI index. In 2016 we were appraised with the National Social Company award as it is important for us to organize our activities responsibly, taking into account the communities where we operate.

The first year for ESO operation proved that we are able not only to adapt to new conditions and challenges, but at the same time to undertake important and responsible work. I firmly believe that in 2017 we will do more with the ESO team of professionals!

Yours sincerely,

Dalia Andrulionienė, CEO and Chair of the Board,
Energijos Skirstymo Operatorius AB

THE MOST SIGNIFICANT EVENTS DURING 2016

ESO shares listed on the Baltic Main List

On January 5, 2016, Nasdaq Vilnius decided to include AB Energijos Skirstymo Operatorius shares in Baltic Main List from January 11, 2016, at the request of the issuer.

ESO share trading began

On January 11, 2016, the Company's shares began trading on the Nasdaq Stock Exchange in Vilnius. The total Baltic Main List included ESO ordinary shares – 894,630,333 units, par value per share – €0.29. ESO stock symbol – ESO1L.

Concerning the court decision

The Vilnius Regional Administrative Court rejected the company's complaint, which sought annulment of the National Commission for Energy Control and Prices 2014-12-19 ruling "Concerning the AB LESTO scheduled inspection" and resolutions accepted on the basis of this ruling and oblige the Commission to evaluate the company's loss of income and additional costs for the period of validity of the resolutions setting of price ceilings in determining the Company's price ceilings for other periods.

Concerning decisions adopted by the Supervisory Board

Augustas Dragūnas was appointed ESO Board Member as well as Finance and Administration Office Director. The ESO Supervisory Board adopted this decision on Friday, February 19. A. Dragūnas replaced Egle Čiužaitė who was appointed Chairman and Managing Director of Lietuvos Energijos Gamyba, a company owned by the Lietuvos Energija group.

Concerning the decision to terminate judicial proceedings

On 2016-03-03 ESO withdrew its complaint to the Vilnius Regional Administrative Court concerning the 2015-02-20 National Commission for Energy Control and Prices ruling. On 2015-02-20 AB LESTO submitted a complaint to the court, requesting annulment of the 2015-01-19 adopted ruling "On fixing AB LESTO 2016-2020 price ceilings for the distribution of medium and low voltage networks."

Concerning the ordinary general meeting of shareholders

On March 29, 2016, the Company's general meeting of shareholders adopted the following decisions: approval of the 2015 annual reports of the AB LESTO group (consolidated report) and the Lietuvos Dujos stock company. The 2015 AB LESTO and joint stock company Lietuvos Dujos annual reports audited by UAB PricewaterhouseCoopers were approved at the meeting. Also the Company's 2015 profits were distributed: €30.596 mln. devoted for dividends or €0.0342 per share for the period from 2015-07-01 to 2015-12-31.

Concerning the decision to terminate judicial proceedings

March 30, 2016, the Supreme Court of Lithuania (SCL) approved the settlement agreement in the case concerning Lietuvos Dujos stock company's action research. In view of the settlement agreement, SCL ceased the dispute. The case was initiated

by the claimant, the Ministry of Energy of the Republic of Lithuania, on March 25, 2011, and was examined in closed court hearings, so the case file is not public.

Regarding the decision by National Control Commission for Prices and Energy

On 21 April, 2016 the National Control Commission for Prices and Energy (hereinafter – Commission) considered the issue of ESO violation according to the routine inspection report of regulated activities of public limited liability company Lietuvos Dujos during the period 2009-2013.

The Commission disapproved the imposition of sanctions for ESO according to the conclusions presented in the routine inspection report of Lietuvos Dujos.

Regarding the change of public electricity price cap for second half of 2016

The Commission on 23 May 2016 decided to change the Commission's decision dated 9 November 2015 when public electricity price ceiling for LESTO consumers buying electricity from medium and low voltage network was set for 2016. According to the Commission's resolution, for the second half of 2016 electricity price cap for consumers in medium voltage networks will amount 7,499 ct/kWh (VAT excluded), in low voltage networks – 9,530 ct/kWh (VAT excluded).

Regarding the Board decision to change electricity prices from the second half of 2016

At its meeting of May 25 the Board of ESO approved the new prices for electricity network services, and the public prices of electricity. After the announcement of the Commission new prices will apply for the second half of 2016

ESO recounted the public electricity prices after the Commission lowered the public interest obligations (VIAP), systemic services, electricity market prices and the price cap of public electricity price.

Regarding announced electricity prices from the second half of 2016

The Commission on May 30, Monday, announced new prices for electricity network services and the public prices of electricity, which will apply for the second half of 2016.

Report on LESTO's social responsibility 2015 published

ESO, which started its operations since January 1, 2016 after a reorganization merging LESTO and Lietuvos Dujos published LESTO Social Responsibility Activity Report 2015. This is the sixth annual report published both in Lithuanian and English.

The 2015 Report provides an overview of LESTO's progress in improving relations with customers and other market participants, the environmental projects in progress, as well as initiatives for employees and the society. The Report also describes LESTO's 2015 programs and achievements in its pursuit of social responsibility objectives.

Regarding the Extraordinary General Meeting of Shareholders

On 4 July 2016 by the decision of the Board of the company it was announced that an Extraordinary General Meeting of Shareholders of the Company is to be convened on 26 July 2016. During Extraordinary General Meeting of Shareholders

it's planned to elect of the audit company for the audit of financial reports of the Company and set of terms of remuneration for audit services.

Regarding the supplemented draft decision of the Extraordinary General Meeting of Shareholders

On 13 July 2016, the document of the shareholder Lietuvos Energija, UAB controlling 94,98% of the shares of the Company, was received. The Company was informed about the recommendation of the Lietuvos Energija, UAB Supervisory Board Audit Committee for the offered audit company.

A decision on the election of the audit company was adopted

On 26 July 2016 at the Extraordinary General Meeting of Shareholders of the Company „PricewaterhouseCoopers“ UAB was elected as the audit company for the audit of the Company. For the audit services of 2016-2018 it will be paid no more than 159 600,00 EUR (VAT not included).

Regarding the Extraordinary General Meeting of Shareholders

On September 1, 2016 the Company received a request from Lietuvos Energija, UAB, to convene the Extraordinary General Meeting of Shareholders. The purpose of the Extraordinary General Meeting of Shareholders - to pay dividends for the period shorter than the usual financial year. In the application Lietuvos Energija, UAB presented a draft decision to allocate 0,014 EUR dividends per share for shareholders of Energijos Skirstymo Operatorius AB for the period shorter than financial year as of the end of 30 June 2016.

Based on the application from Lietuvos Energija, UAB, the Company's Board has decided to convene an extraordinary general meeting.

Regarding the resolutions of Extraordinary General Meeting of Shareholders

On 26 September 2016 the Extraordinary General Meeting of Shareholders of the Company was held. During the meeting the interim Report of the Company for the period of six months and the set of interim Financial Statements of the Company of the first half of 2016, audited by “PricewaterhouseCoopers” UAB, the Company's auditor, was approved. The shareholder also approved the allocation of dividends in the amount of 0,014 EUR per share for the period ended 30 June 2016.

Liudas Liutkevičius resigned from the position of the CEO and the Chairman of the Board

On 10 October 2016 Liudas Liutkevičius informed the Company of his resignation from the position of the CEO and the Chairman of the Board. The term of his position as ESO's CEO and the Chairman of the Board expired on 4 November 2016.

Regarding the price-setting of electricity distribution price caps, and the public electricity price cap for 2017

On 14 October, 2016 the National Control Commission for Prices and Energy established electricity distribution price caps for 2017: in medium - voltage networks 0,830 EUR ct/kWh; in low - voltage networks 1,655 EUR ct/kWh. On 14 October, 2016 Commission established public electricity supply service price cap for 2017 – 0,143 EUR ct/kWh.

Regarding the loan-for-use agreement for the natural gas distribution pipeline concluded between Energijos Skirstymo Operatorius AB and Druskininkų Šilumos Tinklai AB

On 26 October 2016, the Company and Druskininkų Šilumos Tinklai AB signed the loan-for-use agreement for the natural gas distribution pipeline, under which the Company took over the natural gas distribution system in the municipality of Druskininkai with effect from 1 November 2016.

The price cap of the natural gas distribution service for 2017 was established

On 28 October 2016, the National Control Commission for Prices and Energy established the price cap of the natural gas distribution service for the Company to be effective for 2017 equal to EUR 7.25 per MWh (excl. VAT).

Regarding changes in the energy activity licence

The National Control Commission for Prices and Energy changed the Company's energy activity licence No L2-GDS-09 by adding a new territory to the activity area defined in the annex to this licence, i.e. the territory of Druskininkai municipality, except for a territory defined in the natural gas distribution licence issued to Intergas UAB.

The Company's operational strategy for 2016–2020 was approved

The Company's Board approved the 2016–2020 operational strategy of Energijos Skirstymo Operatorius AB (hereinafter "the Strategy") whereby the Company's long-term strategic directions, objectives and indicators were established. The Company's Strategy is available [here](#).

Regarding the decisions adopted by the Supervisory Council and the Board

On 4 November 2016, the Company's Board revoked Liudas Liutkevičius from the positions of the Company's CEO and the Chairman of the Board with effect from 4 November 2016, 16:00, and the Company's Board elected the Company's Services Director Dalia Andrulionienė to temporarily take over the position of the Company's CEO with effect from 4 November 2016, 16:00.

The National Control Commission for Prices and Energy approved prices for the natural gas distribution service

On 17 November 2016, the National Control Commission for Prices and Energy approved the natural gas distribution service prices that were established by the Company's Board on 4 November 2016 to be applicable from 1 January 2017. The prices for the natural gas distribution service declined in respect of all seven price categories. The price for the natural gas distribution service decreased from 1% to 15% depending on a price category. The main reason for the price decrease is a projected rise in volumes of natural gas to be distributed in 2017. The price for the natural gas distribution service is one of the components of the final gas price.

Regarding the decisions adopted by the Company's Supervisory Council and the Board

On 25 November 2016, the sitting of the Company's Board was held where, based on the opinion of the Company's Supervisory Council presented during the sitting held on 25 November 2016, a member of the Company's Board Dalia Andrulionienė was elected to the position of the Company's CEO and the Chair of the Board.

Regarding the purchase-sale agreement of the natural gas distribution pipeline concluded with Druskininkų Šilumos Tinklai AB

On 29 October 2016, the Company and Druskininkų Šilumos Tinklai AB signed the purchase-sale agreement, under which the Company acquired ownership rights to the natural gas distribution system in the municipality of Druskininkai. The Company operated this system from 1 November 2016 by the lending right under the loan-for-use agreement for the natural gas distribution pipeline concluded between the parties on 26 October 2016.

The National Control Commission for Prices and Energy approved fees for the connection of private customers to the gas pipelines to be effective in 2017

On 30 November 2016, the National Control Commission for Prices and Energy (hereinafter “the Commission”) established fees for the connection of new private customers to the natural gas systems. In the following year, a connection fee for each constructed metre of the pipeline will increase by 16.64% from EUR 11.72 to EUR 13.67 (excl. VAT) for residents who wish to introduce natural gas and use it for heating their homes or other premises. A fee for connection to the pipelines, irrespective of distance, will rise by 13.61% up to EUR 228.12 (excl. VAT).

Regarding the Board’s decision to change electricity prices from 2017

On 15 December 2016, the Commission reviewed and increased the price for public service obligations (PSO) and the price caps for electricity public supply for the year 2017 to be applicable to private customers who purchase electricity from low and medium voltage networks. In view of this, on 16 December 2016, the Company’s Board approved the revised prices for electricity public supply which were presented by the Commission.

Regarding the announced electricity prices for 2017

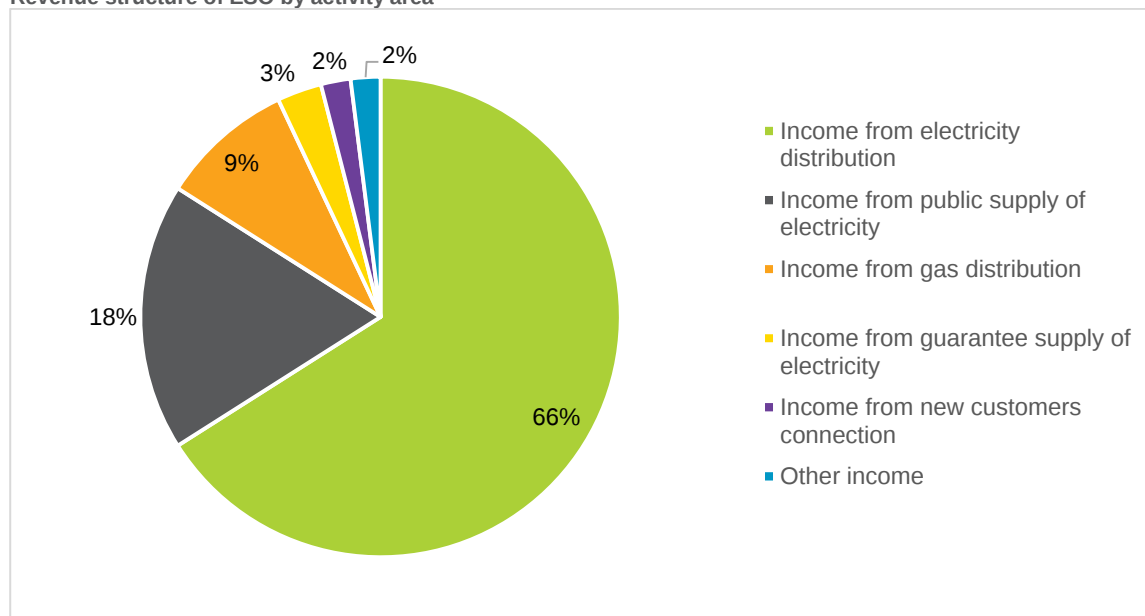
On 23 December, the Commission announced the prices for electricity public supply for 2017 as revised by the decision of 16 December of the Company’s Board. ESO recalculated the prices of electricity after the PSO prices and the price caps for electricity public supply have been reviewed and increased by the Commission. With effect from 1 January 2017, the electricity price for private customers of ESO decreased by an average of 4.9% compared to the prices that were applied in the second half of 2016.

Regarding the dividend policy of the Lietuvos Energija group of companies

On 27 December 2016, the Board of Lietuvos Energija UAB, a company holding 94.98% of the Company’s shares, approved the dividend policy of the Lietuvos Energija group of companies which establishes the uniform net profit appropriation principles to be applicable to all companies of the group. In accordance with the new procedure the Company’s proposal regarding the allocation of dividends will depend on the Company’s ratio on return on equity, financial capacities to pay dividends, implementation of economic projects important to the State and other circumstances.

THE ANALYSIS OF FINANCIAL AND OPERATING INDICATORS

Revenue structure of ESO by activity area



ESO's revenue for 2016 reached EUR 650.1 million, which is a 1.9% increase compared to 2015. Revenue grew due to higher volumes of electricity and natural gas distribution. Electric power distribution is the main source of the Company's revenue. In 2016, distribution revenue comprised 66%, revenue from public supply of electricity represented 18% and revenue from natural gas distribution made up 9% of the Company's total revenue.

EBITDA indicator

	31 Dec 2016	31 Dec 2015
EBITDA, EUR '000	163,314	148,908
EBITDA margin, %	25.12	23.34

* EBITDA (earnings before results of financing activities, tax and depreciation and amortization) = profit (loss) before tax + expenses of financing activities - income from financing activities - dividends received + depreciation and amortisation + impairment expenses + write-off expenses

In 2016, the Company's earnings before interest, taxes, depreciation and amortisation (EBITDA) amounted EUR 163.3 million and was 9.7% higher than in January–December 2015.

Expenses

In 2016, purchases of electricity, natural gas or related services made up EUR 388.2 million and increased by 2.8% compared to 2015. This was mainly influenced by higher electricity distribution and natural gas distribution volumes. During the reporting period, expenses for purchase of electricity, natural gas or related services as well as depreciation and amortisation expenses amounted to EUR 434.2 million or 80% of total ESO's costs.

In 2016, operating expenses¹ decreased by 11.5% compared to 2015 and amounted to EUR 98.6 million. Employee benefits and related social security contributions, as well as repair and maintenance expenses saw the highest decline, i.e. a 16% and 27.9% decrease, respectively.

ESO operating expenses, EUR '000

	31 Dec 2016	31 Dec 2015
Employee benefits and related social security contributions	47,131	56,090
Repair and maintenance expenses	18,484	25,649
Other expenses	16,559	13,797
Telecommunications and IT services	7,711	84,09
Transport	4,540	4,775
Rent and utilities	4,130	2,586
Operating expenses	98,555	111,307

Profit (loss) and profitability ratios

In 2016, net profit of ESO increased by 8.2% compared to 2015 and amounted to EUR 92.5 million. Growth of net profit resulted from higher revenue and lower operating expenses.

ESO profitability ratios

	31 Dec 2016	31 Dec 2015
Net profit margin, %	14.23%	13.40%
Operating profit margin, %	16.61%	16.00%

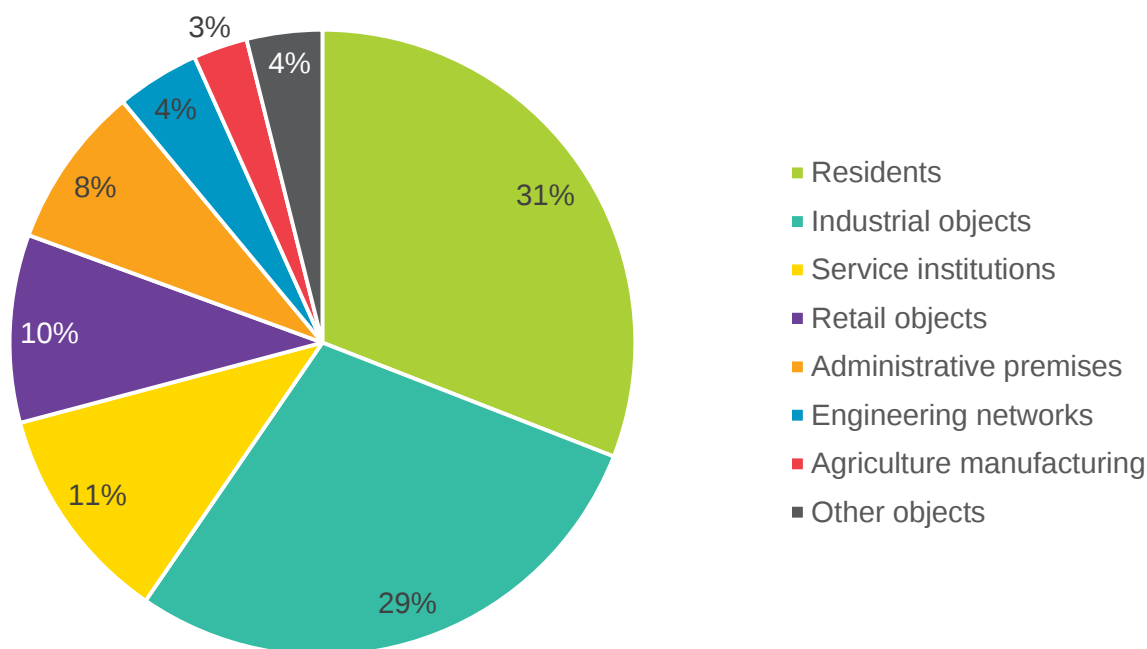
Electricity distribution

During twelve months of 2016, ESO distributed 8.976 billion kWh of electricity to its customers. Electricity sales made up 35.1% of this amount. The remaining customers of ESO were provided only with the distribution service. The amount of electricity sold increased by 0.84%, while the volume of electricity distributed increased by 5.23% compared to the same period of 2015. Technological losses in distribution equipment incurred by the Company during twelve months of 2016 amounted to 629 million kWh or 6.55% of the amount of electricity received. During the same period of 2015, technological losses totalled 6.80%.

Electricity distribution volume by object

Nearly 31% of electricity distributed by ESO were consumed by residents. Industrial objects and service institutions consumed 28.6% and 11.3%, respectively, of electricity distributed. There were no changes in the structure of electricity distribution by object as compared to data of twelve months of 2015.

¹ Operating expenses (OPEX) = operating expenses, excluding expenses attributable to purchase of electricity, natural gas and related services, depreciation, amortisation, impairment and write-off expenses of property, plant and equipment



Natural gas distribution

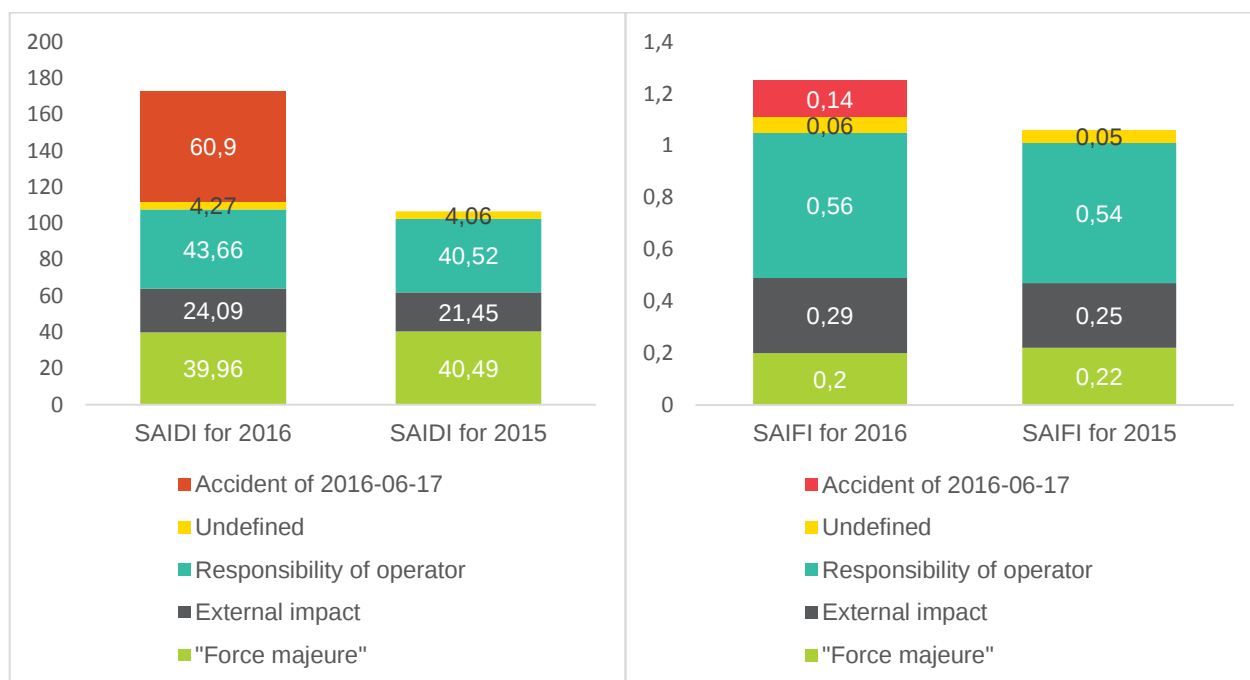
In 2016, ESO transported 7.4 billion kWh (691 million cubic meters) of natural gas through the gas distribution pipelines, which is approx. 8.3% more than in 2015. In 2016, gas distribution volumes increased mainly due to a higher gas consumption by heat and electric power generation plants as a result of colder weather during the heating season.

Electricity supply quality indices (SAIDI, SAIFI)

During 2016, the system average interruption duration index (SAIDI with *force majeure*) per customer was equal to 172.9 minutes. This is 66.4 minutes more compared to 2015 when it was equal to 106.5 minutes. In 2016, the system average interruption frequency index (SAIFI with *force majeure*) per customer reached 1.25 times, which is 0.29 time more compared to 2015 when it was equal to 1.06 times.

More frequent natural disasters caused by extremely changing weather had a significant impact on the operation of the electricity distribution network in 2016. The storm of 17 and 25 June 2016, which was one of the strongest in recent years, had the largest impact on the network reliability indicators. The consequences of this storm, which were eliminated between 17 and 25 June, are classified as an accident, according to the *Regulations on the investigation and recording of electric equipment accidents and disorders of the Republic of Lithuania*.

Electricity supply reliability indices for January–December 2016 and January–December 2015



Investments

In 2016, ESO's investments in the electricity and gas distribution networks amounted to EUR 149.188 million, which is 13.4% more than in 2015 when they were equal to EUR 131.556 million.

ESO's investments, EUR million

	12 months of 2016	12 months of 2015
Renewal of the electricity distribution network	84.659	70.565
Expansion of the electricity distribution network	39.500	42.937
Construction and reconstruction of gas systems	16.499	13.301
Other (IT, management systems, etc.)	8.531	4.754
Total investments	149.188	131.556

In 2016, ESO's investments allocated for the renewal of the electricity distribution network amounted to EUR 84.659 million, which is 20% more compared to 2015. In 2016, investments in the expansion of the electricity distribution network amounted to EUR 39.5 million (2015: EUR 42.973 million).

In 2016, investments in IT, management systems and other assets increased by 1.8 times compared to 2015 and amounted to EUR 8.5 million. This increase was caused by the installation works of the new electricity distribution network management system.

This new system, which is implemented by IGE Energy Management Services Limited, a company belonging to the US industrial and energy concern General Electric, will ensure a better quality of electricity supply and distribution, higher network reliability and more operative restoration of power supply in the event of failure.

In 2016, ESO connected 29.36 thousand new customers to the electricity distribution network, which is 3% more than in 2015 when 28.50 thousand new customers were connected. The admissible electric power of objects of newly connected customers was equal to 349.28 thousand kW, which is 9.7% less than in 2015, when the admissible power was equal to 386.86 thousand kW.

In 2016, ESO's investments in the construction and reconstruction of gas systems amounted to EUR 16.5 million or 37% more compared to 2015. In 2016, the Company constructed 109.1 km of the gas distribution pipeline (2015: 82.7 km) for the connection of new customers to the gas network and connected 5,375 customers* to the gas pipelines, which is 32% more than in 2015 when 40,78 customers were connected.

* number of connected customers who were connected after the construction of the natural gas system by Energijos Skirstymo Operatorius AB, for which documents certifying the completion of construction works were obtained (the agreements on purchase and sale of natural gas and service provision are not necessarily concluded by customers).

In the fourth quarter of 2016 ESO quarter completed the construction of natural gas distribution pipeline in Tauragė. The company built 5.8 kilometers of gas distribution pipeline. The biggest and main user of this pipeline will be one of the largest Lithuanian milk processing companies Vilkyškių Pieninė, which plans to use natural gas for its activity in the first half of 2017. Dairy processing plant plans to consume more than 6.5 GWh of natural gas annually.

On November 29 2016 ESO acquired natural gas distribution system in Druskininkai, and since November 1 2016 when the former gas supplier ceased operations, the company carries a guarantee gas supply activities.

Analysis of financial indicators

At the end of the reporting period, the Company's assets amounted to EUR 1.11 billion. Non-current assets accounted for 92.7% of the total assets. Cash and cash equivalents, i.e. the most liquid assets, amounted to EUR 10.7 million or 13.18% of the total current assets.

ESO's financial leverage ratios

	31 Dec 2016	31 Dec 2015
Debt ratio	0.44	0.47
Debt to assets ratio	0.20	0.23
Liabilities to equity ratio	0.79	0.88
Debt to equity ratio	0.35	0.43
Net borrowings, EUR million	208.4	220.0
Net borrowings to equity ratio	0.33	0.38
Long-term debt to equity ratio	0.26	0.26
General solvency ratio	0.79	0.88
Equity to assets ratio	0.56	0.53
Share price to earnings ratio*	8.34	-
Capitalisation, EUR million*	771.17	-

*Trade in shares of ESO on the stock exchange was started from 11 January 2016

At the end of 2016, ESO's borrowings amounted to EUR 219.1 million and accounted for 44.7% of total liabilities. Non-current borrowings amounted to EUR 161.7 million or 73.8% of total borrowings. At the end of the reporting period, ESO's current liabilities totalled EUR 184.4 million.

ESO's liquidity ratios

	31 Dec 2016	31 Dec 2015
Current ratio	0.44	0.64
Quick ratio	0.43	0.63
Cash ratio	0.06	0.13
Working capital, EUR thousand	-103,528	-75,920
Working capital to total assets ratio	-0.09	-0.07

ESO's current liabilities exceeded current its current assets by EUR 103.5 million. Current ratio is equal to 0.44. Quick ratio does not significantly differ from the current ratio, because inventories represent only 2.1% of total current assets. Borrowings, as reduced by the amount of short-term investments and cash and cash equivalents, are equal to EUR 208.4 million. The Company's net borrowings account for 33% of its equity.

References and additional explanations of disclosures in the financial statements and other significant events and their impact on the financial statements

Other information is presented in the financial statements of ESO for 2016.

FACTORS AFFECTING THE COMPANY'S FINANCIAL INDICATORS

Operating environment

The European Union's gross domestic product is slowly growing for a fourth year in a row. The growth tendency is expected to prevail in the upcoming year and should be influenced by low oil prices, favourable financing conditions, and a weaker euro against the dollar. On the other hand, new risks are beginning to emerge, which can affect economic growth: slower growth in China and other developing countries, weak global trade and geopolitical tensions in neighbouring European countries. GDP growth in 2016 is forecast to rise to 1.8% for the EU as a whole and to 1.7% for the euro area, according to the European Commission's forecast issued in autumn 2016. Meanwhile, in 2017 economic growth is expected to reach 1.6% and 1.5%, respectively².

The Lithuanian economy will grow by 2.0% in 2016 and 2.7% in 2017, according to the European Commission's forecast.³ In their forecasts, the economists of the Lithuanian banks also project that the Lithuanian economy will grow. According to the SEB Bank analysts' forecasts issued in January 2017, Lithuania's gross domestic product increased by 2.2% in 2016 and will increase by 2.5% in 2017⁴. In November 2016, the analysts of Swedbank AB also published the Lithuanian economic outlook: they expected that the gross domestic product would grow by 2.0% in 2016 and 2.8% in 2017⁵. According to the December 2016 forecast issued by the Bank of Lithuania, the Lithuanian gross domestic product grew by 2.0% in 2016 and will grow by 2.4% in 2017⁶.

² Source of data: European Commission. European Economic Forecast Autumn 2016

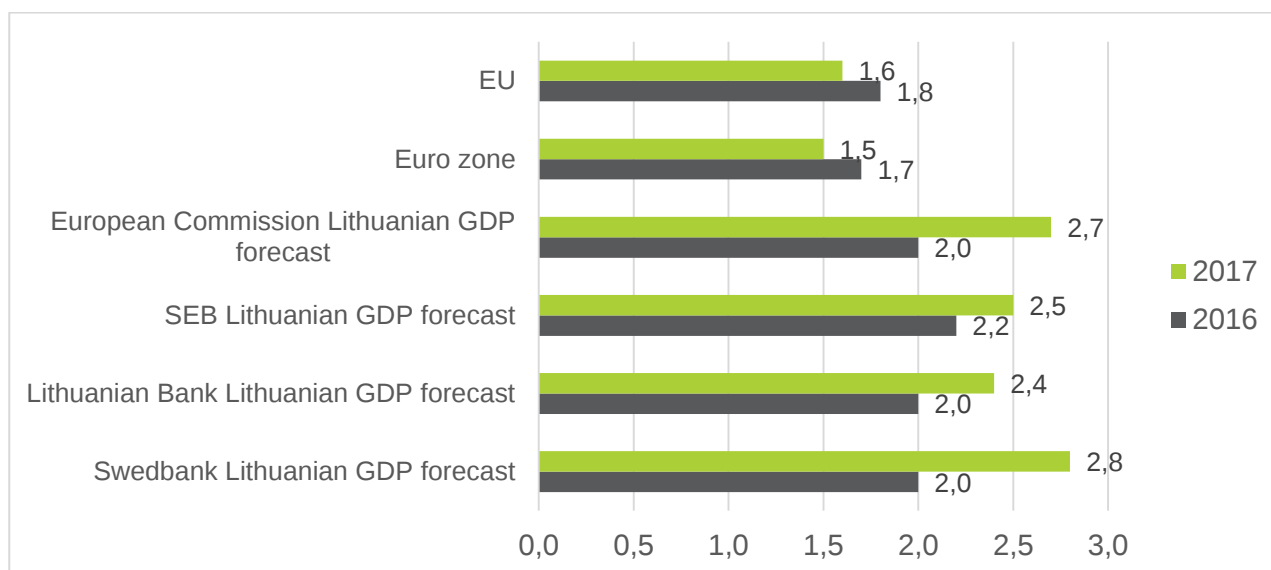
³ Source of data: European Commission. European Economic Forecast Autumn 2016

⁴ Source of data: SEB Bankas. Lithuanian Macroeconomic Review No 64, January 2017

⁵ Source of data: Economic Review of Swedbank. November 2016

⁶ Source of data: Bank of Lithuania. Lithuania's Economic Development and Outlook, December 2016

GDP growth forecast for Lithuania, the European Union and the euro area in 2016–2017, %

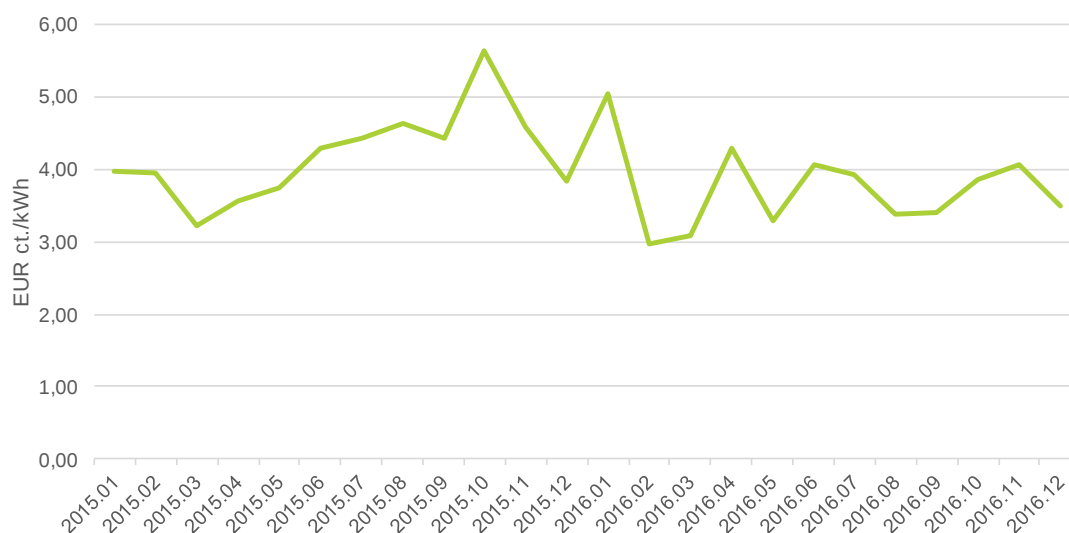


Electricity consumption is closely linked with the growth of a gross domestic product, therefore economic growth also impacts the performance of ESO. Taking into account macroeconomic forecasts for 2017 presented by economists as well as the actual results of operations of ESO for 2016, we hold the opinion that a higher volume of electricity will be distributed in 2017.

Situation in the electricity market

In 2016, the average price of electricity in power exchange Nord Pool trade zone in Lithuania was lower than in 2015⁷.

Average monthly prices at the electricity exchange



⁷ Source of data: Electricity Market Review, December 2016 [interactive]. Viewed on 6 Feb 2016. Access through the internet: <http://www.litgrid.eu/index.php/elektros-rinka/rinkos-apzvalgos/798>

The Company's strategy and objectives

On 2 November 2016, ESO operational strategy for 2016–2020 as approved by the Company's Board was announced. The long-term strategy of ESO is based on customer service reliability and speed, effectiveness, organisational culture based on unified values and continuous improvement.

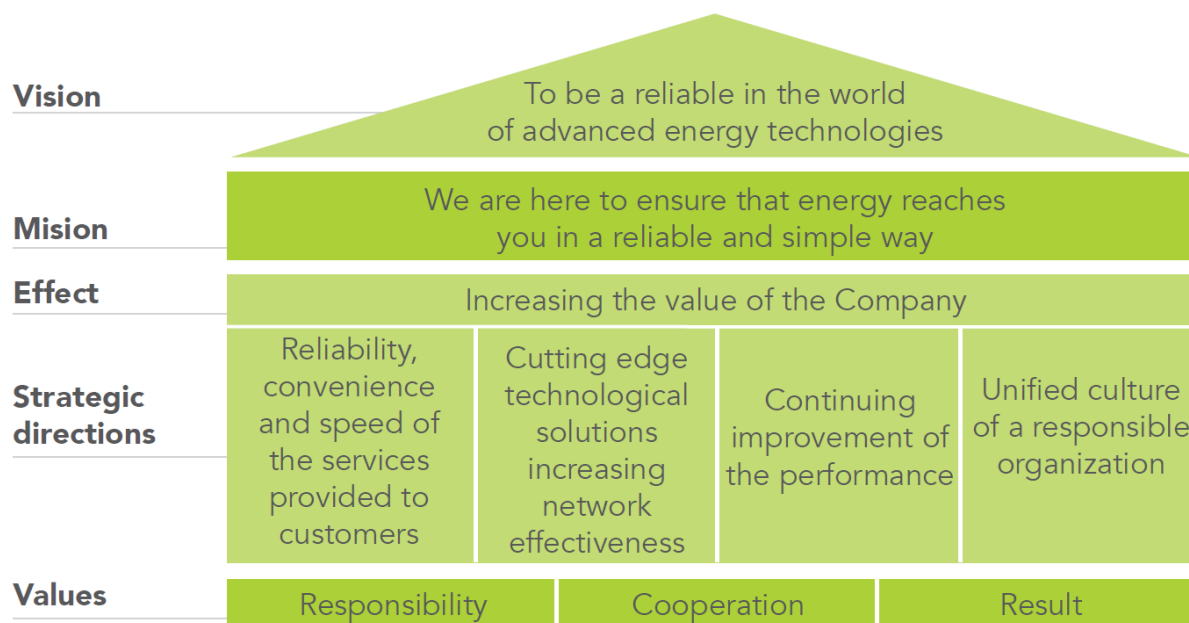
The strategy outlines a further enhancement of operational efficiency and reduction of operating expenses by more than 10% by 2020. A safe and reliable provision of electricity and natural gas distribution services will be achieved by making investments, which are estimated to be increased by 45% by 2020, for the improvement of technical conditions of electricity and natural gas networks.

The Company will focus on significantly improving the reliability of the electricity distribution network until 2020. The system average interruption duration index (SAIDI with *force majeure*) for the electricity network is expected to drop down to 87 minutes (2016: 106 minutes) and the system average interruption frequency index (SAIFI with *force majeure*) will decrease by 0.94 time (2016: 1.06 time) by the year 2020. The Company will also aim to maintain high reliability indices of the natural gas distribution network.

By 2020, the Company plans to shorten the time for new customer connections to the natural gas distribution network by half: from 177 to 85 days. The time for new customer connections to the electricity distribution network is expected to be shortened from 66 to 50 days. The shortening of the process of new customer connection to the electricity network will improve the country's ranking in the World Bank's index *Doing Business* as getting electricity is one of its component indicators.

The Company will aim to maintain a high customer service satisfaction level which is to exceed the European average for energy companies. It is expected that the Company's customer satisfaction index (GCSI) will remain at 80 points in 2020.

ESO's operational strategy scheme



The fulfilment of the ESO's mission, vision, pursuit of its activities are based on the values of collaboration, responsibility and results. These values express a concept that the Company constantly feels responsibility for its actions, cooperates and always strives to achieve the best results for its stakeholders.

All of these elements are considered to be the fundamental assumptions for the achievement of the main strategic goal – increase of the Company's value. The increase of the Company's value is perceived as a sustainable balance between the strategic directions listed below, which are linked by the balanced scorecard methodology to their relevant perspectives:

1. Service customer reliability, convenience and speed (customer perspective);
2. Advanced technological solutions which enhance network performance (internal processes perspective);
3. Unified organizational culture (employee training perspective);
4. Continuous improvement of activities (internal processes perspective).

A consistent implementation of these directions allows us to contribute to the core strategic objective of the Company – increase of the Company's value (financial perspective) – in a balanced way.

Stakeholders

In order to balance the implementation of the strategic directions the Company first takes into account the interests and expectations of stakeholders. During the internal and external analysis the following key stakeholders were identified: customers, society, employees, regulators and contractors. The Company's strategic directions should reflect interests of key stakeholders. The presented scheme shows ESO stakeholders' needs conveyed through the strategic directions. Each strategic direction is associated with one or more stakeholders. According to this rationale, specific objectives and indicators are provided to monitor the fulfilment of stakeholders' interests.

Investment plans

Modernisation of the electricity distribution network

On 3 February 2015, LESTO announced the investment plan for 2015–2025. Over the next ten years ESO, which continues The activities of LESTO, plans to completely modernise the distribution network. In order to ensure reliable, safe and intelligently managed services, the Company plans to invest EUR 1.7 billion in the modernisation and renewal of the network by 2025.

Investments aimed at increasing the resistance of the network to weather conditions will make up a major share (EUR 511 million) of the total investments. This this involve the replacement of overhead lines with underground lines or isolated lines. Over the next 11 years, the portion of such lines is expected to increase from 25% to 40% or underground and isolated lines with the length of 18 thousand kilometres are planned to be constructed. Investments in the programme *Safe and Reliable Network* are expected to reach EUR 426 million. In the course of the programme implementation, unsafe transformers, cable lines and distribution devices will be replaced with advanced equipment which meet the requirements of modern standards.

Investments aimed at improving the quality of the electricity supply voltage are expected to reach EUR 132 million. This will allow to solve the problem of a poor supply voltage for 41 thousand customers by fixing nearly 9.1 thousand kilometres of lines affected by voltage fluctuation. ESO plans to allocate EUR 34 million for the implementation of the smart grid projects. Seven projects are expected to be implemented by 2025 including the automation of the grid, pilot projects of smart reading devices, a single dispatcher centre and installation of the system for the management of the distribution network.

The remaining investments will be allocated for the connection of new customers, investments in IT systems and other measures.

Modernisation of the gas distribution network

On 13 December 2015, Lietuvos Dujos AB announced a ten-year investment plan projecting that its investments in the network will amount to EUR 141.1 million over the next ten years. ESO, which continues the activities of Lietuvos Dujos AB, plans to allocate the largest portion of investments for the development of the distribution system, reconstruction of distribution pipelines and modernisation of the systems of remote data collection and control.

The 2016–2025 investment plan indicates ten directions for investments. The largest portion of investments (EUR 58 million) is earmarked for the development of the gas distribution system, which is necessary due to a growing number of new natural gas customers. Investments in the modernisation of the remote data collection and control systems are expected to amount to nearly EUR 21 million, and EUR 20.4 million is planned to be allocated for the reconstruction of the gas distribution pipelines. The Company plans to allocate EUR 11.7 million for the modernisation of the gas metering system within ten years. Investments in the reconstruction of the gas pressure regulating equipment are to amount EUR 7.7 million, investments in the replacement and additional installation of closing devices –EUR 6.5 million, and investments in the reconstruction of corrosion protection equipment for the pipelines – EUR 1.2 million. Investments for the gas distribution reliability projects are projected to reach EUR 3.5 million and EUR 0.66 million is planned to be assigned to the buyout of the gas distribution pipelines. The Company plans to allocate EUR 3.9 million for the modernisation of technological processes.

Risks and uncertainty factors and their management

Risk management policy

The Company's risk management system is based on the principles of COSO (the Committee of Sponsoring Organisations of the Treadway Commission), ERM (Enterprise Risk Management), AS/NZS ISO 31000:2009 (Risk management – Principles and guidelines) and ISO/IEC 27005:2011 (Information technology – Security techniques – Information security risk management).

ESO understands risk as uncertainty relating to the achievement of the objective which arises from potential events and their possible consequences. ESO's operational objectives are understood broadly and include both general objectives related to the long-term strategy and action plan, as well as the specific objectives relating to individual business processes of the Company. The Company's risk management is based on the assessment of a potential adverse impact on the goals and results of the Company and its business functions (processes). Risk identification, analysis, assessment and management are carried out systematically in accordance with the uniform risk management policy applied by the companies of the Lietuvos Energija UAB group. The Company has adopted a risk management procedure and other internal regulations concerning the risk management.

The main risk management principles of ESO are as follows:

- risk management creates and protects the value created, management scenarios and measures are selected in such a way as to contribute to the achievement of the Company's objectives and performance improvement;
- risk management is integrated in the Company's business processes and linked to the operational planning process, the monitoring of the Company's performance ensures a continuous monitoring of the risk level trends;
- risk management is an integral part of the decision-making process;
- risk management is adapted to the internal and external environment as well as the nature of the risks;
- risk management is systematic, structured, and timely;
- risk management is dynamic, responsive to change, and repetitive;
- risk management process is transparent and comprehensive. Personnel at all levels of the Company are involved in this process. Suitability and reliability are ensured by the Company's Board of Directors, which carries out the functions of a risk management committee, whereas at the Lietuvos Energija UAB group level, suitability and reliability are ensured by the Risk Management Supervision Committee of the Supervisory Council of Lietuvos Energija UAB.

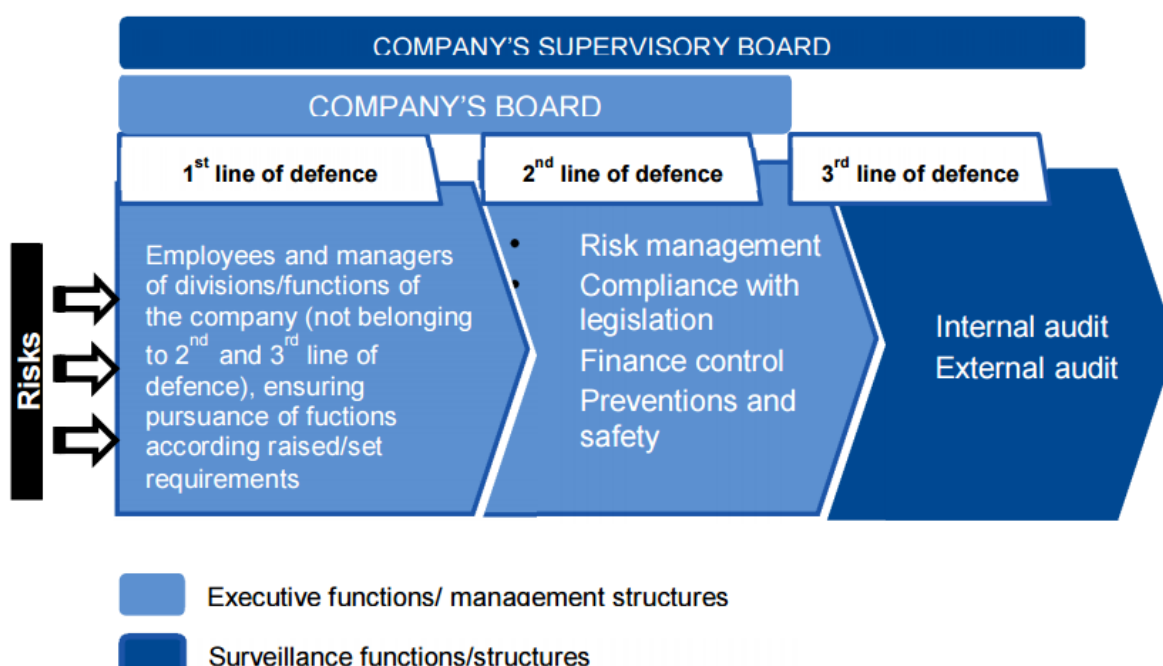
The periodic risk identification and assessment cycle, which measures the residual risk associated with the results of operational functions (processes) and benchmarks strengthening of risk management measures, is held annually during the planning process for operational objectives. Risks (risk factors) that may have an adverse effect on the Company's business objectives and results are determined during this cycle. The risks identified are assessed according to their probability of occurrence and a potential impact on performance goals and results. This way risk management measures are selected for the risks evaluated whose integrated probability and impact assessment exceeds the risk tolerance level. The implementation of the measures should reduce the probability and (or) the impact so that the risk impact on the objectives and results is within the risk tolerance (risk appetite) range. Risk can also be evaluated spontaneously, before making a significant decision for the Company or a significant change in the conditions of internal or external circumstances. Risk management measures are targeted on the avoidance, mitigation, transfer and (or) taking over of risks in view of their impact on the implementation of the Company's objectives, business continuity, taking into account costs of risk mitigation measures as well as their effectiveness. The Company aims to manage all risks that may have a critical impact on

performance goals and business continuity, regardless of their probability. Residual risk compliance with risk tolerance, the emergence of new risks, and compliance of risk management measures' introduction with the risk management plan are reviewed on a quarterly basis. The Company's employee responsible for risk management coordinates the Company's risk management system as well as develops the risk management process. The establishment of measures, analysis and assessment of their impact on the Company's business function (process), preparation and implementation of an appropriate risk management action plan are the responsibility of the owner of a business process or the head of a department, the results of which may negatively affected by these risks.

Risk management and control model

In managing and controlling risks arising from its activities, the Company applies the three lines of defence principle by establishing a clear segregation of duties for risk management and control between the Company's management and supervisory bodies, structural departments or functions (see the figure below).

Risk management and control scheme



The first line of defence includes executive personnel and employees of the Company's departments (other than those included in the second and third lines of defence) who perform operational functions falling within their competence and (or) ensure the fulfilment of operational functions according to the requirements set for these functions, i.e., executive personnel and employees who conclude agreements and (or) organise and implement the Company's main activities, management and support processes (other than those included in the second and third lines of defence). In performing activities that fall within their competence and aiming to achieve the set objectives, employees and executive personnel of the departments/functions included in the first line of defence assume risks related to a respective activity/process and are responsible for the management of these risks and implementation of internal control measures within the processes which fall within their competence.

The second line of defence includes the Company's functions/departments related to risk management, regulatory compliance, financial control, prevention and security:

- A person responsible for risk management is responsible for a proper development of the risk management and control system, the organisation of a risk management process and risk management control;
- The Legal Department ensures that decisions of the Company's executive personnel and employee comply with regulatory requirements;
- The Financial Supervision Department ensures the control of a proper use of financial resources;
- The Prevention Department is responsible for the organisation of the installation and control of preventive risk management measures related to the risk of abuse, physical security, protection of information and property.

The Company's Board of Directors, in performing the functions of a risk management committee, is responsible for a proper risk management and control within the first and second lines of defence. The third line of defence includes: the Internal Audit Department of Lietuvos Energija UAB and the external audit firm. The Internal Audit Department assesses the effectiveness and efficiency of risk management and internal control and makes recommendations for the improvement of risk management and control. The Company's hired external audit firm delivers an opinion on the correctness of the Company's financial statements, and risk management and internal control effectiveness at least once a year. The head of the Internal Audit Department is accountable to the Supervisory Council of Lietuvos Energija UAB and regularly informs the Company's Board and the Supervisory Council on the effectiveness of the Company's risk management and internal control and implementation of the internal audit recommendations. The Company's employee responsible for risk management regularly provides summarised information on risk management and control to the head of risk management function at Lietuvos Energija UAB. The Risk Management Supervision Committee of the Supervisory Council of Lietuvos Energija UAB monitors the effectiveness of the risk management and control system at all three lines of defence according to the established competence.

Key operational risks and their management

The key risks to which the Company is exposed are:

- Strategic risk;
- Compliance / legal risk;
- Operational risk;
- Financial risk.

Strategic risk management

Strategic risk. In the scope of the Company's activities, risks in this category are associated with the planning of activities, unfavourable or erroneous operating decisions, improper implementation of decisions or lack of/delayed response to political, regulatory or technological and (or) scientific (innovation applicability) developments. Market, reputation, damage to the environment and natural resources risks arising from improperly defined strategic directions may also be attributed to this risk category depending on the source of risk. An important macroeconomic risk factor is the generation (or import) price of electricity occurring in the market. This price directly influences the cost of electricity. The price of public supply of electricity is being regulated and fixed irrespective of the electricity price prevailing in the market at that time.

Revenue and profit earned by the Company from distribution and supply operations directly depend on the volumes of electricity distributed/consumed. The domestic macroeconomic situation has a direct impact on electricity sales, connection of electricity and gas equipment of new customers and customer solvency. This risk is managed by the Company conservatively by planning energy consumption and sales revenue.

For the purpose of operating and developing its electricity and gas distribution network, ESO purchases the distribution network equipment and materials, the prices of which depend on market trends. Costs related to the operation of and investments in the network are subject to prices of these goods. These costs affect financial performance of ESO. In order to optimise investments and costs for the network's operation and development, the Company uses the investment ranking method, which is based on objective criteria corresponding to the Company's priorities for the operation and development of the electricity distribution network.

Political risk factors are also important for Company's activities. Electricity distribution and supply is regulated by the Lithuanian Law on Electricity and gas distribution is governed by the Lithuanian Law on Natural Gas. Amendments to the mentioned laws and other related legal acts may affect ESO's activities and results of its operations. The State's policy is important in relation to energy prices. Service prices are regulated and price caps are set and controlled by the National Control Commission for Prices and Energy. The Commission's decisions affect ESO's performance. In order to reduce the impact of the mentioned risk on its operating results, the Company analyses international practice on the regulation of energy companies and, if necessary, submits proposals to legislative state authorities.

In performing the functions of electricity and natural gas distribution, public and guaranteed supply of electricity, the Company seeks to comply with the highest standards of reputation. This objective is reflected by the Company's mission, vision, strategic objectives and values. The heads of the Company pay great attention to the communication of the Company's mission, vision, values and strategic objectives to employees. In addition, the Company carries out social projects consolidating the Company's image as a socially responsible company.

Compliance / legal risk management

Compliance / legal risk is understood as the risk arising from a changing regulatory, legal environment, or validation of specific changes in specific areas, but they are not properly or promptly transferred to the Company's internal documents. Or, with regard to the Company's activities, there is no possibility for such requirements to be implemented promptly or fully. Also, this risk category can be associated with the risk of compliance with a variety of standards and certificates. This is the risk of an increase in losses, loss of reputation, and (or) decrease in confidence, which may be caused by external environmental factors or internal factors (such as violations of internal legal acts and ethical standards, cases of abuse involving employees, etc.).

The Legal Department is responsible for the management of compliance / legal risk. In order to minimise the compliance / legal risk, the Company's lawyers participate in the decision-making process of the Company's management, preparation of internal legal acts and agreements.

Operational risk management

Operational risk is understood as the risk of incurring losses/not earning revenue planned, failing to safeguard the Company's ability to continue its business activities or posing threat to employees and (or) the environment, as well as losing trust due to improper or unfulfilled internal control procedures, improperly organised and managed processes, employee errors and (or) illegal actions and information system failures or those resulting from external events. This category includes risks associated with an improper management of human resources, the organisation's working environment, failure to ensure occupational safety and health, civil, physical protection, fire prevention, inadequate/insufficient information technologies, failure to ensure information security, improper contract management, inefficient internal control systems, failure to manage the quality of products/services/works, failure to ensure customer service quality, damage to the environment or inefficient processes. The management of risk related to interruptions in energy supply plays a very important role in the Company's activities. Reliability of electricity distribution is one of the major factors describing the activity of the distribution network operator, which is assessed taking into account the duration and frequency of electricity supply interruptions (SAIDI, SAIFI). The unpredictable external factors, like natural disasters, cause the risk of failing to ensure a

reliable supply of electricity to consumers, the risk that ESO may not receive expected amount of revenue and that the elimination of breakdown consequences would require additional maintenance expenses. The Company has developed comprehensive emergency management procedures for the management of this risk. Aiming to increase the quality of electricity and reliability of its supply ESO plans to allocate a major part of its total investments for the restoration of the distribution networks, reconstruction of transformer substations and installation of new, long-serving, modern, high quality electricity and gas equipment. The Company is also looking for technological solutions that would ensure a day-to-day monitoring of the condition of the distribution networks being operated, rapid elimination of breakdowns and that would prevent electricity and gas supply interruptions.

Financial risk management

Credit risk is the risk of incurring losses due to customers' and (or) other counterparties' failure to fulfil their financial liabilities to the Company. The Company's credit risk arises from fixed-term and indefinite-term funds held in bank accounts, investments in debt securities, consumers' obligations to pay for electricity consumed. The Company has no significant concentration of credit risk, because a large number of consumers of energy leads to a low concentration of credit risk.

The priority objective of investing activities is the ensurance of security of funds and maximisation of return on investments in pursuance of this objective. The Company applies the established consumer debt management procedures to manage credit risk arising from failure of energy consumers to pay for energy consumed in due time. The Company does not issue guarantees to secure the fulfilment of obligations of third parties.

Market risk is the risk of incurring losses or the risk of loss of future net income due to changes in interest rates, foreign exchange rates, prices of shares and goods traded on stock exchanges.

Interest rates risk

The Group's and the Company's income and operating cash flows are not in principle significantly independent of changes in market interest rates. All the Group's and the Company's loans and borrowings bear variable interest rate linked with EURIBOR. The Company manages interest rate risk by using derivative financial instruments for interest rates.

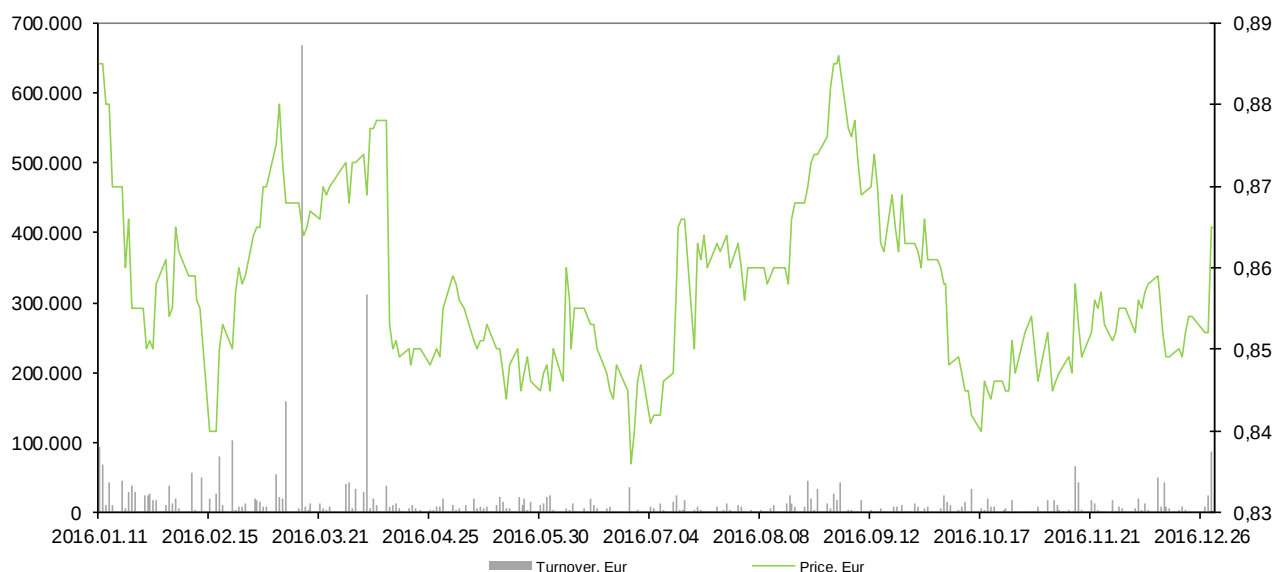
Foreign exchange risk

All monetary assets and liabilities of the Group and the Company are denominated in the euro.

INFORMATION ON THE COMPANY'S AUTHORISED SHARE CAPITAL AND SECURITIES

Share price dynamics and turnover

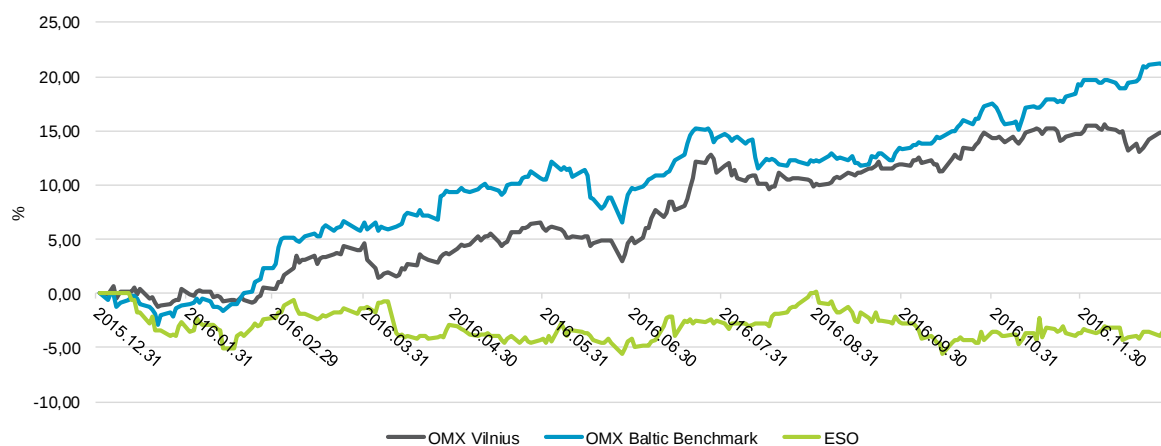
Dynamics of the price of ESO's shares and turnover in shares during the period from 11 January 2016 to 31 December 2016



ESO is the largest company listed on the NASDAQ Baltic stock exchange in terms of the market capitalisation. On 30 December 2016, ESO's capitalisation amounted to EUR 771.17 million. During 2016, the price of shares of ESO decreased by 2.82%. The lowest ESO share price was recorded on 27 June, 2016, the price of ESO share was EUR 0.831. The highest point (EUR 0.889) during the reporting period was reached on 31 August, 2016. In 2016, the average weighted price per share amounted to EUR 0.860.

Dynamics of the price of ESO's shares and OMX Vilnius and OMX Baltic Benchmark indices during the period from 1 January 2016 to 30 December 2016

ESO, OMX Vilnius ir OMX Baltic Benchmark indeksų dinamika, 2016.01.01-2016.12.30



During 2016, the OMX Vilnius index increased by 14.92%, the OMX Baltic Benchmark index rose by 21.57%, while the price of ESO's shares declined by 2.6% of its initial value during 2016.

Structure of the authorised share capital

Type of shares	Number of shares, items	Nominal value, in EUR	Total nominal value, in EUR	Percentage of share capital
Ordinary registered shares	894,630,333	0.29	259,442,796.57	100.00

As at 31 December 2016, the Company's authorised share capital amounted to EUR 259,442,796.57. All the shares issued by the Company are fully paid.

Information on the issuer's securities

With effect from 11 January 2016, the shares of ESO have been listed on the main list of NASDAQ Vilnius AB stock exchange. The Company's shares are not traded in other regulated markets.

ISIN code	Trading list	Securities' abbreviation	Number of shares, items	Nominal value per share, in EUR	Industry under the ICB standard	Supersector under the ICB standard
LT0000130023	BALTIC MAIN LIST	ESO1L	894,630,333	0.29	7000 Utilities	7500 Utilities

Rights and obligations granted by shares

All ordinary registered shares grant the same rights. Property and non-property rights are defined in the law, other legal acts and Articles of Association.

Information on major transactions of associated parties – indicate the value of transactions, the nature of relations among associated parties, and other information on transactions necessary to understand the Company's financial situation, if such transactions are significant or have been concluded in unusual market Conditions

Information on transactions of associated parties is provided in clause 28 of the notes to the audited consolidated annual financial statements for 2016.

Significant agreements to which the Issuer is a party and which would come into effect, change or would be terminated if the control of the issuer changed, as well as effects thereof, except in cases where revelation thereof would cause considerable damage to the issuer due to the nature of such agreements

The Company has not entered into significant agreements which would come into effect, change or would be terminated if the control of the issuer changed.

Information about harmful transactions made by the Issuer during the reporting period, which had or might have negative impact for the Issuer's activity and (or) activity's results, also the information about transactions which are made in conflicts of interest among executives of the Issuer, controlling shareholders or other related parties duties and their private interests and (or) other duties. It is necessary to disclose significant agreements' meaning, conditions, format of conflicts of interests and their influence for the agreement.

During the reporting period the Issuer did not make any harmful transactions (which do not meet Company's objectives, existing normal market conditions, violate shareholders or other groups interests and other) and did not make any transactions made in conflicts of interest among executives of the Issuer, controlling shareholders or other related parties duties and their private interests and (or) other duties.

Procedure for amending the Articles of Association

The General Meeting of Shareholders has the right to amend the Articles of Association of ESO.

Restrictions on the transfer of securities

No restrictions are imposed on the transfer of ESO securities.

Subsidiaries

On 31 December, 2016, ESO had no subsidiaries.

Information about branches and representations

There are no branches and representations of the Company.

Information about committees

There are no committees in the Company.

Total number of shares acquired and the number and par value of own shares. Own shares as a percentage of the share capital

ESO had no own shares prior to the accounting period and did not acquire any own shares in 2016.

The number of acquired and transferred own shares during the reporting period, their nominal value and the part of the share capital represented by such shares

The Company did not acquire or transfer its own shares in 2016.

Information on payment for own shares if these shares were acquired or transferred with charge

The Company did not acquire or transfer its own shares in 2016.

Reasons for acquisition of own shares in the accounting period

The Company did not acquire its own shares in 2016.

Shareholders

As of 31 December 2016, the total number of the Company's shareholders was 8,841.

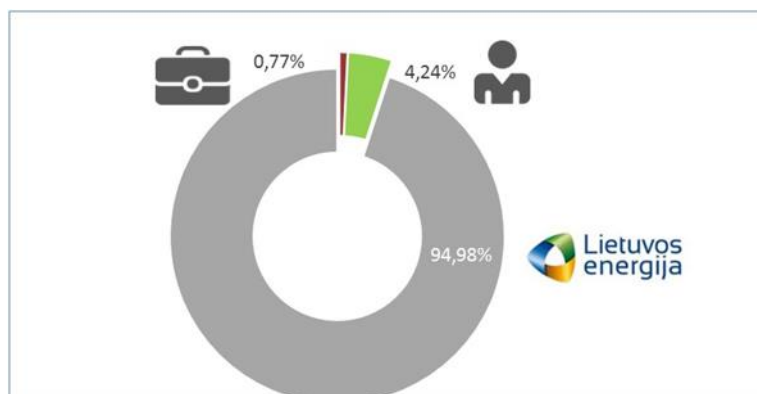
During the reorganisation of LESTO and Lietuvos Dujos, ESO took over assets, rights and obligations of these companies. Consequently, all entities that held shares of LESTO and Lietuvos Dujos as at 11 December 2015 became the shareholders of ESO.

Lietuvos Energija UAB holds 94.98% of the Company's shares. Households own 4.24%, and financial institutions, insurance, and other companies hold 0.77% of ESO's shares.

**Distribution of the number of ESO's
shareholders by country,
at 31 Dec 2016**

Country	Number of shareholders
Lithuania	8549
Estonia	84
Russia	49
Latvia	41
Belarus	39
USA	17
Great Britain	11
Other countries	51
Total	8,841

**Distribution of ESO's shareholders by category,
at 31 Dec 2016**



Agreements between the shareholders which are known to the Issuer and due to which the securities transfer and/or voting rights may be subject to limitations

No agreements between the shareholders of the Company due to which the securities transfer and/or voting rights may be subject to limitations are known to the Company.

Restrictions on voting rights

No restrictions on voting rights are known to the Company.

The Issuer's bodies authorities to issue and to buy shares

The decisions to issue or to buy the Issuer's shares can be made by General Meeting of Shareholders by the Republic of Lithuania law.

Shareholders owning more than 5% of the issuer's authorised share capital as at 31 December 2016

Shareholder's name (company name, legal form, registered office address, code)	Number of ordinary registered shares owned by the shareholder, units	Ownership interest in the authorised capital, %	Percentage of voting rights conferred by shares owned
Lietuvos Energija, UAB, Žvejų g. 14, LT-09310 Vilnius, Company code 301844044	849,743,761	94.98	94.98

Dividends

During the ordinary general meeting of shareholders held on 29 March 2016, a decision was made to pay out dividends to the Company's shareholders for the period from 1 July 2015 to 31 December 2015. Profit appropriated for the payment of dividends amounted to EUR 30.6 million. Dividends per share for the six-month period from 1 July 2015 to 31 December 2015 amounted to EUR 0.0342.

A decision was passed at the September 27, 2016, Extraordinary General Meeting of Shareholders of the Company to pay dividends to shareholders for the period from January 1, 2016, to June 30, 2016. Profit share for dividend pay-out amounted to €12.5 million Dividends for the six-month period from 2016 January 1 to June 30 amounted to €0.014 per share. The net profit of ESO for the six months of 2015 amounted to EUR 53.2 million. Dividend / net profit ratio for the six months of 2016 is equal to 0.23.

Information on agreements with intermediaries of public trading in securities

The authorised manager of securities accounts of ESO is SEB Bankas AB.

The contact details of SEB Bankas AB:

Gedimino Ave. 12, LT-01103 Vilnius;

Telephone: 1528 or +370 5 268 2800.

CUSTOMER SERVICE, SERVICE ASSESSMENT

Number of customers being serviced

On 31 December 2016, ESO had 1.595 million (31 December 2015: 1.579 million) contracts on purchase and sale of electricity concluded with private customers and 68.377 thousand (31 December 2015: 66.7 thousand) contracts on electricity supply or distribution services concluded with commercial customers.

As at 31 December 2016, approx. 565.9 thousand of private customers and approx. 9.6 thousand of commercial customers were connected to the ESO's gas distribution networks for whom the provision of a distribution service was ensured.

Development of service channels

In 2016, the number of customers using remote service channels increased (a new self-service website www.manogile.lt and customer service short number 1802), and electricity consumer flows to the customer service centres in smaller towns declined. At the beginning of 2016, the self-service website was upgraded to enable a single declaration and payment for electricity and gas.

As at 31 December 2016, self-service website www.manogile.lt had 407 thousand registered private customers.

In 2016, more than 1,179 thousand (2015: 999 thousand) customers were serviced at short customer service number 1802; more than 511 thousand (2015: 479 thousand) customer requests on various issues were received and resolved.

During 2016, more than 263 thousand (2015: 249 thousand) customers were serviced at the customer service centres in the seven major Lithuanian cities.

Operation and development of electricity and gas metering devices

In 2016, ESO replaced 97,823 units of metering devices that no longer meet the meteorological requirements, whereof 76,346 units of electricity meters and 21,477 units of natural gas meters. The Company installed 23,339 units of electricity metering devices and 4,877 units of natural gas metering devices for new customers.

By regularly renewing metering devices being operated, the Company and its authorised persons inspected more than 828 thousand units of electricity meters and more than 128 thousand units of natural gas meters. In 2016, the Company also installed 866 controlling metering devices in 10 kV voltage network, thereby increasing their number up to 1,374. This accounts for 40% of the total 10 kV voltage network.

By investing in the modernisation and automation of the electricity and natural gas metering equipment, in 2016 ESO connected 2,435 electricity metering devices installed at the objects of commercial customers to the existing automated data reading systems. As a result, the number of operated electricity meters that are scanned remotely reached 29,773 and the number of respective natural gas meters remained unchanged and is equal to 1,212.

The automation of metering devices allows to automatically submit bills for electricity consumed to commercial customers and establish a precise amount of natural gas consumed by a commercial customer.

In order to test the effectiveness of smart metering devices and their benefits for private customers, in May 2015 the Company announced an international tender for the procurement of smart meters. The tender was won by the consortium of companies consisting of Technolínės UAB, a company registered in Lithuania, and foreign companies ELKO and ADD-Production. ELKO and ADDProduction are implementing similar projects in Latvia, Slovakia, Poland, and other countries. During the implementation of a pilot project on smart meters, 2,927 smart meters were installed for customers that allow using electricity more efficiently and saving household expenses. The self-service website www.manogile.lt provides customers with exact data on the time of electricity consumption and quantity consumed. During the pilot project ESO will also receive more accurate information on the power grid, which will create conditions for a more rapid identification and elimination of the grid's breakdowns.

During the implementation of the project, participants could choose a four time zone tariff plan adapted to the project, which give the opportunity to change electricity consumption habits and reduce costs. More than 12% of the project participants selected the four time zone tariff plan. The Company continues to assess changes in consumption habits of the project participants.

Management of customer settlements

ESO has provided customers with the possibility to pay for electricity according to the average quantity of electricity consumed. Payments according to the average consumption helps plan expenses evenly, because the same amount is paid every month despite seasonality and changes in the amount of electricity consumed. In addition, customers possessing several residential properties have the ability to pay for electricity consumed at several residential properties owned by the customer by making a single payment (a single invoice can be issued). Monthly payments for electricity are calculated according to the previous average quantity of electricity consumed by the customer (in kilowatt hours, kWh), which is adjusted in view of the customer's declared readings or data received during a periodic inspection of meters. Customers can find out and check the applied average amount to be paid at the self-service website www.manogile.lt, by calling the customer service number or visiting customer service centre *Gilė*. The total of 21% of ESO's customers pay according to VAT invoices issued, whereof 11% make payments according to electronic invoices issued.

Market liberalisation

As at 31 December 2016, independent suppliers supply electricity to 68,124 objects of commercial customers. In accordance with the Plan on the Development of the Lithuanian Electricity Market, which was approved by the Government of Lithuania on 8 July 2009, an independent electricity supplier was chosen as at 31 December 2016 by:

- About 95% of objects whose admissible power was 400 kW and more;
- About 86% of objects whose admissible power was 100 kW and more;
- About 75% of objects whose admissible power was 30 kW and more;
- About 55% of objects whose admissible power was less than 30 kW.

The guaranteed provider (ESO) continues to supply electricity to the remaining objects.

SOCIAL RESPONSIBILITY OF THE COMPANY

Social responsibility is not only ideas and values that the Company follows in everyday activities and in planning for the future. This involves very specific solutions and is part of everyday business activities and conduct.

The Company shares the responsibility to contribute to the welfare of society through a secure continuous energy distribution and supply, active participation in public education on the issues of safe and rational use of energy, installation of new, promising and efficient technologies, taking care of customers, employees, communities and promotion of awareness of contractors and suppliers. Our priorities are:

- Promotion of energy efficiency;
- Reduction of environmental impact through energy conservation;
- Fostering of safe and responsible use of electricity and gas.

Environmental protection

Landscape protection. Aiming to reduce impact on landscape, new cables are being installed in place of old electricity overhead lines in areas where wires of existing overhead lines are thin and dangerously close to green spaces, outdated infrastructure has caused many breakdowns. Cable lines ensure a more reliable supply of electricity and are safer.

Conservation of resources. The Company has over 1.6 million customers and encourages them to abandon paper bills and passbooks and use remote service channels. Nearly 93% of ESO's commercial customers are already using electronic invoicing. Around 89% of private customers and around 96% of commercial customers are informed about an incurred interruption of electricity supply and expected duration of its elimination by sending free-of charge notifications by SMS messages and emails.

Public initiatives. ESO implements large-scale long-term social responsibility projects for children, young people and members of the general public, which focus on an active engagement of target groups of society, ideas on safe and efficient use of electricity.

Information security campaign *Safe Energy*. In spring 2016, a large-scale campaign was launched, which was aimed at a safe use of electricity and gas, theft prevention of ESO technological property, provision of useful advice to the general public. In mass media – television, radio, newspapers and the internet – the campaign covered safety issues related to the commencement of fieldworks, with emphasis placed on the underground electricity and gas network, as well as educational advice on safe behaviour during storms. The campaign also focused on thefts that cause electricity supply interruptions as well as on prevention (educational material, videos, articles). Targeted meetings with the representative of local police, community and mass media were organised in the affected regions.

In autumn 2016, the campaign on safe heating with gas was carried out, during which educational material was provided on a proper preparation for the heating season and regular maintenance of gas equipment. The campaign was launched through the internet by using targeted educational charts and other visual means. A public event for the mass media representatives was organised in cooperation with the State Energy Inspection, during which the work of the ESO's dispatch centre and the gas emergency response service was presented and the main issues relevant for residents using natural gas were stressed.

Promotion of energy efficiency – *Not More Than Needed*. Promotion of rational use of energy is one of the priority directions of ESO's social responsibility contributing to the conservation of environment and energy resources as well as the implementation of the country's obligations under the European Union's climate change programs. The project is aimed at creating traditions of rational living by looking for solutions on rational use of electricity, with a particular focus on consumption by businesses and industrial entities.

In autumn 2016, the cycle of free-of-charge events *Not More Than Needed by Industry 2016* was organised in five regions: Vilnius, Kaunas, Klaipėda, Šiauliai and Panevėžys. During these events practical advisory presentations on the application of energy efficiency solutions in business were delivered.

- **Green Protocol.** This is an agreement initiated by the Company (in its sixth consecutive year), the purpose of which is that the signatory companies and organisations confirm that they accept and agree with environment-friendly ideas:
 - To implement energy efficiency measures;
 - To contribute to environmental protection and greenhouse gas (CO₂) emissions reduction;
 - To encourage employees, colleagues, relatives to contribute to the creation of energy-saving society.

In 2016, 25 new companies joined the initiative (the total of 205 companies participate in this initiative).

- **Conference on the rational use of energy *Energy Efficiency Solutions for Competitive Business***

On 11 February 2016, the business conference, which was initiated by ESO and organised in cooperation with business newspaper *Verslo Žinios*, was held for the sixth time. During the event experts from different industry sectors shared their insights about a sustainable energy consumption with more than 220 conference participants. Practical energy efficiency measures, specific electricity and gas infrastructure solutions implemented by companies, energy efficiency financing, transposition of the European Union Energy Efficiency Directive into the national law and other relevant issues were discussed at the conference. According to the survey of the event's participants, the percentage of participants whose expectations for the conference were met increased by three percentage points (from 93% to 96%).

Every year during the event awards are announced and presented to the companies, signatories to the Green Protocol, which conducted their activities in the most efficient manner in terms of energy. In 2016, Šiaulių Vandenys UAB was awarded for the progress made in recent years (implementation of ISO 5001:2011 energy efficiency standard and other means promoting rational use of energy) and the title of the Green Ambassador (awarded to recognise employees who encourage rational use of energy) was awarded to Rasa Pečiulaitė, a manager of development and energy projects at Eika UAB.

Cooperation with the Lithuanian libraries. In March 2015, the agreement was signed with Martynas Mažvydas National Library of Lithuania whereby cooperation is continued for the purpose of implementing the social project *Libraries for Innovation 2* in order to ensure a further expansion of computerised locations of self-service website www.manogile.lt.

National educational programme *Sustainable School*. In order to raise awareness of schools and contribute to the creation of a sustainable, energy-efficient and environmentally-friendly society, ESO together with partners invited educational institutions of the country to participate in a one-year educational programme *Sustainable School*. The project

was elected as the best social responsibility initiative of 2014 during the Swedish business award ceremony held in 2015. The implementation of the project is being continued (see more at www.darnimokykla.lt).

The project *Sustainable School* is implemented by public institution Pakuočių Tvarkymo Organizacija, companies Schneider Electric Lietuva UAB, Mano Būstas LT UAB and the National Consumer Federation.

Support. Through the support fund of “Lietuvos energija” group ESO provides support for public programs and activities, which are significant for public. The budget of the fund consists of all group companies’ contributions to up to 1% of consolidated group companies’ net profit. Applications for the support may be filled annually, according to established procedures and deadlines.

Market, customers and investors. ESO aims for the maximum possible transparency in its relations with all market participants and compliance with the highest ethical standards and principles in its own activities. The Company cares to ensure that its activities bring economic and social benefits to society.

Updated agreement with the Lithuanian National Consumer Federation. A cooperation is being planned in disseminating information to residents about the rational use of energy and by organising various related initiatives.

Relationships with investors. We strive to maintain close relationships with our existing and potential investors and to ensure that they all have equal access to information, which is regularly updated. In January 2016, three awards were granted for the progress achieved by Lietuvos Dujos and LESTO in strengthening relationship with investors at the stock exchange event Nasdaq Baltic Market Awards 2015.

Transparency, anti-corruption activities

ESO does not tolerate any manifestations of corruption and advocates fair business and transparent communication with public authorities by promoting a zero-tolerance policy against corruption, which is implemented across the entire group of Lietuvos Energija, UAB.

The integrated internal control mechanisms intended to detect possible corruption risk factors minimise the risk. Prevention of corruption is one of the functions of the Company’s Prevention Division. ESO carries out a continuous operational control, improves business processes and takes measures to correct detected irregularities, and remove threats to the Company’s reputation. The issues on the zero-tolerance policy against corruption are regularly communicated to the Company’s employees – meetings of executive personnel are held, lectures and discussions are initiated for employees.

The Company operates an anonymous trust line 1802. Both the employees of ESO and other persons can report any noted violations of ethics via email pasitikejimolinija@eso.lt or by filling in the trust line form available at the ESO’s website under the contacts section.

Increase of transparency in public procurements

ESO is the contracting authority. In the group of Lietuvos Energija, UAB, the centralised procurement function is carried out by Verslo Aptarnavimo Centras UAB (VAC). VAC carries out purchases and provides the services of the organisation and performance of public procurements of goods, services or works. The function of public procurements is centralised, procurement processes are standardised and concentrated on a single online platform.

In order to ensure a transparent and open procurement process and open dialogue, VAC invites suppliers to attend communication meetings, during which high-value procurements planned by the organisation are presented.

ESO also publishes technical specifications projects for all procurements, except for low-value purchases, through the means of the Central Public Procurement Information System (CVPIIS). Information on their announcement is also presented on the Company's website, procurement reports and information about ongoing purchases are also being published.

Accountability

ESO is an active member of the Lithuanian Responsible Business Association (LAVA) and a participant of the Global Compact, a United Nations initiative. In order to increase its accountability to the society, the Company publishes annual social responsibility progress reports, which are presented on its website under the section for investors and the Global Compact website profile (www.globalcompact.org).

The latest report of the organisation was [published](#) on 15 May 2016.

THE COMPANY AND ITS MANAGEMENT BODIES

The Company's organisational structure

Name of the company	AB „Energijos skirstymo operatorius“
Company code	304151376
Authorised share capital	EUR 259,442,796.57
Registered office address	Aguonų g. 24, LT-03212 Vilnius
Telephone	(8 5) 277 7524
Fax	(8 5) 277 7514
Email	info@eso.lt
Website	www.eso.lt
Legal-organisational form	Public limited liability company
Date and place of registration	11 December 2015, the Lithuanian Register of Legal Entities
Register accumulating and storing data about the Company	Register of Legal Entities
Registrar	Public institution Centre of Registers

Energijos Skirstymo Operatorius AB started its operations on 1 January 2016 after the merger of LESTO and Lietuvos Dujos. ESO is part of Lietuvos Energija UAB, a state-owned group of companies, which is one of the largest energy company groups in the Baltic countries. On 1 January 2016, ESO took over from LESTO and Lietuvos Dujos all their assets, rights and obligations as well as all non-current and current assets, non-current and current financial and other obligations, amounts receivable and payable under the agreements signed by LESTO and Lietuvos Dujos, including any other otherwise arising obligations.

ESO operates 121.698 thousand kilometres of electricity lines: 78.7% of them consist of overhead electricity lines, and 21.3% electricity cables. The Company also operates 8.4 thousand kilometres of the gas distribution pipelines.

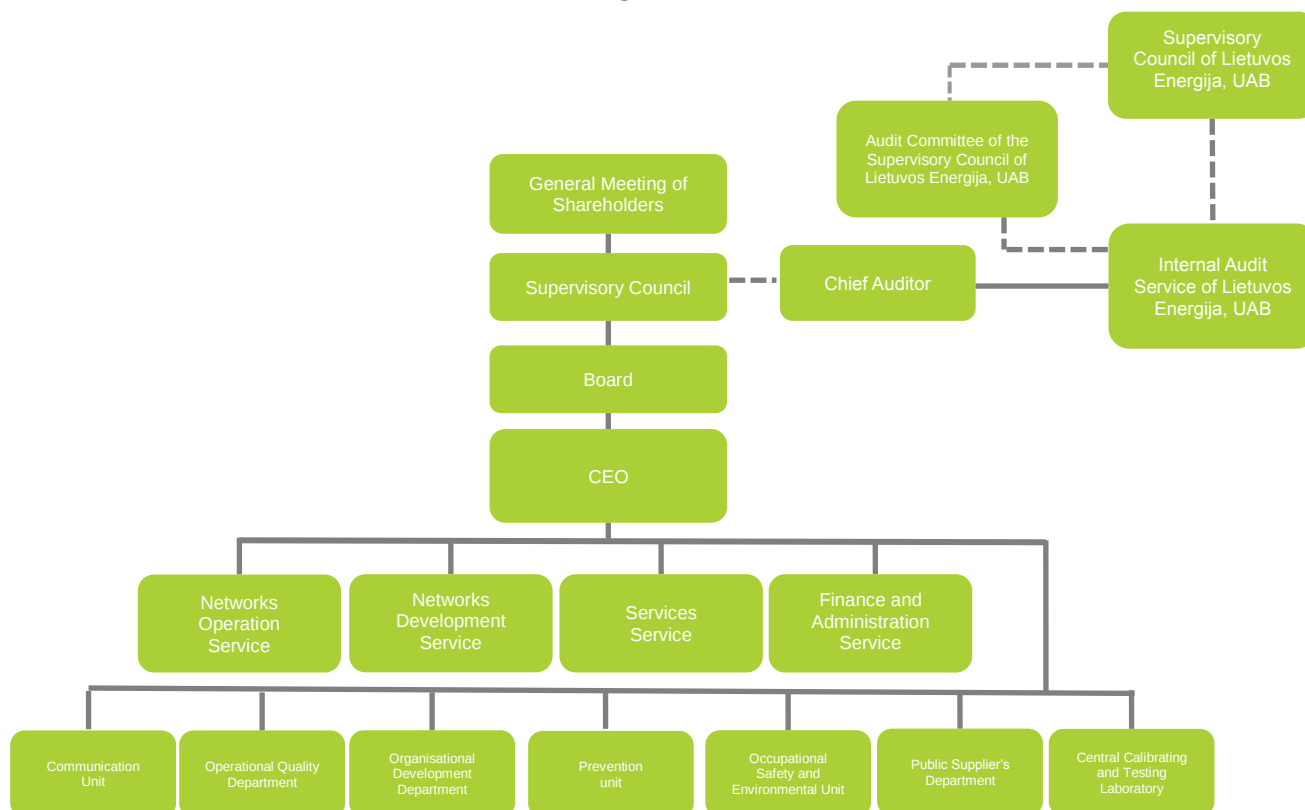
The main functions of ESO are electricity supply and distribution, distribution of natural gas, guaranteed supply of electricity and gas, connection to electricity and gas supply, operation, maintenance, management and development of electricity and gas distribution networks ensuring their safety and reliability. The geographical market of ESO is Lithuania.

Main information about related companies

At the date of signing of the report ESO jointly with other companies controlled Verslo Aptarnavimo Centras UAB and Technologijų ir Inovacijų Centras UAB.

	Technologijų ir Inovacijų Centras UAB	Verslo Aptarnavimo Centras UAB
Address	A. Juozapavičiaus g. 13, Vilnius	P. Lukšio g. 5B, Vilnius
Registration date	4 December 2013	30 July 2014
Company code	303200016	303359627
Telephone	(8 5) 278 2272	(8 5) 259 4400
Fax	(8 5) 278 2299	(8 5) 259 4401
Email	info@etic.lt	vac@le.lt
Website	www.etic.lt	http://vac.le.lt
Ownership interest held by ESO, %, at 1 January 2016	29.01	22.25
Ownership interest held by ESO, %, at 30 September 2016	29.01	22.25
Principal activities	Provision of information technology and telecommunication services for the companies of the energy sector	Provision of services of organisation and performance of public procurements, accounting, administration of employment relationship, customer service, human resources administration, legal services, consultations and trainings on operational efficiency

ESO's management structure



ESO's management

At the date of signing of the report, the Company's Articles of Association stipulated that the Company's management bodies include the General Meeting of Shareholders, a collegiate supervisory body – the Supervisory Council, a collegial management body – the Board, and a single-person management body – the Chief Executive Officer.

General Meeting of Shareholders

The General Meeting of Shareholders is the supreme management body of the Company. The competence of the General Shareholder Meeting, the procedure of its convocation and decision-making are established by laws, other legal acts and the Company's Articles of Association. During the reporting period, the Company's shareholders had equal rights (both property and non-property) established by laws, other legal acts and the Company's Articles of Association. None of the shareholders of the Company had any special control rights; all shareholders have equal rights.

During the reporting period the management bodies of the Company created proper conditions for the implementation of the rights of the Company's shareholders.

In 2016, one ordinary and two extraordinary general meetings of shareholders were held. The ordinary general meeting of shareholders held on 29 March 2016 was attended by the Company's CEO Liudas Liutkevičius, Finance and Administration Service Director, Board Member Augustas Dragūnas and Chairman of the ESO's Supervisory Council Dalius Misiūnas. The extraordinary general meetings of shareholders held on 26 July 2016 and 26 September 2016 were organised through the use of written communication.

The Company's Supervisory Council

The Supervisory Council of ESO is a collegial supervisory body.

The competence of the Supervisory Council, the procedure of decision-making, election and removal of its members are established by laws, other legal acts and the Company's Articles of Association. The Supervisory Council is composed of three members who are elected by the General Meeting of Shareholders for a term of four years. Independent members make up at least a third of the ESO's Supervisory Council. The Chairman of the Supervisory Council is elected from the members of the Supervisory Council.

During the reporting period, the composition of the Supervisory Council remained unchanged. At the date of signing of the report, the Company's Supervisory Council had the following members: Chairman of the Supervisory Council Delius Misiūnas and members Ilona Daugėlaitė and Petras Povilas Čėsna (an independent member). The term of office of the Supervisory Council expires on 3 December 2019.

During the reporting period, thirteen sittings of the Supervisory Council of ESO were held and all of them were attended by all members of the Supervisory Council.



Dr Dalius Misiūnas (born in 1978)
Chairman of the Supervisory Council

Ilona Daugėlaitė (born in 1970)
Member of the Supervisory Council

Petras Povilas Čėsna (born in 1945)
Independent member of the Supervisory Council

In this position from:
3 December 2015

In this position from:
3 December 2015

In this position from:
3 December 2015

End of term of office:
3 December 2019

End of term of office:
3 December 2019

End of term of office:
3 December 2019.

Educational background

Lund University, Doctoral degree in Technological Sciences;
Lund University, Master's degree in Industrial Electrical Engineering and Automatics;

Vilnius University, Master's degree in Hydrogeology and Engineering Geology

Vilnius University, qualification of an economist

Principal workplace

Lietuvos Energija, UAB,
Chairman of the Board, Chief Executive Officer

„Lietuvos energija“, UAB
Organizacinio vystymo direktorė

Exhibition and Congress Centre of Lithuania LITEXPO,
Chairman of the Board

Per 2016 m. sausio-gruodžio mėnesius stebėtojų tarybos nariams priskaičiuotos pinigų sumos, EUR

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2 128

Participation in the activities of companies and organisations and percentage of share capital and voting rights of other companies held in excess of 5%

Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %
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Chairman of the ESO's Supervisory Council	-	Member of the Supervisory Council	-	Independent member of the ESO's Supervisory Council	-
Lietuvos Energija, UAB, Chairman of the Board, Chief Executive Officer	-	Lietuvos Energija, UAB, Member of the Board, Organisational Development Director	-	Exhibition and Congress Centre of Lithuania LITEXPO, Chairman of the Board	-
Member of Higher Education Council	-	Chair of the Board of Technologijų ir Inovacijų Centras UAB	-		-
President of the Alumni Association of Kaunas University of Technology	-		-		
President of the Lithuanian Power Association	-	Member of the Supervisory Council of Elektroninių Mokėjimų Agentūra UAB	-		
Vice-president of the Lithuanian Confederation of Industrialists	-	Chair of the Board of Verslo Aptarnavimo Centras UAB			
Member of the Board of Directors of the Association Eurelectric	-	Spouse holds 3,150 ordinary registered shares of SOLUTIONLAB PRODUCTION UAB (company code 300629188)	63		
Member of the Board of ISM University of Management and Economics					

* According to the ESO's Articles of Association agreements may be concluded with the members of the Supervisory Council regarding the activity related to the Supervisory Council, which establish members' rights, obligations and responsibility. Based on the decision of the general meeting of shareholder remuneration may be paid to independent members of the Supervisory Council for their activity in the Supervisory Council. The terms of the agreements concluded with the members of the Supervisory Council and the independence criteria are established by the general meeting of shareholders according to the requirements of legal acts and the good corporate management practice. On 3 December 2015, the agreements on the activity of the member of the ESO's Supervisory Council were concluded with Dr Dalius Misiūnas, Ilona Daugėlaitė and independent member of the Supervisory Council Petras Povilas Česna. ESO has neither transferred management of assets nor issued guarantees to the members of the bodies. During 2016, the Company did not grant any loans to the members of the management bodies, nor provided any guarantees or sureties to secure the fulfilment of their obligations.

Audit Committee

On 27 August 2013, the Supervisory Council of Lietuvos Energija, UAB established the Audit Committee which was assigned with the functions of the examination and submission of proposals to the Supervisory Board regarding issues that fall within the competence of the Audit Committee and issues which are referred to the Audit Committee by the Supervisory Council. The activity of the Audit Committee is applicable to Lietuvos Energija, UAB and its directly and indirectly controlled subsidiaries, including ESO and legal entities of other legal form, in which Lietuvos Energija, UAB may have direct or indirect ultimate impact.

The main functions of the Audit Committee are as follows:

- to monitor the process of preparation of financial statements of Lietuvos Energija, UAB and the Group companies;
- to monitor the effectiveness of internal controls and risk management systems of Lietuvos Energija, UAB and the Group companies, to analyse and review the need for and relevance of these systems;
- to monitor the adherence to the principles of independence and objectivity by the certified auditor and audit company, to provide related recommendations;
- to monitor the audit performance processes of Lietuvos Energija, UAB and the Group companies, to examine the effectiveness of audit and response of the administration to the recommendations provided to executive personnel by the audit company;
- to monitor the effectiveness of the internal audit function of Lietuvos Energija, UAB and the Group companies, to analyse the need for and relevance of this function, to provide recommendations on the need for, effectiveness of the internal audit function, and on other internal audit related matters.

On 5 January 2015, the internal audit function was centralised at the Lietuvos Energija group that ensured independence and objectivity of internal audit function as well as a uniform methodology and accountability. Audit resources and competences are distributed in a more rational way.

The composition of the Audit Committee of Lietuvos Energija, UAB at the end of the reporting period

Full name	Share of issuer's authorised share capital held, %	Term of office	Workplace
Rasa Noreikienė (Chair of the committee)	0	August 2013 – August 2017	Ministry of Economy of the Republic of Lithuania (Until 13/12/2016)
Aušra Vičkačkienė	0	August 2013 – August 2017	Property Management Department Under the Ministry of Finance
Danielius Merkinas (independent member)	0	August 2013 – August 2017	Nordnet UAB
Gintaras Adžgauskas	0	August 2013 – August 2017	Lithuanian Committee of the World Energy Council
Irena Petruškevičienė (independent member)	0	October 2014 – August 2017	Audit Development Committee of the European Commission

The Company's Board

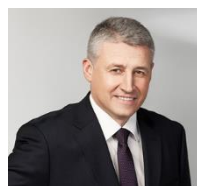
The ESO's Board is a collegial management body of the Company.

The competence of the Board, the procedure of decision-making, election and removal of its members are established by laws, other legal acts and the Company's Articles of Association. The Board is composed of five members who are elected by the Supervisory Council for a term of four years. The Chairman of the Board is elected from the members of the Board.

On 1 January 2016, the Company's Board had the following members: Chairman of the Board Liudas Liutkevičius and members Dalia Andrulionienė, Eglė Čiužaitė, Rytis Borkys and Dalius Svetulevičius. On 19 February 2016, the Supervisory Council of ESO passed a decision to revoke Eglė Čiužaitė from the position of a member of the ESO's Board from 19 February 2016 and to elect Augustas Dragūnas to the position of a member of the Board to be in charge of finances and administration until the expiry of the term of office of the current Board. On 4 November 2016, the Company's Board revoked Liudas Liutkevičius from the positions of the Company's CEO and the Chairman of the Board with effect from 4 November 2016, 16:00, and elected the Company's Services Director Dalia Andrulionienė to temporarily take over the position of the Company's CEO with effect from 4 November 2016, 16:00. During the sitting of the Company's Supervisory Council held on 4 November 2016 a decision was made to approve the mentioned decisions of the Company's Board and revoke Liudas Liutkevičius from the position of the Board member. On 25 November 2016, the sitting of the Company's Board was held where, based on the opinion of the Company's Supervisory Council presented during the sitting held on 25 November 2016, a member of the Company's Board Dalia Andrulionienė was elected to the position of the Company's CEO and the Chair of the Board.

At the end of the reporting period the composition of the Company's Board was as follows: Chair of the Board Dalia Andrulionienė and members Augustas Dragūnas, Rytis Borkys and Dalius Svetulevičius. During the sitting of the Company's Supervisory Council held on 20 January 2017 a decision was made to elect Ignas Pranskevičius to the position of the Company's Board member, who will to be in charge of the provision and development of services, from the end of the sitting of the Company's Supervisory Council, which has elected him, until the expiry of the term of office of the current Board. The Board's term of office expires on 3 December 2019.

During the reporting period, 31 sittings of the Board of ESO were held and all of them were attended by all members of the Board.



Dalia Andrulionienė (born in 1971) Chair of the Board Chief Executive Officer*		Ignas Pranskevičius (born in 1985) Member of the Board**		Augustas Dragūnas (born in 1981) Member of the Board		Rytis Borkys (born in 1969) Member of the Board		Dalius Svetulevičius (born in 1974) Member of the Board	
In this position from: 3 December 2015		In this position from: 20 January 2017		In this position from: 19 November 2016		In this position from: 3 December 2015		In this position from: 3 December 2015	
End of term of office: 3 December 2019		End of term of office: 3 December 2019		End of term of office: 3 December 2019		End of term of office: 3 December 2019		End of term of office: 3 December 2019	
Educational background									
ISM University of Management and Economics, BI Norwegian Business School, Master's degree in Management; Vilnius University, Master's degree in Economics		ISM University of Management and Economics, BI Norwegian Business School, Master's degree in Management; Vilnius University, Master's degree in Economics		Vilnius University, Master's degree in Business Management and Administration		Kaunas University of Technology, higher university education in engineering		Kaunas University of Technology, Master's degree in Measurement Engineering; Vilnius University, Master's degree in Management and Business Administration	
Principal workplace and position held									
ESO's Chief Executive Officer		ESO's Services Director		ESO's Finance and Administration Service Director		ESO's Networks Development Service Director		ESO's Networks Operation Service Director	
Information on payments to ESO's Board members during the twelve months of 2016									
11.908*		–		9.019		11.214		10.428	
Participation in the activities of companies and organisations and percentage of share capital and voting rights of other companies held in excess of 5%									
Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %	Name of a company, institution, organisation, position held	Share of capital and votes held, %
ESO's Chief Executive Officer	-	ESO's Services Director	-	ESO's Finance and Administration Service Director	-	ESO's Networks Development Service Director	0.0001	ESO's Networks Operation Service Director	-
Member of the Board of Verslo Aptarnavimo Centras	-		-	Member of the Board of Technologijų ir Inovacijų Centras	-				
Member of the Board of Lithuanian National Energy Association									

*A member of the Company's Board Dalia Andriulionienė on 25 November 2016 was elected as the Company's CEO and the Chairwoman of the Board.

**Since 1 January 2016 until 19 February 2016 Egle Čiužaitė, a member of the Board, received 2 224 EUR payment for work in the Board.

***On 20 January 2017 Ignas Pranskevičius was elected as the Company's Board member, who will to be in charge of the provision and development of services.

Chief Executive Officer

The Company's General Manager – the Chief Executive Officer – acts as a single-person management body of the Company. The competence of the Chief Executive Officer, the procedure of his/her election and removal is defined by laws, other legal acts and the Company's Articles of Association. The Chief Executive Officer is elected, revoked and dismissed by the Company's Board. The Chief Executive Officer organises and controls the operations of the Company, acts on behalf of the Company and enters into agreements at his own discretion, except for the cases stipulated in the Company's Articles of Association and legal acts.

Remuneration of the Chief Executive Officer of ESO calculated during the reporting period*

	Remuneration, in EUR	Other payments, in EUR
Liudas Liutkevičius, CEO**	52 884	3 224
Dalia Andrulionienė, CEO***	7 922	–

*ESO has neither transferred management of assets nor issued guarantees to the members of the bodies. During January-December 2016, the Company did not grant any loans to the members of the management bodies, nor provided any guarantees or sureties to secure the fulfilment of their obligations.

** Liudas Liutkevičius held the position of the Chief Executive Officer of ESO from 1 January 2016 to 4 November 2016, 16:00.

***Dalia Andrulionienė was appointed to temporarily hold the position of the Chief Executive Officer of ESO from 4 November 2016, 16:00, and based on the decision of 25 November 2016 of the Company's Board continues to hold this position on a permanent basis.

CEO's participation in the activities of companies and organisations and percentage of share capital and voting rights of other companies held in excess of 5%

Full name	Name of a company, body, organisation, position held	Share of authorised share capital held, %	Share of voting rights held, %
Liudas Liutkevičius	See the above-presented information	-	-
Dalia Andrulionienė	See the above-presented information	-	-

Agreements between the issuer and the members of the bodies or employees that provide for compensation in case of their resignation or dismissal without a sound reason or in case of termination of their employment as a result of the change in the control of the Issuer

No agreements of this type have been concluded between the issuer and the members of its bodies or employees.

Employees of the Company

The Company's personnel policy focuses on a continuous professional development of employees and formation of an organisational culture ensuring the creation of higher added value for customers, partners and society. The Company had 2.615* employees as at 31 December 2016.

Structure of the Company's employees by category:

Category of employees	Number of employees*, at 31 Dec 2016
Chief executive officer (CEO)	1
Top-level managers	7
Medium-level managers	153
Experts, specialists, workers	2.455
Total number of employees	2.615

Structure of the Company's employees by educational background:

Education	Number of employees*, at 31 Dec 2016
Higher education	1.504
Advanced vocational education	891
Secondary and vocational education	220

* Actual number of employees; it does not include employees who are in pregnancy and childbirth or parental leave and military service.

Remuneration system

ESO has implemented the employee remuneration system placing the Company among the country's most advanced companies that compensate their employees for work according to results achieved, value created for the organisation and the team. The Hay Group methodology was used in developing the remuneration system, which provides an objective assessment of duties according to the required education, complexity of issues and level of responsibility that is assumed under a specific position. This system enables the Company to effectively manage costs and ensures that ESO's strategic objectives and business management logic are reflected in the remuneration system.

The employee remuneration package consists of financial, non-financial and emotional remuneration. The financial remuneration includes a fixed part of remuneration specified in the employment agreement and paid to the employee on a monthly basis, as well as a variable part of the remuneration paid when the set activity objectives are achieved as well as additional payments stipulated in the collective employment agreement (for overtime, night work, etc.).

Non-financial rewards are an indirect form of employee remuneration resorted to by the Company for the encouragement of employees' efforts, engagement and loyalty, enhancement of employees' well-being and job enrichment. Such rewards include various events organised by the Company, recognition and rewarding of employees who demonstrated outstanding performance, promotion of a healthy way of living, staff development and training.

Emotional remuneration is not easily measured, however it plays an important role in terms of employee engagement in the Company's activities. Emotional remuneration includes the Company's reputation, organisational culture and values, career opportunities, various internal communication programs that give employees an opportunity to share ideas, rise concerns, acquaint with their colleagues through the internal website.

Average salary of the Company's employees

Category of employees	Average salary, in EUR (Before tax) January–December 2016
Chief executive officer (CEO)	6.472
Top-level managers	4.754
Medium-level managers	2.036
Experts, specialists	1.017
Workers	760
Total average	1.033

Collective employment agreement

ESO has signed the collective employment agreement with social partners which ensures greater protection and more additional benefits to the employees of ESO that are not provided for in the Labour Code of the Republic of Lithuanian. The objective of the collective employment agreement is to ensure effective operations of the Company and represent rights and legitimate interests of all employees of the Company. The latter agreement lays down employment, remuneration, social, economic and professional conditions, guarantees that are not regulated by laws or other normative legal acts. Employees are provided with additional guarantees, such as payments in case of accident, sickness, death of close family member, a childbirth grant, additional days of paid leave after the birth of a child, a marriage payment and other payments.

Trade unions

The Company supports employees' participation in voluntary trade unions and cooperates closely with them. Every quarter meetings are organised, during which the implementation of the Company's strategic projects is discussed. Trade union representatives always participate in the working groups when issues related to employees (working conditions, remuneration, social issues) are deliberated.

Development of competences

ESO gives particular attention to the development of employees' competences. Development plans are drawn up every year taking into account the Company's objectives and the matching of employees' competences with the achievement of these objectives. The training courses organised focus on effective and high-quality ensurance of the maintenance of the electricity and gas distribution networks, customer service and safety of works.

In the period between January and December 2016, 1,556 participants attended the compulsory vocational training programmes, at the end of which certificates permitting to perform special works were issued. Employees were trained to work as an operator of emergency diesel electric power station, a high-altitude worker, an operator of lifting platforms and their equipment, a cutter of branches of trees, bushes; learned the skills of first aid and hygiene and attended other programmes.

In the period between January and December 2016, the general training courses were attended by 2,739 participants. These courses are organised by sending individual employees to attend seminars and conferences organised by external suppliers (in Lithuania and abroad) and by forming groups within the Company.

The Company seeks to encourage the engagement of the organisation's employees, i.e. lecturers within the organisation with specific knowledge and skills able to share them with others, in the programmes for competence development, also invests in the training of staff. During 2016, 3,273 participants attended internal training courses. A large part of these trainings was dedicated to the development of energy services related personnel aiming to increase safety of works and quality of customer service. In order to ensure the effectiveness of internal processes, employees are introduced to the initiatives and programmes implemented by the Company, for example, the programmes on operational excellence and employee performance management.

Training programmes are developed in close cooperation with the providers of training programmes, surveys are conducted to assess the quality of trainings. ESO also cooperates regularly with manufacturers and suppliers of equipment who share their knowledge with employees by presenting innovations in the field of energy.

In 2016, ESO provided partial funding for the studies of 15 employees at the Lithuanian higher education institutions aiming to improve professional qualification of workers and develop competences of managers. Employees have the opportunity to study the programmes on energy and management that are related to the Company's activities.

Internship opportunities

ESO actively cooperates with educational institutions and allows university and college students to apply their theoretical knowledge and gain practical skills. In 2016, 46 students completed internship at ESO across the territory of Lithuania. The Company provides students not only with the possibility to complete their mandatory internship, but also welcomes motivated and enthusiastic students who wish to voluntarily enrol in job training with the Company.

Other committees

In addition to the Audit Committee, the Risk Management Supervision Committee and the Appointment and Remuneration Committee are formed at the Lietuvos Energija, UAB group level.

Risk Management Supervision Committee

The Risk Management Supervision Committee is responsible for the provision of conclusions or proposals to the Supervisory Council on the functioning of the management and control system and (or) on key risk factors at the Group level and implementation of measures for risk management or prevention.

The main functions of the Risk Management Supervision Committee are as follows:

- to monitor the identification, assessment and management of risks relevant for the accomplishment of goals of Lietuvos Energija, UAB and the Group companies;
- to assess the relevance of internal control procedures and risk management measures with respect to the identified risks;
- to assess the status of implementation of risk management measures;
- to monitor the implementation of risk management process;
- to analyse financial possibilities for the implementation of risk management measures;
- to assess the risks and risk management plan of Lietuvos Energija, UAB and the Group companies;
- to assess the regular risk identification and assessment cycle;
- to control the establishment of risk registers, analyse their data and provide proposals;
- to monitor the drafting of risk management related internal documents;
- to perform other functions attributed to the competence of the Risk Management Supervision Committee by the decision of the Supervisory Council of Lietuvos Energija, UAB.

Composition of the Risk Management Supervision Committee of Lietuvos Energija, UAB at the end of the reporting period

Full name	Share of issuer's authorised share capital held, %	Term of office	Workplace
Antanas Danys (Chairman of the Committee)	0	2013 September – 2017 August	Director of Grinvest PTE.LTD, Development Director at Kaštonų Kalva UAB
Raimundas Petrauskas (independent member)	0	2013 September – 2017 August	Schmitz Cargobull Baltic, UAB
Donatas Kaubrys (independent member)	0	October 2013 – October 2017	Dovirma, UAB
Tomas Garasimavičius	0	2013 September – 2017 August	Government of the Republic of Lithuania

Appointment and Remuneration Committee

The Appointment and Remuneration Committee is responsible for the provision of conclusions or proposals to the Supervisory Council on the appointment, removal or promotion of the Board members, as well as for the assessment of the activity of the Board and its members and submission of a respective opinion. The Committee's functions also include the formation of the uniform remuneration policy at the Group level, establishment of the amount of remuneration and its components, promotion principles, etc.

The main functions of the Appointment and Remuneration Committee are as follows:

- to assess and provide proposals on the long-term remuneration policy of Lietuvos Energija, UAB and the Group companies (the main fixed part of the remuneration, performance based remuneration, pension insurance, other guarantees and forms of remuneration, compensations, termination benefits, other parts of the remuneration package), principles of compensation for costs related to the individual's performance;
- to assess and provide proposals on the policy of bonuses of Lietuvos Energija, UAB and the Group companies;
- to monitor the compliance of the policy of remunerations and bonuses of Lietuvos Energija, UAB and the Group companies with the international practice and good governance practice recommendations, and provide respective proposals for the improvement of the policy of remunerations and bonuses;
- to provide proposals concerning bonuses upon appropriation of profit (losses) to be appropriated of Lietuvos Energija, UA and the Group companies of the respective financial year;
- to assess the terms and conditions of agreements of Lietuvos Energija, UAB and the Group companies with members of management bodies of the Company and the Group companies;
- to assess the procedures of recruitment and selection of candidates to members of the bodies and senior management of Lietuvos Energija, UAB and the Group companies and establishment of the qualification requirements;
- to perform regular reviews of the structure, size, composition and activities of the management and supervisory bodies of Lietuvos Energija, UAB and the Group companies;
- to supervise how members of management bodies and employees of Lietuvos Energija, UAB and the Group companies are notified of the professional development possibilities and how they upgrade their skills regularly;
- to supervise and assess the implementation of measures ensuring the continuity of operations of the management and supervisory bodies of Lietuvos Energija, UAB and the Group companies;
- to perform other functions attributed to the competence of the Appointment and Remuneration Committee by the decision of the Supervisory Council of Lietuvos Energija, UAB.

Composition of the Appointment and Remuneration Committee of Lietuvos Energija, UAB at the end of the reporting period

Full name	Share of issuer's authorised share capital held, %	Term of office	Workplace
Virginijus Lepeška (Chairman of the Committee)	0	2013 August - 2017 August	Organizacijų Vystymo Centras
Tomas Garasimavičius	0	2013 August - 2017 August	Government of the Republic of Lithuania
Agnė Bagočiutė	0	2016 June – 2017 August	Ministry of Finance of the Republic of Lithuania (until 22/12/2016)

MATERIAL EVENTS IN THE COMPANY'S ACTIVITIES

Material events in the reporting period

In executing its duties in accordance with the applicable legislation regulating securities market ESO publishes information on material events and other regulated information on the EU-wide basis. Information announced by the Company is available at the Company's website www.eso.lt and the website of NASDAQ OMX Vilnius AB www.nasdaqomxbaltic.com.

Information on material events announced by ESO from 1 January 2016

Date	Material event
11 January 2016	<u>Trading of Energijos Skirstymo Operatorius shares commenced on Nasdaq Vilnius</u>
5 February 2016	<u>Regarding Court Decision</u>
15 February 2016	<u>Preliminary unaudited LESTO results of 2015: EBITDA reached EUR 125 million, EBITDA margin increased to 21.5%</u>
15 February 2016	<u>Preliminary unaudited Lietuvos Dujos results of 2015: EBITDA increased 18% to EUR 24 million</u>
19 February 2016	<u>Regarding the decisions of the Supervisory Board of Energijos Skirstymo Operatorius AB</u>
26 February 2016	<u>Lietuvos Dujos results for 2015: revenue grew by 0.6% up to EUR 54.9 million, EBITDA – 18.2% up to EUR 24 million</u>
26 February 2016	<u>LESTO results of 2015: EBITDA amounted to EUR 124.8 million, investment increased by 15.9% up to EUR 117.6 million</u>
3 March 2016	<u>Regarding the decision to terminate judicial proceedings</u>
4 March 2016	<u>Regarding the convocation of the Ordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
9 March 2016	<u>Regarding the resolutions of the Supervisory Board of Energijos Skirstymo Operatorius AB</u>
29 March 2016	<u>LESTO group's audited financial results of 2015 have been approved</u>
29 March 2016	<u>Lietuvos Dujos audited financial results of 2015 have been approved</u>
29 March 2016	<u>Regarding the resolutions of the Ordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
31 March 2016	<u>Regarding the decision to terminate judicial proceedings</u>
22 April 2016	<u>Regarding the decision by the National Control Commission for Prices and Energy</u>
16 May 2016	<u>Preliminary ESO results for three months of 2016: revenue up by 3% to EUR 182 million</u>
23 May 2016	<u>Regarding the public electricity price cap for second half of 2016</u>
25 May 2016	<u>Regarding the Board's decision to change electricity prices from the second half of 2016</u>

30 May 2016	<u>Regarding announced electricity prices from the second half of 2016</u>
31 May 2016	<u>ESO Q1 2016 results: bigger electricity and gas demand has increased the company's revenue</u>
4 July 2016	<u>Regarding the convocation of the Extraordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
15 July 2016	<u>Regarding the supplement to the decision of the Extraordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
26 July 2016	<u>The Extraordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB adopted decision on the election of the audit company</u>
16 August 2016	<u>Preliminary ESO results for six months of 2016: net profit up by 4.9% to EUR 53.2 million</u>
1 September 2016	<u>Regarding the convocation of the Extraordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
9 September 2016	<u>Regarding the resolutions of the Supervisory Board of Energijos Skirstymo Operatorius AB</u>
26 September 2016	<u>Regarding the resolutions of Extraordinary General Meeting of Shareholders of Energijos Skirstymo Operatorius AB</u>
10 October 2016	<u>Regarding Liudas Liutkevičius resignation from CEO and Chairman of the Board of Energijos Skirstymo Operatorius AB</u>
14 October 2016	<u>Regarding the price-setting for Energijos Skirstymo Operatorius AB for electricity distribution service and the price caps of public supply of electricity for 2017</u>
26 October 2016	<u>Regarding the contract concluded between Energijos Skirstymo Operatorius AB and Druskininkų Šilumos Tinklai AB on the use of the natural gas distribution pipeline</u>
28 October 2016	<u>Natural gas distribution price cap set for 2017</u>
31 October 2016	<u>Regarding the modification of the energy activity licence</u>
2 November 2016	<u>Energijos Skirstymo Operatorius AB strategy for 2016-2020 approved</u>
4 November 2016	<u>Regarding the resolutions of the Supervisory Council and the Board of Energijos Skirstymo Operatorius AB</u>
10 November 2016	<u>Regarding the price caps for public supply of electricity for 2017</u>
15 November 2016	<u>Preliminary ESO results for nine months of 2016: net profit up by 11.1% to EUR 72.4 million</u>
17 November 2016	<u>National Control Commission for Prices and Energy approved natural gas distribution prices</u>
22 November 2016	<u>Regarding the decision of the Board of ESO to change electricity prices as of 2017</u>
25 November 2016	<u>Regarding the resolutions of the Supervisory Council and the Board of Energijos Skirstymo Operatorius AB</u>
28 November 2016	<u>Regarding announced electricity prices for 2017</u>
29 November 2016	<u>Regarding the purchase-sale agreement for the natural gas distribution system concluded between Energijos Skirstymo Operatorius AB and Druskininkų Šilumos Tinklai AB</u>

30 November 2016	<u>ESO results for nine months of 2016: revenue up by 2.3% up to EUR 478.8 million, net profit up by 11.1% up to EUR 72.4 million</u>
30 November 2016	<u>Regarding Energijos Skirstymo Operatorius AB presentation to investors</u>
30 November 2016	<u>National Control Commission for Prices and Energy confirmed 2017 prices to private consumers for connecting to gas pipelines</u>
16 December 2016	<u>Regarding the decision of the Board of ESO to change electricity prices as of 2017</u>
23 December 2016	<u>Regarding announced electricity prices for 2017</u>
28 December 2016	<u>Regarding the dividend policy of Lietuvos Energija, UAB group of companies</u>
29 December 2016	<u>Regarding Investor Calendar for 2017</u>

Material events after the end of the reporting period

On 28 February 2017 the Company received a notification of resignation of Mr. Dalius Svetulevičius from the post of a member of the Company's Board. Pursuant to the Republic of Lithuania Law on Companies, the last day of term of office of Mr. Dalius Svetulevičius as Company's Board member will be 14 March 2017. In consideration with this and in accordance with the Articles of Association of the Company, the Supervisory Board has the right to recall the member of the Company's Board before this date.

On 12 January 2017 the National Control Commission for Prices and Energy changed the Company's energy activity licence No L2-GDS-09 by adding a new territory to the activity area defined in the annex to this licence, i.e. the territory of Tauragė region municipality. The mentioned modification of the energy activity licence entitles the Company to ensure the provision of natural gas distribution services in Tauragė region municipality.

20 January 2017 During the sitting of the Company's Supervisory Council held on 20 January 2017 a decision was made to elect Ignas Pranskevičius to the position of the Company's Board member, who will to be in charge of the provision and development of services, from the end of the sitting of the Company's Supervisory Council, which has elected him, until the expiry of the term of office of the current Board.

20 January 2017 On 27 January 2017, the Company and SEB Bankas AB signed the agreement for a long-term loan of EUR 77 million. The loan will be used to refinance the Company's financial liabilities and finance the working capital. The loan repayment term is 10 years and it is subject to a variable interest rate of 3 months EURIBOR.

Annexes

Notice of the compliance with the Corporate Governance Code f or the Companies Listed on Nasdaq Vilnius

Energijos skirstymo operatorius AB (hereinafter referred to as the Company or ESO), acting in compliance with Article 22(3) of the Law of the Republic of Lithuania on Securities and paragraph 24.5 of the Listing Rules of AB NASDAQ Vilnius, hereby discloses how it complies with the Corporate Governance Code for the Companies listed on AB NASDAQ Vilnius as well as its specific provisions or recommendations. In case of non-compliance with this Code or some of its provisions or recommendations, the specific provisions or recommendations that are not complied with are indicated and the reasons for such non-compliance are specified.

Summary of the Corporate Governance Report:

The corporate governance model of energy group was implemented following the governance guidelines approved by the Ministry of Finance of the Republic of Lithuania on 7 June 2013 ([link to the document](#) (in Lithuanian))

Corporate governance activities are focused in the parent company of the Lietuvos Energija Group – Lietuvos Energija, UAB, which coordinates in the Lietuvos Energija Group companies the areas of finance, law, planning and monitoring, human resources, risk management, audit, technology, communication and other common areas.

Activities of companies of the Lietuvos Energija Group in these areas are based on mutual agreement – cooperation focusing on the pursuit of overall result, and is coordinated by policies – general provisions and norms applicable to all Group companies.

Description of principles of corporate governance of the Lietuvos Energija Group and system of governance and control could be found on Lietuvos Energija's webpage ([link](#)).

More information on the management bodies ant its members, committees etc. is provided in the section "The Company and its Management Bodies" of this Report and in the table below, in which information on compliance with the Corporate Governance Code for the Companies listed on NASDAQ Vilnius is disclosed.

Structured table for disclosure

PRINCIPLES / RECOMMENDATIONS	YES / NO / IRRELEVANT	COMMENT
Principle I. Basic Provisions. The overriding objective of a company should be to operate in common interests of all the shareholders by optimizing over time shareholder value.		
1.1. A company should adopt and make public the company's development strategy and objectives by clearly declaring how the company intends to meet the interests of its shareholders and optimize shareholder value.	Yes	The main activities of the Company and its strategic framework are publicly displayed at the Company's internet webpage and in the Company's interim and annual reports.

1.2. All management bodies of a company should act in furtherance of the declared strategic objectives in view of the need to optimize shareholder value.	Yes	The Company's management bodies work to the benefit of the Company and its shareholders while doing their best to succeed in the Company's business objectives.
1.3. A company's supervisory and management bodies should act in close co-operation in order to attain maximum benefit for the company and its shareholders.	Yes	Legal acts, statutes and labour regulations regulating activities of the supervisory and management bodies of the Company establish collaboration principles and methods between the supervisory and management bodies of the Company and also ensure that the supervisory and management bodies operate to the best interests of the Company and its shareholders.
1.4. A company's supervisory and management bodies should ensure that the rights and interests of persons other than the company's shareholders (e.g. employees, creditors, suppliers, clients, local community), participating in or connected with the company's operation, are duly respected.	Yes	The Company's bodies respect the rights and interests of the persons involved in or associated with the Company's performance. Since the foundation of the Company it cooperates and participates in social partnership with the Company's employee representatives (spends funds to execute the collective agreement and to promote employees, etc.). The Company executes its financial and other obligations to creditors. Based on the results of the client satisfaction research and the tendencies in the good international practice, the Company implements systemic means designed to improve the quality of servicing of the Company's clients. The Company organises social projects involving children, young people, local communities and other social groups. More information on the Company's initiatives is available on the Company's website and in its annual report.

Principle II: The corporate governance framework

The corporate governance framework should ensure the strategic guidance of the company, the effective oversight of the company's management bodies, an appropriate balance and distribution of functions between the company's bodies, protection of the shareholders' interests.

2.1. Besides obligatory bodies provided for in the Law on Companies of the Republic of Lithuania – a general shareholders' meeting and the chief executive officer, it is recommended that a company should set up both a collegial supervisory body and a collegial management body. The setting up of collegial bodies for supervision and management facilitates clear separation of management and supervisory functions in the company, accountability and control on the part of the chief executive officer, which, in its turn, facilitate a more efficient and transparent management process.	Yes	According to the Company's Articles of Association a collegial Company's business supervising body – the Supervisory Board and a collegial Company's management body – the Board are formed.
2.2. A collegial management body is responsible for the strategic management of the company and performs other key functions of corporate governance. A collegial supervisory body is responsible for the effective supervision of the company's management bodies.	Yes	According to the Company's Articles of Association, the Board is responsible for the proper strategic management of the Company (it approves operations strategy and budget for the Company's activities, organisational structure of the Company's management, makes decision regarding other issues, specified in the legislation and assigned to the Board competence by the Company's Articles of Association). The Supervisory Board is responsible for the effective supervision of the Company's management bodies (it elects and dismisses Board members; provides the General Shareholder Meeting with offers and comments on the Company's business strategy, the Company's annual financial statements, the Company's profit (loss) allocation project, the Company's annual report, performance of the Board and the manager of the Company; provides the Company's Board with responses and offers regarding the Company's business strategy and budget for the Company's activities, makes decisions regarding other issues, specified in the legislation and assigned to the Board competence by the Company's Articles of Association).
2.3. Where a company chooses to form only one collegial body, it is recommended that it should be a supervisory body, i.e. the supervisory board. In such a case, the supervisory board is responsible for the effective monitoring of the functions performed by the company's chief executive officer.	Irrelevant	According to the Company's Articles of Association a collegial Company's business supervising body – the Supervisory Board and a collegial Company's management body – the Board are formed.
2.4. The collegial supervisory body to be elected by the general shareholders' meeting should be set up and	Yes	According to the Company's Articles of

should act in the manner defined in Principles III and IV. Where a company should decide not to set up a collegial supervisory body but rather a collegial management body, i.e. the board, Principles III and IV should apply to the board as long as that does not contradict the essence and purpose of this body.⁸		Association, the Company elects a collegial Company's business supervising body – the Supervisory Board. The recommendations laid out in the principles III and IV are not implemented fully in the Company, however, the Company complies with all the requirements, as per legal acts, for setting up of a collegial body. It should be noted, that the Company is involved in transfer of electricity energy and natural gas to the users via distribution networks, operates, maintains, manages and develops distribution networks, so it's activities are strictly regulated by legal acts and supervised by respective state institutions (National Control Commission for Prices and Energy, and others). In this way, the clarity and timeliness of the above-mentioned decision-making is ensured as well as the principles of the Company's client non-discrimination, the Company's expenses reduction and other.
2.5. Company's management and supervisory bodies should comprise such number of board (executive directors) and supervisory (non-executive directors) board members that no individual or small group of individuals can dominate decision-making on the part of these bodies.⁹	Yes	According to the article 20 of the Company's Articles of Association, the Company's Supervisory Board consists of 3 (three) members – natural persons. At least 1/3 (one third) of the Supervisory Board should consist of independent members. The Supervisory Board's decisions are accepted and its meeting shall be deemed held, if the meeting is attended by at least half of the Supervisory Board members (article 33.5 of the Company's Articles of Association). According to article 37 of the Company's Articles of Association, the Company's Board consists of 5 (five) members. The Board's decisions are accepted and its meeting shall be deemed held when the meeting is attended by at least 4 (four) or

⁸ Provisions of Principles III and IV are more applicable to those instances when the general shareholders' meeting elects the supervisory board, i.e. a body that is essentially formed to ensure oversight of the company's board and the chief executive officer and to represent the company's shareholders. However, in case the company does not form the supervisory board but rather the board, most of the recommendations set out in Principles III and IV become important and applicable to the board as well. Furthermore, it should be noted that certain recommendations, which are in their essence and nature applicable exclusively to the supervisory board (e.g. formation of the committees), should not be applied to the board, as the competence and functions of these bodies according to the Law on Companies of the Republic of Lithuania (Official Gazette, 2003, No 123-5574) are different. For instance, item 3.1 of the Code concerning oversight of the management bodies applies to the extent it concerns the oversight of the chief executive officer of the company, but not of the board itself; item 4.1 of the Code concerning recommendations to the management bodies applies to the extent it relates to the provision of recommendations to the company's chief executive officer; item 4.4 of the Code concerning independence of the collegial body elected by the general meeting from the company's management bodies is applied to the extent it concerns independence from the chief executive officer.

⁹ Definitions 'executive director' and 'non-executive director' are used in cases when a company has only one collegial body.

		more Board members (article 59.6 of the Company's Articles of Association). From the perspective of the Company, the number of members of the Board and the Supervisory Board is sufficient to ensure the proper Company's business supervision and timely and efficient Company's management.
2.6. Non-executive directors or members of the supervisory board should be appointed for specified terms subject to individual re-election, at maximum intervals provided for in the Lithuanian legislation with a view to ensuring necessary development of professional experience and sufficiently frequent reconfirmation of their status. A possibility to remove them should also be stipulated however this procedure should not be easier than the removal procedure for an executive director or a member of the management board.	Yes	According to the article 20 of the Company's Articles of Association, the members of the Supervisory Board are elected according to the maximum cadency term, specified in the Law on Companies of the Republic of Lithuania – for 4 years per cadence. According to the article 37 of the Company's Articles of Association, the members of the Board are elected according to the maximum cadency term, specified in the Law on Companies of the Republic of Lithuania – for 4 years per cadence. Limitations concerning re-election of the members of the Supervisory Board and the Board are not provided in the Company's Articles of Association, nevertheless, limitations provided by valid legal acts are applied to candidates to members of mentioned bodies. The Company's Articles of Association provide a possibility to revoke (dismiss) both the separate members of the collegial boards, and the whole collegial body <i>in corpore</i>, without waiting for their mandates' terms to end (articles 26 and 44 of Articles of Association). The members of the Board (separate or the body itself) can be dismissed by the Supervisory Board (article 36 of Articles of Association), and the members of the Supervisory Board (separate or the body itself) can be dismissed by the General Shareholder Meeting (article 20 of Articles of Association).

2.7. Chairman of the collegial body elected by the general shareholders' meeting may be a person whose current or past office constitutes no obstacle to conduct independent and impartial supervision. Where a company should decide not to set up a supervisory board but rather the board, it is recommended that the chairman of the board and chief executive officer of the company should be a different person. Former company's chief executive officer should not be immediately nominated as the chairman of the collegial body elected by the general shareholders' meeting. When a company chooses to departure from these recommendations, it should furnish information on the measures it has taken to ensure impartiality of the supervision.

Yes

The chairman of the Supervisory Board, which is elected by the General Meeting of Shareholders, and the manager of the Company is not the same person. Members and the chairman of the Supervisory Board have never been the members of the Board of the Company or the manager of the Company. The manager of the Company is a member and a chairman of the Board, but this does not create assumptions for possible impartial behavior, since the Company has a properly installed Company's activities supervising body – the Supervisory Board.

Principle III: The order of the formation of a collegial body to be elected by a general shareholders' meeting
The order of the formation a collegial body to be elected by a general shareholders' meeting should ensure representation of minority shareholders, accountability of this body to the shareholders and objective monitoring of the company's operation and its management bodies.¹⁰

3.1. The mechanism of the formation of a collegial body to be elected by a general shareholders' meeting (hereinafter in this Principle referred to as the 'collegial body') should ensure objective and fair monitoring of the company's management bodies as well as representation of minority shareholders.

Yes

According to the Articles of Association Article 22, each candidate for the Supervisory Board members to the General Meeting of Shareholders are required to submit candidate declaration of interests indicating there any circumstances that could lead to the candidate and the company's conflict of interest.

The Supervisory Board is being elected by the General Meeting of Shareholders, according to the requirements set out by the Law on Companies of the Republic of Lithuania and the Company's Articles of Association.

3.2. Names and surnames of the candidates to become members of a collegial body, information about their education, qualification, professional background, positions taken and potential conflicts of interest should be disclosed early enough before the general shareholders' meeting so that the shareholders would have sufficient time to make an informed voting decision. All factors affecting the candidate's independence, the

Yes / No

Information on the candidates for the Company's Supervisory Board is presented to the shareholders in accordance with the procedure prescribed by the Law on Companies of the Republic of Lithuania at the General Meeting of Shareholders whose agenda includes consideration of the issue on election of

¹⁰–Attention should be drawn to the fact that in the situation where the collegial body elected by the general shareholders' meeting is the board, it is natural that being a management body it should ensure oversight not of all management bodies of the company, but only of the single-person body of management, i.e. the company's chief executive officer. This note shall apply in respect of item 3.1 as well.

sample list of which is set out in Recommendation 3.7, should be also disclosed. The collegial body should also be informed on any subsequent changes in the provided information. The collegial body should, on yearly basis, collect data provided in this item on its members and disclose this in the company's annual report.

the Supervisory Board members.

Article 21 of corporate articles of association defines that a person proposing a candidate to members of the supervisory board has the obligation to produce written explanations to the General shareholders' meeting as to the qualifications of each candidate proposed to members of the supervisory board, candidate experience of managerial work, and fitness to hold the office of a member of the supervisory board. Information on candidates to become members of the supervisory board is produced to shareholders before the day of the general shareholders' meeting in accordance with the procedure prescribed in legislation.

According to the article 22 of the Company's Articles of Association, each candidate for the Supervisory Board shall submit to the General Meeting of Shareholders a declaration of the candidate's interests, specifying all the circumstances that may give rise to a conflict of interests between the candidate and the Company.

Upon emergence of new circumstances that may give rise to a conflict of interests between a member of the Supervisory Board and the Company, the member of the Supervisory Board shall immediately notify the Company and the Supervisory Board of such new circumstances in written.

The information on the offices held by the members of the Supervisory Board or their involvement in any other companies is collected, accumulated and disclosed in the annual report as well as the Company's website.

[illegible]

		individual programme to newly elected members of the Supervisory Board in order to have a look to the office, organisation and performance of the Company and to organise annual inspections.
3.6. In order to ensure that all material conflicts of interest related with a member of the collegial body are resolved properly, the collegial body should comprise a sufficient ¹¹ number of independent ¹² members.	Yes	The formation of the Supervisory Board (and election of independent members) belongs to the competence of the General Meeting of Shareholders. The article 20 of the Company's Articles of Association provides, that the Company's Supervisory Board is formed of 3 (three) members, of which, at least 1/3 (one third) should be independent. At the day this report is filled, there is 1 (one) independent member of the Supervisory Board out of a total of 3 (three) members.
3.7. A member of the collegial body should be considered to be independent only if he is free of any business, family or other relationship with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgment. Since all cases when member of the collegial body is likely to become dependant are impossible to list, moreover, relationships and circumstances associated with the determination of independence may vary amongst companies and the best practices of solving this problem are yet to evolve in the course of time, assessment of independence of a member of the collegial body should be based on the contents of the relationship and circumstances rather than their form. The key criteria for identifying whether a member of the collegial body can be considered to be independent are the following: He/she is not an executive director or member of the board (if a collegial body elected by the general shareholders' meeting is the supervisory board) of the company or any associated company and has not been such during the last five years;	Yes	According to the article 24 of the Company's Articles of Association, following the requirements provided by legal acts and good Company's management practice, the criterion of independence is set by the General Meeting of Shareholders. While assessing the independancy of members, the Company follows requirements provided in the Corporate Governance Code for Companies Listed on the Regulated Market approved by AB NASDAQ Vilnius, Item 64 of the procedure of the State property and nonproperty rights in state-owned enterprises (approved in 6 June 2012 by resolution No. 665 of the Government of the Republic of Lithuania). According to the article 22 of the Company's Articles of Association, each candidate to members of the Supervisory Board must submit to the General Meeting of Shareholders a declaration of the

¹¹ The Code does not provide for a concrete number of independent members to comprise a collegial body. Many codes in foreign countries fix a concrete number of independent members (e.g. at least 1/3 or 1/2 of the members of the collegial body) to comprise the collegial body. However, having regard to the novelty of the institution of independent members in Lithuania and potential problems in finding and electing a concrete number of independent members, the Code provides for a more flexible wording and allows the companies themselves to decide what number of independent members is sufficient. Of course, a larger number of independent members in a collegial body is encouraged and will constitute an example of more suitable corporate governance.

¹² It is notable that in some companies all members of the collegial body may, due to a very small number of minority shareholders, be elected by the votes of the majority shareholder or a few major shareholders. But even a member of the collegial body elected by the majority shareholders may be considered independent if he/she meets the independence criteria set out in the Code.

He/she is not an employee of the company or some any company and has not been such during the last three years, except for cases when a member of the collegial body does not belong to the senior management and was elected to the collegial body as a representative of the employees;

He/she is not receiving or has been not receiving significant additional remuneration from the company or associated company other than remuneration for the office in the collegial body. Such additional remuneration includes participation in share options or some other performance-based pay systems; it does not include compensation payments for the previous office in the company (provided that such payment is no way related with later position) as per pension plans (inclusive of deferred compensations);

He/she is not a controlling shareholder or representative of such shareholder (control as defined in the Council Directive 83/349/EEC Article 1 Part 1);

He/she does not have and did not have any material business relations with the company or associated company within the past year directly or as a partner, shareholder, director or superior employee of the subject having such relationship. A subject is considered to have business relations when it is a major supplier or service provider (inclusive of financial, legal, counseling and consulting services), major client or organization receiving significant payments from the company or its group;

He/she is not and has not been, during the last three years, partner or employee of the current or former external audit company of the company or associated company;

He/she is not an executive director or member of the board in some other company where executive director of the company or member of the board (if a collegial body elected by the general shareholders' meeting is the supervisory board) is non-executive director or member of the supervisory board, he/she may not also have any other material relationships with executive directors of the company that arise from their participation in activities of other companies or bodies;

He/she has not been in the position of a member of the collegial body for over than 12 years;

He/she is not a close relative to an executive director or member of the board (if a collegial body elected by the

candidate's interests, specifying all the circumstances that may give rise to a conflict of interests between the candidate and the Company. Upon emergence of new circumstances that may give rise to a conflict of interests between a member of the Supervisory Board and the Company, the member of the Supervisory Board shall immediately notify the Company and the Supervisory Board of such new circumstances in written.

At the moment of submission of the report, there is 1 (one) independent member in the Supervisory Board. See also the Comment for Item 3.6.

general shareholders' meeting is the supervisory board) or to any person listed in above items 1 to 8. Close relative is considered to be a spouse (common-law spouse), children and parents.		
3.8. The determination of what constitutes independence is fundamentally an issue for the collegial body itself to determine. The collegial body may decide that, despite a particular member meets all the criteria of independence laid down in this Code, he cannot be considered independent due to special personal or company-related circumstances.	Yes / No	The formation of the Supervisory Board (and election of independent members) belongs to the competence of the General Meeting of Shareholders (see also the Comment for Item 3.6). According to the article 24 of the Company's Articles of Association, following the requirements provided by legal acts and good Company's management practice, the criterion of independence is set by the General Meeting of Shareholders (See also the Comment for Item 3.7). Besides that, the article 23 of the Company's Articles of Association declares, that the position of the Supervisory Board's member cannot be held by: the CEO, a member of the Board, a member of the supervision/management body or administration member of electricity or gas distribution or production (mining) legal person, and any person, that has no right to take this position according to legal acts.
3.9. Necessary information on conclusions the collegial body has come to in its determination of whether a particular member of the body should be considered to be independent should be disclosed. When a person is nominated to become a member of the collegial body, the company should disclose whether it considers the person to be independent. When a particular member of the collegial body does not meet one or more criteria of independence set out in this Code, the company should disclose its reasons for nevertheless considering the member to be independent. In addition, the company should annually disclose which members of the collegial body it considers to be independent.	Yes	The formation of the Supervisory Board (and election of independent members) belongs to the competence of the General Meeting of Shareholders (see also the Comment for Item 3.6). Information on the candidates for the Company's Supervisor Board (including information about matching of candidate with independence requirements) is presented to the shareholders in accordance with the procedure prescribed by the Law on Companies of the Republic of Lithuania at the General Meeting of Shareholders (See also the Comment for Item 3.2). The information concerning elected independent members of the Supervisory Board is provided in annual report of the Company as well as on Company's website.

3.10. When one or more criteria of independence set out in this Code has not been met throughout the year, the company should disclose its reasons for considering a particular member of the collegial body to be independent. To ensure accuracy of the information disclosed in relation with the independence of the members of the collegial body, the company should require independent members to have their independence periodically re-confirmed.	Irrelevant	Until now there has not been occasions in the Company when it would be facing the need to apply this recommendation. In the agreement of independent member of the Board activity signed with the independent member of the Supervisory Board there is an obligation to notify the Company and the Supervisory Board in writing about any new circumstances that may give rise to a conflict of interests between a member of the Supervisory Board and the Company.
3.11. In order to remunerate members of a collegial body for their work and participation in the meetings of the collegial body, they may be remunerated from the company's funds¹³. The general shareholders' meeting should approve the amount of such remuneration.	Yes	Independent member of the Supervisory Board is remunerated for his/her activity in the Supervisory Board according to the signed agreement of independent member of the Supervisory Board activity by determinate order and conditions. The conditions of the agreement for independent member of the Supervisory Board activity are confirmed by the General Meeting of Shareholders (Article 19.1 of the Company's Articles of Association). On 3 December, 2015, the General Meeting of Shareholders made the following decisions: to confirm the conditions of the agreement for independent member of the Supervisory Board activity and to fix the hourly rate of EUR 43.44 for the independent member of the Supervisory Board for the actual work (before taxes). The General Meeting of Shareholder also decided to limit the maximum payments to the independent supervisory board member to EUR 1.014 (before taxes). Information about remuneration for the independent member of the Supervisory Board is published in the interim and annual reports of the Company.

¹³ It is notable that currently it is not yet completely clear, in what form members of the supervisory board or the board may be remunerated for their work in these bodies. The Law on Companies of the Republic of Lithuania (Official Gazette, 2003, No 123-5574) provides that members of the supervisory board or the board may be remunerated for their work in the supervisory board or the board by payment of annual bonuses (tantiems) in the manner prescribed by Article 59 of this Law, i.e. from the company's profit. The current wording, contrary to the wording effective before 1 January 2004, eliminates the exclusive requirement that annual bonuses (tantiems) should be the only form of the company's compensation to members of the supervisory board or the board. So it seems that the Law contains no prohibition to remunerate members of the supervisory board or the board for their work in other forms, besides bonuses, although this possibility is not expressly stated either.

Principle IV: The duties and liabilities of a collegial body elected by the general shareholders' meeting

The corporate governance framework should ensure proper and effective functioning of the collegial body elected by the general shareholders' meeting, and the powers granted to the collegial body should ensure effective monitoring¹⁴ of the company's management bodies and protection of interests of all the company's shareholders.

4.1. The collegial body elected by the general shareholders' meeting (hereinafter in this Principle referred to as the 'collegial body') should ensure integrity and transparency of the company's financial statements and the control system. The collegial body should issue recommendations to the company's management bodies and monitor and control the company's management performance¹⁵.	Yes	The collegial body elected by the General Meeting of Shareholders – the Supervisory Board is responsible for efficient supervision of the Company's management bodies performance (it elects members of the Board and revokes them from office, submits proposals and responses to General Meeting of Shareholders concerning strategy of the Company, the Company's annual financial reports, profit (loss) allocation project, the Company's annual report, performance of the Board and the manager of the Company; submits to the Board of the Company proposals and responses concerning performance strategy of the Company as well as budget of the performance, takes decisions on other questions attributed to the competence of the Supervisory Board by legal acts and Articles of Association).
4.2. Members of the collegial body should act in good faith, with care and responsibility for the benefit and in the interests of the company and its shareholders with due regard to the interests of employees and public welfare. Independent members of the collegial body should (a) under all circumstances maintain independence of their analysis, decision-making and actions, (b) do not seek and accept any unjustified privileges that might compromise their independence, and (c) clearly express their objections should a member consider that decision of the collegial body is against the interests of the company. Should a collegial body have passed decisions independent member has serious doubts about, the member should make adequate conclusions. Should an independent member resign from his office, he should explain the reasons in a letter addressed to the collegial body or audit committee and, if necessary, respective company not-pertaining body (institution).	Yes	All members of the Supervisory Board act in good will with respect to the Company, with due regard to the Company's interests and public welfare. Members of the Supervisory Board have the right to express their opinion concerning all questions included to the agenda that according to work regulations of the Supervisory Board must be properly reflected in the protocol of the meeting.

¹⁴ See Footnote 3.

¹⁵ See Footnote 3. In the event the collegial body elected by the general shareholders' meeting is the board, it should provide recommendations to the company's single-person body of management, i.e. the company's chief executive officer.

4.3. Each member should devote sufficient time and attention to perform his duties as a member of the collegial body. Each member of the collegial body should limit other professional obligations of his (in particular any directorships held in other companies) in such a manner they do not interfere with proper performance of duties of a member of the collegial body. In the event a member of the collegial body should be present in less than a half¹⁶ of the meetings of the collegial body throughout the financial year of the company, shareholders of the company should be notified.	Yes	Members of the Supervisory Board are active participants of the meetings of the collegial body and devote sufficient time to perform their duties as members of the collegial body. In 2016 there were 13 (thirteen) Supervisory Board's meetings, and all of them were attended by all 3 (three) members of the Supervisory Board.
4.4. Where decisions of a collegial body may have a different effect on the company's shareholders, the collegial body should treat all shareholders impartially and fairly. It should ensure that shareholders are properly informed on the company's affairs, strategies, risk management and resolution of conflicts of interest. The company should have a clearly established role of members of the collegial body when communicating with and committing to shareholders.	Yes	Collegial bodies of the Company follow prescribed recommendations. Before taking decisions the members of the collegial body discuss on their influence to the performance of the Company and also to all shareholders. Articles of Association oblige the collegial bodies of the Company and also each of their members to act on behalf of the Company and its shareholders. Communication with the shareholders and obligations for them are determined in accordance with requirements of legal acts.
4.5. It is recommended that transactions (except insignificant ones due to their low value or concluded when carrying out routine operations in the company under usual conditions), concluded between the company and its shareholders, members of the supervisory or managing bodies or other natural or legal persons that exert or may exert influence on the company's management should be subject to approval of the collegial body. The decision concerning approval of such transactions should be deemed adopted only provided the majority of the independent members of the collegial body voted for such a decision.	Yes / No	Agreements concerning performance in the Supervisory Board are made with the members of the Supervisory Board under the decision made by the General Meeting of Shareholders. Terms and conditions of agreements with members and the Chairman of the Board for their performance in the Board are determined by the Supervisory Board. Terms and conditions of agreement made with the manager of the Company are set by the Board of the Company. Collegial bodies of the Company conclude transactions and approve them by observing the requirements set in legal acts and the Company's Articles of Association.

¹⁶ It is notable that companies can make this requirement more stringent and provide that shareholders should be informed about failure to participate at the meetings of the collegial body if, for instance, a member of the collegial body participated at less than 2/3 or 3/4 of the meetings. Such measures, which ensure active participation in the meetings of the collegial body, are encouraged and will constitute an example of more suitable corporate governance.

4.6. The collegial body should be independent in passing decisions that are significant for the company's operations and strategy. Taken separately, the collegial body should be independent of the company's management bodies.¹⁷ Members of the collegial body should act and pass decisions without an outside influence from the persons who have elected it.	Yes	The Company's Supervisory Board is independent from the Company's management bodies in taking their decisions that are significant to the Company's activities and strategy. The Supervisory Board acts independently under the requirements of legal acts and the Company's Articles of Association, as well as according to the guidelines, rules and other performance parameters set by patronizing company LE.
Companies should ensure that the collegial body and its committees are provided with sufficient administrative and financial resources to discharge their duties, including the right to obtain, in particular from employees of the company, all the necessary information or to seek independent legal, accounting or any other advice on issues pertaining to the competence of the collegial body and its committees.	Yes	The Company ensures that the Supervisory Board is supplied with all of the resources required for its activities (monitors technical aspects of the Supervisory Board meetings, provides all the required information and performs other functions specified in the Supervisory Board's Work Regulations).
When using the services of a consultant with a view to obtaining information on market standards for remuneration systems, the remuneration committee should ensure that the consultant concerned does not at the same time advise the human resources department, executive directors or collegial management organs of the company concerned.	No	See the comment for Item 4.13.
4.7. Activities of the collegial body should be organized in a manner that independent members of the collegial body could have major influence in relevant areas where chances of occurrence of conflicts of interest are very high. Such areas to be considered as highly relevant are issues of nomination of company's directors, determination of directors' remuneration and control and assessment of company's audit.	Yes / No	The Supervisory Board acts and makes decisions according to the requirements of the legal acts and the Company's Articles of Association.
Therefore when the mentioned issues are attributable to the competence of the collegial body, it is recommended that the collegial body should establish nomination, remuneration, and audit committees¹⁸. Companies should ensure that the functions attributable to the nomination, remuneration, and audit committees are carried out. However they may decide to merge these functions and set up less than three	Yes / No	The Company believes that work of the supervisory board is sufficiently effective, balanced and well organized meaning that the supervisory board can discharge all functions attributed to these committees properly. No special or exclusive voting rights are conferred on independent members of the supervisory board. Independent members of the board can always express their opinion which is then recorded in the minutes of the meeting.

¹⁷ In case the company's general meeting elected collegial body is the management board, the recommendation regarding its independency from the company's management bodies applied in regard to the independency from the Head of the company.

¹⁸ The Law of the Republic of Lithuania on Audit (Official Gazette, 2008, No 82-53233) determines that an Audit Committee shall be formed in each public interest entity (including, but not limited to public companies whose securities are traded in the regulated market of the Republic of Lithuania and/or any other member state).

committees. In such case a company should explain in detail reasons behind the selection of alternative approach and how the selected approach complies with the objectives set forth for the three different committees. Should the collegial body of the company comprise small number of members, the functions assigned to the three committees may be performed by the collegial body itself, provided that it meets composition requirements advocated for the committees and that adequate information is provided in this respect. In such case provisions of this Code relating to the committees of the collegial body (in particular with respect to their role, operation, and transparency) should apply, where relevant, to the collegial body as a whole.

The Company has no committees formed. The Company's opinion is that the work of the Supervisory Board is sufficiently effective and well-organized, so that the Supervisory Board can properly execute all of the functions, that are assigned to these committees.

According to the regulations of the Audit law of the Republic of Lithuania, the public interest company, which is a secondary company and whose financial reports are consolidated, may not follow the Audit law of the Republic of Lithuania requirement to form an Audit Committee, if it's parent company has one. Since ESO's parent company LE has formed an Audit Committee, a separate Audit Committee is not formed in the Company.

LE, as a parent company, also has formed the Nomination and Remuneration Committee as well as the Risk Management Supervision Committee.

The Nomination and Remuneration Committee of LE, amongst other functions, provides proposals on the Company's long-term remuneration policy, annual bonuses (tantiems) sharing policy. It also evaluates the conditions set out in the Company's agreements with its management bodies, the procedure of search and selection of candidates to become the members of the Company's management body, as well as top management members, and qualification requirement determination. It constantly evaluates the structure, size, composition and activities of the Company's management and supervision body.

The Risk Management Supervision Committee of LE supervises how the Company's objective achievement risks are evaluated and managed, evaluates the internal control procedure and risk management measure adequacy comparing to the identified risks, evaluates risks and the Company's risk management plan, oversees the risk management process implementation.

4.8. The key objective of the committees is to increase efficiency of the activities of the collegial body by ensuring that decisions are based on due consideration, and to help organize its work with a view to ensuring that the decisions it takes are free of material conflicts of interest. Committees should exercise independent judgement and integrity when exercising its functions as well as present the collegial body with recommendations concerning the decisions of the collegial body. Nevertheless the final decision shall be adopted by the collegial body. The recommendation on creation of committees is not intended, in principle, to constrict the competence of the collegial body or to remove the matters considered from the purview of the collegial body itself, which remains fully responsible for the decisions taken in its field of competence.	Yes / No	The Company has no committees formed. See the comments for Items 4.7, 4.12, 4.13, 4.14.
4.9. Committees established by the collegial body should normally be composed of at least three members. In companies with small number of members of the collegial body, they could exceptionally be composed of two members. Majority of the members of each committee should be constituted from independent members of the collegial body. In cases when the company chooses not to set up a supervisory board, remuneration and audit committees should be entirely comprised of non-executive directors. Chairmanship and membership of the committees should be decided with due regard to the need to ensure that committee membership is refreshed and that undue reliance is not placed on particular individuals.	Yes / No	The Company has no committees formed. See the comments for Items 4.7, 4.12, 4.13, 4.14.
4.10. Authority of each of the committees should be determined by the collegial body. Committees should perform their duties in line with authority delegated to them and inform the collegial body on their activities and performance on regular basis. Authority of every committee stipulating the role and rights and duties of the committee should be made public at least once a year (as part of the information disclosed by the company annually on its corporate governance structures and practices). Companies should also make public annually a statement by existing committees on their composition, number of meetings and attendance over the year, and their main activities. Audit committee should confirm that it is satisfied with the independence of the audit process and describe briefly the actions it has taken to reach this conclusion.	Yes / No	The Company has no committees formed. See the comments for Items 4.7, 4.12, 4.13, 4.14.

4.11. In order to ensure independence and impartiality of the committees, members of the collegial body that are not members of the committee should commonly have a right to participate in the meetings of the committee only if invited by the committee. A committee may invite or demand participation in the meeting of particular officers or experts. Chairman of each of the committees should have a possibility to maintain direct communication with the shareholders. Events when such are to be performed should be specified in the regulations for committee activities.	Yes / No	The Company has no committees formed. See the comments for Items 4.7, 4.12, 4.13, 4.14.
4.12. Nomination Committee. 4.12.1. Key functions of the nomination committee should be the following: 1) Identify and recommend, for the approval of the collegial body, candidates to fill board vacancies. The nomination committee should evaluate the balance of skills, knowledge and experience on the management body, prepare a description of the roles and capabilities required to assume a particular office, and assess the time commitment expected. Nomination committee can also consider candidates to members of the collegial body delegated by the shareholders of the company; 2) Assess on regular basis the structure, size, composition and performance of the supervisory and management bodies, and make recommendations to the collegial body regarding the means of achieving necessary changes; 3) Assess on regular basis the skills, knowledge and experience of individual directors and report on this to the collegial body; 4) Properly consider issues related to succession planning; 5) Review the policy of the management bodies for selection and appointment of senior management. 4.12.2. Nomination committee should consider proposals by other parties, including management and shareholders. When dealing with issues related to executive directors or members of the board (if a collegial body elected by the general shareholders' meeting is the supervisory board) and senior management, chief executive officer of the company should be consulted by, and entitled to submit proposals to the nomination committee.	Yes / No	The Nomination committee is not formed in the Company. See the comment for Item 4.7.
4.13. Remuneration Committee. 4.13.1. Key functions of the remuneration committee should be the following: 1) Make proposals, for the approval of the collegial body, on the remuneration policy for members of	Yes / No	The Remuneration committee is not formed in the Company. See the comment for Item 4.7.

management bodies and executive directors. Such policy should address all forms of compensation, including the fixed remuneration, performance-based remuneration schemes, pension arrangements, and termination payments. Proposals considering performance-based remuneration schemes should be accompanied with recommendations on the related objectives and evaluation criteria, with a view to properly aligning the pay of executive director and members of the management bodies with the long-term interests of the shareholders and the objectives set by the collegial body;

2) Make proposals to the collegial body on the individual remuneration for executive directors and member of management bodies in order their remunerations are consistent with company's remuneration policy and the evaluation of the performance of these persons concerned. In doing so, the committee should be properly informed on the total compensation obtained by executive directors and members of the management bodies from the affiliated companies;

3) Ensure that remuneration of individual executive directors or members of management body is proportionate to the remuneration of other executive directors or members of management body and other staff members of the company.

4) Periodically review the remuneration policy for executive directors or members of management body, including the policy regarding share-based remuneration, and its implementation.

5) Make proposals to the collegial body on suitable forms of contracts for executive directors and members of the management bodies;

6) Assist the collegial body in overseeing how the company complies with applicable provisions regarding the remuneration-related information disclosure (in particular the remuneration policy applied and individual remuneration of directors);

7) Make general recommendations to the executive directors and members of the management bodies on the level and structure of remuneration for senior management (as defined by the collegial body) with regard to the respective information provided by the executive directors and members of the management bodies.

4.13.2. With respect to stock options and other share-based incentives which may be granted to directors or other employees, the committee should:

1) Consider general policy regarding the granting of the above mentioned schemes, in particular stock options, and make any related proposals to the collegial body;

2) Examine the related information that is given in the company's annual report and documents intended for the use during the shareholders meeting; 3) Make proposals to the collegial body regarding the choice between granting options to subscribe shares or granting options to purchase shares, specifying the reasons for its choice as well as the consequences that this choice has. 4.13.3. Upon resolution of the issues attributable to the competence of the remuneration committee, the committee should at least address the chairman of the collegial body and/or chief executive officer of the company for their opinion on the remuneration of other executive directors or members of the management bodies. 4.13.4. The remuneration committee should report on the exercise of its functions to the shareholders and be present at the annual general meeting for this purpose.		

4.14. Audit Committee

4.14.1. Key functions of the audit committee should be the following:

- 1) Observe the integrity of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting methods used by the company and its group (including the criteria for the consolidation of the accounts of companies in the group);
- 2) At least once a year review the systems of internal control and risk management to ensure that the key risks (inclusive of the risks in relation with compliance with existing laws and regulations) are properly identified, managed and reflected in the information provided;
- 3) Ensure the efficiency of the internal audit function, among other things, by making recommendations on the selection, appointment, reappointment and removal of the head of the internal audit department and on the budget of the department, and by monitoring the responsiveness of the management to its findings and recommendations. Should there be no internal audit authority in the company, the need for one should be reviewed at least annually;
- 4) Make recommendations to the collegial body related with selection, appointment, reappointment and removal of the external auditor (to be done by the general shareholders' meeting) and with the terms and conditions of his engagement. The committee should investigate situations that lead to a resignation of the audit company or auditor and make recommendations on required actions in such situations;
- 5) Monitor independence and impartiality of the external auditor, in particular by reviewing the audit company's compliance with applicable guidance relating to the rotation of audit partners, the level of fees paid by the company, and similar issues. In order to prevent occurrence of material conflicts of interest, the committee, based on the auditor's disclosed inter alia data on all remunerations paid by the company to the auditor and network, should at all times monitor nature and extent of the non-audit services. Having regard to the principals and guidelines established in the 16 May 2002 Commission Recommendation 2002/590/EC, the committee should determine and apply a formal policy establishing types of non-audit services that are (a) excluded, (b) permissible only after review by the committee, and (c) permissible without referral to the committee;
- 6) Review efficiency of the external audit process and responsiveness of management to recommendations made in the external auditor's management letter.

Yes / No

See the comment for Item 4.7.

According to the provisions of the Audit law of the Republic of Lithuania, the public interest company, which is a public company and whose financial reports are consolidated, may not comply with the requirement of the Audit law of the Republic of Lithuania to form an Audit committee, if its patronizing company has one. Since LESTO patronizing company "Lietuvos energija", UAB, has an Audit Committee, there is no separate Audit committee in the Company.

4.14.2. All members of the committee should be furnished with complete information on particulars of accounting, financial and other operations of the company. Company's management should inform the audit committee of the methods used to account for significant and unusual transactions where the accounting treatment may be open to different approaches. In such case a special consideration should be given to company's operations in offshore centers and/or activities carried out through special purpose vehicles (organizations) and justification of such operations.

4.14.3. The audit committee should decide whether participation of the chairman of the collegial body, chief executive officer of the company, chief financial officer (or superior employees in charge of finances, treasury and accounting), or internal and external auditors in the meetings of the committee is required (if required, when). The committee should be entitled, when needed, to meet with any relevant person without executive directors and members of the management bodies present.

4.14.4. Internal and external auditors should be secured with not only effective working relationship with management, but also with free access to the collegial body. For this purpose the audit committee should act as the principal contact person for the internal and external auditors.

4.14.5. The audit committee should be informed of the internal auditor's work program, and should be furnished with internal audit's reports or periodic summaries. The audit committee should also be informed of the work program of the external auditor and should be furnished with report disclosing all relationships between the independent auditor and the company and its group. The committee should be timely furnished information on all issues arising from the audit.

4.14.6. The audit committee should examine whether the company is following applicable provisions regarding the possibility for employees to report alleged significant irregularities in the company, by way of complaints or through anonymous submissions (normally to an independent member of the collegial body), and should ensure that there is a procedure established for proportionate and independent investigation of these issues and for appropriate follow-up action.

4.14.7. The audit committee should report on its activities to the collegial body at least once in every six months, at the time the yearly and half-yearly statements are approved.

4.15. Every year the collegial body should conduct the assessment of its activities. The assessment should include evaluation of collegial body's structure, work organization and ability to act as a group, evaluation of each of the collegial body member's and committee's competence and work efficiency and assessment whether the collegial body has achieved its objectives. The collegial body should, at least once a year, make public (as part of the information the company annually discloses on its management structures and practices) respective information on its internal organization and working procedures, and specify what material changes were made as a result of the assessment of the collegial body of its own activities.

No

The legal acts of the Republic of Lithuania contain no obligation to assess the activities of the Company's Supervisory Board.

Principle V: The working procedure of the company's collegial bodies

The working procedure of supervisory and management bodies established in the company should ensure efficient operation of these bodies and decision-making and encourage active co-operation between the company's bodies.

5.1. The company's supervisory and management bodies (hereinafter in this Principle the concept 'collegial bodies' covers both the collegial bodies of supervision and the collegial bodies of management) should be chaired by chairpersons of these bodies. The chairperson of a collegial body is responsible for proper convocation of the collegial body meetings. The chairperson should ensure that information about the meeting being convened and its agenda are communicated to all members of the body. The chairperson of a collegial body should ensure appropriate conducting of the meetings of the collegial body. The chairperson should ensure order and working atmosphere during the meeting.

Yes

According to the Company's Articles of Association and the working procedure regulations of the Supervisory Board and the Board as well as the current practice, this recommendation is implemented.

5.2. It is recommended that meetings of the company's collegial bodies should be carried out according to the schedule approved in advance at certain intervals of time. Each company is free to decide how often to convene meetings of the collegial bodies, but it is recommended that these meetings should be convened at such intervals, which would guarantee an interrupted resolution of the essential corporate governance issues. Meetings of the company's supervisory board should be convened at least once in a quarter, and the company's board should meet at least once a month.¹⁹

Yes

According to the Company's Articles of Association and the working procedure regulations of the Supervisory Board and the Board, the meetings of the Company's Supervisory Board are held at least once per quarter and the Board – at least once per two weeks. In case of necessity, the Board can define new meeting periodicity.

¹⁹ The frequency of meetings of the collegial body provided for in the recommendation must be applied in those cases when both additional collegial bodies are formed at the company, the board and the supervisory board. In the event only one additional collegial body is formed in the company, the frequency of its meetings may be as established for the supervisory board, i.e. at least once in a quarter.

5.3. Members of a collegial body should be notified about the meeting being convened in advance in order to allow sufficient time for proper preparation for the issues on the agenda of the meeting and to ensure fruitful discussion and adoption of appropriate decisions. Alongside with the notice about the meeting being convened, all the documents relevant to the issues on the agenda of the meeting should be submitted to the members of the collegial body. The agenda of the meeting should not be changed or supplemented during the meeting, unless all members of the collegial body are present or certain issues of great importance to the company require immediate resolution.	Yes	According to the Company's Articles of Association and the working procedure regulations of the Supervisory Board and the Board, the members of the collegial body and persons that are invited to such meetings, are informed of them in advance. They are also provided with all of the information and materials, needed to examine the questions, presented in the agenda.
5.4. In order to co-ordinate operation of the company's collegial bodies and ensure effective decision making process, chairpersons of the company's collegial bodies of supervision and management should closely co-operate by co-coordinating dates of the meetings, their agendas and resolving other issues of corporate governance. Members of the company's board should be free to attend meetings of the company's supervisory board, especially where issues concerning removal of the board members, their liability or remuneration are discussed.	Yes	The Company does observe the recommendation. The chairman of the Supervisory Board and the chairman of the Board closely cooperate in resolving issues related to the Company's management. According to the article 33.3 of the Company's Articles of Association, the Supervisory Board is obliged to provide the possibility for the members of the Board and the CEO to attend their meetings and provide explanations, as well as the right to attend for other employees whenever issues, related with their activities, are being discussed.
Principle VI: The equitable treatment of shareholders and shareholder rights The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. The corporate governance framework should protect the rights of the shareholders.		
6.1. It is recommended that the company's capital should consist only of the shares that grant the same rights to voting, ownership, dividend and other rights to all their holders.	Yes	The Company's authorized share capital consists of 0.29 Euro denominated ordinary shares, which provide their holders equal property and non-property rights.
6.2. It is recommended that investors should have access to the information concerning the rights attached to the shares of the new issue or those issued earlier in advance, i.e. before they purchase shares.	Yes	The rights, provided by the shares are indicated in the Company's Articles of Association, which is publicly available at the Company's internet webpage.
6.3. Transactions that are important to the company and its shareholders, such as transfer, investment, and pledge of the company's assets or any other type of encumbrance should be subject to approval of the	No	The Company's transactions are made according to the order, specified in the Law on Companies of the Republic of Lithuania and the Company's Articles of Association.

general shareholders' meeting. ²⁰ All shareholders should be furnished with equal opportunity to familiarize with and participate in the decision-making process when significant corporate issues, including approval of transactions referred to above, are discussed.		
6.4. Procedures of convening and conducting a general shareholders' meeting should ensure equal opportunities for the shareholders to effectively participate at the meetings and should not prejudice the rights and interests of the shareholders. The venue, date, and time of the shareholders' meeting should not hinder wide attendance of the shareholders.	Yes	The Company convenes General Meetings of Shareholders and implements other meeting-related procedures in accordance with the procedure established in the Law on Companies of the Republic of Lithuania and creates equal possibilities to its shareholders to participate in the meeting.
6.5. If possible, in order to ensure shareholders living abroad the right to access to the information, it is recommended that documents on the course of the general shareholders' meeting should be placed on the publicly accessible website of the company not only in Lithuanian language, but in English and /or other foreign languages in advance. It is recommended that the minutes of the general shareholders' meeting after signing them and/or adopted resolutions should be also placed on the publicly accessible website of the company. Seeking to ensure the right of foreigners to familiarize with the information, whenever feasible, documents referred to in this recommendation should be published in Lithuanian, English and/or other foreign languages. Documents referred to in this recommendation may be published on the publicly accessible website of the company to the extent that publishing of these documents is not detrimental to the company or the company's commercial secrets are not revealed.	Yes	The Company notifies of a General Meeting of Shareholders being convened and presents to shareholders drafts of proposed decision and any other documents pertaining to the General Meeting of Shareholders being convened also information concerning decisions taken during the General Meeting of Shareholders provides in the manner and under the terms prescribed in legal acts by posting them publicly on the Company's website. All information intended for investors as well as documents are published in Lithuanian and English via informational system of stock-exchange NASDAQ Vilnius and on the website of the Company. Following the Company's articles of association and other laws, the information is also published in NASDAQ Vilnius Stock Exchange and an e-journal of the Centre of Register.
6.6. Shareholders should be furnished with the opportunity to vote in the general shareholders' meeting in person and in absentia. Shareholders should not be prevented from voting in writing in advance by completing the general voting ballot.	Yes	The Company's shareholders can implement their right to participate in the General Meeting of Shareholders personally and through a representative, in case he/she is properly authorized to

²⁰ The Law on Companies of the Republic of Lithuania (Official Gazette, 2003, No 123-5574) no longer assigns resolutions concerning the investment, transfer, lease, mortgage or acquisition of the long-terms assets accounting for more than 1/20 of the company's authorised capital to the competence of the general shareholders' meeting. However, transactions that are important and material for the company's activity should be considered and approved by the general shareholders' meeting. The Law on Companies contains no prohibition to this effect either. Yet, in order not to encumber the company's activity and escape an unreasonably frequent consideration of transactions at the meetings, companies are free to establish their own criteria of material transactions, which are subject to the approval of the meeting. While establishing these criteria of material transactions, companies may follow the criteria set out in items 3, 4, 5 and 6 of paragraph 4 of Article 34 of the Law on Companies or derogate from them in view of the specific nature of their operation and their attempt to ensure uninterrupted, efficient functioning of the company.

		represent the shareholder or a voting right transfer contract is signed according to the regulations of the legal acts. The Company provides possibilities for the shareholders to vote by filling in the general vote ballot paper, as it is specified by the Law on Companies of the Republic of Lithuania.
6.7. With a view to increasing the shareholders' opportunities to participate effectively at shareholders' meetings, the companies are recommended to expand use of modern technologies by allowing the shareholders to participate and vote in general meetings via electronic means of communication. In such cases security of transmitted information and a possibility to identify the identity of the participating and voting person should be guaranteed. Moreover, companies could furnish its shareholders, especially shareholders living abroad, with the opportunity to watch shareholder meetings by means of modern technologies.	No	Currently, according to the Company's point of view, there is no need to organize the voting by means of telecommunication facilities, in addition, this would require considerable investments. However, upon the shareholders' request and by taking into account the objective possibilities, the Company would allow to vote by means of telecommunication facilities.
Principle VII: The avoidance of conflicts of interest and their disclosure The corporate governance framework should encourage members of the corporate bodies to avoid conflicts of interest and assure transparent and effective mechanism of disclosure of conflicts of interest regarding members of the corporate bodies.		
7.1. Any member of the company's supervisory and management body should avoid a situation, in which his/her personal interests are in conflict or may be in conflict with the company's interests. In case such a situation did occur, a member of the company's supervisory and management body should, within reasonable time, inform other members of the same collegial body or the company's body that has elected him/her, or to the company's shareholders about a situation of a conflict of interest, indicate the nature of the conflict and value, where possible.	Yes	The Company does observe the recommendations. According to article 22 of the Company's Articles of Association, each candidate member of the Supervisory Board is obliged to provide his interest declaration for the General Shareholder Meeting, where he undertakes to specify all of the circumstances, which could lead to the conflict of interest between him and the Company. In case any new circumstances arise that may cause the above-mentioned conflict, the member of the Supervisory Board is obliged to immediately inform the Company and the Supervisory Board of them in written. According to the article 39 of the Company's Articles of Association, each candidate member of the Board is obliged to provide his interest declaration for the General Shareholder Meeting, where he undertakes to specify all of the circumstances, which could lead to the conflict of interest between him and the Company. In case any new circumstances arise that may cause the above-

		mentioned conflict, the member of the Board is obliged to immediately inform the Company and the Supervisory Board of them in written. Apart from that, article 41 of the Company's Articles of Association provides, that the members of the Board cannot be employed or perform any duties, which would be inconsistent with their activities as a member of the Board, including managerial positions in other legal persons (excluding positions and employment in the Company and the company group), employment in state institutions, statute institutions. Members of the Board are prohibited to perform other duties or be employed elsewhere, with the exception of the Company duties and duties in other legal persons, where the Company is a part of and pedagogic, creative activities or copyright activities, which they are allowed to take up only with the prior consent of the Supervisory Board.
7.2. Any member of the company's supervisory and management body may not mix the company's assets, the use of which has not been mutually agreed upon, with his/her personal assets or use them or the information which he/she learns by virtue of his/her position as a member of a corporate body for his/her personal benefit or for the benefit of any third person without a prior agreement of the general shareholders' meeting or any other corporate body authorized by the meeting.	Yes	The Company does observe the recommendations.
7.3. Any member of the company's supervisory and management body may conclude a transaction with the company, a member of a corporate body of which he/she is. Such a transaction (except insignificant ones due to their low value or concluded when carrying out routine operations in the company under usual conditions) must be immediately reported in writing or orally, by recording this in the minutes of the meeting, to other members of the same corporate body or to the corporate body that has elected him/her or to the company's shareholders. Transactions specified in this recommendation are also subject to recommendation 4.5.	Yes	The Company does observe the recommendations.
7.4. Any member of the company's supervisory and management body should abstain from voting when	Yes	According to the laws and the Company's legal acts, regulating the activities of the members of the Company's Supervisory

decisions concerning transactions or other issues of personal or business interest are voted on.		Board and management body, the members of the Company's bodies are obliged to avoid situations, when their personal interests are in conflict with the Company's interests. They are also prohibited to vote, whenever the meeting decides upon questions, related to their responsibilities or their activities in the respective company body.
Principle VIII: Company's remuneration policy Remuneration policy and procedure for approval, revision and disclosure of directors' remuneration established in the company should prevent potential conflicts of interest and abuse in determining remuneration of directors, in addition it should ensure publicity and transparency both of company's remuneration policy and remuneration of directors.		
8.1. A company should make a public statement of the company's remuneration policy (hereinafter the remuneration statement) which should be clear and easily understandable. This remuneration statement should be published as a part of the company's annual statement as well as posted on the company's website.	No	The general information on the Company's salary policy and the average salary sizes for different groups of the Company's employees are published in the Company's interim and annual reports. According to the article 25 part 5 of the Energetics law of the Republic of Lithuania, the Company publicly announces salary paid to members of the management bodies as well as any other payments related with the function of the management bodies' members.
8.2. Remuneration statement should mainly focus on directors' remuneration policy for the following year and, if appropriate, the subsequent years. The statement should contain a summary of the implementation of the remuneration policy in the previous financial year. Special attention should be given to any significant changes in company's remuneration policy as compared to the previous financial year.	No	See the comment for Item 8.1. The annual report does not include the remuneration policy of the Company's directors for the coming and later years. The interim and annual reports provide information on the amounts of money paid out to the Company's members of the management bodies (salaries, other payments).
8.3. Remuneration statement should leastwise include the following information: 1) Explanation of the relative importance of the variable and non-variable components of directors' remuneration; 2) Sufficient information on performance criteria that entitles directors to share options, shares or variable components of remuneration; 3) An explanation how the choice of performance criteria contributes to the long-term interests of the company; 4) An explanation of the methods, applied in order to determine whether performance criteria have been fulfilled;	No	See the comment for Item 8.1. The interim and annual reports provide information on the amounts of money paid out to the Company's members of the management bodies (salaries, other payments, tantieme, and other profit related payments). It also contains information on transferred property and guarantees provided to the members of the Company's management bodies as well as other information related with their salaries.

5) Sufficient information on deferment periods with regard to variable components of remuneration; 6) Sufficient information on the linkage between the remuneration and performance; 7) The main parameters and rationale for any annual bonus scheme and any other non-cash benefits; 8) Sufficient information on the policy regarding termination payments; 9) Sufficient information with regard to vesting periods for share-based remuneration, as referred to in point 8.13 of this Code; 10) Sufficient information on the policy regarding retention of shares after vesting, as referred to in point 8.15 of this Code; 11) Sufficient information on the composition of peer groups of companies the remuneration policy of which has been examined in relation to the establishment of the remuneration policy of the company concerned; 12) A description of the main characteristics of supplementary pension or early retirement schemes for directors; 13) Remuneration statement should not include commercially sensitive information.		
8.4. Remuneration statement should also summarize and explain company's policy regarding the terms of the contracts executed with executive directors and members of the management bodies. It should include, inter alia, information on the duration of contracts with executive directors and members of the management bodies, the applicable notice periods and details of provisions for termination payments linked to early termination under contracts for executive directors and members of the management bodies.	No	See the comment for Item 8.1.
8.5. Remuneration statement should also contain detailed information on the entire amount of remuneration, inclusive of other benefits, that was paid to individual directors over the relevant financial year. This document should list at least the information set out in items 8.5.1 to 8.5.4 for each person who has served as a director of the company at any time during the relevant financial year. 8.5.1. The following remuneration and/or emoluments-related information should be disclosed: 1) The total amount of remuneration paid or due to the director for services performed during the relevant financial year, inclusive of, where relevant, attendance fees fixed by the annual general shareholders meeting; 2) The remuneration and advantages received from any undertaking belonging to the same group;	No	See the comment for Item 8.1.

- 3) The remuneration paid in the form of profit sharing and/or bonus payments and the reasons why such bonus payments and/or profit sharing were granted;
- 4) If permissible by the law, any significant additional remuneration paid to directors for special services outside the scope of the usual functions of a director;
- 5) Compensation receivable or paid to each former executive director or member of the management body as a result of his resignation from the office during the previous financial year;
- 6) Total estimated value of non-cash benefits considered as remuneration, other than the items covered in the above points.

8.5.2. As regards shares and/or rights to acquire share options and/or all other share-incentive schemes, the following information should be disclosed:

- 1) The number of share options offered or shares granted by the company during the relevant financial year and their conditions of application;
- 2) The number of shares options exercised during the relevant financial year and, for each of them, the number of shares involved and the exercise price or the value of the interest in the share incentive scheme at the end of the financial year;
- 3) The number of share options unexercised at the end of the financial year; their exercise price, the exercise date and the main conditions for the exercise of the rights;
- 4) All changes in the terms and conditions of existing share options occurring during the financial year.

8.5.3. The following supplementary pension schemes-related information should be disclosed:

- 1) When the pension scheme is a defined-benefit scheme, changes in the directors' accrued benefits under that scheme during the relevant financial year;
- 2) When the pension scheme is defined-contribution scheme, detailed information on contributions paid or payable by the company in respect of that director during the relevant financial year.

8.5.4. The statement should also state amounts that the company or any subsidiary company or entity included in the consolidated annual financial report of the company has paid to each person who has served as a director in the company at any time during the relevant financial year in the form of loans, advance payments or guarantees, including the amount outstanding and the interest rate.

8.6. Where the remuneration policy includes variable components of remuneration, companies should set limits on the variable component(s). The non-variable component of remuneration should be sufficient to allow the company to withhold variable components of remuneration when performance criteria are not met.	Yes	The variable part of the salary payments are determined and regulated in LESTO procedure of employees' variable remuneration determination and payment and in LESTO procedure of CEO's performance indicators determination and the variable part of the salary calculation and appointment. The maximum size of the variable part of the salary is set in the Item 4.5 of LESTO procedure of employees' variable remuneration determination and payment. In sub-item 4.5.1 of LESTO procedure of CEO's performance indicators determination and the variable part of the salary calculation and appointment is provided that the variable part of the CEO's salary cannot exceed 30 % of annual fixed salary and is set by the Company's Board. It should be noted that the same variable remuneration determination and payment principles are applied across the entire companies group of "Lietuvos energija", UAB.
8.7. Award of variable components of remuneration should be subject to predetermined and measurable performance criteria.	Yes	According to LESTO procedure of employees' variable remuneration determination and payment, the Company's Board, taking into account the opinion of the Supervisory Board, sets the measurement indicators for the employees' general (the Company's) objectives and approves their execution. According to LESTO procedure of CEO's performance indicators determination and the variable part of the salary calculation and appointment, the variable part of the salary for the CEO is paid for the execution of objectives (indicators). The objectives (indicators) for the CEO are determined and approved by the Company's Board in accordance with the opinion of the Supervisory Board.

8.8. Where a variable component of remuneration is awarded, a major part of the variable component should be deferred for a minimum period of time. The part of the variable component subject to deferment should be determined in relation to the relative weight of the variable component compared to the non-variable component of remuneration.	Yes	According to LESTO procedure of employees' variable remuneration determination and payment, the variable part of the remuneration to the top-level managers is paid within 2 payments: the first part, equal to 80 % of all calculated and assigned variable part of remuneration (for the achieved objectives (indicators) of the reported period No 1) is paid within 30 calendar days of the decision to pay the variable part of the salary; the second part, equal to 20 % of all calculated and assigned variable part of remuneration (for the achieved objectives (indicators) of the reported period No 1), on purpose to loyalty of the top-level managers and performance continuity, is deferred and paid after 1 year within 30 calendar days of the decision to pay the second variable part of the salary and is paid together with the variable part of the salary (80 %) for the achieved objectives (indicators) of the reported period No 2. The analogous procedure of the variable remuneration payment to the CEO is determined in LESTO procedure of CEO's performance indicators determination and the variable part of the salary calculation and appointment.
8.9. Contractual arrangements with executive or managing directors should include provisions that permit the company to reclaim variable components of remuneration that were awarded on the basis of data which subsequently proved to be manifestly misstated.	Irrelevant	
8.10. Termination payments should not exceed a fixed amount or fixed number of years of annual remuneration, which should, in general, not be higher than two years of the non-variable component of remuneration or the equivalent thereof.	Yes	Termination payments are calculated and paid in accordance with the article 140 of the Labour Code of the Republic of Lithuania.
8.11. Termination payments should not be paid if the termination is due to inadequate performance.	Yes	See the comment for Item 8.10.

8.12. The information on preparatory and decision-making processes, during which a policy of remuneration of directors is being established, should also be disclosed. Information should include data, if applicable, on authorities and composition of the remuneration committee, names and surnames of external consultants whose services have been used in determination of the remuneration policy as well as the role of shareholders' annual general meeting.	No	See the comment for Item 8.1.
8.13. Shares should not vest for at least three years after their award.	Irrelevant	
8.14. Share options or any other right to acquire shares or to be remunerated on the basis of share price movements should not be exercisable for at least three years after their award. Vesting of shares and the right to exercise share options or any other right to acquire shares or to be remunerated on the basis of share price movements, should be subject to predetermined and measurable performance criteria.	Irrelevant	
8.15. After vesting, directors should retain a number of shares, until the end of their mandate, subject to the need to finance any costs related to acquisition of the shares. The number of shares to be retained should be fixed, for example, twice the value of total annual remuneration (the non-variable plus the variable components).	Irrelevant	
8.16. Remuneration of non-executive or supervisory directors should not include share options.	Yes	See the comment for Item 8.1.
8.17. Shareholders, in particular institutional shareholders, should be encouraged to attend general meetings where appropriate and make considered use of their votes regarding directors' remuneration.	Irrelevant	See the comment for Item 8.1.
8.18. Without prejudice to the role and organization of the relevant bodies responsible for setting directors' remunerations, the remuneration policy or any other significant change in remuneration policy should be included into the agenda of the shareholders' annual general meeting. Remuneration statement should be put for voting in shareholders' annual general meeting. The vote may be either mandatory or advisory.	Irrelevant	See the comment for Item 8.1.

8.19. Schemes anticipating remuneration of directors in shares, share options or any other right to purchase shares or be remunerated on the basis of share price movements should be subject to the prior approval of shareholders' annual general meeting by way of a resolution prior to their adoption. The approval of scheme should be related with the scheme itself and not to the grant of such share-based benefits under that scheme to individual directors. All significant changes in scheme provisions should also be subject to shareholders' approval prior to their adoption; the approval decision should be made in shareholders' annual general meeting. In such case shareholders should be notified on all terms of suggested changes and get an explanation on the impact of the suggested changes.	Irrelevant	See the comment for Item 8.1.
8.20. The following issues should be subject to approval by the shareholders' annual general meeting: 1) Grant of share-based schemes, including share options, to directors; 2) Determination of maximum number of shares and main conditions of share granting; 3) The term within which options can be exercised; 4) The conditions for any subsequent change in the exercise of the options, if permissible by law; 5) All other long-term incentive schemes for which directors are eligible and which are not available to other employees of the company under similar terms. Annual general meeting should also set the deadline within which the body responsible for remuneration of directors may award compensations listed in this article to individual directors.	Irrelevant	See the comment for Item 8.1.
8.21. Should national law or company's Articles of Association allow, any discounted option arrangement under which any rights are granted to subscribe to shares at a price lower than the market value of the share prevailing on the day of the price determination, or the average of the market values over a number of days preceding the date when the exercise price is determined, should also be subject to the shareholders' approval.	Irrelevant	See the comment for Item 8.1.
8.22. Provisions of Articles 8.19 and 8.20 should not be applicable to schemes allowing for participation under similar conditions to company's employees or employees of any subsidiary company whose employees are eligible to participate in the scheme and which has been approved in the shareholders' annual general meeting.	Irrelevant	See the comment for Item 8.1.

8.23. Prior to the annual general meeting that is intended to consider decision stipulated in Article 8.19, the shareholders must be provided an opportunity to familiarize with draft resolution and project-related notice (the documents should be posted on the company's website). The notice should contain the full text of the share-based remuneration schemes or a description of their key terms, as well as full names of the participants in the schemes. Notice should also specify the relationship of the schemes and the overall remuneration policy of the directors. Draft resolution must have a clear reference to the scheme itself or to the summary of its key terms. Shareholders must also be presented with information on how the company intends to provide for the shares required to meet its obligations under incentive schemes. It should be clearly stated whether the company intends to buy shares in the market, hold the shares in reserve or issue new ones. There should also be a summary on scheme-related expenses the company will suffer due to the anticipated application of the scheme. All information given in this article must be posted on the company's website.

Irrelevant

See the comment for Item 8.1.

Principle IX: The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between companies and stakeholders in creating the company value, jobs and financial sustainability. For the purposes of this Principle, the concept "stakeholders" includes investors, employees, creditors, suppliers, clients, local community and other persons having certain interest in the company concerned.

9.1. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

Yes

The Company's management system provides protection for the rights of the stakeholders that are protected by laws.

9.2. The corporate governance framework should create conditions for the stakeholders to participate in corporate governance in the manner prescribed by law. Examples of mechanisms of stakeholder participation in corporate governance include: employee participation in adoption of certain key decisions for the company; consulting the employees on corporate governance and other important issues; employee participation in the company's share capital; creditor involvement in governance in the context of the company's insolvency, etc.

Yes

The Company does observe the recommendations. For example, the employee representatives are involved in consultations, negotiations and discussions regarding the Company's business optimization processes. According to the employees' collective agreement, the Company informs representatives of the professional union about the expected changes in the Company, the Company's financial situation and so on. Stakeholders may get involved in the Company's management to the extent prescribed by law.

9.3. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Yes

The Company does observe the recommendations.

Principle X: Information disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material information regarding the company, including the financial situation, performance and governance of the company.

10.1. The company should disclose information on:

Yes

1. The financial and operating results of the company;
2. Company objectives;
3. Persons holding by the right of ownership or in control of a block of shares in the company;
4. Members of the company's supervisory and management bodies, chief executive officer of the company and their remuneration;
5. Material foreseeable risk factors;
6. Transactions between the company and connected persons, as well as transactions concluded outside the course of the company's regular operations;
7. Material issues regarding employees and other stakeholders;
8. Governance structures and strategy.

This list should be deemed as a minimum recommendation, while the companies are encouraged not to limit themselves to disclosure of the information specified in this list.

The Company's interim and annual reports include information on shareholders, owning more than 5 % of the issuer's share capital.

The Company's annual report discloses information regarding the members of the Supervisory Board and the Board as well as CEO.

According to the article 25, part 5 of the Energetics law of the Republic of Lithuania, the Company publicly announces the salary and other payments related with the functions of management bodies paid to the members of the Company's Supervisory Board and the Board.

The information mentioned in the recommendation's sub-points 4 and 6 is published to the extent required by applicable legal acts and annual financial report preparation requirements.

The Company discloses the information specified in this recommendation (except sub-points 4 and 6), in a number of ways:

- 1) The information regarding essential events is published according to the requirements of the laws (i.e. elections of the new member of the Supervisory Board and the Board, the Company's financial results);
- 2) Information is published at the Company's webpage (i.e. the Company's operational objectives);
- 3) Information is published in the annual report (i.e. the members of the Company's Supervisory Board and the Board, foreseeable essential risk factors).

10.2. It is recommended to the company, which is the parent of other companies, that consolidated results of the whole group to which the company belongs should be disclosed when information specified in item 1 of Recommendation 10.1 is under disclosure.

Yes

The Company provides information regarding the consolidated results of the whole company group (i.e. the Company and its subsidiaries).

		Information related to the parent Company Lietuvos Energija, UAB is announced by the parent Company itself.
10.3. It is recommended that information on the professional background, qualifications of the members of supervisory and management bodies, chief executive officer of the company should be disclosed as well as potential conflicts of interest that may have an effect on their decisions when information specified in item 4 of Recommendation 10.1 about the members of the company's supervisory and management bodies is under disclosure. It is also recommended that information about the amount of remuneration received from the company and other income should be disclosed with regard to members of the company's supervisory and management bodies and chief executive officer as per Principle VIII.	Yes	The information specified in item 4 of Recommendation 10.1 is provided in the Company's annual report and at the Company's website. According to the article 25, part 5 of the Energetics law of the Republic of Lithuania, the Company publicly announces the salary and other payments related with the functions of management bodies paid to the members of the Company's Supervisory Board and the Board.
10.4. It is recommended that information about the links between the company and its stakeholders, including employees, creditors, suppliers, local community, as well as the company's policy with regard to human resources, employee participation schemes in the company's share capital, etc. should be disclosed when information specified in item 7 of recommendation 10.1 is under disclosure.	Yes	The information specified in item 7 of Recommendation 10.1 is disclosed to the extent required by the effective legal acts of the Republic of Lithuania. Information regarding relations of the Company and stakeholders is published in the press-releases and at the Company's webpage.
10.5. Information should be disclosed in such a way that neither shareholders nor investors are discriminated with regard to the manner or scope of access to information. Information should be disclosed to all simultaneously. It is recommended that notices about material events should be announced before or after a trading session on NASDAQ OMX Vilnius, so that all the company's shareholders and investors should have equal access to the information and make informed investing decisions.	Yes	The Company discloses the information via the information disclosure system used by the Vilnius Stock Exchange in the Lithuanian and English languages simultaneously. The Company observes the recommendation and announces its material events before or after a trading session on the Vilnius Stock Exchange, except for the cases provided for by legal acts. The Company does not disclose the information likely to impact the price of the issued by it securities in its comments, interviews or otherwise by the time such information is announced via the information system of the Stock Exchange.

10.6. Channels for disseminating information should provide for fair, timely and cost-efficient or in cases provided by the legal acts free of charge access to relevant information by users. It is recommended that information technologies should be employed for wider dissemination of information, for instance, by placing the information on the company's website. It is recommended that information should be published and placed on the company's website not only in Lithuanian, but also in English, and, whenever possible and necessary, in other languages as well.	Yes	In addition to the method of information disclosure referred to Item 10.5, the Company uses various information disclosure instruments (published electronic publications for public announcements published by State Enterprise Center of Registers, news agencies, publicly available Company's website) to ensure, that the disseminated information reaches as many stakeholders as possible. The Company's webpage provides information in both Lithuanian and English languages.
10.7. It is recommended that the company's annual reports and other periodical accounts prepared by the company should be placed on the company's website. It is recommended that the company should announce information about material events and changes in the price of the company's shares on the Stock Exchange on the company's website too.	Yes	The Company publishes all of the information, specified in this recommendation on its webpage.
Principle XI: The selection of the company's auditor The mechanism of the selection of the company's auditor should ensure independence of the firm of auditor's conclusion and opinion.		
11.1. An annual audit of the company's financial reports and interim reports should be conducted by an independent firm of auditors in order to provide an external and objective opinion on the company's financial statements.	Yes	The Company executes its annual financial statement audit. The audit firm also verifies the compliance of the Company's annual report with its audited financial statements.
11.2. It is recommended that the company's supervisory board and, where it is not set up, the company's board should propose a candidate firm of auditors to the general shareholders' meeting.	Yes	The audit firm is being selected according to the procedure, laid out in the Public procurement law of the Republic of Lithuania, the selected audit firm is proposed to the General Shareholder Meeting by the Company's Board.
11.3. It is recommended that the company should disclose to its shareholders the level of fees paid to the firm of auditors for non-audit services rendered to the company. This information should be also known to the company's supervisory board and, where it is not formed, the company's board upon their consideration which firm of auditors to propose for the general shareholders' meeting.	Yes	The Company does observe the recommendations.