



STRATEGY FOR 2014–2020



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1. CHIEF EXECUTIVE'S LETTER



Dear Customers, Employees and Shareholders,

The ambitious goals set forth to the electricity distribution company LESTO a few years ago today have become usual working practise. LESTO has implemented significant changes to make its operations much more effective; we have embraced modern management practises and our performance indicators are now among the best in the region.

However, we live in a constantly evolving environment, therefore, we must evolve as well. We are an important player in the development of Lithuanian economy and we take this big responsibility seriously. Thus, we always have to be one step ahead and strive for the best results possible.

Hereby, I introduce a reviewed strategy of LESTO, which is our most important planning document for the period of 2014–2020. It establishes Company's goals and future perspectives. Based on this strategy we will work in three strategic directions to enhance value of our Company:

- We will assure the interests of electricity consumers and increase the value created in order to maintain high level of customer satisfaction. The improvements of quality and convenience of our services is our top priority and an inexhaustible opportunity.
- Like in previous years, we will remain focused on our operational effectiveness. It allows us to manage costs and assure better customer services, reliability of the distribution network and better organisation of Company's operations as well.

- We will build organisational culture based on key corporate values – cooperation, responsibility, result – in order to create an inspiring company that employees, shareholders and the society are proud of.

We have chosen to take advantage of new technologies, which will help us to achieve our strategic goals. We are open to new experiences and innovations, we learn and educate young specialists who will lead the Company in the future.

LESTO will always be open, transparent, socially active and constantly evolving company with important mission: reliable electrical energy, which creates value for everyone.

We carry out our everyday operations based on your expectations. You are our driving force and the guarantee that our work will remain meaningful in the future.

Let's share the energy and build our future together.

A handwritten signature in blue ink, which appears to read 'Aidas Ignatavičius'.

Aidas Ignatavičius

CEO
LESTO

2. STRATEGY OUTLINE

The purpose of the strategy is to determine strategic directions, goals and KPIs of LESTO AB (hereinafter Company) for 2014–2020.

In 2012–2014 Company worked in accordance with the long-term strategy for 2012–2020. The decision to review the strategy for the period of 2014–2020 was due to the significant changes – establishment of new LE group management model, appointment of new Management and Supervisory Boards, new regulation mechanism for 2015–2019.

The foundation of LESTO strategy is organisational culture built on reliability, effectiveness, high reputation and corporate values.

LESTO mission - reliable electrical energy creating value for everyone.

The reliability stated in the mission is interpreted as the assurance of adequate financing, effective investment and responsible decision making.

LESTO vision - Company of high reputation that employees, shareholders and the society are proud of. The vision emphasises the orientation towards high quality services, maximum transparency of operations and assurance of financial stability.

Implementation of the mission, pursuit for the vision and all LESTO daily activity are based on the following corporate **values**:

1. Cooperation
2. Responsibility
3. Result

All the elements above are considered essential prerequisites in pursuit of the key strategic goal – **the enhancement of Company's value.**

Enhancement of the Company's value is perceived as a sustainable balance among three **strategic directions**:

1. Assurance of the interests of the electricity consumers and an increase of the value added.
2. Continuous improvement of operational effectiveness.
3. Building of value-based organisational culture.

In pursuit of well-balanced strategic directions, Company focuses on the interests and expectations of its stakeholders. An internal and external analysis has determined the most important **stakeholders**:

- Shareholders
- Customers
- Society
- Employees
- Regulator
- Contractors

The achievement of Company's strategic goals is monitored by key **performance indicators (KPIs)** provided in the table below with their interim values for the period of 2014–2020:

LESTO goals for 2014–2020

	2014	2016	2020
SAIDI, min.	72.0	69.2	63.8
SAIFI, interruptions	0.96	0.94	0.89
GCSI, score*	76		
Employee involvement, %	40	46	62

*Significantly higher than the average of utility companies of Europe (at least +3 points).

This strategy document is divided into two main parts:

Part **3. Strategy** (pages 5–10) describes Company's vision, mission, strategic directions, values, KIPs and business planning process.

Part **4. Stakeholders** (pages 11–21) analyses LESTO main stakeholders, their key expectations, related challenges and specific goals.

3. STRATEGY

Long-term strategy is perceived as methods and tools put in place for the pursuit of the long-term goals in continuously evolving environment.

In this part LESTO strategy is expressed through Company's mission, vision, strategic directions, values and performance indicators.

Mission, Vision and Values

The foundation of LESTO strategy is its organisational culture built on reliability, effectiveness, high reputation and corporate values. These elements are considered essential prerequisites for the Company's value enhancement and meeting the stakeholders' expectations.

LESTO mission – reliable electrical energy creating value for everyone.

The reliability stated in the mission is related to the quality of distributed energy, continuous supply, effective investment and responsible decision making.

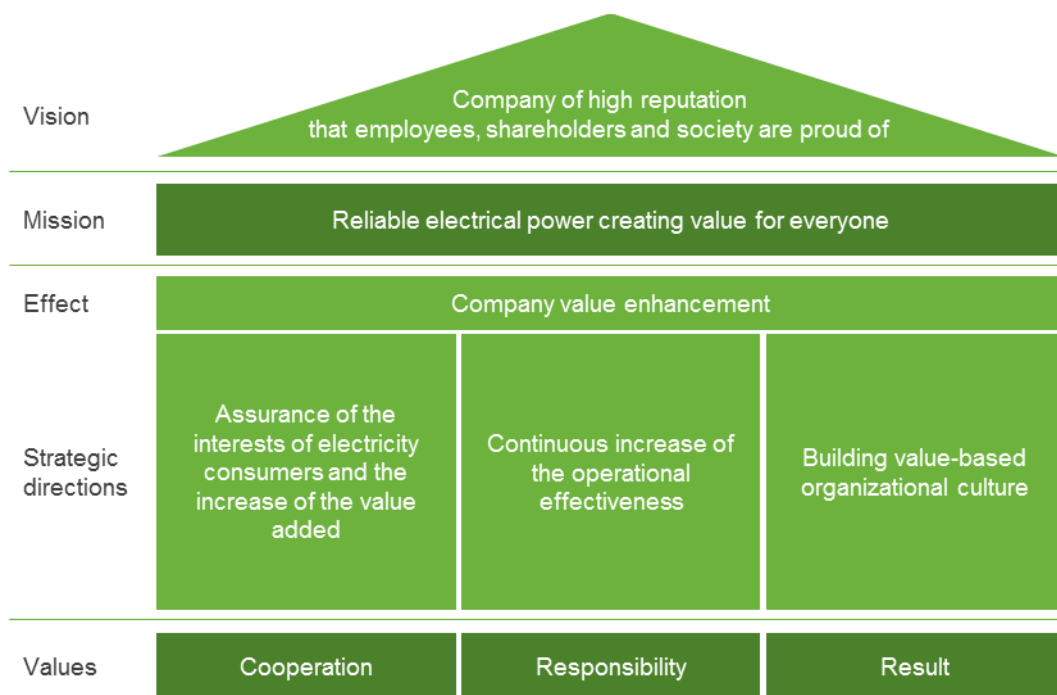
LESTO vision – the company of high reputation that employees, shareholders and the society are proud of.

The vision emphasises LESTO strategic importance for the Country, Company' orientation towards high-quality services, maximum business transparency and assurance of financial stability.

The implementation of the mission, pursuit of the vision and management of LESTO business processes are based on corporate **values: cooperation, responsibility and result.**

Values express the agreement to constantly feel the responsibility for our actions, work together and always pursue the best result for our stakeholders. Detailed value-based behaviour descriptions are provided in Annex 4, *Value-Based Behaviour*.

Picture 1
LESTO strategy chart



Strategic Directions

In order to implement vision and mission of LESTO, Company's Board has defined key strategic directions for 2014–2020. The strategic directions together with the relevant perspectives of the Balanced Scorecard are provided below:

1. Assurance of the interests of electricity consumers and the increase of the value added (**Customer perspective**).
2. Continuous increase of the operational effectiveness (**Internal processes perspective**).
3. Building value based organisational culture (**Learning and growth perspective**).

Consistent implementation of these directions provides a balanced pursuit of the main strategic goal – Company value enhancement (**Financial perspective**).

Goals and KPIs

The main goals define what is most important for the Company and where the main focus should be placed in organising the business processes and setting priorities. Table 1 shows four key performance indicators of LESTO together with their interim and target values for the period of 2014–2020.

These values are used in Company's remuneration system as key goals. Brief explanations of indicators and their significance in measuring business processes are given below (detailed definitions of each of the indicators are presented in Annex 2, *KPI's Definitions*).

SAIDI and **SAIFI** show the reliability of the power distribution network and quality of its maintenance.

GSCI aims at assessing customer satisfaction of all the services provided by the Company.

The employee involvement indicator shows the employee commitment to LESTO mission and values.

Table 1

LESTO main operational indicators and their values for 2014–2020

	2013	2014	2015	2016	2017	2018	2019	2020
SAIDI, min.	72.7	72.0	70.6	69.2	67.8	66.4	65.1	63.8
SAIFI, interruptions	0.97	0.96	0.95	0.94	0.93	0.92	0.91	0.89
GCSI, score*	76	76	76	76	76	76	76	76
Employee involvement, %	36	40	43	46	50	54	58	62**

*Value of the indicator should be significantly higher than the average of utility companies in Europe (at least +3 points).

** No less than the average of the European energy companies.

Together with the main KPIs, additional monitoring indicators were set. Monitoring KPIs support and explain the main indicators (see Table 2).

The list of the monitoring indicators and values may be modified if needed during the period of the strategy implementation, e.g. if an indicator is achieved or loses its relevance.

Table 2
LESTO monitoring indicators and their values for 2014–2020

	2013	2014	2015	2016	2017	2018	2019	2020
World Bank Doing Business rating (Getting electricity component)	75			Among TOP 50 countries				Among TOP 30 countries
Network losses, %	7.48	7.45	7.28	7.10	6.93	6.77	6.61	6.46
Talent retention share, minimum 2 years, %	100	>92						
General turnover of employees, %	8.0	5-10	5-10	5-10	5-10	5-10	5-10	5-10
SAIFI with <i>Force majeure</i> , interruptions	1.43	1.55	1.52	1.50	1.48	1.46	1.43	1.40
SAIDI with <i>Force majeure</i> , min.	154	164	160	157	152	150	148	146
SAIFI planned, interruptions	0.54	0.54	0.53	0.52	0.51	0.50	0.49	0.48
SAIDI planned, min.	213	212	208	204	200	196	192	188

Business Planning Process

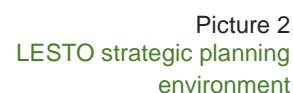
Strategy document is a major part and starting point of the Business planning process. Planning is organised as a continuous cyclic process. The main planning documents are Strategy, Business action plan and Annual budget.

During the preparation of the business planning documents, LESTO primarily considers the Lietuvos energija, UAB (hereinafter LE) group's business strategy, LE group's functional strategies, National energy strategy, relevant European Union directives, regulatory laws, Government decisions and other external regulation documents (see Picture 2, *Strategic Planning Environment*).

Strategy and goals. Strategy is prepared for a period of 5–10 years. During strategy review, an agreement is reached on the vision and mission statements, corporate values, strategic directions, long-term goals and main qualitative and financial indicators. Strategy is to be reviewed every 3 years or after a major event (e.g. changes of top management, shareholders and legal or regulatory environment).

A strategic planning session is held annually and aims at:

- Assessing the relevance of the Company's strategy.
- Reviewing last year performance and discussing key projects for the upcoming year.



Preparation of strategic initiatives and action plan. Action plan is prepared for 3-year period based on the strategy and reviewed annually. Action plan consists of a list of strategic initiatives and main KPIs.

The chart of Company's business planning process that links all the planning documents is provided below (see Picture 3).

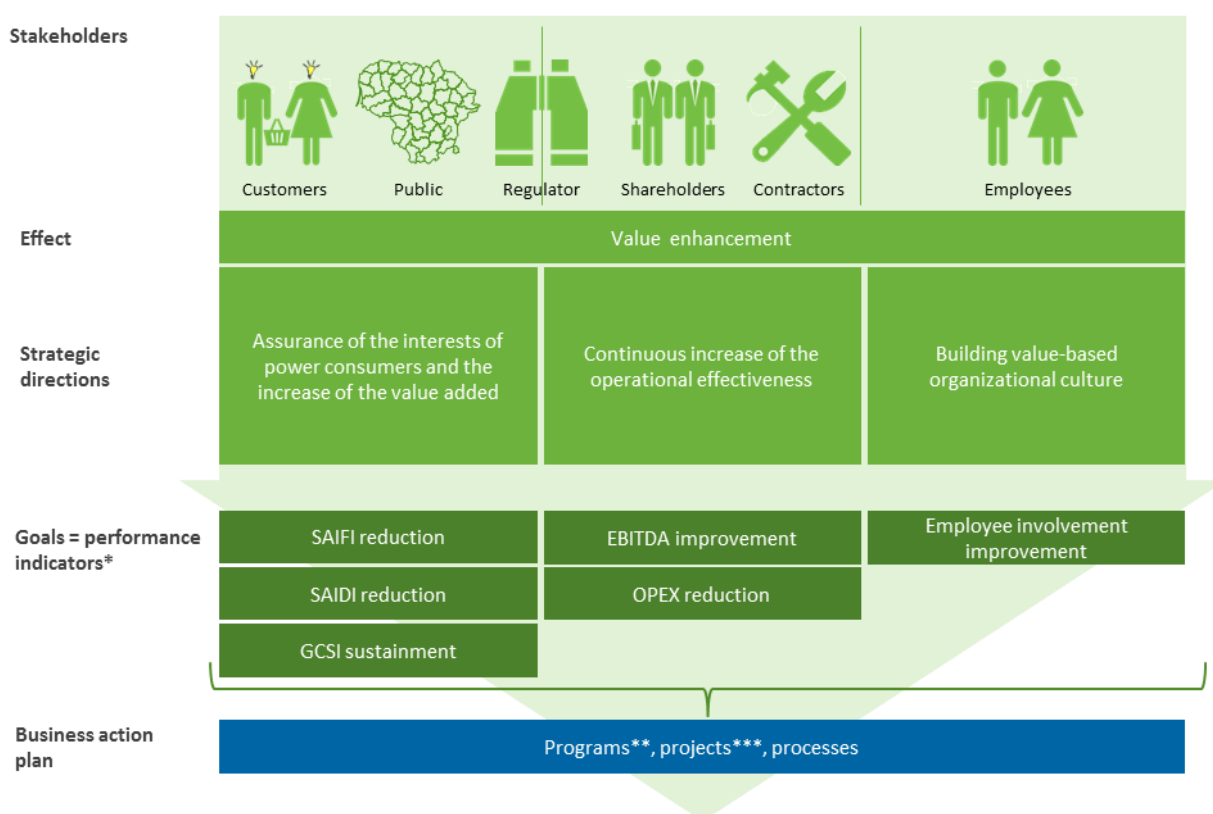


Integrated Strategic Planning

The Company's strategic directions should reflect the interests of its major stakeholders. The following chart shows LESTO stakeholder needs expressed through strategic directions. Each strategic direction is related to one or several stakeholders.

Based on this logic, specific goals and KPIs are presented for the monitoring of the assurance of the stakeholder interests. Detailed description of the stakeholder expectations is presented in Part 4 of the document.

Picture 4
Alignment of LESTO stakeholder interests and strategic directions



* Indicator is a numerical expression.

** In accordance with PMP®, programmes may consist of projects and linear business processes.

*** Projects are implemented according to: (1) LESTO project management procedures, (2) as transformations of business processes.

Map of Company's strategic goals. Map of strategic goals is prepared according to Balanced Score Card (BSC) methodology, see Picture 5.

Picture 5
Map of Strategic Goals



4. STAKEHOLDERS

Company has a wide circle of stakeholders. All of the residents and businesses of Lithuania are LESTO customers; Company's distribution grid covers whole territory of the Country. The analysis of internal and external environment determined main stakeholders and analysed their major expectations and influence for the company. Analysis was carried out applying the stakeholder model.

The identification of major stakeholders included the aggregation of similar interest groups, e.g. individual and business customers were grouped under the same stakeholder category – "Customers".

In this part of the document the analysis of each stakeholder group is carried out according to the following structure:

1. Context (environmental analysis)
2. Expressed or assumed expectations of the stakeholder
3. Challenges for LESTO
4. Goals and KPIs

Customers

Context. Company has more than 1.6 million Customers in Lithuania. LESTO customers could be divided into three major groups: households (97%), business customers (3%) and small power generators (0.1%).

Household customers differ by their demographic (age, marital status), geographic (cities, small towns, villages) characteristics and types of homes (flat, house, summer house). Business customers differ by their business area (industry, service, agriculture) and by their size – level of power consumption. Distributed energy generators differ by the amount of energy they generate, by the number of the generation objects and the source of generation (solar, wind, water). The expectations of the existing and new customers also differ, so LESTO has to address the needs of each group separately.

LESTO provides distribution service to all of its customers. This activity is natural regulated monopoly.

LESTO also acts as an energy supplier to a share of its business customers¹ and all household customers. Company is responsible for the purchase of the power for the end users. LESTO also acts as a supplier of last resort: if the operations of an independent supplier are terminated, LESTO provides power until the customer contracts new energy supplier.

Stakeholder Expectations. Customers may be divided into two large groups based on their expectations:

- Existing customers, who expect rational prices, reliable power supply and easily accessible information (on planned interruptions, billing history, payments etc.).
- New customers, who expect fast and effective connection to the grid, reasonable price for connection service and clear, efficient process.

The amount of information required by these groups is different: new customers need more diverse information from LESTO, while existing customers need less information and not that often.

Challenges. Major challenges for LESTO in customer service management:

- Assuring quality of services. LESTO can create highest value through high quality customer services. The importance of service level grows as customer expectations grow. Customers contact LESTO comparatively rarely, so each contact has to be of high quality. This way customer develops a positive image and associations about the Company.
- In order to optimize operational costs, an important goal is the optimisation of the customer service network and the development of convenient services provided through remote service channels (on-line, mobile, phone).
- As expectations for quality of services grow, the internal processes of LESTO have to be continuously reviewed and simplified in order to achieve effective service. It is especially important for new customer connection process.

¹ 74% of the customers or 7% of all the distributed energy.

Picture 6
Forecast of GCSI indicator for 2014–2020



Goals and KPIs. Assurance of customer interests and increase of their perceived value is one of LESTO strategic directions. LESTO measures the value created for the customers by the energy supply reliability indicators SAIDI, SAIFI and by customer satisfaction index, according to GCSI methodology. Detailed descriptions of indicators are in the Annex 2 *KPIs Definitions*.

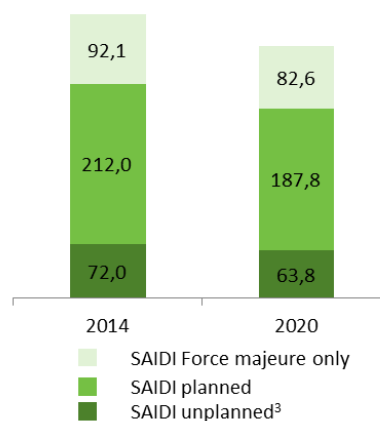
The comparison of LESTO reliability indicators with other utility companies of Central Europe countries (see Annex 3 *KPIs Comparison*) results in conclusion that LESTO service quality indicators are among the best in the region. In order to retain high customer satisfaction, the Company plans:

- Further development of remote customer service channels providing more services more conveniently.
- Improve existing services and make payment for electricity more convenient by discontinuing use of paper pay books and shifting to bills, based on average electricity consumption.
- Continue the optimisation of the network of physical customer service centres.
- Rationally invest in the distribution network and assure sustainable improvement of the reliability indicators² (see Pictures 7 and 8).

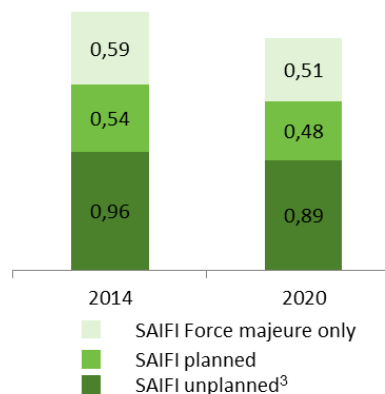
- Make the processes of new customer connection and services more efficient. One of the Company's monitoring indicators is a component of World Bank Doing Business rating "Getting electricity". LESTO intends to considerably shorten and simplify the process of the new customer connection.

Due to these actions, Company plans to maintain the present high value of GCSI indicator of 76 points (see Picture 6).

Picture 7
Forecast of SAIDI indicator and its components, min.



Picture 8
Forecast of SAIFI indicator and its components, number of interruptions



² The Regulator currently is calculating only two components in the unplanned SAIDI and SAIFI indicators (duration and interruptions of the unidentified events and those attributed to the responsibility of the operator). Both of these components belong to the "SAIDI" and "SAIFI" shares of the graph. Apart from this, overall average outage duration and no of interruptions is important for the customer. There is no significant difference for the customer why the power was interrupted (whether due to planned maintenance, operator responsibility, or *Force majeure*). With respect to the customer interests, LESTO plans measures to decrease all components of SAIDI and SAIFI.

³ SAIDI and SAIFI unplanned components are the following ones: attributed to the responsibility of the operator, due to external impact and due to unidentified reasons.

Society

Context. All the households and businesses in Lithuania use LESTO services. Company's vision emphasises the pursuit to be worth the pride of the Country and the Society. LESTO brings value for the Society by assuring reliable power distribution and providing rationally priced services.

Stakeholder expectations. LESTO perceives the Society as a wide circle of stakeholders, who have different interests (see Picture 9). On the one hand, a reasonable and regionally competitive price is important. On the other hand a smooth integration of the renewable energy sources in to the grid, reliable supply of power, transparency, social responsibility, decrease of environmental impact and contribution to the Country strategic projects are also important factors for the Society.

LESTO task is to find a sustainable balance between those expectations.

Challenges. In order to assure the interests of Society, LESTO contributes to the implementation of the EU Directives, the Country energy strategy and initiates social responsibility projects. The key challenges for LESTO in the future are as follows:

- Implementation of the obligations stated in EU Directive on Energy Efficiency. Together with other companies of the energy sector, LESTO will have to assure the common goal of energy consumption saving. LESTO will have to implement energy efficiency projects independently and in cooperation with external partners.
- In recent years, the development of renewables has been disperse and chaotic. This process has a negative influence on the quality of energy supply, increases grid losses and creates preconditions for the development of excess power distribution grid.
- Improvement of the existing technical condition of the distribution grid and assurance of adequate level of investment.

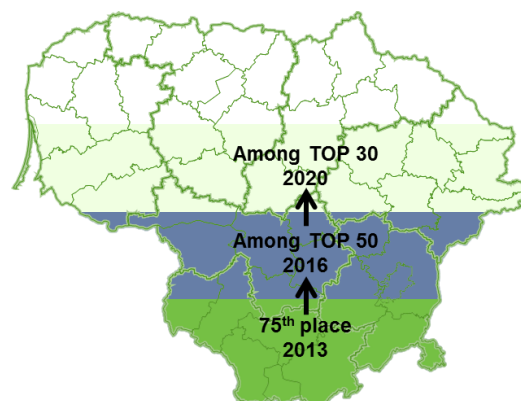
Picture 9
Stakeholder Expectations



Goals and Indicators. With respect to the implementation of the stakeholder expectations, the Company plans to:

- Strengthen social responsibility, further cooperation with public organizations, local municipalities and academic institutions. LESTO was among the first companies in Lithuania that started preparing social responsibility reports according to UN Global Reporting Initiative 4, which demonstrates Company's maturity and transparency.
- Continue to contribute to the growth of Lithuanian business competitiveness. One of the Company's monitoring indicators is the component of Getting electricity index appears in World Bank Doing Business rating. Getting electricity indicator shows the easiness of the connection of new objects to the grid. The Company seeks to minimize the connection time, thus enabling faster business development and growths of the country's competitiveness.
- Improve the investment effectiveness and introduce modern solutions (e.g. smart grid solutions, smart meter readers) as new technologies are developed.
- Enhance the value of the company by investing into innovative, energy saving solutions (implementing the provisions of the Directive on Energy Efficiency).

Picture 10
Doing Business rating indicator "Getting Electricity"



Regulator

Context. In Lithuania, function of the energy industry regulation is performed by the National Commission for Energy Control and Prices (hereinafter the Regulator), which prepares the methodologies for calculation of energy services pricing, coordinates companies' investment plans, monitors how predetermined quality level targets are achieved.

Stakeholder expectations. Major expectations of the Regulator coincide with the purpose of LESTO existence: to provide reliable electricity distribution service at a reasonable price. During recent regulatory periods, LESTO has achieved all quality level indicators defined by the Regulator. Therefore, the Regulator's main expectation is to better understand LESTO daily operations and provide environment for keeping achieved quality level.

Challenges. Main challenges for LESTO in relations with the Regulator are:

- Adjust to a new regulation methodology to be applied for 2015–2019 regulatory period, which is implemented on the principles of Long Run Average Incremental Costs (hereinafter LRAIC) and the virtual optimal distribution grid model, based on actual consumer needs and demand forecasts for the services. The main assumption of the model is that all the costs of transmission and distribution operators may be optimized by mutual agreement of the operators and the Regulator in long-run.
- Prepare the data needed for calculations of LRAIC model. Originally LRAIC methodology was created for the regulation of telecommunication services and has never been applied in Lithuanian energy sector. The essential challenge for LESTO is to provide the Regulator with very detailed financial and technical network data needed for the model calculations. As a large part of the data will be renewed and re-submitted on annual basis, the Company's information systems (hereinafter IS) will have to be adapted for swift update of data, its submission, error control and decision-making. At present, LESTO IS and the data itself are not designed for the task.

Another important challenge related to the LRAIC model is to tailor Company's operational processes to work with the new regulation methods.

As principles of defining OPEX and CAPEX of the distribution grid are being changed significantly, the principles of the grid development, capacity planning, maintenance, renewal and modernisation processes have to be updated accordingly. More accurate forecasting methods are of utmost importance.

- Assure adequate allowed investment needed for providing adequate quality of services and assure Company's financial stability. One of the biggest challenges that the Company has been facing for the last few years is the method of valuation of regulated asset base (RAB). Currently it is valued on the basis of 2003 historic cost and it is a sole method currently applied by the Regulator. This method does not assure adequate investment for the renewal of the worn-out assets. The value of all the tangible fixed assets of LESTO at the end of 2013 was LTL 4.5 bn. while the amount recognised by the Regulator was LTL 1.8 bn. Due to this reason; the asset depreciation calculated by the Regulator is considerably smaller than calculated in Company's financial reports.

This problem is tackled indirectly by the LRAIC methodology – model provides possibility to determine allowed expenditure by the historic cost valuation method as well as by the method of replacement cost value⁴. However, which method will be used in practice was still not clear during preparation of this document.

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Goals and Indicators. Major goals of LESTO

⁴ At the time of the preparation of the present document, the final decision on the asset valuation method to be used in the regulation period 2015–2019 was not taken yet.

related to the Regulator:

- To adapt LESTO IS to work with LRAIC model calculations and integrate the principles of the model into Company's decision-making and long-term planning processes.
- Through active cooperation with the Regulator and participation in a public discussion, to relinquish the usage of historic cost valuation method for RAB valuation and gradually move towards the method of replacement cost valuation.
- Present Regulator with good practices of incentive based regulation in a comprehensive, timely and argumentative manner, with suggestion to evaluate possibility to apply them in Lithuanian energy sector.
- Submit constructive suggestions to the Regulator on the application of consistent and argument-based principles of long-term planning of investment into the distribution grid.
- Create and maintain a continuous, comprehensive and business-minded cooperation with the Regulator, providing constructive suggestions of improvement of the regulation methods and initiating discussions in order to tackle existing problems.

Shareholders

Context. By the end of 2013, Lietuvos energija, UAB, was the largest shareholder of LESTO with direct control of 82.6% of shares. E.ON Ruhrgas International GmbH owned 11.8%; the rest of 5.4% of shares were owned by ~7 thousand minor shareholders. On the day of strategy publication Lietuvos energija, UAB owned 93.39% shares of LESTO.

Company shares are listed at NASDAQ OMX Baltic Stock Exchange.

Stakeholder Expectations. The main expectation of the shareholders is financially stable and sufficiently profitable Company. LESTO transparency and open communication is also highly important to the shareholders.

For LE, the holding company that plays an active role in LESTO management⁵, LESTO financial contribution is primarily important in order to achieve Group's strategic goals. Also shareholders expect that LESTO will not only improve efficiency, but also service quality indicators. Main shareholders expectations are as follows:

- Increase Company value – implement carefully targeted investment programs and projects coordinating them with the National Commission for Energy Control and Prices.
- Increase efficiency – decrease operational expenses (OPEX) by continually optimising processes and organisational structure.
- Provide sufficient distribution service quality: assure sufficient technical condition of distribution network, systematically modernise and automate the distribution grid.
- Provide convenient and easy to use services, by developing and improving electronic channels and shortening services provision timing.
- Introduction and integration of new values: cooperation, responsibility, results.

Challenges. The key challenge for LESTO is to reach the financial goals of 2020 defined by LE Group. LE Group Strategy intends to double the Group value by 2020. LESTO, as the largest company in LE Group, has to make a substantial contribution towards this goal.

Goals and Indicators. Company's financial goals:

- One of the most important goals of LESTO will be to define long-term directions for investment into service quality and reliability of the distribution grid, prepare the strategy for the investment as well as a long-term investment plan.
- Increase operational efficiency: decrease the operational expenses (OPEX) by optimising processes and organisational structure; focus on long-term investment projects in the distribution grid (CAPEX) and keep the present technical condition of the distribution grid.
- Participate in the implementation of LE Group's Efficiency Programme by decreasing expenses using the corporate synergy opportunities of LE Group – unified IT strategy, centralised functions of procurement, accounting, HR etc.

⁵ Strategies and policies of functional areas prepared at the level of LE Group (ITT, human resources, management, etc., see Picture 2).

Contractors

Context. In 2013, LESTO has been working with 455 external service companies, 143 of them were working directly in distribution grid. For the procurement of goods and services, Company annually spends approximately LTL 450M. Majority of this budget is allocated to the purchase of distribution grid renovation, upgrade, new customer connections, ITT services, rent of real estate and vehicles.

Since 2011 operational model has been changing and increasingly larger share of services are being purchased on competitive market, thus the importance of contractors' competence has grown considerably. Reputation of LESTO, its performance indicators and customer satisfaction largely depend on the quality of work and competence of the contractors.

LESTO considers its relationship with the contractors as a partnership of equals. Contractors are highly important for the Company in assuring power distribution reliability, renewing and maintaining the distribution grid and providing services for customers. For the Contractors, LESTO is large and reliable client with a stable cash flow and no overdue payments culture.

Stakeholder Expectations. The contractors expect constructive partnership from LESTO: clear contractual conditions, timely payments for goods and services, smooth process of the work organisation, flexible management of documentation and effective tendering process.

Challenges. Like in many large companies, the preparation and approval of LESTO budget takes place during Q3-Q4. Therefore tendering takes place and contracts with contractors are finalized in Q1- Q2; thus, the completion of the works takes within remaining 4-6 months due to climate conditions. This is not a sufficient term for larger projects and that is the reason why their conclusion and payment is often moved to the next calendar year. Another limitation - contractors have limited number of employees and they want to distribute the work load evenly within the year. Therefore, it is very important to prepare and plan long-term investment projects as early as possible on the basis of the long-term investment strategy and long-term investment plan.

One of the most important aspects of LESTO cooperation with the Contractors is smooth management of procurement process according to Public procurement law, elimination of excessive procedures and shortening of the timeframes.

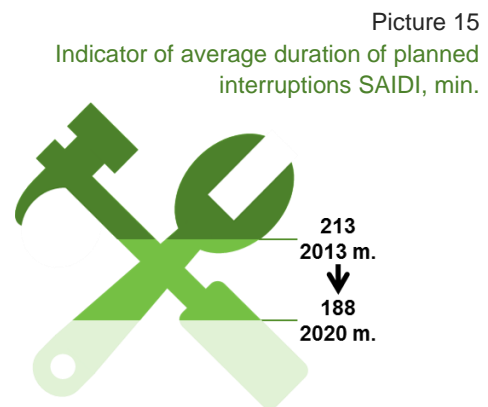
The main challenges that the Company faces are:

- Encouragement of sufficient competition among the contractors. LESTO purchases works of grid renovation and maintenance by territorial principle. The competition among contractors is not sufficient in some territories serviced by the Company and sometimes only one contractor takes part in the tender. It is the best interest of LESTO to attracting more tenderers in such areas, so that optimal price and quality is achieved.
- Selection of competent contractors, in order to improve the quality of works performed and adherence to agreed time limits. Presently, LESTO uses the principle of the lowest price in selection of the most of the contractors. Thus, some contracts are concluded with the contractors who lack the experience of project management and work assessment skills. Due to this reason, the fulfilment of works faces the issues of inadequate quality and overdue deadlines. The value of the contracts where overdue penalties were paid in 2013 accounted for LTL 47M or 14% of all contracts and the overdue penalties were paid nearly 800 times. In such cases the contractors are usually late with the completion of the work and with the submission of documentation defined by the contracts. These situations have a significant negative impact on fulfilment of LESTO obligations.
- Encouragement of work safety and culture. When a large share of the services is being purchased on the market, the differences among various organisational cultures and methods of work within diverse companies present a considerable additional challenge for LESTO. The contractors often participate in tenders without having an adequate number of employees to perform the tasks. When they complete tendering and know the preliminary scope of works, they hire new temporary employees. However, they are not always able to assure proper training.

- Keeping deadlines. In 2013, nearly half of contractors started works in LESTO distribution grid at least with one hour overdue, i.e. later than the start of planned temporary interruptions for the customers. That was the reason for longer duration of planned interruptions, which had negative impact on LESTO strategic KPI' planned SAIDI.

Goals and Indicators. In order to manage risk and organise work with contractors effectively, LESTO intends to:

- Encourage competition among contractors.
- Create an additional motivation system for the contractors who finish tasks in time and with proper quality.
- Assess the possibilities of selection of contractors based not only on the lowest price, but also using the criteria of economic efficiency, based on actual work quality indicators from previous projects.
- Encourage proper training of the contractor employees, so that the number of work accidents on LESTO distribution grid is decreased.
- Prepare a long-term investment plan, which would will basis for earlier execution of tendering.
- Strengthen LESTO functions of project management and communication with contractors.



Employees

Context. At the end of 2013, LESTO had 2391 full-time employees in 96 different positions, with 158 managers among them. There were 5 administrative reporting levels: CEO, heads of divisions, departments and units/groups.

Operations of the Company are organised based on centralized head office and 7 territorial regions. The head office units are responsible for the formation of policies for certain functional areas and coordination of the regional offices operations. Regional offices are responsible for the implementation of these policies, as well as organisation of daily work in the region.

Challenges. Organisations that are successful in achieving sustainable operational results usually are characterised by high employee involvement, encouraging leadership and focus on long-term stability. Key HR challenges for LESTO in pursuit of strategic goals are the following:

- Low employees' involvement. According to the data of the employees involvement survey, the employees and the managers are satisfied with the working conditions at the Company (satisfaction indicator 61%), but they are not sufficiently involved in the activities (involvement indicator 36%): they have a weak emotional relationship with the organisation and do not feel motivated to devote much effort so that the operational goals are achieved. In order to increase employee involvement, it is important to develop managerial competencies within the Company, strengthen internal communication and encourage value-based culture.

- High and growing average age of employees (45 years) and low employee turnover (3.5% in the regions, 4.7% in the head office). Staff renewal rate is slow, especially in managerial competences, therefore, it is getting more difficult for young employees to join and they are not always motivated to choose LESTO as an employer. LESTO has to focus on the rotation of key employees and talent development in order to assure relevant employee competencies and high operational quality.
- Slow changes in technological environment of distribution network, monopolistic position and formerly dominant strictly vertical hierarchical structure created preconditions for the formation of non-effective and bureaucratic processes. It has established a substantial employee orientation towards the process implementation, but not the final result. It takes long time to change such attitude and it is one of the most important challenges for the Company in medium term.

All the challenges listed above are inter-related. The development of value-based working culture, development of competence and encouragement of initiative will help LESTO to become one of the most-desired employers in the market.

Goals and Indicators. One of three strategic goals of LESTO is to form a value-based organisational culture. Promotion of Company's values - responsibility, pursuit of result and cooperation - is of utmost importance for LESTO successful operation (see Annex 4, *Value Definitions*).

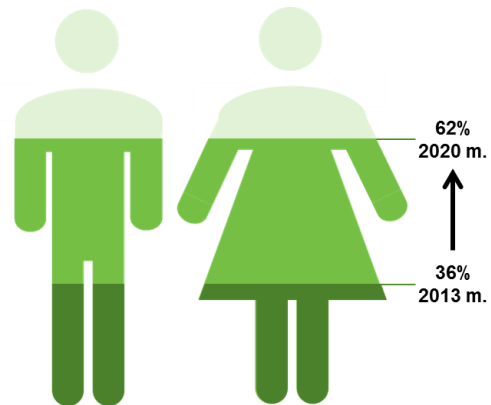
Employee involvement indicator is considered by LESTO as strategically important. Compared to other sectors and countries, this indicator at LESTO is one of the lowest (see Annex 3, *Indicator Comparisons*). Low value of the indicator mostly explains the challenges ahead. The Company goal is to improve the indicator considerably and reach the European average in 2020 (see Picture 16).

In pursuit of sustainable operational results and empowering of employees, LESTO intends the following:

- Incorporate new set of values within the Company and assure their application in day-to-day life.
- Strengthen managerial competences of mid-level managers.

- Integrate employee selection, their coaching and performance management with corporate values.
- To assure the replacement of key employees within organisation, develop new talents and empower them to pursuit best results.
- To encourage cooperation not only within the Company, but also with other companies of LE Group and external partners.
- To develop the remuneration system based on internal fairness, benchmark with the market and based on Company values, which have to be understood and used by all employees. Communication about the compensation should emphasize not only the benefits of financial remuneration, but also opportunities within the Company, LE group and non-financial remuneration.
- Strengthen Company's internal communication and assure the effectiveness and quality of the information circulation.

Picture 16
Indicator of Employee Involvement



5. ANNEXES

The Annexes provide additional and explanatory information that is interpreted in the Strategy and has been used for the preparation of the Strategy.

Annex 1. Terms and Abbreviations

Abbreviation	Definition
Company, LESTO	LESTO AB
EU	European Union
IS	Information system (-s)
LE	Lietuvos energija, UAB
LRAIC	Regulation methodology based on Long-Run Average Incremental Costs
RAB	Regulated Asset Base
Regulator	National Commission for Energy Control and Prices

Annex 2. KPIs Definitions

This section provides LESTO main and monitoring key performance indicators together with their descriptions and formulas.

Main KPIs

KPI	Description
SAIFI	The System Average Interruption Frequency Index – unplanned interruptions. The indicator shows the average number of interruptions that a customer would experience during a reporting period due to unplanned interruptions in the grid. The measurements do not include: (1) interruptions with duration of less than 3 min.; (2) planned interruptions; (3) interruptions due to failures in the transmission grid (only the cases when Company's equipment protection worked properly and the reserve did not include any disconnected equipment of the Company, which may have helped avoid the outage); (4) <i>Force majeure</i> events.
SAIDI	The System Average Interruption Duration Index – unplanned interruptions. The index shows the average outage duration for each customer during a reporting period due to unplanned interruptions in the grid. The measurements do not include: (1) interruptions with duration of less than 3 min., (2) planned interruptions, (3) interruptions due to failures in the transmission grid (only the cases when the Company's equipment protection worked properly and the reserve did not include any disconnected equipment of the Company, which may have helped avoid the outage); (4) <i>Force majeure</i> events.
GCSI	Customer opinion index is measured by customer satisfaction survey. The methodology of the survey results in an indicator that reflects a general satisfaction of household and business customers in the services provided by LESTO and makes it possible to benchmark with the results of energy sectors in other European countries. The indicator shows the dominant opinion in the market; helps to prioritize further actions, identify company's strengths and weaknesses, opportunities and threats. The value of the index is determined by performing an annual survey, when business and household customers are surveyed and assessed separately. LESTO goal is to be significantly above the average of the European utilities (i.e. at least +3 points). The goal is considered to be reached within the margin of 2-point error.

KPI	Description
Employee involvement	The indicator shows whether the employees behave in accordance to the corporate values and how strongly they are committed to the mission and goals of a company. The value of the indicator is determined by performing an annual survey among all LESTO employees.

Monitoring KPIs

KPI	Description
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Network Losses	The level of network losses (including own consumption; excluding 110 kV customers and taking into account the re-declaration when the tariffs are changed).
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Doing Business rating component Getting Electricity	Lithuania's ranking in the rating Getting Electricity of the World Bank initiative Doing Business. Doing Business rating is reviewed annually in accordance with defined methodology. Please find the link to the rating here . Link to the Getting Electricity computing methodology is here .
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SAIFI with <i>Force majeure</i>	See SAIFI, computed including <i>Force majeure</i> (FM). The indicator value is forecasted as an arithmetical moving average of three years, eliminating all accidents determined by the State Energy inspectorate when more than 200 MWh of power have not been supplied during a single accident.
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SAIFI planned	The System Average Interruption Frequency Index – planned interruptions. The indicator shows the average number of interruptions for a customer during a reporting period due to planned interruptions in the grid. The measurements include interruptions required for (1) the renovation of the grid, (2) technical maintenance, (3) new customer connection, (4) other planned works, when the customers were informed about the planned interruptions. Planned interruptions that last several days in a row, but the power is switched back on for the night are calculated as a single planned interruption.
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SAIDI with <i>Force majeure</i>	See SAIDI, computed including <i>Force majeure</i> (FM). The indicator value is forecasted as an arithmetical moving average of three years, eliminating all accidents determined by the State Energy Inspectorate: when more than 200 MWh of power have not been supplied during a single accident.
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SAIDI planned	The System Average Interruption Duration Index – planned interruptions. The indicator shows the average outage duration for each customer during a reporting period due to planned interruptions in the grid. The measurements include interruptions required for (1) the renovation of the grid, (2) technical maintenance, (3) new customer connection, (4) other planned works, when the customers were informed about the planned interruption.
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General Employee Turnover	Number of employees at the end of the reporting period, whose contracts were terminated for all reasons during the reporting period divided by the number of all employees at the beginning of the reporting period. If one of several contracts is terminated, the case is omitted. Individuals are calculated.
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- Individuals that are not taken into account:
- women on pregnancy or delivery leave and
- individuals on maternity leave until a baby reaches the age of 3;
- individuals under mandatory army subscription or an alternative national defence service;
- individuals who have concluded authorship contracts or other civil agreements; students or interns, who do not have employment contracts;
- employees, who performed the functions that are outsourced.

KPI	Description
Talent retention - min. 2 years	<p>Talents are the employees who demonstrate excellent results, high growth potential and involvement</p> <p>Share of the employees identified by LESTO as talents that has not changed during the period: $(1 - (\text{Number of talents, who left on their own will} / \text{overall number of actually working talents})) \times 100$.</p>

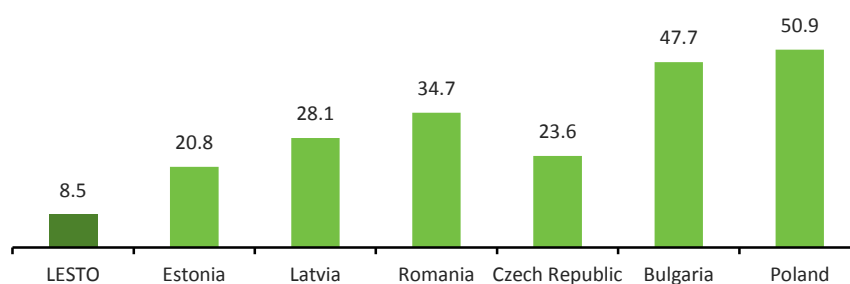
Annex 3. Indicator Comparisons

This section provides the comparison of the main LESTO indicators with distribution system operators in other countries and sectors.

Operational Expenditure Efficiency

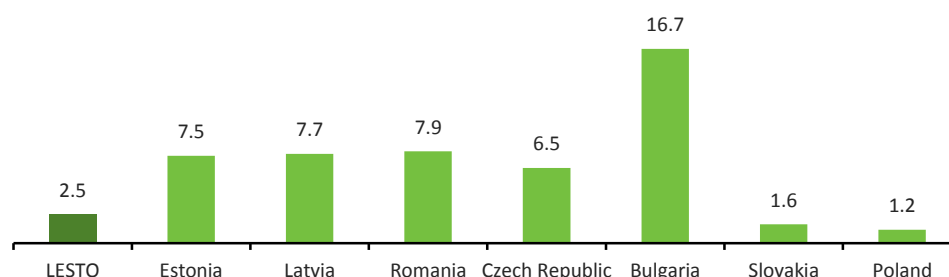
Comparisons are prepared on the basis of the comparative analysis performed by Ernst&Young Baltic UAB (2013). Technological and financial data was collected from the financial reports of the distribution system operators, official websites and the internal EY database; the data is from 2011–2012.

Picture 1
OPEX per transformer, thousand LTL



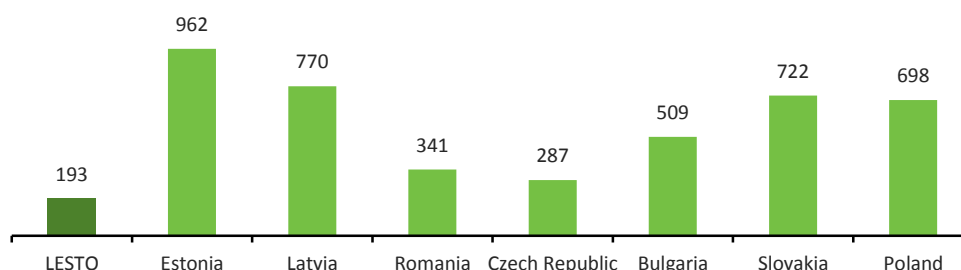
The sum of the operational expenses per one LESTO managed transformer is the smallest among the analysed distribution grid operators. The computed indicator value is more than two-fold smaller compared to other distribution grid operators that have comparatively moderate operational costs – in Czech Republic, Estonia and Latvia.

Picture 2
OPEX per 1 kilometre of power lines, thousand LTL



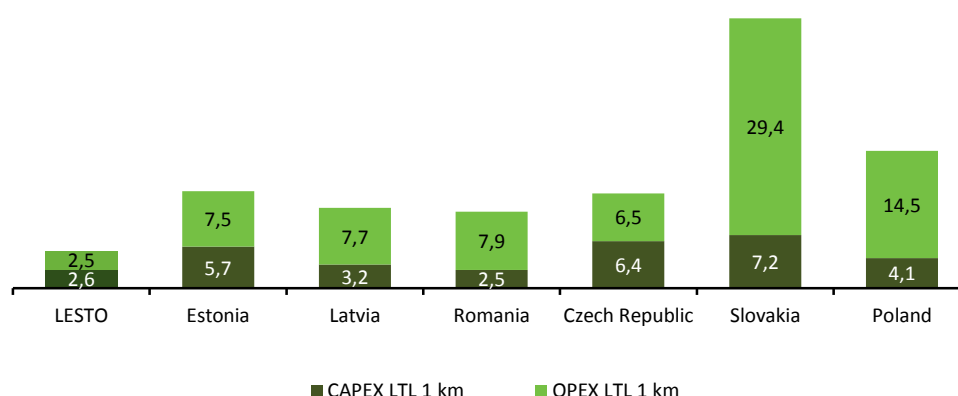
The sum of the operational expenses of LESTO per one kilometre of power lines is the smallest among the analysed distribution grid operators.

Picture 3
OPEX per customer, LTL



The sum of the operational expenses per one LESTO customer is also the smallest among the analysed distribution grid operators. The level of the expenses per one customer in other Baltic States and Poland is much higher than in Lithuania, which also demonstrates LESTO efficiency.

Picture 4
TOTEX per one kilometre of power lines, thousand LTL



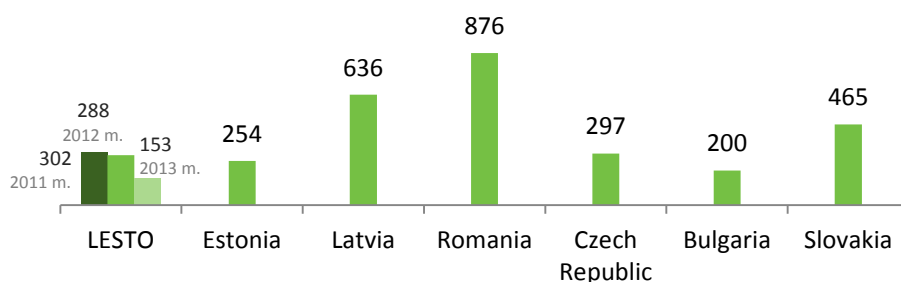
The sum of total expenses (TOTEX) per one kilometre of LESTO power lines is the smallest among the analysed distribution grid operators of different countries. The results of the analysis indicate that having assessed the grid operator's investment (CAPEX) and operational expenses (OPEX), the level of costs of other countries in the region is not exceeded. However, it is unknown whether it will be possible to maintain the present level of services in the future without increasing the investment and /or the expenses for the distribution grid maintenance.

Reliability

The presented comparisons have been prepared on the basis of the comparative analysis performed by Ernst&Young Baltic UAB (2013). The data was collected from the financial reports of the power distribution grid operators, official websites and the internal EY database; the data is from 2011–2012.

Picture 5

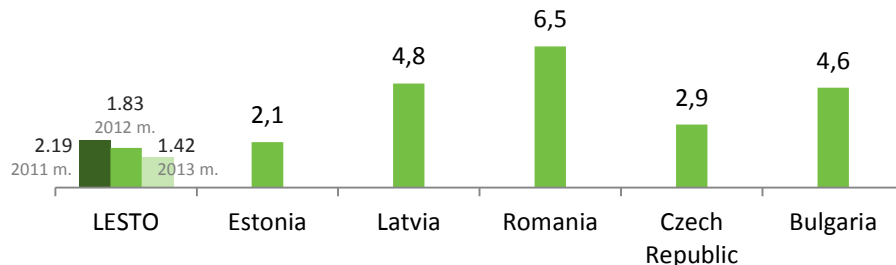
SAIDI, min. with *Force majeure*



LESTO SAIDI indicator, which shows the system average unplanned interruption duration, is among the smallest considering the analysed power distribution grid operators. The low value of the index confirms that LESTO is able to exercise high-quality management of its grid with comparatively low operational expenses. The value of SAIDI indicator used for the analysis included unplanned power supply interruptions (*Force majeure*).

Picture 6

SAIFI, min. with *Force majeure*



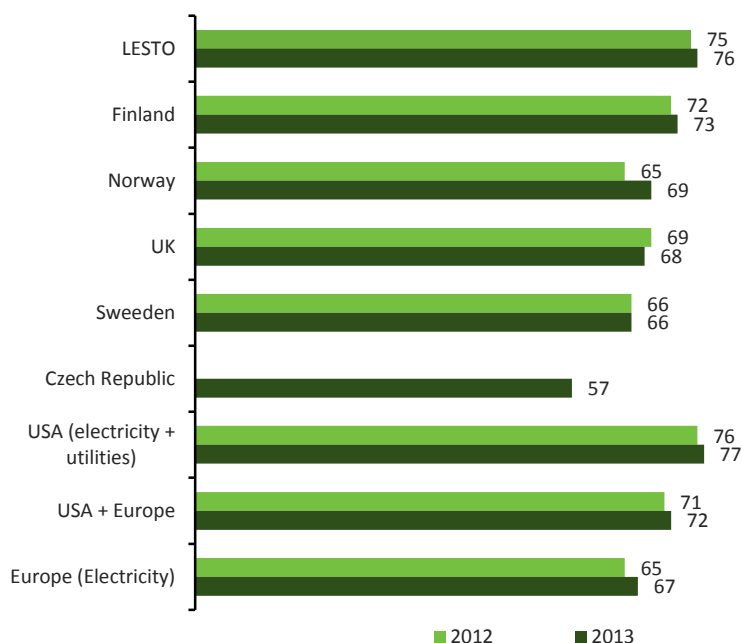
LESTO SAIFI indicator, which shows the system average interruption frequency, is among the smallest considering the analysed power distribution grid operators for 2011-2013. This indicator, like SAIDI above, confirms that LESTO management of its power distribution grid is appropriate and of high quality. In Poland and Latvia, where the distribution grid structure is quite similar to that of Lithuania, SAIFI indicator value is considerably higher compared to Lithuania. The value of SAIFI indicator used for the analysis included unplanned power supply interruptions (*Force majeure*).

Customer Satisfaction

The comparison of the customer satisfaction index has been performed in accordance with the GCSI methodology on the basis of the results of the survey conducted by Synopticom UAB in 2013.

Picture 7

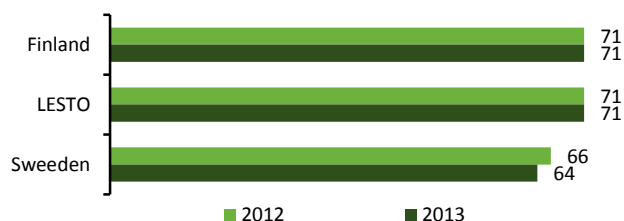
GCSI index comparison, household customers



The comparison of the customer satisfaction indicators of LESTO and other countries (in accordance with GCSI methodology) leads to a conclusion that LESTO household customer satisfaction has remained stable (increase of 1 point is considered insignificant in accordance with the methodology) and is one of the highest among the analysed countries and sectors. It demonstrates that the Company is able to assure high quality of services with comparatively low costs.

Picture 8

GCSI index comparison, business customers



The comparison of business customer satisfaction indicators in LESTO, Finland and Sweden (in accordance with GCSI methods) leads to a conclusion that LESTO business customer satisfaction has remained stable and is one of the highest among the analysed countries (a shorter list of countries is because GCSI methodology is used for assessing satisfaction among household customers more commonly). It proves that the Company is able to assure high quality of services with comparatively low costs.

Employee Involvement

Table 1
Results of employee involvement survey

	High involvement	Reliable leadership	Culture of high operational standards	Employer attractiveness	Stability of human capital
LESTO	36%	31%	42%	41%	36%
Best Lithuanian employers 2012	80%	81%	86%	90%	87%
Organisations with over 1,000 employees, Lithuania 2012	48%	55%	56%	56%	59%
Energy sector RCE 2012	62%	56%	57%	67%	60%
Indicator definition	Employees have positive appreciation of the employer; they have emotional relationship with the organisation and feel motivated to commit much effort for implementation of operational goals.	The top management team is able to appeal to the employees by their future vision. Top managers are role models themselves. They act very efficiently as a team.	Employees know the goals of the organisation and how they contribute personally to the implementation of the common goals. People are motivated in various ways to pursue high-level operations.	Organisation is capable of attracting the employees it needs. Its image in the area of products / services is in line with its image in the labour market. Employees are treated fairly and all agreements are properly followed.	Organisation is oriented towards long-term stable success. It focuses on the assurance of the stability of human capital quantity and quality as well as on external relations.

37% of LESTO employees took part in the survey. The share of the involved employees in the organisation is 36%. Such level of involvement is considered low and limiting the implementation of the organisation's operational goals. Two of five indicators, the culture of high operational standards and employee attractiveness, were assessed comparatively better than others. However, the results by all indicators are considerably lower than in comparative groups; they are significantly lower than those of the Eastern and Central European energy sector and large Lithuanian organisations (over 1,000 employees).

Annex 4. Value-Based Behaviour

Cooperation

- I accept innovations positively; I am involved in Company's initiatives.
- I express my opinion openly and give constructive suggestions.
- I communicate in a language understandable for my colleagues.
- I listen attentively and actively.
- I help, share and suggest willingly.
- I enjoy the success of the company, department or colleague; I encourage with praise.
- I respect my colleague, society and the environment.

Responsibility

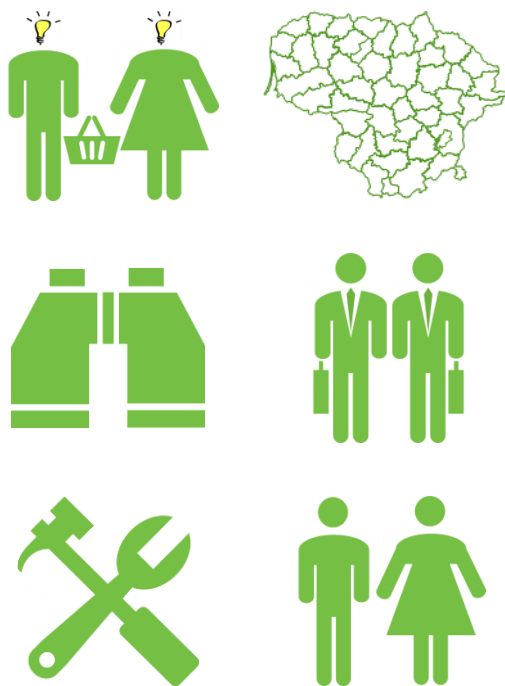
- I care about everything that is going on at LESTO, not only in my department.
- I keep my promises and I am honest.
- I make decisions responsibly.
- I fulfil tasks to the full, in a qualitative and timely manner.
- I accept my mistakes, learn from them and correct them.
- I notice what needs to be changed and I take initiative.
- I criticize reasonably.
- I take responsibility; do not transfer it to anybody else.
- I am never late.
- I work with commitment.

Result

- I know how my work contributes to the common result of the department or the Company.
- Company's goals are more important than those of my own or my department.
- I take care of all the processes and systems so that they lead towards common result.
- I plan my actions consistently.
- I take initiative and look for innovations in order to achieve better result.
- I pursue sustainable and certain result.
- I celebrate achievements.

Annex 5. SWOT analysis

Strengths	Weaknesses
State-managed company of strategic importance	Managerial and engineering competencies are not adequately balanced
Financial stability	Reliability of critical IT systems and data, insufficient level of IS integration
Experienced, qualified and committed specialists	Inefficient processes and bureaucracy; orientation towards the process and not the result
Service quality in line with customer expectations	Inefficient capital structure
Wide customer base	Ineffective customer service network
Opportunities	Threats
Participation in the LRAIC model preparation process provides a possibility to improve cooperation with the Regulator	Insufficient CAPEX level assigned to the maintenance of reliability of the grid due to LRAIC
Development of online channels in order to increase customer satisfaction	Insufficient incentives for implementing efficiency measures
The emergence of new IT technologies provides the opportunities to improve investment effectiveness	Lack of qualified employees and contractors
Development of smart technologies provides the opportunities to manage the grid more efficiently and encourage rational consumption	Chaotic development of distributed generation increases the threat to the quality of power supply, increase network losses and contribute to creation of excess grid.
	IT safety: probability of hacking.



lesto

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