

# Report on the year ended December 31, 2016 for EP Energy, a.s.

- ✓ Consolidated sales reached EUR 1,842 million
- ✓ Consolidated EBITDA amounted to EUR 293 million
- ✓ Consolidated pro forma adjusted EBITDA totaled EUR 286 million
- ✓ Indicative Net Consolidated Leverage Ratio amounted to 2.2x
- ✓ In April 2016, Fitch affirmed EP Energy's Long-term Issuer Default Rating (IDR) at 'BB+' with outlook stable and BBB- for senior secured bonds



EP Energy, a.s. ("group or Group or EPE or EPE Group") is a vertically integrated energy utility that includes 58<sup>1</sup> companies. In 2016 the Group was the leading heat supplier in the Czech Republic, one of major power generators in the Czech Republic and the second largest electricity distributor in Slovakia. The Group benefits from relatively low exposure to market developments, as a significant majority of EBITDA is generated by regulated assets or assets with long term off take contracts. The Group's key operations are located in the Czech Republic, Slovak Republic and Hungary.

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<sup>1</sup> Number as at date of the report

## KEY FIGURES AT A GLANCE

### Consolidated financial results in EUR millions

	FY 2015	FY 2016
Sales	1,971	1,842
EBITDA <sup>1</sup>	331	293
Pro forma Adjusted EBITDA <sup>2</sup>		286
Total net debt <sup>3</sup>	1,217	687
Indicative EPE Net Consolidated Leverage Ratio <sup>4</sup>		2.2x
Profit from operations	206	125
Profit before tax	156	133
Net profit attrib. to EPE	37	88
Total assets	3,734	2,598
CAPEX <sup>5</sup>	168	126

### Operating highlights (EPE excluding SSE)<sup>6</sup>

	FY 2015	FY 2016
Installed <i>cogeneration</i> Capacity ..... MW <sub>e</sub>	896	894
Installed <i>condensation</i> Capacity .... MW <sub>e</sub>	360	360
Installed heat capacity <sup>7</sup> ..... MW <sub>th</sub>	3,856	3,276
Heat supplied ..... TJ <sup>8</sup>	22,197	22,660
Power produced ..... GWh	2,988	3,542
Power traded <sup>9</sup> ..... GWh	22,597	16,048
Power supplied <sup>9</sup> ..... GWh	1,820	2,314
Natural gas supplied <sup>9</sup> ..... GWh	1,392	1,883

### Operating highlights SSE<sup>6,9</sup>

	FY 2015	FY 2016
Power distributed ..... GWh	5,872	5,944
Power traded ..... GWh	7,062	7,159
Power supplied ..... GWh	3,921	3,966
Natural gas supplied ..... GWh	359	326
Power produced ..... GWh	20	19
Installed generation capacity ..... MW <sub>e</sub>	63	63

(1) EBITDA represents profit from operations plus depreciation of property, plant and equipment and amortization of intangible assets minus negative goodwill (if applicable). The EBITDA included in this report does not represent the term EBITDA as may be defined by any documentation for any financial liabilities of the EP Energy, a.s. Group (also "EPE Group"). For further discussion over the EPE Group performance refer to the following pages.

(2) Pro forma Adjusted EBITDA represents pro forma profit from operations plus pro forma depreciation of property, plant and equipment and pro forma amortization of intangible assets minus pro forma negative goodwill (if applicable).

To derive pro forma consolidated financial information, the EPE Group IFRS consolidated financial statements as of and for the year ended December 31, 2016 have been adjusted to reflect a disposal of Pražská teplárenská LPZ, a.s. ("LPZ") on June 1, 2016. Adjusting the EBITDA for LPZ result related to period January 1, 2016 to May 31, 2016 (2016: EUR 7 million, 2015: EUR 9 million).

#### Pro Forma Adjusted EBITDA calculation (in million EUR)

	FY 2016
Profit from operations	125
Depreciation and amortization	168
Negative goodwill	-
<b>Simple EBITDA per Financial statements</b>	<b>293</b>
LPZ Pro Forma Adjustment	(7)
<b>Pro forma Adjusted EBITDA</b>	<b>286</b>

The Pro forma Adjusted EBITDA included in this report does not represent the term EBITDA as may be defined by any documentation for any financial liabilities of the EPE Group. For further discussion over the EPE Group performance refer to the following pages.

(3) Total net debt balance is based on the consolidated financial statements (Total Loans and borrowings plus Total Financial instruments and financial liabilities less Cash and cash equivalents), but excludes the liabilities towards an affiliate Pražská teplárenská Holding a.s. (also "PTH") of EUR 13.6 million (2015: EUR 6.7 million). The Total net debt included in this report does not represent the term Indebtedness as may be defined by any documentation for any financial liabilities of the EPE Group.

#### Net Debt calculation (in million EUR)

		FY 2015	FY 2016
Loans and borrowings (non-current)	<i>add</i>	1,304	1,140
Financial instruments and financial liabilities (non-current)	<i>add</i>	1	11
Loans and borrowings (current)	<i>add</i>	46	10
Financial instruments and financial liabilities (current)	<i>add</i>	5	4
PTH liability	<i>less</i>	7	14
Cash and cash equivalents	<i>less</i>	132	464
<b>Net Debt</b>		<b>1,217</b>	<b>687</b>

(4) We include in this report the calculation as of December 31, 2016 of our "Net Consolidated Leverage Ratio", as defined in the EP Energy Indentures. The calculation of our Net Consolidated Leverage Ratio differs from any leverage ratio included in the offering memoranda for the senior secured notes or otherwise included herein, and consistent with the definition, is made on the basis of certain good faith judgments made by us.

(5) Excluding emission allowances, disregarding actual cash flows and adjusted for capital expenditures relating to discontinued operations (2016: EUR 18 million; 2015: EUR 76 million).

(6) The operating data are based on the results of the respective entities on a 100% basis for the full period, regardless of the date when each entity joined the EPE Group or the ownership share of the EPE Group in each entity, however the data excludes SSE which is presented separately. Furthermore, the operating data do not include results of the German assets that are presented within discontinued operations. Specifically, 2015 data include full-year operations of BERT, despite it was acquired in

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December 2015. In addition, 2016 data include operations of Pražská teplotárenská LPZ, a.s. ("LPZ") for five months only as it was disposed on June 1, 2016.

(7) Installed heat capacity on heat exchangers.

(8) 1 TJ = 0.2778 GWh.

(9) Figure relates to the Power Distribution and Supply segment only.

Difference between consolidation scope for the year 2015 and the year 2016 is described later in section: "Key factors affecting comparability of the results of operations of the EPE Group".

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**Attachments:**

EP Energy, a.s. - Consolidated financial statements as of and for the year ended December 31, 2016 are presented in a separate file as an attachment to this report

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>> *We remain focused on solid business performance, exploiting group synergies, financial performance and deleveraging of the group* <<

Dear shareholders, business partners, colleagues and dear friends,

In 2016, EP Energy Group achieved revenues of EUR 1,842 million, with EBITDA reaching EUR 293 million.

2016 was a year of strategic changes for EP Energy. Parallel to the reorganisation of the ultimate parent company Energetický a průmyslový holding, EP Energy refocused fully on stable, long-term contracted and/or regulated assets.

For this reason, EP Energy sold its shareholding in MIBRAG, including its subsidiary Helmstedter Revier, and Saale Energie ("German assets") operating in the power production and coal mining industry directly to EPH. Subsequently, German assets became a part of the newly-built EP Power Europe Group.

The companies within the EP Energy Group were divided into three segments: *Heat Infra*, which is the producer and distributor of heat in the Czech Republic and Hungary, *Power Distribution and Supply*, which is the regional power distributor in central Slovakia region and successful power and natural gas supplier in the Czech Republic and Slovakia, and the *Renewables* segment, which includes wind and solar power plants and a biogas facility.

Finally, EP Energy became part of the EP Infrastructure that groups companies involved in operating energy infrastructure assets in central Europe.

The *Heat Infra* segment generated revenue of EUR 561 million for 2016, with an EBITDA of EUR 145 million that is up by more than EUR 9 million compared to the previous year. Acquisition of the Hungarian company BERT was fully reflected in the Group's result for the first time in 2016. On the other hand, Pražská teplárenská LPZ, a.s. was sold to a third party for EUR 82 million. EP Energy has remained the largest heat supplier to final consumers in the Czech Republic and the third largest domestic electricity producer.

The *Power Distribution and Supply* segment reached revenues of EUR 1,422 million and EBITDA of EUR 149 million. The gross operating result was temporarily negatively affected by an imbalance of so-called system operation tariff used by the Slovak regulator to carry out state support for renewable sources. This has had a temporary negative impact on operating results. However, under valid legislation in Slovakia, the loss from this tariff mechanism will be fully compensated to the Group in the next two years at the latest.

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The *Renewables* segment is significantly smaller compared to the previous two segments in terms of installed capacity and, consequently, resulting economic performance. However, it remains an important part of our diversified portfolio.

I would like to thank to our employees, investors and partners who contributed to turning our strategy and goals into the reality and support and enable our business activities, and to whom we owe our gratitude for our achievements.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Tomáš David', with a stylized, cursive script.

Tomáš David  
Chairman of the Board of Directors and CEO

## Economy and Market development

### Economy development:

According to the Czech Statistical Office, the Czech gross domestic product adjusted for price, seasonal, and calendar effects increased in the year 2016 by 2.3%, year-on-year, and rose by 0.4% in Q4 2016 compared to the previous quarter. The positive annual GDP development was driven mainly by the household consumption supported by higher investment activity.

According to the Slovak Statistical Office, the Slovak gross domestic product adjusted for price, seasonal, and calendar effects rose in the year 2016 by 3.0%, year-on-year, and increased by 0.8% in Q4 2016 compared to the previous quarter.

According to the Hungarian Central Statistical Office, the Hungarian gross domestic product adjusted for price, seasonal, and calendar effects rose in the year 2016 by 2.0%, year-on-year, and increased by 0.4% in Q4 2016 compared to the previous quarter.

The outlook for the economic development remains rather positive. According to the Czech National Bank<sup>2</sup>, the Czech GDP should increase by 2.8% in 2017 and the International Monetary Fund (also "IMF") expects<sup>3</sup> German GDP to grow by 1.6% in 2017, the Slovak GDP should increase by 3.3% in 2017 and Hungarian GDP should increase by 2.9% in 2017.

### Weather:

Heat and renewable segment performance and electricity production in cogeneration mode are correlated to weather development. Seasonality is natural in the group performance (e.g. heat sales are strongest in 1Q and 4Q, accompanied by higher power production in cogeneration mode).

From the heating business perspective, the year 2016 was by 4% colder than previous year during the heating season, i.e. from January to May and from September to December. This corresponds to a higher supply of heat from the heating plants. Day-degrees, the metrics representing space heating needs during the given period<sup>4</sup>, were in the areas where we deliver the heat year-to-year 6.6% higher.

For better illustration, the average temperature in Prague was 3.2 °C in both first quarters 2016 and 2015 (i.e. first quarters comparable) and 4.6°C in the fourth quarter 2016 as compared to 7.6°C in the fourth quarter 2015. (i.e. better weather pattern from heat production perspective).

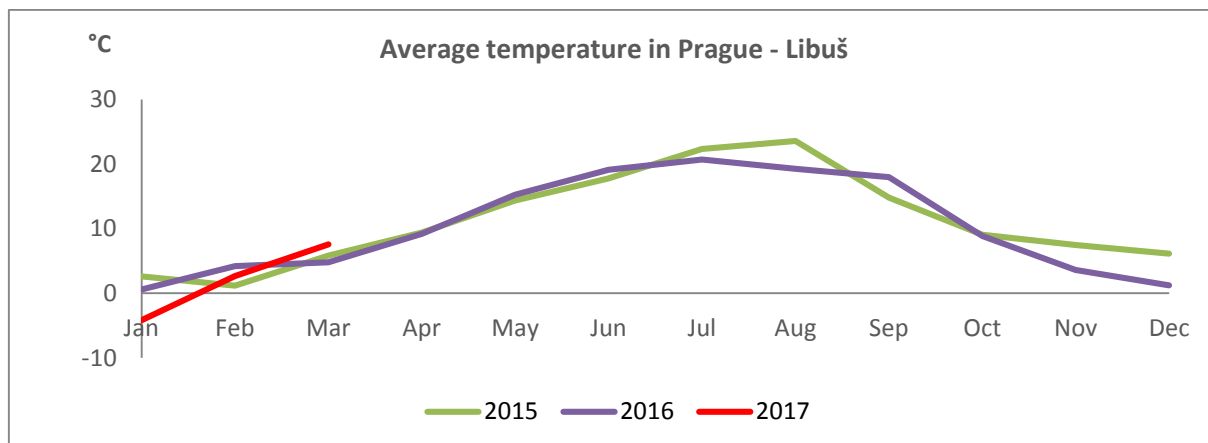
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<sup>2</sup> The most recent forecast published on February 2, 2017

<sup>3</sup> The most recent forecast published on April 12, 2017

<sup>4</sup> Day-degrees measure integrates the difference between reference indoor temperature and outdoor temperature over the given period of time. A higher value indicates that the temperature in the given period was below the reference temperature for a longer period of time. Day-degrees relate to all areas where EPE deliver heat





Source: ČHMU Prague (Czech Hydrometeorological Institute) - monthly average temperature calculated from daily averages

### Heat market:

Our heat business is concentrated in the Czech Republic and since December 2015 also in Hungary, where the market remains solid and stable. The market is regionally diversified with local natural “monopolies”, as the infrastructure for heat transportation creates substantial barriers to entry. The fuel basis varies, although the most commonly used ones in the Czech Republic are brown coal, hard coal and natural gas.

Due to our favourable cost structure (given predominantly by the fact that we produce heat in an efficient cogeneration mode and based on brown coal, the most cost efficient source of primary energy), we are able to offer our customers highly competitive prices.

Heat prices are based on a “costs plus reasonable profit” mechanism, required by the legislation and regulation by the independent Energy Regulatory Office (also “ERO”), which we comply with. This mechanism supports the stability of the heat segment for market participants and allows us to benefit from our favourable cost position. Given the low price levels we charge compared to market average, we are allowed to set prices (i.e. there is no tariff imposed to us) and we are only monitored by the ERO. Hungarian operations are regulated using the standard Regulatory Asset Base (“RAB”) multiplied by WACC plus eligible operating expenses and allowed depreciation formula.

### Electricity and CO2 market:

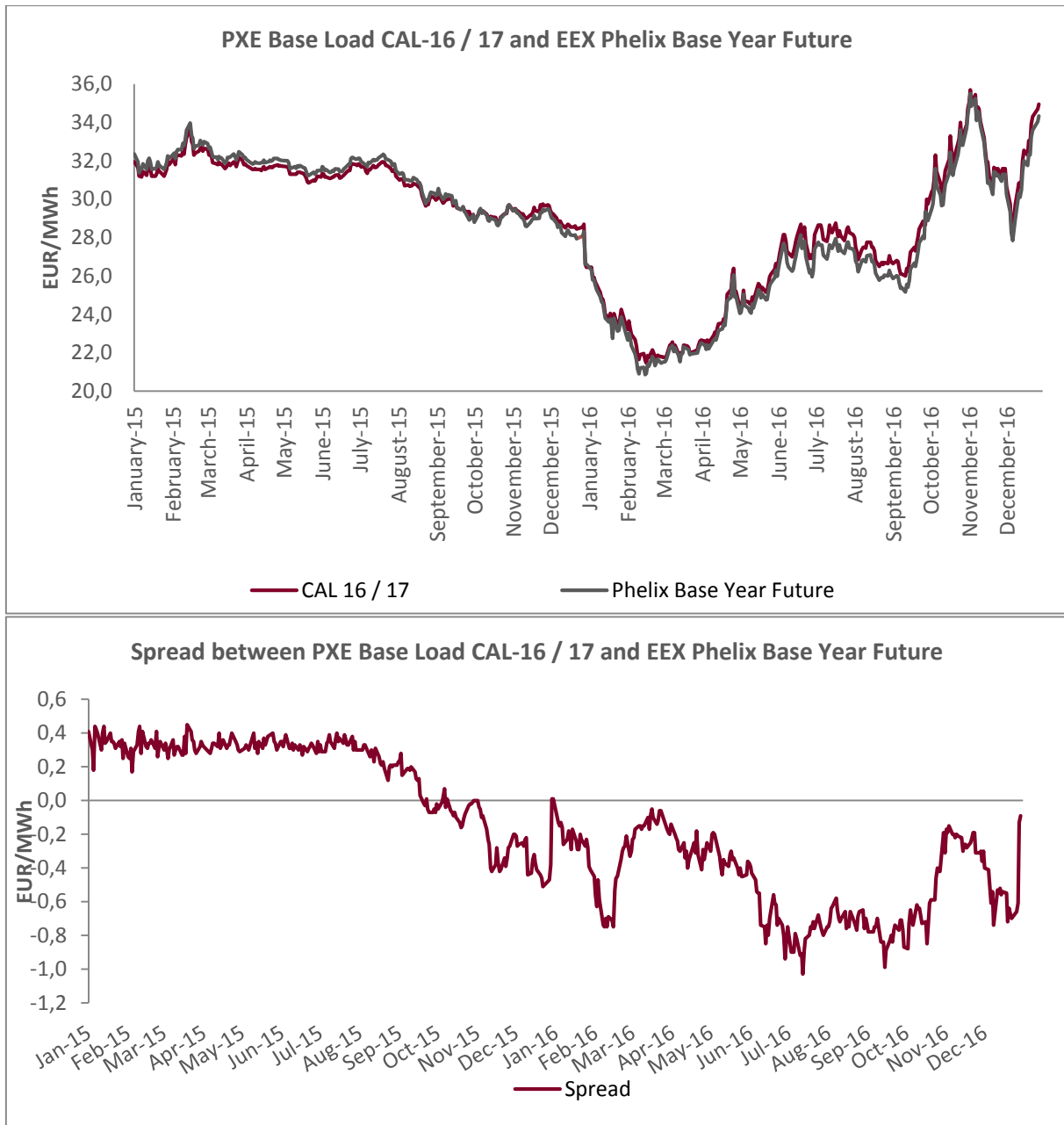
During the years 2015 and 2016 power and EU Allowance (“EUA”) prices remained under pressure due to low prices of hard coal and renewable energy production. In the year 2016 the 1-year forward electricity prices on the European Energy Exchange (also “EEX”) dropped in base load to EUR 26.6 per MWh (compared to EUR 30.9 per MWh year ago) and peak load dropped to EUR 33.5 per MWh (compared to EUR 39.0 per MWh year ago), representing a decrease for the base load and peak load prices of 14%.<sup>5</sup>

EUA with spot delivery was traded at average around EUR 5.35 per ton in the year 2016<sup>6</sup> as compared to EUR 7.69 per ton in the year 2015, which represents substantial decrease of the y-t-y prices of 30.4%.

<sup>5</sup> Source: Thomson Reuters: EEX Base Year Future and Peak Year Future (simple average of the daily price for 1 year forward prices calculated for the respective year)

<sup>6</sup> Source: Thomson Reuters: EEX-EUSP3-SPOT, simple average

As for the Czech market, the power prices follow the German market, as the two markets are physically well interconnected. The spread between German and Czech power prices was oscillating between negative 1.0 and positive 0.5 EUR/MWh during 2015 and 2016 reaching negative values in the year 2016. Recent relative drop in German power prices compared to Czech power price stems from intensified production in German offshore wind farms. The low spreads encourage cross border trading and, vice versa, the liquidity of the Czech market increases.

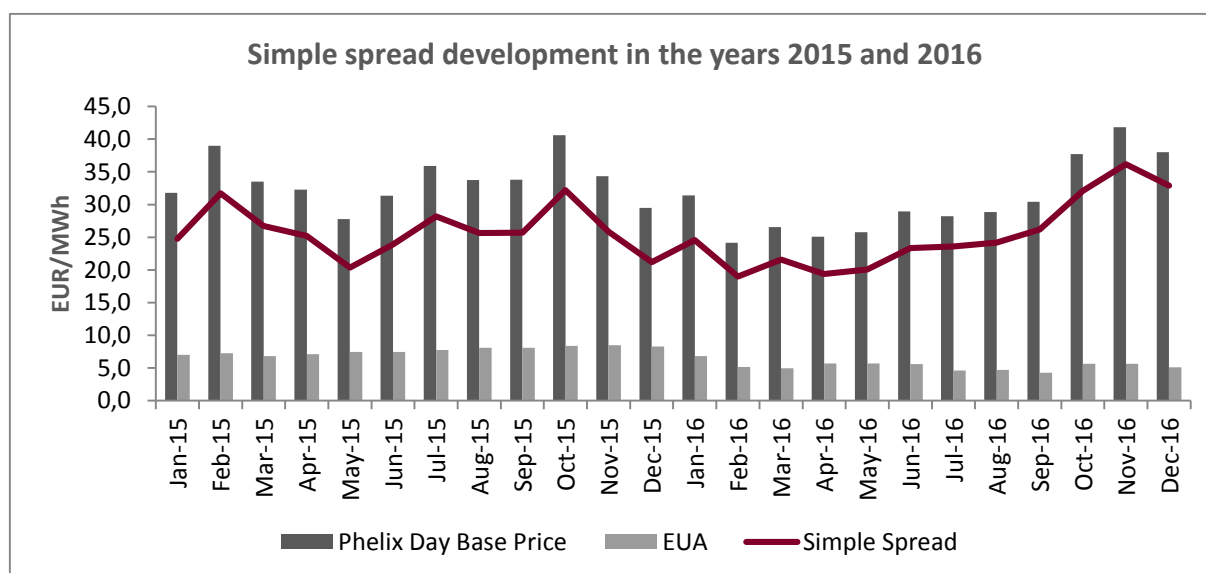


Source: PXE Base Load CAL16 and CAL17; EEX Phelix Base Year Future.

On the Czech market, electricity production from cogenerating units benefit from regulatory support. The CZK 200<sup>7</sup> is received as subsidy for each MWh produced in highly efficient cogeneration mode.

This subsidy accounted for EUR 4 million in 2016 as compared to EUR 5 million in 2015.

Besides relatively low share of power production on EBITDA and cash flow generation of the EPE Group, let us note that from the performance perspective, EPE is exposed to the spread between the power price and the price of emission allowance rather than to development of power prices alone.



Source: Thomson Reuters, EEX Simple Spread defined as the difference between Phelix Day Base and EUA price, using trading day data when both power and EUA are traded and simple monthly averages.

Note: simple spread represents the price difference between power price and EUA price.

<sup>7</sup> Beginning on January 1, 2014 the subsidy was divided into four levels (CZK 200/MWh, CZK 140/MWh, CZK 60/MWh and CZK 45/MWh), depending on the efficiency of the cogeneration production of the plant. We believe that the majority of our power produced in cogeneration mode will continue to receive the CZK 200 per MWh level of subsidy

## Key developments in the year 2016

During 2016 activities and assets held by CE Energy, a.s. (“CEE”; in April 2016 renamed to EP Infrastructure, a.s. - “EPIF”) were reorganized in order to refocus on regulated and/or long-term contracted infrastructure-type assets. The reorganization also included the following matters relating to the EPE Group:

### German assets sale

German assets include, among others, MIBRAG and Saale Energie (“German assets”). MIBRAG is a wholly-owned subsidiary of JTSD, Saale Energie is a wholly-owned subsidiary of EP Germany; both EP Germany and JTSD were wholly-owned subsidiaries of EPE (where EP Germany has been since December 31, 2015 directly owned by JTSD as a result of the sale of all EP Germany shares by EPE to JTSD for EUR 4 million, corresponding to fair value of equity of EP Germany).

The German assets were disposed of by means of sale of 100% shares in JTSD by EPE to EPH for EUR 156 million (corresponding to fair value of equity of JTSD); the disposal was completed on April 1, 2016 and the purchase price was fully settled in cash.

Further, as a part of the restructuring, on February 23, 2016:

- JTSD set-off (a part of) its receivables towards EPE in the amount of EUR 82 million arising from (i) a loan of EUR 17 million provided by JTSD to EPE, and (ii) a loan of EUR 65 million provided by MIBRAG to EPE (assumed by JTSD from EPE for the nominal value thereof); following the set off, the total liabilities of JTSD towards EPE amounted to EUR 314 million; and
- (i) JTSD assumed a liability of EP Germany towards EPE in the amount of EUR 62 million (out of the original total amount of EUR 92 million outstanding under the loan provided by EPE to EP Germany) for the nominal value thereof, and (ii) EPE contributed EUR 71 million to the capital funds of JTSD.

Immediately after the capitalization, the total liabilities of JTSD towards EPE amounted to EUR 305 million. These were settled by JTSD making a payment to EPE in the amount of EUR 305 million (out of the funds drawn under a bank loan contracted by JTSD in the total amount of EUR 309 million for this purpose) and the outstanding receivable of EPE towards JTSD was acquired by EPH for its nominal value as of the date of the JTSD acquisition by EPH; the consideration was fully settled in cash (EUR 1.7 million).

The outstanding amount of the original loan provided by EPE to EP Germany immediately after JTSD assumed part of this liability of EP Germany to EPE was EUR 30 million. This was settled by EP Germany making a payment in the amount of EUR 30 million (out of the funds drawn under a bank loan contracted by EP Germany in the total amount of EUR 31 million for this purpose) and the outstanding receivable of EPE towards EP Germany was acquired by EPH for its nominal value as of the date of the JTSD acquisition by EPH; the consideration was fully settled in cash (EUR 0.2 million).

## Other disposals of shares

The reorganization further included a number of other (smaller in terms of the acquisition price) transfers of assets. These include sale of:

- a. 60% of shares in PGP Terminal, a.s. by EPE (as the seller) to EPH (as the buyer) for the purchase price of EUR 0.3 million in cash (completed on February 29, 2016),
- b. 99.79% ownership interest in EOP & HOKA s.r.o. by EP Sourcing, a.s. (as the seller) to EP Coal Trading, a.s. (as the buyer) for the purchase price of EUR 5 million in cash (completed on February 29, 2016),
- c. 100% of shares in EP COAL TRADING Spółka akcyjna by EP Sourcing, a.s. (as the seller) to EP Coal Trading, a.s. (as the buyer) for the purchase price of EUR 0.4 million in cash (completed on February 29, 2016),
- d. 65% ownership interest in LOKOTRAIN, s.r.o. by EP Cargo a.s. (as the seller) to EP Logistics International, a.s. (as the buyer) for the purchase price of EUR 2 million in cash (completed on April 4, 2016),
- e. 100% ownership interest in EP Cargo Deutschland GmbH by EP Energy, a.s. (as the seller) to EP Logistics International, a.s. (as the buyer) for the purchase price of EUR 0.4 million in cash (completed on April 5, 2016),
- f. 100% of shares in EP CARGO POLSKA s.a. by EP Energy, a.s. (as the seller) to EP Logistics International, a.s. (as the buyer) for the purchase price of EUR 1 million in cash (completed on April 5, 2016); and,
- g. 100% of shares in Adconcretum real estate Ltd., which owns investment property in Serbia, were sold by EP Energy Trading ("EPET") to EPH (as the buyer) for EUR 3 million (completed on May 31, 2016).

Furthermore, the following material events occurred in 2016:

### **Pražská teplárenská ("PT") spin-off**

In May 2015, PT spun off certain assets consisting of small local heat sources and related distribution networks located predominantly on the left bank of Vltava river into Pražská teplárenská LPZ, a.s. ("LPZ").

On February 29, 2016, PT as seller entered into a share purchase agreement with Veolia Energie ČR, a.s. as buyer relating to the sale of 85% of shares in PT LPZ for EUR 61 million (CZK 1,632 million) subject to usual post-closing adjustments based on working capital level against the benchmarked value. Consummation of the transaction was subject to customary conditions precedent including competition clearance. The completion of the transaction took place on June 1, 2016. PT and Veolia Energie ČR, a.s. also entered into an option agreement in relation to the remaining 15% of shares in PT LPZ. As the option was exercised, the total purchase price for 100% of the shares in PT LPZ amounted to CZK 1,920 million. Post closing adjustment calculated based on working capital movement of EUR 11 million was approved by both parties and settled. Total purchase price therefore amounts to

EUR 82 million. Due to the absence of several approvals, the relevant assets and liabilities were not presented as Assets and liabilities held for sale as of December 31, 2015.

#### **SSE - Solar s.r.o.**

SSE – Solar was reported as Asset held for sale as of December 31, 2015. As of December 31, 2016 it was no longer the case.

#### **Repayment of EP Energy's term loans, other financing matters and dividends**

On March 17, 2016 50% minus one share of the capital stock of EP Energy was pledged as part of the refinancing of the EP Infrastructure, a.s.

On April 4, 2016 EPE fully repaid the term loans totalling EUR 175 million previously provided by ČSOB, HSBC and Commerzbank using the proceeds from the sale of JTSD.

On April 4, 2016 EPE unwound an existing FX forward with EPH and as a result, EPE had a receivable of EUR 4 million towards EPH corresponding to the FX forward fair value. This receivable was acquired by EP Infrastructure, a.s. for the nominal value thereof, i.e., EPE had a receivable of EUR 4 million towards EP Infrastructure, a.s.

On April 4, 2016 EP Infrastructure, a.s. assumed from EPH all debts of EPH owed to EPE at their nominal values. The debts of EPH towards EPE of EUR 309 million consisted of unpaid principal loan of EUR 273 million and unpaid accrued interest of EUR 36 million.

On May 2, 2016, EPIF as a sole shareholder of EPE decided on a dividend declaration of EUR 325 million (equivalent of CZK 8,868 million), of which (a) EUR 40 million (equivalent of CZK 1,090 million) was paid in cash and (b) EUR 285 (equivalent of CZK 7,778 million) was, on the same day, partially offset with loans previously provided by EPE to EPIF and fully offset with an EPE receivable from EPIF of EUR 4 million (both described above). Remaining balance of the loans provided to EP Infrastructure after the offset was EUR 26 million (equivalent of CZK 719 million).

On July 26, 2016 SSE distributed first half of dividends, i.e. EUR 17 million was paid to the Slovak Republic and EUR 16 million to EP Energy. The other half of the dividend was paid on November 29, 2016.

On August 11, 2016 EP Energy, a.s. granted a loan to POWERSUN a.s., which used the funds to repay a bank loan of EUR 5 million.

On October 3, 2016 EP Energy, a.s., based on collateral sale offer, repaid EUR 3 million from its bonds (ie. EUR 2 million from the EUR 600 million bond due 2018 and EUR 1 million from the EUR 500 million bond due 2019). The repaid bonds were already cancelled.

On October 31, 2016 EP Energy, a.s. granted a loan to Alternative Energy, s.r.o. which used the funds to repay a bank loan of EUR 4 million and an intra-group loan from EPH of EUR 3 million.

On November 30, 2016, EPIF as a sole shareholder of EPE decided on an interim dividend declaration EUR 26 million (equivalent of CZK 719 million) that was fully offset with remaining balance of the loan provided to EPIF.

## Other matters

On July 1, 2016 EP Energy, a.s. completed an internal reorganisation process of Pražská teplárenská a.s. ("PT"), where real estate entities were spun-off from PT to a newly established sister company of PT called PT Real Estate, a.s., which has the same shareholders' structure as Pražská teplárenská a.s.

On April 6, 2016 the parent company CE Energy, a.s. was renamed to EP Infrastructure, a.s. ("EPIF"). The change was entered to Commercial register on April 11, 2016.

As of April 28, 2016 the voting rights of the shareholders of Energetický a průmyslový holding, a.s., the ultimate parent of EP Energy, a.s., changed, and the structure of their resulting voting rights was as follows:

- BIQUES LIMITED 25.66%
- EP Investment S.à r.l. 37.17%
- MILEES LIMITED 37.17%

In October 2016, Energetický a průmyslový holding, a.s. entered into an agreement with a consortium of global institutional investors led by Macquarie Infrastructure and Real Assets (MIRA) on the sale of a 31% stake in EP Infrastructure, a.s. (EPIF). Following to certain closing conditions including approval by antitrust offices, particularly in Germany and Austria, the transaction was closed on February 24, 2017. The remaining 69% of EPIF remained with EPH, which also retained management control over EPIF. The MIRA-managed consortium is led by Macquarie European Infrastructure Fund 5 and includes global institutional investors.

EPH used proceeds from the sale of EPIF to acquire its own shares which together with a series of transactions resulted in change in structure of the ultimate holders of EPE, as described further in chapter "Business – Shareholders".

## Subsequent events

On January 20, 2017 EP Energy a.s. paid interim dividend of EUR 10 million (equivalent CZK 270 million) that was paid out during January 2017.

On January 20, 2017 EP Energy, a.s. granted loans to ARISUN, s.r.o. and Triskata, s.r.o. that used the funds to repay their bank loans of EUR 1 million each.

On January 26, 2017 PT has taken legal action against the resolution of ERO from 23 December 2016. Together with the appeal PT deposited EUR 4 million to ERO bank account. On 23 February 2017 second instance court complied PT's appeal and confirmed suspensive effect of this claim till the next notice. On April 28, 2017 ERO returned temporarily deposited penalty of EUR 4 million to PT's bank account.

On February 24, 2017 EPH completed the previously concluded agreement with a consortium of global institutional investors led by Macquarie Infrastructure and Real Assets (MIRA) on the sale of a 31% stake in EPIF. The remaining 69% of EPIF remained with EPH, which also retained management control over EPIF.

On March 9, 2017 PT Real Estate, a.s. sold its 100% share in Nový Veleslavín, a.s. for EUR 9 million (CZK 256 million).

On March 9, 2017 Mr. Daniel Křetínský resigned as the Chairman of the Board of Directors of EP Energy, a.s. and Mr. Tomáš David was elected as the new Chairman of the Board of Directors. On March 10, 2017 Mr. Daniel Křetínský was removed from office of member of the Board of Directors and with effect from March 11, 2017 Mr. William Price was elected as the new member of the Board of Directors.

On March 10, 2017 EP Energy a.s. declared interim dividend of EUR 10 million (equivalent CZK 270 million) that was paid out during March 2017.

Except for the matters described above and elsewhere in the Report or in the Consolidated financial statements of EP Energy, the EP Energy a.s.'s management is not aware of any other material subsequent events that could have an effect on the consolidated financial statements as at December 31, 2016.



## **EP Energy, a.s. (the “Company”) Report for the year ended December 31, 2016**

### **Reporting**

This report (the “Report”) is the report required under Section 4.03 of the indenture governing the senior secured notes (the “Notes I” or “2019 Notes”), dated as of October 31, 2012 (the “Indenture I” or “2019 Indenture”), Section 4.03 of the indenture governing the senior secured notes (the “Notes II” or “2018 Notes”) dated as of April 18, 2013 (the “Indenture II” or “2018 Indenture”) and Section 4.03 of the indenture governing the senior notes (“the Notes III” or “2021 Notes”) dated February 7, 2014 (all also the “Notes” and “Indenture”) for the year ended December 31, 2016.

### **Presentation of financial information**

This Report summarizes consolidated financial and operating data derived from the audited consolidated financial statements of EP Energy, a.s. as of and for the year ended December 31, 2016 prepared in accordance with IFRS as adopted by the European Union (“IFRS”).

### **Non-IFRS measures**

In addition, we have included certain non-IFRS financial measures in this Report, such as EBITDA, Pro forma Adjusted EBITDA and certain other financial measures and ratios. Non-IFRS financial measures are derived on the basis of methodologies other than IFRS.

### **Definitions of EBITDA, Pro forma Adjusted EBITDA**

EBITDA represents profit from operations plus depreciation of property, plant and equipment and amortization of intangible assets minus negative goodwill (if applicable). The EBITDA included in this report does not represent the term EBITDA as may be defined by any documentation for any financial liabilities of the EP Energy, a.s. Group (also “EPE Group”). For further discussion over the EPE Group performance refer to the following pages.

Pro forma Adjusted EBITDA represents pro forma profit from operations plus pro forma depreciation of property, plant and equipment and pro forma amortization of intangible assets minus pro forma negative goodwill (if applicable).

To derive pro forma consolidated financial information, the EPE Group IFRS consolidated financial statements as of and for the year ended December 31, 2016 have been adjusted to reflect a disposal of Pražská teplotárenská LPZ, a.s. (“LPZ”) on June 1, 2016. Adjusting the EBITDA for LPZ result related to period January 1, 2016 to May 31, 2016 (2016: EUR 7 million, 2015: EUR 9 million).

**Pro Forma Adjusted EBITDA calculation (in million EUR)**

	FY 2016
Profit from operations	125
Depreciation and amortization	168
Negative goodwill	-
<b>Simple EBITDA per Financial statements</b>	<b>293</b>
LPZ Pro Forma Adjustment	(7)
<b>Pro forma Adjusted EBITDA</b>	<b>286</b>

The Pro forma Adjusted EBITDA included in this report does not represent the term EBITDA as may be defined by any documentation for any financial liabilities of the EPE Group. For further discussion over the EPE Group performance refer to the following pages.

After the listing of the Notes on the Irish Stock Exchange, the EPE Group has begun to report segment information in accordance with IFRS 8 Segment Reporting (starting with the 2012 annual consolidated financial statements). Since we did not previously report segment information using IFRS 8 rules, it may be difficult to compare our segment data with our “line of business” data previously reported elsewhere. For the purposes of this report we have restated segment information comparatives to comply with the IFRS 8 methodology.

We present EBITDA, Pro forma Adjusted EBITDA and other certain financial measures and ratios because we believe these financial measures may enhance an investor’s understanding of the profitability and cash flow generation of our business that could be used to service or pay down debt, pay income taxes and for other uses, and because they are frequently used by securities analysts, investors and other interested parties in the evaluation of companies generally. We use EBITDA and Pro forma Adjusted EBITDA to assess our performance. EBITDA and Pro forma Adjusted EBITDA are not measures calculated in accordance with IFRS and our use of the terms EBITDA and Pro forma Adjusted EBITDA may vary from others in our industry. EBITDA and Pro forma Adjusted EBITDA differ from Consolidated EBITDA and Adjusted EBITDA as may be defined in the Indenture. EBITDA and Pro forma Adjusted EBITDA should not be considered as an alternative to “Sales: energy,” “Sales: other,” “Gross profit,” “Profit/(loss) from operations,” “Cash generated from (used in) operating activities” or any other performance measure derived in accordance with IFRS.

Although we believe EBITDA, Pro forma Adjusted EBITDA and other certain financial measures and ratios to be useful performance indicators for our group as a whole and certain of our segments, we believe that such measurements may not accurately reflect our results of operations, and may not serve as accurate performance indicators, of our Power Distribution and Supply segment due to the implementation of our power optimization strategy in this segment.

EBITDA, Pro forma Adjusted EBITDA and all the other non-IFRS measures presented herein have important limitations as analytical tools and you should not consider them in isolation or as substitutes for analysis of our results as reported under IFRS. We also note that differences in the consolidation scope as described in part of this Report “Key factors affecting comparability of the results of operations of the EPE group” are impacting the comparability of the financial data.

## **Exchange rates**

For your convenience, we have translated Czech crown amounts in this Report into euro. The exchange rates for the income statement and cash flow statement items are the following average exchange rates of the Czech National Bank in Czech crown per euro for the relevant period.

- Year ended December 31, 2015: CZK 27.283 per EUR 1.000
- Year ended December 31, 2016: CZK 27.033 per EUR 1.000

The exchange rates for balance sheet items are the rates as of period end.

- As of December 31, 2015: CZK 27.025 per EUR 1.000
- As of December 31, 2016: CZK 27.020 per EUR 1.000

You should not view such translations as a representation that such Czech crown amounts actually represent such euro amounts, or could be or could have been converted into euro at the rate indicated or at any other rate.

## **Forward-looking statements**

This Report contains “forward-looking statements” within the meaning of the securities laws of certain jurisdictions. In some cases, these forward-looking statements can be identified by the use of forward-looking terminology, including the words “assume,” “believe,” “could,” “estimate,” “anticipate,” “expect,” “intend,” “may,” “will,” “plan,” “continue,” “ongoing,” “potential,” “predict,” “project,” “risk,” “target,” “seek,” “should” or “would” and similar expressions or, in each case, their negative or other variations or comparable terminology or by discussions of strategies, plans, objectives, targets, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth and strategies, our reserves and the industry in which we operate.

By their nature, forward-looking statements involve known and unknown risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance. You should not place undue reliance on these forward-looking statements.

## Risk factors

Many factors may cause our results of operations, financial condition, liquidity, reserves and the development of the industry in which we compete to differ materially from those expressed or implied by the forward-looking statements contained in this Report.

These factors include, among others:

### Risks related to our businesses and industries

#### Risks related to each of our segments

***Negative or uncertain global macroeconomic conditions may lead to declines in the volume and prices of products we sell, or in the failure of our customers to finance their operations, which may adversely impact our business, financial condition, results of operations and cash flows.***

During the most recent economic downturn, we experienced a reduction in demand for power, which adversely affected our results. A future economic downturn could also have a negative impact on the power and, to a lesser degree, heat industries generally. There may be reduced demand for power and heat as a result of a future economic crisis, which could result in both a decrease in the power (and, to a lesser extent, heat) produced and sold by our power plants, as well as a decrease in volumes at our distribution and supply business. In addition, certain market prices may be reduced, such as for wholesale electricity, when market demand falls. Moreover, our large fixed asset base may make it difficult to rapidly adjust our fixed costs downward when demand for our products declines unexpectedly, or where we are forced to reduce our prices. Therefore, any actions we may take in response to such a decline in demand, or price decrease, may be too slow or otherwise insufficient to counter an immediate decline in our sales or earnings, resulting in an adverse effect on our business, financial condition, results of operations and cash flows.

In addition, potential tightening of credit in the financial markets could adversely affect our commercial customers' creditworthiness and their ability to obtain financing for their operations. This could result in a decrease in the demand for our power and heat, the cancellation of trading orders for electricity and natural gas, the restructuring of agreements with our customers (including price reductions) or the inability to collect payments from our customers. If any of the foregoing occurs, our business, financial condition, results of operations and cash flows could be adversely affected.

***Failures, breakdowns, planned or unplanned outages, maintenance repairs and modernization, as well as natural disasters, sabotage, or terrorism in our generation and distribution infrastructure, or public opposition (e.g., demonstrations) at our heat and power plants, may cause delays or interruptions in our operations, increase our capital expenditures, harm our business and reputation or cause significant harm to the environment.***

Our heat and power plants, energy trading platforms, wind and solar farms and biogas facilities, distribution infrastructure (including transmission systems not operated or controlled by us), and our information systems controlling these facilities, could be subject to failure, breakdowns, unplanned outages, capacity limitations, system loss, breaches of security or physical damage due to natural disasters (such as adverse weather conditions, storms, floods, fires, explosions, landslides, slope ruptures or earthquakes), human error, computer viruses, fuel interruptions, criminal acts and other catastrophic events. Certain of these events have happened in the past and we cannot give any assurance that such events will not occur in the future or that the preventative measures taken by us will be effective. Any physical damage to our facilities may be costly to repair and any outages may cause us to lose revenues due to the inability to supply our customers.

The hazards described above can also cause significant personal injury or loss of life, severe damage to, and destruction of, property, plant and equipment, contamination of, or damage to, the environment and suspension of operations. The occurrence of any one of these events may result in our being named as a defendant in lawsuits asserting claims for breach of contract or substantial damages, environmental cleanup costs, personal injury and fines and/or penalties. A successful claim against us could adversely affect our financial results and materially harm our financial condition.

Key infrastructure assets also face the risk that they will be targets for terrorism or sabotage or legally permitted protests (such as demonstrations). Such events could lead to unanticipated costs and delays in the generation of revenues as well as negatively impact our business, employees, properties or assets, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Furthermore, unscheduled technological breakdowns at our customers' facilities may adversely affect demand for our production, and due to the technologies used at certain of our customers' facilities, the occurrence of such unscheduled shutdowns is not infrequent. In addition, scheduled shut-downs can lead to the detection of previously unknown problems which can lead to prolonged shut downs of operations as these problems are resolved.

***Planned or unplanned shutdowns of our facilities may adversely impact our business, financial condition, results of operations and cash flows***

We periodically shut down certain plants in our fleet (or parts of individual plants) and incur expenses in connection with inspections, maintenance or repair activities. In addition to these planned periodic shut-downs, we may have to unexpectedly shut down all or part of our plants as a result of the occurrence of the events described above. In addition, our regularly planned shut-downs may increase in the future due to, for example, increased government regulations. We cannot predict the timing or impact of these outages with certainty.

In particular, certain of our plants operate heat and power generating equipment that may require significant capital expenditures for maintenance or replacement over time, and our heat and power supply and distribution operations depend upon the operation of power and district heating networks, which are composed of complex infrastructure divided into multiple sections, which require continuous maintenance and ongoing partial replacement. These facilities and networks will require periodic upgrades and improvements to ensure they operate safely, efficiently and effectively and in compliance with existing and future regulatory requirements, which could require significant capital expenditures in the near future and on an on-going basis.

Furthermore, we cannot rule out the risk of delay to, or the inability to complete, certain projects resulting from, *inter alia*, uncertainty in securing sufficient funds, environmental protests, staff strikes, higher costs of investments, delays on the part of contractors in processing our orders, difficulties in obtaining necessary permits (including the imposition of additional conditions by public authorities), revocation or limitation of existing permits or other unforeseeable difficulties.

Particularly in our Renewables segment, we use equipment which is often newly developed and less seasoned than that in other areas of our business. New and less seasoned equipment can lead to unforeseen malfunctions and breakdowns which we and other suppliers in general do not have as much experience in resolving or have not experienced before. This can lead to further unpredicted disruption to this segment.

Any service disruption in our businesses may cause disruption to our generation of electricity and heat or customer dissatisfaction and may also lead to liability for damages, the imposition of penalties, including termination of sales agreements with customers, and other unforeseen costs and expenses.

***Our heat and power generation operations are heavily dependent upon the extraction and use of brown coal as a primary fuel source, which produces significantly more emissions than other fuel sources, and exposes us to the risk that our operations will become politically unpopular or the subject of restrictive regulations or private legal action.***

We operate a vertically integrated heat and power generation and distribution and supply business that depends upon the extraction and use of brown coal as a primary fuel source. Brown coal produces significantly more emissions, most notably CO<sub>2</sub>, than other primary fuel sources, such as natural gas or nuclear fuel. If brown coal-fired heat and power generating activities become subject to increasing public and political opposition, as they have on occasions in the past, we could face increased costs in burning brown coal as a primary fuel source, as well as in selling the power we produce from brown coal, as a result of potentially adverse environmental regulations, increased taxes, fees or fines, or private lawsuits against us and our brown coal-purchasing customers. We may be adversely affected not only by measures that directly impede use of brown coal in heat or power production, but also by measures that promote other fuel sources or alternative technologies for heat and power production (such as renewable energies). Any of the foregoing could materially increase our costs of doing business, decrease our revenues and/or have a material adverse effect on our business, financial condition, results of operations and cash flows. See “—The EPE Group’s operations are subject to strict environmental, heritage and health and safety regulation and enforcement,” “—Our operations are subject to significant government regulation and laws and our business, financial condition, results of operations and cash flows could be adversely affected by changes in the law or regulatory schemes”.

***Certain of our businesses are sensitive to variations in weather.***

Certain of our businesses are affected by variations in general weather conditions and unusual weather patterns. Our businesses forecast heat and power sales on the basis of normal weather, which represents a long-term historical average. While we also consider possible variations in normal weather patterns and potential impacts on our facilities and businesses, there can be no assurance that such planning can prevent negative impacts on our businesses. Generally, demand for electricity peaks in the winter and summer, and demand for heat peaks in the winter. Typically, when winters are warmer than expected or summers are cooler than expected, demand for energy, and in the case of winter, heat, is lower, resulting in less demand for heat and electricity than forecasted for our heat and power generation businesses. When Central Europe experiences longer periods of sunny weather, our solar energy parks are able to produce more electricity, whereas unexpectedly long periods of rain and cloud-cover could significantly reduce our solar energy production. Additionally, variations in weather can indirectly affect the outstanding balance owed to SSE in compensation for additional costs paid by SSE in support of renewable energy sources in Slovak Republic. Because SSE partially recovers the compensation through a special tariff charged to end consumers, if customers use less power than the average usage because of warmer winters, then a larger deficit will need to be compensated by the RONI correction mechanism. Because the RONI’s correction mechanism refunds a deficit over two years, any increase in the deficit may temporarily increase our cash flow requirements and have a negative effect on our profits and EBITDA generation.

***Congestion of the electricity transmission grid may lead to a reduction in power off-take from brown coal-fired power plants.***

Guaranteed feed-in tariffs for electricity from renewable energy sources, coupled with a priority feed-in right for those renewable energy sources into the electricity grid, can adversely affect power generation from other fuel sources such as brown coal, and can lead to grid congestion at certain times

of the day (*i.e.*, during periods with high-wind and low electricity consumption levels and therefore low off-take from the grid). As a result of this congestion, the available grid capacity for conventional power plants, including brown coal-fired plants, might be reduced, which might lead to a reduction in the power off-take from such plants.

As renewable power generation might expand in the Czech Republic again, there is an increased risk of grid congestion, which may lower the profitability and volume of power generation in our brown coal-fired power plants. Any such reduction could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***Our revenues and margins of operations may be negatively impacted by volatile prices for power, natural gas, hard coal and emission allowances for CO<sub>2</sub> and volatility in the revenues we receive from heat sales.***

Our profitability is influenced by the prices we receive for the power we generate as well as the revenues we receive from heat sales. Volatility in the prices at which we sell our power and in our revenues from heat sales may cause us to achieve a lower than anticipated price and adversely affect our business, financial condition, results of operations and cash flows.

#### ***Power and heat***

Volatility in (i) prices for power and (ii) revenues generated by heat sales may result from, among others, the following factors:

- weather conditions;
- seasonality;
- changes in electricity and fuel usage;
- changes in the prices of alternative fuels (in particular natural gas and hard coal);
- illiquidity in the wholesale electricity market or other markets;
- transmission or transportation constraints, inoperability or inefficiencies;
- availability of competitively-priced alternative energy sources;
- changes in generation efficiencies;
- development of renewable energy sources;
- outages at our generation facilities or those of our competitors;
- changes in production levels and storage costs of natural gas, coal, crude oil and refined products;
- natural disasters, wars, sabotage, terrorist acts, embargoes and other catastrophic events; and
- EU, national and state energy, environmental and other regulation and legislation.

Power prices have showed a decreasing trend in most of the European regions since the beginning of 2013 because supply from renewables has been growing faster than the demand for power, pushing the market price of electricity downwards. The continuation of such trend could have a material adverse effect on our business, financial condition, results of operations and cash flows. For more information, see “Management’s discussion and analysis of financial condition and results of operations—Factors impacting the results of our Heat Infra segment—The “Clean Spread”—Power.”

In our power generation business, we attempt to minimize our exposure to price volatility and in case of favorable power prices we also enter into power supply forward contracts in respect up to two years in advance. However, it may not be possible to enter into forward sales on commercially acceptable

terms, or at all, for any or all of the electricity generated at our plants. Moreover, we sell some of our electricity on the spot markets and, therefore, despite our attempts to minimize our exposure to electricity price volatility, such volatility could have a material adverse impact on our business, financial condition, results of operations and cash flows. The amount and proportion of our power generation sold this way may increase to the extent our business becomes more focused on generating power in condensation mode.

On the supply side for our power and heat businesses, we also seek to limit our exposure to fluctuations in fuel prices by entering into long-term forward contracts for brown coal, natural gas and hard coal with a limited number of suppliers. For example, through our supply and trading subsidiary, EP Sourcing (“EPS”), we have a major brown coal supply contract which lasts until 2035 (with a price formula partially fixed and partially linked to both the consumer price index in the Czech Republic and electricity price fluctuations) to supply our plants. This contract accounts for more than United Energy a.s.’s (“UE”) brown coal consumption projected to be required, and the supplies may be redirected as needed to the Plzeňská energetika a.s. (“PE”) and Elektrárny Opatovice, a.s. (“EOP”) plants. We also have (i) another contract expiring in December 2017 to provide a substantial amount of brown coal for the PE facility and (ii) a brown coal supply contract which lasts until 2025, in both cases with a price formula partially fixed and partially linked to the industrial production index, the consumer price index in the Czech Republic and electricity price fluctuations. However, a significant portion of our fuel purchases are made on a yearly basis, exposing us to changes in the market price for natural gas, which are volatile. Even under certain of our long-term contracts, the prices fluctuate in accordance with a combination of inflation indices, fuel price indices and prices in the spot market. In addition, our long-term contracts contain provisions which may allow our counterparties to terminate the contracts under certain circumstances, which, if exercised, would force us to purchase fuel at market prices.

In addition, the heat generation and distribution market in which we operate is subject to competition from alternative heating arrangements. For example, if customers perceive our heat supply to be too expensive or prefer alternatives to heat sourced from coal and gas-fired plants, individual customers may choose to improve insulation in their homes or receive their heat in an alternative manner, e.g., install gas-powered boilers, rather than obtain their heat through the district heating network. Enhanced insulation of houses is expected to lead to an ongoing slight decrease of consumption of heat, and alternative heating could lead to a loss of our customers.

In our Heat Infra segment, we are also sensitive to pricing pressures from alternative sources of power. Although final electricity prices have increased in the past, as time goes on, increasing competition could cause reductions in the market price for power. If feed in from power generation sources with lower variable costs (i.e., nuclear and renewables) increases faster than consumption, our profit margins will likely decrease because our variable costs will remain unchanged. For example, the principal nuclear power plant in the Czech Republic—Temelín—is being evaluated for a potential expansion project that could result in a significant increase in the availability of nuclear-power generation in the Czech Republic. This expansion project could increase the competitive pressures in the Czech power generation market, and could therefore have a material adverse effect on our business, financial condition, results of operations and cash flows as demand shifts from our power plants to nuclear power plants. In addition, in the Czech Republic higher demand from end-customers for renewable energy or the promotion of renewable energy could also lead to an increase in renewable energy projects that have preferential access to the distribution grid and thus reduce the access of our power plants to the grid for off-take of power generation, lowering our volumes. The evolution of competitive electricity markets may cause price and access pressure in certain power markets where we sell or intend to sell power.



Despite our efforts, volatility in the market price for commodities, including our fuel and emissions allowances, could have a material adverse impact on our business, financial condition, results of operations and cash flows. See “—Risks related to governmental regulations and laws—We are exposed to changes in the way emissions allowances are allocated, including the conditions attaching to free allocations and the allocation of emissions allowances, as well as volatility in the market prices of emissions allowances that we need to acquire.”

#### ***Shale gas and liquefied natural gas***

In addition to the above, an increase in natural gas imports into Europe through existing and new pipelines, increased liquefied natural gas imports, an increase in conventional natural gas production from existing and new fields and further development of shale gas production or hydraulic fracturing, in particular in Europe, might lead to substantially lower power prices as well as render production of electricity and heat from brown coal uneconomical. Despite the current lack of extensive shale gas exploitation in Europe, certain countries, including the Czech Republic and Hungary, are enhancing scientific evaluations of the chances and risks of an increase in shale gas exploitation through new techniques or are considering legislation to permit or, where it is already generally permitted, facilitate such exploitation in the future or introduce more precise regulations for the permissibility of certain methods of shale gas exploitation. Any increase in the availability of natural gas could impact the prices of the power, which could have an adverse effect on our business, financial condition, results of operations and cash flows.

#### ***Power distribution and supply***

Prices in the European energy markets in which we operate through our trading activities are not subject to general price regulation. Thus, price fluctuations occur in the wholesale energy market, as well as in the CO<sub>2</sub> emissions allowances market and impact our Power distribution and supply segment. These fluctuations are particularly significant when there are major tensions and volatility in the energy markets. Any shortage of products or lack of liquidity could limit our ability to reduce our exposure to risk quickly in the energy market. In addition, these markets remain in part partitioned by country, largely as a result of a lack of transmission interconnections, and may experience significant increases or decreases in price movements and liquidity crises that are difficult to predict. Any such fluctuations in the wholesale energy markets could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A significant portion of SSE’s expenses are its costs of purchasing electricity and, to a much smaller degree, gas, which are heavily influenced by prices in the world market for electricity, gas and fuel oil and other commodities, such as coal or uranium. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels. In order to manage the volatility and risk exposure, SSE implements a hedging and risk management strategy as described in SSE’s audited consolidated accounts for the year ended December 31, 2016. However, there can be no assurance that these measures will be effective at all times to manage the risk of material changes in gas and electricity prices, and SSE could experience significant price fluctuations which are not adequately hedged and which can adversely affect its financial position and results of operations.

#### ***Our licenses may be suspended, amended or terminated prior to the end of their terms or may not be renewed.***

Our licenses and permits required to conduct our business operations, including for operating our power plants and heat and power distribution networks, could be revoked, withdrawn or amended by the relevant authorities under certain circumstances. For example, a license or permit could be revoked, withdrawn or amended if there is a breach of a collateral clause, a subsequent change of facts

or a relevant regulation, such permit is found to be contrary to the public interest, or it is deemed necessary to prevent severe harm to the common good.

Moreover, private individuals and the public have the right to comment upon the process, raise objections to proposed permits and initiate court proceedings to intervene and prevent the granting of requested permits. In addition, environmental organizations, residents or other third parties may raise objections to our current or proposed activities or file suits challenging our operations and the granting or existence of permits and licenses to conduct our operations.

The permitting rules are complex and may change over time, making our ability to comply with the applicable requirements more difficult or even impossible, thereby precluding continuing or future operations. Regulatory authorities exercise considerable discretion in the timing and scope of permit issuance. Requirements imposed by these authorities may be costly and time consuming and may result in delays in the commencement or continuation of production operations.

If any of our licenses or permits is revoked, withdrawn or amended, or if we have difficulty renewing a license or permit, we may experience delays in our operations which could adversely impact our business, financial condition, results of operations and cash flows.

***Disruptions in the supply of coal, gas, power or other raw materials or transportation services, or an unexpected increase in their cost, could materially and adversely affect our business, financial condition, results of operations and cash flows.***

In the ordinary course of our business, we are exposed to the risk of disruptions in the supply of coal, gas, power or other raw materials or transportation. Our generation operations depend upon obtaining deliveries of adequate supplies of raw materials on a timely basis and are therefore vulnerable to changes in the supply of these raw materials, in particular brown coal. In our Power distribution and supply segment, a significant proportion of our supplied electricity is purchased. SSE does not operate any material electricity or gas generation facilities. SSE purchases a significant proportion of its electricity from Slovenské elektrárne, a.s., the dominant Slovak electricity producer. Any significant shortages or interruption in the supply of raw materials or transportation services or amendments to laws and regulations affecting such supply or services could disrupt our operations and increase our costs, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. For example, we may be forced to meet our fuel requirements by purchasing fuel at market prices, exposing us to market price volatility and the risk that fuel and transportation may not be available during certain periods at any price. Furthermore, as certain of our power plants are calibrated to run on certain ranges of grades of brown coal and other fuel, in many cases it may be difficult to find a replacement supplier that is immediately able to meet our raw material specifications, especially if any such replacement supplier were to have to seek licenses to access additional fuel reserves.

In addition, we are generally dependent on the provision of certain services (such as project management, engineering, construction, operations and maintenance, process design and planning and transportation) by third-party contractors and consultants in order to carry out our operations and implement our business plan. Our operations and developments may be interrupted or otherwise adversely affected by the failure of third-party providers to supply contracted-for services, any adverse change to the terms on which these contracted-for services are made available, or the failure of such third-party providers to provide services that meet our quality requirements. If we found it necessary to change a service provider, this could result in our experiencing additional costs, interruptions to continuity of supply, or other adverse effects on our business. Additionally, we may not be able to find adequate replacement services in a timely manner or at all. Any disruption or deterioration or increase

in cost with respect to our third-party arrangements could have an adverse effect on our business, financial condition, results of operations and cash flows.

***We frequently engage a very small number of suppliers, particularly in our power and heat businesses, which significantly magnifies the risk of disruptions in the supply of coal, natural gas and other necessary raw materials and services we receive from third parties.***

As we frequently engage a single supplier to supply the vast majority of the raw materials we use at each of our heat and power plants and depend on single third party contractors to carry out certain operations, our risk of disruptions in supply or services is significantly magnified.

For example, our brown coal supply contract with Czech Coal, a Czech mining company which supplied brown coal to our EOP facility, was originally scheduled to terminate at the end of 2015, but was terminated early by Czech Coal and became the subject of a legal dispute between Czech Coal and us. Although we concluded the dispute with Czech Coal by signing an out-of-court settlement (and recently signed a new contract with Czech Coal for portion of volume stipulated in original coal supply contract and have contracted the remainder of required coal supplies with other suppliers), we also have other large brown coal supply contracts under which we could face similar disputes. Should any similar dispute arise in the future, it could result in a shortfall in the supply of brown coal required to operate our heat and power plants.

We would attempt to cover any such shortfall through supplies from other suppliers. As the brown coal we may receive from alternative suppliers may differ in quality from the brown coal we are currently using, additional capital expenditures may be required in order to refit our power plants to accept a different grade of brown coal. Furthermore, the location of any alternative sources could make transporting brown coal from such mines to other power plants more expensive than our current transportation costs. Switching to a different grade of brown coal may result in a reduction of installed capacity and higher SOx emissions at our power plants, which could have an adverse effect on our business, financial condition, results of operations and cash flows.

***Certain clauses in some of our power, heat supply and purchase contracts may be subject to review by antitrust and other regulatory authorities and lead to increased regulatory scrutiny.***

From time to time, the Czech wholesale power generation market and other markets in which we operate are scrutinized by regulatory authorities, including the European Commission, to ensure competitive behavior. The European Commission and other regulatory authorities are empowered to undertake investigations and invoke financial penalties and other sanctions on companies with respect to alleged anti-competitive activities. For example, in July 2011, the European Commission publicly announced the initiation of proceedings against the state incumbent, ČEZ, in relation to concerns that ČEZ was allegedly preventing the entry of competitors into the wholesale power generation market. Additionally, in May 2010, the European Commission initiated formal proceedings against Energetický a průmyslový holding, a.s. (“EPH”), the EPE’s parent company, and EP Investment Advisors, s.r.o. (“EPIA”), an affiliated company, for potential breach of their procedural obligations during the on-site inspection in November 2009 undertaken as part of an antitrust investigation. As a result of the proceeding, on March 28, 2012, the European Commission imposed a fine of EUR 2.5 million on EPH and EPIA. EPH and EPIA are jointly and severally liable for the fine and have recorded provisions on their respective balance sheets. In June 2012, EPH and EPIA appealed the European Commission’s decision, and a hearing was on March 6, 2014. On 26 November 2014 The European Court of Justice upheld the decision of the European Commission. As there are no other possible instruments of appeal, the decision is final and binding. We cannot provide any assurance that the EU Commission or other regulatory authorities will not make similar challenges in the future, including against us.

For example, in 2014, EOP increased its price for heat. This price increase was challenged by one of its customers and submitted for review by the ERO. The ERO initiated a standard review procedure during which a price calculation and reasoning for the price increase was requested from EOP. ERO took no action against EOP as a result of the review procedure and the case was closed. Although the Company believes EOP was fully compliant in this case, a finding adverse to the Company in potential future cases could result in a downward price adjustment, which would have an adverse effect on the Group's business, financial condition, results of operations, cash flows and prospects.

As another example in October 2015 ERO started the regulatory proceeding with PT claiming that prices charged to customers of PT's local small-scale heating infrastructures in 2011 were in breach of the Czech Act on Prices. ERO issued decision obligating PT to pay penalty and restitution to affected customers. PT appealed against the decision and believes that with high probability the legal action against the decision related to both the penalty and to the restitution to affected customers will be successful. For more details concerning the case see: "Business – Legal proceedings".

In addition, contracts under which we supply or purchase power and heat contain provisions such as long-term or exclusivity clauses, may give rise to competitive concerns under EU, Czech, Hungarian or Slovak competition law. Long-term commodity supply contracts, in particular exclusive supply contracts or contracts under which a customer purchases a large portion of its overall demand, have in the past been subject to investigations by competition authorities and courts in Germany. Certain clauses, particularly exclusivity clauses and certain pricing mechanisms have been declared to be incompatible with competition law. Potential legal risks include the invalidation of certain clauses in the agreements, in particular exclusivity and long-term obligations and pricing and price adjustment provisions, the voidance of the whole contractual agreement, the imposition of amendments to contracts and administrative fines. In addition, these risks could be exacerbated if the standards generally applied by competition authorities and courts are changed or tightened. Any such legal consequences could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We have recently added new businesses to the EPE Group and have made and may make acquisitions in the future. Newly added or acquired businesses may not be integrated or managed successfully, and we may fail to realize the anticipated synergies, growth opportunities and other benefits expected or experience unanticipated costs from these additions or acquisitions as a result.***

Our operations have been consolidated under the EPE Group only in recent years. In addition, strategic acquisitions have been an important part of our growth strategy. Although most of the companies we have acquired are well-established operationally, as a group we were formed in December 2010, and most of our subsidiaries were acquired by our parent company, EPH, or one of its shareholders, within the last ten years.

In June 2012, we gained control over our 73.8% owned subsidiary, PT, under an agreement with the City of Prague as the minority (24.3%) shareholder. The remaining approximately 1.9% is owned by several small shareholders. Although PT has been a part of the EPE Group in some form since 2011 and has been in operation for many years prior to these acquisitions, we may nevertheless face certain administrative difficulties integrating it more fully into the EPE Group.

In December 2013, EPH contributed shares in EPH Fin II, the holding company for its recently acquired 49% interest in SSE, to us, and we completed the acquisition stake in Budapesti Erőmű Zrt. ("BERT") in December 2015. Although both these businesses have been operated by E.D.F. International for many years, there is no guarantee that we will be able to successfully integrate the new businesses into the

EPE Group or fully benefit from the anticipated synergies related to further matching our production volumes with the volume of power we sell to end customers that led us to acquire these businesses.

As we continue to expand our business, we must take steps to ensure that our managerial, technical and operational knowledge is sufficient and that we continue to effectively allocate resources and implement effective management information systems. We will be required to manage relationships with a greater number of customers, suppliers, contractors, service providers, lenders and other third parties. Further, we will need to continue to strengthen our internal control and compliance functions to ensure that we will be able to comply with our legal and contractual obligations and minimize our operational and compliance risks. We cannot be certain that steps we take to improve and manage our growth will be effective. Further, there can be no assurance that our expansion plans will not adversely affect our existing operations. In addition, any future acquisitions of businesses or facilities could entail a number of additional risks, including problems with effective integration of operations, inability to maintain key pre-acquisition business relationships, increased operating costs, exposure to unanticipated liabilities, and difficulties in realizing projected efficiencies, synergies and cost savings, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In addition, acquired businesses may not achieve the levels of revenue, profit or productivity we anticipate or otherwise perform as we expect. We cannot be sure that our past or future acquisitions will be accretive to earnings or otherwise meet our operational or strategic expectations. If we are not able to successfully integrate and/or manage any acquired company and its respective personnel, the transaction may fail to achieve the desired benefits. Certain of our new acquisitions may present exposure to new risks, or greater risks than we currently face, such as increased exposure to wholesale electricity prices following any significant purchase of a power plant operating primarily in condensation mode. We may be unable to manage these risks and management's attention may be diverted away from ongoing business concerns. Any occurrence of the aforesaid risks could adversely affect our business, financial condition, results of operations and cash flows.

We may also discover areas of financial concern after making an acquisition that we did not foresee prior to the acquisition. In certain instances, we may have limited time or restricted access to the target and its records and may not always be able to conduct sufficient due diligence prior to completing our acquisition, which may prevent us from realizing the value or achieving the strategic objective we anticipated to result from such investment or result in the need for unanticipated capital expenditures. Further, the historical books, records and contracts of acquired or newly consolidated businesses may be incomplete, and we cannot be certain that corporate and other actions have all been recorded or completed as required by applicable law. This could lead to adverse consequences, including potential disputes under contracts, the need to make provisions or to write down acquired assets and may place additional demands upon our senior management in order to integrate the business. This could have an adverse effect on our business, financial condition, results of operations and cash flows.

Furthermore, if any of the aforementioned risks resulting from acquisitions of new entities materializes and our acquisitions do not perform as expected, this could lead to impairment in the carrying value of our goodwill, which would negatively impact our consolidated results of operations and net worth.

We may engage in certain acquisitions in the future. There can be no assurance that our expansion plans will not adversely affect existing operations. In addition, any future acquisitions of businesses or facilities could entail a number of additional risks, including problems with effective integration of operations, inability to maintain key pre-acquisition business relationships, increased operating costs, exposure to additional liabilities, and difficulties in realising projected efficiencies, synergies and cost

savings, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We may participate in joint venture projects where we have granted protective rights to minority holders or otherwise hold interests in entities in which we own less than a majority of the equity or which we do not manage or otherwise control, which entails certain risks.***

We may enter into joint venture arrangements where we grant protective rights to minority holders or otherwise hold interests in entities in which we own less than a majority of the equity or which we do not manage or otherwise control. In these cases we may be dependent on our joint venture partners to operate such projects or entities, and they may not have the level of experience, technical expertise, human resources, management or other attributes necessary to operate these projects or entities optimally. The approval of such partners may also be required for us to receive distributions of funds from the projects or entities or to transfer our interest in projects or entities. Any current or future joint ventures and/or minority investments may also involve our making significant cash investments, issuing guarantees or incurring substantial debt. In addition, we may enter into joint venture arrangements or otherwise hold interest in entities alongside public entities, such as national and municipal governments, or other entities with divergent interests from us. For example, we share ownership of PT with the City of Prague, which holds a 24.3% interest, alongside EPE Group's 73.8% interest as well as several smaller shareholders, and the National Property Fund of the Slovak Republic ("NPF") holds 51% of the shares of SSE, alongside EPE Group's 49% interest. Such public entities or other joint venture partners may have divergent and at times competing interests that are not always dependent on purely commercial considerations. We therefore face the risk that the operations and management of any joint ventures or entities in which we hold interests alongside such entities may be adversely affected by political and/or social considerations. Any occurrence of these risks could have an adverse effect on the success of the joint venture arrangement or on our interest therein and, in turn, on our business, financial condition, results of operations and cash flows.

In relation to SSE, although we have management control over SSE, the Slovak Republic may influence or block certain decisions of SSE. The Slovak government's objectives may conflict with our objectives as a commercial enterprise. For example, the Slovak government's key objective is to ensure the stable supply of electricity and gas to the country's residents and businesses at affordable costs rather than the optimization of SSE's revenue and profits (and payments of dividends to its shareholders). The Slovak Republic attempted to strengthen its influence over public utilities (such as SSE) in 2008 by way of special legislation that provided that price regulation proposals by public utilities to the RONI must be approved by a general meeting. The special legislation was revoked in 2011, but it was reintroduced in August 2012. Annual tariff negotiations held with the RONI play a key role in determining our revenues. There can be no assurance that negotiations will be favorable or that the government will not amend the legislation or take other action to further its own objectives which may be in conflict with our interests or the interests of the holders of the Notes in the future.

***The success of our operations depends to a large extent on our skilled personnel. Therefore, our business, financial condition, results of operations and cash flows could be adversely affected if we fail to attract or retain key managers or senior executives or are not able to attract or retain a sufficiently skilled labor force.***

Our ability to maintain our competitive position and to implement our business strategy is largely dependent on our ability to retain key managers and senior executives and to attract and retain additional qualified personnel who have experience in our industries and in operating a company of our size and complexity, especially as our business continues to develop and expand. There may be a limited number of persons with the requisite experience and skills to serve in our senior management positions, and we may not be able to locate or employ or retain qualified executives on acceptable terms, or at all. Losses of our key personnel or an inability to attract and retain additional senior

management or technical personnel could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, certain of our senior personnel are not employed by us but are rather employed by an affiliate and provide services on a consultancy basis to the EPE Group. There is no assurance that these senior personnel will continue in this role in future or they may have other responsibilities which divert their attentions away from the EPE Group.

In addition, our industries require highly-skilled employees, including employees trained and certified to work at power plants and employees with sophisticated derivatives trading experience in our energy trading business. We may experience a shortage of adequately skilled candidates. In such cases, we may be unable to hire or retain employees with the requisite skills and thus may be unable to maintain our current operating levels, or we may be forced to increase wages to attract suitably skilled candidates, which could increase our costs substantially. Any future shortage of skilled employees, or increases in our labor costs, could have an adverse impact on our labor productivity and costs and on our ability to expand our operations. Losses of or an inability to attract and retain technical personnel could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We depend on good relations with our workforce, and any significant disruption could adversely affect our operations.***

During 2016, we employed in average approximately 3,767 full-time equivalent employees in our operations. Many of our employees are unionized or represented by works councils and may possess certain bargaining or other rights. These employment rights may require us to expend substantial time and expense in altering or amending employees' terms of employment or making staff reductions. For example, our employees' works councils generally must approve changes in conditions of employment, including salaries and benefits. This requires us to enter into tariff negotiations with the trade union to conclude collective agreements that normally last between 12 and 18 months. While our tariff negotiations have been successful in the past, this may not be the case in the future.

If our relations with our work force, the works council or the trade union deteriorate for any reason, including as a result of changes in compensation or any other changes in our policies or procedures that are perceived negatively by our employees, the works council or the trade unions, or we are unable to successfully conclude any future shop agreements with the works council and collective bargaining agreements with the trade union, we may experience a labor disturbance or work stoppage at the relevant facility or facilities, which could have a material adverse effect on any such facility's operations and on our business, financial condition, results of operations and cash flows.

***We are exposed to currency fluctuation risks that could adversely affect our profitability.***

Although EPE currently reports its results in euro, we conduct a significant portion of our business in Czech crowns and we are subject to risks associated with currency fluctuations. Our Slovak operations are all euro denominated, our Czech operations are denominated in Czech crowns, except for power sales, CO2 emission allowances purchases, some coal purchases and some capital expenditures which are euro denominated, our Hungarian operations are denominated in Hungarian forints, except for power sales, CO2 emission allowances and gas purchases and some capital expenditures which are euro denominated, and a significant proportion of the Group's debt is denominated in euro, including the Notes.

EPE will continue to conduct a significant portion of our business in Czech crowns and will continue to be subject to risks associated with currency fluctuations. Therefore, our results of operations may be affected by both the transaction effects and the translation effects of foreign currency exchange rate fluctuations. We are exposed to transaction effects when one of our subsidiaries incurs costs or earns revenue in a currency different from its functional currency. We are exposed to the translation effects

of foreign currency exchange rate fluctuations when we convert currencies that we receive for our products into currencies required to pay our debt, or into currencies in which we purchase raw materials, meet our fixed costs or pay for services, any of which could result in a gain or loss depending on such fluctuations. In particular, a large proportion of our cost of sales and our selling, general and administrative expenses are incurred in euro, reflecting the nature of our industries and the location of SSE's operations in the Slovak Republic. At the same time, although many of our sales are invoiced in euro, certain amount of revenues is invoiced in Czech crowns or Hungarian forints. Therefore, EPE's financial results in any given period may be materially and adversely affected by fluctuations in the value of the Czech crown relative to the euro or of Hungarian forint relative to the euro.

Furthermore, on November 7, 2013, the Czech National Bank implemented a currency intervention measure by which the Czech Crown was artificially devalued to an exchange rate of CZK 27 per Euro. This represented an almost 10% change from the former market exchange rate of CZK 25 per euro. The Czech National Bank committed to keep the Czech Crown artificially devalued at or around an exchange rate of CZK 27 per euro by end of the first quarter 2017 as a matter of monetary policy in order to, among other things, stabilize inflation. On April 4, 2017 the Czech National Bank announced ceasing of the interventions and leaving the Czech crown exchange rate to move according to supply and demand on the foreign exchange market. Consequently, the Czech crown may fluctuate in either direction in the short term. Potential volatility of the Czech crown, due to aforementioned translation and transaction risks and related tax risks, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We are exposed to financial risks and market volatility that could have a material adverse effect on our business, financial condition, results of operations and cash flows.***

In the normal course of our business, we are exposed to interest rate, commodity price and currency risks. While we partially hedge these risks using a variety of derivative instruments, including interest rate swaps, currency forward exchange contracts and purchases and sales of foreign currency at spot rates and commodity swaps, we may incur losses if any of the variety of instruments and strategies we use to hedge exposures are not effective. Our actual hedging decisions will be determined in light of the facts and circumstances existing at the time of the hedge and may differ from time to time. In some cases, we may not elect or have the ability to implement such hedges or, if we do implement them, they may not achieve the desired effect and may result in significant losses. Furthermore, although hedging transactions may limit to some degree our risk from fluctuations in currency exchange and interest rates, we potentially forego benefits that might result from such fluctuations.

The risk management procedures we have in place may not always be followed or may not work as planned. In particular, if prices of commodities or interest rates significantly deviate from historical prices or if the price volatility deviates from historical norms, our risk management system may not protect us from significant losses. As a result, fluctuating commodity prices may negatively impact our financial results to the extent we have unhedged or inadequately hedged positions. In addition, certain types of economic hedging activities may not qualify for hedge accounting under the accounting standards on which EPE's financial statements are based, resulting in increased volatility in our net income. In addition, there is a risk that the current parties to these arrangements may fail or are unable to perform their obligations under these arrangements. The occurrence of any of the aforesaid risks could adversely affect our business, financial condition, results of operations and cash flows.

We also face risks from our energy trading operations. In general, we seek to limit our open trading positions and in many cases trade on a back-to-back basis with our energy supply business. See "Risks related to Power distribution and supply segment —Our traders may fail to adhere to our risk management policies, exposing us to open positions on the energy trading market" and "Management's discussion and analysis of financial condition and results of operations—Quantitative



and qualitative disclosures about market risk for the EPE Group.” To the extent we are unable to limit our open positions or match our trades on a back-to-back basis, we may suffer significant losses which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We face an increased risk of default or delay by financial institutions with which we enter into treasury and derivatives transactions.***

From time to time we enter into framework agreements and related derivatives transactions with major European banks in the countries in which we operate. Due to the recently past debt crisis, the threat of continuing or deepening economic recession in Europe, the threat of a breakdown of the Eurozone and the potential impact of each of these threats on Europe’s financial services industry, there is a risk that some of our treasury and derivatives’ counterparties might become unable to perform their obligations or otherwise default under such agreements and transactions. The occurrence of any of these events may materially and adversely affect our business, financial condition, results of operations and cash flows.

***EPE’s consolidated financial statements included in this Report may not be representative of our historical or future results of operations and may not be comparable across periods, which may make it difficult to evaluate our results of operations and future prospects.***

The financial information included in this Report comprises the consolidated financial statements for the EPE Group as of and for the year ended December 31, 2016.

While we believe that the financial statements and financial information included in this Report provide a meaningful accounting presentation of the businesses currently owned and operated by the EPE Group, they are not comparable across the periods presented because of, among other things, the acquisition of various subsidiaries or additional interests in such subsidiaries and the disposition of certain subsidiaries. The lack of comparable data may make it difficult to evaluate the EPE Group’s results of operations and future prospects. Before EPE’s formation, many of the current subsidiaries of EPE were subsidiaries of the EPE’s ultimate parent, EPH, but because the EPE Group has grown steadily through acquisitions, these entities have been under common control for only a short period of time. A significant part of EPE’s current subsidiaries were acquired in 2012 (including agreements with respect to PT that permit full consolidation of these entities from July 1, 2012), 2013 (acquisition of our stake in SSE Group in November 2013) and 2015 (acquisition of our stake in Budapesti Erőmű Zrt. (“BERT”) in December 2015), while certain significant disposals were undertaken in 2016 (namely disposition of MIBRAG, Saale Energie and Helmstedter Revier GmbH on April 1, 2016 and Pražská teplárenská LPZ on June 1, 2016).

***Our insurance coverage with respect to our operations may be inadequate and the occurrence of a significant event could adversely affect our business, financial condition, results of operations and cash flows.***

In 2014 we started the development of the international insurance program that respects the latest trends in the energy industry. The objectives of the program are to optimize the mix of premium, cover scope, limits and deductibles in terms of holding view. However, we maintain an amount of standalone insurance protection that we consider adequate in the ordinary course of operations, but we cannot provide any assurance that our insurance will be sufficient or provide effective coverage under all circumstances and against all hazards or liabilities to which we may be exposed. For example, only some elements of SSE’s distribution network are insured, namely transformation stations and substations. Specifically, SSE’s insurance does not cover its power lines. Damages or third party claims for which we are not fully insured could materially and adversely affect our business, financial condition, results of operations and cash flows.

Further, due to rising insurance costs and changes in insurance markets, insurance coverage may not continue to be available to us on terms similar to those presently available or at all. Any losses not covered by insurance could have an adverse effect on our financial results. From time to time, we may be subject to subrogation claims by insurance providers, and if such subrogation claims are not covered by other insurance policies, it could have an adverse effect on our business. Although we carry property insurance on our facilities and business interruption insurance, if we have a stoppage at any of our facilities, our insurance policies may not cover every contingency and may not be sufficient to cover all of our lost revenues. In addition, in the future, we may be unable to purchase sufficient business interruption insurance for our facilities at a commercially reasonable cost or at all.

***If we fail to maintain an effective system of internal controls over financial reporting, we may not be able to accurately report our financial results or prevent fraud.***

We have designed and continue to design our internal controls with the objective of providing reasonable assurance that (i) our transactions are properly authorized; (ii) our assets are safeguarded against unauthorized or improper use; and (iii) our transactions are properly recorded and reported, all to permit the preparation of our consolidated financial information in conformity with applicable accounting principles. Any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. In particular, the EPE Group does not have integrated information systems and each subsidiary has its own accounting platform and accounting methodologies. The EPE's subsidiaries prepare separate financial statements under the applicable local accounting standards for statutory purposes (including in the Czech Republic, Slovak Republic, The Netherlands, Cyprus, Serbia and Hungary). Part of the IFRS financial statements consolidation process is manual. It involves the transformation of the statutory financial statements of the EPE's subsidiaries into IFRS financial statements through accounting adjustments and a consolidation of all entities' financial statements. This process is complicated and time-consuming and involves significant manual intervention, all of which increases the possibility of error. In addition, this process requires significant attention from our senior accounting personnel. In addition, as we continue to integrate recently acquired businesses into our operating group, we may experience difficulties adapting our internal controls to these businesses, which could further exacerbate the risk of inaccuracies in our financial reporting.

Any failure to maintain adequate internal controls or to be able to produce accurate consolidated financial information on a timely basis could increase our operating costs and materially impair our ability to operate our business, any of which could materially and adversely affect our business, financial condition, results of operations and cash flows.

***We are subject to various legal proceedings, which may have a material and adverse effect on our business and there can be no assurance that any provisions created by us in respect of such proceedings would be adequate to cover the potential losses.***

In the ordinary course of our business, we are subject to numerous civil, administrative and arbitration proceedings. EPE's audited consolidated financial statements show provisions relating to particular proceedings and we also record provisions relating to various other risks and charges, primarily in connection with regulatory disputes and disputes with local authorities. However, we have not recorded provisions in respect of all legal, regulatory and administrative proceedings to which we are a party or to which we may become a party. In particular, we have not recorded provisions in cases in which the outcome is unquantifiable or that we currently expect to be ruled in our favour, for example in respect of the regulatory proceedings of ERO against PT which was commenced in October 2015 and resulted in a decision of ERO which the management of the Group intends to challenge. As a result, we

cannot give any assurance that our provisions will be adequate to cover all amounts payable by us in connection with any such proceedings. Our failure to quantify sufficient provisions or to assess the likely outcome of any proceedings against us could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In addition to the potential financial exposure we may face relating to the litigation mentioned above, litigation, whether or not successful, could materially affect our reputation in the market or a relationship with our customers or suppliers who may cease to trade with us, and the proceedings or settlement in relation to litigation may involve internal and external costs, which may, even in the case of the successful completion of a relevant proceeding, not be fully reimbursable, divert senior management's time or use other resources which would otherwise be utilized elsewhere in our business. Each of these additional consequences of litigation could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***A majority of our revenues is derived from sales made in the Central European market, and any significant downturn in the economies of Central European countries, or any significant political, economic or legal uncertainties in the Czech Republic, the Slovak Republic or Hungary could have a material and adverse effect on our business, financial condition, results of operations and cash flows.***

All of the EPE Group's power and heat generation and distribution are made in the Central European market, specifically in the Czech Republic, the Slovak Republic and Hungary and, to a lesser extent, other European countries. The local nature of district heating distribution networks through which we distribute much of our heat production, reduces our ability to expand geographically based on our current cogeneration assets. As such, the EPE Group's business, financial condition, results of operations and cash flows are highly dependent on the Central European market. Any significant downturn in the economies of Central European countries could have a material and adverse effect on the EPE Group's business and results of operations. Furthermore, a decline in demand for power and heat in the region may have a material and adverse effect on the EPE Group's business, financial condition, results of operations and cash flows.

The Central European economic risks mentioned above may be exacerbated by unstable global economic conditions such as the recent global financial crisis, during which banks around the world have faced severe limitations on their ability to lend, which has seen economic activity in nearly all countries either decline or experience less rapid growth than previously anticipated and which has led, and may lead in the future, to high fluctuations in currency exchange rates, particularly the euro. See "—We are exposed to currency fluctuation risks that could adversely affect our profitability." A significant decline in the economic growth of any of the countries' trading partners, in particular Germany and other member states of the EU, could in the future have an adverse effect on the Czech Republic's or Slovak Republic's balance of trade and adversely affect their economic growth. Any continuation of adverse economic circumstances or deterioration in the global economy may exacerbate any problems specific to the Central European economy, and may have an adverse effect on our business, financial condition, results of operations and cash flow.

As a result of the slowdown in the global economy caused by the financial crisis which started in 2008, the Czech Republic sustained a substantial decline in GDP of 4.8% in real terms in 2009. Although the Czech Republic's economy returned to growth in 2010 and 2011 with growth rates of 2.3 and 2.0 per cent., respectively, the economic recovery remained fragile and the Czech Republic's economy

suffered further declines of 0.8 and 0.5% in 2012 and 2013 before returning to growth in 2014 at a rate of 2.7% and further accelerating in 2015 with growth of 4.5%<sup>8</sup>. Growth in 2016 reached 2.3%<sup>9</sup>.

The Slovak Republic also suffered a decline in GDP of 5.4% in real terms in 2009. The economy has since grown in real terms, but the rate of growth has fallen from 5.0% in 2010, to 2.8% in 2011, 1.7% in 2012 and 1.5% in 2013 and partially recovered in 2014, 2015 and 2016 with a growth rate of 2.6% and 3.8%<sup>10</sup> and 3.0%<sup>11</sup>.

A significant portion of our business is conducted in the Slovak Republic, the Czech Republic and Hungary. Any changes in economic, tax, regulatory, administrative or other conditions or policies of the Slovak, Czech or Hungarian government, as well as political or economic developments in the Slovak Republic, the Czech Republic or Hungary over which we have no control, could have a significant effect on the Slovak, Czech or Hungarian economy, which in turn could have a material and adverse effect on our business, financial condition, results of operations, cash flows or our ability to proceed with our business plan. With regard to the Czech Republic for example, in May 2012, the EU announced concerns over the management and control systems related to the use of funds it contributes to the Czech Republic and has requested that corrective measures be taken before any such funding continues. Although funding by the EU resumed in July 2012, any similar or other reduction in funding from the EU could result in increases in the country's public finance deficits, which could potentially weaken the Czech crown against foreign currencies, increase inflation and increase the borrowing costs of the Czech Republic and for us, and could have a material and adverse effect on our business, financial condition, results of operations or cash flows. The Slovak Republic has also faced similar problems. Although funding for certain operational programs (i.e., transport and environment) has been reinstated, such funding was temporarily suspended by the EU for several months as a result of administrative defects in the drawdown of the EU funds. Furthermore, as of the end of 2013, the Slovak Republic's share in the drawing of the allocated EU funds was slightly above 50.0 %, which is low compared to other EU countries' drawdown. The drawing shortfalls could have a negative impact on the country's public finances as a reduction in EU funds could result in increases in the country's public finance deficits and increase the borrowing costs of the Slovak Republic, and could have a material and adverse effect on our business, financial condition, results of operations or cash flows.

There can be no assurance that any crises, slowdown or economic decline such as those described above or similar events will not negatively affect investor confidence in markets relevant for our businesses. Any of such crises, economic decline or similar events could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In addition, the tightening of credit in the financial markets could adversely affect our commercial customers' creditworthiness and their ability to obtain financing for their operations. This could result in a decrease in the demand for heat and power produced and distributed by us, the restructuring of agreements with the Group's customers (including price reductions) or the inability to collect payments from the customers. If any of the foregoing occurs, our business, financial condition, results of operations and cash flows could be materially adversely affected.

***We may not successfully implement our key strategies.***

Our key strategies include continuing to focus on cash flow generating assets and improve our risk profile; continuing to grow through selective acquisitions that match our strategic targets; using strict

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<sup>8</sup> According to Eurostat data available as at date of report

<sup>9</sup> According to Czech Statistical Office

<sup>10</sup> According to Eurostat data available as at date of report

<sup>11</sup> According to Slovak Statistical Office

discipline to maintain low costs and prudent levels of capital expenditures; and continuing our strategy of energy optimization while maintaining strict controls on open trading positions. However, we face many risks that could adversely affect our ability to implement our key strategies, such as changes in power and heat demand in the Czech Republic, the Slovak Republic, Hungary and in Central Europe generally, changes in power, heat and emission allowance prices and the regulatory framework, increases in generation and distribution costs, future developments affecting the power and heat distribution infrastructure within Central Europe, competition in the markets in which we operate, political and economic developments affecting Central Europe, EU legal and regulatory requirements and the reliability of our current and future partners for expanding our business within Central Europe. Any failure to implement our key strategies successfully could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***Failures by our counterparties or failures of the IT or telecommunication systems we use may interfere with our ability to complete a trade.***

We face the risk that our trading counterparties may fail to complete contracted trades, thus leaving us exposed to an unanticipated open position. We also depend heavily on our IT and telecommunication systems and trading platforms to execute trades on a timely basis. If we were to experience any IT or telecommunication failures or disruptions, it could negatively impact our ability to make or complete our trades. The failure of one of our counterparties to complete a trade or any disruptions or failures of our IT or telecommunication systems we use to conduct our trading operations could materially and adversely impact our business, financial condition, results of operations and cash flows.

**Risks related to heat and power generation**

***Our ability to supply electricity is dependent upon transmission and distribution systems and our reliance on third parties.***

The transmission and distribution of electricity from our power plants and our supply business is dependent upon the infrastructure of the power grid systems in the countries in which we operate. We have no control over the operation of these power grid systems and we must rely on independent third party power grid system operators.

For example, in the Czech Republic the power grid is operated on two levels—the transmission grid, which is operated by ČEPS a.s., the state-owned transmission system operator (TSO), and the local distribution grids, operated regionally by one of ČEZ Distribuce, a.s., E.ON Distribuce a.s. or PRE Distribuce, a.s.

Any failure of such power grid systems or reduction of available capacity, including as a result of grid congestion, natural disasters, insufficient maintenance or inadequate development, could prevent us from distributing power from our power plants to end-consumers. Additionally, under the Act No. 458/2000 Coll., on business conditions and public administration in the energy sectors, as amended (the “Czech Energy Act”), network operators are responsible for the security and reliability of the power supply system and obliged to balance differences between generation and consumption. Therefore, if the safety or reliability of the transmission system is endangered, particularly in the case of grid bottlenecks, network operators are obliged to take remedial grid-related or market-related action, including changes to current electricity feed-in, transit and output. In doing so, network operators may choose to disconnect power plants from the grid temporarily to reduce or prevent congestion. In any such case, conventional power plants would be the first to be disconnected, followed by cogeneration plants and renewable power plants. We would not be entitled to compensation by the network operator for the losses incurred as a consequence of such measures. As renewable power generation and cogeneration increases rapidly in the Czech Republic and the

capacity of affected transmission and distribution grids is often not expanded sufficiently to accommodate this increase, there is an increasing risk of grid congestion and subsequent regulation of feed-in power capacity of conventional power plants during certain hours, including brown coal-fired power plants.

Any failure of the power grids or a disconnection of one of our plants from the power grid, *e.g.*, due to congestion and respective measures by the network operator, could negatively impact our sales of power and brown coal, and could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The distribution of electricity to SSE's distribution networks is dependent upon the infrastructure of the Slovak transmission system. SSE has no control over the operation of this transmission system and it is entirely reliant on the transmission system operator in the Slovak Republic, which is a state-owned entity. Any failure of the Slovak transmission system, including as a result of natural disasters, insufficient maintenance or inadequate development, could prevent SSE from distributing electricity to its end consumers, which in turn could have a material adverse effect on our business, results of operations and financial condition.

***Our Sale and Purchase Agreement for the sale of Energotrans to ČEZ, a.s. is subject to reversal if our long-term heat supply contract with Energotrans is breached or invalidated.***

In 2012, PT sold Energotrans, a heat generating company, to ČEZ, a.s. As part of the sale, PT continues to have an important long-term heating supply contract with Energotrans, valid through 2036, whereby PT buys heat from Energotrans to distribute through PT's heat distribution network in Prague. In connection with the sale, the parties obtained competition clearance to supply heat through 2021. The sale and purchase agreement provides for remedies in the event that the heating supply contract is breached or challenged by either party or invalidated or otherwise terminated by the courts or authorities. For minor breaches or challenges to the contract, PT may be forced to adjust certain commercial terms of the contract. In the worst case scenario, PT could be forced to repurchase Energotrans from ČEZ, a.s. at a predefined price to be determined by an agreed-upon formula. Such purchase price could be substantial and in certain cases (in particular if the repurchase is triggered due to material breaches by PT) represent a premium to PT's original sale price. There can be no guarantee that PT will have sufficient funds or access to outside funding to fulfill those obligations. Any such challenge, and any resulting changes to our contract with Energotrans or the reversal of the sale to ČEZ, a.s., could have an adverse effect on our business, financial condition, results of operations and cash flows.

***Our ability to supply heat to our customers is dependent upon distribution systems.***

The heat distribution from our CHP plants and our heat supply business is dependent upon the infrastructure of the heat distribution systems. Any failure of such distribution systems or reduction of available capacity, including as a result of natural disasters, insufficient maintenance or inadequate development, could prevent us from distributing heat from our power plants to end-consumers.

Certain of our heat transmission operation uses parts of property owned by third persons. Historically, these rights (easements) were established on the basis of the then-applicable legislation while some of them were established without registration in land cadastre and without proper remuneration. Occasionally, owners of the affected property seek renegotiation of such easements with fair remuneration. Rarely, the owners may even seek the removal of such infrastructure from their property. Any significant costs which could be incurred or difficulties encountered when renegotiating these rights or possible relocation of parts of infrastructure could have an adverse effect on the business, financial condition, results of operations and cash flow.

## **Risks related to power distribution and supply**

***Our traders may fail to adhere to our risk management policies, exposing us to open positions on the energy trading market.***

Our trading business purchases and sells electricity and energy commodities in the wholesale market, including sales of electricity generated by us in our Heat Infra segment to our end-consumers through our supply business. Our trading business also sells and purchases CO<sub>2</sub> emissions allowances and purchases electricity for delivery by our power generation business at times when it is more economical for us to buy electricity for sale under our forward sale contracts rather than generate it ourselves. While the majority of our trades are conducted on a back-to-back basis, we also engage in limited opportunistic electricity and gas trading activities, mainly in relation to sales of electricity from our own production, where the result of such trading activity depends on movements of wholesale electricity prices. Additionally, in connection with the optimization of our power distribution and supply business, we are dependent on the liquidity of the wholesale market, and as a result, we may take limited open trading positions. These trades relate, for instance, to (a) speculation on seasonal differences in electricity and natural gas prices (such as the purchase of gas in the spring and summer with the intention of selling it at a higher price in the winter) and (b) speculation based on announcements relating to the availability of emissions allowances, as a reduction in the number of available emissions allowances will lead to an increase in emissions allowance prices and thus increasing power prices due to higher production costs. The maximum exposure we may take through proprietary trading is subject to limits setting the maximum risk of loss on trading portfolios (Risk capital).

Under our current trading policies, EPET's potential open positions in electricity and gas are limited by Risk Capital and Value-at-Risk limits, these are set at a maximum loss of 750,000 EUR (450,000 Power and 300,000 Gas) and 350,000 Value-at-Risk (200,000 Power, 150,000 Gas). If the EPET exceeds these thresholds on the EPET's open positions, it is required by EPE Group policies to close out of its open positions to a value below these thresholds. Under the current SSE risk policy, exposure to market price risk in electricity and natural gas derived from open volume positions is limited by a maximal level of Risk Capital representing a max loss of EUR 1.6 million (EUR 500,000 for electricity, EUR 500,000 for natural gas, EUR 600,000 for a speculative portfolio) as well as Value-at-Risk set for each portfolio (EUR 250,000 for electricity, EUR 250,000 for natural gas, EUR 300,000 for a speculative portfolio). Risk on trading books is managed using a parametric Value-at-Risk method with a 99% confidence level. This means that according to our risk analysis, there is a 99% chance that the day-on-day loss on the specific trading book will not exceed the relevant Value-at-Risk limit. There is also a volume limit for open positions for each portfolio and each trading year. If the VaR limit is exceeded, it is required to close out the open position to decrease the risk.

However, despite our risk management policies and monitoring activities, we could be exposed to open positions in excess of those prescribed by our risk management policies if, for example, any of our traders makes trades in violation of our trading policies or changes thereto, or flaws in such policies emerge. Any failure to adhere to our risk management policies or weaknesses in the policies themselves could materially and adversely affect our business, financial condition, results of operations and cash flows.

***We are subject to the risks associated with EU regulation of energy market mechanisms, including the credit and cash settlement requirements for trading of commodities and financial instruments.***

We trade on the financial and energy wholesale markets of Europe. EU regulations, such as the Regulation on Wholesale Energy Market Integrity and Transparency (REMIT), the Markets in Financial Instruments Directive (MiFID) and the European Market Infrastructure Regulation (EMIR) require the implementation of strict rules for wholesale commodity trading, including potential cash margining

requirements for all over-the-counter deals, transparency and reporting obligations and the central clearing of transactions involving certain energy derivatives. These regulations may significantly modify current financial and commodity instrument rules based on rules of the European Federation of Energy Traders (EFET) and of the International Swaps and Derivatives Association (ISDA). Changes to credit and cash settlement requirements could require us to post cash collateral to cover mark-to-market fluctuations in the margin of all our wholesale forward sales of electricity used for hedging our generation portfolio in case of power price increases. Although we seek to limit our open positions and focus on trading supported predominantly by back-to-back production at our facilities by purchasing energy to match the timing of the sale of our production volumes with a corresponding purchase of the volumes required to meet our supply customer's requirements (which are generally lower than the total energy volumes we produce), due to our high trading volumes and the volatility of power prices, we may require significant liquidity to meet our trading obligations that may be difficult to cover. In addition, foreign exchange hedging transactions could also be affected. As a result, EU regulation of energy market mechanisms, including any changes to credit and cash settlement requirements for trading of commodities and financial instruments, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We face competition in the energy supply market.***

The energy supply market is very competitive with many businesses operating on the markets in which we trade. Our primary competitors in the Czech energy supply market are RWE, E.ON and ČEZ, a.s. Our supply prices must remain competitive which makes strong profitability a challenge in this business line. Our customers may leave in order to obtain their energy from other suppliers. In order to compete with other energy suppliers, we may have to reduce our prices further. If we are unable to remain competitive, it may have a negative impact on our business, financial condition, results of operations and cash flows.

***We are exposed to increased competition in the electricity and natural gas markets in the Slovak Republic.***

We are the natural monopoly distributor of electricity in the central part of the Slovak Republic and this activity generated majority of SSE's EBITDA for the year ended December 31, 2016. However, with regard to the supply of electricity and gas, we operate in an increasingly competitive market.

We compete with up to 30 major suppliers of electricity and gas in the Slovak Republic and some of these companies may have greater financial or technical resources than us or other competitive advantages. In particular, the Group's affiliate SPP a.s., the dominant gas supplier in the Slovak Republic, has recently begun to supply electricity as well and is expected to gain a significant market share through its ability to cross-sell electricity to its existing gas supply customer base. The majority of competitors offers supply of both commodities: electricity and natural gas. In addition, both SE Predaj (a subsidiary of the dominant Slovak electricity producer, Slovenské elektrárne, a.s.) and ČEZ (a major regional energy group based in the Czech Republic) are actively seeking to enlarge their customer bases. Reflecting this increasing competition, the rate of customer churn in the Slovak electricity supply market has increased in recent years. In 2009, 0.4% of customers switched their electricity supplier and this number has increased in each year since 2009 to 3.56% in 2012. In following years the percentage of customers that switched the supplier stabilized around 3% and in 2016 was 2.92%. In the past, SSE experienced a loss of customers to competitors who offered below-market rates. If a significant number of SSE's electricity customers choose to switch their supplier, our supply business and results of operations could be significantly adversely affected.



## Risks related to renewables

### ***Our renewable energy projects and other initiatives face considerable uncertainties including development, operational, technical and regulatory challenges.***

Our renewable energy projects are subject to substantial risks. Projects of this nature are relatively new and have been developed through advancement in technologies that may not be proven or are unrelated to our core businesses. Although renewable energy in the Czech Republic is currently supported by various governmental subsidies, it is generally expected that the subsidy scheme for new projects shall be materially reduced or cancelled in the future. In addition, in 2010, with effect as of January 1, 2011, a withholding tax in the Czech Republic in the amount of (i) 26% of the income corresponding to the feed-in tariff or (ii) 28% of the income corresponding to a “green bonus” was imposed on solar power facilities commissioned in 2009 and 2010, which negatively affected three of our solar power facilities that began operating between 2009 and 2010 and are therefore subject to the withholding tax. Such withholding tax was in effect until December 31, 2013. Effective as of January 1, 2014, a withholding tax in the Czech Republic in the amount of (i) 10% of the income corresponding to the feed-in tariff or (ii) 11% of the income corresponding to a “green bonus” was imposed on solar power facilities commissioned between January 1, 2010 and December 31, 2010, impacting Greeninvest Energy, a.s. with installed capacity of 5 MW. Such tax burden applies starting from January 1, 2014 and continuing for the duration of the period during which the respective facility has the right to claim the subsidy. However, we cannot predict any legal developments in respect thereof. See “—Risks related to governmental regulations and laws—We could incur unforeseen taxes, tax penalties and sanctions or could lose tax exemptions and benefits, which could adversely affect our business, financial condition, results of operations and cash flows.”

Furthermore, in addition to the imposition of taxes discussed above, renewable energy projects in the Czech Republic not yet commissioned do not benefit from existing government subsidies and face considerable risks resulting from changes in governmental support, such as a waning legislative support for waste-to-energy facilities, which would adversely affect our business in this area. In addition to imposing taxes or cancelling subsidies, the government could also choose to curb development by issuing fewer authorizations and permits to operate renewable energy facilities, which could make it more difficult and more expensive to expand our renewables business.

In the Czech Republic the applicable renewable energy feed-in tariffs may be subject to changes in the future. In January 1, 2013, a new act on the promotion of renewable energy sources entered into force (Act No. 165/2012 Coll., on Promoted Energy Sources, the “Czech Promoted Energy Sources Act”) which, among other changes, reduced support for certain types of renewable energy sources (for example solar installations), as well as reduced support (through lower feed-in tariffs and lower green bonuses) for new installations in order to combat what was considered to be excessive and unbalanced promotion of renewable energy sources. To support development of on-going projects and to prolong the deadline for commissioning of wind, geothermal, hydro and biomass energy plants to obtain the state support, the amendment to the Czech Promoted Energy Sources Act was enacted in 2013. The amendment, among other things, provides that only facilities that obtained permits prior to October 2013 and are commissioned prior to December 31, 2015 have a right to a subsidy, with an exemption for small hydropower plants with installed capacity less than 10 MW. Moreover, the Czech Government has prolonged the deadline for commissioning of wind, geothermal, hydro and biomass energy plants to obtain subsidy from December 31, 2015 to 6-year period commencing from date of issuance of authorization to develop a renewable energy plant provided to an investor by the Czech Ministry of Industry and Trade. Adoption of the amendment prolonged the deadline for commissioning of VTE Moldava till June 19, 2019.

Currently in the Slovak Republic, there is also feed-in support for renewable energy sources. Although the RO is currently safeguarding such support for existing renewable energy assets, including our 9.8

MW solar generation (at SSE) and 2.6 MW hydro generation (at SSE) assets, new renewable energy projects are facing a much more stringent approval process and less feed-in support, which has been scaled back to prevent speculative capital and uncontrolled building of decentralized generation assets. There have also been some discussions regarding the imposition of a special tax on renewable energy generation assets, inspired by the Czech market. Although no such tax has been imposed, we cannot guarantee that the Slovak government will not impose such a tax in the future. The imposition of such a tax or any similar tax or the withdrawal of renewable energy feed-in support or any other support may adversely affect our business, financial condition, results of operations and cash flows.

We intend to further develop one wind park project in the Czech Republic (VTE Moldava).

Any delays in the commissioning of planned projects and any amendments to the applicable feed-in tariffs scheme under statutory law could materially and adversely affect our business, financial condition, results of operations and cash flows.

In addition, because these projects depend on technology outside of our areas of expertise in coal-fired power and heat generation, there are risks associated with our ability to develop and manage such projects profitably. At the development or acquisition stage, our ability to predict actual performance results may be hindered and the projects may not perform as predicted. Additionally, these projects can also be capital intensive and generally require us to obtain third party financing, which may be difficult to obtain. As a result, these capital constraints may reduce our ability to develop these projects in the time projected or at all, or at the costs projected. In addition, we only receive feed-in tariffs if our renewable energy assets are operational, and if the wind farm that we are currently developing in the Czech Republic (VTE Moldava) is not commissioned by June 19, 2019, it will not qualify for existing governmental support. The development of VTE Moldava relies on numerous approvals with an undefined timeline, many elements of which are not within our control. In the event that our renewable energy assets are taken offline or do not qualify for feed-in tariffs, the loss or lack of the feed-in tariff may adversely affect our financial results. Any changes to government regulations and laws, increases in taxation, lack of legislative support or the availability of authorizations and permits or difficulty obtaining licenses/permits or the financing necessary for development of our renewable energy projects could materially and adversely affect our business, financial condition, results of operations and cash flows.

#### **Risks related to governmental regulations and laws**

***Our operations are subject to significant government regulation and laws and our business, financial condition, results of operations and cash flows could be adversely affected by changes in the law or regulatory schemes.***

Our businesses are subject to increasingly strict regulation under applicable law with respect to matters such as:

- price-setting for heat and power distribution;
- permitting and licensing requirements and limitations on land use;
- unauthorized profits from power and heat sales;
- employee health and safety;
- restrictions on related-party transactions in the co-generation industry;
- air quality standards and limits on CO<sub>2</sub> released into the atmosphere;
- protection of human health, plant life and wildlife and prevention of water pollution and the discharge of materials into the environment;

- energy efficiency targets;
- grid congestion management and grid/network access;
- the decommissioning and operation of certain power plants (including potential obligations to continue operation and prohibitions on decommissioning certain power plants);
- promotion of renewable energy and/or combined heat and power, including costs due to burden-sharing mechanisms;
- use and implementation of CCS technology (carbon capture and storage);
- promotion of the construction of new power plants;
- supply and trading of energy and energy derivatives;
- provisions on security of supply and network stability; and
- tax laws.

The costs, liabilities and requirements associated with these and other laws and regulations may be extensive and may potentially delay commencement or continuation of power and heat production and distribution of power. Failure to comply with these regulations may result in the assessment of administrative, civil and criminal penalties, the imposition of clean-up and site restoration costs and liens, the issuance of injunctions to limit or cease operations, the suspension or revocation of permits and other enforcement measures that could have the effect of limiting production from our operations. We may also incur costs and liabilities resulting from claims for damages to property or injury to persons arising from our operations. We must compensate employees for work-related injuries.

In the Slovak Republic, the Ministry of Labor, Social Affairs and Family promulgated decree no. 147/2013 Coll., which requires that work at heights or above open depths in areas not protected against weather conditions at which the temperature falls below -10°C must be suspended. Such work is necessary for power distribution system operators, including Stredoslovenská energetika - Distribúcia, a.s. The Ministry of Labor, Social Affairs and Family has prepared an amendment for comment by the Slovak distribution system operators and other utility companies, and we expect that the legislation will be amended. However, if it is not amended, we believe the Slovak Energy Act, which requires us to operate the system securely, reliably, safely and effectively and maintain the quality of electricity (and ancillary service) supply, supersedes the decree. Any such limitations on our operations and the incurrence of such costs and liabilities may adversely affect our business, financial condition, results of operations and cash flows.

In addition, new legislation or administrative regulations (or new judicial interpretations or administrative enforcement of existing laws and regulations), including proposals related to the protection of the environment that would further regulate and tax the power and heat industries, may also require us or our customers to change operations significantly, incur increased costs or cease certain operations altogether.

The Third EU Energy Package was implemented in the Slovak Republic in 2012. SSE has managed to comply with the new regulatory regime and it continues to allocate adequate resources to achieve and maintain compliance with the Third EU Energy Package. However, the relevant authorities in the Slovak Republic and the European Union may enforce existing regulations more strictly than they have done in the past and may in the future impose stricter standards, or higher levels of fines and penalties for violations, than those which are in effect at present. For example, the RONI amended legislation in September 2012 which focused on the regulation of quality to introduce automatic compensation payments to customers for any failure to comply with required quality standards after January 1, 2013,

the amount of which depends on the type and duration of the violation. A general evaluation of quality standards is conducted at the end of every year to determine a distribution system operator's quality of service level. In 2011, after the introduction of quality standards for reporting and monitoring purposes only, SSE had the highest quality violation standard rate among the three DSOs distribution system operators ("DSO") in the Slovak Republic (measured as a percentage of events with respect to which a distributor system operator has failed to comply with RONI requirements out of total count of monitored events). SSE has since changed the most affected processes to comply with the quality standards. However, any material noncompliance in the future may have a material adverse effect on our business, financial condition, results of operations and cash flows.

Additionally, the DSO, SSE's subsidiary, Stredoslovenská energetika—Distribúcia, a.s. ("SSE-D") is obliged to purchase electricity from renewable energy sources at regulated prices, which are higher than market prices. The DSOs are intended to be compensated for the incentive payments they make through system operation tariffs ("SOT") collected from the final electricity consumers. The regulation currently states that all DSO's renewable energy support related costs shall be compensated and any negative balance between the DSO's costs of mandatory purchase of electricity from renewable energy prices and the SOT revenues should be taken into account when assuming new tariffs with a view to providing such reimbursement within two years. As the reimbursement takes the form of tariffs paid to the DSOs based on assumed distribution volumes, any divergence of actual volumes from the assumptions would impact the reimbursement rate. SSE-D has in the past experienced imbalances between the costs incurred from purchasing renewable energy and the tariff payments received, partially due to inadequate estimates made by RONI. High volumes of production of solar sources in the region in which SSE operates, which may be the result of favourable weather conditions or new installations, results in the costs associated with this obligation to purchase renewable energy generally exceeding the revenue associated with the reimbursement tariff. Recently these volume increases have been growing at a slower rate and since December 2013 no new major renewable energy sources have been connected to the network except for small installations built for own consumption purposes.

***The impact of the new Czech Civil Code on businesses in the Czech Republic, including ours, is subject to significant uncertainty.***

As of January 1, 2014, a broad reform of Czech private law came into effect. The Czech civil law was completely revised into a new Czech Civil Code (Act No. 89/2012 Coll., as amended) and the existing Czech Commercial Code was replaced by the new Czech Corporation Act (Act No. 90/2012 Coll., as amended). These changes will impact a wide variety of aspects of civil and corporate legal undertakings in the Czech Republic, including basic concepts of interpretation of legal acts, intentions of parties, contractual autonomy and basic corporate matters. Although certain limited market practice has developed since the introduction of the changes, it is still not possible to predict the application and interpretation of these new legal rules by Czech courts or other authorities. Relevant case law may not become available for a significant period of time, thus impacting legal certainty in the Czech Republic. We cannot influence the aforementioned factors in any way and cannot guarantee that the political, economic or legal development in the Czech Republic will be favourable to our business undertakings.

***Our operations are subject to strict environmental, heritage and health and safety regulation and enforcement and compliance with or liabilities thereunder may require significant expenditures that could adversely affect our business, financial condition, results of operations and cash flows.***

Our operations are regulated by a wide range of environmental requirements in the Czech Republic, the Slovak Republic, Hungary and the European Union, including those governing the discharge and emission of pollutants, the management and disposal of hazardous materials, the cleaning of contaminated sites and worker health and safety. For example, we are subject to regulations that impose strict standards for CO<sub>2</sub>, sulphur oxides ("SO<sub>x</sub>"), mono-nitrogen oxides ("NO<sub>x</sub>"), carbon oxide

(CO) and solid particulate matter emissions, which may restrict our ability to supply additional power and heat or require us to modify our existing operations and increase our costs of doing business. We also could incur significant costs, including civil and criminal fines or sanctions, claims for environmental damages, remediation obligations, revocation of environmental authorizations or temporary or permanent closure of facilities, as a result of violations of liabilities under environmental requirements.

We have made, and expect to continue to make, expenditures to maintain compliance with environmental laws. For example, starting in 2016, the stricter emission targets set forth by the European Industrial Emissions Directive (IED) applies for large combustion plants, including those that we operate, which required additional capital expenditures in excess of EUR 80 million for power plants in the Czech Republic (predominantly at EOP and minor technology improvements at UE and PE). Non-compliance with the stricter emission targets set forth by the European Industrial Emissions Directive, the Air Protection Act or the operation permit in the designated time periods may lead to the imposition of penalties or even result in operations being shut down.

SSE is subject to a range of environmental regulations, including regulations aimed at protecting soil and water from oil leakage from its transformer stations and birds from fatal injury resulting from its electricity network. SSE has implemented several measures to reduce the risk of liabilities arising from these regulations, including the installation of oil catching components at its transformer stations and consoles for birds. Additionally, SSE also has insurance coverage for environmental damages. See “— Our insurance coverage with respect to our operations may be inadequate and the occurrence of a significant event could adversely affect our business, financial condition, results of operations and cash flows” for information pertaining to risks associated with inadequate insurance coverage. Non-compliance with applicable environmental regulations may result in legal proceedings and penalties, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Environmental requirements are also a factor in the development of new projects and continuation of current projects. Czech, Slovak, Hungarian and EU environmental regulations have become increasingly stringent in recent years, especially in connection with the approval of new projects, and this trend may continue. The environmental impact of new projects also attracts public interest and, therefore, may be subject to political considerations and litigation that are beyond our control.

In addition, we may be liable for damages caused by our activities on properties owned by third parties and may be required by law to create and maintain reserves to cover potential liabilities arising from such damages. Our operations also increase the level of noise and may negatively impact air quality, through emissions and by creating dust, which could directly and negatively impact populated areas in the immediate vicinity of such operations and cause complaints, legal actions or administrative measures.

Our liability for any claims related to environmental impact or contamination with hazardous materials may be joint and several, so that we may be held responsible for more than our share of the remediation costs or other damages, or even for the entire share. We have from time to time been subject to claims arising out of contamination at our own and other facilities and may incur such liabilities in the future.

Future changes in environmental laws, or in the interpretation of those laws, including new or more stringent requirements related to air and wastewater emissions, new or stricter regulations and agreements related to climate change or changes in the application, interpretation or enforcement of

existing requirements could result in substantially increased operating and compliance costs, and could impose conditions that restrict or limit our operations.

***Changes in regulated tariffs or the introduction of new obligations to pay regulated tariffs could have a material adverse effect on our business, financial condition, results of operations and cash flows.***

In the Czech Republic, our heat business, which accounts for a significant portion of our sales, depends on regulated tariffs. Our renewables business in the Czech Republic also depends on regulated tariffs. Tariffs for heat, renewable energy, electricity distribution, electricity supply to certain types of customers and network access are also set by the regulatory authorities or legislatures of other countries in which we operate, including in respect of renewable energy, the Slovak Republic.

The Czech Energy Regulatory Office (“ERO”) issues pricing decisions that set forth mandatory guidelines that apply to the calculation of heat prices. These rates are comprised of (i) the economically justified costs necessary for production and distribution of heat, (ii) appropriate profit and (iii) VAT. Furthermore, the ERO sets the limit price for heat which allows the Company’s subsidiaries to set their own heat price on the condition that it is lower than the limit price and follows the calculation principles. Nevertheless, the ERO also has the right to review retroactively the operations of a heat producer for the previous 5 years with respect to the heat price setting mechanism applied by that particular entity. If the entity is not able fully to support the pricing mechanism applied, ERO can impose significant penalties which might have a material adverse effect on the Group’s business, financial condition, results of operations, cash flows and prospects. The fact that the price of heat is not set by the ERO as a fixed amount per unit, gives rise to a degree of uncertainty on the part of the operator as there is the possibility that the calculation it carried out will be assessed as incorrect by the ERO.

As regards electricity produced by cogeneration plants in the Czech Republic, the ERO also stipulates the amount of subsidy for electricity from high-efficiency cogeneration sources in its price decision in the form of a green bonus, which is set per MWh and granted on an annual or hourly basis. The price decision distinguishes between a basic tariff (which applies to cogeneration plants in general) and additional tariff (which applies only to some of them). The respective tariff is set in the price decision in CZK per MWh and has different levels depending on the size of the plant, overall time of its use during a year and the fuel it uses. It is common that the ERO issues the price decision annually, in the autumn for the coming calendar year.

In respect of power tariffs for renewables in the Czech Republic, producers of renewable energy have two different options to sell their energy: (i) by way of feed-in tariffs that provide for the mandatory purchase of renewable energy by power distribution companies at a tariff fixed by the ERO or (ii) by way of green bonuses that are determined by the ERO and that are added to the market price.

A significant portion of SSE’s revenue from electricity distribution and supply of electricity and natural gas in the Slovak Republic is derived from the regulated tariff rates charged to customers (in the case of SSE’s natural gas and electricity supply activities only in relation to households and small and medium size enterprises). Generally, the RONI sets maximum prices or regulates rules for determination of maximum prices or tariffs depending on the manner of price regulation set forth by the applicable laws. The price regulation is adopted by the RONI within a legal regulatory proceeding that commences on the basis of a proposal for a new price submitted to the RONI by the respective regulated subject or *ex officio*. In this respect, the RONI shall either approve the submitted proposal or determine the maximum price by individual decision.

The maximum price for power distribution is calculated on the basis of complex input parameters that cover only eligible costs of operation, eligible depreciation, fair (allowed) profit and expected distribution volume and capacity. The current regulatory period in respect of power distribution started on 1 January 2017 and will end on 31 December 2021. The tariff was determined as the total of OPEX, depreciation, fair (allowed) profit divided by the average distribution volume. OPEX include eligible costs necessary for providing safe and reliable distribution. Depreciation is calculated based on the regulatory asset base with reference to the technical lifetime, as set by the RONI, and used for the entire regulatory period. Fair (allowed) profit was calculated by multiplying the regulatory asset base by the weighted average cost of capital, as also set by the RONI.

The assessment of the tariff can be affected by a number of factors, including RONI's approach to the valuation of SSE's regulatory asset base or determination of eligible operating expenses, and there is no guarantee that the regulated tariffs set by RONI will be sufficient to cover SSE's future operating expenses and any costs of future infrastructure development projects.

With respect to the gas and power supply, RONI implements price regulation, inter alia, by setting the maximum price for "vulnerable" customers, defined as household customers or small enterprises (mid-market).

As a result, we are affected by the pricing decisions made by the RONI for distribution tariffs and regulated electricity and gas supply prices in the Slovak Republic that are not foreseeable. The RONI may delay or limit tariff rate increases or may decide to apply methodology for the calculation of regulated prices which is less favorable to us for various reasons. For example, the RONI has discretion when determining certain variables in tariff calculation formulae, including the value of the regulatory asset base, technical lifetimes of assets and permitted return on the regulatory asset base. Although the RONI is required to apply transparent and justifiable methodology and legal remedies might be available to us in some cases, any delays, mistakes or negative changes affecting the RONI's pricing decisions could have an adverse effect on our business, results of operations and financial conditions. Additionally, during the approval process for regulated prices, the RONI may request special downward adjustments to a power distributor's margin. Although such negotiations with the RONI during this process are typical, in the future the RONI may adopt stricter negotiating positions, which may have an adverse effect on our business, results of operations, revenue from regulated activities and financial conditions.

The legislative or regulatory authorities in the countries in which we operate may decide to limit or even block tariff increases, with no change to the quality of service, or may change the conditions of access to such regulated tariffs, including changes to the price setting mechanisms as a result of political interference. We cannot give any assurance that new tariffs would be set at a level which would allow us to preserve our short-, medium- or long-term profitability or our property interests, while ensuring a fair return on the capital invested in our power generation, distribution and supply assets. As a result, any changes in regulated tariffs, particularly those that may affect our revenues from power and heat distribution, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In addition, under the applicable legislation, the distribution system operator ("DSO") SSE-D, SSE's subsidiary, is obliged to purchase electricity from renewable energy sources at regulated prices, which are higher than market prices in support of renewable energy sources in the Slovak Republic. Whilst the SSE Group is entitled to fully recover the compensation through a special regulated tariff charged to end customers, differences and fluctuations in power consumption by end customers and power generation by renewable sources can cause a mismatch between the amounts of subsidies paid and the compensation received through the tariff charged to end customers which may result in

accumulation of deficit by the SSE Group. Although the applicable legislation provides that RONI's correction mechanism should ensure that such deficit is refunded within two years, any increase in the deficit may have a negative effect on the Group's financial condition, results of operations and cash flows between the time of incurrence of such deficit and time when the compensation for the deficit is received.

***We are exposed to changes in EU ETS and potentially also other nation-wide or regional CO<sub>2</sub> emission regulation, if applicable, in the way emissions allowances are allocated, including the conditions attaching to free allocations and the allocation of emissions allowances, as well as volatility in the market prices of emissions allowances that we need to acquire.***

In 2005, the European Union introduced the EU ETS. Within the EU ETS, each greenhouse gas emitter is allocated a certain cap by the relevant national government, which is in turn allocated a national cap by the European Commission, within which it is allowed to emit greenhouse gases (such as CO<sub>2</sub>). Any emissions in excess of this cap must be counterbalanced by emissions allowances acquired in the open market at a market price, otherwise the emitter is penalized. Allocations are fixed for a specific trading period. In 2011 and 2012, the allocation of emissions allowances without cost in the Czech Republic to CO<sub>2</sub> emission producers selling electricity to third parties was subject to a gift tax. We expensed tax of approximately EUR 15 million of such tax for the year ended December 31, 2011 and approximately EUR 8 million of such tax for the year ended December 31, 2012. Although this tax is currently only applicable for the years ended 2011 and 2012, and we recognised a refund of this tax together with related interest in revenue (in the amount of EUR 13.2 million) in 2015 based on their claim backed up by the preliminary ruling of the European Court of Justice and the judgment of the Supreme Administrative Court, any extension or amendment to such tax legislation or introduction of any similar tax in the future, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

In the trading periods after 2012, the majority of, or potentially all emissions allowances for the power generation sector are sold in auctions rather than allocated for free. However, the Czech Republic has received a partial exemption from this change. The scope of this emissions allowance derogation is limited to installations that began power generation before December 31, 2008 or for which the investment process was "physically initiated" by that date. All our Czech power plants are covered by the derogation. The extension period will last from 2013 to 2019, and the free allowance extension is limited to no more than 70% of emissions for domestic electricity supply in 2013 and approximately 60% in 2014, declining annually thereafter to zero from 2020 onwards. The EU ETS Directive requires that installations benefitting from free allocations under the derogation invest in projects designed to modernize power generation in the Czech Republic. The value of these investments must mirror the value of the free allocation of emissions allowances, which we continue to achieve through our investments in our existing power plants, facilities and infrastructure to comply with this requirement. Different principles apply under the EU ETS Directive to heat; according to these principles, district heating CHP plants shall receive free allowances for heat supply from 2013 to 2027. The derogation is available to all Member States, but is limited in terms of eligibility and quantity. All district heating and highly efficient cogeneration plants are eligible, regardless of the commissioning date. However, the EU ETS Directive sets a limit of a maximum of 80% of free allowances in 2013 with a gradual decline in subsequent years to reach 30% in 2020. Further gradual decline will reach zero free emissions allowances in 2027. As this decline of free emissions allowances will lead to an increase in market demand, since market participants will likely need to increase the volume of the allowances purchased to meet their volume targets, prices will likely increase as well. Contrary to the free emission allocation extension granted for power generation in the Czech Republic, the EU ETS Directive does not require heating plants benefitting from the free allocation under the derogation to invest in any projects. Since January 1, 2013, we have had to buy emissions allowances on the market, and over time the proportion of emissions allowance we are required to purchase will increase as available free allowances are



gradually eliminated. Moreover, as the number of allowances gradually declines during the respective derogation periods, we expect the price of allowances on the market to gradually increase. As a result, our emission allowance allocation remains uncertain and our costs may increase significantly, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, we will be more vulnerable to risks relating to volatility in the price of emissions allowances.

Moreover, the market price for emissions allowances may be affected by external interventions. For example, the Commission adopted the Commission Regulation (EU) No 176/2014, which entered into force on 27 February 2014 and which postponed (“back-loaded”) the auctioning of 900 million allowances originally scheduled for allocation in 2014-2016 until 2019-2020. The effects of the back-loading on the amounts of available emission allowances can be summarised as follows:

Year	Volume of reduction	Volume of increase
2014	400 million	-
2015	300 million	-
2016	200 million	-
2017	-	-
2018	-	-
2019	-	300 million
2020	-	600 million

Furthermore, the EU ETS overall cap may need to be further reduced in connection with the target of a 40% reduction in EU greenhouse gas emissions below 1990 levels by 2030 as set out in a proposed policy framework for climate and energy in the period from 2020 to 2030 proposed by the Commission in January 2014 in a Communication to, inter alia, the EU Parliament and the European Council EU (the “2030 Climate and Energy Framework Proposal”). In order to achieve this goal, the cap may need to be lowered by 2.2% per year from 2021, compared with the current 1.74%. Further details are expected to be contained in the future legislation implementing the 2030 Climate and Energy Framework Proposal.

In January 2014, the EU Commission presented a proposal for legislation to establish a market stability reserve after 2020 providing for an automatic adjustment of the supply of auctioned allowances downwards or upwards based on a pre-defined set of rules with the goal of enhancing market stability. This proposal does not constitute binding legislation and will be subject to further discussion before potentially being adopted.

The long-term efforts on emissions reductions were further supported by the outcome of the agreement reached in Paris on December 12, 2015 by the parties to the United Nations Framework Convention on Climate Change (the “Paris Agreement”), which embodies a commitment of limiting global temperature increase to below 2 degrees Celsius and closer to 1.5 degrees. Each signatory is to develop its own implementation plan known as the “Nationally Determined Contribution” (NDC), while the EU’s proposed implementation is through a single set of NDCs for the entire EU, mostly by relying on regulatory initiatives that were already underway (including the EU’s existing energy strategy). In order to achieve the goals set by the Paris Agreement, the EU intends to, among others: (i) continue its existing initiative of using market forces to cut emissions, while the EU ETS will be reformed to ensure it is more responsive to changes in market conditions (reflecting on recent low prices for permits as a result of the glut of permits after the periods of low economic growth), (ii) introduce a new EU Renewable Energy Directive in 2016, with the aim of achieving the binding EU-level target of at least

27% renewable energy by 2030, (iii) increase the share of renewables in the energy mix as well as encourage further investments in an appropriate backup in the form of other non-polluting sources of energy, and (iv) set a priority to the energy efficiency (improve labelling requirements as to energy consumption, etc.).

A continual decrease in the allocation of emissions allowances across the European Union and, potentially, a greater decrease in the allocation of emissions allowances than is provided for under the current scheme in the next allocation period and, any increase in the price of emissions allowances, as well as further measures to be taken in order to achieve emissions reductions anticipated by the Paris Agreement, may result in a substantial increase in variable generation costs making the price of electricity and heat offered by the Group uncompetitive, which would have a material adverse effect on the Group's business, financial condition, results of operations, cash flows and prospects.

Furthermore, additional changes in policies or change in perception of the value of emission allowances may cause the price of the emission allowances to increase substantially in the future, which would have a material adverse effect on our business, financial condition, results of operations and cash flows.

***We have no control over the security and operational processes of the national registries for emissions allowances within Europe.***

We own a significant number of emissions allowances and emission credits, which are registered as intangible assets by national registries in individual EU countries. National emissions allowances and emission credits registries are operated by independent governmental bodies and are governed by EU law. We have no control over or influence on the security and operational processes of these national registries. The financial value of our assets registered in such registries is significant and a change in the quantity of permitted emissions represented by our allowances and credits or an unauthorized transfer on the relevant registries of such allowances and credits to another party could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***RONI and the Czech Energy Regulatory Office (ERO) have a wide regulatory scope.***

The business operations of our operating subsidiaries and certain personnel changes are subject to the regulatory decisions of RONI and ERO. RONI and ERO have broad regulatory powers, including adoption of secondary legislation, setting regulatory policy and setting the regulation of energy prices, quality and other matters. The development of RONI's and ERO's scope of influence and the impact it may have on the operations of our operating subsidiaries is out of our control.

***Changes in the European Union's and Member States' renewable energy policies and an accelerated market shift towards renewable energy sources and a focus on increased energy efficiency could have a material adverse effect on our business, financial condition, results of operations and cash flows.***

The power generation industry in Europe is strongly influenced by the European Union's policy, implemented in 2008 by the EU Climate and Energy Package, to increase the share of electricity generated by renewable energy sources. Furthermore, individual Member States have renewable energy policies, some of which are more progressive than the EU's policy. We are effectively obliged, due to economic incentives, to reflect these policies within our own strategy. Furthermore, support for renewable sources may decrease energy prices, limit production time, decrease the stability of transmission and the distribution grid, cause grid congestion, limit the profitability of distribution services provided by us and the production quantity of conventional power plants that we operate, and may decrease our market share. Continued or increased support for renewable energy sources in the European Union, particularly in the Czech Republic and Germany, may adversely affect our profit

from coal-fired and gas power plants, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The Directive 2012/27/EU (Energy Efficiency Directive (“EED”)), which targets a 20% increase in energy efficiency by 2020, entered into force on December 4, 2012, obliges Member States to set national energy efficiency targets, report any progress achieved towards these targets to the European Commission by April 30 of each year from 2013 and imposes mandatory energy-savings schemes on utility companies and energy audits on large companies, which may require substantial capital expenditure by such companies. The EED states that high-efficiency cogeneration and district heating have significant potential for saving primary energy and Member States should carry out a comprehensive assessment of the potential for high-efficiency cogeneration and district heating. New power generation installations and existing installations, which are substantially refurbished or whose permits or licenses have been renewed, should, subject to a cost-benefit analysis showing a cost-benefit surplus, be equipped with high-efficiency cogeneration units to recover waste heat stemming from the production of electricity. The EED further states that Member States should encourage the use of financing incentives to further the objectives of the EED. Such financing incentives could include financial contributions and fines resulting from non-fulfilment of certain provisions of the EED, resources allocated to energy efficiency under EED and in the Multiannual Financial Framework, which regulates the EU’s annual budget, cohesion, structural and rural development funds and dedicated European financial instruments.

Pursuant to the EED, as an alternative to setting up an energy efficiency obligation scheme, Member States may opt to take other policy measures to achieve energy savings among final customers. The annual amount of new energy savings achieved through this approach would be equivalent to the amount of new energy savings required by the energy efficiency obligation scheme option. *Provided* that equivalence is maintained, Member States may combine obligation schemes with alternative policy measures, including national energy efficiency programs. The policy measures may include, but are not limited to:

- the implementation of energy or CO<sub>2</sub> taxes that have the effect of reducing end-use energy consumption,
- financing schemes and instruments or fiscal incentives that lead to the application of energy-efficient technology or techniques and have the effect of reducing end-use energy consumption,
- regulations or voluntary agreements that lead to the application of energy-efficient technology or techniques and have the effect of reducing end-use energy consumption,
- standards and norms that aim at improving the energy efficiency of products and services, including buildings and vehicles, except where these are mandatory and applicable in Member States under EU law,
- energy labeling schemes, with the exception of those that are mandatory and applicable in the Member States under EU law, and
- training and education, including energy advisory programs that lead to the application of energy-efficient technology or techniques and have the effect of reducing end-use energy consumption.

To meet these targets once they are implemented into national law we may require substantial capital expenditure. This could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***State support for certain power generation sources could have a material adverse effect on our business, financial condition, results of operations and cash flows.***

The Czech Renewable Energy Act requires distribution companies to purchase certain amounts of electricity from environmentally friendly “co-generation,” “small hydro,” “decentralized” or “renewable” facilities. This results in significantly higher state support for small generation sources. This support may be in the form of regulated subsidized prices or preferential access for these generation sources to the distribution grid. While we believe that these purchases of electricity by the distribution companies and the preferential treatment of renewable sources will not substantially adversely affect the generation volumes of our conventional generation facilities, we cannot provide any assurance that this will in fact be the case or that the price at which we can sell our power to supply companies will not decrease, which could in turn have a material adverse effect on our business, financial condition, results of operations and cash flows.

The Slovak Republic currently operates a system of subsidies to support electricity generation from renewable energy sources and highly efficient cogeneration, such as combined heat and power production plants. We are obliged to purchase electricity from renewable energy sources which meet certain criteria at a price which is above the market price. We are also obliged to prioritize the supply of such electricity over supply from other sources. SSE is especially affected by this regime as it operates in a region of the Slovak Republic that has a high level of renewable energy production. The additional costs incurred by us in these activities are generally recoverable through a special tariff charged to the end consumers and self-producers, but the amount of such tariff and the time for its recovery depends on a number of conditions and factors, including approval by the RO and the degree of volatility in generation from renewable energy sources. Any deficit or surplus resulting from support for renewable energy sources should be compensated by the RONI through a correction mechanism over two years, which can result in a cash flow disadvantage to us from time to time.

***Our exposure to several tax jurisdictions may have an adverse effect on us.***

Although a substantial part of our operations are located in the Czech Republic, the Slovak Republic and Hungary, we are subject to the tax laws of several other jurisdictions, including the Netherlands. The EPE and/or any of its subsidiaries may be treated as being resident for tax purposes and/or otherwise subject to tax in jurisdictions other than its place of incorporation. The effect of the application of the tax laws of multiple jurisdictions, including the application or disapplication of tax treaties concluded by the relevant countries, and/or variation in interpretation by the relevant tax authorities could, under certain circumstances, produce contradictory results and related tax liabilities for us, and may materially and adversely affect our business, financial condition, results of operations and cash flows.

***We are subject to risks in connection with the tax positions taken in the course of our business.***

We take tax positions in the course of our business with respect to various tax matters, including but not limited to a company and/or group restructuring(s), taxation of foreign exchange results, compliance with the arm’s length principles in respect of transactions with related parties, exemption of various revenues from taxation and tax deductibility of interest and other costs and the amount of depreciation or write-down on assets we can recognize for tax purposes.

As a vertically integrated group, we are in the process of concluding and will continue to conclude in the future, a significant number of transactions with related parties across various jurisdictions. Specifically, these cross-border transactions relate and/or might relate to the sale/purchase of fuels, emissions allowances and purchase/provision of certain services, as well as other transactions such as cross-border financing transactions. Even though the EPE and its subsidiaries try to carefully follow the arm’s length principle as well as general standards in respect of dealings with affiliates, we cannot

preclude potential disputes with the tax authorities which may, in fact, challenge any transaction at their discretion. In particular, regarding transactions for which there is no established market price, we may be subject to claims/challenges by tax and/or other authorities. Also for transactions for which there is an established market price or for which there are available comparable transactions on the market, the tax authorities may still challenge any such transaction arguing to be off the market (price) and thus aimed to reduce or even avoid payment of taxes. Therefore, for instance, financing transactions may be challenged in terms of applied interest rates and/or suitability of the financing itself, prices for heat, energy, raw materials and/or services may be challenged in terms of appropriateness of method applied, determination of appropriate base for calculation(s), applied profit margin(s), reflection of changes (and their frequency) in the market terms affecting the calculation(s), etc.

EPE and/or its subsidiaries have been subject to corporate restructuring in the past, therefore may be subject to taxes in relation to such restructurings, which have not yet been identified.

In case tax authorities disagree with our position taken and take a different position on any interpretive matter and/or challenge any tax position taken by us in any transaction, we may be subject to additional tax liabilities and/or penalties that may have an adverse effect on our business, financial condition, results of operations and cash flows.

With reference to the above, EPE and/or its subsidiaries are exposed to the risk of changes in tax legislation, changes or variations in interpretations or approaches by the tax authorities, and changes in the tax climate in general or as a consequence of certain wider initiatives such as for instance outcomes of the OECD/G20/EU Base Erosion and Profit Shifting Project/Initiative ("BEPS Project"). BEPS Project, which is generally aimed to address tax avoidance and to combat tax planning strategies that exploit gaps and mismatches in tax rules to shift profits artificially to low or no-tax locations, consists of 15 identified action points aimed to tackle international tax avoidance. After a two-year consultation process, the OECD/G20 in early October 2015 published deliverables on those 15 actions. As of now, the OECD/G20 has developed an inclusive framework on BEPS and currently the main focus is on the monitoring of implementation for the four minimum standards (Action 5, Action 6, Action 13 and Action 14) as well as setting up the review mechanism for other elements of the BEPS framework. Although it is currently still hard to predict and assess impact of the BEPS project on EPE and/or its subsidiaries, certain aspects such as (not limited to) increased (tax) reporting obligations are expected. In addition, EPE and/or its subsidiaries may be affected by changes in tax law following implementation of certain BEPS requirements/recommendations (e.g. changes in the thin can rules), change(s) in interpretations and/or application of double tax treaties, in interpretations and applicability of various (previously issued) tax regulations and/or interpretations, and/or new or adjusted requirements and interpretations concerning the transfer pricing area. We can't even exclude a situation that tax authorities will – in light of the BEPS Project and its outcomes and recommendations – apply those outcomes and recommendations retrospectively. In case tax authorities disagree with our position taken and take a different position on any interpretive matter and/or challenge any tax position taken by us in any transaction, we may be subject to additional tax liabilities and/or penalties that may have an adverse effect on our business, financial condition, results of operations and cash flows.

***We could incur unforeseen taxes, tax penalties and/or sanctions or could lose tax exemptions and benefits, which could adversely affect our business, financial condition, results of operations and cash flows.***

Generally, we are exposed to the changes in the tax legislation and/or its interpretation (either by tax authorities or relevant courts of particular countries or Court of Justice at the EU). Any such change may have an adverse effect on our business, financial condition, results of operations and cash flows.

A number of EU Member States, as a response to the significant budget deficits caused, among other reasons, by lower tax revenues related to slow economic growth and the global economic downturn experienced in the previous years, imposed new taxes and/or similar charges on the electricity generation and utilities sector. For instance, we may mention (i) special sector levies enacted in Slovakia (currently similar measures are from time to time also part of the political discussions in the Czech Republic), (ii) so called Robin Hood taxes were enacted in Hungary and Italy (in the latter case already abolished by the court as unconstitutional), or (iii) gift taxes on emission allowances in the Czech Republic. In addition, EPE and/or its subsidiaries are exposed to a risk of volatility in the market prices of necessary emissions allowances as well as additional taxation following political actions aimed at reduction of (deemed) excessive profitability of certain forms of energy production (e.g. solar plants, biomass plants). In this respect, tax and/or other authorities may tend to take a more aggressive approach in challenging tax positions taken by tax payers, including EPE and its subsidiaries. In addition, certain countries – either as a response to the budget deficits, with intention to increase its tax collections, and/or arguing for combat against tax frauds – are more aggressive in the way of interpretation of the relevant tax legislation, collection of taxes and application of available tools.

For instance, Czech government enacted in 2011 a gift tax for emissions allowances, in respect of which we expensed a tax of ca EUR 15 million in 2011 and ca EUR 8 million in 2012.

Due to the recent global financial and economic crisis, the Slovak Republic experienced a deterioration in its public finances. To reduce its public deficit, the Slovak Republic conducted fiscal consolidation under which it imposed measures such as a special levy on businesses in regulated industries, including the energy sector. The special sector levy is payable by any regulated entity, i.e. a licensed entity with revenues from regulated business activities exceeding 50% of the total company's revenues for the respective accounting period. The special sector levy, which was originally planned to be in force until the end of 2013, has been extended until the end of 2016. In the second half of 2016, it was decided that the levy is to be further extended until end of 2021. The rate of special levy in 2017 is even increased to higher level with a decreasing trend until 2021. The imposition of any new taxes or the increase of the current taxes in the Slovak Republic could have an adverse effect on our business, results of operations and financial condition of the impacted subsidiaries and, accordingly, EPE.

Further, a special levy is imposed on Hungarian companies operating in the energy sector (mining, electricity generation, electricity trading, electricity distribution, electricity universal service, gas trading, gas distribution, and gas universal service) pursuant to a separate act from 2008 (évi LXVII. törvény a távhőszolgáltatás versenyképesebbé tételéről; in English: law on the competitive position of district heating). Originally, it was to remain in place until 2010 but it remained to be in force and is expected to continue in the future. Since the tax obligation arises only on electricity generation and trading in the case of BERT which performs other activities as well, the tax base needs to be split using the proportion of electricity trading and generation revenues compared to the total revenues, which meant 50-52% in previous years. The tax rate is 31% since 2013 and is expected to stay at this level in future.

In early 2013, the European Commission adopted a proposal for a directive on a common financial transactions tax (the "FTT") to be implemented under the enhanced cooperation procedure by eleven Member States (including Slovakia). The proposed FTT has a very broad scope and could, if introduced in its current form, apply to exchanges of financial instruments (including secondary market transactions) in certain circumstances. Under current proposals, the FTT could apply also to persons outside the participating member states if at least one party is established in a participating member state. The FTT proposal remains subject to negotiations between the participating member states. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate. Given the lack of certainty surrounding the FTT proposal

and its implementation, it is not possible to predict what effect the proposed FTT might have on the Group or its subsidiaries, which could have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

Operators of certain solar electricity producing facilities in the Czech Republic (which have started its operations between January 1, 2009 and December 31, 2010) were subject to a Czech withholding tax in the amount of (i) 26% of the income corresponding to the feed-in tariff, or (ii) 28% of the income corresponding to a "green bonus." Through our wholly owned subsidiary POWERSUN a.s., we own and operate three solar power facilities with an installed capacity of 3.2 MW<sub>e</sub> and we own a 41.7% ownership interest in the Greeninvest Energy, a.s. solar facility, with an installed capacity of 4.0 MW<sub>e</sub> in the Czech Republic. Three of these solar power facilities were put into operation between 2009 and 2010 and were therefore subject to the withholding tax. Effective from January 1, 2014, taxation was amended in terms that the operators of certain solar power facilities in the Czech Republic put into operation between January 1, 2010 and December 31, 2010 are newly subject to a Czech withholding tax in the amount of (i) 10% of the income corresponding to the feed-in tariff or (ii) 11% of the income corresponding to a "green bonus". The tax is to be applied from January 1, 2014 and continue for the duration of the period during which the respective facility has the right to claim the subsidy. We cannot predict any further future changes in the tax legislation, and any extension or amendment to such tax legislation or introduction of other similar tax in the future, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The imposition of any new taxes in the countries in which we operate, or changing interpretations or application of tax regulations by the tax authorities, harmonization of Czech and EU tax law and regulation, significant tax disputes with tax authorities, any change in the tax status of any member of our Group, extensive time periods relating to overdue liabilities and the possible imposition of penalties and other sanctions due to unpaid tax liabilities may result in additional amounts being payable by us, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We have been subject to corporate restructuring in the past, we may be subject to taxes in relation to such restructurings, which have not yet been identified.

### **Risks related to our financial profile**

#### ***Our substantial leverage and debt service obligations could adversely affect our business and prevent us from fulfilling our obligations with respect to the Notes.***

We have a substantial amount of outstanding indebtedness. As of December 31, 2016, we had total loans and borrowings excluding Financial instruments and financial liabilities of EUR 1,136 million (this excludes a loan from PTH to PTHI as of December 31, 2016 of EUR 14 million, which is expected to be offset with dividends assumed to be declared by PTH in 2017).

The level of our indebtedness could have important consequences to holders of the Notes, including, but not limited to:

- making it difficult for us to satisfy our obligations with respect to the Notes;
- increasing our vulnerability to, and reducing our flexibility to respond to, general adverse economic and industry conditions;
- requiring the dedication of a substantial portion of our cash flow from operations to the payment of principal of, and interest on, indebtedness, thereby reducing the availability of such cash flow for, and limiting the ability to obtain additional financing to fund, working capital, capital expenditures, acquisitions, joint ventures or other general corporate purposes;

- limiting our ability to borrow additional funds and increasing the cost of any such borrowing;
- restricting us from making strategic acquisitions or exploring business opportunities;
- limiting our flexibility in planning for, or reacting to, changes in our business and the competitive environment and the industry in which we operate; and
- placing us at a competitive disadvantage compared to our competitors, to the extent that they are not as highly leveraged or have greater financial resources.

Any of these or other consequences or events could have a material adverse effect on our ability to satisfy our debt obligations, including the Notes.

We may be able to incur substantial additional indebtedness in the future. Although the Indentures contain restrictions on the incurrence of additional secured indebtedness, these restrictions are subject to a number of significant qualifications and exceptions, and under certain circumstances, the amount of indebtedness that could be incurred in compliance with those restrictions could be substantial. In addition, the Indentures do not prevent us from incurring obligations that do not constitute indebtedness under those agreements, and the Indentures do not prevent us from incurring unsecured indebtedness. Moreover, some of the indebtedness we may incur in the future could be structurally senior to the Notes and may be secured by collateral that does not secure the Notes.

***We are subject to restrictive debt covenants that may limit our ability to finance our future operations and capital needs and to pursue business opportunities and activities.***

The Indentures governing the Notes include covenants limiting our ability to:

- make investments or other restricted payments;
- transfer or sell Collateral;
- engage in transactions with affiliates;
- create liens on assets to secure indebtedness;
- impair security interests; and
- merge or consolidate with or into another company.

The terms of the indebtedness at our subsidiaries also include a variety of affirmative and negative covenants. All these limitations are subject to significant exceptions and qualifications. The covenants to which we are subject could limit our ability to finance our future operations and capital needs and our ability to pursue business opportunities and activities that may be in our interest.

Moreover, terms of certain indebtedness of EPE and its subsidiaries may restrict EPE or such subsidiaries from making distributions, which may in turn adversely affect the EPE's ability to service its indebtedness or to pay dividends.

***Our failure to comply with the covenants under the Indentures or under other agreements governing our indebtedness, including as a result of events beyond our control, could result in an event of default which could materially and adversely affect our financial condition, financial returns and results of operations.***

Our ability to comply with the covenants and restrictions under the Indentures and other agreements governing our indebtedness may be affected by events beyond our control. These include prevailing economic, financial and industry conditions.

If an event of default occurs under the Indentures or any other of our debt instruments and is not cured or waived, borrowings under any other debt instruments that we have outstanding, including



the Notes, that contain cross-acceleration or cross-default provisions may also be accelerated or become payable on demand, together with accrued and unpaid interest and other fees payable thereunder.

***We require a significant amount of cash to service our debt and sustain our operations. Our ability to generate sufficient cash depends on many factors beyond our control.***

Our ability to make payments on and to refinance our debt, to fund working capital, and to make capital expenditures, will depend on our future operating performance and ability to generate sufficient cash. This depends on the success of our business strategy and on general economic, financial, competitive, market, legislative, regulatory and other factors, as well as the other factors discussed in these “Risk factors,” many of which are beyond our control.

We cannot assure you that our business will generate sufficient cash flows from operations, that revenue growth, cost savings and operating improvements will be realized or that future debt and equity financing will be available to us in an amount sufficient to enable us to pay our debts when due, including the Notes, or to fund our other liquidity needs. See “Management’s discussion and analysis of financial condition and results of operations—Liquidity and capital resources of the EPE Group.”

If our future cash flows from operations and other capital resources are insufficient to pay our obligations as they mature or to fund our liquidity needs, we may be forced to:

- reduce or delay our business activities and any capital expenditures;
- sell assets;
- discontinue specified operations;
- obtain additional debt or equity capital; or
- restructure or refinance all or a portion of our debt, including the Notes, on or before maturity.

We cannot assure you that we would be able to accomplish any of these alternatives on a timely basis or on satisfactory terms, if at all. Any failure to make payments on the Notes on a timely basis would likely result in a reduction of our credit rating, which could also harm our ability to incur additional indebtedness. In addition, the terms of our debt, including the Notes, limit, and any future debt may limit, our ability to pursue any of these alternatives. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business, financial condition and results of operations. There can be no assurance that any assets which we could be required to dispose of can be sold or that, if sold, the timing of such sale and the amount of proceeds realized from such sale will be acceptable.

***Derivative transactions may expose us to unexpected risk and potential losses.***

We are party to certain derivative transactions, such as interest rate and foreign exchange rate swap contracts and commodity derivative contracts, with financial institutions to hedge against certain financial and other risks. Changes in the fair value of these derivative financial instruments that are not cash flow hedges are reported in income, and accordingly could materially affect our reported income in any period. Moreover, in light of current economic uncertainty and potential for financial institution failures, we may be exposed to the risk that our counterparty in a derivative transaction may be unable to perform its obligations as a result of being placed in receivership or otherwise. In the event that a counterparty to a material derivative transaction is unable to perform its obligations thereunder, we may experience losses that could materially adversely affect our financial condition, financial returns and results of operations.

Additionally, we cannot guarantee that we will be successful in hedging against all interest rate and commodity price risks although we enter into derivative transactions to hedge against such risks.

***The results of PT, SSE and BERT are fully consolidated in the financial statements of EPE however EPE owns less than a 100% ownership interest in each entity.***

As of July 1, 2012, PT's financial results are fully consolidated in the consolidated income statement of the EPE Group; however, EPE owns only a 73.8% ownership interest in PT. The results of PT are fully consolidated, because the PT is a "subsidiary" of, and is controlled by, or it is controlled by, EPE. Because the results are fully consolidated, but EPE only owns a 73.8% interest, we have access to less than 100% of the EBITDA and net assets of PT.

As of December 16, 2013, SSE's financial results are fully consolidated in the consolidated income statement of the EPE Group; however, EPE owns only a 49% interest in SSE. The results of SSE are fully consolidated because SSE is controlled by EPE through the shareholders' agreement with, inter alia, the NPF, the majority owner of SSE. Because the results are fully consolidated, but EPE only owns a 49% interest, we have access to less than 100% of the EBITDA and net assets of SSE.

As of December 1, 2015, BERT's financial results are fully consolidated in the consolidated income statement of the EPE Group; however, EPE owns only approximately a 95.6% ownership interest in BERT. The results of BERT are fully consolidated, because the BERT is a "subsidiary" of, and is controlled by, or it is controlled by, EPE. Because the results are fully consolidated, but EPE only owns approximately a 95.6% interest, we have access to less than 100% of the EBITDA and net assets of BERT.

See Notes 37 and 6 to EPE's financial statements for the year ended December 31, 2016.

***Market perceptions concerning the instability of the euro, the potential re-introduction of individual currencies within the Eurozone, or the potential dissolution of the euro entirely could have adverse consequences for us with respect to our outstanding debt obligations, such as the Notes, that are euro-denominated.***

As a result of the recent credit crisis in Europe, in particular in Greece, Italy, Ireland, Portugal and Spain, the European Commission created the European Financial Stability Facility (the "EFSF") and the European Financial Stability Mechanism (the "EFSM") to provide funding to Eurozone countries in financial difficulties that seek such support. In March 2011, the European Council agreed on the need for Eurozone countries to establish a permanent stability mechanism, the European Stability Mechanism (the "ESM"), to be activated by mutual agreement and to assume the role of the EFSF and the EFSM in providing external financial assistance to Eurozone countries after June 2013. In December 2011, the European Council and each Eurozone country agreed to a package of measures designed to restore confidence and address the continued tensions in financial markets, including (i) bringing forward implementation of the ESM from June 2013 to as soon as Member States representing 90% of the capital commitments to the ESM have ratified the ESM Treaty, which occurred on September 27, 2012 and (ii) a new fiscal compact between all 18 Eurozone countries and, subject to parliamentary vote, all other non-eurozone countries (except the United Kingdom) to put deficit restrictions on Member State budgets, with associated sanctions for those Member States who violate the specified limits. Despite these measures, concerns persist regarding the debt burden of certain Eurozone countries and their ability to meet future financial obligations, the overall stability of the euro and the suitability of the euro as a single currency given the diverse economic and political circumstances in individual Member States. These and other concerns could lead to the re-introduction of individual currencies in one or more Member States or, in particularly dire circumstances, the possible dissolution of the euro entirely. Should the euro dissolve entirely, the legal and contractual consequences for holders of euro-denominated obligations and for parties subject to other contractual provisions

referencing the euro such as supply contracts would be determined by laws in effect at such time. These potential developments, or market perceptions concerning these and related issues could have adverse consequences for us with respect to our outstanding debt obligations that are euro-denominated, such as the Notes and, as we have a substantial amount of debt denominated in euro, our financial condition may be materially affected. Furthermore, the Indentures contain covenants restricting our and our subsidiaries' corporate activities. See "—We are subject to restrictive debt covenants that may limit our ability to finance our future operations and capital needs and to pursue business opportunities and activities." Certain of such covenants impose limitations based on euro amounts (e.g., the amount of additional indebtedness we or our subsidiaries may incur). As such, if the euro were to significantly decrease in value, the restrictions imposed by these covenants would become tighter, further restricting our ability to finance our operations and conduct our day-to-day business.

These risks and others described under "Risk factors" are not exhaustive. Other sections of this Report describe additional factors that could adversely affect our business, financial condition, results of operation, cash flows, reserves and the development of the industry in which we operate. New risks can emerge from time to time, and it is not possible for us to predict all such risks, nor can we assess the impact of all such risks on our business or the extent to which any risks, or combination of risks and other factors, may cause actual results to differ materially from those contained in any forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Given these risks and uncertainties, you should not rely on forward-looking statements as a prediction of actual results.

Any forward-looking statements are only made as of the date of this Report and we do not intend, and do not assume any obligation, to update forward-looking statements set forth in this Report. You should interpret all subsequent written or oral forward-looking statements attributable to us or to persons acting on our behalf as being qualified by the cautionary statements in this Report. As a result, you should not place undue reliance on these forward-looking statements.

## Management's discussion and analysis of financial condition and results of operations

### Overview of the EPE Group

We are a leading vertically integrated energy utility focusing on heat and power generation and distribution, as well as energy supply and trading. We generate a substantial percentage of our EBITDA in the Czech Republic, the Slovak Republic, where our principal operations are located. In addition, through the acquisition of BERT in December 2015 we entered the Hungarian market. For the year ended December 31, 2016, the EPE Group had sales and consolidated EBITDA of EUR 1,842 million and EUR 293 million, respectively. A significant part of our business comes from regulated activities (*i.e.*, heat and power distribution and renewable energy), and business contracted through long-term agreements with a stable customer base (*i.e.*, grid balancing services as part of our power generation activities), which we believe provides us with resiliency of cash flows and future performance.

### Principal operating subsidiaries of the EPE Group

The EPE Group's principal operating subsidiaries are Elektrárny Opatovice, a.s. ("EOP"), Pražská teplárenská a.s. ("PT"), United Energy, a.s. ("UE"), Stredoslovenská energetika, a.s. ("SSE"), EP ENERGY TRADING, a.s. ("EPET"), and Budapesti Erőmű Zrt ("BERT"). EOP, PT, UE and BERT operate in the Heat Infra segment and SSE with EPET operate in the Power Distribution and Supply segment. Together these subsidiaries accounted for the vast majority of the EPE Group's sales and EBITDA for the year 2016.

For a list of EPE's other subsidiaries and minority interests, see Note 37 to EPE's consolidated financial statements as of and for the year ended December 31, 2016.

### EPE operating segments

We operate in the following reportable segments:

- Heat Infra,
- Power Distribution and Supply,
- Renewables,
- Holding,
- Other.

Heat Infra and Power Distribution and Supply are the core segments of the Group.

Until April 1, 2016 the Group also operated Mining segment which was disposed as part of the reorganization of EP Infrastructure, a.s. ("EPIF") in 2016 (see the section Key developments - German assets sale). Mining segment was classified as discontinued operation in 2015 (for details please see section Reorganization) and therefore did not affect the EBITDA of 2016 and 2015.

### Heat Infra

The Heat Infra segment owns and operates four large-scale combined heat and power plants (CHPs) in the Czech Republic operated in highly efficient cogeneration mode and represented primarily by: Elektrárny Opatovice, a.s., United Energy, a.s., Plzeňská energetika a.s. ("PE") and Pražská teplárenská a.s., which is operating the largest district heating system in the Czech Republic, supplying heat to the City of Prague. The heat generated in its cogeneration power plants is supplied mainly to retail customers through well maintained and robust district heating systems that the EPE Group owns in most of the cases. The segment also includes Budapesti Erőmű Zrt acquired in December 2015, which is a leading heat and power producer in Hungary, operating three Combined Cycle Gas Turbine ("CCGT") plants in the Budapest area. In addition, EPE disposed Pražská teplárenská LPZ, a.s. ("LPZ")

on June 1, 2016 therefore the below data include its operations in relevant period in 2015 and until June 1 in 2016.

The segment also included Saale Energie GmbH and Helmstedter Revier GmbH until April 1, 2016. These entities were classified as discontinued operations in 2015 therefore these entities do not affect the EBITDA of 2015 and 2016 and subsequently were disposed as part of the reorganization of EP Infrastructure, a.s. ("EPIF") in 2016 (see the section Key developments - German assets sale).

### ***Power Distribution and Supply***

The Power Distribution and Supply segment consists of a Power Distribution division and a Supply division. The Supply division primarily supplies power and natural gas to end-consumers in the Czech Republic and Slovakia. The Power Distribution division purchases and sells in the wholesale market power generated by the Heat Infra segment and purchases from external sources and purchases electricity and natural gas to supply customers through the Supply division. In addition, this segment reports distribution of electricity in the central Slovakia region. This segment is mainly represented by SSE, EPET, EP Sourcing, a.s. ("EPS") and EP Cargo a.s. ("EPC").

### ***Renewables***

The Renewables segment owns and operates three solar power plants and holds a minority interest in an additional solar power plant and a majority interest in one wind farm in the Czech Republic. The Group also owns two solar power plants in Slovakia, and a biogas facility in Slovakia.

The segment also included Mibrag Neue Energie until April 1, 2016 that was classified as discontinued operation in 2015 therefore does not affect the EBITDA of 2015 and 2016 and the entity was disposed as part of the reorganization of EP Infrastructure, a.s. ("EPIF") in 2016 (see the section Key developments - German assets sale).

### ***Holding***

The Holding and other segment mainly represents EP Energy, a.s. as a holding company. The segment profit therefore primarily represents dividends received from its subsidiaries and results from acquisition accounting.

### ***Other***

The segment Other consists of minor operations not fitting to our key segments.

### ***Reorganization***

As part of the reorganization of EPIF in 2016, the Company sold-off its power generation activities in Germany as well as its mining operations in Germany to its ultimate parent company EPH (effective on April 1, 2016). The decision to sell-off these activities, which comprise an isolated geographical segment (Germany), was reached at the end of 2015. Due to the fact that these operations were predominantly representing the whole German operations, mining operations and condensation power production, the Company presents these activities as discontinued operations as of and for the for the year ended December 31, 2015. Gain on disposal of the German assets is presented as part of profit (loss) from discontinued operations in the statement of comprehensive income for the year ended December 31, 2016 (i.e. does not affect EBITDA).

The operating data are based on the results of the respective entities on a 100% basis for the full period, regardless of the date when each entity joined the EPE Group or the ownership share of the EPE Group in each entity (unless stated otherwise). Furthermore, the operating data do not include results of the German assets that are presented within discontinued operations.

For the purpose of the Chapter “Business, operational and financial performance”, we comment on the segments and their performance, based on the segment reporting as presented in the Notes to the consolidated financial statements of EP Energy, a.s. as of and for the year ended December 31, 2016 prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The EBITDA and any other EBITDA included in this report does not represent EBITDA, as may be defined by any documentation for any financial liabilities of the Group.

The table below shows summary financial information for the EPE segments:

In million EUR	For the year ended December 31	
	2015	2016
<b>Total sales</b>		
Heat Infra .....	429	561
Renewables.....	5	5
Power Distribution and Supply .....	1,687	1,422
Other.....	5	8
Total segments.....	2,126	1,996
Holding.....	-	-
Intersegment eliminations.....	(155)	(154)
Consolidated data .....	<b>1,971</b>	<b>1,842</b>
<b>Depreciation and amortization</b>		
Heat Infra .....	(84)	(97)
Renewables.....	(3)	(3)
Power Distribution and Supply .....	(71)	(68)
Other.....	(0)	(0)
Total segments.....	(158)	(168)
Holding.....	0	0
Intersegment eliminations.....	0	0
Consolidated data .....	<b>(158)</b>	<b>(168)</b>
<b>Negative goodwill</b>		
Heat Infra .....	33	0
Renewables.....	0	0
Power Distribution and Supply .....	0	0
Other.....	0	0
Total segments.....	33	0
Holding.....	0	0
Intersegment eliminations.....	0	0
Consolidated data .....	<b>33</b>	<b>0</b>
<b>Profit/(loss) from operations</b>		
Heat Infra .....	85	48
Renewables.....	0	1
Power Distribution and Supply .....	124	81
Other.....	0	2
Total segments.....	209	132
Holding.....	(3)	(4)
Intersegment eliminations.....	0	(3)
Consolidated data .....	<b>206</b>	<b>125</b>
<b>EBITDA<sup>(1)</sup></b>		
Heat Infra .....	136	145
Renewables.....	3	4
Power Distribution and Supply .....	195	149
Other.....	0	2
Total segments.....	334	300
Holding.....	(3)	(4)
Intersegment eliminations.....	0	(3)
Consolidated data .....	<b>331</b>	<b>293</b>

(1) Represents Profit/(loss) from operations *plus* Depreciation and amortization *less* Negative goodwill

## Heat Infra

The Heat Infra segment accounted for 48.3% of consolidated EBITDA for the year 2016 and 40.7% of consolidated EBITDA for the year 2015, in each case before intersegment eliminations and Holding result allocation. We conduct our Heat Infra operations in the Czech Republic through the following major subsidiaries: Pražská teplárenská, Elektrárny Opatovice, United Energy and Plzeňská energetika and in Hungary through Budapesti Erömű Zrt (since the completion of the acquisition as of December 10, 2015). We note that Saale Energie and the HSR Group were classified as discontinued operation in the year ended December 31, 2015 and therefore they were excluded from the segment Heat Infra in the years 2015 and 2016 (for further information please see section Key developments - German assets sale). The table below shows a summary of key operating data for the Heat Infra segment. The operating data are based on the results of the whole entity regardless of the date when each entity joined the EPE Group or the ownership share of the EPE Group in each entity. Particularly, EPE disposed Pražská teplárenská LPZ, a.s. ("LPZ") on June 1, 2016 therefore the below data include its operation in relevant period in 2015 and until June 1 in 2016. Results of all other subsidiaries of the Group which belong to the Heat Infra Business are for the entire period.

		As of and for the year ended December 31,	
		2015	2016
Installed heat capacity <sup>(1)</sup> .....	MW <sub>th</sub>	3,856	3,276
Heat supplied .....	TJ	22,197	22,660
Installed cogeneration capacity .....	MW <sub>e</sub>	896	894
Installed condensation capacity .....	MW <sub>e</sub>	360	360
Certified grid balancing capacity <sup>(2)</sup> .....	MW <sub>e</sub>	517	517
Cogeneration production .....	GWh	1,546	1,694
Condensation production.....	GWh	1,442	1,848
Grid balancing services.....	GWh	1,715	2,197

(1) Heat capacity installed on heat exchangers.

(2) Grid balancing capacity is included in Installed condensation capacity and Installed cogeneration capacity.

## Installed heat capacity

Installed heat capacity decreased by 580 MW<sub>th</sub>, or 15.1%, to 3,276 MW<sub>th</sub> for the year 2016, as compared to 3,856 MW<sub>th</sub> for the year 2015. This decrease was mainly due to the fact that on June 1, 2016 the Group disposed LPZ that operated total installed heat capacity of 525 MW<sub>th</sub>.

## Heat supplied

Heat supplied increased by 463 TJ, or 2.1%, to 22,660 TJ for the year 2016 as compared to 22,197 TJ for the year 2015. The increase in heat supplied was primarily driven by better weather conditions. As outlined previously in the Report, day-degrees, the metrics representing "coldness" of the weather pattern (difference between reference indoor temperature and actual outdoor temperature integrated over the given period of time) were in the areas where we deliver the heat period-to-period by 6.6% higher which resulted in higher heat offtake at customers. This translated into increase in associated EBITDA period-to-period. On the other hand, disposal of LPZ at the beginning of June 2016 had negative effect on heat supplied in 2016.<sup>12</sup>

<sup>12</sup> While LPZ supplied 1,728 TJ of heat in 2015, only 1,018 TJ in period 1 January 2016 to 1 June 2016 (i.e. until its disposal date)



### Installed capacity

Installed cogeneration capacity decreased by 2 MW<sub>e</sub>, or 0.2% to 894 MW<sub>e</sub> for the year 2016, as compared to 896 MW<sub>e</sub> for the year 2015. This decrease was due to the disposal of LPZ at the beginning of June 2016 that operated total installed cogeneration capacity of 2 MW<sub>e</sub>.

Installed condensation capacity remained at 360 MW<sub>e</sub> at December 31, 2016, and December 31, 2015.

Certified grid balancing capacity remained at 517 MW<sub>e</sub>, at December 31, 2016, and December 31, 2015.

### Cogeneration production

Cogeneration production increased by 148 GWh, or 9.6%, to 1,694 GWh for the year 2016, as compared to 1,546 GWh for the year 2015. This increase was primarily attributable to BERT that had higher cogeneration production driven by higher heat production (caused by lower temperatures in Q4).

### Condensation production

Condensation generation increased by 406 GWh, or 28.1%, to 1,848 GWh for the year 2016, as compared to 1,442 GWh for the year 2015. This increase in condensation generation was primarily due to an increase at EOP that undertook a substantial IED refurbishment and was in outage in part of 2015.

### Grid balancing services

Grid balancing services increased by 482 GWh, or 28.1%, to 2,197 GWh for the year 2016 as compared to 1,715 GWh for the year 2015. Main drivers of the increase are a higher success rates in winning tenders for grid balancing services organized by the Czech TSO CEPS and increased range of capabilities for providing grid balancing services.

The table below shows a summary of key financial performance data for the Heat Infra segment. The financial data is based on EPE consolidated financial information before eliminations of intersegment transactions and take into account acquisition date of each entity. The EPE's majority interest in BERT was only acquired on December 10, 2015 and therefore the below data include results of BERT for one month in the year ended December 31, 2015. In addition, EPE disposed LPZ on June 1, 2016 therefore the below data include its operations in relevant period in 2015 and until June 1 in 2016. Results of all other subsidiaries of the Group which belong to the Heat Infra Business are for the entire period.

		For the year ended December 31,	
		2015	2016
Total sales .....	in EUR millions	429	561
EBITDA .....	in EUR millions	136	145

### EBITDA

As our contracts with suppliers for our Heat Infra operations in the Czech Republic are generally priced in Czech crowns, but our contracts for sales of electricity are primarily priced in EUR. EBITDA from our power generation operations presented in CZK as a functional currency may increase or decrease (and even be negative) depending on currency exchange rate fluctuations (our heat operations are not affected by currency fluctuations as all sales transactions are priced in Czech crowns, but EBITDA is affected by translation of CZK to EUR for reporting presentation purposes as the EPE Group's presentation currency is EUR). We generally lock in the exchange rate at the time a contract is entered

through the use of derivatives, the amounts due or paid under these derivative contracts, which offset the exchange rate fluctuation effects discussed above, are included in EBITDA in Total sales as Gain (loss) from commodity derivatives for trading with electricity and gas, net.

EBITDA increased by EUR 9 million, or 6.6%, to EUR 145 million for year 2016 as compared to EUR 136 million for the year 2015. Three main drivers influenced EBITDA development. Firstly, BERT contributed EUR 26 million in the year 2016, while EUR 5 million in the year 2015 as it was acquired only in December 2015. Secondly, 2015 EBITDA was positively influenced by one off tax refund totaling EUR 11 million and related EUR 2 million penalty received by Czech CHPs. The refund and penalty received related to gift tax of 32% levied on emission allowances allocated free of charge for production of electricity in 2011 and 2012<sup>13</sup> (for further detail see *Risk factors – We are exposed to changes in EU ETS and potentially also other nation-wide or regional CO2 emission regulation, if applicable, in the way emissions allowances are allocated, including the conditions attaching to free allocations and the allocation of emissions allowances, as well as volatility in the market prices of emissions allowances that we need to acquire*). Thirdly, disposal of LPZ decreased EBITDA on year to year basis by EUR 2 million (LPZ contribution to EBITDA was EUR 9 million in 2015, while EUR 7 million in period from January 1, 2016 until June 1, 2016). Excluding the three aforementioned effects, EBITDA of Heat segment increased by EUR 3 million, which was mainly due to higher volume of heat supplied and power produced in 2016. This positive volume effect was partially offset by lower power prices, higher fuel costs and continuing decrease in allocated emission allowances.

### **Power Distribution and Supply**

The Power Distribution and Supply segment accounted for 49.7% of consolidated EBITDA for the year 2016 and 58.4% of consolidated EBITDA for the year 2015, in each case before intersegment eliminations and Holding result allocation. We conduct our Power Distribution and Supply operations in the Slovak Republic and the Czech Republic mainly through our subsidiary Stredoslovenská energetika, a.s., EP ENERGY TRADING, a.s., EP Sourcing, a.s. and EP Cargo a.s.

The table below shows a summary of key operating data for the Power Distribution and Supply segment. The operating data are based on the results of the whole entity regardless of the date when each entity joined the EPE Group or the ownership share of the EPE Group in each entity, however the data excludes SSE which is presented separately.

		For the year ended December 31,	
		2015	2016
Power traded .....	GWh	22,597	16,048
Power supplied .....	GWh	1,820	2,314
Natural gas traded .....	GWh	7,541	2,061
Natural gas supplied .....	GWh	1,392	1,883

<sup>13</sup> based on the claim of Czech entities backed up by the ruling of the European Court of Justice and the judgment of the Supreme Administrative Court of the Czech Republic

The table below shows a summary of key operating data for the SSE Group:

		As of and for the year ended December 31,	
		2015	2016
Power distributed .....	GWh	5,872	5,944
Power traded .....	GWh	7,062	7,159
Power supplied .....	GWh	3,921	3,966
Natural gas supplied .....	GWh	359	326
Power produced .....	GWh	20	19
Installed capacity .....	MW <sub>e</sub>	63	63

### Power distributed

Power distributed by SSE reached 5 944 GWh for the year 2016, which represents an increase by 72 GWh, or 1.2%, as compared to 5,872 GWh for the year 2015. Decrease in the high voltage level has been exceeded by higher consumption on the medium and low voltage levels power distribution.

### Power traded

Power traded (excluding SSE) decreased by 6,549 GWh, or 29.0%, to 16,048 GWh for the year 2016 as compared to 22,597 GWh for the year 2015. This decrease in power traded was caused by lower trading activity of EPET and by the fact that EPET benefited from a significant one-off power trading opportunity in 2015.

Power traded realized by SSE reached 7,159 GWh for the year 2016, which is an increase of 1.4%, or 97 GWh, as compared to 7,062 GWh for the year 2015. Main driver for the increase in activity was higher re-sold volume coming from renewable resources on the Slovak market in the year ended December 31, 2016.

### Power supplied

Power supplied (excluding SSE) increased by 494 GWh, or 27.1%, to 2,314 GWh for the year 2016 as compared to 1,820 GWh for the year 2015. This increase in power supplied stems from higher customer base resulting from an acquisition of Optimum Energy, a.s., primarily acting as power and gas supplier, by EPET in August 2015.

Power supply realized by SSE reached 3,966 GWh for the year 2016, which is an increase by 45 GWh, or 1.2%, as compared to 3,921 GWh for the year 2015.

### Natural gas traded

Natural gas traded (excluding SSE) decreased by 5,480 GWh, or 72.7%, to 2,061 GWh for the year 2016 as compared to 7,541 GWh for the year 2015. This considerable decrease stems from the fact that EPET benefited from significant one-off natural gas trading transactions in 2015.

### Natural gas supplied

Natural gas supplied (excluding SSE) increased by 491 GWh, or 35.3%, to 1,883 GWh for the year 2016 as compared to 1,392 GWh for the year 2015. This increase in natural gas supplied reflects higher customer base resulting from an acquisition of Optimum Energy, a.s., primarily acting as power and gas supplier, by EPET in August 2015.

Natural gas supplied by SSE reached 326 GWh for the year 2016, which is a decrease by 33 GWh, or 9.2%, as compared to 359 GWh for the year 2015. This decline is due to a loss of a significant customer in 2016. This decrease was partially offset by effect of acquisition of new customers.

The table below shows a summary of key financial data for the Power Distribution and Supply segment. The financial data are based on EPE consolidated financial information before eliminations of intersegment transactions and take into account acquisition date of each entity.

		For the year ended December 31,	
		2015	2016
Total Sales.....	in EUR millions	1,687	1,422
EBITDA .....	in EUR millions	195	149

## EBITDA

As part of our power trading activities, EPET engages in sales of power generated by EPE Group companies, as well as resales of power purchased on the wholesale market in connection with our energy production optimization process, which leads to an overall increase in the volume of sales of power. However, with an increasing number of resales, total costs as a percentage of total sales increase as the margins realized on each subsequent optimization transaction tend to decline as the frequency of optimization transactions increases. Moreover, because our contracts with suppliers for our Heat Infra operations in the Czech Republic are generally priced in Czech crowns (with the exception of supplies under certain contracts for brown coal to the EOP and UE, which are priced in EUR and were significantly reduced starting in 2016). However, we may purchase power in EUR, EBITDA from our supply operations may increase or decrease (and even be negative) depending on currency exchange rate fluctuations (the EBITDA is affected by translation of CZK to EUR for reporting presentation purposes as the EPE Group's presentation currency is EUR). We generally lock in the exchange rate and power prices at the time a contract is entered into through the use of derivative contracts. The amounts due or paid under these derivative contracts, which offset the exchange rate and power price fluctuation effects discussed above, are included in EBITDA and the effect of fair valuation of financial commodity derivatives is included in Total sales as Gain (loss) from commodity derivatives for trading with electricity and gas, net, unless they qualify for hedge accounting under IFRS, in which case they are reflected in the Cost of sales: Other and Sales: Other lines for currency derivatives and in the Sales: Energy and Cost of sales: Energy for derivatives hedging the price of power.

EBITDA decreased by EUR 46 million, or 23.6%, to EUR 149 million for the year 2016 as compared to EUR 195 million for the year 2015. EBITDA realized by SSE decreased by EUR 41 million to EUR 134 million primarily due to the SOT gap effect<sup>14</sup> that deteriorated EBITDA approximately by EUR 69 million. Specifically, the SOT gap had a negative income statement impact of EUR 61 million in 2016, while positive impact of EUR 8 million was recorded in 2015. Positive effect of SOT gap in 2015 is a one-off result of inactivity of green energy producers that did not fulfil administrative conditions. As such, they were not entitled to receive regulated power price for their production in 2015, which they sell to SSE-D, as required by the regulation. The SOT gap negative effect was partially compensated by

<sup>14</sup> System Operation Tariffs ("SOT")

Support for renewable energy sources in the Slovak Republic is carried out via DSOs, such as SSE's subsidiary SSE-D. The DSOs are intended to be compensated for the incentive payments they make through system operation tariffs ("SOT") collected from the final electricity consumers. However, imbalances ("SOT gap") may occur in the compensation system that may result in a negative balance of the SSE Group with respect to the incentive payments. Per the current legislation (specifically the Coll. 309/2009 paragraph 5, section 1), the SOT gap will be compensated in two-year period at the latest

improvement in SSE's core business activities of EUR 17 million and savings of EUR 11 million on operating expenses in 2016. Improvement in core business mainly results from higher margin on power distribution, which results from more convenient power distribution structure (i.e. increase at low and medium voltage level), higher trading margin, savings on gas purchases and higher revenue from re-sale of green energy. Operating expenses savings stem from (i) lower occurrence of calamities in the year 2016 and (ii) fact that more projects are undertaken internally (and relevant expense capitalised subsequently) and (iii) further savings in other operating expenses as result of undertaken optimization measures, including cost and work efficiency improvements (e.g. maintenance and procurement). Furthermore, EPET's sales and EBITDA experienced a drop by EUR 202 million and EUR 5 million, respectively, which was driven by decreased natural gas and power trading activity in the year 2016 as EPET benefited from significant one-off trading transactions in the year 2015.

### **Renewables**

The Renewables segment accounted for 1.3% of consolidated EBITDA for the year 2016 and 0.9% of consolidated EBITDA for the year 2015, in each case before intersegment eliminations and Holding result allocation. Our Renewables business is conducted in the Czech Republic and the Slovak Republic, and operations include wind, solar and biogas power generating facilities.

The table below shows a summary of key operating data for the Renewables segment.

		<b>As of and for the year ended December 31,</b>	
		<b>2015</b>	<b>2016</b>
Installed Capacity .....	MW <sub>e</sub>	14	14
Power Production.....	GWh	32	25

### **Installed capacity**

Installed capacity remained at 14 MW<sub>e</sub> as of December 31, 2016 and December 31, 2015.

### **Power production**

Power production decreased by 7 GWh, or 21.9%, to 25 GWh for the year 2016 as compared to 32 GWh for the year 2015. This decrease was primarily due to lower production in the biogas facility, as a compared to the year 2015.

The table below shows a summary of key financial data for the Renewables segment. The financial data are based on EPE consolidated financial information before eliminations of intersegment transactions and take into account the ownership share of the EPE Group in each entity and its acquisition date.

		<b>For the year ended December 31,</b>	
		<b>2015</b>	<b>2016</b>
Total Sales .....	in EUR millions	5	5
EBITDA.....	in EUR millions	3	4

### **EBITDA**

EBITDA increased by EUR 1 million to EUR 4 million for the year 2016 as compared to EUR 3 million for the year 2015, driven by better result of solar power plants.

### **Other**

The Other segment accounted for 0.7% of consolidated EBITDA for the year 2016 and 0.0% of consolidated EBITDA for the year 2015, in each case before intersegment eliminations and Holding result allocation. The table below shows a summary of key financial data for the Other segment:

		For the year ended December 31,	
		2015	2016
Total sales.....	in EUR millions	5	8
EBITDA.....	in EUR millions	-	2

### **EBITDA**

EBITDA increased by EUR 2 million to EUR 2 million for the year 2016 as compared to EUR 0 million for the year 2015.

### **Holding**

The table below shows a summary of key financial data for the Holding entities segment:

		For the year ended December 31,	
		2015	2016
Total sales.....	in EUR millions	-	-
EBITDA.....	in EUR millions	(3)	(4)

The main driver of the negative EBITDA in both 2016 and 2015 was the other operating expenses of EP Energy, as the only entity presented within Holding. The costs were primarily associated with costs relating to outsourcing of various functions and costs for professional services charged to EP Energy.

### **Other revenues and expenses**

Our repeating expenses are generally related to wages and salaries of executive and part-time employees (administrative staff) and associated social and health insurance, administrative costs for repairs and maintenance, other taxes and fees, costs for audit and accounting services, costs for legal consultancy, operating leases, rent of premises, communication expenses, travel expenses, costs for translation, non-tax deductible fees, rental income and other administrative costs.

### **German assets sale**

As part of the reorganization of EPIF in 2016, EPE sold-off its power generation activities in Germany as well as its mining operations in Germany to its ultimate parent company EPH (effective on April 1, 2016). The decision to sell-off these activities, which comprise an isolated geographical segment (Germany), was reached at the end of 2015. Due to the fact that these operations were predominantly representing the whole German operations, mining operations and condensation power production, EPE presents these activities through restatement of comparatives as discontinued operations as of and for the year 2015. Gain on disposal of the German assets is presented as part of profit (loss) from discontinued operations in the statement of comprehensive income for the year ended December 31, 2016 (i.e. does not affect EBITDA).

The scope of disposed entities is as follows:

	Country of incorporation	Ownership (%)
JTSD Braunkohlebergbau GmbH	Germany	100
Mitteldeutsche Braunkohlengesellschaft mbH	Germany	100
MIBRAG Consulting International GmbH	Germany	100
GALA-MIBRAG-Service GmbH	Germany	100
Mitteldeutsche Umwelt- und Entsorgung GmbH	Germany	50
Fernwärme GmbH Hohenmölsen – Webau	Germany	48.96
Ingenieurbüro für Grundwasser GmbH	Germany	25
Bohr & Brunnenbau GmbH	Germany	100
Helmstedter Revier GmbH	Germany	100
Norddeutsche Gesellschaft zur Ablagerung von Mineralstoffen mbH	Germany	51
Terrakomp GmbH	Germany	100
MIBRAG Neue Energie GmbH	Germany	100
EP Germany GmbH	Germany	100
Saale Energie GmbH	Germany	100
Kraftwerk Schkopau GbR	Germany	41.90
Kraftwerk Schkopau Betriebsgesellschaft mbH	Germany	44.40

Note: percentage of ownership same as at December 31, 2015 and at the date of disposals

German assets include, among others, MIBRAG and Saale Energie. MIBRAG is a wholly-owned subsidiary of JTSD, Saale Energie is a wholly-owned subsidiary of EP Germany; both EP Germany and JTSD were wholly-owned subsidiaries of EPE (where EP Germany has been since 31 December 2015 directly owned by JTSD as a result of the sale of all EP Germany shares by EPE to JTSD for EUR 4 million, corresponding to fair value of equity of EP Germany).

The German assets were disposed of by means of sale of 100% shares in JTSD by EPE to EPH for EUR 156 million (corresponding to fair value of equity of JTSD); the disposal was completed on April 1, 2016 and the purchase price was fully settled in cash.

Discontinued operations in the year ended December 31, 2015 related to segments Mining, Heat Infra and Renewables.

The Mining segment, was represented by Mitteldeutsche Braunkohlengesellschaft GmbH (MIBRAG), produced brown coal, which it supplied to power plants under long-term supply agreements. The Mining segment included JTSD and the MIBRAG Group (excluding MIBRAG Neue Energie and Helmstedter Revier GmbH and its subsidiaries). The EPE Group conducted other mining operations in Germany through the Heat Infra segment, which included the Schöningen mine in the Helmstedt mining district, which the EPE Group acquired through the acquisition of the HSR Group on December 31, 2013.

The Heat Infra segment included Saale Energie GmbH purchased in 2012, which owned 41.9% of the Schkopau-power plant representing a beneficial use right over 400MW of the plant's total capacity of 900MW. In December 2013, the EPE Group acquired a 100% share in Helmstedter Revier GmbH which operated a condensation mode power plant Buschhaus with an installed capacity of 390MW. These entities were classified as discontinued operations in 2015.

The Renewables segment included a wind farm in Germany at MIBRAG (Mibrag Neue Energie), which was classified as discontinued operation in 2015.

Key operating data for the Heat Infra segment and Renewables are presented without the operating data of discontinued operations (e.g. data for Saale Energy GmbH and Helmstedter Revier GmbH in

the Heat Infra segment and for Mibrag Neue Energie in the Renewables segment were excluded from relevant segments) in 2016 and 2015.

Profit (loss) from discontinued operations is presented at the bottom of EP Energy Consolidated statement of comprehensive income for the year ended December 31, 2016. The operations were classified as discontinued operations for 2016 and 2015. Gain on disposal of the German assets is presented as part of profit (loss) from discontinued operations in the statement of comprehensive income for the year ended December 31, 2016.

From the gain from discontinued operations in 2016 of EUR 22 million of which gain EUR 34 million relates to result of sale and loss of EUR 12 million to profit from operations (in year 2015: loss of EUR 20 million), a gain of EUR 22 million (2015: a loss of EUR 20 million) is attributable to the owners of the Company and no profit or loss is attributable to the non-controlling interest.

### **Factors affecting the results of operations of the EPE Group**

We believe that the following factors have had, and will continue to have, a material effect on the results of operations and financial condition of the EPE Group. As many of these factors are beyond our control and certain of these factors have historically been volatile, past performance will not necessarily be indicative of future performance and it is difficult to predict future performance with any degree of certainty. In addition, important factors that could cause our actual operations or financial conditions to differ materially from those expressed or implied below, include, but are not limited to, factors indicated in this Report under “Risk factors.”

### **Acquisitions and divestitures and the structure of the EPE Group**

The EPE Group was formed through a series of strategic acquisitions, bolt-ons and business combinations and we may continue to acquire additional subsidiaries in the future or divest subsidiaries and interests in subsidiaries. This will affect our operations and the overall EPE Group’s results. Our acquisitions and divestitures may affect our results of operations and the period-to-period comparability of EPE’s financial statements. We have recently added new businesses to the EPE Group and have made and may make acquisitions in the future. Newly added or acquired businesses may not be integrated or managed successfully, and we may fail to realize the anticipated synergies, growth opportunities and other benefits expected from these additions or acquisitions.

One of our strategies has been, and continues to be, expanding the vertical integration of the EPE Group. Although we believe that this strategy is key to the EPE Group’s future success, increased vertical integration can result in positive results in one segment and corresponding negative results in another segment.

### **Key factors affecting comparability of the results of operations of the EPE Group**

The EPE Group was formed through a series of strategic acquisitions and business combinations. The current EPE Group was originally formed with acquisitions of ownership interests in Pražská energetika (“PRE”) in 2004 and in UE in 2005 by J&T Group, which was one of the founders and until recently one of beneficial owners of EPH (our ultimate parent company). EPH was formed in 2009 and the ownership interests in PE, EOP, UE, EPET and PEAS were transferred to it by J&T Group. We were formed on December 16, 2010, but we have restated financial statements from August 2009, based on the results of our subsidiaries that were owned by EPH during that period. Before our formation, many of our current subsidiaries were subsidiaries of EPH, but because the EPE Group has grown steadily through acquisitions. The acquisition of various subsidiaries or additional interests in such subsidiaries and the disposition of certain subsidiaries mean that our results of operations necessarily



differ before and after these acquisitions and dispositions and do not reflect a change in organic operating results but rather the impact of an acquisition or disposition.

The following table sets out the periods for which the major entities are included in our consolidated financial statements and the basis for the stand-alone financial information, which we used in Chapters “Business and operation performance” and “Financial performance”:

Periods presented in the EPE Group’s consolidated IFRS financial statement		
<b>Subsidiary</b>	<b>FY 2015</b>	<b>FY 2016</b>
Elektrárny Opatovice, a.s.	Fully consolidated	Fully consolidated
United Energy, a.s.	Fully consolidated	Fully consolidated
Pražská teplárenská a.s.	Fully consolidated	Fully consolidated
Plzeňská energetika a.s.	Fully consolidated	Fully consolidated
EP ENERGY TRADING, a.s.	Fully consolidated	Fully consolidated
Budapesti Erömu Zrt	Fully consolidated since December 1, 2015	Fully consolidated
Stredoslovenská energetika, a.s.	Fully consolidated	Fully consolidated
EP Cargo, a.s.	Fully consolidated	Fully consolidated
JTSD/MIBRAG (including its subsidiary, among others, MNE)	Classified as discontinued operation and not included in operations	Classified as discontinued operation and not included in operations
Helmstedter Revier GmbH	Classified as discontinued operation and not included in operations	Classified as discontinued operation and not included in operations
Saale Energie GmbH	Classified as discontinued operation and not included in operations	Classified as discontinued operation and not included in operations

We have recently added new businesses to the EPE Group and may have made and may make acquisitions in the future. Newly added or acquired businesses may not be integrated or managed successfully, and we may fail to realize the anticipated synergies, growth opportunities and other benefits expected from these additions or acquisitions. Our consolidated financial statements included in this Report may not be representative of our historical or future results of operations and may not be comparable across periods, which may make it difficult to evaluate our results of operations and future prospects.

#### **Factors impacting the results of our Heat Infra segment**

Our Heat Infra segment sells the following key products to our customers: (a) heat used for heating and hot water, (b) power, (c) grid balancing services and (d) energy generation by-products, such as ash and fly ash. Factors impacting our top line are typically specific for each of these products, while factors influencing the cost are typically general to all of these products. With some minor exceptions, all production facilities are combined heat and power facilities, operating in both, highly efficient cogeneration mode, which is an ecological form of conversion of primary energy in fuel, supported by both national and EU legislation, and in condensation mode. Substantially all of our production in the Czech Republic is based on brown coal, the cheapest fossil fuel available on the market, which further significantly contributes to our competitiveness. Our Hungarian operations are gas fired, i.e. using natural gas, which is the cleanest and safest fossil fuel.

## **Weather condition fluctuations**

As the vast majority of our heat deliveries are used for heating and the preparation of hot water, weather condition fluctuations (warm vs. typical vs. cold winters) have a material effect on the results of our operations, especially with respect to heat sales. For the same reason, our heat supplies are fairly inelastic when compared to companies that primarily service industrial customers to provide industrial steam, which is more affected by global economic cycles. Unusually warm (or cold) winter temperatures may reduce (or increase) consumers' demand for heat and correspondingly reduce (or improve) our financial performance and results of operations. Even though heat off-take fluctuates with weather conditions in a given year, these fluctuations are relatively small and show no discernible trend in changing weather patterns on average.

## **Customer demand**

Beyond the weather condition fluctuations, customer demand and customer base dynamics are other factors influencing heat supply. As our heat supplies are primarily driven by heating, the key factor influencing our heat supplies is the degree of insulation in our customers' homes, which has been steadily growing in the last two decades. The reduction of heat supply due to the growing degree of insulation has been partially off-set by new connections. The overall annual effect has resulted in the last several years in a slight reduction of heat supplies (assuming typical weather patterns, at the level of 1-2% p.a. depending on the region). As the degree of insulation is now relatively high, we believe that this remaining negative trend will level off in years to come. The effect of insulation has a less significant effect on customer demand than weather condition fluctuations have.

## **Regulation**

Heat and power generation and supply activities are generally liberalized in the Czech Republic, Hungary and elsewhere throughout the European Union, although heat supply is regulated in the Czech Republic and heat distribution, due to its network nature, generally has high barriers to entry (in each territory there is only one distribution network, and the construction of a new distribution network by a competitor would involve large capital investments and costs) and is regulated.

Individual countries and the European Commission apply various rules and use various schemes through which they try to influence the behaviour of individual market participants, particularly with respect to heat and power generation activities. Examples of these measures include various support schemes designed to encourage heat and power generation by renewable sources and CHPs, promotion of efficient district heating and cooling, an EU-wide CO<sub>2</sub> allowance trading scheme, emission limits, regulation of access to the heat and power transmission and distribution grids and measures aimed at increasing interconnections between national power transmission grids, as well as cross-border interconnections.

Our Heat Infra segment is not entirely liberalized throughout the European Union, and in the Czech Republic and Hungary the regulators may influence the maximum prices that may be charged for heat distribution and/or supply. We are therefore exposed to pricing decisions of the regulators in those jurisdictions. See "Risk factors—Risks related to governmental regulations and laws—Our operations are subject to significant government regulation and laws and our business, financial condition, results of operations and cash flows could be adversely affected by changes in the law or regulatory schemes." In the Czech Republic, the ERO defines the framework for determining the price that can be charged for supplying heat. The regulation of heat prices is based on economically justified costs necessary for production and distribution of heat, an "appropriate" profit margin for producers and VAT. The appropriate profit margin is set individually for each company and is based on historical margins both for the individual company as well as for its peer companies. See "Risk factors—Risks related to governmental regulations and laws—Changes in regulated tariffs could have a material adverse effect

on our business, financial condition, results of operations and cash flows". Hungarian operations are regulated using the standard Regulatory Asset Base ("RAB") multiplied by WACC plus eligible operating expenses and allowed depreciation formula.

### **Forward contracts**

An important factor contributing to our results of operations is our strategy of entering into forward contracts both to supply the EPE Group with raw materials on the cost side and to sell our power on the revenue side. We historically contract our purchase of fuel under long-term framework agreements, and in case of favourable power prices we also supply our power on the basis of forward contracts up to two years in advance, with corresponding purchases of emissions allowances. On the other hand, in case of low power prices, instead of entering into such forward contracts, we use the flexibility of our own power generating capacities to react to current power prices with the aim to achieve better average selling price.

### **The "Clean Spread"**

A major driver of our profitability is attributable to the fluctuating spread between the prices at which we can sell power on the one hand and the major costs of power production on the other—namely the cost of primary fuel sources, in our case predominantly brown coal and to a small degree also natural gas and to an even smaller degree hard coal, and CO<sub>2</sub> emissions allowances—the "Clean Spread." Our power production operations are flexible, allowing us to activate production opportunistically when the Clean Spread is high, and to reduce it when the Clean Spread is low. A higher Clean Spread allows us to increase power production at a higher margin of profitability. While both power prices and the cost of CO<sub>2</sub> emissions allowances have fallen recently (and the price of brown coal has remained relatively stable), the price of power has fallen at a greater rate, lowering the Clean Spread. This, coupled with our increasing need to purchase CO<sub>2</sub> emissions allowances as a result of the gradual discontinuation of the free allocation of such allowances is expected to have a negative impact on our future results. See "—Factors affecting the results of operations of the EPE Group—Acquisitions and divestitures and the structure of the EPE Group."

### **Power**

We sell a majority of the power we generate in liberalized markets, primarily to professional counterparties via OTC transactions at prevailing prices or through power exchanges (primarily the PXE in Prague and the EEX in Leipzig), including under our forward-contracted sales. As such, all related revenues are subject to fluctuations in wholesale power prices. Since power markets are liberalized in the Czech Republic, Germany and neighbouring European Union countries and due to cross-border integration, prices in these markets are closely correlated and the primary price-setting market is Germany and the European Energy Exchange in Leipzig. In particular, wholesale power prices in the Czech Republic are fairly similar to those in Germany, which reflects fluctuations in the cost of transferring power across the border. Accordingly, the prices at which we sell the power we produce may reflect events outside their respective domestic territories, such as the development of gas and hard coal prices, prices of emissions allowances, demand-supply dynamics in the German power market (recently namely in relation to power production of German off-shore wind farms) and other factors.

The impact of wholesale power price fluctuations on our operating profit is further exacerbated by the fact that the variable costs of generating power through our generation facilities are fairly stable and not related to the factors that drive power prices in the region. Accordingly, our margins are directly impacted when power prices change. We also sell power in regional markets outside the Czech Republic, where different factors such as government and industry regulation and type and price of

fuel used for generation may drive power prices. Our variable cost structure is different in those markets, leading to different patterns of volatility that impact our results.

In order to reduce the impact of price volatility, in case of favourable power prices, we sell most of the power we generate up to two years in advance at market prices (i.e. with reference to EEX or PXE). On the other hand, in case of low power prices, instead of entering into such forward contracts, we use the flexibility of own power generating capacities to react to current power prices with the aim to achieve better average selling price.

The Czech electricity market is strongly tied to other European markets and thus reflects their respective key developments. In 2011, the Czech Republic underwent an important legislative update to accommodate the requirements of the 3rd EU Climate and Energy Package. The main consequences of the 3rd EU Energy Package, implemented into national law through Act No. 211/2011 Coll. ("Energy Act Amendment") and effective since August 18, 2011, include unbundling, a guarantee of a high standard of public service and customer protection. The national energy regulators, most notably the ERO, were granted extended authority and independence in order to increase the effectiveness of the regulatory regime and further improve the competitiveness and transparency of the market.

The regional wholesale electricity market integration continued with the expansion to Hungary of the already coupled Czech and Slovak day-ahead market. This interconnection, which enabled parallel trading on the electricity spot markets in the Czech Republic, the Slovak Republic and Hungary, was successfully launched on September 11, 2012. Additionally, as part of a larger Central and Eastern Europe initiative, the regional transmission system operators were able gradually to shift from a system of market-based bilateral bids for cross-border power capacities to coordinated auctions for the whole region encompassing the Czech Republic, Hungary, Germany, Poland and the Slovak Republic.

Further European wholesale electricity market integration continued with the North-Western Europe ("NWE") day-ahead price coupling project which commenced in February 2014. This highly complex project, which is the largest of its type ever undertaken, enables price coupling in countries that account for more than 75% of the total electricity consumption in Europe. A single algorithm, calculating simultaneously the market prices, net positions and electricity exchanges between markets are now applied based on implicit auctions facilitated through the Price Coupling of Regions ("PCR") solution. With the NWE project becoming operational, all interconnectors between the following countries are now utilised with improved efficiency: Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK.

### **Energy production optimization**

We both sell power generated by it in the Heat Infra segment in the wholesale market and purchase power from the wholesale market for delivery by the power generation division of the Heat Infra segment at times when it is more economical for us to buy power for sale under our forward sale contracts rather than generate it itself. This decision depends on the price of power on the wholesale market. If the price of power on the wholesale market is lower than the cost of producing power, we buy power, and if the price on the wholesale market is higher than the cost of producing power, we produce it. The process of energy production optimisation also involves selling and then reselling, potentially many times, the power we produce or the power we buy on the wholesale market. We conduct this sale and resale process in order to take advantage of price changes for power on the wholesale market to allow us to capture additional margin on the price of power. For example, if after selling the power that we intend to produce and lock in the sale price, the price of power drops to below our marginal cost of production, we will instead purchase the required amount of power for

delivery. If the price of power then increases above our marginal cost of production, we will once again sell power we intend to produce, again locking in the sale price. If prices rise and fall further, we will repeat the process.

## **Fuel**

As part of our power production activities, we purchase and consume large quantities of brown coal, and smaller quantities of hard coal delivered predominantly by Przedsiębiorstwo Gornicze "SILESIA" Sp. z o.o. (a related party to EPE), natural gas and other alternative fuels. The majority of consumed brown coal was provided by external suppliers, including MIBRAG (a related party to EPE), Severoceske doly, Emeran 1860 and Sokolovska uhelna. Due to the surplus of lignite supply in the Czech Republic, we plan to primarily purchase fuel on the Czech market and use MIBRAG only as back-up supplier.

## **Emissions allowances**

In accordance with the regulations of the EU ETS Directive governing the emissions allowance trading scheme, we were allocated free emissions allowances by the Czech government according to its National Allocation Plan until 31 December 2012. We acquire emissions allowances through governmental allocations as well as purchase emissions allowances on the open market, if needed to offset our actual emissions. We sell any excess emissions allowances not used in our production activities on the open market. Although the free allocation of allowances under the EU Emissions Allowances Trading System was largely discontinued effective 1 January 2013, on 6 July 2012, the European Commission announced in MEMO/12/530 that it had authorized the Czech Republic's request for a continued free allocation of emissions allowances to the Czech power sector beyond the end of 2012. The scope of these allowances is limited to installations that started to generate power before 31 December 2008 or for which the investment process was "physically initiated" by that date. All of our Czech power plants are covered by the derogation. The extension period will last from 2013 to 2019, and the free allowance extension is limited to no more than 60% of emissions for domestic power supply in 2014, with the percentage declining by 10 percentage points each year to 0% in 2020. The EU ETS Directive requires that installations benefitting from free allocations under the derogation invest in projects designed to modernise power generation in the Czech Republic. The value of these investments must mirror the value of the free allocation of emissions allowances, which we continue to achieve through investments in our existing power plants, facilities and infrastructure to comply with this requirement. Different principles apply under the EU ETS Directive regarding heat. In compliance with Article 10a of the EU ETS Directive as revised in 2009, District Heating and CHP high efficiency plants shall receive free allowances for heat supply from 2013 to 2027.

As regards the free emission allowances tax, although this tax was only applicable for the years 2011 and 2012, and the Czech Heat Infra entities obtained a refund of this tax together with related interest in the amount of EUR 13.2 million (of which the interest amounted to EUR 2.4 million) based on their claim backed up by the preliminary ruling of the European Court of Justice and the judgment of the Supreme Administrative Court of the Czech Republic, any extension or amendment to such tax legislation or introduction of any similar tax in the future, could have a material adverse effect on our business, financial condition, results of operations and cash flows. Out of the above sum, EUR 12.5 million was received in December 2015 and the remaining EUR 0.7 million in January 2016. However, both payments were recognized as income in the year ended 31 December 2015.

Our ability to secure sufficient emissions allowances is essential to our results of operations. Some of our power generation operations are required to purchase emissions allowances. The amount we will need to purchase will increase over time as a result of the allocation system under which fewer emissions allowances are allocated free of charge. Although the price of emissions allowances has decreased, we will need to buy increasingly large amounts of emissions allowances as free allowances in our operations are phased out by 2020 for power and 2027 for heat. Further, the limits for the years

2017 and 2018 are to be set providing for a linear decrease which may require additional investment on the part of EPE.

## **Factors impacting the results of our Power Distribution and Supply segment**

### **Price regulation and tariffs**

Electricity distribution tariffs in the Slovak Republic are regulated pursuant to the applicable legislation. Gas and electricity supply prices for households and small and medium-sized enterprises are also regulated pursuant to the applicable legislation in the Slovak Republic and the Czech Republic.

The regulated tariffs for both gas and electricity distribution are set by RONI by way of a maximum tariff for access to the distribution network and for distribution. The tariffs are set for the duration of the relevant regulatory period, which currently runs from 2017 to 2021. The tariff for access to the distribution network is either set as a fixed fee (for households and small and medium-sized enterprises) or depends solely on the capacity booked with the SSE Group, which is usually booked on the basis of one-year contracts. The tariff for distribution depends on the capacity actually used by customers of the relevant supplier.

The tariffs are generally determined by a formula that takes into account OPEX, depreciation and fair (allowed) profit and the result is then divided by the average distribution volume. RONI's approach to the determination of these components (including the regulatory asset base and the weighted average cost of capital which is used as a basis for determination of fair profit and eligible OPEX) may substantially impact the determination of the tariff for the relevant period and, accordingly, the profitability of the Power Distribution and Supply segment.

However, in the past the regulator focused on tariff stability allowing only moderate tariff changes over time. Even when switching between regulation periods 2012-2016 and 2017-2021, the allowed revenues were determined in a way allowing the regulator to keep rather stable tariffs. The average tariff was allowed to fluctuate as a result of the development of the distributed volumes, since the regulator's primary focus was the stability of individual fees for end-customers.

In the Slovak Republic, RONI also regulates the maximum electricity and gas supply prices for the so-called "vulnerable" customers, consisting of households and small enterprises.

### **Weather condition fluctuations**

Changes in weather conditions have an effect on gas consumption patterns and, to a lesser extent, on electricity consumption patterns. As a result, changes in weather conditions may have a direct impact on revenues of the electricity and gas supply business. Also, as part of the electricity distribution fees depend on the volumes of electricity that are actually distributed, such fees fluctuate in line with the consumption in the relevant period.

As a result, unusually warm (or cold) winter temperatures may reduce (or increase) consumers' demand for gas and, to a lesser extent, electricity and correspondingly reduce (or improve) our financial performance and results of operations.

### **Policies in respect of green sources of energy**

Support for renewable energy sources in the Slovak Republic is effected using DSOs, such as SSE's subsidiary SSE-D, as "pass-through" vehicles. The DSOs are intended to be compensated for the incentive payments they make through SOTs collected from the final power consumers. However, imbalances may occur in the compensation system that may result in negative balance of the SSE Group with respect to the incentive payments. Whilst these should be reimbursed within two years by

adjusting the tariffs, there may be substantial delays in receipt of such reimbursement by the SSE Group. In near future RONI assumes establishment of single entity for SOT related payments mechanism that would effectively close DSOs exposure on temporary imbalances. As of 31 December 2016 and 2015, the respective year negative balance created as a result of deviation of the actual cost of support of the renewable energy sources from the estimates used by the RONI to set the tariffs, which so far had not been reimbursed by adjustment of the tariffs, was EUR 138 million and EUR 73 million, respectively.

### **Liberalisation of electricity and gas supply market and arrival of new competitors**

As a result of EU legislation imposing a duty on Member States to unbundle the ownership of electricity and gas networks, including the transmission and distribution system, the electricity and gas markets have undergone a period of liberalisation. This liberalisation has given consumers the right to choose their gas and electricity supplier. The SSE Group is the incumbent market participant in the supply of electricity in the central region of Slovakia. As a result of this liberalisation and arrival of new competitors, the SSE Group's share of total electricity supplied in the central Slovakia region calculated as supply volume divided by distribution volume fell from 77.0% in 2010 to 66.7% in 2016.

### **Wholesale power prices**

In our Power Distribution and Supply segment, we both sell power generated by us in our Heat Infra segment in the wholesale market and purchase power from the wholesale market for delivery by the Power Generation division of our Heat Infra segment at times when it is more economical for us to buy power for sale under our forward sale contracts rather than generate it ourselves. As such, all related revenues are subject to fluctuations in wholesale power prices. Since power markets are liberalized in the Czech Republic and neighbouring European Union countries, prices in these markets are closely correlated. Accordingly, our margins are directly impacted when power prices change. However, we will only trade when it is economically beneficial to do so, so this uncertainty is somewhat mitigated and our trading revenues during a particular period may vary from comparable periods depending on our trading volume.

### **Commodity supply and trading**

As part of our Power Distribution and Supply segment, we supply and trade power and natural gas. While our power and natural gas trading policies require that the majority of our trades are conducted on a back-to-back basis, i.e., we typically only purchase commodities on the market when we have an offsetting sales contract, and we do not maintain large open positions which expose us to downside risk, we also engage in limited opportunistic power and gas trading activities. These trades primarily relate to (a) speculation on seasonal differences in power and natural gas prices, i.e., we purchase gas in the spring and summer with the intention of selling it at a higher price in the winter; and (b) speculation based on announcements relating to the availability of emissions allowances, as a reduction in the number of available emissions allowances typically leads to an increase in emissions allowance prices and thus increasing power prices due to higher production costs. Additionally, in connection with the optimisation our supply and trading business, we are dependent on the liquidity of the wholesale market, and as a result, we may take limited open trading positions, i.e. not match a sale with a purchase until there is more liquidity in the market, or if prices are falling, wait to make the matching purchase transaction. Nevertheless, such opportunistic trading activity is fairly limited, and the maximum exposure we may take through proprietary trading is subject to limits that set the maximum risk of loss on trading portfolios. Under our current trading policies, EPET's potential open positions in electricity and gas are limited by Risk Capital and Value-at-Risk limits, these are set at a maximum loss of 750,000 EUR (450,000 Power and 300,000 Gas) and 350,000 Value-at-Risk (200,000 Power, 150,000 Gas). If the EPET exceeds these thresholds on the EPET's open positions, it is required by EPE Group policies to close out of its open positions to a value below these thresholds. Under the

current SSE risk policy, exposure to market price risk in electricity and natural gas derived from open volume positions is limited by a maximal level of Risk Capital representing a max loss of EUR 1.6 million (EUR 500,000 for electricity, EUR 500,000 for natural gas, EUR 600,000 for a speculative portfolio) as well as Value-at-Risk set for each portfolio (EUR 250,000 for electricity, EUR 250,000 for natural gas, EUR 300,000 for a speculative portfolio). Risk on trading books is managed using a parametric Value-at-Risk method with a 99% confidence level. This means that according to our risk analysis, there is a 99% chance that the day-on-day loss on the specific trading book will not exceed the relevant Value-at-Risk limit. There is also a volume limit for open positions for each portfolio and each trading year. If the VaR limit is exceeded, it is required to close out the open position to decrease the risk.

## **Other factors impacting the results of the EPE Group**

### **Project execution**

The success of a renewables project is significantly influenced by external factors associated with obtaining required permits and approval processes. This mainly involves obtaining permits under applicable environmental protection legislation from the competent authorities, often including approval of an Environmental Impact Assessment ("EIA"), changes in land zoning plans, approval of all authorities and private parties affected by the planned project, and obtaining a land use decision by the state authority to satisfy zoning requirements, a construction permit and a usage permit. An EIA study has already been prepared or is under preparation for the projects we are currently planning. A negative ruling (or the absence of a ruling or the delay in receiving a ruling) by state administrative and government authorities or other legal entities can result in a delay or suspension of a project. Conditions imposed by authorities may negatively influence the timing or profitability of a project. During project development, obstacles can occur that we cannot anticipate and that are not known to us at the time of project implementation. A project can also be negatively influenced by failure to reach agreement with a key land owner, as the project construction, including connection to energy mains, may need to pass through the land of a number of owners, so it is essential to obtain easements on the land concerned.

Another factor influencing the financial success of a project can be unexpected problems during construction, in particular, problems associated with geology, delays related to weather conditions, transportation of excess loads, technological deficiencies and delayed deliveries of key components. Delayed construction can have a negative effect on obtaining a subsidy; Another significant factor is the conclusion of contracts and the compliance of suppliers of individual parts with the contractual conditions.



## Capital expenditures

Capital expenditures are necessary to maintain and improve the operations of our facilities and meet operating standards dictated by governmental regulations. Construction and maintenance costs have increased throughout the power industry over the past several years, and future costs will be highly dependent on the cost of components and availability of contractors that can perform the work necessary to maintain and improve other facilities. See “—Liquidity and capital resources of the EPE Group—Capital expenditures.”

The table below summarizes our capital expenditures (disregarding actual cash flows) for the **Heat Infra segment**:

In EUR millions	For the year ended December 31,	
	2015	2016
Capital expenditures relating to tangible fixed assets.....	112	63
Capital expenditures relating to intangible fixed assets excluding emission rights .....	1	1

Capital expenditures relating to tangible fixed assets decreased by EUR 49 million, or 43.8%, to EUR 63 million in 2016 from EUR 112 million in 2015. The main reason for relatively high capital expenditures in the year 2015 are investments at EOP incurred predominantly in order to comply with the stricter emission targets set forth by the European Industrial Emissions Directive (“IED”) that applies for large combustion plants since 2016.

Capital expenditures relating to intangible fixed assets (excluding emission rights) were not significant and on stable level.

The table below summarizes our capital expenditures (disregarding actual cash flows) for the **Power Distribution and Supply segment**:

In EUR millions	For the year ended December 31,	
	2015	2016
Capital expenditures relating to tangible fixed assets.....	49	57
Capital expenditures relating to investment properties .....	2	-
Capital expenditures relating to intangible fixed assets excluding emission rights .....	4	5

Capital expenditures relating to tangible fixed assets increased by EUR 8 million, or 16.3%, to EUR 57 million in 2016 from EUR 49 million in 2015. The majority of these capital expenditures are directly connected to SSE’s operations, for example technical improvements on existing distribution network of EUR 24 million and extension of distribution network of EUR 9 million in the year 2016 (EUR 17 million and EUR 10 million respectively in the year 2015). Installation of smart electrometers for EUR 3 million in the 2016 (EUR 2 million in 2015) was performed at SSE – Distribúcia, a member of SSE Group, as a long term project to be in line with legislature that requires their installation by 2020. In addition, technical appreciation of SSE’s Property, plant and equipment of EUR 6 million (EUR 12 million in 2015) was recorded and acquired free of charges in 2016. Furthermore, EP Cargo incurred EUR 4 million in the year 2016 in relation to acquisition of a new machinery.

Capital expenditures relating to intangible fixed assets increased by EUR 1 million, or 25.0%, to EUR 5 million in 2016 from EUR 4 million in 2015. The changes were not material.

Capital expenditures in the **Renewables, Other and Holding segment** are not material which stems from the nature of operations within these segments.

## The EPE Group

### Description of key income statement line items and key performance indicators of the EPE Group

#### Key income statement line items

**Sales: Energy.** EPE presents Sales: Energy in four component parts: sales of electricity (incl. distribution), sales of heat, sales of gas and sales of coal across all of our segments. EPE recognizes revenue when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. Revenue from the sale of own products and goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Discounts are recognized as a reduction of revenue as the sales are recognized, if it is probable that discounts will be granted and the amount can be measured reliably. Revenues from services rendered are recognized in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed. No revenue is recognized if there are significant uncertainties regarding the recovery of the consideration due, associated costs or the possible return of goods.

**Sales: Other.** Sales: Other represent revenues from non-core activities, including sales of brown coal dust and energy by-products (such as ash and gypsum).

**Gain (loss) from commodity derivatives for trading with electricity and gas, net.** At the date of the financial statements, trading derivatives are measured at fair value. As the trading in commodity derivatives forms a significant part of the Group's total trading activities, the measurement effect is recognised in "Gain (loss) from commodity derivatives for trading with electricity and gas, net", a separate line item under "Total sales".

**Cost of sales: Energy.** Cost of sales: Energy is divided into five component parts, namely cost of sold electricity, cost of sold gas and other energy products, cost of coal and other material, consumption of energy and other cost of sales. Cost of sales: Energy does not include directly attributable overhead costs (particularly personnel expenses, depreciation and amortization, repairs and maintenance, emission rights, taxes and charges). Cost of sales: Energy also includes losses incurred in energy trading transactions.

**Cost of sales: Other.** Cost of sales: Other is divided into four component parts, namely cost of goods sold, consumption of material, consumption of energy and other cost of sales. Cost of sales: Other does not include directly attributable overhead costs (particularly personnel expenses, depreciation and amortization, repairs and maintenance, emission rights, taxes and charges).

**Personnel expenses.** Personnel expenses represent expenses related to employees and board members, including wages and salaries of employees, benefits, remuneration of board members, social and health insurance, provisions related to employees (e.g., provisions for untaken holidays, accruals for bonuses and rewards), revenues/expenses related to employee benefits recorded in accordance with IAS 19 and other costs related to employees during the reporting period.

**Depreciation and amortization.** Depreciation represents non-cash expenses of tangible assets over time. Amortization represents non-cash expenses of intangible assets over time.

**Repairs and maintenance.** Repairs and maintenance represent externally incurred costs to bring an asset back to an earlier condition or to keep the asset operating in its present condition.

**Emission rights, net.** Emission rights, net comprise the profit from sale of emission allowances and the consumption of emission allowances on a continuous basis based on the actual production of emissions, with a corresponding decrease in the carrying value of deferred income on a systematic basis over the period for which the rights were issued.

**Negative goodwill.** Negative goodwill (gain on bargain purchase) represents a gain occurring when the price paid for an acquisition is less than the fair value of net assets of the acquired company.

**Taxes and charges.** Taxes and charges comprise gift taxes on emission allowances allocated by the Czech government, electricity taxes, property taxes and other taxes and charges (excluding income tax).

**Other operating income and expenses.** Other operating income and expenses represent items that are of secondary importance compared to the EPE Group's principal activities. These items include, for example, rental income, contractual penalties received from suppliers or paid to customers, consulting fees and commissions expense, transport services, insurance services, consumption of material, gains/losses on sale of intangible assets/property (excluding the sale of emissions allowances), plant and equipment or inventories, creation and reversal of various provisions, outsourcing and administrative fees and professional and advertising services.

**Finance income.** Finance income comprises interest income on funds invested, dividend income, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains (only if total foreign currency gains and losses result in net income; receivables in foreign currency are recalculated mark-to-market at the end of the accounting period to Czech crowns) that do not qualify for hedge accounting, gains on sale of investments in securities and gains on hedging instruments that are recognized in profit or loss.

**Finance expense.** Finance cost comprises interest expense on borrowings, unwinding of the discount on provisions (e.g., on provisions for decommissioning), foreign currency losses (only if total foreign currency gains and losses result in a net expense; payables in foreign currency are recalculated mark-to-market at the end of the accounting period to Czech crowns); realized profit from currency derivative contracts that do not qualify for hedge accounting, changes in the fair value of financial assets at fair value through profit or loss, fees and commissions expense for payment transactions and guarantees and impairment losses recognized on financial assets.

**Profit/(loss) from financial instruments.** Profit/(loss) from financial instruments represents profit or loss from commodity derivatives that are not presented as a part of Gain (loss) from commodity derivatives for trading with electricity and gas, net, currency derivatives (including both realized and mark-to-market valuations at the end of the accounting period), hedging activities and interest rate derivatives that do not qualify for hedge accounting.

**Share of profit/(loss) of equity accounted investees.** Share of profit/loss of equity accounted investees represents a share of profit of equity accounted associates.

**Gain/(loss) on disposal of subsidiaries, special purpose entities, joint ventures and associates.** Gain/Loss on disposal of subsidiaries, special purpose entities, joint ventures and associates comprises gain or loss from selling an ownership interest in a company.

**Income tax expenses.** Income tax expenses represent the sum of the tax currently payable and deferred tax. The tax currently payable is based on taxable profit for the year. Deferred tax is accounted

for using the balance sheet method and is recognized on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases.

**Other comprehensive income for the year, net of tax.** Other comprehensive income represents the difference between net income in the income statement and comprehensive income (which is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources; it includes all changes in equity during a period except those resulting from investments by owners and distributions to owners).

**Total comprehensive income for the year.** Total comprehensive income for the year represents the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income comprises all components of “profit or loss” and of Other comprehensive income, net of tax, and represents the certain gains and losses of the enterprise not recognized in the income statement.

### Results of operations of the EPE Group

The following sections provide a period-by-period comparison of the EPE Group’s historical income statement data. The financial data has been prepared in accordance with IFRS, and has been derived from the EPE’s consolidated financial statements for the year ended December 31, 2016 (which include financial information for the year ended December 31, 2015 as a comparison) and should be read in conjunction with and is qualified in its entirety by reference to these financial statements, including the notes thereto.

### Results of operations of the EPE Group: Year 2016 compared to the year 2015

The following table sets forth our historical income statement data derived from the EPE’s consolidated financial statements for the year 2016, prepared in accordance with IFRS as adopted by the EU, as well as other financial data. For a description of the changes in the reporting perimeter, see “—Key factors affecting comparability of the results of operations of the EPE Group”.

### Consolidated statement of comprehensive income

**For the year ended 31 December 2016**

*In millions of EUR (“mEUR”)*

	2015	2016
Sales: Energy	1,917	1,807
of which: Electricity	1,301	1,293
Heat	295	355
Gas	246	132
Coal	75	27
Sales: Other	44	34
Gain (loss) from commodity derivatives for trading with electricity and gas, net	10	1
<b>Total sales</b>	<b>1,971</b>	<b>1,842</b>
Cost of sales: Energy	(1,483)	(1,365)
Cost of sales: Other	(33)	(29)
<b>Total cost of sales</b>	<b>(1,516)</b>	<b>(1,394)</b>
<b>Subtotal</b>	<b>455</b>	<b>448</b>

Personnel expenses	(95)	(108)
Depreciation and amortisation	(158)	(168)
Repairs and maintenance	(9)	(5)
Emission rights, net	(4)	(15)
Negative goodwill	33	-
Taxes and charges	9	(3)
Other operating income	26	27
Other operating expenses	(51)	(51)
<b>Profit (loss) from operations</b>	<b>206</b>	<b>125</b>
Finance income	42	19
Finance expense	(89)	(65)
Profit (loss) from financial instruments	(2)	(9)
<b>Net finance income (expense)</b>	<b>(49)</b>	<b>(74)</b>
Share of profit (loss) of equity accounted investees, net of tax	-	-
Gain (loss) on disposal of subsidiaries, special purpose entities, joint-ventures and associates	(1)	63
<b>Profit (loss) before income tax</b>	<b>156</b>	<b>133</b>
Income tax expenses	(54)	(19)
<b>Profit (loss) from continuing operations</b>	<b>102</b>	<b>114</b>
Profit (loss) from discontinued operations	(20)	22
<b>Profit (loss) for the period</b>	<b>82</b>	<b>136</b>
<b>Items that are or may be reclassified subsequently to profit or loss:</b>		
Foreign currency translation differences for foreign operations	(21)	5
Foreign currency translation differences from presentation currency	59	(6)
Fair value reserve included in other comprehensive income	(4)	-
Effective portion of changes in fair value of cash flow hedges, net of tax	31	3
<b>Other comprehensive income for the year, net of tax</b>	<b>65</b>	<b>2</b>
<b>Total comprehensive income for the year</b>	<b>147</b>	<b>138</b>
<b>Profit (loss) attributable to:</b>		
<b>Owners of the Company</b>		
Profit for the year from continuing operations	57	66
Profit for the year from discontinued operations	(20)	22
Profit for the year attributable to owners of the company	37	88
<b>Non-controlling interest</b>		
Profit for the year from continuing operations	45	48
Profit for the year from discontinued operations	-	-
Profit for the year attributable to non-controlling interest	45	48
<b>Profit (loss) for the period</b>	<b>82</b>	<b>136</b>
<b>Total comprehensive income attributable to:</b>		
Owners of the Company	97	89
Non-controlling interest	50	49
<b>Total comprehensive income for the year</b>	<b>147</b>	<b>138</b>

## Key line items

### Sales: Energy

Sales: Energy decreased by EUR 110 million, or 5.7%, to EUR 1,807 million for the year 2016 as compared to EUR 1,917 million for the year 2015.

### **Sales of electricity**

Sales of electricity decreased by EUR 8 million, or 0.6%, to EUR 1,293 million for the year 2016 as compared to EUR 1,301 million for the year 2015. The effect of BERT acquisition, which had electricity sales of EUR 79 million from power generation primarily in cogeneration mode in the year 2016, as compared to EUR 13 million in the year 2015 as it was acquired in December 2015, was offset by a decrease in sales of electricity stemming from (i) lower power trading activity of EPET and (ii) lower power prices in the year 2016 as compared to the year 2015.

### **Sales of heat**

Sales of heat increased by EUR 60 million, or 20.3%, to EUR 355 million for the year 2016 as compared to EUR 295 million for the year 2015. The increase in sales of heat was primarily due to the acquisition of BERT, which had heat sales of EUR 73 million in the year 2016, while EUR 10 million in the year 2015 as it was acquired in December 2015. Higher heat realized by the Czech CHPs due to colder winter was offset by the sale of LPZ in June 2016.

### **Sales of gas**

Sales of gas decreased by EUR 114 million, or 46.3%, to EUR 132 million for the year 2016 as compared to EUR 246 million for the year 2015. This decrease in natural gas was primarily due to significant one-off natural gas trading transactions performed by EPET in 2015.

### **Sales of coal**

Sales of coal decreased by EUR 48 million, or 64.0%, to EUR 27 million for the year 2016 as compared to EUR 75 million for the year 2015. This decrease stems from lower trading activity at EPS.

### **Sales: Other**

Sales: Other decreased by EUR 10 million, or 22.7%, to EUR 34 million for the year 2016 as compared to EUR 44 million for the year 2015. This decrease was primarily due to disposal of EP Coal Trading Polska in February 2016, which caused decrease in Sales: Other by EUR 7 million.

### **Gain (loss) from commodity derivatives for trading with electricity and gas, net**

Gain from commodity derivatives for trading with electricity and gas, net decreased by EUR 9 million, or 90.0%, to EUR 1 million for the year 2016 as compared to EUR 10 million for the year 2015. This resulted from fair value re-measurement of trading derivatives at the date of financial statements and corresponded to contracted trading margin during the period.

### **Cost of sales: Energy**

Cost of sales: Energy decreased by EUR 118 million, or 8.0%, to EUR 1,365 million for the year 2016 as compared to EUR 1,483 million for the year 2015. This decrease was primarily due to lower natural gas and power trading activities undertaken by EPET, which resulted in lower natural gas and power purchases. On the other hand, the Group recorded higher fuel consumption for the heat and power production (as described above).

### **Personnel expenses**

Personnel expenses increased by EUR 13 million, or 13.7%, to EUR 108 million for the year 2016 as compared to EUR 95 million for the year 2015. This increase in personnel expenses was mainly attributable to increase in average headcount number primarily influenced by the acquisition of BERT in December 2015.

### **Depreciation and amortization**

Depreciation and amortization increased by EUR 10 million, or 6.3%, to EUR 168 million for the year 2016 as compared to EUR 158 million for the year 2015. This increase stems primarily from acquisition of BERT, which was partially offset by the end of lifetime of selected assets in 2015 as well as by the gradual introduction of operating leasing of the company cars at SSE (and also other EPE Group entities) in January 2015.

### **Repairs and maintenance**

Repairs and maintenance decreased by EUR 4 million, or 44.4%, to EUR 5 million for 2016 as compared to EUR 9 million for 2015. This decrease was primarily due to higher portion of capitalised general overhauls in 2016 as compared to 2015, thus decreasing the normal maintenance and repairs in 2016.

### **Emission rights, net**

Emission rights, net decreased by EUR 11 million to negative EUR 15 million for the year 2016 as compared to negative EUR 4 million for year 2015. This decrease primarily results from continuing decrease of emission allowances free allocation and increased consumption of emission allowances as result of higher production in 2016 as compared to 2015.

### **Negative goodwill**

Negative goodwill changed by EUR 33 million to EUR 0 million for the year 2016 as compared to EUR 33 million for the year 2015. The Group realized gain on the acquisition of BERT in December 2015, as the seller of BERT was exiting the Hungarian heating market and the Group was able to negotiate very favourable terms of the acquisition, including the purchase price.

### **Taxes and charges**

Taxes and charges changed by EUR 12 million to expense of EUR 3 million for the year 2016 as compared to income of EUR 9 million for the year 2015. It is result of one-off significant income related to refund of the free emission allowances tax in the amount of EUR 11 million<sup>15</sup> recognized in 2015 based on the claim of Czech Heat Infra entities backed up by the ruling of the European Court of Justice and the judgment of the Supreme Administrative Court of the Czech Republic.

### **Other operating income**

Other operating income increased by EUR 1 million, or 3.8%, to EUR 27 million for the year 2016 as compared to EUR 26 million for the year 2015, which was driven by more minor effects.

### **Other operating expenses**

Other operating expenses remained at EUR 51 million for both years 2016 and 2015.

### **Finance income**

Finance income decreased by EUR 23 million, or 54.8%, to EUR 19 million for the year 2016 as compared to EUR 42 million for the year 2015. Finance income is mostly represented by interest income, primarily due from loans provided to the parent and ultimate parent companies. Decrease in interest income stems mainly from partial offset of balances between EPE and EPIF from May 2, 2016.

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<sup>15</sup> related penalty received of EUR 2 million was recorded in Other operating income in 2015

### **Finance expense**

Finance expense decreased by EUR 24 million, or 27.0%, to EUR 65 million for the year 2016 as compared to EUR 89 million for the year 2015. Primary reason for decrease of finance expense is improved FX result by EUR 15 million compared to 2015. Further decrease by EUR 7 million relates to lower interest expense which was result of repayment of several EPE bank loans in April 2016.

### **Profit/(loss) from financial instruments**

Profit/(loss) from financial instruments deteriorated by EUR 7 million to a loss of EUR 9 million for the year 2016 as compared to a loss of EUR 2 million for the year 2015. This negative change in profit/(loss) from financial instruments was primarily due to mark-to-market revaluation of interest rate swaps (IRS) that EP Energy contracted in 2016 in order to hedge its interest rate risk.

### **Share of profit/(loss) of equity accounted investees, net of tax**

Share of profit/(loss) of equity accounted investees, net of tax is immaterial in both periods 2016 and 2015.

### **Gain/(loss) on disposal of subsidiaries, special purpose entities, joint ventures and associates**

Gain/(loss) on disposal of subsidiaries, special purpose entities, joint ventures and associates increased by EUR 64 million to gain of EUR 63 million for the year 2016 as compared to loss of EUR 1 million for the year 2015. Gain was primarily due to the disposal of Pražská teplárenská LPZ, a.s, resulting in gain of EUR 57 million.

### **Income tax expenses**

Income tax expenses decreased by EUR 35 million to EUR 19 million for the year 2016 as compared to EUR 54 million for the year 2015. Primarily it relates to decrease of current income tax expense by EUR 18 million in 2016 to EUR 33 million as compared to EUR 51 million in 2015, followed by change of deferred tax for EUR 17 million to deferred tax income of EUR 14 million compared to EUR 3 million deferred tax expense in 2015. This is combination of two factors (i) lower taxable profit in 2016 compared to 2015 affecting current income tax and (ii) change in tax rates for periods after 1 January 2017 in Slovakia and Hungary affecting deferred tax.

### **Profit/(loss) from discontinued operations, net of tax**

Profit from discontinued operations, net of tax, of EUR 22 million increased in 2016 compared to loss of EUR 20 million in 2015. This is primarily result of profit from sale of discontinued operations of EUR 34 million in April 2016, to certain extent offset by loss of EUR 12 million achieved by discontinued operations in 2016 until their disposal.

### **Other comprehensive income for the year, net of tax**

Other comprehensive income for the year, net of tax, decreased by EUR 63 million to EUR 2 million in 2016. This decrease was primarily due to foreign currency translation differences from presentation currency and from changes in the fair value of cash flow hedges predominantly relating to a cash flow hedge recognised on the EPE Group level.

### **Total comprehensive income for the year**

Total comprehensive income for the year decreased by EUR 9 million to EUR 138 million for the year 2016 as compared to EUR 147 million for the year 2015. This increase was primarily due to the factors described above.



## **Liquidity and capital resources of the EPE Group**

### **Capital resources**

EPE's financial condition and liquidity are and will continue to be influenced by a variety of factors, including:

- our ability to generate cash flows from our operations;
- the level of our outstanding indebtedness, and the interest EPE is obligated to pay on such indebtedness, which affects our financing costs;
- prevailing interest rates, which affect our debt service requirements;
- our ability to continue to borrow funds from banks and international debt capital markets;
- our level of acquisitions activity; and
- our capital expenditure requirements and development projects.

EPE's historical liquidity requirements have arisen primarily from the need for us to meet EPE's debt service requirements, to fund capital expenditures for the general maintenance and expansion of EPE's production and heat distribution facilities and for new facilities, to fund growth in our working capital and to support our acquisition strategy.

EPE's primary sources of liquidity historically have been cash flows from operations of subsidiaries, cash on EPE's balance sheet and external financings (including shareholder loans and bonds since EPE's issuance of the Notes). EPE's ability to generate cash from our operations depends on future operating performance, which is in turn dependent, to some extent, on general economic, financial, competitive market, legislative, regulatory and other factors, many of which are beyond our control.

EPE believes that its operating cash flows, together with the cash reserves and future borrowings permitted under EPE's debt facilities, will be sufficient to fund EPE's working capital requirements, anticipated capital expenditures and debt service requirements as they become due. EPE intends to maintain cash balances at EPE to meet the Group's short-term liquidity needs, including working capital (which we intend to replenish periodically with cash from operations).

EP Energy and its subsidiaries may from time to time use available liquidity (from any sources) to reduce the indebtedness of the Group. In particular, subject to compliance with applicable law and the terms and conditions of the bonds, the Company and its subsidiaries may from time to time repurchase outstanding bonds issued by them in the open market or otherwise at any time and at any price, as they may determine in their absolute discretion depending on prevailing market conditions.

## Cash flow

The following table summarizes selected positions from our consolidated cash flows for the years 2015 and 2016.

In millions of EUR ("mEUR")	2015	2016
<b>OPERATING ACTIVITIES</b>		
<b>Operating profit before changes in working capital</b>	<b>426</b>	<b>327</b>
<i>Selected changes to working capital</i>		
Change in trade receivables and other assets	23	1
Change in inventories (including proceeds from sale)	(22)	(1)
Change in assets held for sale and related liabilities	4	(54)
Change in trade payables and other liabilities	12	-
<b>Cash generated from (used in) operations</b>	<b>451</b>	<b>272</b>
Interest paid	(66)	(63)
Income taxes paid	(39)	(51)
<b>Cash flows generated from (used in) operating activities</b>	<b>346</b>	<b>158</b>
<b>INVESTING ACTIVITIES</b>		
Received dividends	5	-
Interest received	17	11
Repayment of loans from discontinued operations	-	302
Purchase of emission rights	(27)	(9)
Acquisition of property, plant and equipment, investment property and intangible assets	(244)	(126)
Acquisition of subsidiaries and special purpose entities, net of cash acquired	8	-
Net cash inflow from disposal of subsidiaries and special purpose entities including received dividends	-	79
Net cash inflow from disposal of discontinued operations	-	156
Other investing activities	19	14
<b>Cash flows from (used in) investing activities</b>	<b>(222)</b>	<b>427</b>
<b>FINANCING ACTIVITIES</b>		
Proceeds from loans received	256	15
Repayment of borrowings	(294)	(209)
Repayment of bonds issued	-	(3)
Dividends paid	(125)	(89)
<b>Cash flows from (used in) financing activities</b>	<b>(163)</b>	<b>(286)</b>
<b>TOTAL CHANGES IN CASH FLOW</b>	<b>(39)</b>	<b>299</b>

## Operating Activities

Cash flows generated from (used in) operating activities changed by EUR 188 million to cash in-flow from operating activities of EUR 158 million for the year 2016, as compared to cash in-flow from operating activities of EUR 346 million for the year 2015. This change is primarily due to a lower Operating profit before changes in working capital, which was at EUR 327 million for the year 2016 as compared to EUR 426 million for the year 2015. Particularly, 2015 operating profit before changes in working capital was positively influenced by the result of discontinued German operations of EUR 172 million, as compared to a loss of EUR 22 million in 2016.

## **Investing Activities**

Cash flows from (used in) investing activities improved by EUR 649 million to cash inflow of EUR 427 million in 2016, as compared to cash outflow of EUR 222 million in 2015. This positive change was mainly driven by proceeds from disposal of JTSD by EPE to EPGH for EUR 156 million (see the section Key developments - German assets sale) and related net repayment of liabilities of JTSD towards EPE in the amount of EUR 302 million and sale of Pražská teplárenská LPZ, a.s for EUR 82 million.

Acquisition of property plant and equipment, investment property and other intangible assets decreased by EUR 118 million to EUR 126 million in 2016 primarily due to the fact that Czech CHPs incurred substantial IED related capital expenditures in 2015 and also because of inclusion of capital expenditures relating to discontinued operations which were particularly significant in 2015 while fully excluded in 2016 (2016: EUR 18 million (fully excluded), 2015 EUR 76 million).

## **Financing Activities**

Cash flows from (used in) financing activities changed by EUR 123 million to negative cash flows used in financing activities of EUR 286 million in 2016, as compared to negative cash flows from financing activities of EUR 163 million in 2015. Change in financing activities stems primarily from refinancing undertaken in both years. While 2016 was influenced mainly by full repayment and termination of HSBC, CSOB and Commerzbank term loans in total amount of EUR 175 million by EPE (see the section Debt facilities), in 2015 EPE undertook a refinancing of bank loans used for acquisition of a 49% share in SSE. Further, EPE Group paid out dividends of EUR 89 million in 2016 (EUR 125 million in 2016).

## **Capital expenditures**

Our strategy is to focus capital investments on projects that maintain our technical equipment and increase operational efficiency. We have managed to keep capital expenditures at reasonably low levels by means of controlled business planning, engineering, procurement and project management at our operating subsidiaries. As noted earlier, the stricter emission targets set forth by the European Industrial Emissions Directive (IED) applied starting 2016 for large combustion plants, including those operated by us, driven the capital expenditure in past. In 2015 predominantly driven by capital expenditure at EOP and minor technology improvements at UE and PE. Non-compliance with the stricter emission targets set forth by the European Industrial Emissions Directive, the Air Protection Act or the operation permit in the designated time periods may lead to the imposition of penalties or even result in operations being shut down.

We also expect to continue in our capital expenditure on certain refurbishments to our heating network operations over the next year in order to be eligible for public subsidies currently available in the Czech Republic.

During the year 2015 and 2016, capital expenditures (excluding the effect of discontinued operations) were as follows:

	As of and for the year ended December 31,	
	2015	2016
Capital expenditures for tangible fixed assets .....	161	120
Capital expenditures for intangible fixed assets excluding emission rights .....	5	6
Capital expenditures for investment property .....	2	-
Capital expenditures for emission rights .....	20	18
<b>Total capital expenditures .....</b>	<b>188<sup>(1)</sup></b>	<b>144<sup>(2)</sup></b>
Property, plant and equipment, at depreciated cost.....	1,606	1,564

(1) Includes also EUR 0.7 million CAPEX of LPZ disposed on June 1, 2016

(2) Includes also EUR 0.2 million CAPEX of LPZ disposed on June 1, 2016

### **Capital expenditures for tangible fixed assets, intangible fixed assets excluding emission rights and investment property**

Capital expenditures for tangible fixed assets decreased by EUR 41 million, or 25.5%, to EUR 120 million for the year 2016 as compared to EUR 161 million for the year 2015. The main reason for relatively high capital expenditures in the year 2015 are investments at EOP incurred predominantly in order to comply with the stricter emission targets set forth by the European Industrial Emissions Directive ("IED") that applies for large combustion plants since 2016.

Capital expenditures for intangible fixed assets excluding emission rights immaterially increased by EUR 1 million, or 20.0%, to EUR 6 million for the year 2016 as compared to EUR 5 million for the year 2015.

No capital expenditures for investment property were made in 2016 compared to EUR 2 million for the year 2015, which related to an investment into real estate in Serbia<sup>16</sup> undertaken by EPET.

### **Capital expenditures for emission rights**

For the periods presented in this Report out of all entities included in EPE Group, EOP, PE, UE and BERT were required to purchase emission allowances for their own respective consumption due to an insufficient allocation of emission allowances or cover the difference between consumption and allocation by emission allowances they had at their disposal. The EPE Group's accounting policy is to hold emission allowances at cost, i.e. no revaluation to fair value at period end is carried out and emission allowances are consumed in heat and power production using the FIFO method. The share that our Czech and Hungarian operating subsidiaries will need to purchase will increase over time as the result of the allocation system under which fewer emissions allowances are now allocated free of charge. See "Risk factors—Risks related to governmental regulations and laws—We are exposed to changes in the way emissions allowances are allocated, including the conditions attaching to free allocations and the allocation of emissions allowances, as well as volatility in the market prices of emissions allowances that we need to acquire."

<sup>16</sup> 100% of shares in Adconcretum real estate Ltd., which owns investment property in Serbia, were sold by EP Energy Trading ("EPET") to EPH (as the buyer) for EUR 3 million (completed on May 31, 2016)

The operating data are based on the results of the entire relevant subsidiary regardless of the date when each such subsidiary joined the EPE Group or the ownership share of the EPE Group in each such subsidiary.

Allocation and consumption of emissions allowances for the EPE Group for the year ended December 31, 2016:

in tons <sup>(1)</sup>	Allocated	Consumed	Surplus (+) / Deficit (-)
EOP.....	813,330	1,793,143	(979,813)
UE .....	355,712	918,202	(562,490)
PE .....	187,452	333,293	(145,841)
PT .....	74 149	36 471	37 678
BERT.....	411,737 <sup>(2)</sup>	727,020	(315,283)
<b>Total .....</b>	<b>1,842,380</b>	<b>3,808,129</b>	<b>(1,965,749)</b>

(1) One emissions allowance equals one ton.

(2) Of which 139,286 were received from MVM as part of Power purchase agreement.

Emissions allowances granted to EOP without payment for the year ended December 31, 2015 were lower than the number of emissions allowances required by 979,813, or 54.6%. EOP purchased 979,813 emissions allowances to meet its shortfall in emissions allowances in the year ended December 31, 2016 at an average purchase price of 5.5 EUR/ton.

Emissions allowances granted to UE without payment for the year ended December 31, 2015 were lower than the number of emissions allowances required by 562,490, or 61.3%. UE purchased 562,490 emissions allowances to meet its shortfall in emissions allowances in the year ended December 31, 2016 at an average purchase price of 10.4 EUR/ton.

Emissions allowances granted to PE without payment for the year ended December 31, 2016 were lower than the number of emissions allowances required by PE by 145,841 or 43.8%. PE's shortfall in emissions allowances was covered by emissions allowances PE had at its disposal.

Emissions allowances granted to PT without payment for the year ended December 31, 2016 exceeded the emissions allowances consumed by PT by 37 678, or 103.3%.

Emissions allowances granted to BERT without payment for the year ended December 31, 2016 were lower than the number of emission allowances required by 315 283, or 43.4%. BERT purchased 315,283 emission allowances to meet its shortfall in emission allowances in the year end December 31, 2016 at an average purchase price of 6.74 EUR/ton.

## Contractual and other material financial obligations of the EPE Group

The table sets out our loans and borrowings as of December 31, 2015 and 2016.

In EUR millions	December 31, 2015	December 31, 2016
Loans payable to credit institutions.....	223	38
Loans payable to other than credit institutions.....	10	14
<i>of which owed to the parent company .....</i>	3	-
<i>of which owed to other related companies.....</i>	7	14
Bank overdraft .....	20	-
Notes .....	1,097	1,098
<b>Total.....</b>	<b>1,350</b>	<b>1,150</b>
Non-current .....	1,304	1,140
<i>of which owed to the parent company .....</i>	-	-
<i>of which owed to other related companies .....</i>	7	14
Current.....	46	10
<i>of which owed to the parent company .....</i>	3	-
<i>of which owed to other related companies .....</i>	-	-
<b>Total .....</b>	<b>1,350</b>	<b>1,150</b>

## Off-balance sheet arrangements of the EPE Group

The table below sets out EPE's financial commitments and contingencies as of December 31, 2015 and 2016.

In EUR millions	December 31, 2015	December 31, 2016
Granted pledges – securities.....	1,013	855
Guarantees given .....	179	117
Other granted pledges .....	1,677	886
<b>Total .....</b>	<b>2,869</b>	<b>1,858</b>

Granted pledges represent securities of individual EPE Group companies used as collateral for external financing.

### Guarantees given

Guarantees given mainly include contracts for the future supply of energy for EUR 113 million (2015: EUR 173 million).

### Other granted pledges

In EUR millions	Dec 31, 2015	Dec 31, 2016
Loans granted <sup>(1)</sup> .....	1,157	325
Property, plant and equipment.....	374	395
Cash and cash equivalents .....	45	75
Trade receivables .....	72	62
Inventories .....	28	29
Investment property .....	1	-
<b>Total .....</b>	<b>1,677</b>	<b>886</b>

All other contingencies were used as collateral for external financing.

(1) Total balance of pledged granted loans includes intercompany loans of EUR 319 million (December 31, 2015: EUR 925 million)

## Off balance sheet assets

In EUR millions	Dec 31, 2015	Dec 31, 2016
Received promises .....	263	395
Other received guarantees and warranties.....	4	4
<b>Total .....</b>	<b>267</b>	<b>399</b>

### Received promises

Received promises mainly comprise the contracts for the future purchase of energy in amount of EUR 197 million (2015: EUR 120 million), loan commitment received recognised by EP Energy, a.s. of EUR 50 million (2015: EUR 30 million) and regulatory contingent assets related to green energy of EUR 138 million (2015: EUR 73 million) recognised by Stredoslovenská energetika, a.s., which are represented by the contingent assets related to green energy.

Received promises also include a contingent asset amounting to EUR 8 million recognized by EP Cargo a.s. EP Cargo a.s. has agreed with one of its clients on compensation of losses arising from a long term contract relating to rental of transportation equipment. The part of the compensation that has not been paid prior to end of year 2016 has been recognized by EP Cargo a.s. as contingent asset.

### Regulatory contingent assets related to green energy

The SSE Group is legally bound to connect producers of green energy, if they comply with requirements set by RONI and to purchase the green electricity generated, which is used to cover network losses. The purchase tariff for green energy is set by RONI and is covered by the Tariff for system operation ("TPS").

For the year ended December 31, 2016 the SSE Group recognised a loss of EUR 57 million (2015: EUR 27 million) as the difference between the costs of purchased green energy and costs related to the subvention of electricity produced from coal and revenues from TPS in the period from January 1, 2016 to December 31, 2016. The loss disregards effects from recognition and releasing of accrued income as described below.

Based on the current Regulatory Framework the losses incurred in 2016 and 2015 will be compensated in two years' time, i.e. relevant amounts in 2017 and 2018 through an increase of revenues from TPS. The 2016 loss is included in the contingent asset of EUR 138 million (2015: EUR 73 million) specified above.

Based on a RONI decision from December 2016 the resulting asset of EUR 73 million originating in the year 2015 was recognised as accrued income in the consolidated statement of financial position as of 31 December 2016 and will be fully collected in the course of 2017.

Similarly, based on the RONI decision from December 2015 the resulting asset of EUR 77 million originating in the year 2014 was recognised as accrued income in the consolidated statement of financial position as of 31 December 2015 and was collected in the course of 2016.

The loss for 2016 has not yet been recognised as the asset does not yet meet the recognition criteria set by IFRS as adopted by the EU and will be recognised during the course of 2017 once an RONI confirmation on the exact amount shall be received.

## **Quantitative and qualitative disclosures about market risk for the EPE Group**

Our activities expose us to a variety of market risks. Our primary market risk exposures relate to foreign exchange, interest rate and commodity risks. To manage these risks and our exposure to the unpredictability of financial markets, we seek to minimize potential adverse effects on our financial performance and capital. Where appropriate, we use derivative financial instruments solely for the purpose of hedging exposure, which corresponds to managing the currency, interest and commodity risks arising from our operations and sources of financing. For this purpose, we have established financial and risk management policies. Although we do not enter into derivative financial instruments for speculative purposes, we do manage the commodity price risks associated with our proprietary trading activities by generally trading on a back-to-back basis, i.e., purchasing from the market where we have a customer in place to purchase the commodity. While the majority of our trades are conducted on a back-to-back basis, we also engage in limited opportunistic power and gas trading activities, mainly in relation to sales of power from own production, where the result of such trading activity depends on movements of wholesale power prices. See “—Commodity risk” below for our trading policies.

The following discussion and analysis only addresses our market risk and does not address other financial risks which we face in the normal course of business, including credit risk and liquidity risk.

### **Foreign exchange risk**

We have exposure to transactional foreign currency risk on sales, purchases and borrowings that are denominated in currencies (primarily euro) other than the respective functional currencies of EPE Group entities (primarily Czech crowns for Czech based entities and Hungarian forint for Hungarian entities). We use various types of derivatives, including forward exchange contracts with maturities of less than one year, to reduce the exchange rate risk on foreign currency assets, liabilities and expected future cash flows. These contracts are normally agreed with a notional amount and expiry date less than or equal to that of the underlying financial liability or the expected future cash flows, so that any change in the fair value and/or future cash flows of these contracts stemming from a potential appreciation or depreciation of the Czech crown against other currencies is fully offset by a corresponding change in the fair value and/or the expected future cash flows of the underlying position. In respect of monetary assets and liabilities denominated in foreign currencies, we seek to keep our net exposure at acceptable levels by buying or selling foreign currencies at spot rates or forward rates when necessary to address short-term imbalances.

### **Interest rate risk**

Our operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or re-price at different times or in different amounts. The length of time for which the interest rate is fixed on a financial instrument indicates to what extent it exposes us to interest rate risk. We use interest rate swaps and other types of derivatives to reduce the amount of debt exposed to interest rate fluctuations and to reduce borrowing costs. These derivative contracts are normally agreed with a notional amount and maturity date lower than or equal to that of the underlying financial liability, so that any change in the fair value and/or expected future cash flows of these contracts is offset by a corresponding change in the fair value and/or the expected future cash flows from the underlying position.

### **Liquidity risk**

Liquidity risk is the risk that the EPE Group will experience difficulties in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset. To counteract this risk, EPE focuses on diversifying sources of funds, which makes it less dependent on one financing source, and we also hold a portion of our assets in highly liquid funds. Liquidity risk is



evaluated by monitoring changes in the financing structure and comparing these changes with the EPE Group's liquidity risk management strategy. The EPE Group typically seeks to have sufficient cash available on demand and assets within short maturity to meet expected operational expenses for a period of 90 days, including servicing financial obligations (although this excludes the impact of extreme events that cannot be reliably predicted, like natural disasters).

### **Credit risk**

Credit risk is the risk of financial loss to the EPE Group if customers or counterparties to a contract fail to meet their contractual obligations. This risk arises primarily from the EPE Group's receivables from customers and loans and advances. To counteract this risk, EPE has established a credit policy under which every new customer purchasing services/products over a certain limit, which is based on the size and nature of the particular business, has its individual creditworthiness examined before the EPE Group's standard terms and conditions of payment and delivery are offered. The EPE Group also may require suitable collateral to be granted by customers, and the EPE Group monitors its exposure to credit risk on an ongoing basis.

### **Commodity risk**

Our exposure to commodity risk principally consists of exposure to fluctuations in the prices of commodities, especially emission allowances, both on the supply and the demand side. Our primary exposure to commodity price risks arises from the nature of our physical assets, namely power plants and to a lesser extent from proprietary trading activities.

We manage the natural commodity risk connected with our electricity generation primarily by selling the power we expect to produce on an up to two-year forward basis. In addition, we purchase emission allowances on a forward basis.

We aim to reduce exposure to fluctuations in commodity prices through the use of swaps and various other types of derivatives.

We manage the commodity price risks associated with our proprietary trading activities by generally trading on a back-to-back basis, i.e., purchasing from the market where we have a customer in place to purchase the commodity. It is our trading policy not to maintain any large open positions. EPET's potential open positions in electricity and gas over any period of time are limited by Risk Capital and Value-at-Risk limits, these are set at a maximum loss of 750,000 EUR (450,000 Power and 300,000 Gas) and 350,000 Value-at-Risk (200,000 Power, 150,000 Gas). If the EPET exceeds these thresholds on the EPET's open positions, it is required by EPE Group policies to close out of its open positions to a value below these thresholds. Under the current SSE risk policy, exposure to market price risk in electricity and natural gas derived from open volume positions is limited by a maximal level of Risk Capital representing a max loss of EUR 1.6 million (EUR 500,000 for electricity, EUR 500,000 for natural gas, EUR 600,000 for a speculative portfolio) as well as Value-at-Risk set for each portfolio (EUR 250,000 for electricity, EUR 250,000 for natural gas, EUR 300,000 for a speculative portfolio). Risk on trading books is managed using a parametric Value-at-Risk method with a 99% confidence level. This means that according to our risk analysis, there is a 99% chance that the day-on-day loss on the specific trading book will not exceed the relevant Value-at-Risk limit. There is also a volume limit for open positions for each portfolio and each trading year. If the Value-at-Risk limit is exceeded, it is required to close out the open position to decrease the risk.

### **Critical accounting policies of the EPE Group**

The financial statements for the EPE Group, included elsewhere in this Report, are prepared in conformity with IFRS<sup>17</sup>, which require us to make a number of estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, income and expenses, and the disclosure of contingent assets and liabilities. Estimates and assumptions may differ from actual future results. Our significant accounting policies are set out in full in Note 3 to EPE's consolidated audited financial statements for the years ended December 31, 2016 and 2015.

The estimates and assumptions that we consider most critical and that have a significant inherent risk of causing a material adjustment or involve a significant degree of judgment or estimation are discussed below, and should be read in conjunction with the full statement of accounting policies.

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<sup>17</sup> International Financial Reporting Standards as adopted by the European Union

## Debt Facilities

Following is summary of terms and outstanding balances of significant facilities drawn or available to EPE Group:

### EPE – HSBC Facility Agreement

*The following is a summary of the revolving, overdraft and documentary facility agreement dated April 2, 2014 between EP Energy, a.s. (the “EPE”) and EP ENERGY TRADING, a.s. (the “EPET”) as borrowers and HSBC Bank plc acting through HSBC Bank plc – pobočka Praha (the „HSBC“) as a lender, as amended from time to time (the „EPE HSBC Loan Agreement“).*

The EPE HSBC Loan Agreement provides for a revolving, overdraft and documentary facility limit („EPE HSBC Loan Limit“) in the amount of up to EUR 50 million (including certain sublimits) for the purpose of financing general corporate purposes.

The EPE HSBC Loan Limit matured on April 2, 2017 for revolving and overdraft facilities and on April 2, 2018 for documentary facilities. The EPE HSBC Loan Agreement has not been renewed.

The EPE HSBC Loan Limit is neither guaranteed nor secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

### EPE – KB Facility Agreement

*The following is a summary of the revolving, overdraft and documentary facility agreement dated April 2, 2014 between EP Energy, a.s. (“EPE”) as borrower and Komerční banka, a.s. („KB“) as a lender, as amended from time to time („EPE KB Facility Agreement“).*

The EPE KB Facility Agreement provides for a revolving, overdraft and documentary facility limit („EPE KB Facility Limit“) in the amount of up to EUR 50 million (with certain defined sublimits) for financing of general corporate purposes.

The EPE KB Facility Limit initially matured on April 17, 2017 for revolving and overdraft facilities and on April 17, 2018 for documentary facilities.

During 2017 the EPE KB Facility limit maturity was extended until April 17, 2020 for revolving and overdraft facilities and until April 17, 2021 for documentary facilities.

The EPE KB Facility Limit is neither guaranteed nor secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

### EPE – UniCredit Facility Agreement

*The following is a summary of the revolving, overdraft and documentary facility agreement dated October 20, 2014 between EP Energy, a.s. (the “EPE”) as borrower and UniCredit Bank Czech Republic and Slovakia ,a.s. (the „UNI“) as a lender, as amended from time to time (the „EPE UNI Facility Agreement“).*

The EPE UNI Facility Agreement provides for a revolving, overdraft and documentary facility limit (the „EPE UNI Facility Limit“) in the amount of up to EUR 50 million for financing of general corporate purposes.

The EPE UNI Facility Limit matures on October 20, 2017 for revolving and overdraft facilities and on October 20, 2018 for documentary facilities.

The EPE UNI Facility Limit is neither guaranteed nor secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

### **SSE-Solar—TB Loan Agreement**

*The following is a summary of the Loan Agreement dated August 17, 2010, between the company SSE-Solar, s.r.o. (a subsidiary of the SSE) as a borrower (the “SSE-Solar”) and Tatra banka, akciová spoločnosť, an affiliate of the Raiffeisen Zentral Bank Group (the “Tatrabanka”), as a lender (the “SSE-Solar Loan Agreement”).*

The SSE-Solar Loan Agreement provides for a loan (the “SSE-Solar Loan”) in the amount of EUR 24 million for the purpose of financing SSE-Solar’s investment activities. The SSE-Solar Loan has been fully drawn down, and as of December 31, 2016, EUR 9.6 million of the principal amount of the loan was outstanding.

The SSE-Solar Loan matures on December 31, 2020.

The SSE-Solar Loan is secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

### **SSE—SLSP Loan Agreement**

*The following is a summary of the Loan Agreement dated July 25, 2013 between Stredoslovenská energetika, a.s. (“SSE”) as a borrower and Slovenská sporiteľňa (the “SLSP”) as a lender (the “SSE SLSP Loan Agreement”).*

The SSE SLSP Loan Agreement provides for a loan (the “SSE SLSP Loan”) in the amount of EUR 25 million for the purpose of financing of SSE’s operational and investment needs. The SSE SLSP Loan has been fully drawn down, as of December 31, 2016, EUR 17.5 million of the principal amount of the loan was outstanding.

The SSE SLSP Loan matures on June 30, 2023.

The SSE-SLSP Loan is neither guaranteed nor secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

### **SSE Project Development—KB Loan Agreement**

*The following is a summary of the Investment Loan Agreement dated June 23, 2008 between Stredoslovenská energetika—Project Development, s.r.o. as a borrower and Komerční banka, a.s. (acting through its organizational unit in Slovak Republic) (the “KB”) as a lender, as amended from time to time (the “SSE Project Development KB Loan Agreement”).*

The SSE Project Development KB Loan Agreement provides for a loan (the “SSE Project Development KB Loan”) in the amount of EUR 21.6 million for the purpose of financing of 80% of the costs related to the construction of a gas-fired power plant. The SSE Project Development KB Loan has been fully drawn down and as of December 31, 2016, EUR 2.7 million of the principal amount of the loan was outstanding.

The SSE Project Development KB Loan matures on December 29, 2017.

The SSE Project Development KB Loan is secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

#### **SSE – VÚB Loan Agreement**

*The following is a summary of the revolving and overdraft Loan agreement dated July 31, 2014 between Stredoslovenská energetika, a.s. as a borrower and Všeobecná úverová banka, a.s. (the “VUB”) as a lender, as amended from time to time (the “SSE VUB Loan Agreement”).*

The SSE VUB Loan Agreement provides for a revolving and overdraft limit (the “SSE VUB Loan Limit”) in the amount of up to EUR 20 million for the financing of general operating needs. The SSE VUB Loan Limit is available to be utilized in form of revolving and overdraft loan. The availability of the SSE VUB Loan is from the signing date until July 31, 2016. As of December 31, 2016 none of the loan was utilized.

The SSE VUB Loan limit matures on July 31, 2017.

The SSE VUB Loan is neither guaranteed not secured and is subject to covenants, representations, undertakings and defaults typical for loans of this type.

#### **Terminated Agreements in 2016**

##### **EPE – CSOB Term Loan Agreement**

The EPE CSOB Term Loan Agreement provided for a single-currency term loan (the “EPE CSOB Loan”), dated August 28, 2015, in the amount of EUR 75 million for the purpose of financing general corporate purposes. The EPE CSOB Loan has been fully drawn down, and as of December 31, 2015, EUR 75 million of the principal amount of the loan was outstanding and was terminated by repayment in full amount on April 4, 2016.

##### **EPE – Commerzbank Term Loan Agreement**

The EPE Commerzbank Term Loan Agreement provides for a single-currency term loan (the “EPE Commerz Loan”), dated August 31, 2015, in the amount of EUR 50 million for the purpose of financing general corporate purposes. The EPE Commerzbank Loan has been fully drawn down, and as of December 31, 2015, EUR 50 million of the principal amount of the loan was outstanding and was terminated by repayment in full amount on April 4, 2016.

##### **EPE – HSBC Term Loan Agreement**

The EPE HSBC Term Loan Agreement provides for a single-currency term loan (the “EPE HSBC Loan”), dated August 31, 2015, in the amount of EUR 50 million for the purpose of financing general corporate purposes. The EPE HSBC Loan has been fully drawn down, and as of December 31, 2015, EUR 50 million of the principal amount of the loan was outstanding and was terminated by repayment in full amount on April 4, 2016.

## Business

In this section, all references to “EPE Group”, “EPE”, “we,” “us,” and “our” are to EP Energy, a.s. and its consolidated subsidiaries. Any projections and other forward-looking statements in this section are not guarantees of future performance and actual results could differ materially from current expectations. Numerous factors could cause or contribute to such differences. See “Risk factors” and “Forward-looking statements.”

### Overview

We are a leading vertically integrated energy utility focusing on heat and power distribution and generation, as well as energy supply and trading. We generate a substantial percentage of our EBITDA in each of the Czech Republic, the Slovak Republic and Hungary, where our principal operations are located. For the year ended December 31, 2016, the EPE Group had sales and consolidated EBITDA of EUR 1,842 million and EUR 293 million, respectively. A significant part of our business comes from regulated activities (*i.e.*, heat and power distribution and renewable energy), and business contracted through long-term agreements with a stable customer base (*i.e.*, grid balancing services as part of our power generation activities), which we believe provides us with resiliency of cash flows and future performance.

We operate our group through the following principal segments: Heat Infra (which has two divisions: Heat Generation, Distribution and Supply and Cogeneration (“Heat and Cogeneration”) and Power Generation); Power Distribution and Supply (which has two divisions: Power Distribution and Energy Supply) and Renewables. Our core segments, Heat Infra and Power Distribution and Supply, contributed 98% to the EPE Group’s consolidated EBITDA for the year ended December 31, 2016 (before intersegment eliminations). For the year ended December 31, 2016, Heat Infra accounted for 48.3% of the EPE Group’s consolidated EBITDA and Power Distribution and Supply accounted for 49.7% of the EPE Group’s consolidated EBITDA, in each case before intersegment eliminations.

Our Heat Infra segment owns and operates three large-scale cogeneration plants in the Czech Republic and we also own and operate, through our 73.8% owned subsidiary, PT, the most extensive district heating system in the Czech Republic, which supplies heat to the City of Prague. We are the largest heat supplier in terms of heat supplied in the Czech Republic (disregarding heat supplied by ET to PT), supplying 4.4 TWh (15.9 PJ) of heat for the year ended December 31, 2016 and 4.4 TWh (15.9 PJ) of heat for the year ended December 31, 2015. Further we gained dominant position on Budapest Heat supply market as a result of BERT acquisition by supplying 1.9 TWh (6.7 PJ) for heat for year ended December 31, 2016 and 1.8 TWh (6.3 PJ)<sup>18</sup> for year ended December 31, 2015.

We are one of the lowest cost providers of heat in the Czech Republic and we consistently charge lower heat tariffs than the national average in the Czech Republic, with the exception of PT that had tariffs slightly higher than the national average, however less than would correspond to the overall higher level of prices in Prague where the average GDP per capita is the highest in the Czech Republic. The heat generated in our cogeneration power plants is supplied mainly to retail customers through well-maintained and robust district heating systems.

We were also the third largest producer of power in terms of electricity generated in the Czech Republic (including ancillary services reported by ERO) as of December 31, 2016.

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<sup>18</sup> Heat supplied by BERT for whole year

Additionally, due to strict zoning requirements, as well as the capital intensive nature of the heat and cogeneration business, the Heat and Cogeneration division is characterized by high barriers to entry which we believe, coupled with off-take price regulation, do not make it economically feasible for new competitors to enter these markets. As a result, we believe that our exposure to the regulated heat business, support from the government for cogeneration production and our price leadership provides resiliency of cash flows.

Our Power Distribution and Supply Business consists of (i) the Power distribution division mainly undertaking electricity distribution activities in the central Slovakia region conducted through SSE-D and (ii) Energy supply division performing activities involving supplies of power and natural gas to end-consumers conducted through SSE Group and EPET in the Czech Republic and Slovakia. EPET and the SSE Group also purchase and sell power, including sales in the wholesale market of electricity generated by our Heat Infra segment and purchases of electricity and natural gas to supply customers as part of the division's supply activities.

Through our subsidiary EP Sourcing, a.s. ("EPS"), the Power Distribution and Supply segment also deals in brown coal and other solid fuels and supplies these primarily to our Czech heat and power companies. In addition, through our subsidiary EP Cargo, a.s. ("EPC"), the Power Distribution and Supply segment provides rail transport of brown coal and other bulk substrates, primarily brown coal, for our companies including UE, EOP and PE and companies outside the Group.

In 2016, SSE distributed 5,944 GWh of electricity through 743,821 connection points and supplied 3,966 GWh of electricity to approximately 598,841 customers. Based on information published by ZSE<sup>19</sup> and VSE<sup>20</sup>, we are the second largest, in terms of amount of electricity distributed, of the three regional electricity distributors with a market share of approximately 31% for 2015.

For the Power Distribution Business, RONI applies price regulation on distribution system operators through fixed prices which reflect economically justified costs and reasonable profits. We participate in consultations with the regulator and takes a proactive approach when responding to regulatory policy initiatives.

## Reorganization

As part of the reorganization of EPIF in 2016 (further described in the section Management's discussion and analysis of financial condition and results of operations -German assets sale), EPE sold-off its power generation activities in Germany as well as its mining operations in Germany to its ultimate parent company EPH (effective on April 1, 2016). The decision to sell-off these activities, which comprise an isolated geographical segment (Germany), was reached at the end of 2015. Due to the fact that these operations were predominantly representing the whole German operations, mining operations and condensation power production, the Company presented these activities as discontinued operations and therefore did not affect the EBITDA of 2016 and 2015. Gain on disposal of these operations is presented in the line Profit/(Loss) from discontinued operations, net of tax in the 2016 statement of comprehensive income (i.e. does not affect EBITDA).

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<sup>19</sup> Source: ZSE Annual Report (2015)

<sup>20</sup> Source: VSE Annual Report (2015)

## The Company

EP Energy is a joint-stock company, with its registered office at Pařížská 130/26, 110 00 Prague, the Czech Republic.

Energetický a průmyslový holding, a.s. (“EP Holding” or “EPH”) founded EP Energy on December 16, 2010, as a subsidiary to act as a holding company for entities belonging to the energy businesses of EPH and its subsidiaries (the “EPH Group”), in order to separate its strategic energy assets from the other business activities of the EPH Group. However, EPH has additional energy business operations that are not part of the EPE Group. Although EP Energy was formed in 2010, many of the individual subsidiaries in the EPE Group have a long operating history and a track record of strong performance.

On January 24, 2014, EP Infrastructure, a.s. (“EPIF”), a 100% subsidiary of EPH, acquired all of the outstanding shares of EP Energy, a.s. from its sole shareholder EPH. EPIF, founded by EPH on December 6, 2013, is intended to be an EPH subsidiary that will operate investments in critical energy infrastructure that are mostly regulated and/or long-term contracted.

As part of EPIF reorganization in 2016, EPE sold-off its power generation activities in Germany as well as its mining operations in Germany (including among others MIBRAG, Saale Energie and Helmstedter Revier GmbH), to its ultimate parent company EPH (effective on April 1, 2016).

## Shareholders

We are a wholly owned subsidiary of EPIF, which is a joint-stock company established under the laws of the Czech Republic. On September 30, 2016 EPH signed agreement with global consortium of institutional investors represented by Macquarie Infrastructure and Real Assets (“MIRA”) to sell a 31% minority share in EPIF. Following to certain closing conditions including approval by antitrust offices, particularly in Germany and Austria, the transaction was closed on February 24, 2017. The remaining 69% of EPIF remained with EPH, which also retained management control over EPIF. The MIRA-managed consortium is led by Macquarie European Infrastructure Fund 5 and includes global institutional investors.

EPH used the proceeds from the sale of EPIF to acquire its own shares (representing in aggregate 30% of EPH share capital) from Biques Limited, Milees Limited and EP Investment S.à r.l. for a total consideration of app. EUR 1.5 billion. This was reflected in structure of the ultimate holders of the EPE. Prior to the transaction EP Investment S.à r.l. held 37.17% share, Milees Limited 37.17%, and Biques Limited 25.66%. Currently, the ultimate beneficial owners of EPE are EP Investment S.à r.l. with share of 36.57%, EP Investment S.à r.l. 2 with share of 32.43%, and Mira Co. with share of 31.00%. Through its 69% ownership of EPIF, EPH retains management control over the company and continues to fully consolidate its financials.

Ultimate Shareholders of the EP Energy	As at December 31, 2016	As of date of the report
	(%)	(%)
EP Investment S.à r.l	37.17	36.57
Milees Limited	37.17	-
Biques Limited	25.67	-
EP Investment S.à r.l 2	-	32.43
Mira Co.	-	31.00
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

EP Investment S.à r.l. and EP Investment S.à r.l. 2 are controlled by Mr. Daniel Křetínský, the Chairman of the Board of Directors of EPE and a former corporate partner of the J&T Group. A share of 11.32%



in EP Investment S.à.r.l. is owned by ManCo, company of the management of EPH, who thus have a 6% indirect economic ownership in EPH.

### **History and development of the EPE Group**

The management team of the current EPE Group began to take shape in 2001 within the corporate investment branch of the J&T Group headed by Daniel Křetínský. Shortly after the formation of the team, it began to focus on corporate investments in the energy business and changed its approach from being a financial investor to being a strategic investor.

As a result, the J&T Group and the PPF Group founded EPH in 2009 as a platform for strategic investments in the energy and ancillary industries. The J&T Group (through Milees Limited and Biques Limited) contributed its assets to EPH in exchange for a 40% participation in EPH, and the PPF Group purchased (partly from the J&T Group) a 40% participation for cash. Daniel Křetínský received a 20% participation in exchange for a contribution of assets and for his partnership interest in the J&T Group. In 2010, EPE was formed by EPH and the interests in our current subsidiaries owned at that time by EP Holding (including those mentioned above (PE, UE and EPET)) were contributed to EPE.

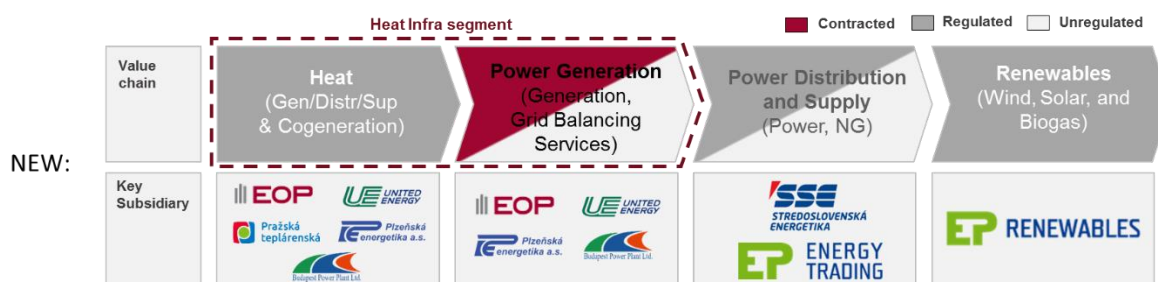
The following timeline provides an overview of the evolution of the EPE Group, through either direct acquisitions, or acquisitions by affiliates which were subsequently contributed to the EPE Group:

- In 2004, a 34% ownership interest in Pražská energetika a.s. ("PRE") was acquired by the J&T Group;
- In 2005, an 85.16% ownership interest in United Energy a.s. ("UE") was acquired by the J&T Group;
- Between 2006 and 2008, a 100% ownership interest in Plzeňská energetika a.s. ("PE") was acquired by the J&T Group (50% in 2006 and 50% in 2008) and in 2008 the interest in PRE was increased to 41.1%;
- In 2009, a 50% ownership interest in MIBRAG was acquired by an entity controlled by Daniel Křetínský;
- In 2009, a 100% ownership interest in International Power Opatovice, a legal predecessor of EOP, and a minority share in PT were acquired by the J&T Group;
- In 2009 EPH was formed, and the ownership interests in PRE, PE, UE, PT, PEAS (now merged with EPET) and EPET (formerly, United Energy Trading, a.s.) were contributed to EPH by the J&T Group, and EOP was sold by the J&T Group to EPH;
- In 2010, as part of a swap transaction, EPH's ownership interest in PT was increased to 72.98% and the stake in PRE was sold;
- In 2010, EPE was formed and the ownership interests in PE, UE, PEAS (now merged with EPET) and EPET, as well as a portion of the interest in PT, were contributed to it by EPH;
- In 2011, the 50% ownership interest in MIBRAG was contributed to EPE by an entity controlled by Daniel Křetínský and EOP and EPE's remaining interest in PT were contributed by EPH to EPE;
- In 2011, EPE acquired an additional interest in PT, bringing our ownership to 73.3%;

- In 2012, as part of the same transaction, EPE acquired the remaining 50% ownership interest in MIBRAG and EPE (through PT) sold its interest in Energotrans a.s. (“Energotrans”), a heat producer in the Czech Republic, but retained a long-term contract with Energotrans for the purchase of heat which we distribute through PT;
- In 2012, EPE entered into an agreement with the City of Prague regarding the management of day-to-day operations of PT, under which EPE undertook the management of the company;
- In 2012, EPE acquired a 41.9% ownership interest in Schkopau (including our beneficial use right over 400 MW<sub>e</sub> of the plant’s total capacity), one of MIBRAG’s customers for brown coal sales, through our acquisition of a 100% ownership interest in Saale Energie;
- In 2013, EPE completed the acquisition of HSR, including the Buschhaus power station and the Helmstedt mining district, from E.ON;
- In 2013, EPH acquired a 49% interest (including management control) in SSE (a Slovak power distribution and supply company) from E.D.F. International through EPH Fin II. EPH contributed shares in EPH Fin II to EPE on December 16, 2013;
- In 2014, EPIF, a 100% subsidiary of Energetický a průmyslový holding, a.s. (also “EPH”), acquired all of the outstanding shares of EP Energy, a.s. from EPH; and
- In 2014 the EPE Group acquired 60% share in EŽC a.s. (renamed to EP Cargo, a.s.) for EUR 5.8 million and 60% share in PGP Terminal, a.s. for EUR 0.7 million;
- In 2015, EPE acquired a 96% share in Budapesti Erőmű Zrt.;
- As part of EPIF reorganization in 2016, EPE sold-off its power generation activities in Germany as well as its mining operations in Germany (including among others MIBRAG, Saale Energie and Helmstedter Revier GmbH), to its ultimate parent company EPH (effective on April 1, 2016);
- As part of EPIF reorganization in 2016, EPE disposed other non-core entities by means of sale for a total equity value of EUR 12 million;
- On June 1, 2016 PT sold its shareholding in Pražská teplárenská LPZ, a.s. (“LPZ”) to a third party for approx. EUR 82 million.

## Segments

We operate our business through the following principal segments: Heat Infra (which has two subdivisions: Heat Generation, Distribution and Supply and Cogeneration (“Heat and Cogeneration”) and Power Generation); Power Distribution and Supply (which has two subdivisions: Power Distribution and Energy Supply) and Renewables. Our core segments are Heat Infra and Power Distribution and Supply. The following presents how our business lines are vertically integrated and the focus of certain of our subsidiaries within our business lines. For operational data for our principal segments, see “Management’s discussion and analysis of financial condition and results of operations.”



## Heat Infra

We conduct operations within this segment in the Czech Republic and since December 2015 also in Hungary through the following subsidiaries: PT (Czech Republic), EOP (Czech Republic), UE (Czech Republic), PE (Czech Republic) and Budapesti Erőmű Zrt. (Hungary).

The Heat Infra segment generated sales of EUR 561 million for the year ended December 31, 2016. In the same period, the Heat Infra segment generated EBITDA of EUR 145 million (before intersegment eliminations), or 48.3% out of Group's EBITDA before intersegment eliminations and Holding result, with the Heat and Cogeneration division being a greater contributor than Power Generation.

We were the leading heat supplier in terms of PJ of heat supplied to final consumers in the Czech Republic and as of December 31, 2016, the third largest power supplier in terms of electricity generated in the Czech Republic (including ancillary services). As of the date of this report, the heat distribution network length is approximately 1,050 km and the Heat Infra segment has 323,900 customers. According to the Czech Statistical Office<sup>21</sup>, 183 PJ of net heat was produced in the Czech Republic in 2011, 186 PJ in 2012, 178 PJ in 2013, 172 PJ in 2014, and 159 PJ in 2015.

We own and operate a group of plants in the Czech Republic and Hungary, all of which, other than PT plants, are cogeneration plants with the ability to operate in condensation mode and only to produce power when demand and prices warrant. The table below lists the network length for each of our plants:

Company	Location	Type	As at 31 December 2016
			Network length
Elektrárny Opatovice ("EOP")	Opatovice, Czech Republic	Cogeneration (CHP) Brown coal fired	313 km
United Energy ("UE")	Komořany, Czech Republic	Cogeneration (CHP) Brown Coal fired	148 km
Plzeňská Energetika ("PE")	Pilsen, Czech Republic	Cogeneration (CHP) Brown Coal fired	40 km
Pražská Teplotárenská ("PT")	Prague, Czech Republic	Natural gas and hard coal fired	549 km
Budapesti Erőmű Zrt. ("BERT")	Budapest, Hungary	Cogeneration (CHP), natural gas and LFO	-- (1)

Notes:

(1) The heat distribution network is owned and operated by Főtáv Zrt., which is also the only customer of BERT

<sup>21</sup> Source: Czech Statistical Office Balance of Energy Processes; 2015 based on preliminary data (March 24, 2017)

### Key operational performance indicators

The table below sets forth key operating data for the Heat Infra segment. The operating data are based on the metrics of the relevant entity for the entirety of the relevant annual period regardless of the date when each entity became part of the Group or the ownership share of the Group in each entity:

	2015	2016
Installed heat generation capacity (MW <sub>th</sub> ) .....	3,856	3,276
Installed electricity generation capacity – cogeneration (MW) .....	896	894
Installed electricity generation capacity – condensation (MW) .....	360	360
Weather impact measure (day-degrees for period) <sup>(1)</sup> .....	2,933.0	3,158.7
Heat supplied during period (GWh <sub>th</sub> /TJ) .....	6,166/22,197	6,294/22,660
Power production during period (GWh) .....	2,988	3,542

Note:

- (1) “Day-degrees” integrates the difference between reference indoor temperature and outdoor temperature over the given period of time. A higher value indicates that the temperature in the given period was below the reference temperature for a longer period of time. “Day-degrees” relate to all areas where the Heat Infra segment delivers heat, such as Praha, Pardubice, and Hradec Králové etc.

The table below lists installed capacities for each of our plants as of December 31, 2016:

As at 31 December 2016				
Company	Installed Capacity			Ownership
	Heat <sup>(1)</sup>	Cogeneration <sup>(2)</sup>	Condensation <sup>(2)</sup>	
Elektrárny Opatovice (EOP).....	937 MW <sub>th</sub>	189 MW <sub>e</sub>	189 MW <sub>e</sub>	100%
United Energy (UE) .....	487 MW <sub>th</sub>	89 MW <sub>e</sub>	150 MW <sub>e</sub>	100%
Plzeňská Energetika (PE) .....	197 MW <sub>th</sub>	90 MW <sub>e</sub>	21 MW <sub>e</sub>	100%
Pražská Teplárenská (PT) .....	999 MW <sub>th</sub>	130 MW <sub>e</sub>	- MW <sub>e</sub>	73.8%
Budapesti Erőmű (BERT).....	656 MW <sub>th</sub>	396 MW <sub>e</sub>	- MW <sub>e</sub> <sup>(3)</sup>	95.6%

Note:

- (1) Installed heat capacity on heat exchangers.
- (2) Installed cogeneration capacity represents the electrical capacity of generators that can deliver heat in cogeneration mode. Installed condensation capacity represents electrical capacity of generators that can produce power in condensation mode only. Total installed electrical capacity is determined by adding installed cogeneration capacity and installed condensation capacity together.
- (3) Despite the fact that BERT does not have any dedicated installed condensation capacity, it is able to produce small portion of power in condensation mode.

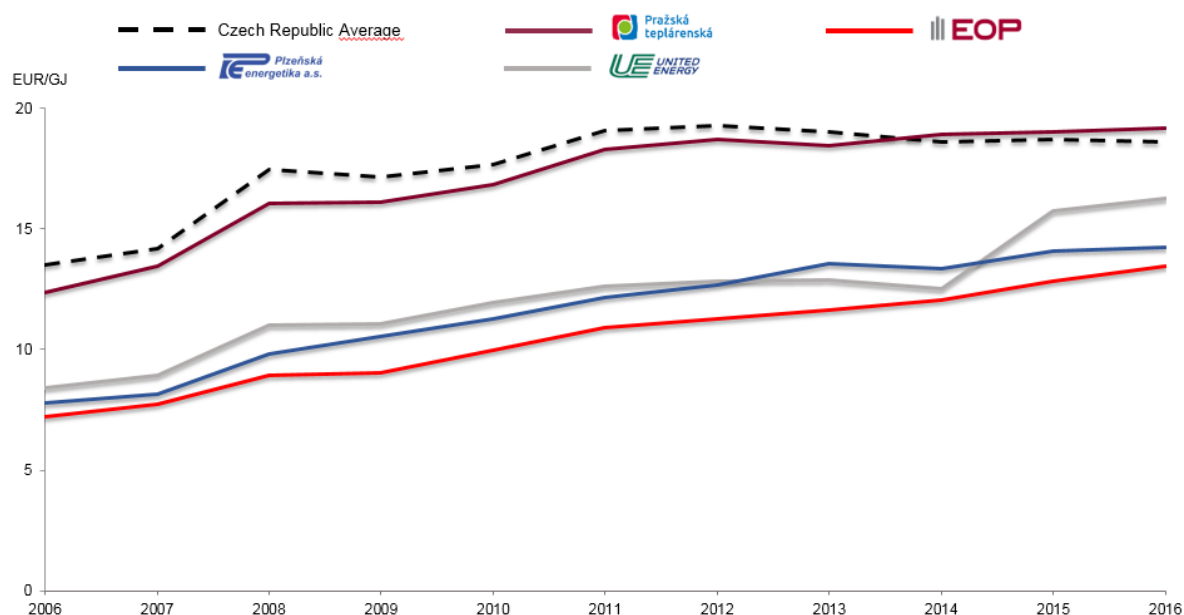
In the Czech Republic, heat generation and distribution is a regulated activity, whereby the ERO approves the methodology by which annual tariff rates for heat are set. Such tariffs are set by the individual companies based on direct costs plus justified indirect costs and an “appropriate” profit margin for the producers. The “appropriate” profit margin is set individually for each company and is based on invested capital. Furthermore, ERO sets the limit price for heat which allows our subsidiaries to set their own heat price on the condition that it is lower than the limit price and follows the calculation principles.

The heat generation and distribution industry is generally characterised by high barriers to entry due to ownership restrictions imposed by the government of the sole regional heat distribution system. This, combined with the regulated prices in the heat generation and distribution business, underpins the resilience of the cash flows of the heat business.

The Heat and Power segment has a highly competitive cost structure, which is the product of (i) operational efficiency resulting from a mainly brown coal fuel based and cogeneration plant design, (ii) multiple long-term contracts securing its primary fuel sources, (iii) well-maintained district heating distribution networks that require low capital expenditures by it, (iv) a long-term supply contract between PT and Energotrans for the supply of heat by Energotrans to PT for distribution to PT's customers and (v) potential derogation from the EU ETS auctioning of emissions allowances until 2020.

These factors allow us to offer low-cost heating to its customers, with its subsidiary EOP providing heat at one of the lowest price points in the Czech Republic (approximately 27% below the average Czech market price in 2016) and both PE and UE providing heat at approximately 23% and 12%, respectively, below the average 2016 Czech market price (average prices in the Czech Republic based on data published by ERO<sup>22</sup>). Although our subsidiaries recently raised prices moderately, we currently offer prices below that of alternative heating solutions, which allows it flexibility to increase prices further, if necessary, while remaining competitive.

The following chart provides a comparison of the heat prices charged by our companies, compared to the average heat prices charged by all heat distributors throughout the Czech Republic:



Sources: Company, ERO Assessment of Prices of Heat as of 1 January 2016 (April 2017)

### **Cogeneration versus condensation mode**

With the exception of those operated by PT, all of our plants are capable of being run in either cogeneration mode, whereby the by-product of power generation, heat, is funnelled into a heating distribution network, thus capturing otherwise wasted energy, and sold in the form of heat to its customers, or condensation mode, whereby only power is produced. We switch between cogeneration and condensation modes depending upon (1) the demand for heat and (2) the price of power. Although

<sup>22</sup> Source: ERO Assessment of Prices of Heat as of January 1, 2016 (April 2017)

plants operating in cogeneration mode are more energy efficient, they will produce less power than the less efficient condensation mode. Therefore, when the price of power relative to the price of heat is high, we may operate in condensation mode for greater power capacity. Conversely, during the winter months, the demand for heat is high enough relative to the demand for power that it is economical for it to run most capacity in cogeneration mode.

### ***Efficient and low-cost CHP plants***

The Heat and Cogeneration and Power Generation divisions of our Heat Infra segment share the same CHP plants and technologies, which results in shared fixed costs and allows us to charge lower prices than many of our competitors and realize higher margins in both divisions.

Combined heat and power plants are typically able to achieve approximately 75% efficiency, while an equivalent combination of conventional power plant and boiler is able to achieve only approximately 50% efficiency<sup>23</sup>. The Group's fleet of CHP plants, in contrast, operates at higher peak efficiencies in cogeneration mode (up to 85% depending on heat off take and almost 77% at BERT) by capturing some or all of the otherwise wasted by-product, heat, created in the power generation process.

In addition, our CHP plants are largely fuelled by brown coal, which allows us to maintain a competitive cost structure in both the heat and cogeneration and power generation businesses. BERT is gas-fired plant using primarily natural gas as its fuel. In 2016, majority of the heat that PT sold was purchased from Energotrans, all of which is generated by brown coal. The cost of brown coal, the primary fuel for plants, and the cost of the CO<sub>2</sub> emissions permits under the EU ETS required to offset the CO<sub>2</sub> the Group produces, are significantly lower than those associated with either natural gas or hard coal. Our revenues and margins may be negatively impacted by an increase of prices of emission allowances, whether as a result of change in regulations, policies or other factors.

Moreover, we source the majority of our brown coal for the CHP plants from suppliers under long-term contracts. Through these contracts we are able to purchase brown coal at relatively low and stable prices, which provide us with more predictable costs. Our use of brown coal as our primary power source means we are able to operate the CHP plants more cheaply and more efficiently than our non-brown coal based competitors, which results in lower off-take prices for its customers. On the other hand, we are able to benefit from present low market prices of hard coal and use hard coal in order to optimise its fuel base.

In addition, there is significant support from EU energy and environmental regulations and initiatives, which adds to the advantageous positioning of the Heat Infra segment within the European heat and power sectors. Directive 2004/8/EC of the European Parliament and of the Council already affirmed that "promotion of high-efficiency cogeneration based on a useful heat demand is a Community priority" due to its ability to save primary energy, avoid network losses, reduce emissions and increase the security of Europe's internal energy supply. For example, our CHP plants have much smaller carbon footprints than typical steam condensation plants. Combined heat and power plants are typically able to achieve approximately 50% saving in terms of CO<sub>2</sub> emissions required for the same energy output compared to equivalent combination of conventional power plant and boiler<sup>24</sup>.

More recently the EED was adopted and entered into force on 4 December 2012 providing a common legal framework for the promotion of energy efficiency within the EU aiming at ensuring the achievement of the EU's energy efficiency target of 20% by 2020. According to the EED, electricity from high-efficiency cogeneration must be afforded priority or guaranteed access to the transmission or

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<sup>23</sup> Source: U.S. Environmental Protection Agency, CHP Benefits (21 March 2016)

<sup>24</sup> Source: U.S. Environmental Protection Agency, CHP Benefits (21 March 2016)

distribution network and EU Member States must carry out a comprehensive assessment of the potential for the application of high-efficiency cogeneration and efficient district heating and cooling and must notify the EU Commission of the results. EU Member States must also encourage the implementation of methods of high-efficiency cogeneration and take adequate measures for efficient district heating and cooling infrastructure to be developed. In light of the foregoing, we expect cogeneration to continue to be a key part of EU energy strategy and a focus for support.

Furthermore, due to its efficiency, cogeneration is currently experiencing a positive market image and a high level of public and political support in the Czech Republic and in Europe in general, which we believe provides us with growth opportunities and a competitive advantage over non-CHP competitors. Additionally, we receive a government subsidy, which is divided into four levels (CZK 200 per MWh, CZK 140 per MWh, CZK 60 per MWh and CZK 45 per MWh of power generated in highly efficient cogeneration mode in the Czech Republic), depending on the efficiency of the cogeneration production of the plant. In 2016, the subsidies received by the Heat Infra segment amounted to approximately EUR 4.1 million as compared to EUR 4.5 million in 2015. We believe that the majority of our power produced in cogeneration mode will continue to receive the CZK 200 per MWh level of subsidy. The grant of subsidies is governed by the Czech Promoted Energy Sources Act and compliance with the applicable requirements is supervised by the ERO and Czech State Energy Inspection.

### ***Extensive heating distribution networks***

All of our cogeneration plants are connected to large-scale district heating networks, which were built to connect to large numbers of households and to supply densely populated areas and therefore have a large and stable customer base.

We operate extensive heat distribution networks in the Czech Republic, which supply both residential and industrial clients with heat. We supply heat to the largest Czech cities, including Prague, Pilsen, Hradec Králové, Pardubice, Most and Litvínov. Extensive, highly-developed and well-maintained district heating systems in the Czech Republic allow us to cheaply and efficiently distribute the energy we capture in the cogeneration process as heat to end-consumers linked to those district heating systems. PT also purchases heat for distribution to our customers under a long-term contract with Energotrans. We have a stable customer base, with a significant portion of our heat off-take delivered to residential apartment blocks through district heating systems, which we believe means our Heat and Cogeneration division is less vulnerable to economic downturns and industrial cyclicalities. District heating supplies buildings and homes within the heat transmission network from a central heat source through a network of insulated pipelines carrying hot water and steam. Currently, most of the steam pipelines have been replaced with hot water pipelines. This reduces leakages and lost heat. We believe district heating is an important and growing market in the Czech Republic.

In addition, in February 2013 the Czech government proposed the imposition of a carbon tax in its proposed Act on Changes to Taxation of Solid Fuels, Gas and Mineral Oils, which was to be applied from January 2014. However, the proposed bill was rejected by Parliament and, while the carbon tax is still discussed, we believe that it is not currently included in any existing or expected proposals.

### ***Derogation from EU ETS***

On July 6, 2012, the European Commission announced in MEMO/12/530 that it had authorized the Czech Republic's request for a continued free allocation of the EU ETS allowances to Czech power sectors beyond the end of 2012, which had initially been set as the date for the end of free allocations. The scope of these allowances is limited to installations that started to generate electricity before December 31, 2008 or for which the investment process was "physically initiated" by that date, and thus, all of our Czech power plants are covered by the derogation. The extension period lasts until 2019 at the latest, and the free allowance extension is limited to no more than 70% of emissions for domestic

electricity supply in 2013 and approximately 60% in 2014, declining annually thereafter to zero from 2020 onwards. Additionally, the Directive requires that installations benefitting from free allocation under the derogation invest in projects designed to modernise power generation in the Czech Republic. The value of these investments must mirror the value of the free allocation, which we continue to achieve through its investments in existing power plants, facilities and infrastructure to comply with this requirement.

Different principles apply to the EU ETS Directive regarding heat. In compliance with the revised EU ETS Directive Article 10a, district heating CHP plants receive free allowances for heat supply until 2027. The derogation is available to all Member States, but is limited in terms of eligibility and quantity. All district heating and highly efficient cogeneration plants are eligible, regardless of the commissioning date. However, the Directive requires a maximum of 80% of free allowances in 2013 with a gradual decline in subsequent years to reach 30% in 2020. Further gradual decline will reach zero free allowances in 2027. Contrary to the free emission allocation extension granted for electricity, the EU ETS Directive does not require heating plants benefitting from the free allocation under the derogation to invest in any projects.

The following table provides an overview of the actual and expected free allocation of emission allowances for the Heat Infra segment located in the Czech Republic and Hungary:

	2014	2015	2016	2017	2018	2019	2020
	<i>(in thousand tons)</i>						
Heat <sup>(1),(2)</sup> .....	758	648	644	544	460	360	294
Power Generation .....	1,589	1,324	1,059	794	529	265	-
<b>Total</b> .....	<b>2,347</b>	<b>1,972</b>	<b>1,703</b>	<b>1,338</b>	<b>989</b>	<b>625</b>	<b>294</b>

(1) Emission allowances allocated to BERT included from 2016

(2) Excludes emission allowances allocated to LPZ starting 2016

As all free allocations will be granted directly from the European Commission, the extent of any such allocations (either in respect of power generation or cogeneration) applicable to our businesses, if any, is uncertain.

### **Grid balancing services**

In our Power Generation division, we are one of the largest certified providers of grid balancing services in the Czech Republic in terms of revenues and megawatt hours of capacity provided and in 2016 we had an approximately 11.45% market share in the Czech Republic in the provision of grid balancing services, according to data provided by ČEPS<sup>25</sup>, the Czech Transmission System Operator ("TSO").

Grid balancing services are balancing services (*i.e.*, decreases or increases in electricity supply on a short-notice basis (in some cases within 30 seconds of the order instructions)) offered by electricity producers to the TSO in order to assist the TSO in maintaining a reliable transmission system. As a result of the contracting process for the provision of grid balancing services through an advance auction process and a framework agreement with the TSO, we have visibility over the entire revenue stream for one year in advance and over 70%-80% for two years in advance. Therefore, this business provides a predictable and steady stream of revenue and a reliable contribution to our EBITDA. The grid balancing services portion of our Power Generation division is poised to grow as an increasing share of the power generation market moves to renewables, which will in turn increase the demand

<sup>25</sup> Source: ČEPS AnS Statistics (2016)



for grid balancing services as power produced through renewable sources can be more unpredictable and erratic than power produced through other sources of supply.

We have two separate revenue streams from the provision of grid balancing services, derived from two distinct fee arrangements: Capacity fees and “as-provided” fees. Capacity fees are those paid by the TSO regardless of whether an individual service is actually provided through a framework agreement with the TSO. As-provided fees, in contrast, are paid by the TSO for individual services (although we only receive capacity fees for some services) as and when they are actually supplied.

Our Power Generation division offers a wide range of grid balancing services. The table below summarizes the types of grid balancing services offered by our Power Generation division in 2016:

<b>Name of Service</b>	<b>Nature of Service</b>
Primary Frequency Control	<ul style="list-style-type: none"> <li>• Ability to increase or decrease power output automatically based on grid frequency</li> <li>• Must be available within 30 seconds of the instruction</li> <li>• Capacity fee only</li> </ul>
Secondary Power Control	<ul style="list-style-type: none"> <li>• Change in power output of a regulated generating unit, as requested by the load frequency controller, a mechanism operated by the TSO</li> <li>• Must be enabled in full within 10 minutes of the request from the load frequency controller</li> <li>• Both capacity and as-provided fee</li> </ul>
Minute Reserve Available Within 15 minutes (Negative)	<ul style="list-style-type: none"> <li>• Decrease in generating unit power output following a request from the TSO</li> <li>• Both capacity and as-provided fee</li> </ul>
Minute Reserve Available Within 15 Minutes (Positive)	<ul style="list-style-type: none"> <li>• Increase in generating unit power output following a request from the TSO</li> <li>• Both capacity and as-provided fee</li> </ul>
Minute Reserve Available Within 5 Minutes	<ul style="list-style-type: none"> <li>• Ability to start power generation from 0 MWe to certified capacity within 5 minutes</li> <li>• Both capacity and as-provided fee</li> </ul>
Island Operations Capability	<ul style="list-style-type: none"> <li>• Capability to generate power to supply an isolated part of the system (a so-called “island”)</li> <li>• Capacity fee only</li> </ul>
Black Start Capability	<ul style="list-style-type: none"> <li>• Capability to start up without an external power supply, reach the set voltage value, connect to the grid and supply an island</li> <li>• Capacity fee only</li> </ul>

## **Power Distribution and Supply**

We conduct our Power Distribution and Supply business mainly through SSE and EPET that sell power and natural gas to end customers mainly in the Czech Republic and the Slovak Republic. For the year December 31, 2016, the Power Distribution and Supply segment generated sales of EUR 1,422 million. In the same period, the Power Distribution and Supply segment generated EBITDA of EUR 149 million (before intersegment eliminations), or 49.7% out of Group’s EBITDA before intersegment eliminations and Holding result allocation.

The SSE Group is included in this division from the date of its acquisition on 27 November 2013 when we acquired a 49% interest in the SSE Group. Our results include 100% of the results of the SSE Group because we have management control over the SSE Group.

## Power distribution

Electricity distribution is the final stage in delivery and involves the electricity supplied by an electricity supplier being carried from the nationwide transmission system and delivered to end consumers through the distributors' regional distribution network.



Slovakia has three regional distribution power networks operated by three vertically integrated groups: SSE group (Central Slovakia), ZSE (Western Slovakia) and VSE (Eastern Slovakia).

All these groups are partially privatised and as part of the unbundling process under the Second EU Energy Package, each created wholly-owned subsidiaries that operate their distribution systems. These subsidiaries are: SSE-D, Západoslovenská distribučná, a.s. and Východoslovenská distribučná, a.s. Each of these companies retains a natural monopoly in its respective territory.

SSE acts as distributor in the distribution of power, which is a regulated activity in the Slovak Republic and can be broken down into several categories: high voltage, medium voltage and low voltage distribution.

SSE distributes electricity to both businesses and households in the Slovak Republic and serves approximately 600,000 customers. SSE is based in the city of Žilina and operates in the central part of the Slovak Republic, which accounts for approximately a third of the area of the Slovak Republic and 25%<sup>26</sup> of the population. As of December 31, 2016, SSE-D, SSE's wholly-owned subsidiary through which SSE conducts regulated distribution activities, owned nearly 35,000 km of high-, medium- and low-voltage power lines and served approximately 743,821 delivery points. SSE-D also operates six high-voltage substations, 55 high-voltage/medium-voltage substations, 56 switching stations and 8,737 distribution substations. The table below shows the breakdown of SSE-D's network by type as of December 31, 2016:

	December 31, 2016
	(in km)
High Voltage.....	2,532
Medium Voltage .....	10,718
Low Voltage .....	21,201
<b>Total.....</b>	<b>34,451</b>

Source: Company

<sup>26</sup> Source: Slovak Statistical Office: Demographic informations - Number of inhabitants in region Central Slovakia as of December 31, 2016

In 2016, SSE distributed 5,944 GWh of electricity through 743,821 connection points and supplied 3,966 GWh of electricity to approximately 598,952 customers. Based on information published by ZSE<sup>27</sup> and VSE<sup>28</sup>, we are the second largest, in terms of amount of electricity distributed, of the three regional electricity distributors with a market share of approximately 31.4% for 2015.

Price-cap regulation has been implemented for the current regulatory period, meaning price regulation is implemented, *inter alia*, through a limitation of allowed profit, which is the profit allowed to be received by the relevant DSO and is part of the relevant formula for the calculation of transmission and distribution tariffs. The allowed profit is determined for a given regulatory period as a rate of return on the regulatory asset base before tax.

Price regulation concerning access to the electricity distribution network and electricity distribution by the regional DSO applies. The maximum price for access to the distribution network and electricity distribution is determined separately for each voltage level (low, medium and high) and calculated for the respective voltage level as a weighted average of specified tariffs.

The formula set by RONI stipulates that the distribution tariff calculation takes into account OPEX, depreciation and fair (allowed) profit. The regulatory weighted average cost of capital used by RONI for the calculation is 6.47%.

The electricity suppliers are obliged to pay the distribution tariffs notwithstanding whether and when they collect payment from end customers. The distribution agreements are regulated by the Rules for the Operation of the Electricity Market and other regulatory measures issued by RONI. According to the Group's standard practice, framework distribution agreements have a term of one calendar year.

The distribution tariff structure that RONI approves includes a fixed capacity-based payment (on average an allowed maximum of approximately 65% of the total tariff, while actual share is lower based on structure of customers). The remaining smaller part of the tariff is consumption-based. Therefore, a significant part of the distributor's revenues from power distribution are fixed and do not depend on the amount of electricity consumed. This mitigates the risks resulting from volatility in electricity consumption and makes our key distribution revenues more resistant to economic cycles.

### **Energy supply**

The supply business represents sales of power and natural gas to end consumers. The liberalisation of the electricity supply markets represents challenges but also opportunities for SSE and EPET, including the possibility of penetrating territories of other traditional suppliers. We have a portfolio of large customers, not only in the commercial sector, but also in the public and municipal sector, and we are successfully expanding in the retail sector, namely through the SSE Group, which is the traditional supplier in the region.

EPET, a wholly owned subsidiary, is a leading independent trader of namely power and supplier of electricity, natural gas and related services to final customers in the Czech Republic and the Slovak Republic. EPET's advantage is its access to our own electricity generating capacities and its core function is to exploit synergies with our other segments to cover the entire energy value chain.

Acting as a supplier enables SSE to take advantage of synergies with our other segments, especially the Power Generation division of Heat Infra segment and the Trading division of the Power Distribution and Supply business. Our Trading division buys power generated by its Heat Infra segment and sells it

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<sup>27</sup> Source: ZSE Annual Report (2015)

<sup>28</sup> Source: VSE Holding a.s. Annual Report (2015)

to the wholesale market while also buying from the wholesale market and selling to the supply division the volume of power that the supply division will sell to end-customers. Our trading arm also allows it to perform power procurement for supplies to end customers through purchases from significant market players, independent traders, and the Power Exchange Central Europe, a.s. ("PXE"). As the final step of the value chain, the supply division provides a direct link to its customers and removes risks from potential redistributions of margins, allowing it to capture full margins across the value chain. Additionally, our supply division allows us to leverage existing relationships with customers by providing dual fuel solutions (i.e., both power and natural gas). Excluding SSE, we sell to end customers, at least synthetically, volumes of power equivalent to approximately 65% of the total power we produce, which means that we retain the profit margins to third parties with respect to these sales. Furthermore, in line with our aim to strengthen our vertical integration, we continue to expand our retail operations in our Power Distribution and Supply Business, with expansion into the retail sector for electricity in order to diversify and stabilise our customer base and to reduce risks associated with customer concentration.

In 2016, SSE supplied approximately 4.0 terawatt hours ("TWh") of power to approximately 600,000 customers. SSE also owns and operates a small number of generation assets with a total installed capacity of 63 MWe: solar power plants with an aggregate capacity of 9.8 MWe, small hydropower plants with an aggregate capacity of 2.6 MW and a 50 MW gas turbine dedicated to the sale of system services to the Slovak TSO, SEPS. In 2012, SSE also launched a gas supply business.

SSE's supply of power in the Slovak Republic can be broken down into three categories: (i) business-to-business, (ii) mid- market and (iii) household. Of the electricity supplied by SSE in 2016, 52% is supplied to the business-to-business category. This category is characterised by high competition, and prices are not regulated. Therefore, customers use tenders and e-auctions to obtain price quotes, putting pressure on margins and favouring penetration pricing policies. In the past, SSE experienced a loss of customers to competitors who offered below-market rates. In the business-to-business category, SSE has already entered into power supply and power purchase contracts. In 2015, SSE also lost two major clients from the business-to-business category due to a change in the composition of the shareholders of the SSE Group.

In 2016, 12.8% of the electricity supplied by SSE was supplied to the mid-market category. This is the most attractive category as it generates the highest unit margin. The Company believes that the high acquisition costs and low price sensitivity of customers, prevents competitors from offering discounts attractive enough to create major customer churn.

In 2016, 35.2% of the electricity supplied by SSE was supplied to the household category, which is a regulated category. SSE has managed to keep its portfolio in this category generally stable and its switching rate lower than that in the mid-market and business-to-business categories, despite aggressive sales campaigns by its competitors.

The Group also trades power and natural gas primarily to fulfil its supply obligations or virtually to match its power production with its supply obligations.

### ***Energy production optimization and trading activities***

Our Power Distribution and Supply segment provides our CHP plants with constant access to the power market, enabling us to utilize state-of-the-art energy production optimization based on market demand. As part of this strategy, we both sell electricity generated by us in our Heat Infra segment in the wholesale market and purchase electricity from the wholesale market for delivery by our power generation business at times when it is more economical for us to buy electricity for sale under our forward sale contracts rather than generate it ourselves.

This decision depends on the price of power on the wholesale market. If the price of power on the wholesale market is lower than the cost of producing power, we will buy power, and if the price on the wholesale market is higher than the cost of producing power, we will produce it. The process of energy production optimization also involves selling and then reselling, potentially many times, the power we produce or the power we buy on the wholesale market. We conduct this sale and resale process in order to take advantage of price changes for power on the wholesale market to allow us to capture additional margin on the price of power. For example, if after selling the power that we intend to produce and locking in the sale price, the price of power drops to below our marginal cost of production, we will instead purchase the required amount of power for delivery. If the price of power then increases above our marginal cost of production, we will once again sell power we intend to produce, again locking in the sale price. If prices rise and fall further, we will repeat the process.

While our power and natural gas trading policies require that the majority of our trades are conducted on a back-to-back basis (for example, we typically only purchase commodities on the market when we have an offsetting sales contract, and we do not maintain large open positions which expose us to downside risk), we also engage in limited opportunistic power and gas trading activities. These trades primarily relate to (a) speculation on seasonal differences in power and natural gas prices, i.e., we purchase gas in the spring and summer with the intention of selling it at a higher price in the winter; and (b) speculation based on announcements relating to the availability of emissions allowances, as a reduction in the number of available emissions allowances typically leads to an increase in emissions allowance prices and thus increasing power prices due to higher production costs. Additionally, in connection with the optimization of our supply and trading business, we are dependent on the liquidity of the wholesale market, and as a result, we may take limited open trading positions, i.e., not matching a sale with a purchase until there is more liquidity in the market, or if prices are falling, waiting to make the matching purchase transaction. Nevertheless, such opportunistic trading activity is fairly limited, and the maximum exposure we may take through proprietary trading is subject to limits setting the maximum risk of loss on trading portfolios. Under our current trading policies, EPET's potential open positions in electricity and gas are limited by Risk Capital and Value-at-Risk limits, these are set at a maximum loss of 750,000 EUR (450,000 Power and 300,000 Gas) and 350,000 Value-at-Risk (200,000 Power, 150,000 Gas). If EPET exceed these thresholds on our open positions, we are required by EPE Group policies to close out of EPET's open positions to a value below these thresholds. Under the current SSE risk policy, exposure to market price risk in electricity and natural gas derived from open volume positions is limited by a maximal level of Risk Capital representing a max loss of EUR 1.6 million (EUR 500,000 for electricity, EUR 500,000 for natural gas, EUR 600,000 for a speculative portfolio) as well as Value-at-Risk set for each portfolio (EUR 250,000 for electricity, EUR 250,000 for natural gas, EUR 300,000 for a speculative portfolio). Risk on trading books is managed using a parametric Value-at-Risk method with a 99% confidence level. This means that according to our risk analysis, there is a 99% chance that the day-on-day loss on the specific trading book will not exceed the relevant Value-at-Risk limit. There is also a volume limit for open positions for each portfolio and each trading year. If the Value-at-Risk limit is exceeded, it is required to close out the open position to decrease the risk.

## **Renewables**

The Renewables segment generated sales of EUR 5 million for the year ended December 31, 2016. In the same period, the Renewables segment generated EBITDA of EUR 4 million (before intersegment eliminations), or 1.3% out of Group's EBITDA before intersegment eliminations.

Our renewable energy output is fed into the national grid, and in general, off-take prices and feed-in tariffs for solar, wind and biogas energy are fixed for 15 years for facilities that became operational before January 1, 2013 and for 20 years for facilities that became operational in 2013 in the Czech Republic and the Slovak Republic, in each case following the commissioning date. We believe this pricing framework allows for reliable visibility into our future results of operations.

Our wind operations are conducted in the Czech Republic through VTE Pchery, s.r.o., in which we hold a 64% stake, with an installed capacity of 6.0 MW<sub>e</sub>. In the Czech Republic, we also own and operate one solar facility with an installed capacity of 3.1 MW<sub>e</sub> and have a 41.7% ownership interest in another solar facility, which we also operate, with an installed capacity of 5.0 MW<sub>e</sub> (unconsolidated). We own two solar power plants in the Slovak Republic, each with an installed capacity of 1 MW<sub>e</sub>, and a 72% interest in a biogas facility in the Slovak Republic with an installed capacity of 3.0 MW<sub>e</sub>. The total installed capacity remained at 18.1 MW<sub>e</sub> at December 31, 2016 and December 31, 2015.

While we believe that we will continue to experience growth in our Renewables segment through the development projects, we expect that it will remain a relatively small part of our business. We are focusing less on our Renewables segment due to less favorable legislation and delays in the permitting process. For example, our VTE Pastviny project was discontinued because we did not obtain a permit before 2013.

### **Employees**

In 2016, we had on average 3,767 full-time equivalent employees in our operations, whereas 3,677 on average in 2015. The majority of our employees is employed in the Heat Infra and Power Distribution and Supply segments.

Historically we have enjoyed good labor relations and we are committed to maintaining these relationships. Other than management and professional personnel, the majority of our employees is represented by local trade unions and is covered by a number of collective bargaining and works council agreements, which usually last between 12 and 18 months. Effective January 1, 2017, we entered into a collective bargaining agreement for employees of PT which extends until December 31, 2020, and, effective January 1, 2017, the collective bargaining agreements for employees of UE and PE, respectively, were amended. On December 2, 2011, we entered into a collective bargaining agreement at EOP that will need to be renegotiated upon the responsible union providing us with six months' notice as the collective bargaining agreement for employees of EOP is concluded for an indefinite period. We continue to enter into further collective bargaining agreements as required in the Czech Republic, Hungary and the Slovak Republic. We extended the framework collective bargaining agreement for employees employed by SSE through December 31, 2015. SSE is member of the Union of Employers of the Power Industry in Slovakia, which is a party to the higher level collective agreement concluded with the Power-Chemical Trade Union on February 10, 2017, which is valid and effective until December 31, 2019. BERT has had a collective bargaining agreement ("CBA") for more than 30 years, which was updated in 2015 to fulfill the requirements of the new Labor Code in Hungary, signed on behalf of the employees by the trade unions existing at BERT. The CBA also contains all the obligations and rights regarding the work and the operation of the trade unions. The Collective Agreement of the Electricity Sector is the higher level collective agreement, which must be respected by BERT, and in cases where it prescribes more rights than BERT's CBA, it must be taken in consideration.

### **Corporate Social Responsibility**

We work with a number of charity partners on community reach-out and public service programs. Although we do not have a Group-wide CSR policy, our operating subsidiaries maintain separate CSR policies and engage in a variety of activities in this area.

In addition, a number of our entities work together with EPH Foundation Fund, which supports disabled children and their families, supports preservation of local heritage (including funding of restoration of local historical buildings) and also funds certain humanitarian activities in Northern Iraq, including a mobile clinic.

## **Environmental matters**

Operations in our Heat Infra and Renewables segments often involve the requirement to comply with regulatory regimes designed to protect the environment. We endeavour to comply with all known environmental regulations and have not been made aware of any material breaches of applicable environmental regulations by any member of the EPE Group.

Although we do not have a group-wide environmental initiative, the relevant operating subsidiaries implement their own policies with respect to compliance with environmental regulations and the mitigation of the Company's environmental footprint. This affects not only the operation of facilities, which we are trying to adjust to minimise their impact on environment, but also our investments. For example, EOP completed its programme for the protection of the environment which included a substantial refurbishment of some of EOP's facilities and the installation of four new particle filters and certain other modifications. EOP is already in compliance with the dust limits that will be applicable from January 2020.

## **European Union**

Czech, Slovak, Hungarian and EU regulations impose strict standards for CO<sub>2</sub>, SO<sub>x</sub>, NO<sub>x</sub>, CO and solid particulate matter emissions. Since 2016, the stricter emission targets set by the European Industrial Emissions Directive ("IED") principally apply for large combustion plants, which required additional capital expenditures in excess of EUR 80 million for our power plants, which has been invested recently in the Czech Republic (predominantly at EOP and minor technology improvements at UE and PE). Non-compliance with the stricter emission targets set forth by the European Industrial Emissions Directive, the Air Protection Act or the operation permit in the designated time periods would lead to imposition of penalties or even result in operations being shut down. In addition, there are continuing initiatives on the EU level to further decrease emission limits past 2020. No firm outcome in this matter has been reached so far while we are monitoring legislative process in the detail.

## **Czech Republic**

The key law focusing solely on the energy sector is Act No. 458/2000 Coll., on conducting business and governmental supervision in the energy sectors, as amended (the "Czech Energy Act"), which provides the legal basis for conducting business in the energy sector and obtaining the necessary licenses for the generation, distribution and sale of electricity, natural gas and heat. The Czech Parliament enacted the Czech Energy Act in 2000 and broadly amended it in August 2011 as a means of implementing the EU Third Electricity Directive. The Czech Energy Act contains provisions in compliance with applicable EU legislation. Its main principles are: (i) the conduct of business in the electric energy sector only with licenses issued by the ERO; (ii) the unbundling of transmission and distribution system operations; (iii) the liberalization of the market by allowing competition in the energy sector; (iv) the establishment of a strong and independent regulatory authority (*i.e.*, the ERO); and (v) the protection of end-consumers.

We believe that we are in full compliance with all applicable regulations and requirements under the Act No. 201/2012 Coll., on protection of the air, as amended (the "Czech Air Protection Act"). Since we own numerous coal-fired power plants classified as "existing particularly large combustion plants," under applicable legislation we may exchange and allocate the assigned aggregate emission limits between our coal-fired power plants in such a way as to ensure compliance with the Czech Air Protection Act and we are therefore able to optimize heat and power generation.

## **Slovak Republic**

The main law in the Slovak Republic regulating the energy sector is Act No. 251/2012 Coll., on the Energy Sector and on amendments to certain acts, as amended (the "Slovak Energy Act"), which

regulates the conduct of business in the electricity and gas energy sector, particularly production, transmission, distribution and supply of electricity and gas. Conducting business in the field of thermal energy, *i.e.*, heat production, heat production and distribution or heat distribution is governed by Act No. 657/2004 Coll., on the Thermal Energy Sector, as amended (the “Slovak Thermal Energy Sector Act”). The Slovak Energy Act and Slovak Thermal Energy Sector Act also regulate requirements for obtaining licenses to conduct business in the respective fields of the energy sector. Furthermore, the Slovak Energy Act also regulates measures aimed at securing the supply of electricity and gas and the functionality of the internal market for electricity and gas. The Slovak Thermal Energy Sector Act determines the rights and obligations of the heat market stakeholders. Both acts have implemented relevant EU energy legislation.

We believe that we are in full compliance with all applicable regulations and requirements under the Slovak IPPC Act, the Slovak Water Act and the Slovak Waste Act.

### **Legal proceedings**

Companies in our segments often face litigation both on a private commercial level, as well as litigation commenced by national and local regulatory bodies.

Elektrárny Opatovice, a.s. is involved in a dispute with its former minority shareholders who claim that compensation received for their shares through a compulsory sell-out procedure (“squeeze-out”) was inadequate, and who are challenging the underlying expert valuation. As the compensation was not paid by Elektrárny Opatovice, a.s. but instead by its former majority shareholder (International Holdings, B.V.), any resulting liability is thus expected to be the responsibility of the former shareholder.

United Energy, a.s. is involved in several disputes with its former shareholders, who claim that compensation received for their shares subject to a compulsory buy-out procedure (“squeeze-out”) was inadequate, and who are challenging the validity of the underlying resolution of the general shareholders meeting. The outcome of this matter is unforeseeable and United Energy, a.s. intends to defend itself. In May 2014, Court of appeal came to the conclusion that one claim challenging the validity of the underlying resolution of the general shareholders meeting is not relevant and UE believes that this conclusion may serve as a precedent for the other claims. Next court hearing is planned to be held during 2017. The parallel dispute regarding inadequate compensation is still ongoing with no clear outcome. Next court hearing is expected to be held during 2017.

In August 2012, Škoda Investment a.s. (SI) filed a claim for unjust enrichment against Plzeňská energetika a.s. (PE) for approximately EUR 2.3 million. This unjust enrichment claim allegedly arises from the fact that Plzeňská energetika a.s. owns and operates utility distribution systems (e.g., for gas, water and heat), which lie on the property of Škoda Investment a.s., thereby illegally restricting the ownership of Škoda Investment a.s. In February 2016 both parties, *i.e.* PE as well as SI, received an official request from the court to settle the dispute by mediation. Following this request, the hearing has been adjourned until further notice. In June 2016 SI has filed an additional claim for unjust enrichment against PE for approximately EUR 1 million. Additional claim covers period 2013 – 2014. EPE Group’s management believes that the claim is unfounded and should be dismissed by the court. For this reason, Plzeňská energetika a.s. did not create a provision for this litigation as at December 31, 2016.

The SSE Group is a party to various legal proceedings. As at December 31, 2016 and 2015 no legal provisions were recorded. The Group management has decided not to disclose details in respect of material legal claims as they are currently ongoing and disclosure may prejudice the SSE Group.



PT is involved in regulatory proceedings commenced in October 2015 by ERO claiming that prices charged to customers of PT's local small-scale heating infrastructures in 2011 were in breach of the Czech Act on Prices. In March 2016, ERO issued a decision ordering PT to pay EUR 9 million (CZK 240 million) consisting of a penalty in the amount of EUR 4.5 million (CZK 120 million) and restitution to affected customers in the amount of EUR 4.5 million (CZK 120 million). PT appealed the decision on March 24, 2016 with supplemental information provided on April 14, 2016. On July 7, 2016 PT received a resolution from ERO by which the Chairman of ERO returned the case again to the first instance for a new hearing. In November 2016 PT received new decision which confirmed the result of the court of the first instance. PT appealed again and on December 23, 2016 ERO issued a decision changing the amount to be paid to EUR 8 million (CZK 222 million) consisting of a penalty in the amount of EUR 4 million (CZK 111 million) and restitution to affected customers in the amount of EUR 4 million (CZK 111 million). Since PT believes that with high probability the legal action against the decision related to restitution to affected customers will be successful only the provision in the amount of EUR 4 million (CZK 111 million) corresponding to the amount of the penalty was recorded. On January 26, 2017 PT has taken legal actions against the resolution of ERO from December 23, 2016. Together with the appeal, PT deposited EUR 4 million to ERO bank account. On February 23, 2017 second instance court complied PT's appeal and confirmed suspensive effect of this claim till the next notice.

Other than the private commercial litigation described above, we are not involved in any legal or arbitration proceedings that are expected to have, either individually or in the aggregate, a material adverse effect on our financial position. To our knowledge, no such other legal or arbitration proceeding is currently threatened.

### **Information technology systems**

Our operational efficiency, which we believe is core to our competitive advantage, is partly a result of group-wide investments in information technology systems which allow our operating entities to coordinate their operations and help us to maintain group-wide policies and management of our operations. This is especially important in the coordination between the Power Generation division of our Heat Infra segment and our Power Distribution and Supply segments, which requires minute-by-minute information about levels of supply available to be sold or traded and the prices of power and natural gas on the wholesale market. In addition, the Trading division of our Power Distribution and Supply segment relies on proprietary software for the monitoring and clearing of trades in electricity and natural gas.

### **Safety systems**

Safety and quality management covering health and safety and environment ("HSE") management systems, technology and people is an integrated part of our management system. We believe, we, as well as our facilities and equipment, are in compliance with all legal requirements and best practices and continually attempt to improve the level of safety in our operations by implementing measures to evaluate, avoid, remove and mitigate risks. Furthermore, we maintain comprehensive training programs designed to ensure the safety of our employees. Additionally, when selecting and evaluating our suppliers, we take their approach to safety issues into account.

Our subsidiaries operating in the Heat Infra segment have implemented an integrated health and safety management system, BOZP (*bezpečnost a ochrana zdraví při práci*), which complies with the standards set by international norm ISO 14001, as well as Czech norm ČSN OHSAS 18001, and which provides HSE guidelines and best practices, as well as training programs for our employees.

For the year ended December 31, 2016, our major subsidiaries had the following accident rates (expressed in number of accidents per one million hours): EOP (9.71), PT (1.56), UE (6.30), PE (0.00), SSE (2.22) and BERT (2.20).

The EPE Group subsidiaries have the following certificates in the area of health protection, safety and processes:

- EOP – ISO 14001:2005, OHSAS 18001:2008
- PT – ISO18001:2008, ISO 14001:2005
- EPET – ISO 9001:2009
- SSE - ISO 14001 certification for environmental management and OHSAS 18001 certification for health and safety management at work; ISO 9001:2008 – certification of quality management (in respect of SSE, a.s. and EEM, a.s.)
- BERT - OHSAS 18001 certification for health and safety management at work; ISO 9001:2015 – certification of quality management

### **Insurance**

While our senior management makes all commercial, procedural and supervisory decisions regarding insurance policies, historically we entered into insurance contracts at the individual company-level. However during the last year, we started the development of combined insurance programs that respect the latest trends in the industry. The combined solution has been already implemented for property damage, business interruption and third-party liability insurance lines in EOP, PT, UE, PE and BERT. Our main insurance carriers are currently Generali and Allianz. At the individual company-level including the key operating companies EOP, PT, UE, PE, BERT and SSE our policies cover risk to property damage (fire, flood, earthquake, natural hazards and theft). The Heat and Power segment maintains “all-risk” property damage and business interruption cover, which includes insurance against machinery breakdown, loss of profit and terrorism and also maintains insurance for damages or third party claims.

Although we are covered by the industry standard insurances we cannot provide any assurance that the insurance will be sufficient or provide effective coverage under all circumstances and against all hazards or liabilities to which we may be exposed. For example, only some elements of SSE’s distribution network are insured, namely transformation stations and substations. Specifically, SSE’s insurance does not cover its power lines. Damages or third party claims for which we are not fully insured could materially and adversely affect our business, financial condition, results of operations and cash flows.

We believe that our policies are in accordance with customary industry practices, including deductibles, limits of indemnity and scope of coverage.

## Management

### Executive officers and directors of EP Energy, a.s. (“EP Energy”)

The following table sets forth the name, age (as of December 31, 2016) and principal position of each of EP Energy’s current members of the board of directors (the “Board”) and officers as of December 31, 2016:

Name	Age	Position
Daniel Křetínský.....	41	Chairman of the Board
Petr Sekanina .....	43	Vice Chairman of the Board
Tomáš David .....	45	Member of the Board; Chief Executive Officer
Pavel Horský .....	43	Member of the Board
Jiří Feist.....	54	Member of the Board; Chief Strategic Officer
Marek Spurný .....	42	Member of the Board
David Onderek.....	46	Director of Heat and Cogeneration
Tomáš Novotný .....	43	Director of Logistics and Coal Trading
Filip Bělák.....	38	Chief Financial Officer
Pavel Bureš .....	43	Procurement Director

The members of the Board and officers listed above can be reached at Pařížská 130/26, 110 00 Prague 1, Czech Republic.

There are no potential conflicts of interest between any duties of any of the member of the Board or officers listed above and their private interests or other duties, except for any such potential conflict described in “Certain relationships and related party transactions” and “Principal Shareholders”.

**Daniel Křetínský** has been the Chairman of the Board since EP Energy was founded on December 16, 2010 and through his role as a partner in the J&T Group, was also involved in the founding of EP Energy’s ultimate parent company, Energetický a průmyslový holding a.s. (“EPH”). At EP Energy, he is also a member of the Strategic committee. Mr. Křetínský holds board positions at certain of EP Energy’s subsidiaries. Mr. Křetínský also serves on several boards of companies that are affiliated with EP Energy, including its ultimate parent company EPH, parent company EPIF, SPP-I, eustream, NAFTA and EP Investment Advisors, s.r.o., and also holds positions at companies unaffiliated to EP Energy, including Vice Chairman of the Board of AC Sparta Praha fotbal, a.s. Mr. Křetínský was previously on the board of several EP Energy companies as well as on the board of several companies unaffiliated with EP Energy. Mr. Křetínský holds a bachelor degree in political science and master and doctoral degrees in law from the Masaryk University in Brno.

**Petr Sekanina** has been the Vice Chairman and member of the Board since October 12, 2016. He also serves on boards of directors and supervisory boards of several of EP Energy’s subsidiaries and affiliates, including EPIF, SSE, and Pražská teplárenská holding, a.s. He holds a master’s degree in mathematics and economics from the Masaryk University in Brno.

**Tomáš David** has been the Chief Executive Officer and a member of the Board of EP Energy since March 5, 2013, and had been the Head of the Heat Infra segment since EP Energy’s incorporation in 2010. He acted as the Director of Renewables and Power Distribution and Supply since March 2012 till September 2014. At EP Energy, he is also a member of each of the Strategy, Investment and Compliance Committees. Mr. David has also served on the board of directors of Elektrárny Opatovice,

a.s. and as a member of the supervisory board of NPTH, a.s., both subsidiaries of EP Energy, since August 1, 2010. Mr. David holds various positions with companies affiliated with EPH, for example as the Director of Energy Sector Development of EPH. Prior to that, he worked as the Chief Strategy Officer at Eurotel Praha, a leading Czech mobile phone operator, and 9 years in A.T. Kearney, a leading global management consulting firm. He holds an M.Sc. degree in Nuclear Physics from the Charles University in Prague and a Master of Business Administration degree from Rochester Institute of Technology, New York.

**Pavel Horský** has been a member of the Board of EP Energy since March 20, 2012 and served as EP Energy's Chief Financial Officer since September 1, 2012 until May 1, 2014 and till now serves as a member of the Risk and Strategy Committees of EP Energy. He is the CFO of EPH and he holds positions on the boards of directors or the supervisory boards of several other companies that are affiliated with EP Energy, including EPH and Slovak Gas Holding B.V. Prior to joining EPH, he held a market risk advisory position at RBS. Mr. Horský has a master's degree in mathematics and physics from Masaryk University in Brno.

**Jiří Feist** has been the Chief Strategy Officer since April 1, 2012 and has been a member of the Board of EP Energy since March 5, 2013. Mr. Feist formerly served as the Strategy and Business Development Director for the ČEZ Group and Chief Strategy Officer for ČEPS, a.s. Mr. Feist holds a master's degree from ČVUT FEL Praha.

**Marek Spurný** has been a member of the Board since EP Energy was founded in 2010, and was the Vice Chairman of the Board until March 2013. He also serves on EP Energy's compliance committee and on boards of directors and supervisory boards of several of EP Energy's subsidiaries and affiliates, including SPP Bohemia, a.s. (a subsidiary of SPP) and EP Investment Advisors. Mr. Spurný has been a member of the board of directors of EPH since October 7, 2009. Before joining EP Energy, Mr. Spurný served in various supervisory board positions at other affiliated companies of EP Energy. He has a law degree from Palacký University in Olomouc.

**David Onderek** has been the Director of Heat and Power since March 7, 2013. He also serves on various management boards of companies that are affiliated with EP Energy. Prior to joining EP Energy in July 2012, Mr. Onderek held the position of Vice Chairman of the Supervisory Board of PPC Úžín, a.s., an affiliate of ČEZ, and he previously worked for companies affiliated with the ČEZ group from January 1994. He holds a Master's degree in Economics of Power Generation from the Czech Technical University in Prague and a Master of Business Administration degree from the University of Pittsburgh.

**Tomáš Novotný** has been Director of EP Energy's Coal Trading and Logistics since February 2012 and also serves as the Chairman and Executive Head of EP Sourcing a.s. (a subsidiary of EP Energy). Mr. Novotný also serves as a member of the board of directors and as Executive Head of EP Cargo a.s. (a subsidiary of EPE), a supplier of logistics to EP Energy, and holds various management board positions at other companies affiliated with EP Energy. Mr. Novotný holds a Master of Economics degree from the University of Economics in Prague.

**Filip Bělák** has been EP Energy's Chief Financial Officer since May 1, 2014 and also serves as a member of the Risk and Investment Committees of EP Energy. Before joining EP Energy, Mr. Bělák spent 11 years at KPMG, a multinational accounting and consulting firm where he held various positions. He holds a Master of Economics degree from the University of Economics in Prague and is a member of two professional finance and accounting associations.

**Pavel Bureš** has been Procurement Director of EP Energy since August 25, 2014. He is also a member of the Investment Committee. Before joining EP Energy, Mr. Bureš spent 10 years at A.T. Kearney, a

leading global management consulting firm. He holds a Master degree in Finance from the University of Economics in Prague and a Master of Business Administration degree from Rochester Institute of Technology.

The board of directors of EPIF, as sole shareholder, appoints the members of the Board that conducts EP Energy's operations. The EP Energy Board requires the approval from its supervisory board to undertake certain significant transactions and measures. These include, *e.g.*, material debt financing, material acquisitions and divestitures and mergers.

## Principal shareholders

We are a wholly owned subsidiary of EPIF, which is a joint-stock company established under the laws of the Czech Republic. The ultimate beneficial owners of EPE as of April 28, 2017 are EP Investment S.à r.l. (36.57%), EP Investment S.à r.l. 2 (32.43%), and Mira Co. (31.00%)

<b>Ultimate Shareholders of EP Energy</b>	<b>As of date of report</b>
	(%)
EP Investment S.à r.l	36,57
EP Investment S.à r.l 2	32.43
Mira Co.	31.00
<b>Total</b>	<b>100.00</b>

EP Investment S.à r.l. and EP Investment S.à r.l. 2 are controlled by Mr. Daniel Křetínský, the Chairman of the Board of Directors of EPE and a former corporate partner of the J&T Group. The J&T Group, together with its subsidiaries, is a leading investment group operating predominantly in the Czech and Slovak Republics. A share of 11.32% in EP Investment S.à.r.l. is owned by ManCo, company of the management of EPH, who thus have a 6% indirect economic ownership in EPH.

## Certain relationships and related party transactions

We enter into transactions with certain related parties or our affiliates from time to time and in the ordinary course of our business. For all transactions above a certain monetary threshold we follow arm's length principles, and we apply unified standards with regards to dealings with affiliates, especially those that function as investment advisors, and we believe these agreements are on terms no more favorable to the related parties or our affiliates than what they would expect to negotiate with disinterested third parties.

For the purposes of this discussion:

- Accounts receivable and other financial assets represent money owed to EPE;
- Accounts payable and other financial liabilities represent money owed by EPE;
- Revenues means income of EPE; and
- Expenses means costs of EPE.

### Relationship with EPH

EPH is our ultimate parent company, owning 69% of the shares in EPIF that is our parent company.

The total value of transactions and balances between EPH and EPE and its subsidiaries as of and for the years ended December 31, 2015 and 2016 are set out below:

	As of and for the year ended December 31,	
	2015	2016
	(EUR in millions)	
Accounts receivable and other financial assets .....	309.4	-
Accounts payable and other financial liabilities.....	2.7	-
Revenues.....	12.1	2.9
Expenses.....	2.2	0.2

### Loan Agreements

Our transactions and balances with EPH primarily consisted of loans between EPH and EPE, each acting as both lender and borrower. Balances of loans provided and received were set-off during reorganization process described above and as of December 31, 2016, there were no outstanding balances from loans received nor provided.

### Other relationships

Although we do not have formal arrangements with EPH, management level EPE employees have assisted, and in the future will assist on, projects at EPH, as EPH seeks to support the operations of EPE. Additionally, we share certain business operation services with EPH, for example our email servers and computer systems. We intend to continue these relationships going forward.

### Relationship with EPIF

EPIF is our parent company, owning 100% of the shares in EPE.

The total value of transactions and balances between EPIF and EPE and its subsidiaries as of and for the years ended December 31, 2015 and 2016 are set out below:

	As of and for the year ended December 31,	
	2015	2016
	(EUR in millions)	
Accounts receivable and other financial assets .....	-	-
Accounts payable and other financial liabilities.....	-	-
Revenues.....	0.2	1.4
Expenses.....	-	-

### Relationship with EP Investment Advisors

EP Investment Advisors ("EPIA") is a company wholly-owned by EPH, which makes it our affiliate.

The total value of transactions and balances with EPIA as of and for the periods ended December 31, 2014 and 2015 are set out below:

	As of and for the year ended December 31,	
	2015	2016
	(EUR in millions)	
Accounts receivable and other financial assets .....	0.2	0.1
Accounts payable and other financial liabilities.....	3.5	0.9
Revenues.....	-	-
Expenses.....	3.3	1.6

EPIA provides consulting services to the EPE Group through a number of specific consulting agreements as well as more informal arrangements. This includes certain members of our senior management. The balances at period ends and expenses incurred to EPIA for these consulting services are set out above.

In addition to these agreements, EPIA has entered into a number of other agreements with certain of the subsidiaries related to the provision of various consultancy services (for instance, in relation to financing and merger and acquisition arrangements) and other business operations services.

EPIA also provides more informal services at the management level to both EPE and EPH. For example, most of the legal counsel and financial and technical analysts at the company are employees of EPIA, but provide assistance to both EPE and EPH on a project-by-project basis. We intend to put in place a framework agreement to formalize these arrangements in the future.

### Relationship with EP Industries

EP Industries ("EPI") is a company owned by certain of our shareholders. We have no formal arrangements with EPI, however our employees will at times assist with specific projects at EPI or will provide services to EPI in relation to specific projects.

### Relationships with certain other institutions

Certain credit institutions are treated as “Other related parties.” The total value of material transactions with certain of these credit institutions, namely J&T BANKA, a.s. (“J&TB”) which mainly related to bank account deposits and loans used to finance our operations, were as follows as of December 31, 2015 and December 31, 2016.

	As of and for the year ended December 31,	
	2015	2016
	(EUR in millions)	
Accounts receivable and other financial assets .....	-	-
Accounts payable and other financial liabilities.....	0.1	0.1
Revenues .....	-	-
Expenses.....	-	0.2



## Glossary

Unless otherwise indicated or where the context otherwise requires, references to:

*"2004 JORC Code"* are to the 2004 version of the Australasian Joint Ore Reserves Committee Code;

*"2012 JORC Code"* are to the version of the Australasian Joint Ore Reserves Committee Code that was published on December 20, 2012 and came into effect on December 1, 2013;

*"2012 Senior Credit Facility"* are to the term loans and revolving facilities under an agreement entered into on October 18, 2012 among EP Energy and the lenders and other parties named therein, which was repaid in full and canceled on April 18, 2013;

*"2018 Indenture"* are to the indenture dated April 18, 2013 among EP Energy as issuer, certain subsidiaries of EP Energy as guarantors and the Existing Notes Trustee, pursuant to which the 2018 Notes were issued;

*"2018 Notes"* are to the €600,000,000 aggregate principal amount of 4.375% senior secured notes due 2018 issued by EP Energy under the 2018 Indenture;

*"2019 Indenture"* are to the indenture dated October 31, 2012 among EP Energy as issuer, certain subsidiaries of EP Energy as guarantors and the Existing Notes Trustee, pursuant to which the 2019 Notes were issued;

*"2019 Notes"* are to the €500,000,000 aggregate principal amount of 5.875% senior secured notes due 2019 issued by EP Energy under the 2019 Indenture;

*"BERT"* are to Budapesti Erőmű Zrt.

*"Brown coal"* are to lignite, or a coal with a higher water content and lower calorific value than hard coal, which is mined by MIBRAG and is the type of fuel used to power our CHP plants (other than those operated by PT);

*"Buschhaus"* are to the Buschhaus brown coal-fired power plant in Lower Saxony (Niedersachsen), Germany;

*"Calorific value"* are to a measure of heating power or energy content;

*"CCGT"* are to combined cycle gas turbines;

*"CEE"* are to CE Energy, a.s. (renamed to EP Infrastructure, a.s. in 2016);

*"Cogeneration"* are to the process by which CHP plants produce both power and heat;

*"Collateral"* are to the rights, property and assets securing the notes and any rights, property or assets over which a lien has been granted to secure the obligations of the Issuer under the notes and the Indenture;

*"Combined Heat and Power plants"* or *"CHP plants"* are to plants that capture some or all of the heat generated during the power generation process and convert it into thermal energy, usually in the form of hot water or steam;

*"Czech Coal"* are to Czech Coal a.s., a Czech mining company;

*"District heating"* are to the supply of buildings and homes with heat (by using hot water or steam as a carrier) within a heat transmission network of pipes from a central heat source;

*"EEA"* are to the European Economic Area;

*"EEG"* are to the Federal Renewable Energy Act (*Erneuerbare-Energien-Gesetz*);

*"EEX"* are to the European Energy Exchange;

*"EIA"* are to Environmental Impact Assessment;

“E.ON” are to E.ON SE and all of its subsidiaries;

“EOP” are to Elektrárny Opatovice, a.s.;

“EPC” are to EP Cargo a.s.;

“EP Energy” are to EP Energy, a.s. (formerly CE Energy, a.s.);

“EPE” and “EPE Group” are to EP Energy and its direct and indirect subsidiaries, unless otherwise indicated or where the context otherwise requires;

“EPET” are to EP ENERGY TRADING, a.s. (formerly known as United Energy Trading, a.s.);

“EPIF” are to EP Infrastructure, a.s.;

“EPH” or “EP Holding” are to Energetický a průmyslový holding, a.s.;

“EPH Fin II” are to EPH Financing II, a.s., the entity through which we hold our 49% interest in SSE;

“EPH Group” are to EPH and its subsidiaries;

“ERO” are to the Czech Energy Regulatory Office;

“EU” are to the European Union;

“EU ETS” are to the European Trading System for CO<sub>2</sub> emission allowances;

“Eurozone” are to the 19 EU Member States that have adopted and retained the euro as their common currency and sole legal tender;

“Existing Notes” are to the 2018 Notes and the 2019 Notes;

“Existing Notes Guarantors” are to the guarantors who guarantee the Existing Notes and the SSE Acquisition Credit Facility;

“FIT” are to feed-in tariff;

“GAAP” are to generally accepted accounting principles;

“German assets” are to, among others, MIBRAG and Saale Energie. MIBRAG is a wholly-owned subsidiary of JTSD, Saale Energie is a wholly-owned subsidiary of EP Germany; both EP Germany and JTSD were wholly-owned subsidiaries of EPE (where EP Germany has been since 31 December 2015 directly owned by JTSD as a result of the sale of all EP Germany shares by EPE to JTSD)

“GDP” are to Gross Domestic Product;

“GJ” are to gigajoules, a measure of heat equal to 10<sup>9</sup> joules (3.6 GJ = 1 MWh);

“Group,” “we,” “us” and “our” are to the EP Energy and its direct and indirect subsidiaries, unless otherwise indicated or where the context otherwise requires;

“GWh” are to gigawatt hours, a measurement of electricity volume equal to a steady power of one billion watts running for one hour;

“HSR” are to Helmstedter Revier GmbH, which owns Buschhaus and the Helmstedt mining district, and its consolidated subsidiaries (Norddeutsche Gesellschaft zur Ablagerung von Mineralstoffen mbH and Terrakomp GmbH), unless otherwise indicated or where the context otherwise requires.

“IFRS” are to the International Financial Reporting Standards promulgated by the International Accounting Standards Board or any successor board or agency as endorsed by the European Union;

“Indenture” are to the indenture governing the terms of the notes between, among others, the Issuer and the Trustee, dated the Issue Date;

“JORC Code” are to the Australasian Joint Ore Reserves Committee Code;

“J&T Group” are to J&T Finance Group a.s. and its subsidiaries;

“Kt” are to kiloton, a measure of volume of brown coal equal to one thousand metric tons;

“KWh” are to kilowatt hours, a measure of power volume equal to a steady power of one thousand watts running for one hour;

“Lippendorf” are to the brown-coal fired power plant in Lippendorf;

“ManCo” are to entity controlled by senior management of EPH that is shareholder of EP Investment S.à.r.l.

“Member States” are to the countries that are members of the EU;

“Merit order” are to a system of ranking different sources of power generation, in ascending order of their short-run marginal costs of production, so that those with the lowest marginal costs are the first sources of power generation to be brought online to meet demand for power, and the sources with the highest marginal costs are the last to be brought online;

“MIBRAG” are to Mitteldeutsche Braunkohlengesellschaft mbH;

“MIBRAG Group” are to MIBRAG, MIBRAG Consulting International GmbH, GALA-MIBRAG-Service GmbH, Bohr & Brunnenbau GmbH Stedten (acquired in December 2012), Mitteldeutsche Umwelt- und Entsorgung GmbH, Fernwärme GmbH Hohenmölsen—Webau, Ingenieurbüro für Grundwasser GmbH and MIBRAG Neue Energie GmbH;

“Mining Authority” are to the relevant state governmental mining authority in Germany;

“MJ” are to megajoules, a measure of energy equal to one million joules;

“Mt” are to million tons, a measure of brown coal volume equal to one million metric tons;

“MW<sub>e</sub>” or “MW” are to megawatt electrical, a measure of installed power capacity;

“MWh” are to megawatt hours, a measure of power volume equal to a steady power of one million watts running for one hour;

“MWt” or “MWth” are to megawatt thermal, a measure of thermal power capacity equal to one million thermal watts;

“NPF” are to the National Property Fund of the Slovak Republic;

“OKTE” is Slovak Short term electricity market operator established as a subsidiary of Slovak TSO („Slovenská elektrizačná prenosová sústava, a.s.”)

“On boilers” are to maximum installed thermal capacity;

“Open-pit mining” are to method of extracting coal from the earth by its removal from an open pit as opposed to extracting coal from underground mines;

“Overburden” are to the excess geological material that lies above a coal seam, and which needs to be removed in order to mine coal;

“PE” are to Plzeňská energetika a.s.;

“PEAS” are to První energetická a.s., which merged with EPET on January 1, 2013;

“PJ” are to petajoules, a measure of heat equal to 10<sup>15</sup> joules (3.6 PJ = 1 TWh);

“Process steam” are to high pressure steam;

“PT” are to Pražská teplárenská a.s.;

“Purchase Agreement” are to the purchase agreement between the Issuer and the Initial Purchasers, in relation to the Notes offered hereby;

“PXE” are to the Power Exchange Central Europe, a.s.;

“RO” are to the Regulatory Office for Network Industries of the Slovak Republic;

“Saale Energie” are to Saale Energie GmbH;

“Schkopau” are to the Schkopau CHP plant in Germany;

“SEC” are to the United States Securities and Exchange Commission;

“SEPS” are to Slovenská elektrizačná prenosová sústava, a.s., the Slovak transmission system operator;

“SPP” are to Slovenský plynárenský priemysel, a.s., a Slovak integrated gas utility;

“SSE” are to Stredoslovenská energetika, a.s. and its consolidated subsidiaries, in which EPH acquired a 49% interest on November 27, 2013 and which was contributed to EPE on December 16, 2013;

“SSE Acquisition Credit Facility” are to the senior secured term facilities under an agreement entered into among, *inter alia*, EPH Fin II as borrower, the agents and the mandated lead arrangers party thereto;

“Stripping Ratio” are to the ratio of volume of overburden required to be handled in order to extract a volume of coal;

“TJ” are to terajoules, a measure of heat equal to  $10^{12}$  joules (3.6 TJ = 1 GWh);

“Ton,” “ton,” “T” or “t” are to metric ton, a measure of volume of brown coal;

“Trustee” are to Citibank, N.A., London Branch in its capacity as trustee under the Indenture;

“TSO” are to transmission system operator;

“TWh” are to terawatt hour, a measure of power volume equal to a steady power of  $10^{12}$  watts running for one hour;

“UE” are to United Energy, a.s.;

“U.S. Exchange Act” are to the U.S. Securities Exchange Act of 1934, as amended;

“U.S. Securities Act” are to the U.S. Securities Act of 1933, as amended; and

“VTE” are to wind parks.

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**Attachments:**

EP Energy, a.s. - Consolidated financial statements as of and for the year ended December 31, 2016 are presented in a separate file as an attachment to this report