



AB AMBER GRID STRATEGY

2017–2022

CONDENSED VERSION

Updated in 2020

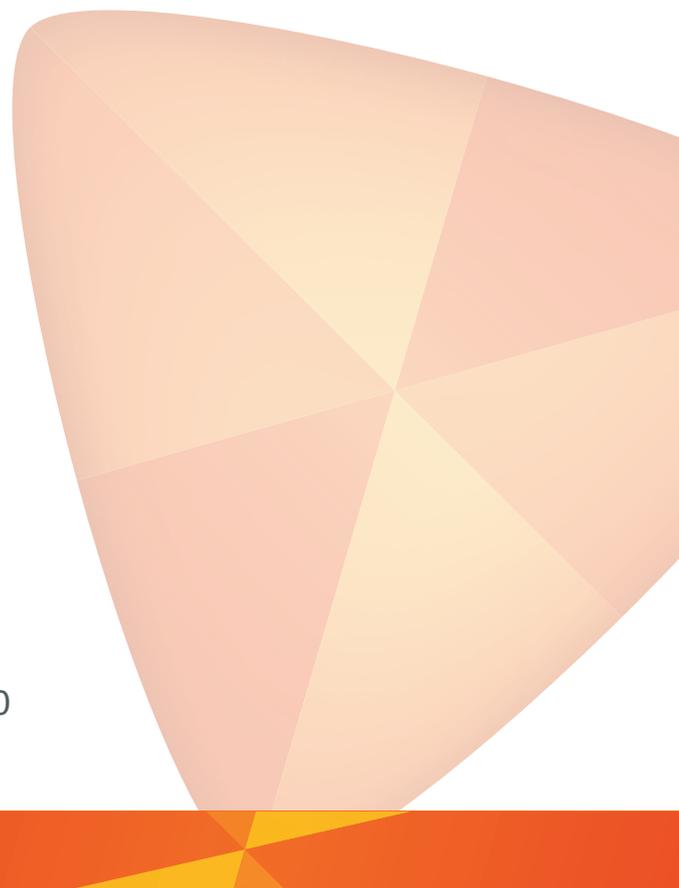


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SUMMARY

The purpose of this document is to set the strategic directions, goals, objectives and actions (programs) of AB Amber Grid (hereinafter – Amber Grid, the Company) for 2017-2022, to formulate specific indicators for measuring the efficiency of its operations in the short and long term. The long-term Strategy of the Company, that on 1 August 2013 started operating independently in the field of gas transmission, was approved in 2015. In the Strategy Paper 2017-2022, we provide updated data, forecasts, objectively assess environmental changes and the changing market situation, which affect the long-term strategy of the Company.

The Amber Grid strategy is based on integration into the single regional natural gas market, efficiency and modernisation, fostering of infrastructure, creating an advanced organization. These elements are essential in pursuing strategic and financial objectives set by the shareholder.

AMBER GRID’S MISSION

We provide effective and reliable gas transmission, we create favourable conditions for competition in the gas market and for the development of renewable energy sources.

Amber Grid is the gas transmission system operator in Lithuania. The Company manages, operates and develops the natural gas infrastructure – Lithuanian gas transmission pipelines and related facilities, ensures safe and reliable gas transportation.

The main tasks of the Company: to interconnect gas systems, to provide access to the system on a non-discriminatory basis, to create conditions for competition in the gas market and for the development of renewable energy sources, to contribute to ensuring that gas, as a source of energy, helps the economy to grow.

AMBER GRID’S VISION

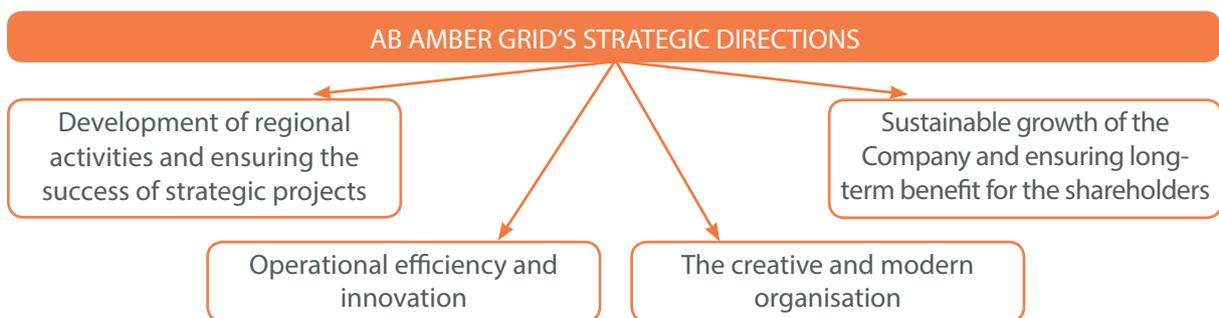
Innovative energy company in the integrated European gas network.

In the perspective of 2021-2022, Amber Grid sees the gas markets of four eastern Baltic countries – Lithuania, Latvia, Estonia and Finland – as a single market, i.e. operating in accordance with harmonized rules, a market in which a single area for gas trading, balancing and of entry-exit points is formed.

After construction the intersystem interconnection that connects Amber Grid and GAZ-SYSTEM S.A. gas pipelines (after implementing the Project of gas interconnection between Poland and Lithuania (GIPL)), the gas market in the region will be connected with the European Union (hereinafter – the EU) gas market.

In pursuit of the Company’s vision and strategic goals set by the state and the shareholder, or to be more precise, to increase the value of the Company and to ensure the implementation of the country’s strategic interests in the gas sector, Amber Grid will focus on four strategic directions:

- ▲ development of regional activities and ensuring the success of strategic projects;
- ▲ sustainable growth of the Company and ensuring long-term benefit for the shareholders;



- ▲ operational efficiency and innovation;
- ▲ the creative and modern organisation.

The strategic directions of the Company are identical to those of EPSO-G Group. To implement the strategic directions, Amber Grid shapes the appropriate culture of the organization that is based on the shared values of the Group. The values of Amber Grid form the foundation of the conduct of the Company, its operations and of the organizational culture.

The company is guided by three core values:

- ▲ professionalism;
- ▲ cooperation;
- ▲ progress.

Strategic objectives, targets and measures with the result sought and the deadlines are prepared for each strategic direction of the Company.

Specific indicators for measuring are formed for the strategic objectives of the Company. Based on them, the Company will evaluate the effectiveness of its performance in the short and long term.

This long-term Strategy Paper also analyses the current situation, presents the results of the analysis of the external and internal factors of the Company, and of strengths, weaknesses, opportunities and threats (SWOT) analysis, describes risks and measures for their management, financial objectives and indicators, principles of strategy evaluation, improvement and support.

1. DESCRIPTION OF THE ACTIVITIES

1.1. Company activities

Amber Grid is the Lithuanian natural gas transmission system operator responsible for the transmission (transportation via high pressure pipelines) of natural gas to the system users, the operation, maintenance and development of the natural gas infrastructure. Amber Grid was registered on 25 June 2013, the activities and ownership of the Company were separated from

	2018	2017	2016
Revenue, thousand EUR	54,290	64,322	66,742
EBITDA, thousand EUR	24,552	38,252	41,765
Net profit (loss), thousand EUR	-21,592	-9,861	20,928
Average return on equity (ROE), %	-14.22	-5.26	10.53
Asset, thousand EUR	235,416	280,198	328,382
Quantity of gas transported to the domestic exit point, GWh	22,320	24,290	23,336
Quantity of gas transported to the adjacent transmission systems ¹ , GWh	30,140	28,262	23,985
Number of system users	106	100	95
Number of employees	329	346	357

Table 1. Key performance indicators of Amber Grid

¹ Transmission systems of Latvia and Kaliningrad Region of the Russian Federation.

the natural gas undertakings active in production and supply. On 10 April 2015, the National Commission for Energy Control and Prices (NCC) (from 1 July 2019 – the National Energy Regulatory Council or NERC) issued the Company with an open-ended license of the transmission system operator, and the Company was designated as a Transmission System Operator certified in accordance with EU requirements.

Amber Grid holds 100% of UAB GET Baltic shares. UAB GET Baltic administers an electronic trading system that trades in short and long term natural gas products on the trading platforms in Lithuania, Latvia and Estonia.

From 1 November 2015, Amber Grid is the member of the European Network of Transmission System Operators for Gas (ENTSO-G).

Changes in the regulatory environment, decrease in return on investment set by the NERC from 7.09% (2014-2018 regulation period) to 3.33% (2019-2020) resulted in decrease in the fair value of the Company's non-current assets. After the procedures of accounting of the costs of impairment of assets were made, the Company's operations were loss-making, and, respectively, the ROE indicator was negative too. After eliminating the influence of impairment of

assets, the net normalized profit in 2019 would amount to EUR 10,441 thousand, and in 2017 – EUR 20,320 thousand. The key performance indicators of the Company presented in the Table 1.

1.2. Shareholder structure of the Company

According to the data as of 30 June 2018, more than 2,200 Lithuanian and foreign natural persons and legal entities were the shareholders of the Company, of them one shareholder – UAB EPSO-G – held a controlling (96.58%) stake in the Company. The remainder of the Company's shares (3.42%) is quoted on the Baltic Secondary List of the NASDAQ Vilnius Stock Exchange (the Company abbreviation on stock exchange – AMG1L).

The principal shareholder of the company – UAB EPSO-G is 100% controlled by the Ministry of Energy of the Republic of Lithuania. UAB EPSO-G also holds a controlling stake of Litgrid AB, which is the Lithuanian electricity transmission system operator, and also controls other companies.

The management scheme of the parent company is shown in Figure 1.

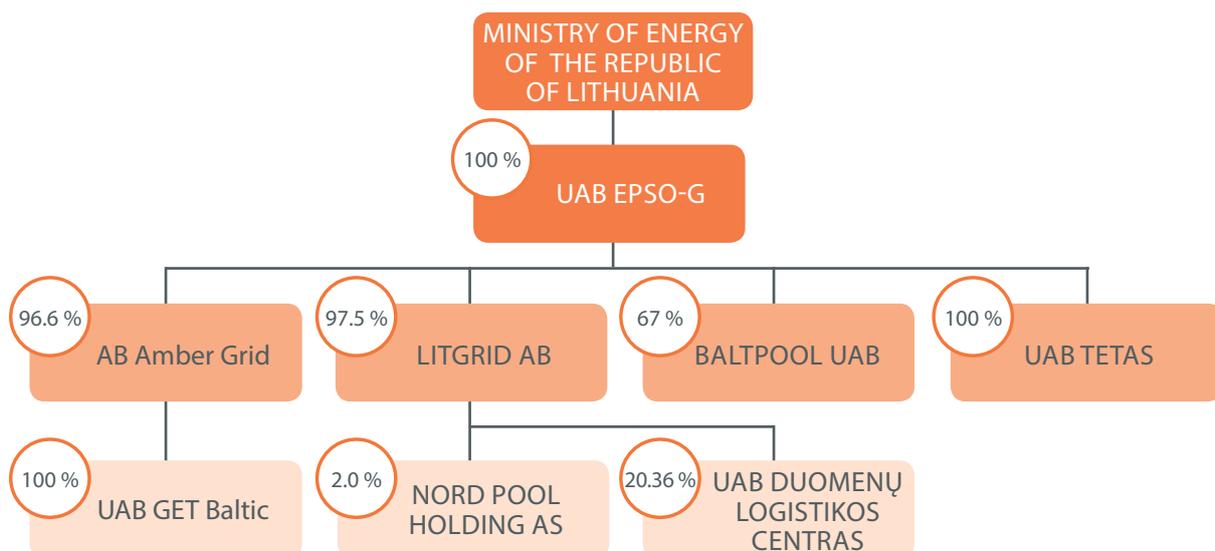


Figure 1. UAB EPSO-G Group

1.3. Services provided by the Company, and the customers

In carrying out its activities as a natural gas transmission system operator, the Company provides the following services to the system users, other operators and natural gas market participants:

- ▲ natural gas transmission in the territory of the Republic of Lithuania;
- ▲ natural gas flow balancing in the transmission system;
- ▲ administration of funds intended to compensate the cost of installing and operating the liquefied natural gas (LNG) terminal, its infrastructure and connection;
- ▲ from 1 June 2019, Amber Grid administers the National Register of Guarantees of Origin of Gas from Renewable Energy Sources, i.e. performs the functions of issuing, transferring and canceling guarantees of origin, supervision and control of the use of guarantees of origin, and of recognition in Lithuania of guarantees of origin issued in other countries.

The customers of the Company include large electricity, district heating, industrial companies, and medium-sized Lithuanian business companies, natural gas supply companies which are provided with natural gas transmission services. Structure of the natural gas transmission system users based on the quantities of natural gas transmitted is shown in Figure 2.

Currently, the natural gas transmission system in Lithuania consists of:

- ▲ 2,113 km of gas transmission pipelines;
- ▲ 68 points of connection with distribution systems and system users;
- ▲ 2 cross-border gas metering stations;
- ▲ 2 gas compressor stations.

Below (Figure 3) is shown a map of the Lithuanian natural gas transmission system with the main infrastructure managed by Amber Grid, which is flagged on the map.

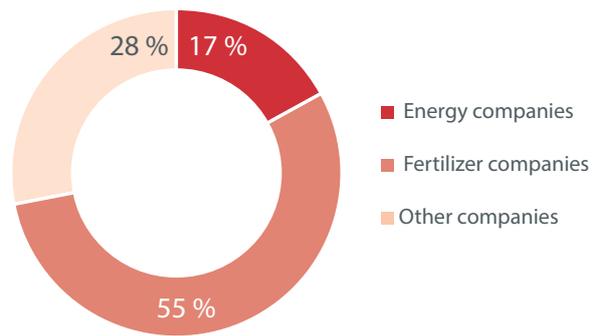


Figure 2. Structure of natural gas transmission volume by system users, 2018, %.

Pricing of regulated activities of the natural gas transmission system operator

The prices of the regulated activities of Amber Grid in providing services of natural gas transportation through the natural gas transmission system and of balancing are regulated by the NERC (until 1 July 2019 – the National Commission for Energy Control and Prices or NCC). The NERC also sets an additional component of the security of natural gas supply, that is intended to compensate the costs of installing and operating the LNG terminal, its infrastructure and connection, and for administration of the said funds.

Until 2020, price caps of the regulated activities (in providing services of natural gas transportation through the natural gas transmission system) per unit of capacity ordered at each entry or exit point of the transmission system (2015-2018) or a price cap for the total unit of quantity of natural gas transported through the transmission system (excluding (in case of the period 2013-2014) / including (in case of 2019) transportation to a third country and transportation within EU countries) were set for the Company, and these prices were eligible for adjustment on the annual basis in accordance with the procedure prescribed by law. From 2020, the revenue cap of the regulated activities, that was set for the Company for the year 2020 by the Decision of the NERC of 10 June 2019, became effective. This revenue cap may also be adjusted annually in accordance with the procedure prescribed by law. Currently, the Company derives

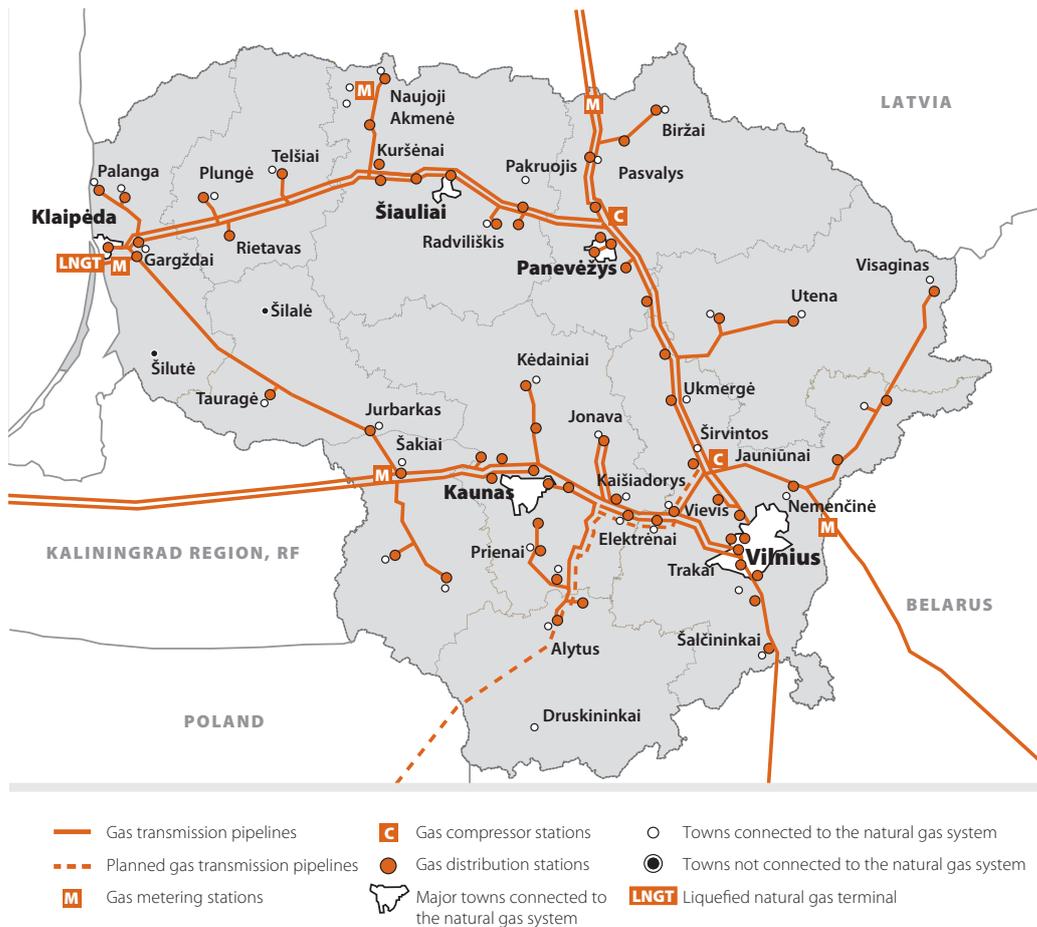


Figure 3. Map of Lithuania's natural gas transmission system

its basic revenue from transportation of natural gas through the natural gas transmission system. Most of its revenue comes from transportation services to Lithuanian natural gas consumers.

From 2016, a trinomial price applies at the domestic exit point of the transmission system: price for the reserved transmission capacity, price for the prescribed consumption capacity² and price for the quantity transported. Recovery of a part of transmission system costs by applying a price for consumption capacity creates conditions for the

Dynamics of the prices for the needs of Lithuanian consumers in 2010-2020 is shown in Figure 4.¹

¹ Average service prices have been calculated without taking into account the indicators attributable to the service of gas transportation to a third country, 2015-2020 - also without taking into account the indicators attributable to gas transportation through the cross-border entry / exit point of Kiemenai GMS, i. e. the prices include average prices for the needs of Lithuanian consumers. The average prices for 2010-2020, which consist of prices for gas transmission capacity (from 2016 - not only for reserved capacity, but also for consumption capacity) and prices for the quantity of gas transported, are expressed in units of energy (MWh). Prices in units of energy are only set from 2015 onwards. Until 2015, the prices were set per volume unit (thousand m³). According to the price cap for the year 2019, that was set by the NERC, the average price for Lithuanian consumer needs in 2019 could increase, compared to the price of 2018, more significantly. However, due to the decisions applied by the Company, in order to reduce the prices of the services of transportation through the natural gas transmission system, in 2019 the average price of long-term services for the needs of Lithuanian consumers increased slightly.

² Natural gas consumption capacity - the maximum daily amount of natural gas which is required by the user and / or consumer of the natural gas system to meet their maximum natural gas consumption needs at each natural gas delivery point. Consumption capacity is calculated and determined in accordance with the procedure established by the Government, which also provides a mechanism that encourages consumers / system users not to exceed, when reserving transmission capacity, the level of consumption capacity declared by them or prescribed for them.

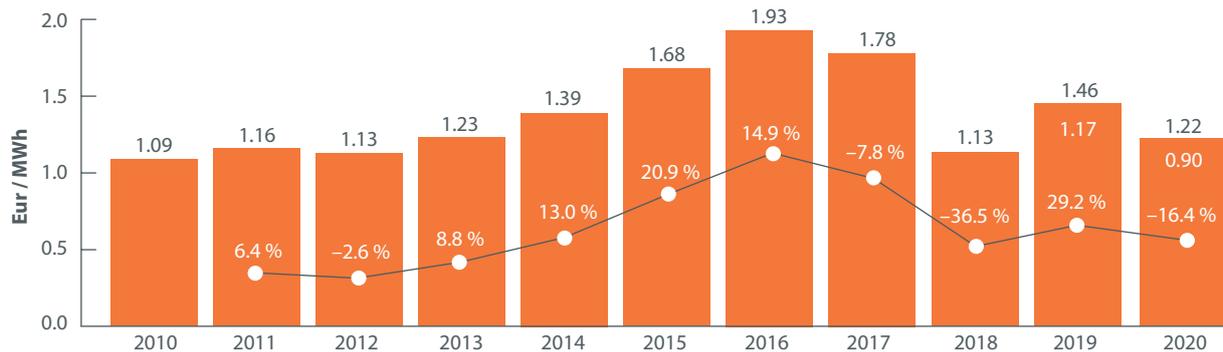


Figure 4. Dynamics of the average prices of the services of natural gas transportation through the natural gas transmission system in 2010-2020.

formation of a rational behaviour of the users of the natural gas transmission system – promotes efficient use of the capacity that they need in the transmission system and thus reduce the costs of using the transmission system infrastructure, which allows optimization of the investment in the transmission system. This allows optimizing investment in the transmission system.

Significant ongoing processes and intended changes in pricing:

- ▲ The Regulation establishing a network code on harmonised transmission tariff structures for gas (2017/460) has been applied in the European Union from 6 April 2017; from 31 May 2019, its provisions apply to the full scope (price publication requirements, methodology for transfer price-setting, pricing of transmission capacity products, harmonization of the level of allowed revenue, etc.); therefore, the provisions of the Regulation have already been applied in setting the prices of the regulated activities for the year 2020, and will be applied in setting the prices for subsequent years;
- ▲ given that in recent years at certain points gas flows are of no seasonal nature, and in order to promote the development of the natural gas market of Lithuania and the whole Eastern Baltic region, from 2018 at all entry points and at the exit point to the Republic of Latvia (Kiemėnai point) the prices of short-term (quarterly, monthly, daily / intraday) transmission capacity are set without no longer applying seasonality multipliers (i.e. by eliminating price differences in different

seasons). Such pricing has an incentive effect on cross-border gas flows

- ▲ from 2019, the new 5-year regulatory period began (1 January 2019 – 31 December 2023). Changes in the regulatory regime, which took effect at the same time as the new regulatory period began, had an impact on the Company’s activities and results: the new regulatory period that began resulted in the application for the Company of the new methodology for determining the rate of return on investment, that was approved by the NERC, and from the beginning of 2019 the rate of return on investment was significantly reduced (from 7.09% to 3.33% for the year 2019 and to 3.38% for the year 2020);
- ▲ the “postage stamp” principle (as the principle of determining reference prices at the entry and exit points) applicable in determining prices for natural gas transmission services, which is enshrined in the Methodology for Determining Revenues and Prices of State-Regulated Natural Gas Transmission Activities, that was approved by the NERC in October 2018, and which, as a reference price methodology with certain features applied in Lithuania, following the evaluation of the results of the public consultation conducted by the NERC (see further information below), will continue to be used for subsequent years of the 2019-2023 regulatory period;
- ▲ taking into account the provisions of Regulation 2017/460, there was a transition in the Methodology for Determining Revenues and Prices of State-Regulated Natural Gas Transmission Activities, that was approved by

the NERC in February 2019, from the regulatory regime where the price caps are set for the Company to the regulatory regime where the level of allowable revenue is set for the Company;

- ▲ In June 2019, the NERC has set for the Company the regulated activities revenue cap for the year 2020 – 36.1 million euros (for the year 2019, the revenue cap of 43.9 million euros was set; at the end of the 2014–2018 regulatory period, the cumulative deviation of return on investment, by which the level of allowable revenue for the year 2020 was reduced, was assessed). The purpose of comparison: if the cap expressed per unit of quantity of natural gas forecasted for transportation (including transportation to third countries and the EU Member States) would have been calculated for the 2020, it would be 0.73 EUR / MWh. Taking this into consideration, the average price for the needs of Lithuanian consumers (considering both long-term and short-term services, and only long-term services) for the year 2020, compared to the price of 2019, has decreased significantly;
- ▲ In 1st half 2019, the NERC conducted the public consultation according to the requirements of Regulation 2017/460 regarding the pricing of the services provided by the Company for the year 2020, and for the subsequent years of the regulatory period. Having regard to the comments of market participants and the opinion announced by the Agency for the Cooperation of Energy Regulators (ACER) on 4 July 2019, on 10 October 2019 the NERC approved the prices for the year 2020 that were set on 23 September 2019 by the Board of the Company. To increase the ease and flexibility of the use of the transmission system, and to promote the development of the regional gas market, the prices of the year 2020 at the entry points⁴ and price multipliers for short-term services were harmonized with the prices and price multipliers for short-term services applicable from 2020 in the neighbouring price area covering Latvia, Estonia and Finland. Accordingly, in order to facilitate and promote cross-border trade and gas flows, in 2020 the price multipliers for short-

term services of all entry points³ and of the exit point to the Republic of Latvia (Kiemėnai) are set at a lower level than in 2019;

- ▲ in order to comply fully with the provisions of Regulation 2017/460, and due to integration processes of the regional natural gas market in the Eastern Baltic region, from 2021 and / or subsequent years, changes are possible in the structure of the prices of the natural gas transportation services provided by the Company.

More detailed information about the prices of the services of natural gas transportation through the natural gas transmission system, that are provided by the Company, about the pricing, and information according to Regulation 2017/460 is available on the Company website www.ambergrid.lt (column “Prices and taxes” of the heading “Services”).

2. ANALYSIS OF ENVIRONMENTAL FACTORS

Further in this paper, internal and external factors that have the greatest impact on the Company’s activities are analysed. Within the Guidelines for Strategic Planning and Strategic Management prepared by the Ministry of the Economy and Innovation of the Republic of Lithuania, in the operational strategy of Amber Grid environmental influence is seen as a combination of external environmental factors (political, economic, social, legal, environmental and technological), internal strengths and weaknesses, and opportunities and threats from outside. All this affects the company for selected strategic directions. In Figure 5 shows the main influence of Amber Grid for internal and external factor.

At the beginning of 2016, the Company carried out a comprehensive analysis assessing the prospects

³ Except at the entry point from Klaipėda LNG terminal, for which (in the light of the results of the public consultation, and in order to create as better as possible conditions for market participants to use Klaipėda LNG terminal, and thus increase competitive pressure on gas market prices) in 2020 the transmission price discount of 75% (same as in 2019) applies.

for natural gas transmission activities until 2035. This analysis is updated annually. In performing Amber Grid environmental factors analysis of 2019, as well as in forming the strategic goals and objectives, the said analysis was relied upon.

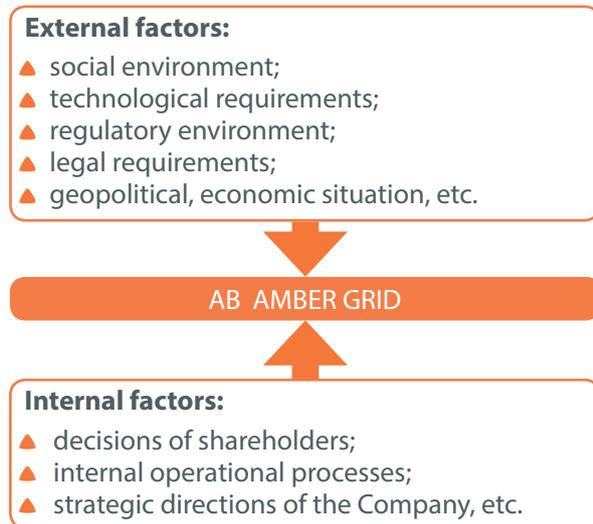


Figure 5. Amber Grid matrix of internal and external factors

The environment in which Amber Grid operates is constantly influenced by:

- ▲ changing EU and Lithuanian legal framework;
- ▲ energy and environmental policies;
- ▲ changes in the regulatory environment;
- ▲ development of technologies in energy sector.

For these reasons, the Company’s directions of development and strategic activities are partly based on assumptions.

Although the Company has no control over the external factors that are further addressed in this strategy, they are constantly evaluated and observed. In the light of changing circumstances, the Company seeks to anticipate risk in a timely manner, to avoid emerging threats and to take advantage of established opportunities for expansion and business development.

After considering the above circumstances, it can be fairly objectively determined which direction of development Amber Grid should choose, and what results the Company may achieve during the strategy implementation period.

2.1. Analysis of the internal environment of the Company

The Company is engaged in the single principle activities – the activities of transmission system operator; it has clearly defined functions and has no activities that are not related to the principle activities. Management of internal processes, their purposefulness and efficiency – these three elements form one of the key areas that is necessary for efficient carrying of natural gas transmission activities.

The Company has sufficient technological, managerial and financial capacity to carry out its principle activities.

The total length of the transmission system pipelines in the territory of Lithuania is more than 2.1 thousand km. The natural gas infrastructure used for the Company’s activities has been developed since 1961. More than half of the pipelines were laid more than 25 years ago. The condition of the gas transmission system infrastructure is assessed during pipeline internal diagnostics. Currently, 1.39 thousand km (66%) of the pipelines are adapted for inspection by the said method. The aim is to ensure by 2023 the possibility of inspecting 1.67 thousand km (80%) of the pipeline. For that purpose, launching and receiving chambers for diagnostic probes are installed in separate sections of the pipelines.

For several years now, the Company has been implementing telemetry systems that enable remote closing and opening of valves, starting and stopping compressors, monitoring of the operation parameters of the GDS, collecting gas metering data. The remotely controlled cathodic protection system for pipelines was installed.

The moderate, balanced investment policy pursued by the Company maintains the proper condition and reliability of the infrastructure. Until 2015, the infrastructure was adapted to transmit natural gas received from a single source. Until 2015, the infrastructure was adapted to transmit natural gas received from a single source.

From the end of 2014, after the construction of the LNG terminal in Klaipėda, gas is imported from two

sources. The LNG terminal provided an opportunity for market participants to import gas from global gas markets. At the end of 2015, after the construction of Klaipėda-Kuršėnai gas transmission pipeline, conditions were created to make full use of the capacity of the LNG import terminal and to transport gas in Lithuania and in direction of other Baltic States. The LNG terminal can meet about 90% of the demand in three Baltic States, it ensures diversification of natural gas supply and security of supply. Works of the implementation of the Project of a gas interconnection between Poland and Lithuania (GIPL) are in progress. The GIPL construction project is planned to be completed in 2021. In 2018, a feasibility study of a project of increasing the capacity of the gas interconnection between Latvia and Lithuania and the cost benefit analysis were carried out together with Latvian transmission system operator Conexus Baltic Grid. This project is expected to be completed by the end of 2023.

The information systems of the Company are customized to changes related to diversification of natural gas supply, sale of transportation capacity and changes in units of measurement of transported gas quantity. The information systems used by the Company are coordinated with the information systems of the transmission system operators in the region, that are used in transmission capacity management, gas flow balancing and in the conduct of gas trading. To manage internal processes within the company, the Asset Management System and Pipeline Integrity Management System (PIMS) are implemented.

The financial position of the Company is good and stable. The nature and regulation of the activities allow the Company to generate revenue that covers the required costs and a regulated return on investment. The equity to debt ratio of the Company enables it to effectively execute investment and development projects.

Amber Grid structure and governance principles

After the amendments to the Law of the Republic of Lithuania on Companies became effective in 2018, the Board of AB Amber Grid was strengthened by providing it with supervisory functions. In order to

continue to comply with good governance practices, the representatives of the Company’s administration who perform executive function can no longer be elected to a five-member board which performs supervisory functions. It is laid down in the Articles of Association of the Company that the Board of the Company consists of 5 (five) members who are elected for the period of 4 years. The Board of the Company consists of two independent members and three employees of the parent company UAB EPSO-G. Information on the management of the Company is available on www.ambergrid.lt, in the column “About us” -> “Governance”.

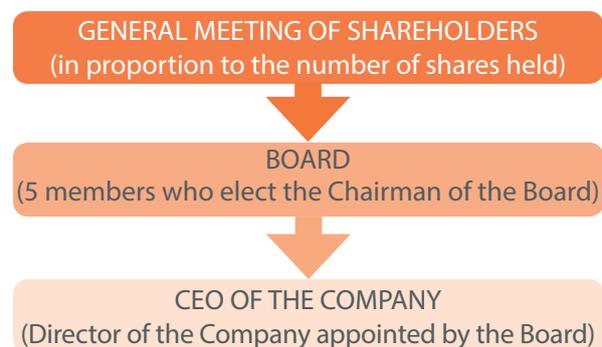


Figure 6. Amber Grid’s governance principles

In 2014, Amber Grid has become a company of EPSO-G Group, and, at the same time, a company indirectly controlled by the state. The corporate governance structure of the Company is broadly in line with the regulation of state-imposed policies towards state-controlled enterprises. The principles of good management practice, and corporate governance of the state-controlled companies are implemented in the corporate management.

2.2. Analysis of the external environment of the Company

Gas transmission activities are licensed. The license grants exclusive rights to provide transmission services throughout the territory of the Republic of Lithuania. The company operates in a strictly regulated environment which is constantly changing and is dependent on the requirements of EU and national legislation, and the regulatory policy for the natural gas transmission sector, and

on the actions of the authorities implementing this policy.

2.2.1. Overview of key events in the region

In the Eastern Baltic region, which includes Finland, Estonia, Latvia and Lithuania, demand for natural gas has contracted by 15% since 2013, and since 2016 it has stabilized. The main reasons for this are fuel conversion in the heat sector switching to production of renewable energy, the possibility of importing cheap electricity, which makes the local power generation uncompetitive, and decline in industrial consumption, e. g. in declining paper production in Finland. Finland is the most gas consuming country in the region (30.0 TWh). Out of the three Baltic States, Lithuania consumes the largest amount of natural gas – 22.3 TWh. This is almost one and a half times more than in Latvia (15.1 TWh) and over four times more than in Estonia (5.2 TWh). Natural gas consumption is predicted to stabilize at this level.

The implementation of the EU Third Energy Package is rapidly changing the European natural gas sector. The purpose of this legislative package is to liberalize the natural gas market by promoting competition between different natural gas suppliers. The following legal acts are of relevance for the gas sector:

Directive:

- ▲ Concerning common rules for the internal market in natural gas (2009/73/EB).

Regulations:

- ▲ On conditions for access to the natural gas transmission network (715/2009);
- ▲ Establishing a European Union Agency for the Cooperation of Energy Regulators (713/2009).

In accordance with the package regulations and directives, European countries are implementing unbundling of natural gas transmission activities from gas supply and distribution business areas in vertically integrated natural gas undertakings. The aim is to create an integrated natural gas market in European countries thus creating preconditions

for greater market liquidity, price formation on competitive grounds, more efficient use of infrastructure, and greater security of supply.

Currently, the most important occurrences in the Eastern Baltic region, which are related to the activities of natural gas transmission system operators, are separation of types of activities of gas companies and transfer of shares to new legal units, and cooperation between the gas sector representatives in creating a liberal and integrated gas market.

Lithuania and Estonia already have the separate gas transmission companies – Amber Grid and Elering AS. The latter also carries out electricity transmission activities. From the beginning of 2017, AS Connexus Baltic Grid is the operator of the Latvian natural gas transmission system and of underground natural gas storage. It was established after gas transmission activities through gas pipelines were separated from AS Latvijas Gāze. In 2020, the newly established gas transmission system operator Gasgrid Finland Oy started operations in Finland. The wholesale and retail gas markets were also opened for foreign companies.

The functioning of the Eastern Baltic regional market requires harmonized legislation and regulations in the region and sufficient infrastructure.

At the beginning of 2015, a special working group was set up to coordinate the development of the Regional Market. It consists of the representatives of the transmission system operators, of the ministries responsible for energy and of the national regulators of the countries in the Eastern Baltic region. In March 2016, at the order of the transmission system operators, the consulting company Frontier Economics prepared a study on the development of the Eastern Baltic regional market. It was funded by the Baltic Sea Region Energy Cooperation Organization – BASREC. The study recommends that combining the gas markets of Lithuania, Latvia, Estonia and Finland into a single market area by creating a single four-country entry-exit point system with one virtual point of sale and one balancing area is the most appropriate model for market integration. On the basis of the study, the working group prepared a

plan of creating a regional gas market in the Eastern Baltic region, which was approved in December 2016 by the Prime Ministers of the Baltic States.

On 1 July 2017, the Company, together with Latvian and Estonian transmission system operators, started using implicit capacity allocation model at cross-border interconnection points in the Baltic States, and from 1 January 2020 it was also introduced in Finland for the distribution of within-day and day-ahead capacity. It is a transitional instrument for the integration of the Baltic gas, in order to increase the competitiveness of gas markets and to promote cross-border trade in gas.

During the first half of 2019, no consensus was reached on the full integration of the gas market. Only Latvia and Estonia have agreed on a common natural gas market from 2020. From 2020, they, together with Finland, will form a common tariff area – a zero transfer price will apply in the connection with Finland, and transfer prices for access to the tariff area will be converged. Although Lithuania strongly supports the idea of creating a common regional gas market, such agreement does not safeguard Lithuania's interests because, once Lithuania will join the area, it would impose an unjustified additional financial burden on domestic users. Therefore, there are ongoing negotiations with Latvian, Estonian and Finnish operators regarding cost sharing. The aim is to create a single market under conditions that are acceptable to all parties, including the Lithuanian population and business. Lithuania aims to join the common tariff area at a later stage from 2022.

Investment in the interconnection of the natural gas transmission systems in the region is also planned.

The region is planned to be connected with the European natural gas markets after building the gas interconnection between Poland and Lithuania (GIPL). In October 2015, the contract between Amber Grid, GAZ-SYSTEM A.S. and the EU Innovation and Networks Executive Agency was awarded. Under this contract, the EU support of 60% of eligible costs was granted for the construction of the GIPL project. The estimated total value of the project is around EUR 500 million. The end of the project implementation – 31 December 2021.

In May 2018, the cost allocating agreement was signed between the transmission system operators of Poland, Lithuania, Latvia and Estonia, which established how the costs of the GIPL project will be allocated between the states. Also in May 2018, Amber Grid and GAZ-SYSTEM S.A. signed the interconnection agreement which confirmed the final decision to invest in the GIPL project. In January 2020, works of construction were started in the territory of Lithuania.

In 2019, the construction of Estonian-Finnish gas pipeline Balticconnector, which interconnected Estonian and Finnish gas transmission systems and integrated Finland into the regional gas market, was completed. The transmission system operators also started implementing the project of expanding the cross-border connection between Latvia and Lithuania, and the modernization project of Inčikalns underground gas storage in Latvia by increasing its ability to supply gas during the winter. The services of Klaipėda LNG terminal are elaborated through the development of LNG bunkering services which are designed for the fueling of ships and supply of LNG to smaller terminals, and in constructing the over-ground LNG distribution station that, with help of gas carriers, will supply natural gas to areas not covered by gas transmission systems.

2.2.2. Political, economic, social, technological, environmental and legal factors

The decisions of state institutions regarding strategic directions of the country's energy and development priorities of individual energy sectors, the decisions related to the promotion and development of renewable energy sources, increasing energy efficiency, implementation of the requirements of the Network Codes adopted by the EU in the areas of safety, reliability, interoperability of gas pipelines, as well as in the areas of access terms, trading, pricing, and other will have the biggest impact on the Company's plans.

From 2019, a new 5-year regulatory period began; also, from 2020, the Commission Regulation (EU)

2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (TARNC) will be fully applicable to the pricing of transmission activities. Due to the application of the provisions of the TAR NC, as well as due to the integration of the regional market, changes in the price structure of the services provided by the Company are possible.

On 21 June 2018, the Seimas of the Republic of Lithuania (LR) approved the renewed National Energy Independence Strategy. The National Energy Independence Strategy foresees that the extent of natural gas consumption in industry, transport and households will depend on the competitiveness of natural gas as an energy source. Consumption of natural gas in industry and transport, which will increase in the short and medium term, is expected to partially offset the decline in natural gas consumption in power generation, and the extent of natural gas consumption in the long term will depend on the use of natural gas for non-energy needs in industry and transport. The legal environment that has a significant impact on the Company's business decisions, particularly in the areas of national energy policy, EU support policy, is heavily dependent on political developments and is subject to frequent changes in the legislation governing the gas transmission sector. And this may adversely affect the sustainability of the Company's long-term strategic decisions.

The most important economic factors affecting the natural gas transmission sector are the promotion and development of the use of biofuels and other renewable energy sources in the energy sector, and the more efficient use of energy and energy resources. Large subsidies, which are granted in various forms (incentive tariffs for energy purchases, direct grants or incentive economic regulatory regime), create unequal competitive conditions, leading to a rapid increase in the use of biofuels in both the electricity and heat sectors. This reduces the demand for natural gas and competitiveness in the market, and, with largely constant infrastructure costs, increases the prices for gas transmission and distribution services, and the LNG terminal maintenance costs (an additional component of the security of natural gas supply)

for market participants. Moreover, in state-regulated energy fields, the investments of which must be approved by the regulators, decisions to invest in the use of alternative fuels for heat and power generation are adopted so far without carrying out a full socio-economic assessment. This stimulates re-investment and creates risks for the implementation of economically unjustified investments.

Other significant economic factors that may affect the operational decisions of the Company are customer structure which determines the significant dependence of the Company operating revenues on several large gas system users (the top 10 system users generate about 90% of Company revenue); access to EU support for the development and upgrading of the gas transmission system.

Technological factors that determine the operational decisions of the Company are related to ensuring the proper condition of the natural gas infrastructure used for the Company's activities. It has to be taken into account that 57% of the pipelines were built more than 25 years ago. The condition of the existing pipelines is inspected using advanced methods, such as internal diagnostics, external diagnostics based on electromagnetic field measurements, inspection of pipelines using a helicopter that carries laser, highly sensitive gas leak detection equipment, etc. According to the results obtained, the minimum works of repair of individual pipeline sections are carried out thus ensuring the security and reliability of the transmission system.

Social factors also have an indirect impact on gas transmission activities. The social factors that determine consumer behaviour – to choose another fuel type – include relatively low purchasing power of the country's population, high emigration and negative demographic indicators, even though in the recent years gas prices have decreased significantly and also the quality parameters have improved (security of gas supply has increased significantly and the possibility to choose gas suppliers or acquire gas on the natural gas exchange). Economic growth and consumption will also be adversely affected by

the increasing shortage of skilled labour and rising wages.

The activities of the Company are influenced by EU environmental policy – the tightening environmental requirements may result in the need for additional investment. Furthermore, for the purpose of implementing environmental requirements, renewable energy development policy, which has a significant impact on the decline in natural gas consumption, is prioritised.

2.2.3. Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis

Subject to the Guidelines for Strategic Planning and Strategic Management prepared by the Ministry of Economy and Innovation of the Republic of Lithuania, for the purpose of generalization of environmental factors analysis, the Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis was carried out. During the analysis, strengths and weaknesses of Amber Grid, which depend on the Company's internal factors, were identified. Opportunities and threats – the external factors beyond the Company's control – are also identified.

Analysis of the internal and external environment revealed the essential strengths and weaknesses of Amber Grid, it also identified the most significant external threats and opportunities.

The results of the SWOT analysis form the basis for formulating operational scenarios, strategic directions and objectives. The results of the analysis must be taken into account in setting strategic objectives or drawing up the action plans which are used to achieve the strategic objectives of the Company. The following sections describe the strategic directions, objectives, detail strategic tasks and programs that are based on the results of the SWOT analysis.

After summarizing the SWOT analysis carried out, the mission, vision, and values of the Company were formulated, and the strategic goals and objectives were set.

3. AMBER GRID STRATEGY

3.1. Mission, Vision, Strategic Directions and Values

The activities of the transmission system operator carried out by Amber Grid are regulated in detail by EU and Lithuanian national law. Therefore, the fundamental elements of the Company's strategy derive from the legislation regulating activities – the EU Third Energy Package, the Law of the Republic of Lithuania on Natural Gas and its implementing legal acts, the National Energy Independence Strategy. The Company's strategy is influenced by EU and national energy policy and the regulatory policy pursued by EU and national regulators. The regulatory policy pursued by the regulator directly influences the Company's strategic plans in the financial perspective. The ten-year network development plan of the natural gas transmission system operator drawn up by Amber Grid is harmonised by the NERC. The Company's strategy is influenced by the fact that the Company's activities are essentially related to those of the transmission system operators of other countries and their strategy. In addition, the Company is a company of Lithuanian state-owned Group which is influenced by the Policy of state-owned enterprises set by the State of Lithuania indirectly defining the expected returns, the strategic planning guidelines and the governance principles.

In 2015, the European Commission presented an ambitious plan of creating an Energy Union which covers the dimensions of security of supply, creation of a single energy market, energy efficiency, research, innovation and reduction of pollution.

By 2021, in energy it will be most important to ensure high utilization of the created infrastructure for the development of the country, transparency, to strengthen regional cooperation. Amber Grid associates its contribution in implementing the European Energy Policy with the creation of a common market for natural gas in the Baltic

region, and the construction and expansion of interconnections.

AMBER GRID'S MISSION

We provide effective and reliable gas transmission, we create favourable conditions for competition in the gas market and for the development of renewable energy sources.

- ▲ EFFECTIVELY – we pursue the best results working efficiently and optimizing our operating processes.
- ▲ RELIABLY – we transport gas to our customers safely and without any unplanned interruptions.
- ▲ CONDITIONS FAVOURABLE FOR COMPETITION – we work for the conditions of the use of the transmission system and the services provided to be flexible and convenient for the existing and new gas market players, allowing to easily obtain gas from various sources.
- ▲ DEVELOPMENT OF RENEWABLE ENERGY SOURCES – by administering the register of “green” gas guarantees of origin and with other initiatives, we seek for the development of production and trade of gas from renewable energy sources.

AMBER GRID'S VISION

Innovative energy company in the integrated European gas network.

- ▲ INNOVATIVE – applying advanced methods and techniques, which allow working faster, more efficiently, offering innovative solutions to customers and partners.
- ▲ INTEGRATED EUROPEAN GAS NETWORK – when the Baltic and the European gas markets both having access to the global LNG market are interconnected by physical infrastructure as well as well-functioning market and

infrastructure rules, enabling easy and flexible gas transportation and trade.

Strategic directions

For a clearer link between the strategies of EPSO-G Group companies in implementing strategic directions, the decision was made to unify them in all companies of the Group. The strategic directions are formulated after assessing a thorough analysis of environmental factors, that helps to purposefully focus the Company's strengths on exploiting opportunities.

The strategic directions of Amber Grid will contribute to the implementation of the objectives for the natural gas sector that are set in the National Energy Independence Strategy – to ensure technically reliable and diversified supply of natural gas to domestic customers at the costs and competitive prices that are based on the principle of efficiency and economy, and to contribute to promotion of development of renewable energy sources.

The strategy of Amber Grid is based on integration to a single natural gas market of the region, efficiency, modernization and implementation of innovations, fostering infrastructure, building an advanced organization. These elements are essential in pursuing the strategic and financial objectives set by the shareholder. The scheme below summarizes the strategy of Amber Grid.

In pursuit of the Company's vision and the strategic goals set by the state and the shareholder - to increase the value of the Company and to ensure the implementation of the country's strategic interests in the gas sector, Amber Grid will focus on four strategic directions:

- ▲ development of regional activities and ensuring the success of strategic projects;
- ▲ sustainable growth of the Company and ensuring long-term benefit for the shareholders;
- ▲ operational efficiency and innovation;
- ▲ the creative and modern organisation.

Strategic objectives, tasks and measures with deliverable result and deadlines are prepared for each strategic direction of the Company.



Figure 7. Scheme of the strategy of Amber Grid

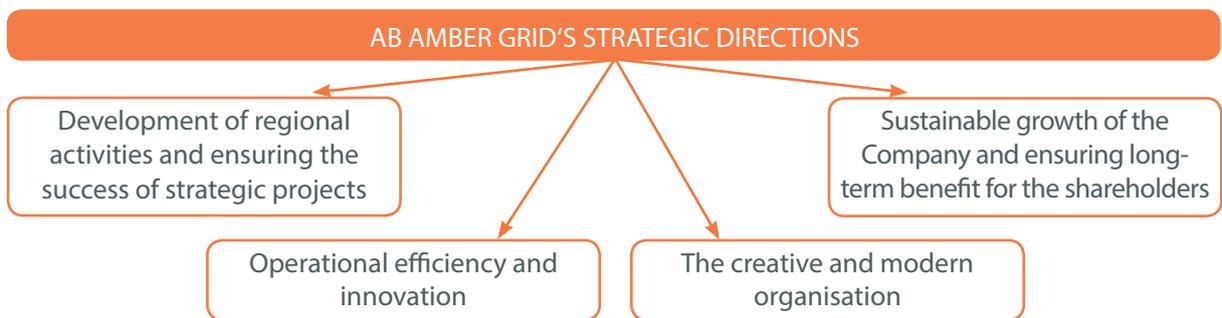


Figure 8. Strategic directions of Amber Grid

Values

To implement strategic directions, Amber Grid shapes the appropriate organizational culture based on the Company's values.

Amber Grid is guided by common human, country and professional values. The values of Amber Grid form the foundation of the Company behaviour, activities, and organizational culture. Amber Grid

distinguishes three core values: professionalism, cooperation and progress.

3.2. Strategic goals and their measurement indicators

Amber Grid has formed specific strategic goals for each of the Company's strategic directions (see Figure 9) which the Company will seek during the strategy implementation period (by 2022).



Figure 9. Interface between the strategic directions and objectives of Amber Grid

4. RISK AND ITS MANAGEMENT

Risk is the possibility of unplanned events that can affect the achievement of strategy and business objectives both negatively and positively. There can be one or more consequences of risk. No organization is protected against risk. Therefore, a proactive (to take actions to manage the risk before its manifestation) and integrated approach to risk management is needed in order to achieve the set goals.

Risk management is an integral part of the Company’s activities and in managing risks the Company aims to:

- ▲ to increase the likelihood of achievement of the Company’s operational goals;
- ▲ to increase operational efficiency;

- ▲ to increase public and state confidence in the Company;
- ▲ to pre-plan and implement in a coordinated manner the actions which would reduce the negative impact of potential events or the likelihood of their occurrence;
- ▲ to improve the safety of the employees, third parties and of the environment;
- ▲ to improve the prevention and management of unforeseen events;
- ▲ to establish the responsibility of the employees involved in the risk management process for specific risks;
- ▲ to ensure effective risk management process in the Company.

The Risk Management Methodology has been prepared in accordance with the provisions of the international standard COSO ERM (edition of June 2017), the Risk Management Methodology of EPSO-G, and the internal documents of Amber Grid.

5. IMPLEMENTATION OF THE STRATEGY

In order to accomplish the objectives stated in the Strategy, and thus move towards the implementation of the vision and mission of the Company, Amber Grid continuously assesses and controls the progress made in implementing the Strategy. Based on the collected information, the problematic and to be improved areas of the activities of the Company are identified. If new external factors are identified during the evaluation process, or in the event of dramatic change in the economic, political and social environment or other essential prerequisites for the Strategy, the strategy of the Company may be improved and the target values of the indicators may be adjusted.

In assessing the implementation of the strategy, the representative indicators defined for each strategic objective and / or task are used.

Monitoring of the indicators achieved is carried out periodically. When discrepancies are found, the activities of the Company are improved, for example, the organizational structure and processes, actions, skills of the employees are improved or new employees are attracted. If necessary, the values of the indicators are changed. Changes are made to the medium-term plans of the Company and, if necessary, to the long-term strategy - the Company strives to be ambitious, while objectively assessing changes in the environment and the changing market situation.

The strategy monitoring is conducted systematically and periodically, information on monitoring results is used in the management of the Company, or is provided to other interested parties.