

TO
the Extraordinary General Meeting of CEZ Electro Bulgaria AD
scheduled for 18 April 2022

material under item 6 of the agenda

**SUBSTANTIATED REPORT OF THE MANAGEMENT BOARD OF CEZ ELECTRO
BULGARIA AD**

pursuant to Art. 114a, Par. 1 of Law on Public Offering of Securities

Re: Expediency and Terms and Conditions of Realisation of Deal in Accordance with Art. 114, Par. 1, item 2, last proposal in relation to item 1, letter "6" of the LPOS

1 GENERAL INFORMATION REGARDING THE DEAL

1.1 General Description of the Deal

The deal represents an agreement for the provision of information and communication services against consideration by and between CEZ Electro Bulgaria AD (hereinafter referred to as the "**Company**") and CEZ Information and Communication Technologies Bulgaria EAD, a company incorporated and operating under the laws of the Republic of Bulgaria, with registered seat at Mladost Region, Tsarigradsko shose Blvd. 159, BenchMark Business Centre, Sofia 1784, Bulgaria, ID Number: 203517599 (hereinafter referred to as "**CEZ ICT**").

The Company and CEZ ICT qualify as *related parties* pursuant to §1, item 13, letter "6" of the Additional Provisions of the Law on Public Offering of Securities (hereinafter referred to as the "**LPOS**"). The sole owner of the share capital of CEZ ICT is CEZ Distribution Bulgaria AD, a company incorporated and operating under the laws of the Republic of Bulgaria, with registered seat at Mladost Region, Tsarigradsko shose Blvd. 159, BenchMark Business Centre, Sofia 1784, Bulgaria (hereinafter referred to as "**CEZ Distribution**"). The legal entity, under whose joint control are the Company, CEZ Distribution and its subsidiary – CEZ ICT, is Eastern European Electric Company B.V. (the Netherlands), a limited liability company, incorporated and operating under the laws of the Netherlands, registered with the Business Register at the Chamber of Commerce of the Kingdom of the Netherlands under number 75462788, having seat at: the Kingdom of the Netherlands, Amsterdam and a correspondence address at: Basisweg 10, 1043AP, Amsterdam, the Kingdom of the Netherlands (hereinafter referred to as "**EEEC**"). The control is exercised in the manner under §1, item 14, letter "a" of the Additional Provisions of the LPOS and is manifested in the direct holding by EEEEC of 69.34% of the share capital of the Company, 88.19% of the share capital of CEZ Distribution, which, in turn, holds 100% of the share capital of CEZ ICT.

With regard to the above, and having in consideration the fact that CEZ ICT, apart from being a related entity to the Company, is also a party to the deal, the following entities qualify as *interested parties* with regard to the deal:

- EEEEC - in the meaning of Art. 114, Par. 7, item 2 of the LPOS;
- CEZ Distribution - in the meaning of Art. 114, Par. 7, item 2, first proposal of the LPOS; and
- CEZ ICT - in the meaning of Art. 114, Par. 7, item 1, first proposal of the LPOS.

Under the terms and conditions of the deal the Company assumes or could assume liabilities, where the total amount of those liabilities exceeds or could exceed 2% of the lower of the values of the Total Assets on the latest prepared two Balance Sheets of the Company, at least one of which has been audited and which have been disclosed publicly following the procedure of Art. 100r of the LPOS.

1.2 Economic Essence of the Deal

The day-to-day operation of the licensed activities of the Company as: (i). end-supplier of electricity; (ii). last-resort supplier of electricity; and (iii). trader of electricity, necessarily requires the use of services in the area of information and communication technologies (hereinafter referred to as the “**ICT Services**”). Presently, the ICT Services are provided to the Company by a third non-related party. The proposed deal is for a Service Level Agreement with CE ICT (hereinafter referred to as the “**ICT SLA**”), which will substitute the existing agreement for ICT Services and will keep the ICT Services aligned with the up-to-date needs of the Company.

The ICT SLA is designated on a *pay-as-you-consume* basis and provides for prices of each of the ICT Services.

1.3 Management and Officers of the Company and External Advisors Engaged with the Deal

The following persons have been engaged with the preparation of the deal:

The Management Board of the Company consisting of three members, namely:
Dimcho Stanev Stanev, Karel Král and Christo Borissov Babbev

Finance Director of the Company:
Rozelina Kostova

Director Legal and Regulatory Operations of the Company:
Maria Yovcheva-Panayotova

Investor Relations Director of the Company:
Radoslav Dimitrov

The Market Price Evaluation was prepared by:
Deloitte Bulgaria EOOD and PriceWaterhouse Coopers Bulgaria EOOD

1.4 Information with Regard to the Approval of the Report:

This present Substantiated Report (referred to hereinafter as the “**Report**”) is approved by the Management Board of the Company (hereinafter referred to as the “**MB**”) and represents a material under item 6 of the agenda of the Extraordinary General Meeting of the Company scheduled for 18 April 2022 (hereinafter referred to as the “**GM**”).

2 TO THE ATTENTION OF THE SHAREHOLDERS AND VOTE-HOLDERS

Dear Shareholders and Vote-Holders,

The Report is prepared on the grounds of Art. 114a, Par. 1 of the LPOS and has the contents required by Art. 33, Par. 1 of Ordinance No. 2 dated 9 November 2021 on the Initial and Recurring Disclosure of Information in Public Offering of Securities and Admission of Securities to Trade at a Regulated Market, in force and effect as from 1 January 2022, issued by the Financial Supervision Commission, as follows:

- (i). description of the proposed deal, including its subject-matter, value, beneficiaries, as well as of the other essential terms and conditions of the deal, which are necessary to provide complete information and avoid misleading of the shareholders;
- (ii). the trade names of the parties to the proposed deal;

- (iii). the trade names of the parties, which qualify as interested parties under Art. 114, Par. 7 of the LPOS, the reasons to qualify as such and the grounds of their interest in the deal;
- (iv). the market valuation of the proposed deal under Art. 114a, Par. 6 of the LPOS (insofar as such valuation is possible as at the moment of preparing the Report given the character of the deal; and
- (v). description of the economic benefits of the Company of the proposed deal.

The Report aims to present to the attention of the shareholders of the Company the essential terms and conditions and the expediency of the ICT SLA.

The Report contains all of the essential terms and conditions of the ICT SLA, necessary for the adoption of an informed and substantiated resolution by the GM with regard to the authorization of the MB on the entering into the ICT SLA.

In the absence of approval by the GM, the MB would not have the powers to enter into the ICT SLA. In the event that the ICT SLA would anyway be concluded in the absence of such approval, then it would have been null and void pursuant to Art. 114, Par. 12 of the LPOS.

3 ESSENTIAL TERMS AND CONDITIONS OF ICT SLA

3.1 *Parties and Interested Persons*

The parties to the ICT SLA are CEZ ICT, as the provider of ICT Services, and the Company, as the assignor of ICT Services. As it was mentioned above, the parties to the ICT SLA qualify as related parties and as parties interested in the deal qualify EEEEC - in the meaning of Art. 114, Par. 7, item 2 of the LPOS, CEZ Distribution - in the meaning of Art. 114, Par. 7, item 2, first proposal of the LPOS; and CEZ ICT - in the meaning of Art. 114, Par. 7, item 1, first proposal of the LPOS.

The interest of EEEEC in the ICT SLA arises from its capacity of a majority shareholder of the Company and of an indirect controlling shareholder of CEZ ICT and is manifested in the following:

- (a). efficient supply of ICT Services to the Company – of quality, which would allow the performance of the obligations of the Company as a license-holder at a price, which would be possibly the lowest for the Company at such quality;
- (b). optimisation of the cashflow of the Company; and
- (c). maintenance of stable financial condition of the Company.

The interest of CEZ Distribution in the ICT SLA arises from its capacity of a sole owner of the share capital of CEZ ICT and related party to the Company, controlled by the majority shareholder of the Company – EEEEC. The interest of CEZ Distribution is manifested in the creation of receivables of CEZ ICT from the Company in result of the concluded deal.

The interest of CEZ ICT arises from its capacity of a related party to the Company pursuant to §1, item 13, letter “6” of the Additional Provisions of the LPOS of a party to the deal is in the form of creation of receivables of from the Company in result of the concluded deal.

3.2 *Subject-Matter of the ICT SLA*

The subject-matter of the ICT SLA is the provision against consideration of ICT Services in accordance with a specification (Catalogue of ICT Services), which services are necessary for the licensed operations of the Company. The ICT Services are specified by several main categories, where

each main category includes a different number of sub-categories of different level of detail, to the maximum possible extent describing the respective service.

3.2.1 Main Categories of ICT Services

The main categories of ICT Services are 6 (six) and are defined in accordance with the areas of operation of the Company, for which they are used, as follows:

- I. Communication Infrastructure and System Service;
- II. Support, Development and Provision of Business Information Systems;
- III. End-user Support;
- IV. Communication and Phone Services;
- V. Strategy, Consultancy, Programming and Administration; and
- VI. Data Exchange between Systems – Internal and External.

3.2.2 Sub-categories of ICT Services of First Level

The sub-categories of ICT Services of first level are listed in the table below:

<u>Services</u>			<u>Short Description</u>	<u>Service No</u>
<u>ICT Area</u>	<u>Structuring by Field</u>	<u>End-up Service</u>		
<u>S1. Main, Network Infrastructure and Services</u>	01. Base Package	Network Infrastructure & System Services	Development and maintenance of main corporate communication infrastructure and system service. The NET&SYS is a composite service, which is a mandatory condition for the provision of all other ICT resources and services. It includes delivery, installation and set-up of the necessary base equipment and software, administration and maintenance of systems, information security systems, reserving and technology updates, warranty and out-of-warranty service	<u>S1.01.NET&SYS</u>
		Service Desk	HelpDesk & IDM – provides uniform channel of contact with users, platform for ordering ICT Services, supply of IT equipment, access to information systems and service	<u>S1.01.SD&IdM</u>

<u>S2. Business systems support, development, delivery</u>	01. Business Application Support - CORE	ERP	Provision of access to the Process Automation System in the field of: finance, logistics, document management system, resource management	<u>S2.01.ERP</u>
		ISU	Provision of access to Client Information System for automation of the main business processes: clients' file; meter readings; billing; debts and payments; work orders for technical personnel; customer care – clients' request execution, registration of contacts with clients, etc.	<u>S2.01.ISU</u>
		xEnergie	Provision of access to Electricity Consumption Analysis System and Preparation of Forecasts	<u>S2.01.XE</u>
		CRM	Provision of access to Customer Relations Management System	<u>S2.01.CRM</u>
	02. Business Application Support - NON CORE	Graphic Design Program	Provision of access to specialized graphic design and image processing software	<u>S2.02.GDP</u>
		Acstre	Provision of access to specialized software / system for electronic administrative services (registration of document turnover, tasks control, etc.)	<u>S2.02.ACST</u>
		PIS	Provision of access to legal information system	<u>S2.02.PIS</u>
		Optical Character Recognition product	Provision of access to specialized software for optic recognition of characters.	<u>S2.02.OCR</u>
	04. Business Application Support - NON CORE	NON IT HelpDesk	Provision of access to System for Management of Client Requests by automation of processes and services of operational business divisions within CEZ Group Bulgaria outside the ICT services	<u>S2.02.NON-IT-HD</u>
		E-Learning	Provision of access to Electronic Training and Testing System	<u>S2.04.EL</u>
	05. Web Services	WEB INT	Provision of access to Intranet portal; access to company documentation and information	<u>S2.05.WEBINT</u>
		WEB EXT	Provision of information service integrated in the corporate internet portal cez.bg	<u>S2.05.WEBEXT</u>
<u>S3. Enduser Support</u>	01. Personal Computing	PC	Provision of computerized workplace – PC with operating system, office package and antivirus protection	<u>S3.01.PC N/VIP</u>
	02. Audio-visual provision and support	Videoconference	Provision and maintenance of video-conference connection infrastructure	<u>S3.02.VIDEO</u>

	03. ICT Printing Service	Print-Copy-Scan	Provision of printing, copying and scanning devices	<u>S3.03.PCS</u>
	04. Remote Access	VPN	Provision of services for remote access to corporate information resources	<u>S3.04.VPN</u>
	05. HandHeld Devices Support	HandHeld	Provision of HandHeld mobile computer devices for automation of work processes	<u>S3.05.HH</u>
	06. Email Client	Email Client	Provision of e-mail service for end-users.	<u>S3.06.EMAIL.C N/VIP</u>
<u>S4. Communication and Phone Services</u>	01. Mobile services, IP, conventional telephony	Mobile Services	Provision of access to mobile services – provision of mobile phones, mobile internet devices, SIM cards of different kinds	S4.01.MOB
		VoIP	Provision of access to internal telephone system, Voice over IP. Maintenance and management of gateways of infrastructure for connections to external users.	S4.01.VOIP
<u>S5. Strategy, consultancy and Administration</u>	01. Software Provision and Licensing	Licensing	Provision of maintenance and management of licenses.	S5.01.LICEN
	02. Business analysis and consultancy. ICT project management.	Consultancy	Consultancy services in the field of ICT	S5.02.CON
	04. Administrative Analysis	Reporting & Analysis	Provision of additional verifications and analysis of standard verifications and reports or new ones	S5.04.R&A
<u>S6. Data Exchange</u>	01. Data Exchange	Internal External Data Exchange	Automated Internal External Data Exchange integration middleware	S6.IEDE

3.2.3 ICT Services Catalogue

A specification of the ICT Services at their deepest level of detail is contained in the so called *Service Catalogue*, which represents an appendix to the ICT SLA and is updated on an annual basis.

3.3 *Duration of the ICT SLA*

The ICT SLA will enter into force and effect as from the first date of the month, following the month when the Company and CEZ ICT have organized their internal processes in a way, as to procure for the performance of the ICT Services and will remain in force and effect for 5 (five) years.

3.4 *Price of the ICT SLA*

3.4.1 Compliance with Transfer Pricing Requirements

The prices of the ICT Services under the ICT SLA are determined by pricing-method and by amount in accordance with transfer pricing documentation. The requirements of Ordinance № H-9 dated 14 August 2006 on the Order and the Manners of Implementation of the Methods on Determination of Market Prices, as well as of the Principles of Determination of Market Prices of the Organisation for Economic Co-Operation and Development and of the Transfer Pricing Guidelines, are fully complied with in the preparation of that documentation.

In order to comply, at each moment of the duration of the ICT SLA, with the up-to-date market price levels of ICT Services, the Company and CEZ ICT will receive recurrently (at each twelve-month period) comparative pricing analysis and, if significant changes to the market conditions have arisen, will agree on corresponding adjustment to the prices under the ICT SLA. Significant changes to the market conditions are the changes, where net mark-up rate applied at the given period does not any longer fall within the interquartile range of the analysis (see item 4.3. of the Report hereinbelow).

3.4.2 Pricing Method

The prices of the ICT Services under the ICT SLA are determined under the method of *transactional net margin (i.e. operational cost plus rate of net mark-up)*. The relevant costs with regard to the provision of the ICT Services are the following:

- (a). cost for salaries and social contributions and other personnel costs;
- (b). cost for depreciation of long-term assets;
- (c). cost of materials and services (mainly payments to the ultimate suppliers of licenses, hardware, Component Information Systems and communications, equipment, maintenance, etc.); and
- (d). other costs (mostly related to business trips).

The relevant costs do not include any costs, which are not directly relevant to the providing of the ICT Services (e.g. financial costs, foreign and local corporate tax).

The mark-up is 11% of the total value of the approved costs.

During the term of the ICT SLA the levels of the mark-ups will be subject to periodic adjustment, as indicated above in item 3.4.1. of the Report.

3.5 *Estimate of the Value of the ICT SLA against the Thresholds under the LPOS*

Under the ICT SLA, the Company will receive the ICT Services, which will lead to *creation of liabilities* in the meaning of Art. 114, Par. 1, item 2 of the LPOS. The total value of the ICT SLA is estimated to reach the thresholds, determined in the aforementioned legal provision.

Due to the qualification of the Company and CEZ ICT as *related parties* and the qualification of EEEEC, CEZ Distribution and CEZ ICT as *interested parties* with respect to the ICT SLA, the applicable threshold is the one under Art. 114, Par. 1, item 2, last proposition of the LPOS, namely: *2% of the lower of the values of the Total Assets on the latest prepared two Balance Sheets of the Company, at least one of which has been audited and which have been disclosed publicly following the procedure of Art. 100m of the LPOS.*

As of the moment of the preparation of the Report, the last audited Balance Sheet of the Company is the one as at 31 December 2020 and the last prepared Balance Sheet of the Company is the one as at 31 December 2021. As at the effective date of the ICT SLA, it is expected that the Annual Financial Statements of the Company as of 31 December 2021 would be prepared and audited, however they would not differ from the ones for the last quarter of 2021 in their relevant sections to an extent impacting the applicability (respectively, non-applicability) of Art. 114, Par. 1, letter "6" in relation to Art. 114, Par. 2, item 2, last proposition of the LPOS and Art. 114a, Par. 6 of the LPOS with regard to the ICT SLA.

The value of the assets is as follows:

	Balance Sheet as at 31 December 2020	Balance Sheet as at 31 December 2021
Value (BGN '000)	339,983	333,793

The lower of the two values is the one under the Balance Sheet as of 31 December 2021, of which 2% are equal to circa BGN 6,676 thousand.

From the comparison between the abovementioned threshold and the estimated total value of the supplies under the ICT SLA for its whole duration, it can be concluded that the ICT SLA falls within the scope of Art. 114, Par. 1, item 1, letter "6" in relation to item 2, last proposition of the LPOS, due to which it is subject to preliminary approval by the GM.

In the present item of the Report the term "*Balance Sheet*" is used as a synonym of a "*statement of financial position*".

3.6 *Estimated Fee for under ICT SLA*

The estimated fees under the ICT SLA within the 5-year period is, as follows:

Estimated Fee	5-year period
Amount (BGN '000)	11,675

3.7 *Terms of Payment of the ICT Services*

The remuneration for the ICT Services under the ICT SLA is paid on the basis of monthly invoices following the signing by the Company and by CEZ ICT of a protocol of delivery-acceptance of the services provided in the respective period. The payment will become due as of the date of the signing of that protocol and will have to be done not later than 5 (five) calendar days following the date of the issuance of the invoice.

3.8 *Beneficiaries of the ICT SLA*

The ICT SLA is concluded as beneficent to both parties.

3.9 *Other Essential Terms and Conditions of the ICT SLA*

The MB considers the following as essential terms and conditions of the ICT SLA, to which the shareholders of the Company should pay specific attention:

- The ICT Services are provided with resources (including, but not limited to, technical and employment), whose economic owner is CEZ ICT.

- The specific type and volume of the ICT Services is determined by the Company through periodic orders.
- If need be, the Company has the right to request a new service or a variation of an existing service upon identical conditions.
- The quality of the ICT Services shall correspond to procedures, methods and rules approved by the Company. The Company has the possibility to control and exercise constant inspections with regard to the technical parameters of the ICT Services.
- In the provision of the ICT Services, CEZ ICT is obliged to ensure the security of the systems and the protection of the data in accordance with the statutory requirements and the applicable Security Policy of the Company in the area of the information and the information systems.
- In the event of default or deficiency in quality of the ICT Services, CEZ ICT will owe the Company penalty depending on the type of the services and materiality of the case. CEZ ICT will be held liable for damage incurred by the Company in result from the quality of the ICT Services (including, but not limited to, sanctions imposed by competent administrative authorities and payments to suppliers).
- On top of the general grounds for termination, the Company will have the right to unilaterally terminate the ICT SLA by written notice to CEZ ICT also in any of the following cases:
 - with an immediate effect – in the event of substantial breach of the ICT SLA by CEZ ICT; and
 - by 1-year prior notice – by each of the parties to the ICT SLA without cause – where the term of notice will commence on the first date of the month following the day of receipt of the notice.
- The ICT SLA is regulated by Bulgarian law.
- Any disputes relating to the ICT SLA will be submitted for resolving by the competent Bulgarian court.

4 MARKET VALUATION

4.1 *Transfer Pricing Documentation*

As required by Art. 114a, Par. 6 of the LPOS, the ICT SLA, if approved by the GM and entered into by the MB, should be at a price equal to the market value of the ICT Services.

The market value of the ICT Services is determined by an independent advisor – a leader in the area of providing professional tax advice, including transfer pricing matters. The value is set forth in a written study prepared under the requirements for transfer pricing study (hereinafter referred to as the “**Transfer Pricing Study**”). It takes into consideration the traditional references to sources and databases of transnational character.

The Local File of the Transfer Pricing Documentation for the fiscal year 2020 of CEZ ICT, as prepared in June 2021 by Deloitte Bulgaria EOOD, analyses the transfer pricing policy applied to dealings with affiliated parties and whether or not the results of such policy would be aligned with the arm’s length principle. The documentation reviews the transactions between CEZ ICT and its related parties done in 2020 from the perspective of the functions performed, the assets used and the risks

borne by either party and analyses whether the pricing of those transactions is aligned with the principle of independent business dealings. The Analysis is done in compliance with:

- Ordinance № H-9 dated 14 August 2006 on the Order and the Manners of Implementation of the Methods on Determination of Market Prices issued by the Minister of Finance;
- the Transfer Pricing Guidelines, as announced on the web-site of the National Revenue Agency (www.nap.bg) in 2010; and
- the Guidelines of the Organisation for Economic Co-Operation and Development on Transfer Pricing for Multinational Enterprises and Tax Administrations.

The documentation shows that the most appropriate transfer pricing method is the *Transactional Net Profit Method* (TNPM), which compares the rate of the net profit on a controlled deal, calculated as the ratio between the net profit and a selected basis (sales revenue, operating expense, assets), with a comparable rate of net profit, calculated on the same basis on a deal between non-affiliated parties. By using publicly accessible information are identified independent third parties, which do comparable transactions with a disclosed rate of net profit. The TNPM is, therefore, selected as the most suitable method for testing the market compliance of the pricing of the transactions under review. After consideration of the profile of the Company and review of the analysed deals, it is determined that the Rate of Net Profit is the most appropriate indicator for the purpose of the analysis. The market level of the Rate of Net Profit, as confirmed in the Local File of the Transfer Pricing Study, are set put in Section 4.3 hereinbelow.

In line with the tax laws and the regulations of the preparation of Transfer Pricing Documentation, contained in Chapter VIII „a“ of the Tax and Social Security Procedure Cide, the local file of CEZ ICT is updated annually and the results of the economic analysis are applied to the pricing of the truncations between the related parties. As at the moment of preparing this present Report, Pricewaterhouse Coopers Bulgaria EOOD have been assigned to prepare the update of the Local File of the Transfer Pricing Documentation for the fiscal year 2021 for CEZ ICT.

Because the Transfer Pricing Study is not in the materials under item 1 of the agenda of the GM, it will be made available to the shareholders of the Company, who would like to get acquainted with its complete version, by the Investor Relations Director at the following contacts:

1784 Sofia
Mladost Region
159, Tsarigradsko Shosse Blvd.
BenchMark Business Centre
phone: +359 2 8958 027
email: radoslav.dimitrov@cez.bg

4.2 Functional Analysis

According to their functional analysis, the ICT Services represent: services in the area of information and communication technologies through providing for use of program products and providing their exploitation and support; providing, support and administration of computer equipment; development and providing of access to corporate telecommunication infrastructure to internal users and outside suppliers; and providing of specialized program and technical means of automation of business processes.

The description of the risks associated with the provision of the ICT Services and their allocation between the Company and CEZ ICT is, as follows:

4.2.1 Market Risk

CEZ ICT will bear significant market risk with regard to the provision of the ICT Services. Although CEZ ICT has a guaranteed client (the Company, and other Bulgarian companies of the corporate group, whose member CEZ Electro is), CEZ ICT will employ on its own behalf significant tangible and intangible assets exclusively dedicated to the provision of the ICT Services.

4.2.2 Exchange Rate Risk

Neither of the parties to the ICT SLA will undertake significant exchange rate risk related to the execution of the ICT SLA.

4.2.3 Credit Risk

Neither of the parties to the ICT SLA will undertake significant credit risk related to the execution of the ICT SLA.

4.2.4 Interest Risk

CEZ ICT shall bear the interest risk with regard to the provision of the ICT Services corresponding to the time-gap between the average term of payment of the services by clients (about 1.5 – 2 months following their supply) and the average term of payment to the employees and the suppliers to CEZ ICT.

4.2.5 Inventory Risk

Neither of the parties to the ICT SLA will undertake significant inventory risk related to the execution of the ICT SLA.

4.2.6 Risk related to Quality

CEZ ICT will bear the risk with regard to the quality and the timely supply of the ICT Services. That risk represents the accrual of penalties in cases of non-compliance with the quality parameters of the ICT SLA and in the event of delay.

4.2.7 Cost Increase Risk

CEZ ICT and the Company will bear the risk of increase of the costs.

4.3 *Amount of the Mark-Up*

The Transfer Pricing Study contains an analysis on the comparability of the terms and conditions of providing the ICT Services under the ICT SLA with the terms and conditions, under which identical or substantially similar services are provided between non-related parties in an environment, which is identical or substantially similar from competition point of view.

Based on the results of the analysis, the applicable transfer pricing method is the *Transactional Net Profit Method*. That method consists of the comparison between a net profit rate of a taxable person in a controlled deal (or deals, which would suitably be grouped) with a net profit rate, which that same person realizes in a comparable non-controlled deal. The net profit rate is the return on total cost (rate of operating profit) determined by way of dividing the operating profit by the total operating cost.

Further, the analysis established that the average rate of net profit (return on total costs) realised by companies comparable to CEZ ICT providing services in the relevant areas is within the following boundaries (the so called “*inter-quartile range*”):

	Minimum	Lower Quartile	Median	Upper Quartile	Maximum
Rates of Net Profit (return on total costs) (%)	-9,42%	2,57%	9,88%	23,69%	84,50%

Adopting a conservative approach, the management of the Company contemplates an amount of the mark-up on the service costs under the ICT SLA of 11%, which would result in fitting around the median rate of net profit (return on total costs). That amount of the mark-up corresponds to the main requirement for compliance with market levels – the rate of net profit falls within the inter-quartile range between the lower quartile and the upper quartile. At the same time, the amount does not deviate from the acceptable price levels from tax perspective, which following the good practices supported by the tax authorities, fall within the range between the lower quartile and the median.

5 ECONOMIC BENEFIT TO THE COMPANY

The opinion of the MB is that the ICT SLA will be economically beneficial to the Company in the sense that it would utilize a combination of strategic benefits (in substance – synergies in the CEZ Group) and financial benefits (in substance – savings from capital and operational expenses), as follows:

5.1 *Strategic Benefits*

CEZ ICT operates as a shared service centre for ICT Services (referred to hereinafter as “SSC”) for the companies from the group, whose member CEZ Electro is. With that regard the MB is of the opinion that the ICT SLA will lead to the following benefits:

5.1.1 Advantages of the SSC

These advantages include:

- allowing management and staff of the Company to focus on core activities (not on service procurement);
- ensuring higher quality of service with guaranteed quality parameters compared to in-sourcing by reason of specialization;
- realizing economies of the scale – joining to the license scheme of the Group, sharing of contracts on supply and maintenance with leading technology suppliers, etc; and
- reducing overall operational costs by reason of avoiding double operations at group level and other synergies.

As CEZ ICT is designated to service the companies of the group, whose member CEZ Electro is, the Company would, on top of the above benefits, achieve an overall reduction of costs, for the following reasons:

- through the SSC would be channelled the most significant part of the supply chain (purchase → distribution → supply → payment), which would enable a smooth co-ordination of processes; and
- the Company would have its stake of the usual synergies, which arise in SSCs in the utility sector, and would be available to the remaining members of the CEZ Group too.

In result of the above, the ICT SLA would to a maximum extent ensure the performance of the licensed obligations of the Company.

5.1.2 Benefits of One-Stop Shopping

The essence of the ICT Services varies widely, therefore, procuring them directly from the market would inevitably lead to the generation of costs for non-core processes, as for example:

- separate management of each of the ICT Services;
- maintenance of staff specialized exclusively in the relationship with an external supplier for only 1 specific service;
- need for follow-up integration at the level of the Company of the results / supplies received from many uncoordinated suppliers.

The above disadvantages could be eliminated by the ICT SLA, which would -from the perspective of the Company – guarantee one-stop shopping of ICT Services.

5.1.3 Benefits of Tailored Supply

The shared service centre of CEZ ICT is created and periodically shaped to meet particularly the needs of the Bulgarian companies of the group, whose member CEZ ICT is. This is particularly efficient where the consideration for the ICT Services is based on cost of service, as irrelevant or non-value costs are eliminated in full as pricing components.

5.2 *Financial Benefits*

5.2.1 Scope of the Financial Analysis

The MB of the Company performed a financial analysis of all possible options for the procurement of the ICT Services, where were compared the conditions of:

- (i). the ICT SLA;
- (ii). the as-is situation, where the procurement of the ICT Services is done from professional suppliers, which are independent from the Company and the group, whose member CEZ Electro is, with their own technical and personnel resources (i.e. **Independent External Supplier**).

The financial analysis is done by employees of the Company.

5.2.2 Activities Performed in the Financial Analysis

The activities performed in the financial analysis of the possibilities provided under the ICT SLA and by an Independent external supplier are, as follows:

Activity	Result
Analysis of the processes and the sub-processes (the ICT Services) with regard to their specifics and the technical possibility for their provision	
Defining of internal and external benchmarks for sizing and evaluation of offers for the ICT Services	

Activity	Result
Defining of general calculation model for comparing the offers for the ICT Services	Presence of objective criterion for comparison of the costs
Defining of time-period for the comparison	Measurement as of the present market moment (the beginning of 2022) and reflection of the market dynamics for 12 months backwards (for the whole 2021)

5.2.3 Comparison Criteria of the Financial Analysis

In the financial analysis the ICT SLA and the Independent external supplier of the ICT Services are compared by the following economic criteria:

- (i). comparing the costs of the ICT Services in the two options;
- (ii). valuing the synergies from the SSC by a coefficient, which reflects the economies of the scale and the avoidance of doubling (loss of synergy coefficient);
- (iii). the analysis is based on the plans and forecasts of the management for restructuring of the operations of the Company and assuming volumes of the operation by each process against the levels of cost for 2021 in line with such plans.

According to the prevailing metrics standard, the comparative analysis of the cost of the ICT Services is done based on the *full-time equivalent (FTE)* criterion – a measure equal to 1 man occupied professionally with the provision of the ICT Services at a full-time business day in the year. The synergies of the SSC are calculated based on the above analysis.

5.2.4 Results of the Financial Analysis

Comparison of the costs

The comparison of costs of the ICT Services under the ICT SLA and if provided by Independent external supplier considering the plans and forecasts of the management for restructuring of the operations of the Company is summarized in the below table:¹

	ICT SLA	Independent external supplier
Total amount of annual cost	2,335	2,521
Surplus over the cost of the ICT SLA	n/a	186

All amounts in the table are in BGN '000 (thousand Bulgarian Leva).

Summary:

By using the ICT SLA with CEZ ICT, the cost of the ICT Services would be reduced by the amount of up-to BGN 186 thousand per year.

¹ Source: data pertaining to the Company

5.2.5 Reasons for the Decrease of Cost with the ICT SLA

The main reasons for the decrease of cost in the case of the ICT SLA are the following:

- reduction of the cost of licenses, systems and assets due to the better prices available to the group, whose member CEZ Electro is;
- sharing the Help Desk for the group;
- gain from the specialization in the ICT Services sphere (which is present in the big volume of the companies from the group, whose member CEZ Electro is).

6 **DRAFT RESOLUTION**

With regard to the abovementioned, the MB proposes to the General Meeting to adopt a resolution, as it is contained into the Invitation to the GM:

Draft-resolution: "The General Meeting, on the grounds of Art. 114, Par. 1, item 2, last proposal, in connection with Art. 114, Par. 1, item 1, letter "6" and Art. 114a, Par. 6 of the LPOS, authorizes the Management Board of the Company to enter, in accordance with the rules for representation of the Company before third parties, into a Contract for provision of services under the following significant terms and conditions:

(a). parties to the contract:

CEZ Electro Bulgaria AD as a customer and CEZ Information and Communication Technologies Bulgaria EAD as a supplier.

(b). subject-matter of the contract:

provision against consideration of information and communication technologies services in accordance with the specification, which services are necessary for the usual activities of CEZ Electro Bulgaria AD

(c). price of the services:

The prices are individual for each service, which amount is determined in accordance with the transfer pricing documentation.

The services are reported and paid on a monthly basis after their acceptance.

(d). expected total remuneration of the contract:

The expected estimated total remuneration under the Contract over a period of 5 (five) years is prognosticated, as follows:

BGN 11.675 million (eleven million and six hundred and seventy-five thousand leva)

(e). duration of the contract:

The Contract enters into force and effect on the first day of the month following the month when the Company and CEZ ICT have organized their internal processes, so as to ensure the implementation of the ICT Services and remains in force for a period of 5 (five) years.

(f). beneficiaries of the contract:

CEZ Electro Bulgaria AD and CEZ Information and Communication Technologies Bulgaria EAD

(g). other essential terms and conditions of the contract:

The specific type and volume of services are determined by CEZ Electro Bulgaria AD with periodic requests for services.

The quality of the services corresponds to the procedures, methodologies and rules approved by CEZ Electro Bulgaria AD.

The services are provided with resources (including, but not limited to, technical and staff) economically owned by CEZ ICT.

If necessary, the Company has the right to request a new service or modification of an existing service under similar conditions.

In performing the Services, CEZ ICT undertakes to ensure the security of the systems and the data protection in accordance with the legal requirements and the current Company's Policy for security in the field of information and information systems.

In case of non-performance or poor performance of the Services, CEZ ICT owes the Company a penalty depending on the type of the services and the severity of the non-performance. CEZ ICT is liable for damages caused to the Company as a result of the quality of the ICT Services (including, but not limited to, sanctions imposed by competent administrative authorities and payments to suppliers).

In addition to the general grounds for termination, the Company has the right to unilaterally terminate the Contract for ICT Services by a written notice to CEZ ICT in each of the following cases:

- with an immediate effect - in case of significant non-fulfillment of the Contract for ICT Services by CEZ ICT; and

- with one year notice - by each of the parties to the Contract for ICT Services without giving a specific reason, as the notice period starts from the first day of the month following the date of receipt of the notice.

The Contract is regulated by Bulgarian law.

Disputes concerning the Contract are referred to the competent Bulgarian court for resolution."

7 NOTICE OF ABSENCE OF VOTING RIGHTS OF THE INTERESTED PARTIES

The shareholder EEEEC is hereby notified that pursuant to Art. 114a, Par. 5 of the LPOS that shareholder shall not be allowed to vote on the proposed draft-resolution by reason of its capacity of an interested party by virtue of Art. 114, Par. 7, item 2 of the LPOS.

Members of the Management Board of CEZ Electro Bulgaria AD:

The signature was placed, but removed on the grounds of Art. 5, Par. 1 of Regulation (EU) 2016/679.

Dimcho Stanev

The signature was placed, but removed on the grounds of Art. 5, Par. 1 of Regulation (EU) 2016/679.

/Christo Babbev