Czech Gas Networks Investments S.à r.l.

Consolidated Management Report
for the period from 22 March 2019 to 31 December 2019

Contents

1. CGNI Group Profile

The Czech Gas Networks Investments S.à r.l. consolidation scope is made up of Czech Gas Network Investments S.à r.l. (the "Company" or "CGNI") and its subsidiaries Czech Grid Holding a.s., GasNet, s.r.o. and GridServices, s.r.o. ("Czech Grid Group"). All subsidiaries are fully owned by Czech Gas Network Investments S.à r.l. (the „Group").

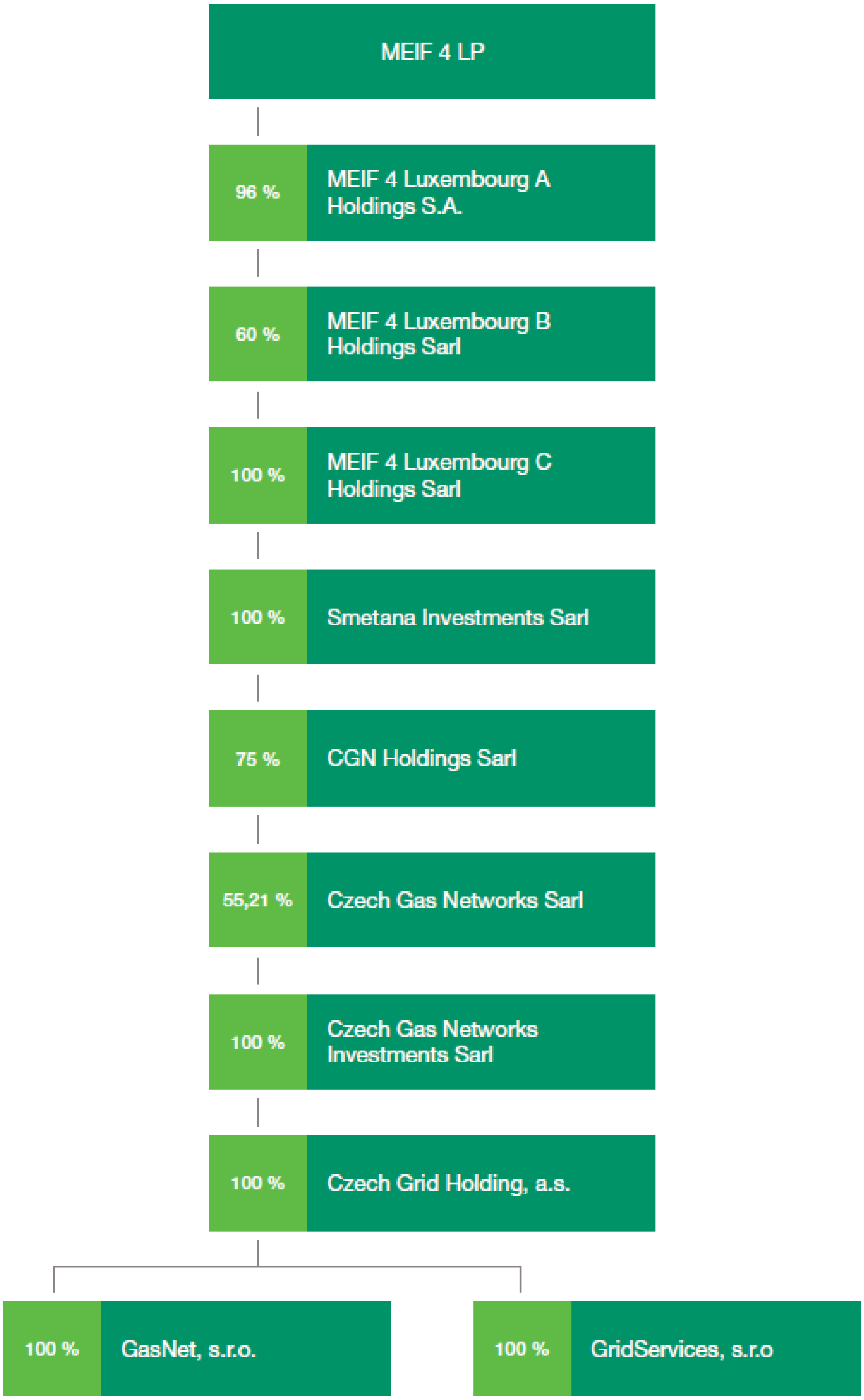
The Company was incorporated on 22 March 2019 and is domiciled in Grand Duchy of Luxembourg. The Company's registered office is Grand Duchy of Luxembourg, 20, Boulevard Royal, L-2449 Luxembourg.

On 30 September 2019 the Group purchased 100% shares in Czech Grid Group.

The Czech Grid Group distributes natural gas throughout the territory of the Czech Republic with the exception of Prague and South Bohemia. The gas distribution activity of the Company is regulated by an independent regulatory body, Energy Regulatory Office ("ERO"). The regulation of the Company is conducted by determining the overall level of allowed revenues (the Revenue Cap) and the subsequent calculating of tariffs for distribution services for individual customers. These distribution prices (tariffs) are published annually in a price resolution issued by ERO. Further, the Czech Grid Group oversees the operation and maintenance of the distribution system and the corresponding gas assets. The Group's other business activities include comprehensive document management and administration, measuring natural gas consumption and quality, connecting and disconnecting customers, and, no less importantly, engineering services for the construction and reconstruction of natural gas distribution networks.

The Group prepares consolidated financial statements in accordance with International Financial Reporting Standards („IFRS") as adopted by the European Union ("EU") under the historical cost convention. The Group financial year begins of 1 January and ends on 31 December.

The structure of CGNI Group for the period from 30 September 2019 to 31 December 2019 is the following:



[Minority shareholders of Czech Gas Networks S.à r.l.:

- *British Columbia Investment Management Corporation through its subsidiaries (the final subsidiary Iskut IMC Inc.) with 26,29% share*
- *Allianz SE through its subsidiaries (the final subsidiary Allianz Infrastructure Luxembourg II S.à r.l.) with 18,5% share]*

2. Background and significant events in the year 2019

2.1 Key Group Ratios 2019

In millions of CZK	Period from 22 March to 31 December 2019
Total sales revenue	4,199
EBITDA	2,409
Operating profit	266
Loss before income tax	(486)
Loss for the period	(501)
Investments	837
Number of employees (FTE)	2,182

2.2 Group Investments

Throughout the period after the acquisition of Czech Grid Group, the Group executed investment projects worth in total CZK 837 million in accordance with the approved investment plan. Most of the funds was invested into distribution system renovation.

2.3 Distribution System

The distribution system is operated by GasNet, s.r.o., a company from the Czech Grid Group, based on Gas Distribution License No. 220604925 granted on 1 January 2007 and updated under Annex 032 issued by the Energy Regulatory Office on 1 October 2019 in accordance with the Energy Act (Act No. 458/200), as in effect.

Overview of Group Gas Assets		**2019**
Length of operated pipelines		
Local networks	km	42,661
Service lines	km	11,119
Long-distance lines	km	11,205
Transfer and very-high-pressure regulating stations	Units	55
High-pressure regulating stations	Units	2,763
Medium-pressure regulating stations	Units	781
Cadastral communities with distribution licence	Units	6,888

2.4 Business and Risk Management

Business

In 2019, growth on the liberalized natural gas market slowed down in comparison with a development in previous years. The extent of supplier switching recorded by GasNet, s.r.o., a company from the Czech Grid Group, was below the levels achieved in 2017 and 2018, when over 200 thousand supplier switches were made annually. Still, the 186,000 supplier switches in 2019 evidence that a large number of consumers continue to monitor the development of prices and services offered by individual natural gas suppliers.

Risk management and anti-corruption policy

The Group companies record all risks in the Risk Catalogue. All risks are also recorded in a matrix of risks, which helps to identify the most serious risks in terms of the probability of their occurrence and size of potential damage. For reach risk, the owner of the risk is clearly defined and is responsible for managing the risk. In 2019, the management of the companies of the Group did not identify any risks to the continuance of the Group as a going concern.

The Group companies use a Incorrect Conduct Prevention Program aimed at preventing actions that go against the Company's interests. Such actions include fraud, occupational health and safety violations, discrimination, and corruption. Detailed information is available to employees in the policy Investigation into Suspicions of Dishonest Actions against the Company's Interests. The program is overseen by the assigned Compliance Officer together with the Internal Audit Department.

The Board of Directives defines the objectives, principles, tasks and competencies to manage financial, operational and legal risks. Financial risk comprises market risk (including interest rate risk and foreign currency exchange risk), credit risk and liquidity risk. The primary focus of financial risk management is to establish risk limits and to ensure that any exposures to risk stay within these limits. The operational and legal risk management functions are intended to ensure the proper functioning of internal policies and procedures in order to minimise operational and legal risks.

Foreign exchange rate risk

The Group is exposed to the currency risk stemming from the loans denominated in other currency than CZK. Based on the internal policies at least 85% of the notional amount of each facility, which is denominated in a currency other than CZK is hedged through cross-currency swap for a term of at least 12 months. The company does not operate internationally and is primarily exposed to FX risk from financing facilities, and negligibly from operational matters.

Interest rate risk

The Company is exposed to interest rate risk which relates primarily to the Company´s loan facilities with a floating interest rate. To mitigate the interest rate risk, the Company took the internal measures and hedged the minimum of 75% of the notional amount of each loan facility by interest rate swaps.

Credit risk

The Group exposes itself to credit risk, which is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to meet its obligations. Exposure to credit risk arises as a result of the Group's lending and other transactions with counterparties, giving rise to financial assets. Credit risk is one of the most significant risks for the Group´s core distribution business. However, the major part of the Group´s risk related to gas distribution services provided mostly to traders, gas suppliers and local distributors is managed by means of credit rules called "Conditions of Financial Eligibility" implemented in the Group´s Network Code (that is a part of legal framework approved by ERO based on non-discriminatory rules).

Liquidity risk

The liquidity risk consists of the potential shortage of funds needed for paying due obligations and for financing business activities. The Group manages its liquidity risk by securing sufficient funds to be able to meet its financial obligations within a period of no less than three months in accordance with the currently valid Cash-flow outlook.

To mitigate liquidity risk, the Group focuses on precise liquidity planning. Management drafts financial plans for individual years in the framework of regular forecasts. Subsequently, the planned cash flow is updated on a monthly basis for a 12-month period and, moreover, specified with a greater accuracy through regular updates, if necessary. The Group plans cash flows for a period of at least 12 months on a daily basis.

2.5 Financial instruments

Derivative financial instruments, including currency and interest rate swaps are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the period. Derivatives are only used for economic hedging purposes and not as speculative investments. The Group does not apply hedge accounting.

In compliance with the internal policies, the Group entered into a number of cross-currency swap agreements on 30 September 2019, all maturing on 31 December 2026, to hedge the notional amount of the credit facilitiess for a total amount of EUR 548 million to cover the Group's position in EUR. The fair value of cross-currency swap agreements (derivative liability) amounted to CZK 589 million as at 31 December 2019.

On 30 September 2019 the Group also entered into a number of interest rate swap agreements to hedge the interest payments under the credit facilities, all maturing after period end. The fair value of interest swap agreements (derivative asset) amounted to CZK 116 million as at 31 December 2019.

2.6 Human Resources

In 2019, the Group had 2,182 employees (FTE). Throughout the reported year, wages at the Group developed in accordance with the remuneration and wage increase principles agreed in the current Collective Agreement and its annexes. The Company fulfilled obligations to which member companies of the CGH Group are subject under the Collective Agreement for the years 2018-2020 and all its annexes.

2.7 OHS and Environmental Protection

One of our highest priorities, environmental protection is reflected in all aspects of the Group's operations, processes, and decisions. The Group companies are committed not only to complying with legislative requirements, but also to continually improving employees' awareness of environmental issues to provide them with general knowledge of ecology laws and the environmental impact of their actions.

In line with the Group's long-term target of upgrading technologies and, consequently, reducing emissions, 2019 saw the continuation of investments into the refurbishment and modernization of assets at selected gas transfer stations. State-of-the-art technologies were deployed as part of modernization projects.

Occupational health and safety is one of the Group's priorities. In 2019, no serious injuries were sustained by core employees of the Group companies. Close attention was paid to contractors, which included training for construction site supervisors, extensive courses for workers working on gas assets, and intensification of OHS inspections on construction sites. These efforts improved significantly the level of safety on worksites.

Inspections carried out by government authorities of the Group companies found no violations of environmental laws and regulations. There was no serious incident in the framework of operations of of the Group companies with an adverse impact on the environment in 2019.

2.8 Outlook

All of the Group's efforts will focus on improving the safety and reliability of natural gas supply to customers, taking into account financial considerations. In the forthcoming year, investments will be made into network renovation. All reconstruction projects are planned based on an assessment of the technical condition of pipelines in accordance with network capacity calculations and long-term forecasts pertaining to the development of gas consumption in given localities.

A high standard of operating safety will be maintained through the ongoing elimination of technical risks during planned network renewal project. A contribution in this regard will be made by a predictive model that selects gas assets to be reconstructed based on past experience with the development of defects in specific facilities and helps allocate funds in an effective manner with the aim of reducing the incidence of leaks to a minimum.

2.9 Subsequent events

Regulation

The year 2019 was the fourth year of the fourth regulatory period. The year 2020 will be the last year of the fourth regulatory period, with the fifth regulatory period beginning Jan 1 2021. The final parameters of the methodology for price regulation for the fifth regulatory period (2021-2025) were published on 9 June 2020. The Group believes the final parameters are in compliance with its expectations, which includes amongst others a pre-agreed trajectory of RAB reconciliation to net book values until 2025, a fixed WACC of 6.43%, and a balanced framework for allowed operating costs covering inflation and efficiency requirements. Overall, tariff stability will be maintained, while providing sufficient cash flow to finance the company's capital expenditures needs to renew the network.

COVID-19 impact

The existence of the novel coronavirus (COVID-19) was confirmed in early 2020 and has spread across mainland China and beyond, including the Czech Republic, causing disruptions to businesses and economic activity. The Group expects the impact of COVID-19 to result in a certain decrease in revenues which will be compensated by the regulation in years 2021-2022.The COVID-19 pandemic could have a some adverse effect on the Group's business, financial condition, results of operations and/or cash flows. The Group predicts the negative impact on revenues from the sale of capacity to be approx. CZK 125 million for the period from June till December 2020, while the actual impact on revenue from March to May 2020 was approx. CZK 66 million. Both amounts are relatively not significant in relation to overall revenue and cash from operating activities. The COVID-19 pandemic may also impact the gas traders, whose financial situation may be deteriorated by the pandemic. The Group is exposed to the risk that the gas traders may be unable, or may refuse, to perform their contractual financial obligations to the Group. As of the issuance of this report, all retailers have fulfilled their obligations in time, including covering credit exposure or financial eligibility according to the network code. There are no negative consequences yet.

Fluctuations in currency exchange rates could adversely affect the Group's financial condition. The Group is exposed to currency fluctuations, primarily to the Euro to Czech Crown exchange rate, as the Group's key revenue streams are denominated in CZK, but part of the Group's debt is denominated in EUR. The Group has hedging arrangements in place covering 85% of the currency risk.

The Group considers this outbreak to be a non-adjusting post balance sheet event with no effects on its ability to continue as a going concern.

3 Consolidated Financial Statements and Independent Auditor's Report

Czech Gas Networks Investments S.à r.l.

Consolidated Financial Statements and Independent Auditor's Report

31 December 2019

20, Boulevard Royal

L-2449 Luxembourg

RCS Luxembourg: B 233444

Share capital: CZK 700,000

Contents

Audit report

To the Board of Managers of
Czech Gas Networks Investments S.à r.l.

Our opinion

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Czech Gas Networks Investments S.à r.l. (the "Company") and its subsidiaries (the "Group") as at 31 December 2019, and of its consolidated financial performance and its consolidated cash flows for the period from 22 March 2019 (date of incorporation) to 31 December 2019 in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated balance sheet as at 31 December 2019;
- the Consolidated statement of profit or loss and other comprehensive income for the period from 22 March 2019 (date of incorporation) to 31 December 2019;
- the consolidated statement of changes in equity for the period from 22 March 2019 (date of incorporation) to 31 December 2019;
- the consolidated statement of cash flows for the period from 22 March 2019 (date of incorporation) to 31 December 2019; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with the Law of 23 July 2016 on the audit profession (Law of 23 July 2016) and with International Standards on Auditing (ISAs) as adopted for Luxembourg by the "Commission de Surveillance du Secteur Financier" (CSSF). Our responsibilities under the Law of 23 July 2016 and ISAs as adopted for Luxembourg by the CSSF are further described in the "Responsibilities of the "Réviseur d'entreprises agréé" for the audit of the consolidated financial statements" section of our report.

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

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) as adopted for Luxembourg by the CSSF together with the ethical requirements that are relevant to our audit of the consolidated financial statements. We have fulfilled our other ethical responsibilities under those ethical requirements.

Other information

The Board of Managers is responsible for the other information. The other information comprises the information stated in the annual report but does not include the consolidated financial statements and our audit report thereon.

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

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

Responsibilities of the Board of Managers for the consolidated financial statements

The Board of Managers is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs as adopted by the European Union, and for such internal control as the Board of Managers determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

Responsibilities of the "Réviseur d'entreprises agréé" for the audit of the consolidated financial statements

The objectives of our audit are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an audit report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;

- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;

- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Managers;

- conclude on the appropriateness of the Board of Managers' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our audit report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our audit report. However, future events or conditions may cause the Group to cease to continue as a going concern;

- evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation;

- obtain sufficient appropriate audit evidence regarding the financial information of the entities and business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

Restriction on Distribution and Use

Our audit report on the consolidated financial statements is prepared in the context of a contractual consolidation audit requested by management to submit it to the sole shareholder and to satisfy bonds listing needs. Our report is intended solely for the Board of Managers, the sole Shareholder and Bonds holders, and should not be distributed to or used by any other party. We do not accept responsibility to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers, Société coopérative — Luxembourg, 29 June 2020
Represented by

Electronically signed by:
Pierre Mallet

Pierre Mallet

Consolidated Statement of Financial Position as at 31 December 2019

In millions of CZK	**Note**	**31 December 2019**	**22 March* 2019**
ASSETS			
Non-current assets			
Property, plant and equipment	3.1	108,421	-
Right-of-use assets	3.3	2,379	-
Intangible assets	3.2	417	-
Derivative financial assets	3.12	116	-
Other non-current assets		1	-
Total non-current assets		**111,334**	**-**
Current assets			
Inventories		6	-
Trade and other receivables	3.5	661	-
Income tax prepayment		38	-
Cash and cash equivalents	3.4	926	-
Total current assets		**1,631**	**-**
TOTAL ASSETS		**112,965**	**-**
EQUITY			
Share capital	3.7	1	-
Share premium	3.7	27,856	-
Legal reserves	3.7	-	-
Accumulated deficit		(501)	-
Total equity		**27,356**	**-**
LIABILITIES			
Non-current liabilities			
Borrowings	3.8	64,132	-
Lease liabilities	3.3	1,357	-
Deferred income tax liabilities	4.5	16,288	-
Provisions		26	-
Other non-current liabilities	3.9	241	-
Derivative financial liabilities	3.12	589	-
Total non-current liabilities		**82,633**	**-**
Current liabilities			
Borrowings	3.8	271	-
Lease liabilities	3.3	194	-
Trade and other payables	3.11	1,528	-
Contract liabilities	3.6	756	-
Current income tax payable		24	-
Other taxes payable	3.10	190	-
Provisions		13	-
Total current liabilities		**2,976**	**-**
Total liabilities		**85,609**	**-**
TOTAL LIABILITIES AND EQUITY		**112,965**	**-**

Approved for issue and signed on behalf of Management Board on 26 June 2020.

Charles Roemers
Manager

Rosa Villalobos
Manager

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the period ended 31 December 2019*

In millions of CZK	**Note**	**2019**
Revenue	4.1	4,199
Other income		11
Capitalisation of internal costs	3.1	61
Net impairment losses on financial assets	3.5	(1)
Raw materials and consumables used		(51)
Employee benefits expense	4.2.1	(485)
Depreciation and amortisation	3.1, 3.2, 3.3	(2,143)
Services	4.2.2	(870)
Other operating expenses	4.2.3	(455)
Operating profit		**266**
Finance income	4.4	403
Finance costs	4.3, 3.3	(1,155)
Loss before income tax		**(486)**
Income tax expense	4.5	(15)
Loss for the period		**(501)**
Other comprehensive income for the period		-
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD		**(501)**

Rosa Villalobos Charles Roemers
Managers

* In these financial statements the reporting period is from 22 March 2019 till 31 December 2019

Consolidated Statement of Changes in Equity
for the period ended 31 December 2019

In millions of CZK	Note	Share capital	Share premium	Legal reserves	Accumulated deficit	Total
Balance as at 22 March 2019		**-**	**-**	**-**	**-**	**-**
Loss for the period		-	-	-	(501)	**(501)**
Total comprehensive loss for the period		**-**	**-**	-	**(501)**	**(501)**
Transactions with owners in their capacity as owners:						
Share capital and share premium increase	3.7	1	27,856	-	-	**27,857**
Balance as at 31 December 2019		**1**	**27,856**	-	**(501)**	**27,356**

Rosa Villalobos   Charles Roemers
Managers

Consolidated Statement of Cash Flows for the period ended 31 December 2019

In millions of CZK	**Note**	**2019**
Cash flows from operating activities		
Loss before income tax		(486)
Adjustments:		
Depreciation and impairment of property, plant and equipment	3.1	2,044
Amortisation and impairment of other intangible assets	3.2	52
Depreciation of right-of-use assets	3.3	47
Net impairment losses on financial assets	3.5	1
Net loss on disposals of property, plant and equipment	4.2.3	255
Other finance income	4.4	(4)
Interest expenses	4.3	566
Net fair value adjustment on derivatives	4.3, 4.4	473
Net foreign exchange gain on borrowings	4.4	(283)
Other non-cash operating costs		(4)
Operating cash flows before working capital changes		**2,661**
Increase in trade and other receivables		(298)
Decrease in inventories		22
Decrease in other non-current liabilities	3.9	(7)
Decrease in contract liabilities, trade and other payables		(525)
Decrease in provisions		(5)
Increase in other taxes payable	3.10	5
Income taxes paid		(72)
Interest income received		4
Interest paid	3.3, 3.8	(274)
Net cash from operating activities		**1,511**
Cash flows from investing activities		
Purchases of property, plant and equipment and intangible assets		(1,565)
Proceeds from the sale of property, plant and equipment		12
Cash and cash equivalents acquired on business combination	6.1	1,047
Lease payments for subsurface rights	3.3	(4)
Net cash used in investing activities		**(510)**
Cash flows from financing activities		
Principal elements of lease payments	3.3	(81)
Settlement of promissory note	6.1	6
Net cash used in financing activities		**(75)**
Change in cash and cash equivalents		926
Cash and cash equivalents as at 22 March 2019		**-**
Cash and cash equivalents as at 31 December 2019		**926**

Rosa Villalobos   Charles Roemers
Managers

Notes to the Consolidated Financial Statements

1 General Information

1.1. Group and its Operations

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU for the reporting period ended 31 December 2019 for Czech Gas Network Investments S.à r.l. (the "Company" or "CGNI") and its subsidiaries (together the "Group"). CGNI controls the operating entities GasNet, s.r.o. and GridServices, s.r.o. through intermediate holding entity Czech Grid Holding a.s.. Czech Grid Holding a.s., GasNet, s.r.o. and GridServices, s.r.o. are together referred to as "the Czech Grid Group". There are no non-controlling interests within the Group.

The Company was incorporated on 22 March 2019 and is domiciled in the Grand Duchy of Luxembourg. The Company is organised under the laws of Luxembourg as a Société a Responsabilité Limitée for an unlimited period of time and was set up in accordance with regulations of Luxembourg. The Company's registered office is the Grand Duchy of Luxembourg, 20, Boulevard Royal, L-2449 Luxembourg.

As at 31 December 2019, the Company's immediate parent company was Czech Gas Network S.à r.l. ("CGN"), registered office the Grand Duchy of Luxembourg, 20, Boulevard Royal, L-2449 Luxembourg with its share of 100%. The ultimate parent company of the Group was fund MEIF IV LP (Macquarie European Infrastructure Fund) registered in Grand Duchy of Luxembourg.

On 30 September 2019 the Group acquired 100% shares in Czech Grid Holding a.s.

Principal activity. The Group's main business activity is operating a natural gas distribution system. The Group operates a distribution system serving an area, defined in its license, which is the largest in the Czech Republic in terms of the area covered by and the length of the operated gas pipelines. The distribution system operator's key obligations include providing for the safe, reliable and economical operation and the maintenance, replacement and development of the distribution system in the delineated area, while gaining funds for these activities by selling distribution capacity.

Presentation currency. These consolidated financial statements are presented in millions of Czech crowns ("CZK"), unless stated otherwise.

Regulatory framework. The gas distribution activity of the Group is regulated by an independent regulatory body, ERO. There were several changes in the leadership of this office in 2019.

The regulation of the Group is conducted by determining the overall level of allowed revenues (the Revenue Cap) and the subsequent calculating of tariffs for distribution services for individual customers. These distribution prices (tariffs) are published annually in a price resolution issued by ERO.

The year 2019 was the fourth year of the fourth regulatory period. The year 2020 will most likely be the last year of the fourth regulatory period.

In the autumn 2018, ERO initiated a discussion with other regulated entities in the electricity and gas industries on regulatory principles to be applicable within the subsequent fifth regulatory period. During the spring and the beginning of the summer 2019, regulated entities jointly and individually met with experts from ERO several times as well as with members of the ERO Council. The discussion process was ongoing until July 2019.

On 1 August 2019, the Government appointed Stanislav Trávníček as the new chairman of the ERO Council and, at the same time, two other members of the ERO Council were replaced.

As at 30 August 2019, ERO published the Draft of the Price Regulation Methodology and started a public consultation process as required in the Energy Act.

The public consultation process is divided into several stages. Until the end of October 2019, all regulated entities were invited to submit their comments to published documents. The participants had a second chance to submit additional comments on the proposed methodology through the end of December 2019. In January 2020, ERO organised a public hearing during which all those who sent comments could participate. In February, ERO addressed all the submitted comments and suggestions and closed the consultation process by publishing the results of the consultations on its website. The final parameters of the methodology for price regulation for the fifth regulatory period (2021-2025) were published on 9 June 2020. The Group believes the final parameters follow with its expectations, which includes amongst others a pre-agreed trajectory of Regulated Asset Base (RAB) reconciliation to net book values until 2025, a fixed WACC of 6.43%, and a balanced framework for allowed operating costs covering inflation and efficiency requirements. Overall, tariff stability will be maintained, while providing sufficient cash flow to finance the Group's capital expenditures needs to renew the network.

1.2. Significant Accounting Policies

Basis of preparation. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") under the historical cost convention. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

The preparation of consolidated financial statements in conformity with IFRS as adopted by the EU requires the use of certain critical accounting estimates. It also requires that management exercises its judgement in the process of applying the Group's accounting policies. Areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 1.3.

Consolidated financial statements. Subsidiaries are those investees that the Group controls because the Group (i) has power to direct the relevant activities of the investees that significantly affect their returns; (ii) has exposure, or rights, to variable returns from its involvement with the investees; and (iii) has the ability to use its power over the investees to affect the amount of the investor's returns. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all its subsidiaries use uniform accounting policies consistent with the Group's policies.

Foreign currency translation. The functional currency of the Company and its subsidiaries, and the Group's presentation currency, is CZK, the national currency of the Czech Republic.

Transactions and balances. Monetary assets and liabilities are translated into the functional currency (CZK) at the official exchange rate of the Czech National Bank ("CNB") at the respective end of the reporting period. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at the official period-end exchange rates of the CNB are recognised in profit or loss as finance income or costs. Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of profit or loss within "finance income or costs". Translation at period-end rates does not apply to non-monetary items that are measured at historical cost.

Property, plant and equipment. Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required. Property, plant and equipment include assets under construction for future use as property, plant and equipment.

Repairs and maintenance expenditures are expensed as incurred. Costs of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

At the end of each reporting period, management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs of disposal and its value in use. For the purposes of assessing impairment, items of property, plant and equipment are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). The carrying amount is reduced to the recoverable amount, and the impairment loss is recognised in profit or loss for the period. An impairment loss recognised for an asset in prior periods is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use or fair value less costs of disposal. Prior impairments of property, plant and equipment are reviewed for possible reversal at each reporting date as well.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in profit or loss for the period.

Depreciation. Land is not depreciated. Depreciation of other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives in years
Buildings	14 to 50
Equipment	7 to 20
Furniture and fittings	3
Gas network	40

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Intangible assets. The Group's intangible assets have definite useful lives and primarily include capitalised computer software and royalties. Acquired computer software is capitalised on the basis of the costs incurred to acquire and bring it to use.

Intangible assets are amortised using the straight-line method over their useful lives:

	Useful lives in years
Software	3
Other	up to 6

Financial instruments – key measurement terms. *Fair value ("FV")* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is the price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Amortised cost ("AC") is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any allowance for expected credit losses *("ECL")*. Accrued interest includes the amortisation of transaction costs deferred at initial recognition and of any premium or discount to the maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of the related items in the consolidated statement of the financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Financial instruments – initial recognition. Financial instruments at Fair Value Through Profit or Loss ("FVTPL") are initially recorded at fair value. All other financial instruments are initially recorded at fair value adjusted for transaction costs. Fair value at initial recognition is best evidenced by the transaction price. After the initial recognition, an ECL allowance is recognised for financial assets measured at AC and investments in debt instruments measured at Fair Value through Other Comprehensive Income ("FVOCI"), resulting in an immediate accounting loss.

Financial assets – classification and subsequent measurement – measurement categories. Financial assets are classified in the following measurement categories: FVTPL, FVOCI and AC. The classification and subsequent measurement of debt financial assets depends on (i) the Company's business model for managing the related assets portfolio and (ii) the cash flow characteristics of the asset.

Financial assets – classification and subsequent measurement – business model. The business model reflects how the Company manages its assets in order to generate cash flows – whether the Company's objective is (i) solely to collect the contractual cash flows from the assets ("hold to collect contractual cash flows") or (ii) to collect both the contractual cash flows and the cash flows arising from the sale of assets ("hold to collect contractual cash flows and sell") or, if neither (i) nor (ii) is applicable, the financial assets are classified as part of "other" business model and measured at FVTPL. The business model is determined for a group of assets (on a portfolio level) based on all relevant evidence about the activities that the Company undertakes to achieve the objective set out for the portfolio available at the date of the assessment.

Financial assets – classification and subsequent measurement – cash-flow characteristics. Where the business model is to hold assets to collect contractual cash flows or to hold contractual cash flows and sell, the Company assesses whether the cash flows represent solely payments of principal and interest ("SPPI"). Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are consistent with the SPPI feature. In making this assessment, the Company considers whether the contractual cash flows are consistent with a basic lending arrangement, i.e. interest includes only consideration for credit risk, the time value of money, other basic lending risks and profit margin.

The relevant category to the Group is financial assets at amortised cost. The Group measures financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows and;
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets impairment – credit loss allowance for ECL. The Company assesses, on a forward-looking basis, the ECL for debt instruments measured at AC. The Company measures ECL and recognises Net impairment losses on financial assets at each reporting date. The measurement of ECL reflects (i) an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes, (ii) time value of money, and (iii) all reasonable and supportable information that is available without undue cost and effort at the end of each reporting period about past events, current conditions and forecasts of future conditions. Debt instruments measured at AC are presented in the financial statement of the financial position net of the allowance for ECL.

The Company applies a three-stage model for impairment, based on changes in credit quality since initial recognition. A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial assets in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that results from default events possible within the next 12 months or until contractual maturity, if shorter ("12 months ECL"). If the Company identifies a significant increase in credit risk ("SICR") since initial recognition, the asset is transferred to Stage 2 and its ECL is measured based on ECL on a lifetime basis, that is, up until contractual maturity but considering expected prepayments, if any ("Lifetime ECL"). If the Company determines that a financial asset is credit-impaired, the asset is transferred to Stage 3 and its ECL is measured as a Lifetime ECL.

For trade receivables, the Group applies a simplified approach in calculating ECLs. Therefore, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

Financial assets – write-off. Financial assets are written off, in whole or in part, when the Company has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event. The Company may write off financial assets that are still subject to enforcement activity when the Company seeks to recover amounts that are contractually due, however, there is no reasonable expectation of recovery.

Derivative financial instruments. *D*erivative financial instruments, including currency and interest rate swaps are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in the fair value of derivative instruments are included in profit or loss for the period. The Group does not apply hedge accounting.

Financial assets - derecognition. The Group derecognises financial assets when: (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire, or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all the risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

Cash and cash equivalents. Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method because: (i) they are held for collection of contractual cash flows and those cash flows represent SPPI, and (ii) they are not designated at FVTPL.

Trade and other receivables. Trade and other receivables are recognised initially at fair value and are subsequently carried at amortised cost using the effective interest method.

Trade and other payables. Trade payables are accrued when the counterparty performs its obligations under the contract and are recognised initially at fair value and subsequently carried at amortised cost using the effective interest method.

Borrowings. Borrowings are recognised initially at fair value, net of transaction costs incurred, and are subsequently carried at amortised cost using the effective interest method.

Capitalisation of borrowing costs. General and specific borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when: (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditures on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred on the specific borrowings less any investment income on the temporary investment of these borrowings are capitalised. A qualifying asset is the one that needs more than 12 months to construct. The Group finances the acquisition of qualifying assets mainly from specific borrowings.

Leases.

The Group's leasing activities and how these are accounted for

The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

The lease term of other lease contracts is either explicitly stated in the contract or the lease term is indefinite with termination options. The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

The Group leases gas pipelines, buildings, administration buildings, land, subsurface rights and cars. Lease contracts for gas pipelines are usually of an indefinite lease term with a termination option. As the Group assesses that it will not exercise the termination option in the foreseeable future, it sets the lease term according to an analysis of the average residual useful life of the pipeline. Determination of the lease term involves significant judgement, which is disclosed in Note 1.3.

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present-value basis. Lease liabilities include the net present value of the following lease payments:

a) fixed payments (including in-substance fixed payments), less any lease incentives receivable,

b) variable lease payment that are based on an index or a rate,

c) amounts expected to be payable by the lessee under residual value guarantees,

d) the exercise price of a purchase option if the lessee is reasonably certain that it will exercise that option, and

e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease where it is known (lease of cars). If that rate cannot be determined, the group incremental borrowing rate is used.

Right-of-use assets are measured at cost comprising the following:

f) the amount of the initial measurement of lease liability,

g) any lease payments made at or before the commencement date less any lease incentives received, and

h) any initial direct costs and restoration costs.

Payments associated with short-term leases (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option) and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss.

The Group does not have any arrangements with variable lease payments.

The Group does not provide residual value guarantees within leases.

Income taxes. Income taxes have been provided for in the consolidated financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the period, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if the consolidated financial statements are authorised prior to filing the relevant tax returns. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on the initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, which are expected to apply to the period when the temporary differences reverse, or the tax loss carry forwards are utilised.

Deferred tax assets for deductible temporary differences are recorded only to the extent that it is probable that the temporary difference will reverse in the future, and there is sufficient future taxable profit available against which the deductions can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred tax assets and liabilities are netted only within the individual companies of the Group.

The Group controls the reversal of temporary differences relating to taxes chargeable on dividends from subsidiaries or on gains upon their disposal. The Group does not recognise deferred tax liabilities on such temporary differences except to the extent that management expects the temporary differences to reverse in the foreseeable future.

The Group recognises deferred income tax asset or liability on the right-of-use asset and lease liability on a net basis.

Uncertain tax positions. The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management’s best estimate of the expenditure required to settle the obligations at the end of the reporting period. Adjustments for uncertain income tax positions, other than interest and fines, are recorded within the income tax charge. Adjustments for uncertain income tax positions in respect of interest and fines are recorded within finance expenses and other gains/(losses), net, respectively.

Value-added tax. Output value-added tax related to sales is payable to tax authorities on the earlier of (i) collection of receivables from customers or (ii) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. Tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability. Where provision has been made for the ECL of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

Inventories. Inventories are recorded at the lower of cost and net realisable value. The cost of inventory is determined on the weighted average basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on the normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses.

Prepayments. Prepayments are carried at cost less the provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the period.

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

Dividends. Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the consolidated financial statements are authorised for issuance are disclosed in the subsequent events note.

Provisions for liabilities and charges. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as an interest expense.

Levies and charges, such as taxes other than income tax or regulatory fees based on information related to a period before the obligation to pay arises, are recognised as liabilities when the obligating event that gives rise the need to pay a levy occurs, as identified by the legislation that triggers the obligation to pay the levy. If a levy is paid before the obligating event, it is recognised as a prepayment.

Revenue. The Group provides natural gas distribution services within the Czech Republic, which represent the majority of the Group’s revenue from contracts with customers.

The Group recognises revenues once it has fulfilled (as it fulfils) its supply commitment by transferring the promised goods or service (the “asset”) to the customer. The asset is transferred (being transferred) once the customer has gained (as it gains) control over the asset. In determining the transaction price, the Group considers the terms of the contracts and its standard business practice. The transaction price is the amount of consideration to which the Group is, in its view, entitled in exchange for transferring the promised goods or service to the customer, with the exception of amounts collected on behalf of third parties. The consideration promised in the contract with the customer may include fixed amounts, variable amounts, or both.

Each contract with a customer (usually a gas trader) includes the following contractual obligations:

- a promise to transfer natural gas to end gas consumers; and
- a promise to connect the end customer to the distribution network, e.g. install the measuring equipment (gas meter). The gas meter remains in the ownership of the Group.

The distribution of gas and gas meter installation are not distinct because they do not provide a benefit to the customer individually (or together with other available resources that are readily available to the customer) – the installation of a gas meter is not beneficial to the customer if this service is not bundled with gas distribution. Therefore, the two activities represent a single performance obligation.

The transaction price, i.e. the fee for distributing gas is determined in the contract with the customer (usually a gas trader) and is stated as a fixed amount for each performance obligation (per volume of distributed gas).

Revenues i.e. the prices for natural gas distribution to partners in the Czech Republic are regulated by ERO.

Revenue from gas distribution is satisfied over time and measured using the output method to assess progress towards complete satisfaction of the service, because the Group delivers the distribution services and the customer (gas trader) receives and consumes the benefits over the period defined in the contract (i.e. continuous supply contract to meet immediate demands).

Revenues from distribution services are divided into several categories.

Natural gas distribution to end-consumers for high-volume and middle-volume categories is billed to traders on a monthly basis based on measured consumption by end-consumers. Gas distribution to low-volume categories and households is billed to particular traders periodically, when the consumption reading is performed at least once every 14 months for each end-consumer.

Revenues from low-volume and household categories consist of actually billed revenues and revenues from so-called “unbilled distribution". The amount of unbilled distribution is calculated from the total amount of distributed gas in the particular period based on the past behaviour of individual consumers and is measured based on the valid price resolution of ERO.

The normal credit term is 14 days upon delivery.

Disclosures relating to significant accounting judgements, estimates and assumptions relating to revenue from contracts with customers are provided in Note 1.3.

Trade receivables. A receivable represents the Group’s right to an amount of consideration that is unconditional (i.e., only the passage of time is required before payment of the consideration is due). Refer to the accounting policies of financial assets in the section on Financial instruments – initial recognition and subsequent measurement

Contract liabilities. A contract liability is the obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer. If a customer pays the consideration before the Group transfers goods or services to the customer, a contract liability is recognised. Contract liabilities are recognised as revenue when the Group performs under the contract.

Government grants. Grants from the government are recognised at their fair value where there is reasonable assurance that the grant will be received, and the Group will comply with all attached conditions.

Government grants relating to the purchase of property, plant and equipment are included in Other non-current liabilities as deferred income and are credited to profit or loss on a straight-line basis over the expected lives of the related assets. Government grants relating to costs are deferred and recognised in profit or loss for the period over the period necessary to match them with the costs that they are intended to compensate.

Employee benefits. Wages, salaries, contributions to the Czech state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and other services) are accrued in the period in which the associated services are rendered by the employees of the Group. The Group has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the statutory defined contribution scheme.

The Czech state pension plan is a defined contribution plan. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due.

The Group provides its employees with a voluntary defined contribution scheme. Participating employees can contribute part of their salaries each month to a pension fund approved by CNB, with a contribution from the Group. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense when they are due.

Segment reporting. Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM), and for which discrete financial information is available. The CODM is the person or group of persons responsible for allocating resources to the operating segments of the Group and assesses its performance. Segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Information related to segment, whose revenue, result or assets are ten percent or more of all the segments should be reported separately. Management assessed that the whole Group is one reportable segment.

Amendment of the consolidated financial statements after issuance. Any changes to these consolidated financial statements after issuance require the approval of the general meeting of shareholders who authorised these consolidated financial statements for issuance.

1.3. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant impact on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include the following:

Functional currencies of different entities of the Group. Different entities within the Group have different functional currencies, based on the underlying economic conditions of their operations. This determination, of what the specific underlying economic conditions are, requires judgement. In making this judgement, the Group evaluates among other factors, the location of activities, the sources of revenue, risks associated with activities and denomination of currencies of operations of different entities. Specifically, in determination of the functional currencies of the Company, the Group based its judgement on the fact that the Company operates internationally on markets mainly influenced by the Czech crown (CZK) and their major activities include the provision of services to Czech subsidiaries. Moreover, the majority of its operations are denominated in CZK and also, CZK is the currency in which the business risks and exposures are managed, and the performance of its business is measured.

Useful lives of property, plant and equipment. The estimation of the useful lives of items of property, plant and equipment is a matter of judgment based on the experience with similar assets. The future economic benefits embodied in the assets are consumed principally through use. However, other factors, such as technical or commercial obsolescence and wear and tear, often result in the diminution of the economic benefits embodied in the assets. Management assesses the remaining useful lives in accordance with the current technical conditions of the assets and estimated period during which the assets are expected to earn benefits for the Group. The following primary factors are considered (a) the expected usage of the assets; (b) the expected physical wear and tear, which depends on operational factors and maintenance program; and (c) the technical or commercial obsolescence arising from changes in market conditions.

Were the estimated useful lives to differ by 10% from management's estimates, the impact on depreciation for the period ended 31 December 2019 would be to increase it by CZK 175 million or decrease it by CZK 176 million.

Revenues

Identifying performance obligations. The contractual obligations of the Group are to

- Distribute a certain amount of gas from the boundaries of the Czech Republic to end gas consumers; and
- To connect the end gas consumers to the distribution network e.g. install the measuring equipment (gas meter). The gas meter remains in the ownership of the Group.

The transport of gas and gas meter installation are not distinct because they do not provide a benefit to the customer individually (or together with other available resources that are readily available to the customer) – the installation of a gas meter is not beneficial to the customer if these services are not bundled with gas distribution.

Determining the timing of satisfaction of gas distribution services. The Group concluded that revenue from gas distribution services is to be recognised over time because the customer simultaneously receives and consumes the benefits provided by the Group. The fact that another entity would not need to re-perform the distribution services that the Group has provided to date demonstrates that the customer simultaneously receives and consumes the benefits of the Group's performance as it performs it.

The Group records revenue based on

- Volume of gas distributed and measured (actually billed revenues); and
- Volume of gas distributed but not yet measured (unbilled distribution) – the volume is estimated based on the total volume of gas distributed in the particular year based on past behaviour of individual customers and is measured based on the valid price resolution of ERO and also includes the distribution of gas which was started but not yet completed.

The total volume of gas distributed is adjusted by gas losses in the distribution system, which are calculated as the four-year average of the last known difference between the volume of gas entering the system and the real billing to all customers in the same period.

Segment reporting. The main activity of the Group is gas distribution. Other activities include construction activities, changes and removal of constructions, repairs and revisions, etc. and are inseparably connected with the main activity of the Group.

The Board of Directors ("Management") of the Group is the "chief operating decision maker". Management assesses financial performance based on the key performance indicators of the whole Group. Management of the Group regularly reviews operating results of the whole Group and makes decisions about resources to be allocated to business activities and assesses Group's performance. Additionally, the means of controlling and assessing operating managers is carried out at the Group level. Their remuneration depends on fulfilment of the Group's key performance indicators.

As a result, the Group management views the whole Group as one operating segment.

Determining the lease term. In determining the lease term, management considers all facts and circumstances that create an economic incentive to not exercise a termination option as most of the lease contracts are for indefinite period with termination option.

Periods after termination options are only included in the lease term if it is reasonably certain that the lease will not to be terminated.

As the Group assesses that it will not exercise the termination option in the foreseeable future, it sets the lease term based on the expected period of asset use (usually remaining useful economic life).

The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee. During the current financial period, there was no significant financial impact of revising lease terms to reflect the effect of exercising termination options.

Discount rates used for determining lease liabilities. The Group uses its incremental borrowing rates as a base for calculating the discount rate when the interest rate implicit in the lease cannot be readily determined. As an incremental borrowing rate, the Group uses market interest rates for interest rate swaps with a similar maturity, adjusted by the respective credit margin. Such an approach, based on the management view, reflected the best estimate of the incremental borrowing rates as at the date of initial application of the standard. The interest rates differ based on the length of the contract term (categories of contract terms). Such incremental borrowing rates are revised for new or modified contracts.

A 10% increase or decrease in the discount rate as at 31 December 2019 would result in a decrease of CZK 36 million or, respectively, an increase in the amount of CZK 38 million in lease liabilities.

Provisional accounting for a business combination. On 30 September 2019, the Company acquired 100 % of the share capital (and voting rights) of Czech Grid Holding, a.s. and its 100 % owned subsidiaries – GasNet, s.r.o. and GridServices, s.r.o. (the "Czech Grid Group"). The transaction was accounted for as a business combination where the Company was the acquirer. Due to the complexity of the measurement and the large number of individual items of the gas distribution network and related assets acquired in the business combination the fair values of property, plant and equipment and the goodwill resulting from the acquisition have been determined only provisionally (for more information see Note 6.1).

1.4. First-time Adoption of IFRS

These consolidated financial statements are the Group's first annual consolidated financial statements that comply with IFRS. The date of transition to IFRS is 22 March 2019, which is the date when the Company was incorporated.

The Group did not present consolidated financial statements for previous periods under local GAAP. Therefore, the Group does not provide reconciliations between IFRS consolidated financial statements and the previous GAAP financial statements. The Group applied neither mandatory exceptions nor voluntary exemptions, as none of them were applicable to the Group.

The Group applied accounting policies based on IFRS, effective for periods ended 31 December 2019.

1.5. New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2020 or later, and which the Group has not adopted.

(a) New standards and interpretations and amendments thereto that have been published and adopted by the EU, but have not come into force yet and are not applied by the Group at the reporting date

Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020). The revised Conceptual Framework includes new chapters on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting. The amendments are not expected to significantly impact the Group’s consolidated financial statements.

Definition of materiality – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020). The amendments clarify the definition of material and how it should be applied by including guidance in the definition that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The amendments are not expected to affect significantly the Group’s consolidated financial statements.

Interest Rate Benchmark Reform - IFRS 9, IAS 39 and IFRS 7 (Amendments). The amendments are effective for annual periods beginning on or after 1 January 2020 and must be applied retrospectively. Earlier application is permitted. In September 2019, the IASB issued amendments to IFRS 9, IAS 39 and IFRS 7, which concludes phase one of its work to respond to the effects of Interbank Offered Rates (IBOR) reform on financial reporting. Phase two will focus on issues that could affect financial reporting when an existing interest rate benchmark is replaced with a risk-free interest rate (an RFR). The amendments published deal with issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate and address the implications for specific hedge accounting requirements in IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement, which require forward-looking analysis. The amendments provided temporary relief, applicable to all hedging relationships that are directly affected by the interest rate benchmark reform, which enable hedge accounting to continue during the period of uncertainty before the replacement of an existing interest rate benchmark with an alternative nearly risk-free interest rate. There are also amendments to IFRS 7 Financial Instruments: Disclosures regarding additional disclosures around uncertainty arising from the interest rate benchmark reform. The amendments are not expected to significantly impact the Group’s consolidated financial statements.

(b) New and amended standards and interpretations, which have been published, but not yet adopted by the European Union or not come into force as at the reporting date

Definition of a business – Amendments to IFRS 3 (issued on 22 October 2018 and effective for acquisitions from the beginning of annual reporting period that starts on or after 1 January 2020).The amendments revise the definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if there are no outputs. The definition of the term ‘outputs’ is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a ‘concentration test’. The assets acquired would not represent a business if substantially, all the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets).

Amendments IAS 1 Presentation of Financial Statements: Classification of Liabilities as Current or Non-current. The amendments are effective for annual reporting periods beginning on or after 1 January 2022 with earlier application permitted. The amendments aim to promote consistency in applying the requirements by helping companies determine whether, in the statement of financial position, debt and other liabilities with an uncertain settlement date should be classified as current or non-current. The amendments affect the presentation of liabilities in the statement of financial position and do not change existing requirements around the measurement or timing of recognition of any asset, liability, income or expenses, nor the information that entities disclose about those items. Also, the amendments clarify the classification requirements for debt which may be settled by the company issuing its own equity instruments.

Classification of liabilities as current or non-current – Amendments to IAS 1 (issued on 23 January 2020 and effective for annual periods beginning on or after 1 January 2022). These narrow-scope amendments clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Liabilities are non-current if the entity has a substantive right, at the end of the reporting period, to defer settlement for at least twelve months. The guidance no longer requires such a right to be unconditional. Management's expectations whether they will subsequently exercise the right to defer settlement do not affect the classification of liabilities. The right to defer only exists if the entity complies with any relevant conditions as of the end of the reporting period. A liability is classified as current if a condition is breached at or before the reporting date even if a waiver of that condition is obtained from the lender after the end of the reporting period. Conversely, a loan is classified as non-current if a loan covenant is breached only after the reporting date. In addition, the amendments include clarifying the classification requirements for debt a company might settle by converting it into equity. 'Settlement' is defined as the extinguishment of a liability with cash, other resources embodying economic benefits or an entity's own equity instruments. There is an exception for convertible instruments that might be converted into equity, but only for those instruments where the conversion option is classified as an equity instrument as a separate component of a compound financial instrument. The Group is currently assessing the impact of the amendment on its financial statement.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Group's consolidated financial statements.

2 Segment information - entity-wide disclosures

The Group derived revenue from the customer innogy Energie, s.r.o. in the amount of CZK 1,528 million in the period ended 31 December 2019, which represented 37% of the total Group's revenue in the period ended 31 December 2019. Revenue from the other customers of the Group individually did not exceed 10% of the total Group's revenue in the period ended 31 December 2019.

3 Statement of Financial Position Items

3.1. Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment were as follows:

In millions of CZK	Freehold Land	Buildings	Gas Network	Equipment	Construc-tion in progress	Total
Carrying amount as at 22 March 2019	-	-	-	-	-	-
Acquisition of subsidiaries	119	3,051	99,219	6,446	1,214	**110,049**
Additions	1	53	378	252	-	**684**
Transfers	-	3	277	19	(299)	**-**
Disposals	-	(1)	(206)	(61)	-	**(268)**
Depreciation charge	-	(109)	(1,670)	(265)	-	**(2,044)**
Carrying amount as at 31 December 2019	**120**	**2,997**	**97,998**	**6,391**	**915**	**108,421**
Cost at as 31 December 2019	120	3,106	99,666	6,653	915	**110,460**
Accumulated depreciation	-	(109)	(1,668)	(262)	-	**(2,039)**
Carrying amount as at 31 December 2019	**120**	**2,997**	**97,998**	**6,391**	**915**	**108,421**

Construction in progress comprises mainly construction of the gas network. Upon completion, assets are transferred to use. Borrowing costs were capitalised to construction in progress in the amount of CZK 6 million during the reporting period ended 31 December 2019.

The Group capitalised own works to fixed assets (mainly gas network) of CZK 61 million in the reporting period ended 31 December 2019.

3.2. Intangible Assets

Movements in the carrying amount of intangible assets were as follows:

In millions of CZK	Software	Other	Total
Carrying amount as at 22 March 2019	**-**	**-**	**-**
Acquisition of subsidiaries	330	47	**377**
Additions	41	51	**92**
Amortisation charge	(49)	(3)	**(52)**
Carrying amount as at 31 December 2019	**322**	**95**	**417**
Cost as at 31 December 2019	371	98	**469**
Accumulated amortisation	(49)	(3)	**(52)**
Carrying amount as at 31 December 2019	**322**	**95**	**417**

3.3. Leases

i) Amounts recognised in the balance sheet

The statement of financial position shows the following amounts related to leases:

In millions of CZK	31 December 2019
Right-of-use assets	
Gas network	980
Subsurface rights	914
Buildings	450
Motor vehicles	27
Land	8
Total right-of-use assets	**2,379**

In millions of CZK	31 December 2019
Lease liabilities	
Current	194
Non-current	1,357
Total lease liabilities	**1,551**

Additions to the right-of-use assets during the period ended 31 December 2019 were CZK 61 million.

In millions of CZK	Note	Liabilities from financing activities 2019
Lease liabilities as at 22 March 2019		-
Acquisition of subsidiaries	6.1	1,571
Interest on the lease liability	4.3	12
Acquisition of leases		61
Cash flows		(93)
Lease liabilities as at 31 December 2019		**1,551**

ii) Amounts recognised in the statement of profit or loss

The statement of profit or loss shows the following amounts related to leases:

In millions of CZK	2019
Depreciation charge of right-of-use assets	
Buildings	25
Gas network	11
Subsurface rights	7
Motor vehicles	4
Total depreciation charge	**47**
Interest expense (included in finance cost) – Note 4.3	**12**

Expenses related to the short-term leases, expenses related to leases of low-value assets and expenses related to variable lease payments were insignificant for the Group in the period ended 31 December 2019.

The total cash outflow for leases in 2019 was CZK 97 million. Out of that, the amount CZK 4 million was paid in advance for the whole length of the contract; therefore, no lease liability was recognised in respect of these lease contracts.

3.4. Cash and Cash Equivalents

In millions of CZK	31 December 2019
Cash at bank	926
Total cash and cash equivalents	**926**

The credit quality of cash and cash equivalents balances based on Moody's ratings:

In millions of CZK	31 December 2019
A1	822
Aa3	104
Total cash and cash equivalents	**926**

There was no expected credit loss allowance recognised in respect of cash and cash equivalents as at 31 December 2019.

Cash at bank was pledged in the amount of CZK 104 million as at 31 December 2019.

3.5. Trade and Other Receivables

In millions of CZK	**31 December 2019**
Trade receivables gross amount	366
Other financial receivables	19
Less credit loss allowance	(1)
Total financial assets within trade and other receivables	**384**
Other receivables	6
Prepayments	271
Total non-financial assets within trade and other receivables	**277**
Total trade and other receivables	**661**

On 30 September 2019 the Group acquired the trade and other receivables of Czech Grid Holding and its subsidiaries in the course of a business combination, which were recognised at fair value at that date in the amount of CZK 360 million. Details of gross contractual amount are disclosed in Note 6.1.

The Group applies the IFRS 9 simplified approach to measure expected credit losses which uses a lifetime expected loss allowance for all financial trade receivables.

To measure the expected credit losses, trade receivables have been grouped based on shared credit risk characteristics and the days past due.

The expected loss rates are determined from payment profiles of sales over a period of 36 months before 31 December 2019 and the corresponding historical credit losses experienced within this period based on the historical information available to Czech Grid Holding, a.s. and its subsidiaries, i.e. before the acquisition date. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of customers to settle receivables. The Group has identified the Czech GDP to be the most relevant factor and, accordingly, adjusts the historical loss rates based on expected changes in these factors.

The credit loss allowance for trade and other receivables is determined according to the provision matrix presented in the table below. The provision matrix is based on the number of days that an asset is past due, adjusted for forward-looking information on the GDP of the Czech Republic.

In % of gross value	31 December 2019 Loss rate	 Gross carrying amount	 Lifetime ECL
Trade receivables from non-related parties			
- current	0.14%	359	-
- less than 30 days overdue	5.00%	2	-
- 30 to 90 days overdue	25,00%	1	-
- 91 to 180 days overdue	30.00%	1	-
- over 360 days overdue	34.00%	3	1
Total trade receivables from non-related parties		**366**	**1**
Other financial receivables			
- current	0.5%	19	-
Total financial assets within trade and other receivables		**385**	**1**
Total credit loss allowance		(1)	
Total financial assets within trade and other receivables (net carrying amount)		**384**	

The following table explains the changes in the credit loss allowance for trade and other receivables under the simplified ECL model during the period ended 31 December 2019:

in millions of CZK	**2019**
Credit loss allowance	
Balance as at 22 March	**-**
New originated	(7)
Reversal	6
Total credit loss allowance charge in profit or loss for the period	**(1)**
Balance as at 31 December	**(1)**

3.6. Contract Balances

The Group has recognised the following balances arising from contracts with customers:

In millions of CZK	Note	31 December 2019
Trade receivables	3.5	365

Trade receivables consist of trade receivables gross amount less credit loss allowance (see Note 3.5).

In millions of CZK	31 December 2019
Contract liabilities – advances from customers for gas distribution	754
Contract liabilities – advances from customers (services)	2
Total current contract liabilities	**756**

There was no revenue recognised against contract liabilities as at the beginning of the reporting period, since there were no contract liabilities as at 22 March 2019.

The Group needs not disclose information about its remaining performance obligations, as it has a right to a consideration from a customer in an amount that corresponds directly to the value to the customer of the entity's performance completed to date.

3.7. Share Capital and other reserves

In millions of CZK	Share Capital	Share premium	Legal reserves
At 22 March 2019	**0.35**	**-**	**-**
Share capital increase	0.35	27,856	0.07
At 31 December 2019	**1**	**27,856**	**0.07**

In thousands	Number of outstanding shares
At 22 March 2019	**350**
Increase in number of shares	350
At 31 December 2019	**700**

Share capital was presented by subscribed capital, which consisted of 700,000 ordinary shares with a nominal value of CZK 1 each as at 31 December 2019 (22 March 2019: 350,000 shares with a nominal value of CZK 1 each), all were fully paid. Each ordinary share carried one vote. They entitle the holder to participate in dividends, and to share in the proceeds of winding up the company in proportion to the number of and amounts paid on the shares held.

The movement in subscribed capital during the period corresponded to an increase of CZK 0.35 million following to the decision taken by the Extraordinary General Meeting of the sole shareholder held on 30 September 2019. According to that, the shareholder increased the Company's equity by CZK 27,856 million, share capital increased by the amount of CZK 0.35 million, share premium increased by the amount of CZK 27,856 million and CZK 0.07 million was allocated to the legal reserves. The increase was performed by capitalisation of part of the promissory note issued by the Group on the acquisition of Czech Grid Group (refer to Notes 3.8 and 6.1).

Shareholder structure	As at 31 December 2019 Number of shares (in thousands)	Share (%)	As at 22 March 2019 Number of shares (in thousands)	Share (%)
Czech Gas Network S.à r.l.	700	100	350	100
Total	**700**	**100**	**350**	**100**

The individual financial statements of the Company under Luxembourg GAAP for 2019 were approved by the Board of Managers on 6 March 2020.

3.8. Borrowings

Borrowings comprise the loan issued by the Company to its sole shareholder and borrowings from credit institutions, as follows:

In millions of CZK	**31 December 2019**
Term loans	
- Non-current portion	64,132
- Current portion	271
Total borrowings	**64,403**

In millions of CZK	**31 December 2019**
Non-current borrowings	
- Komerční banka, a.s.	42,388
- Czech Gas Network S.à r.l.	21,744
Total non-current borrowings	**64,132**

Non-current bank borrowings consist of 4 tranches as at 31 December 2019 with the weighted average interest rate of 2.72 % p.a..

Non-current bank borrowings as at 31 December 2019 have maturities ranging from 2024 to 2026.

Nature	Lender	Maturity date	Interest rate	Currency	Carrying amount as at 31 December 2019
Facility A1	Komerční Banka, a.s.	30 September 2024	1.05% + EURIBOR 6m	EUR	16,197
Facility A2	Komerční Banka, a.s.	30 September 2024	0.95% + PRIBOR 6m	CZK	6,671
Facility B	Komerční Banka, a.s.	30 September 2024	1.1% + PRIBOR 6m	CZK	9,760
Facility C	Komerční Banka, a.s.	30 September 2026	1.35% + PRIBOR 6m	CZK	9,760
Total					**42,388**

The interest rate of Facility A1 is composed of a margin of 1.05% and a floating rate (EURIBOR 6 months, in case of negative floating rate, it is capped at 0%), the interest rate of other Facilities is composed of a margin and a floating rate PRIBOR 6 months (equalled to 2.15% in the reporting period).

On 4 April 2019, the Company entered as borrower and guarantor into an English-law-governed facilities agreement (the "Facilities Agreement"), between, among others, Czech Gas Networks S.à r.l. ("CGN") as parent, CGN Holdings S.à r.l. as original borrower, several banks as original lenders and Komerční banka, a.s. as the agent and security agent for an aggregate amount of CZK 26,500 million (nominated in CZK) and CZK 16,573 million (nominated in EUR).

Apart from term-loan facilities, there is the possibility of drawing a capex commitment for an amount of CZK 6,350 million and a revolving credit facility for an amount of CZK 500 million. As at 31 December 2019
the Company has not drawn any amount under the capex commitment or the revolving credit facility.

On 30 September 2019 the Group assumed the total bank loan payable in the amount of CZK 42,644 million (original bank borrowing of CZK 43,173 million less CZK 529 million in transaction costs). That bank loan payable was transferred from CGN Holdings S.à r.l. as the original borrower to the Group as a part of consideration payable for the acquisition of Czech Grid Holding, a.s. and its subsidiaries, for more details refer to Note 6.1.

The respective transaction costs were allocated by facilities proportionally based on the carrying amount of a facility drawn.

The Company entered into hedging agreements with nine different banks, under which:

- a minimum of 75% of the notional amount of each facility is hedged by fixed rate and/or effectively bears a fixed rate, for different hedging periods depending on the facility;
- 85% of the notional amount of each facility, which is denominated in a currency other than CZK is hedged through a cross-currency swap for a term of at least 12 months.

For more details, refer to Note 3.12.

On 30 September 2019, the Group issued a promissory note amounting to CZK 49,594 million payable to the previous owner, CGN Holdings S.à r.l., as a part of the consideration payable for the acquisition of Czech Grid Holding, a.s. and its subsidiaries (Note 6.1). On the same date, the promissory note was reassigned from the previous owner, CGN Holdings S.à r.l. to Czech Gas Networks S.à r.l. ("CGN"), the shareholder of the Group. The promissory note was partly contributed to the Group's equity in the amount of CZK 27,856 million, partly converted to the loans from shareholder in the amount of CZK 21,744 million (refer to Note 3.7), and the remaining part was paid in cash to the Group in the amount of CZK 6 million.

Details of the loans from shareholder were as follows:

Tranche	**Noteholder**	**Maturity date**	**Interest rate**	**31 December 2019**
Loan Notes A	CGN	30 September 2044	*4.90%*	7,700
Loan Notes B	CGN	30 September 2044	*4.90%*	14,044
Total				**21,744**

Loans from the shareholder will at all times be subordinated in right and priority of payment to all other existing and future liabilities and obligations of the Group.

Current borrowings as at 31 December 2019 amount to CZK 271 million and consist of accrued interest payable on the loan notes issued by the Group to its shareholder.

The table below sets out an analysis of liabilities from financing activities and the movements in the Group's liabilities from financing activities for each of the periods presented. The items of these liabilities are those that are reported as cash flows from financing activities:

In millions of CZK	Note	Bank borrowings	Loans from Shareholder	Promissory note	Total
Liabilities from financing activities as at 22 March 2019		-	-	-	-
Non-cash movements:					
Issued on acquisition of subsidiaries	6.1	-	-	49,594	**49,594**
Borrowings assumed on acquisition of subsidiaries	6.1	42,644	-	-	**42,644**
Settlement of purchase consideration for acquisition of subsidiaries	6.1	-	21,744	(21,744)	**0**
Increase of equity	3.7			(27,856)	**(27,856)**
Interest expenses	4.3	285	269		**554**
Interest capitalised	4.3, 3.1	4	2	-	**6**
Foreign exchange difference		(283)	-	-	**(283)**
Total non-cash movements		**42,650**	**22,015**	**(6)**	**64,665**
Cash movements:					
Settlement of promissory note		-	-	6	**6**
Interest paid (expensed and capitalised)		(262)	-	-	**(262)**
Total cash movements		**(262)**	**-**	**-**	**(262)**
Liabilities from financing activities as at 31 December 2019		**42,388**	**22,015**	-	**64,403**

Fair values of borrowings are disclosed in Note 5.4.

3.9. Other Non-current Liabilities

The balance of non-current liabilities comprises the following:

in millions of CZK	**31 December 2019**
Deferred income from government grants	227
Other non-current liabilities	14
Total	**241**

Government grants were provided in 1999 for the development of the gas network. They were recognised as deferred income and credited to profit or loss (Other income) on a straight-line basis over the expected useful lives of the related assets. The current part of government grants amounted CZK 10 million as at 31 December 2019 and was included in Trade and Other payable.

3.10. Other Taxes Payable

In millions of CZK	**31 December 2019**
Other taxes payable within one year comprise the following:	
Value-added tax	177
Personal income tax	13
Other taxes payable – current	**190**

3.11. Trade and Other Payables

In millions of CZK	**31 December 2019**
Trade payables	785
Refundable deposits received	416
Accrued liabilities	124
Other payables	6
Total financial payables within trade and other payables	**1,331**
Other payables	15
Liabilities to employees	143
Liabilities to social security and health insurance	39
Total non-financial payables within trade and other payables	**197**
Total trade and other payables	**1,528**

Refundable deposits received are cash deposits obtained from customers and serve as a guarantee for the Group. If the cooperation with customer is finished, they are returned in cash.

3.12. Derivative Financial Instruments

On 30 September 2019, the Group entered into a number of cross-currency swap agreements, all maturing on 31 December 2026, to hedge the notional amount of the facility A1 with Intesa Sanpaolo S.p.A., Commerzbank, Societe Generale and Komerční Banka, a.s for a total amount of EUR 548 million to cover the Group's position in EUR. The fair value of cross-currency swap agreements (derivative liability) amounted to CZK 589 million as at 31 December 2019.

On 30 September 2019, the Group also entered into a number of interest rate swap agreements to hedge the interest payments under the facility A1, A2, B and C, all maturing after the period end. The fair value of interest swap agreements (derivative asset) amounted to CZK 116 million as at 31 December 2019.

In millions of CZK	**31 December 2019**
Non-current assets	
Interest rate swaps	116
Non-current liabilities	
Cross currency swaps	(589)
Total net fair value of derivative financial instruments	**(473)**

(i) Classification of derivatives

Derivatives are only used for economic hedging purposes and not as speculative investments. The derivatives are classified as "held for trading" for accounting purposes and are accounted for at fair value through profit and loss. They are presented as non-current assets and non-current liabilities to the extent they are not expected to be settled within 12 months after the end of the reporting period.

Foreign exchange derivative financial instruments entered into by the Group are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. Derivatives have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in market interest rates, foreign exchange rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

(ii) Fair value measurement

For information about the methods and assumptions used in determining the fair value of derivatives, refer to Note 5.4.

(iii) Amounts recognised in profit or loss

The following amounts were recognised in profit or loss in relation to derivatives:

In millions of CZK	**2019**
Finance costs	
Fair value loss on interest rate swaps	(589)
Finance income	
Fair value gain on cross currency swaps	116
Net loss on derivative financial instruments	**(473)**

4 Profit or Loss Items

4.1 Analysis of Revenue by Category

Analysis of revenue by category is presented as follows:

In millions of CZK	**2019**
Revenue from gas distribution	4,145
Revenues from rendering of other services and sale of goods	54
Total revenue	**4,199**

The Group recognised 97% of total gas distribution revenue from wholesale traders of gas and 3% from end consumers of gas distribution during the period ended 31 December 2019.

The Group disaggregated its revenue from gas distribution by category of end consumers, which are either direct customers of wholesale traders (mentioned above) or customers of the Group:

In millions of CZK	**2019**
Revenues from gas distribution	
Large and medium sized consumers category	1,386
Small sized consumers category	669
Households category	2,090
Total revenue	**4,145**

The disaggregation of revenue was disclosed as such in order to present the structure of ultimate customers' portfolio, since each customer category has its own pricing, risks and other specifics.

4.2 Expenses

4.2.1 Employee benefits expense

In millions of CZK	**2019**
Wages and salaries	364
Statutory pension contributions	58
Statutory health insurance and social security	41
Supplementary pension insurance	9
Other employee benefits	13
Total employee benefits expense	**485**

4.2.2 Services

In millions of CZK	**2019**
Gas transportation	288
Shared service centre	154
Gas network maintenance	140
IT and network services	105
Energy market operation fees	41
Billing services	14
Travel expenses	10
Phone costs	6
Car fleet maintenance	22
Training expenses	4
Consultancy fees	58
Other services	28
Total services	**870**

Shared service centre expenses comprise particular types of services, mainly the Call centre, Asset management, HR, Legal, Finance, Back-office, Procurement and other services.

4.2.3 Other operating expenses

In millions of CZK	**2019**
Net loss on disposal of property, plant and equipment	255
Operating losses within gas transportation	125
Utilities	37
Other taxes and charges	21
Insurance expenses	5
Other items	12
Total other operating expenses	**455**

4.3 Finance Costs

In millions of CZK	**2019**
Interest expenses	
Interest expense on borrowings	560
Interest expense on the lease liability	12
Less capitalised finance costs	(6)
Net interest expenses recognised in profit or loss	**566**
Fair value loss on cross-currency swaps	589
Total finance costs recognised in profit or loss	**1,155**

4.4 Finance income

In millions of CZK	**2019**
Net exchange gain on foreign currency borrowings	283
Fair value gain on interest rate swaps	116
Other finance income	4
Total finance income	**403**

4.5 Income Taxes

(a) Components of income tax expense/(benefit)

Income tax expense recorded in profit or loss comprises the following:

In millions of CZK	**2019**
Current tax	305
Deferred tax	(290)
Income tax expense for the period	**15**

(b) Reconciliation between the income tax expense and profit or loss multiplied by the applicable tax rate

The income tax rate applicable to the majority of the Group's income in 2019 was 19%. The reconciliation between the expected and the actual taxation charge is provided below.

In millions of CZK	**2019**
Loss before tax	**(486)**
Theoretical tax charge at statutory rate of 19%:	(92)
Tax effect of items which are not deductible or assessable for taxation purposes:	
- Income which is exempt from taxation	(75)
- Non-deductible expenses	178
- Effect of different statutory tax rates	4
Income tax expense for the period	**15**

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and statutory taxation regulations give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

In millions of CZK	**22 March 2019**	**Acquisition of subsidiaries**	**Credited/ (charged) to profit or loss**	**31 December 2019**
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting value of Property, plant and equipment (different tax depreciation)	-	(16,575)	281	(16,294)
Provisions for liabilities and charges	-	8	20	28
Right of use assets and lease liabilities	-	(11)	(11)	(22)
Net deferred tax liability	**-**	**(16,578)**	**290**	**(16,288)**
Recognised deferred tax asset	-	-	6	6
Recognised deferred tax liability	-	(16,578)	284	(16,294)
Net deferred tax liability	**-**	**(16,578)**	**290**	**(16,288)**

In the context of the Group's current structure, the tax losses and current tax assets of different Group companies may not be offset against the current tax liabilities and taxable profits of other Group companies and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity.

5 Risk Management

5.1 Offsetting Financial Assets and Financial Liabilities

Financial assets and liabilities are offset, and the net amount is reported in the balance sheet where the Group currently has a legally enforceable right to offset the recognised amounts, and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.
There was no offsetting of financial assets and financial liabilities as at 31 December 2019.

5.2 Financial Risk Management

The Board of Directives defines the objectives, principles, tasks and competencies to manage financial, operational and legal risks. All risk management is described in the respective directives that all companies in the Group must adhere to. Financial risk comprises market risk (including interest rate risk and foreign currency exchange risk), credit risk and liquidity risk. The primary focus of financial risk management is to establish risk limits and to ensure that any exposures to risk stay within these limits. The operational and legal risk management functions are intended to ensure the proper functioning of internal policies and procedures in order to minimise operational and legal risks.

Credit risk. The Group exposes itself to credit risk, which is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to meet its obligations.

Exposure to credit risk arises as a result of the Group’s lending and other transactions with counterparties, giving rise to financial assets.

Credit risk management. Credit risk is one of the most significant risks for the Group´s core distribution business. However, the major part of the Group´s risk related to gas distribution services provided mostly to traders, gas suppliers and local distributors is managed by means of credit rules called “Conditions of Financial Eligibility” implemented in the Group´s Network Code (that is a part of legal framework approved by ERO based on non-discriminatory rules). Moreover, the credit loss related to the P&L impact from bad debts is recognised by ERO and is fully reimbursed with a time lag as an eligible cost.

The Conditions of Financial Eligibility of the Group define individual counterparty Credit Limits for its counterparties differentiated based on the counterparty’s ratings from external international rating agencies such as Standard & Poor’s, Fitch and Moody’s, or scorings from agencies like Creditreform. Furthermore, the Credit Limits are scaled down based on the counterparty’s equity. There are threshold ratings for minimum acceptable creditworthiness.

The evaluation of the Group’s Credit Exposure (settlement exposure) from the distribution business is generally defined in the Conditions of Financial Eligibility. It is modelled and takes into account metering-type specific payment terms (such as prepayments) and legal terms and conditions for switching and early contract termination. The Credit Exposure is calculated automatically on a daily basis in monthly granularity for the period of the following 12 months based on the current status of the counterparty’s customer portfolio and distribution capacity booking requests. The counterparty receives automated notifications from the Group’s system in the event that the Credit Exposure exceeds the set Credit Limit.

If a counterparty’s rating does not fall into the best rating range, there is a possibility to arrange an unsecured Credit Limit only if all the defined financial covenants are fulfilled (Debt ≤ 0.8 x equity; EBIT/Interest costs ≥ 2.7; 3 x EBITDA ≥ Debt). These financial covenants are calculated from the latest audited annual reports that have to be provided to the Group. If the rating/scoring is not sufficient and/or if the financial covenants are broken, then the Group’s credit exposure has to be collateralised by means of the one (or a combination) of the following risk mitigation tools: bank guarantee, cash deposit or parent company guarantee. There are also minimum rating requirements introduced for guarantee providers (for banks and parent companies).

Expected credit loss ("ECL") measurement. Measurement of ECLs is an accounting estimate that involves the determination methodology, models and data inputs. The following components have a major impact on credit loss allowance: definition of default, significant increase in credit risk, probability of default ("PD"), exposure at default ("EAD"), and loss given default ("LGD"). The Group regularly reviews and validates the models and inputs to the models to reduce any differences between ECL estimates and actual credit loss experience. In general, ECL is the sum of the multiplications of the following credit risk parameters: EAD, PD and LGD, that are defined and explained below, and discounted to present value using the instrument's effective interest rate.

Probability of default ("PD"). Two types of PDs are used for calculating ECLs: 12-month and lifetime PD. An assessment of a 12-month PD is based on the latest available historic default data and adjusted for supportable forward-looking information when appropriate. Lifetime PDs represent the estimated PD occurring over the remaining life of the financial instrument and it is a sum of the 12-month PDs over the life of the instrument.

Exposure at default ("EAD") is an estimate of exposure at a future default date, taking into account expected changes in the exposure after the reporting period, including repayments of principal and interest, and expected drawdowns on committed facilities.

Loss given default ("LGD") is an estimate of a loss arising on a default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from any collateral. It is usually expressed as a percentage of the EAD. The expected losses are discounted to present value at the end of the reporting period. The discount rate represents the effective interest rate ("EIR") for the financial instrument or an approximation thereof.

Significant increase in credit risk ("SICR"). In order to determine whether there has been a significant increase in credit risk, the Group compares the risk of a default occurring over the life of a financial instrument at the end of the reporting date with the risk of default at the date of initial recognition. There is a presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

- For the purposes of measuring PD, the Group defines ***default*** as a situation when the exposure meets one or more of the following criteria:

(a) the borrower is significantly past due on its contractual payments;
(b) international rating agencies have classified the borrower in the default rating class;
(c) the borrower meets the unlikeliness-to-pay criteria listed below:
  - it is becoming likely that the borrower will enter bankruptcy;
  - the borrower is insolvent.

Quantitative credit risk disclosure for Trade and other receivables it is presented in Note 3.5, for Cash and cash equivalents it is presented in Note 3.4.

Market risk. The Group's market risk is predominantly controlled by a central treasury department (Group's treasury) under policies approved by the board of directors. The Group's treasury identifies, evaluates and hedges financial risks in close co-operation with the group's operating units. The board provides written principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest rate risk. Market risks arise from open positions in interest-bearing assets and liabilities and from liabilities denominated in currencies other than CZK which are exposed to market movements.

Foreign exchange rate risk. The Group is exposed to the currency risk stemming from the loans denominated in currencies other than CZK.

Based on internal policies, at least 85% of the notional amount of each facility, which is denominated in a currency other than CZK, is hedged through cross-currency swap for a term of at least 12 months. The Group does not operate internationally and only FX risk that is Group-exposed is from financing facilities and negligible from operational matters.

On 30 September 2019, the Group entered into a number of cross-currency swap agreements, all maturing on 31 December 2026, to hedge the notional amount of the facility A1 with Intesa Sanpaolo S.p.A., Commerzbank, Societe Generale and Komerční Banka, a.s for a total amount of EUR 548 million to cover the Group's position in EUR. The fair value of cross-currency swap agreements (derivative liability) amounted to CZK 589 million as at 31 December 2019. The fair value of the cross-currency agreements was driven especially by appreciation of CZK against EUR and by increase of PRIBOR rate.

The Group's exposure to foreign currency risk at the end of the reporting period, expressed in CZK, was as follows:

In millions of CZK	**31 December 2019** **EUR**
Assets	
- Cash and cash equivalents	104
Liabilities	
- Borrowings	(16,197)
- Cross-currency swap agreements	(589)

As shown in the table above, the group is primarily exposed to changes in CZK/EUR exchange rates. The sensitivity of profit or loss to changes in the exchange rates arises mainly from EUR-denominated financial instruments.

In millions of CZK	**Impact on post tax profit 2019**
EUR/CZK exchange rate - increase 10% (CZK depreciates)	(199)
EUR/CZK exchange rate - decrease 10% (CZK appreciates)	181

Interest rate risk. The Group is exposed to the interest rate risk which relates primarily to the Group´s loan facilities with a floating interest rate. To mitigate the interest rate risk, the Group took internal measures and hedged the minimum of 75% of the notional amount of each loan facility with interest rate swaps.

On 30 September 2019, the Group also entered into a number of interest rate swap agreements to hedge the interest payments under the facility A1, A2, B and C, all maturing after the period end. The fair value of interest swap agreements (derivative asset) amounted to CZK 116 million as at 31 December 2019.

All the Groups external long-term debt instruments have floating interest rates, while the shareholder loans have fixed interest rates and do not expose the Group to any interest rate risk.

The table below summarises the Group's exposure to interest rate risks. The table presents the aggregated amounts of the assets and liabilities subject to interest rate risk at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates:

In millions of CZK	**Note**	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**More than 1 year**	**Total**
31 December 2019						
Bank loans received	3.8	-	-	-	(42,388)	(42,388)
Net interest sensitivity gap as at 31 December 2019		**-**	**-**	**-**	**(42,388)**	**(42,388)**

Swaps currently in place cover approximately 75% of the variable loan principal outstanding. In 2020, the hedge ratio will be increased to 90% for the outstanding variable loans. The swap contracts require settlement of net interest receivable or payable semi-annually. The settlement dates do not coincide exactly with the dates on which interest is payable on the underlying debt.

The volatility of market interest rates can have a significant impact on profit, which can be positive or negative depending on the development. An increase in interest rates causes the Group's financing costs to rise. If the interest rates as at 31 December 2019 were 50 basis points higher / (lower) for loans at floating interest with all other variables held constant, net loss post tax for the period ended 31 December 2019 would have been CZK 13 million higher / (lower).

The range of actions, responsibilities and controls are set out in guidelines to which the Group is obliged to adhere when conducting financial transactions. The Group's financial transactions are recorded in the system, enabling them to be monitored. To mitigate interest rate risk and liquidity risk, the maturity of the long-term debts is spread over several years, and a new loan financing the development project is issued in each year.

Cash and cash equivalents comprising bank balances payable on demand bear floating interest and are insignificant.

Liquidity risk. The liquidity risk consists of the potential shortage of funds needed for paying due obligations and for financing business activities. The Group manages its liquidity risk by securing sufficient funds to be able to meet its financial obligations within a period of no less than three months in accordance with the currently valid Cash-flow outlook.

To mitigate liquidity risk, the Group focuses on precise liquidity planning. Management drafts financial plans for individual years in the framework of regular forecasts. Subsequently, the planned cash flow is updated on a monthly basis for a 12-month period and, moreover, specified with a greater accuracy through regular updates, if necessary.

The Group plans cash flows for a period of at least 12 months on a daily basis.

Financial planning mainly concentrates on planning revenues and expenses with respect to exact due dates (weekends and public holidays must be taken into account) with an emphasis on the conformity of planned reciprocal items between individual Group companies.

The table below shows liabilities as at 31 December 2019 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows and gross loan commitments.

When the amount payable is not fixed, the amount disclosed is determined by referencing the conditions existing at the end of the reporting period.

The maturity analysis of financial liabilities based on undiscounted cash flows as at 31 December 2019 was as follows:

In millions of CZK	**Carrying amount**	**Future payments, including principal and interest**	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**
Liabilities							
Trade and other payables	1,331	1,331	1,130	201	-	-	-
Bank loans received	42,388	48,872	-	184	488	37,704	10,496
Loans from shareholder	22,015	37,764	-	-	1,071	4,265	32,428
Lease liability	1,551	2,037	16	33	145	633	1,210
Total	**67,285**	**90,004**	**1,146**	**418**	**1,704**	**42**	**44,134**

The table below shows the cash flow from derivatives based on undiscounted basis. The inflow from cross currency swaps is expressed in CZK but settled in EUR currency. The cash flow from interest rate swaps (float for fix) is shown on a netted basis at fair market value and split into contractual maturities.

In millions of CZK	**Carrying amount**	**Total contractual cash flows**	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 12 months to 5 years**	**Over 5 years**
Derivatives							
Gross settled cross currency interest swaps							
inflow	15,395	16,899	-	-	155	809	15,935
outflow	(15,984)	(17,502)	-	-	(532)	(1,979)	(14,991)
Interest rate swaps							
inflow	116	156	-	14	73	69	-
outflow	-	(38)	-	-	-	(38)	-
Total	**(473)**	**(485)**	**-**	**14**	**(304)**	**(1,139)**	**944**

During 2020, the Company plans to refinance the term loan facilities from the borrowing disclosure at carrying amount as at 31 December 2019 of CZK 16,388 million (The Facility A1) and CZK 6,750 million (the Facility A2) by issuing bonds with the longer maturity (over 5 years) in order to mitigate the cash-flow risk and spread the maturities over several years.

The Group had access to the following undrawn bank borrowing facilities at the end of the reporting period:

In millions of CZK	**31 December 2019**
Revolving credit facility line	500
Capex facility line	6,350

The bank overdraft facilities are committed credit lines and might be drawn at any time until 30 September 2024 from the portfolio of banks. At the reporting date, no funds from these facilities were drawn.

5.3 Management of Capital

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amounts of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt. The amount of capital that the Group managed as at 31 December 2019 was CZK 27,356 million.

In maintaining or adjusting its capital structure, the Group targets a long-term capital structure compliant with an investment grade rating.

Consistent with others in the industry, the Group monitors capital on the basis of the gearing ratio. This ratio is calculated as total external debt divided by RAB (Regulated Asset Base). During 2019, the Group's strategy was to maintain the gearing ratio below 90% of RAB. As at 31 December 2019, the actual gearing ratio based on RAB was 89.7%.

The Group has complied with all externally imposed capital requirements throughout 2019.

5.4 Fair Value Disclosures

Fair value measurements are analysed by level in the fair value hierarchy, as follows: (i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities; (ii) level two measurements are valuation techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and (iii) level three measurements are valuations not based on observable market data (that is, unobservable inputs). Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

Financial Assets and liabilities measured at fair value

The Fair value of the interest rate swaps was determined as the present value of future cash flows based on the observable yield curve from the Bloomberg terminal as at 31 December 2019 adjusted for the own credit risk applied as at the contract date.

The cross currency swap was determined as the present value of future cash flows based on the forward exchange rates as at the balance sheet date and future cash flows were discounted by the observable yield curves from the Bloomberg terminal as at 31 December 2019 and adjusted for the own credit risk applied as at the contract date.

	31 December 2019
Recurring fair value measurements in millions of CZK	**Level 2 fair value**
ASSETS	
Derivatives	
- interest rate swaps	116
TOTAL ASSETS	**116**
LIABILITIES	
Derivatives	
- Cross currency interest swap	589
TOTAL LIABILITIES	**589**

For all the borrowings as at 31 December 2019, their fair values were not materially different from their carrying amounts, since:

(i) the floating interest payable on bank borrowings was close to the current market rate.

(ii) the loans from the shareholder were provided at market terms on 30 September 2019. For the short timeframe from 30 September 2019 to 31 December 2019 there was no significant fluctuation in the market long interest rate.

Carrying values of Trade and other receivables, Trade and other payables approximate to their fair values because of their short-term nature.

The fair values in level 3 of the fair value hierarchy (for Borrowings) were estimated using the discounted cash-flow valuation technique. The fair value of floating-rate instruments that are not quoted in an active market were estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments were estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risks and remaining maturities. As inputs to the DCF model, the Group used intra-group credit margins and market interest rates for interest rates swaps ("IRS") with the similar duration to the duration of financial instruments held at AC. The discount rate was determined as a sum of the intra-group margin and IRS rate.

Financial assets carried at amortised cost. The fair value of floating-rate instruments is normally their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risks and remaining maturities.

Liabilities carried at amortised cost. The estimated fair value of fixed interest rate instruments with stated maturities were estimated based on expected cash flows discounted at current interest rates for new instruments with similar credit risks and remaining maturities.

5.5 Presentation of Financial Instruments by Measurement Category

As at 31 December 2019, all the Group's financial liabilities and financial assets were carried at amortised cost except the derivatives, which were carried at fair value.

6 Other

6.1 Business Combinations

On 30 September 2019, the Company acquired 100 % of the share capital (and voting rights) of Czech Grid Holding, a.s. and its 100-%-owned subsidiaries GasNet, s.r.o. and GridServices, s.r.o. (the "Czech Grid Group"). The Czech Grid Group's primary business activities are the administration and management of natural gas distribution systems in a number of regions in the Czech Republic. GasNet, s.r.o. is a gas distribution company, which is in principle a "natural monopoly" and is regulated by an independent regulatory body – Energy Regulatory Office (ERO). The regulation of gas distribution is conducted by determining the overall level of allowed revenues (the revenue Cap) and a subsequent calculation of tariffs for distribution services for particular end-gas consumers. The distribution prices are annually published in a price resolution. GridServices, s.r.o. provides specialised construction activities, construction modifications and removals, repairs, revisions and tests of designated gas and electricity equipment to GasNet, s.r.o. only, and its revenues are eliminated on consolidation.

The Czech Grid Group had the following equity ownership structure prior to the acquisition that took place on 30 September 2019:

- 50.04% owned by RWE Czech Gas Grid Holding B.V. ("RWE", which is an unrelated third party),
- 34.96% owned by CGN Holding S.à r.l. ("CGN1" which is the controlling shareholder of the Group),
- 15% owned by CGN Holding 2 S.à r.l. ("CGN2" which is an entity under common control with CGN1).

On 30 September 2019, CGN1 acquired 15 % of share capital of Czech Grid Holding, a.s. (the parent of Czech Grid Group) from CGN2 and 50.04 % of share capital and control in Czech Grid Group from RWE. The purchase consideration for both transactions was equal to the fair value of the share transferred, and the transactions resulted in CGN 1 gaining 100 % ownership interest (and voting rights) in Czech Grid Group.

At the same date, 30 September 2019, CGN1 transferred its 100 % ownership interest (and voting rights) in Czech Grid Holding, a.s. to the Company for a total consideration of CZK 92,238 million, where CZK 70,636 million of the consideration related to the 100 % equity interest and CZK 21,602 million related to the shareholder loan to Czech Grid Group. This shareholder loan was eliminated on consolidation against the borrowing payable within the net assets acquired by the Group (the borrowing is excluded from the net assets acquired disclosed below).

Management concluded that the acquisition of Czech Grid Group by CGN1 and subsequent transfer to the Group are in substance part of a single transaction due to the following facts:

- Control was acquired by CGN1 at the acquisition date from a third party;
- The transactions were executed at the same date;
- Control over Czech Grid Group was retained by CGN1 after the transfer of Czech Grid Group to the Company;
- The consideration paid by the Group for Czech Grid Group to CGN1 proportionally corresponded to the fair value of the consideration paid by CGN1 to RWE for the 50.04 % share in Czech Grid Group.

Therefore, the Group has by substance on 30 September 2019 acquired 34.96 % of the share capital of the Czech Grid Group from CGN1, 15 % from CGN2 and the remaining 50.04 % from RWE, where CGN1 was acting as an intermediary. All the stakes representing together 100% interest in Czech Grid Group were acquired for a consideration corresponding to the fair value of respective shares in the Czech Grid Group. Thus, the Group was identified as the acquirer in the Group's consolidated financial statements and the acquisition method of accounting was used to record the transaction.

Details of the assets and liabilities acquired were as follows:

In millions of CZK	**Attributed fair value**
Non-current assets	**112,789**
Property, plant and equipment (determined provisionally)	110,049
Right-of-use assets	2,362
Intangible assets	377
Other non-current assets	1
Current assets	**1,697**
Inventories	27
Trade and other receivables	360
Income tax prepayment	263
Loans issued	0
Cash and cash equivalents	1,047
Total assets	**114,486**
Non-current liabilities	**18,234**
Lease liabilities	1,392
Deferred income tax liabilities	16,578
Provisions	16
Other non-current liabilities	248
Current liabilities	**4,014**
Lease liabilities	179
Trade and other payables	2,353
Contract liabilities	1,252
Current income tax payable	17
Other taxes payable	185
Provisions	28
Total liabilities	**22,248**
Fair value of identifiable net assets acquired	**92,238**
Goodwill arising from the acquisition (determined provisionally)	-
Purchase consideration transferred	**92,238**

in millions of CZK	Cash flow on acquisition
Cash acquired with the subsidiaries	1 047
Cash paid	-
Net cash flow on acquisition	**1 047**

The fair value of acquired trade and other receivables was CZK 360 million. The gross contractual amount for trade receivables due was CZK 556 million.

The acquired subsidiaries contributed revenue of CZK 4,199 million and a loss of CZK 3 million to the Group for the period from the date of acquisition to 31 December 2019.

If the acquisition had occurred on 22 March 2019 (i.e. the start of the reporting period), the Group's revenue for 2019 would have been CZK 9,544 million, and the loss for 2019 would have been CZK 1,887 million. These amounts have been calculated using the subsidiaries' results and adjusting them for

- differences in the accounting policies between the Group and the subsidiaries, and
- the additional depreciation and amortisation that would have been charged assuming the fair value adjustments to property, plant and equipment, intangible assets and right-of-use assets had applied from 22 March 2019, together with the consequential tax effects.

In millions of CZK	Purchase consideration
Issue of promissory note by the Company in favour of CGN1	49,594
Transfer of bank debt from CGN1 to the Company	42,644
Total purchase consideration	**92,238**

As there were no differences between the fair value of the acquiree's identifiable assets, liabilities, no goodwill or gain on acquisition was recognised at the acquisition date.

CGN1 transferred its receivable under the promissory note mentioned above (CZK 49,594 million) to Czech Gas Networks S.à r.l. (100% shareholder of the Company), that subsequently contributed partly to the Group's equity in the amount of CZK 27,856 million, partly converted to the loan from the shareholder in the amount of CZK 21,744 million (refer to Note 3.7 and Note 3.8) and remaining part was paid in cash to the Group in the amount of CZK 6 million.

Due to the complexity of the measurement and the large number of individual items that need to be assessed, the fair value measurement of the gas distribution network and related assets acquired in the business combination has not been completed. Therefore, the fair values of property, plant and equipment and the goodwill resulting from the acquisition have been determined provisionally.

6.2 Contingencies and Commitments

Tax contingencies. Czech tax legislation which was enacted or substantively enacted at the end of the reporting period is subject to varying interpretations when being applied to the transactions and activities of the Group. Consequently, tax positions taken by management and the formal documentation supporting the tax positions may be challenged by tax authorities. The Czech tax administration is gradually strengthening, including the fact that there is a higher risk of review of tax transactions without a clear business purpose or with tax noncompliant counterparties. Fiscal periods remain open for review by the authorities in respect of taxes for three calendar years preceding the year when decisions about the review were made. Under certain circumstances, reviews may cover longer periods.

Czech transfer pricing (TP) legislation is generally aligned with the international TP principles developed by the Organisation for Economic Cooperation and Development (OECD), although it has specific features. The TP legislation provides for the possibility of additional tax assessment for controlled transactions (transactions between related parties and certain transactions between unrelated parties) if such transactions are not on an arm's-length basis. Management has implemented internal controls to comply with current TP legislation. Transfer pricing documentation has been regularly prepared by external tax advisors.

Tax liabilities arising from controlled transactions are determined based on their actual transaction prices. It is possible, with the evolution of the interpretation of TP rules, that such prices could be challenged. The impact of any such challenge cannot be reliably estimated, but it may be significant to the financial position and/or the Group's operations.

The Group does not have any significant contingent liabilities as at 31 December 2019.

Capital expenditure commitments. As at 31 December 2019, the Group had contractual capital expenditure commitments in respect of property, plant and equipment of CZK 2,385 million.

Bank commitments. As part of the Facilities Agreement described in Note 3.8, the Company entered - as the original debtor - into an intercreditor agreement, between, among others, CGN as parent, CGN1 and original debtor, bank facilities lenders and Komerční banka, a.s. as the security agent pursuant to which the right of priorities of the respective creditors of the Company have been set forth.

In consideration of the Facilities Agreement, several securities were produced by the Company to Komerční Banka, a.s., including namely the following:

- the pledge agreement dated 27 September 2019 over 100% of the Company's shares, future shares and distributions;

- the first ranking pledge dated 27 September 2019 over (i) any claims of CGN against the Company and (ii) Loan Notes and related distributions;

- a first ranking pledge over the bank accounts of the Company.

The Company also entered into the following agreements:

- the pledge agreement over the shares in CGH dated 1 October 2019, pursuant to which the Company agrees to irrevocably and unconditionally charge all the certificated registered shares it holds in CGH to Komerční Banka, a.s.

- the pledge agreement dated 1 October 2019 over existing and future intra-group loans receivables pursuant to which the Company agrees to irrevocably and unconditionally charge all existing and future monetary receivables of the Company owed by its subsidiary GasNet, s.r.o to Komercni Banka, a.s.;

- the security assignment agreement dated 27 September 2019, pursuant to which the Group assigns the right to all the receivables of Czech Gas Networks Investments S.à r.l. as a security for the payment to Komerční Banka, a.s.in case of a default event.

6.3 Balances and Transactions with Related Parties

Parties are generally considered to be related if the parties are under common control, or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related-party relationship, attention is directed to the substance of the relationship, not merely the legal form.

As at 31 December 2019, the Group was owned by Czech Gas Networks S.à r.l. (CGN S.à r.l.).

As at 31 December 2019, the outstanding balances with related parties were as follows:

In millions of CZK	**Major immediate parent company CGN S.à r.l.**
Borrowings	22,015

Details of Borrowings are disclosed in Note 3.8.

The income and expense items with related parties for the period ended 31 December 2019 were as follows:

In millions of CZK	Note	Major immediate parent company CGN S.à r.l.
Finance costs	3.8	271

Key management compensation. Key management represented 4 Senior Executives of the subsidiaries, 7 Non-executive Directors of the Group's Board of Directors and 6 Non-executive Directors of Czech Grid Holding, a.s. as at 31 December 2019.

Non-executive directors are directors whose main responsibilities are outside of the Group, and only occasionally dedicate time to the Group's activities. Their remuneration was paid by entities outside of the Group and is not recharged to the Group. Therefore, the Group does not have a basis to provide information about their compensation in relation to the Group.

The information regarding remuneration of the 4 Senior Executives in the period ended 31 December 2019 is set out below:

	2019	
In millions of CZK	**Expense**	**Trade and other payables**
Short-term benefits:		
- Salaries	3	-
- Short-term bonuses	2	7
- Social security costs	1	-
Other long-term employee benefits:		
- Long-term bonus scheme	1	2
Total key management compensation	**7**	**9**

Short-term bonuses fall due wholly within the twelve months after the end of the period in which management rendered the related services.

Besides the above-stated, an in-kind consideration in the form of using the cars leased by the Group amounted to CZK 1 million and presented as a depreciation of right-of-use assets in the period ended 31 December 2019.

6.4 Principal Subsidiaries

The Group's principal subsidiaries as at 31 December 2019 are set out below.

The country of registration is also their principal place of business.

Name	Nature of business	Percentage of voting rights	Percentage of ownership	Country of registration
Czech Grid Holding, a.s.	Holding of participations in directly owned subsidiaries	100%	100%	Czech Republic
GridServices, s.r.o.	Construction activities, repairs, revisions of designated gas and electrical equipment.	100%	100%	Czech Republic
GasNet, s.r.o.	Gas distribution	100%	100%	Czech Republic

7 Events after the Reporting Period

Events in the regulatory framework are disclosed in Note 1 - General information.

On 25 February 2020, the Czech companies of the Group ("the Czech Grid Group") concluded a so-called Transitional Service Agreement ("TSA") with innogy Česká republika, a.s. and innogy Zákaznické služby, s.r.o (see also Note 1 – General information). The purpose of the TSA is to provide a framework for the operational separation of the Czech Grid Group from the innogy group in the Czech Republic. The TSA foresees a separation in 2020 of over 60 software applications, so far being used or managed by innogy Česká republika, a.s. for the former integrated innogy group in the Czech Republic. Up to 230 employees (FTE) being transferred from innogy group in the Czech Republic to the Czech Grid Group and up to 125 employees (FTE) being transferred from innogy Zákaznické služby, s.r.o. (Customer Care) to the Czech Grid Group. The plan also considers the purchase of 25 selected buildings from innogy Česká republika, a.s. by Czech Grid Group as well as movable assets. Moreover, around 500 commercial contracts with relevance to the Czech Grid Group's activities have to be split and negotiated on a bilateral basis with contractors.

The existence of the novel coronavirus (COVID-19) was confirmed in early 2020 and has spread across mainland China and beyond, including the Czech Republic, causing disruptions to businesses and economic activity. The Group expects the impact of COVID-19 to result in a certain decrease in revenues which will be compensated by the regulation in years 2021-2022.The COVID-19 pandemic could have some adverse impact on the Group's business, financial condition, results of operations and/or cash flows. The Group predicts the negative impact on revenues from the sale of capacity to be approx. CZK 125 million for the period from June to December 2020, while the actual impact on revenue from March to May 2020 was approx. CZK 66 million. Both amounts are relatively insignificant in relation to overall revenue and cash from operating activities. The COVID-19 pandemic may also impact the gas traders, whose financial situation may be deteriorated by the pandemic. The Group is exposed to the risk that the gas traders may be unable, or may refuse, to perform their contractual financial obligations to the Group. As of the issuance of this report, all retailers have fulfilled their obligations in time, including covering credit exposure or financial eligibility according to the network code. There are no negative consequences yet.

Fluctuations in currency exchange rates could adversely affect the Group's financial condition. The Group is exposed to currency fluctuations, primarily to the Euro to Czech Crown exchange rate, as the Group's key revenue streams are denominated in CZK, but part of the Group's debt is denominated in EUR. The Group has hedging arrangements in place covering 85% of the currency risk.

The full extent of the COVID 19 impact is currently uncertain. The ultimate magnitude of the COVID-19 pandemic, including the extent of its impact on the Group's financial and operational results, which could be material, will be determined by the length of time that the pandemic continues, its effect on the demand for the Group's products and services and the supply chain, as well as the effect of governmental regulations imposed in response to the pandemic.

The Group considers this outbreak to be a non-adjusting post-balance-sheet event with no effects on its ability to continue as a going concern.