

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 29 September 2021¹

LATVIA

AS AUGSTSPRIEGUMA TIKLI

[Redacted in line with the EBRD's Access to Information Policy]

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¹ As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

As permitted by paragraph 2.6 of Section III of the Access to Information Policy, disclosure of this Board Report was deferred.

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ABBREVIATIONS / CURRENCY CONVERSIONS

AST	Augstsprieguma Tikls AS
BRELL	Belarus, Russia, Estonia, Latvia, Lithuania
CAPEX	Capital Expenditures
CGAP	Corporate Governance Action Plan
CHP	Combined Heat and Power
CSCC	Cross-Sectoral Coordination Centre
DCM	Debt Capital Markets
DFI	Development Finance Institutions
DSCR	Debt-Service Coverage Ratio
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest Tax and Depreciation
EC	European Commission
EFSD	European Fund for Sustainable Development
EIB	European Investment Bank
ENSTO	European Network of Transmission System Operators
EPG	Economics, Policy & Governance
FTSE	Financial Times Stock Exchange Group
GET	Green Economy Transition
GHG	Greenhouse Gas
HPP	Hydro Power Plant
ICMA	International Capital Market Association
IFI	International Financial Institution
IFRS	International Financial Reporting Standard
kV	kilovolt
kWh	Kilowatt hour
LET	Latvijas elektriskie tikli AS
LNG	Liquefied Natural Gas
MDB	Multilateral Development Bank
MNPI	Material Non-Public Information
MoF	Ministry of Finance
MSCI	Morgan Stanley Capital International
MW	Megawatt
MWh	Megawatt hour
NIB	Nordic Investment Bank
PIA	Project Implementation Plan
PEP	Politically Exposed Persons
PPR	Procurement Policies and Rules
PUC	Public Utilities Commission
RAB	Regulatory Asset Base
RAROC	Risk-adjusted Return on Capital
SOE	State-Owned Enterprise
SRSS	Structural Reform Support Service
SSF	Shareholder Special Fund
TEC	Thermal Power Plants
TI	Transition Impact
TSO	Transmission System Operator

PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report concern an operation in favour of AS Augstsprieguma Tikli (the “Company”), a company incorporated in Latvia, are submitted for consideration by the Board of Directors.

The facility will consist of an investment of up to 20% (EUR 32 million) in the EUR 160 million green bond issue of the Company (the “Project”), which will be independently certified as compliant with the Green Bond Principles established by the International Capital Markets Association. [REDACTED]. The proceeds will be applied to refinance short term loans used to finance the transmission assets transferred from Latvenergo as part of the TSO unbundling required to comply with EU regulations, [REDACTED] implementing the Company’s ten years investment programme focusing on the grid synchronisation with the continental European power network, and upgrading of the electricity grid in Latvia leading to significant losses reduction and increased renewable energy absorption capacity.

The operation will be the Company’s first green bond issuance and first time to raise funding through capital markets. The expected transition impact of the Project stems from the *Green* and *Resilient* qualities. As a certified Green Bond, the Project is 100% GET compliant. This issuance will enable the Company to diversify its funding base and to utilise green funding sources to fund its transition to a highly efficient and low carbon asset base (*Green*). The operation will also contribute to the local debt capital market development which has suffered from a lack of investable securities and poor secondary market liquidity (*Resilient*). In addition, to promote gender equality internally, the Company will introduce improved HR standards, including on Gender-Based Violence and Harassment and on care responsibilities, as well as develop and implement an Equal Opportunities Action Plan.

I am satisfied that the operation is consistent with the Bank’s Strategy for Latvia, the Energy Sector Strategy, the Green Economy Transition Approach 2021–2025, the Strategy for the Promotion of Gender Equality, the Local Currency and Capital Markets Development Initiative and with the Agreement Establishing the Bank.

I recommend that the Board approve the proposed investment substantially on the terms of the attached Report.

Odile Renaud-Basso

BOARD DECISION SHEET

Latvia – Project Novus - DTM 52822	
Transaction / Board Decision	Board approval ² is sought for a green bond investment of up to EUR 32 million in favour of AS Augstsprieguma Tikli, a company incorporated in Latvia (the “Company” or the “Issuer”). The Bank’s investment will not exceed 20% of the bond issue. The bond will be listed on Nasdaq Riga stock exchange. The bond issuance is expected to be implemented in two tranches, the first tranche to refinance short term loans associated with the transmission assets transferred from Latvenergo as part of the TSO unbundling, and the second tranche to finance part of the Company’s ten year investment programme.
Client	AST is the Latvian Transmission System Operator (‘TSO’), 100% owned by the Republic of Latvia, with EUR 147.3m revenues and EUR 41.5m EBITDA in FY2020. The Company’s total assets stood at EUR 905.5 million as of FY2020. The Company operates the electricity transmission network in Latvia. AST was rated BBB+ with stable outlook in February 2021 by S&P.
Main Elements of the Proposal	<p><u>Transition impact:</u></p> <ul style="list-style-type: none"> - <i>Green:</i> As a certified Green Bond, the Project is 100% GET compliant. The investment will reduce the network losses [REDACTED] and accordingly will result in [REDACTED] CO2 emission savings annually. - <i>Resilient:</i> The Project will contribute to the local debt capital market development which suffers from a lack of investable securities and poor secondary market liquidity. The Bank’s participation will be limited to up to 20% of the issue to allow the balance to be allocated to commercial investors. <p><u>Additionality:</u></p> <ul style="list-style-type: none"> - <i>Financing structure:</i> The Bank’s financing is expected to provide a valuable signal to the market, close the funding gap and facilitate a successful placement in the current market conditions. - <i>Risk mitigation:</i> The Bank’s involvement in the Project provides comfort to other investors and encourages market participation. - <i>Standard setting:</i> The Bank will support AST to enhance its gender standards in line with international best practice by developing an Equal Opportunities Action Plan and introducing improved HR standards. <p><u>Sound banking:</u> The Bank will invest on the same terms as other commercial investors.</p>
Key Risks	<p><u>Issuer credit risk:</u> Moderate leverage, strong financial standing and stable cash generation capacity provide sufficient comfort that the Company would honour its debt obligations.</p> <p><u>Exit risk:</u> While the investment is treated as buy to hold, early exit could be undertaken, in case of favourable market conditions [REDACTED].</p>
Strategic Fit Summary	The Transaction is consistent with the Bank's Strategy for Latvia, especially in the context of financing development of green infrastructure solutions (e.g. Baltic energy interconnections); the Energy Sector Strategy, the Green Economy Transition Approach 2021-2025, the Strategy for the Promotion of Gender Equality, the Local Currency and Capital Markets Development Initiative and with the Agreement Establishing the Bank.

² Article 27 of the AEB provides the basis for this decision.

ADDITIONAL SUMMARY TERMS FACTSHEET

EBRD Transaction	Subscription of up to EUR 32 million for the debut green senior unsecured fixed coupon corporate bonds to be issued by AS Augstsprieguma Tīkli (the “AST”, the “Issuer”, or the “Company”). The Company is expected to place, in two tranches, a green bond of up to EUR 160 million with maturity of up to 7 years. The green bond will be listed on the Nasdaq Riga exchange, an EU regulated platform that is part of the Sustainable Stock Exchanges Initiative. The Bank’s participation will be limited to 20% of the issuance to support the successful placement of the bond. It will also benefit from a second party opinion from S&P prior to issuance. [REDACTED].
Existing Exposure	None to the Issuer
Maturity / Exit / Repayment	7 years maturity [REDACTED].
Potential AMI eligible financing	None
Use of Proceeds	<ul style="list-style-type: none"> • The bond proceeds will be used as follows: (i) [REDACTED] To refinance short term loans used to finance the electricity transmission assets transferred from Latvenrgo as part of the TSO unbundling in accordance with the EU regulations, and (ii) [REDACTED] To finance part of the Company’s 2021-2030 investment programme as explained in “Investment Plan” below. • The existing assets to be refinanced include the following projects: <ul style="list-style-type: none"> ○ Final phase of the Kurzeme Ring which represent 330 kV overhead high voltage transmission line in the Western part of Latvia that was developed to increase the evacuation capacity in that area including renewable projects (wind power generation). The Kurzeme Ring constitutes a part of the larger Baltic - Nordic Countries interconnection project, NordBalt. [REDACTED]. ○ CHP 2 - Riga HPP 330 kV power transmission line which is part of the European ENTSO-E ten year development plan and aims at reinforcing the electricity grid in Latvia to ensure full functionality of the Estonia-Latvia third interconnection. [REDACTED]. ○ The Latvia-Estonia 3rd interconnection project that is focused on increasing the security of energy supply in the Baltic Sea region as well as increasing the competitiveness of electricity producers in the Baltic and Nordic countries. [REDACTED]. • EBRD’s green bond investment proceeds will be allocated pro-rata to the two tranches as committed by the Company in the Framework Agreement to be signed in parallel to the bond issue. • Pursuant to the Green Bond Principles the Issuer will report annually. Consistent with the MDB Guidelines on Climate Finance reporting, 100% of the Project ABI is classified GET. • Standard & Poor's (S&P) will certify compliance of the bonds with the Green Bond Principles. S&P is one of the most respected of such certifying agencies.
Investment Plan	[REDACTED]
Financing Plan	[REDACTED]

Key Parties Involved	<ul style="list-style-type: none"> • Issuer: AS Augstsprieguma Tīkli • Lead arranger: Luminor • Green bond framework second opinion provider: S&P • Rating agency: S&P
Conditions to subscription / disbursement	[REDACTED]
Key Covenants	[REDACTED]
Security / Guarantees	Unsecured
Other material agreements	Framework Agreement between the Issuer and the Bank
Associated Donor Funded TC and co-investment grants/concessional finance	None

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

Latvia has high shares of renewable energy in its energy supply due largely to the country's sizable legacy hydropower resources. Approximately 40% of final energy consumption in 2020 was from renewable sources, above the EU 27 average of 18.88% and close to the country's 2020 target of 40.95% under the EU 20/20/20 targets. However, Latvia has committed to a more ambitious target under its National Energy and Climate Plan to produce 45% of its final energy consumption from renewable sources by 2030.

In its national energy strategy, Latvia has another important target for energy security by targeting to reduce the share of imports in gross national energy consumption to 30.5% in 2030. One of the main energy challenges is that Latvia remains dependent on gas imports. While the Klaipeda LNG Terminal in Lithuania (operating since 2014) and gas interconnectors to Lithuania are major improvements to diversify its energy supplies, more investment is needed to strengthen the country's energy supply security and efficiency.

In achieving the goals of both an increased share of renewables and enhanced energy security, a more efficient network is a critical element. Improving the efficiency and flexibility of its network will result in lower electricity losses, increased absorption of renewable capacity and more resilience to disruption and shifting supply sources.

In the context described above, AST, the TSO in Latvia, has decided to approach the capital market for the first time focusing on green bond issuances to raise the capital required to make the investments needed to (i) renovate its network, (ii) implement the synchronisation of its grid with the EU network together with Estonia and Latvia [REDACTED], (iii) and further develop its interconnection capacity with the Baltic and Nordic countries. The Company has prepared a EUR 160 million green bond programme and is expecting to go to the market in October 2021.

The first tranche of [REDACTED] the Issuer's bond programme will refinance bridging loan taken out to finance the asset transfer from Latvenergo (existing 330 kV and 110 kV transmission lines) to AST [REDACTED].

The second tranche [REDACTED] will finance part of the [REDACTED] capital expenditures programme up to 2030 in the electricity transmission grid related to grid synchronisation with the European network. The investment programme will result in transmission losses reduction [REDACTED]. Based on the current level of energy transmission, the CO2 savings are expected [REDACTED].

The bond programme represents the first instance where the Issuer approaches debt capital markets. By participating in the bond programme, the Bank confirms its support for capital market development. Importantly, the scale of the bond, and its "green" rating under the Green Bond Principles certified by an independent certification agency, will entrench the highest standards in this key green funding mechanism. This is further

evidenced by the policy dialogue of the EBRD via various technical cooperation projects funded by the EU aimed at promoting the pan-Baltic capital market development.

In addition, the Company will be supported in introducing gender-responsive Human Resources standards, by i) developing and implementing an Equal Opportunity Action Plan (EOAP), ii) improving policies and practices to support care responsibilities (e.g. shared parental leave), and iii) incorporating recommendations from the EBRD's "Addressing Gender-Based Violence and Harassment" guidance note – as appropriate. [REDACTED].

The Transaction is consistent with the Bank's Strategy for Latvia, especially in the context of financing development of green infrastructure solutions (e.g. Baltic energy interconnections); the Energy Sector Strategy, the Green Economy Transition approach, the Strategy for the Promotion of Gender Equality, the Local Currency and Capital Markets Development Initiative, and with the Agreement Establishing the Bank.

1.2 TRANSITION IMPACT

The table below sets out the TI objectives and details of the Project. The relevant Monitoring Indicators and timing for delivery are shown in section 2.

Primary Quality: Green

Obj. No.	Objective	Details
1.1	The project contains one or more activity(ies) that can qualify as GET and the percentage of EBRD use of proceeds that qualifies as GET finance is equal to or exceeds the sectoral threshold in the GET TI assessment methodology.	<p>As a certified green bond, the project is in line with the Bank's GET methodology and will be 100 percent GET compliant. The Project also contributes to climate mitigation through improving energy efficiency. The expected annual emission savings resulting from this investment are expected [REDACTED]. The bond will be compliant with the ICMA's Green Bond Principles and reviewed by S&P.</p> <p>In addition, the bond will contribute to improve competitiveness of the structure of the electricity system in Latvia under EU legislation, as Tranche 1 [REDACTED] is for refinancing liabilities associated with the full ownership unbundling of the transmission assets complying with EU legislation on TSO unbundling (EU Directive 2009/72/EC), as well as strengthening the electricity grid and will accordingly facilitate more private investments in renewable generation.</p>

Secondary Quality: Resilient

Obj. No.	Objective	Details
2.1	At least 80% of the issuance is expected to be placed with private non-IFI investors.	The Bank's participation will be capped at up to 20 percent in accordance with the Debt Capital Markets guidelines. Following the anticipated scale back, at least 80 percent of the issue is expected to be placed with institutional investors such as Pillar II pension funds who would benefit greatly from further securities being available on the pan-Baltic market. Currently, there is a lack of investable securities and poor secondary market liquidity in place, key features of the local market which are seen as major impediments by investors. These constraints in Latvia were highlighted as part of the roadmap towards achieving the 'Emerging Market Status' ² and during follow-up policy dialogue with leading index providers such as FTSE Russell and MSCI.
2.2	The transaction contributes moderately to capital market development (not a new product, market expansion is very modest) and has a similar or shorter maturity compared to previous issuances in the market in the past year (debt instrument).	The Latvian corporate debt securities market has stagnated over the past few years. At the end of 2020, debt securities of Non-financial corporates stood at EUR 326 million (1.2 percent of GDP). The majority of listed bonds are issued by banks and other financial institutions, including ALTUM, a Latvian state-owned development finance institution, representing roughly 1.1 percent of GDP. The listing of bonds on the local exchange in the region remains marginal. The last bond issued on the market was by Latvenergo in amount of EUR 50 million in May 2021 with 7 years maturity.
2.3	The issuance will be publicly offered and listed on a national exchange. It either has a credit rating from a rating agency other than "Big Three" (including local credit rating agencies) or it is not rated but the issuer is rated by at least one of the "Big Three".	The issuance will be listed on the local capital market - Nasdaq Riga - and available for trading for all Nasdaq Baltic investors. The Issuer is rated BBB+ by S&P Ratings, Feb 2021 and hence the issuance follows the same rating. The Transaction is a good follow-on investment from the ongoing policy dialogue undertaken via the technical cooperation (TC) projects led by the EBRD's CMD team and funded by DG REFORM: i) SOE Policy Review implemented with the Latvian Government entity, CSCC; and ii) Green Capital Markets with the Lithuanian MoF and with a pan-Baltic coverage.

Delivery Risk:

The primary delivery risks are related to the fact that this is AST's first bond issuance and this is mitigated by the Bank's participation.

1.3 ADDITIONALITY

Identified triggers	Description
A significant share [REDACTED] of the project is for refinancing purposes	The Issuer faces a large upcoming maturity [REDACTED]. However, as a regulated utility and a government-related entity, the Issuer is well positioned to address the upcoming refinancing through the issuance of an inaugural green bond in 2021.
Additionality sources	Evidence of additionality sources
Financing structure: EBRD offers a large volume instrument that fills a market funding gap and is required to structure the project.	Average issuance size in the local bond market (Riga) of approx. EUR 80 million in the last two years is below the Issuer's targeted issue size of EUR 100 million for the first tranche, which is an ambitious target for the local market. This contemplated bond issue will be one of the largest bonds launched by a Latvian company.
Financing structure: Capital market: EBRD financing is expected to effectively ' close the funding gap ' and allows carrying out a successful book-building process .	The Bank's participation is necessary for the success of the issuance because this is the first time AST is approaching the capital market for raising financing. The Company faces a large upcoming maturity [REDACTED].
Financing structure: Public sector: EBRD investment is needed to close the funding gap. At the same time, EBRD does not crowd out other sources, such as from other IFIs, government, commercial banks and/or complements them.	This is the first time the Company approaches the capital market to raise capital, therefore the Company is taking comfort from the Bank's participation to ensure a fully subscribed and successful issuance. The Bank is expected to be the only available IFI involved [REDACTED].
Risk Mitigation: EBRD's involvement in a debt capital market transaction provides comfort to other investors and further widens market participation.	The Bank's participation as a significant investor in the proposed transaction should be positively viewed by the market given the Bank's strong credentials as a green investor. This is expected to send a strong signal to institutional investors with regard to the quality of the issue and the credibility of the Issuer.
Standard setting: Client seeks/makes use of EBRD expertise on higher inclusion (e.g. adherence to labour standards which goes beyond the provisions set in PR2 of the environmental and social policy), gender standards and/or equal opportunities action plans (e.g. improving women's access to skills and employment opportunities).	AST seeks EBRD expertise to incorporate higher gender equality standards in its Human Resources policies and practices and to develop an Equal Opportunities Action Plan (EOAP). This will be instrumental in promoting gender equality internally and will include improving policies and practices to support care responsibilities (e.g. improved maternity leave arrangements, paternity leave policies, parental leave policies with transferrable days between spouses, subsidised child/ elderly care support, flexible working arrangements, etc.). To reduce the social barriers that affect women's rights and capabilities in the work place, this will also include incorporating recommendations from EBRD's guidance note on Gender-Based Violence and Harassment (GBVH).

1.4 SOUND BANKING - KEY RISKS

Risks	Probability / Effect	Comments
Project specific risks		
Issuer credit risk	Medium / High	<p>A deterioration in the Company's financial performance could influence the Company's ability to repay or refinance the debt. Also, in the light of the bond programme size, there is a risk that (if fully utilised) the leverage of the Company would increase.</p> <p><u>Mitigation:</u> Stable cash generation capacity from the regulated asset base (the regulator has approved the 10 year capex program) on top of a strategic nature of the Company and full state ownership, gives sufficient comfort that the Company would honour its debt obligation.</p>
Exit risk	Medium / Low	<p>The bond will be listed in the local bond exchange market. Although the previous green bonds are actively traded in the market, there is a risk of not enough liquidity in the market in the future for the Bank's exit.</p> <p><u>Mitigation:</u> Considering the stable regulatory environment it is expected that the Borrower will be able to honour its debt service obligation. An early exit could be undertaken in case of favourable market conditions, as the Bank should be able to find a partner for a sale of entire exposure given the growing interest for green bonds investment, rather than selling gradually via liquidity in the market. Banking Portfolio Management, Banking, Risk, and Treasury will assess over time the possibilities to sell.</p>
Management experience risk	Medium / Low	<p>The bond will be the first bond issued by AST. AST's has limited expertise in debt capital market as a financing tool as well as green capital market products.</p> <p><u>Mitigation:</u> As an anchor investor, the Bank will provide a comprehensive support throughout its green bond issuance process with enough, recent experience from the green bond project in Latvia with Latvenergo and expertise in green capital market. The current deal is a logical follow-on investment from the ongoing policy dialogue undertaken via the technical cooperation (TC) projects led by the EBRD's DCM team: i) SOE Policy Review implemented with the Latvian Government entity, CSCC; and ii) Green Capital Markets with the Lithuanian MoF and with a pan-Baltic coverage. The Issuer is rated BBB+ by S&P Ratings, Feb 2021 and hence the issuance is expected to follow the same rating.</p>
COVID-19 impact	Medium / Low	<p>The ongoing Covid-19 pandemic and any possible future outbreaks of viruses may have impact Company's operations, including personnel and electricity consumption.</p> <p><u>Mitigation:</u> Current COVID-19 effect on electricity consumption was mild and the vaccination rate is in line with Baltic peer countries. The final implications of the pandemic are difficult to estimate at this stage but the strategic nature of the Company and full state ownership, gives sufficient comfort that the Company would honour its debt obligation.</p>

<i>External risks</i>		
Macro-economic risk	Medium / Medium	<p>The major risk faced by the principal business activity of the Company includes that an economic slowdown in Latvia may affect electricity and gas demand.</p> <p><u>Mitigation:</u> the Latvian economy continues to benefit from strong fundamentals: low, stable public debt, a fairly solid fiscal position and a reasonably stable financial system, which is reflected in high country credit rating (A+ with stable outlook by S&P). Latvia's GDP growth was 2.0% in 2019 followed by 3.6% decline in 2020 and forecasted rebound to 3.5% (source: EBRD forecast, July 2021).</p>
Regulatory risk	Low / Medium	<p>The electricity transmission tariffs are determined in accordance with the methodology approved by the Public Utilities Commission (PUC), an independent national regulatory authority. In November 2020, tariffs for the regulatory period from January 2021 to December 2022 were approved, but there is a risk of unexpected changes in tariffs while the Bank remains as investor.</p> <p><u>Mitigation:</u> The regulator is in compliance with the EU's standard. Additionally, the Latvian government's good history of implementing the EU acquis provides evidence of the government's consistency over time.</p>

2. MEASURING / MONITORING SUCCESS

<i>Overall objectives of project</i>	<i>Monitoring benchmarks</i>	<i>Implementation timing</i>
- Successful bond issue - Good financial and operational performance	[REDACTED]	[REDACTED]

Primary Quality: Green

Obj. No.	Monitoring indicator	Details	Baseline	Target	Duration
1.1	<i>CO2 Emissions reduced (tonnes/yr)</i>	CO2 savings from transmission loss reduction annually	[REDACTED]	[REDACTED]	[REDACTED]
1.2	<i>New or updated GET technology or product leading to energy efficiency introduced</i>	Reduce network losses [REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Secondary Quality: Resilient

Obj. No.	Monitoring indicator	Details	Baseline	Target	Duration
2.1	Share of non-IFI/non-DFI institutional investors in capital market instrument or equity fund at the issuance	Percentage of non-IFI/DFI investors more than at least 80%	[REDACTED]	[REDACTED]	[REDACTED]
2.2	Issuance listed on a national or/and international exchange	To be listed in Nasdaq Riga	[REDACTED]	[REDACTED]	[REDACTED]
2.3	Volume of new capital market activity raised	Issuance of at least EUR 100 million successfully subscribed	[REDACTED]	[REDACTED]	[REDACTED]

Additional Indicators

Type	Monitoring indicator	Details	Baseline	Target	Duration
Advisory & Policy Indicators	Practices of the relevant stakeholder improved (equal opportunity practices of the client)	The Company will develop and implement an EOAP and improve its HR policies and practices, including on care responsibilities and on GBVH.	[REDACTED]	[REDACTED]	[REDACTED]

3. KEY PARTIES

3.1 ISSUER

AST is the Latvian electricity transmission system operator established in 2004, 100% owned by the Ministry of Finance of the Republic of Latvia and currently employing more than 500 employees. In 2020, the Company had total assets of EUR 905.5 million and generated approx. EUR 42.3m of EBITDA, and EUR 10m of net profit.

The Company also owns a majority (68.46%) of AS Conexus Baltic Grid (Conexus), the natural gas transmission and storage system operator in Latvia. Conexus also manages the Inčukalns underground gas storage facility and the main natural gas transmission system directly connecting the Latvian natural gas market with Lithuania, Estonia and the North-West region of Russia.

Important historical milestones of AST:

- Until 2011 the Company operated as an integral part of AS Latvenergo Group which was then a vertically integrated incumbent state owned power utility.
- In 2011-2012, the Parliament adopted amendments to the Electricity Market Law in order to establish an independent transmission system operator. At this time AST was established as a subsidiary of Latvenergo.
- In 2013, the Public Utilities Commission approved the Company as an independent transmission system operator. Thereafter, during 2013-2019 the trading area of Latvia was opened in the Baltic electricity market and NordPool next day electricity market ELSPOT started operating in Latvia. The Company took over the transmission system operation and maintenance functions as well as the transmission system development, and construction of new networks.
- In October 2019 the government agreed on full ownership unbundling of the electricity transmission system operator, and, therefore, in 2020 AST was separated from Latvenergo. Following the completion of the unbundling from Latvenergo the Company has 5,612 km of power lines (330 kV and 110 kV voltage levels) and 140 substations under ownership and management. By separating electricity management from generation and distribution, both in Latvia and in Europe, system operators were given the opportunity to develop, restricting historical energy monopolies and freeing up the way for competition both locally and on a European scale.

4. MARKET CONTEXT

The Latvian power market has been officially liberalised since July 2007 under the EU Third Energy Package, with no restrictions for new entrants in electricity generation and supply or for electricity consumers, who can freely change their suppliers. Electricity is freely traded in the wholesale market NordPool. The retail market is competitive with approximately 30 retailers including other regional players including Ignitis (Lithuania), and Eesti Energia (Estonia).

According to the Electricity Market Law and the Company's license the Company is the only electricity transmission system operator in Latvia. Electricity transmission is carried out by the transmission system operator through a transmission system that includes interconnected networks and equipment, including cross-border connections,

with a voltage of 110 kV or more. The Latvian energy system is well connected to Estonia (two 330 kV lines & two 110 kV lines, with third 330 kV in plan) and Lithuania (four 330 kV lines & three 110 kV lines), as well as to Russia (one 330 kV line). These cross-border interconnections help liberalize the market and increase liquidity. As previously noted despite existing connections with Poland, Sweden and Finland, the Baltic countries still operate in synchronous mode with Russia and Belarus until the planned synchronization with the continental European network ENSTO-e in 2025.

The Company is regulated by the independent Public Utilities Commission under the guidance of its Supervisory Board. The regulator introduced a new tariff methodology in 2021 based on the RAB model which provides cash flow visibility and protection against volume risk. The new framework introduces regulatory periods, with the first spanning two years (the subsequent periods are five years) in line with other EU regulatory frameworks.

During 2020, 5 961 GWh were transmitted to users, which is 1 per-cent less than in 2019 (6 012 GWh). The impact of the reduction in the amount of electricity transmitted to consumers on the revenues from the provision of transmission services is insignificant. In the first half of 2021, the Company transmitted to its customers in Latvia 3 087 GWh of electricity, which is 6 per-cent more than in the first half of 2020 (2 926 GWh).

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL ANALYSIS

[REDACTED]

5.2 FINANCIAL PROJECTIONS

[REDACTED]

5.3 SENSITIVITY ANALYSIS

[REDACTED]

5.4 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT

Categorised B (2019 ESP). The Project is a capital markets transaction (Green Bond issuance) and the Bank's due diligence has been limited to a review of publicly available documents by ESD. The in-house due diligence was based on publicly available information, questionnaires and discussion with the Company. The level of available information allowed for adequate assessment of environmental and social risks of this Project in accordance with the Bank's 2019 ESP. The use of proceeds is focused on refinancing of constructed power transmission lines and upgrade of substations and will explicitly exclude any new category A projects. The bond issuance is in line with the International Capital Market Association's ("ICMA") Green Bond Principles ("GBP"), as verified by a second party opinion. The Project is aligned with the Paris Agreement (PA) for mitigation and adaptation based on meeting the GBP criteria.

The Environmental and Social Due Diligence (ESDD) has reviewed the status of compliance and the Company's approach to environmental and social governance ("ESG") principles and capacity to implement the Bank's PRs. The ESDD focussed on a corporate level review of the Company's management systems, sustainability strategy, policies and operations and its current compliance status as well as a desktop review of the power lines project that have been recently constructed and the planned upgrades of substations. Overall, AST has a good compliance record and is developing corporate EHS management systems and no material non-compliance issues have been identified. It has a dedicated EHS management team and develops sustainability reports for the group however these will need to be strengthened in the future to take account of EU Corporate Sustainability Reporting Directive (CSRD) as well as the EU Taxonomy. The ESDD confirmed that the Company has the institutional capacity to implement the Bank's Performance Requirements. The ESDD has also confirmed that the Company has good HR Policies in line with best practice and is implementing Covid-19 response measures. The Company's EHS practices are in compliance with national regulations, which are aligned with EU law.

An ESAP has been developed based of the findings of the ESDD and will include requirements relating to, among others, strengthening of non-financial reporting in line with best practices and EU guide on climate related information. This includes a commitment to implement TCFD recommendations as part of EU CSRD implementation in the future. The ESAP will also require that i) if the Company was to develop projects in sensitive areas or of sensitive habitats, those would need a full ESIA in line with the Bank's E&S policy; ii) AST undertakes every 3 years an independent assessment of its E&S performance. The EBRD proceeds will not be used for any new Category A projects. The Company does not own any generating capacity and will not invest in any in the future. The ESAP will be included in the Framework Agreement to be signed shortly before subscription.

The Bank will monitor the Company's performance through reviewing annual reports prepared by the Company and published on its website.

6.2 INTEGRITY

Integrity due diligence was undertaken on the Company, its senior management and other relevant parties. The review [REDACTED] concluded that it is sufficiently mitigated and therefore this project does not pose an unacceptable integrity or reputational risk to the Bank. [REDACTED].

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the Transaction.

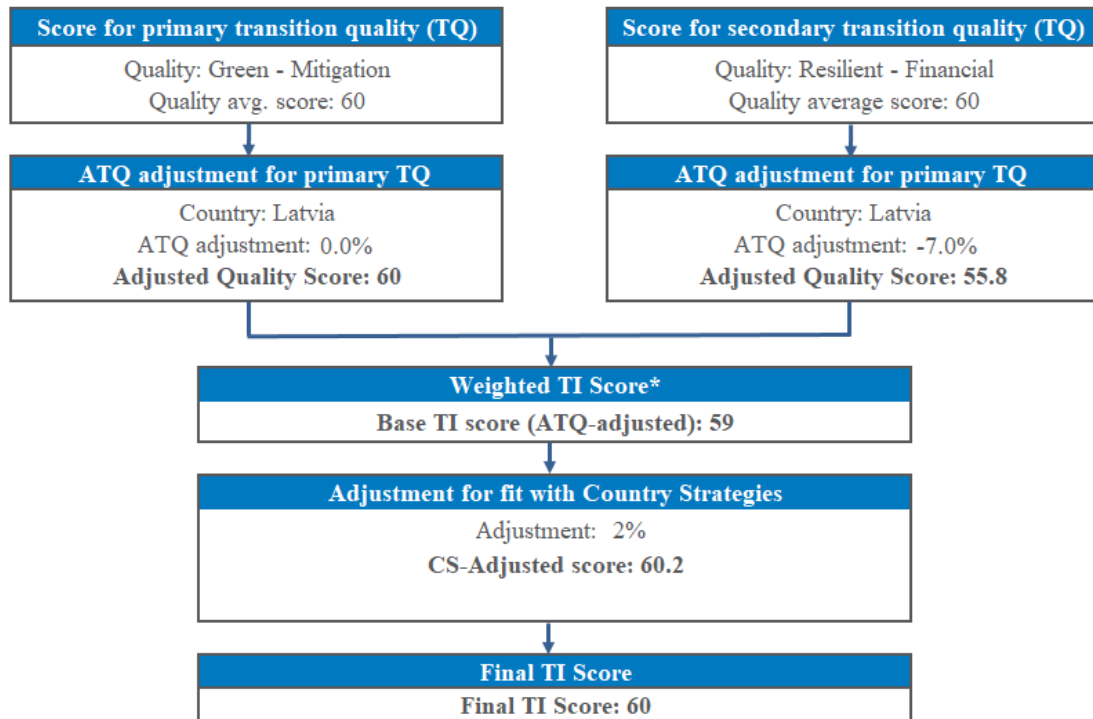
6.3 OTHER ISSUES: PROCUREMENT

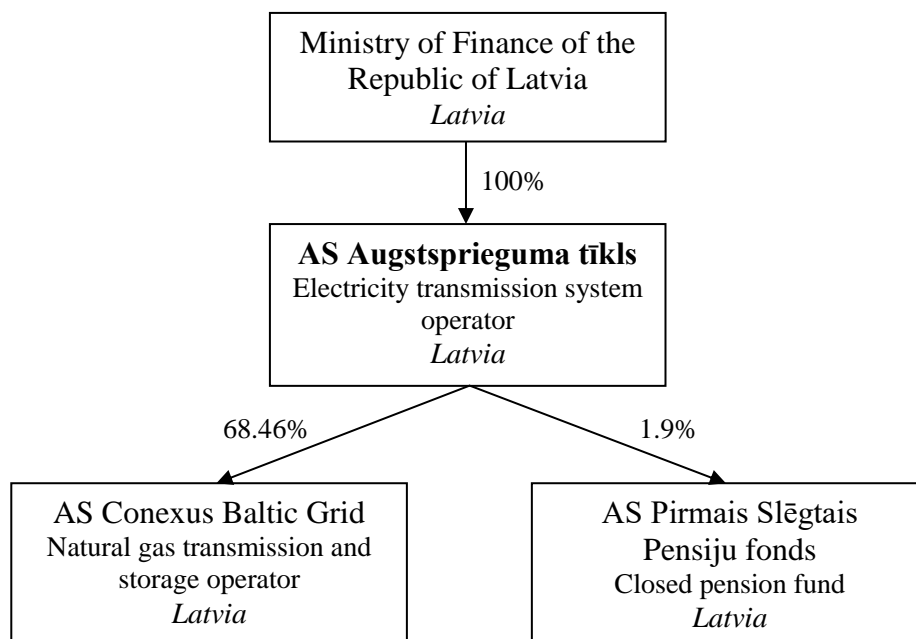
The Bank's financing will be used in the refinancing tranche, and in the capex tranche represented by contracts below EUR 250,000 for goods and services and EUR 7.5 million for works and supply and installation contracts. The Issuer may procure these contracts in accordance with national public procurement rules and regulations applicable to Latvenergo AS that are conducted through the national e-procurement system. This is in line with the requirements of para 3.10 of the Bank's PPR that deal with the circumstances for using alternative procurement procedures in accordance with national law. For more details please see Annex 6.

ANNEXES TO OPERATION REPORT

ANNEX 1	Transition Impact Scoring Chart
ANNEX 2	Shareholding Structure
ANNEX 3	Historical Financials
ANNEX 4	Green Assessment Summary
ANNEX 5	Latvia Bond Market
ANNEX 6	Project implementation

ANNEX 1 – TRANSITION IMPACT SCORING CHART



ANNEX 2 – SHAREHOLDING STRUCTURE

ANNEX 3 – HISTORICAL FINANCIALS

[REDACTED]

ANNEX 4 – GREEN ASSESSMENT SUMMARY

Introduction

As a certified green bond, the project is 100% GET eligible. The project was determined as aligned with mitigation and adaptation goals of the Paris Agreement. As a client in the power sector, the counterparty was initially flagged as higher risk for carbon transition – however detailed review indicated that as a transmission system operator in a country with high renewables penetration and without any generation assets, the final carbon transition risk was deemed low.

Paris alignment assessment

<i>General screening of alignment with the mitigation goals of Paris Agreement</i>	
Is a project/economic activity included in the 'aligned list'?	Y
Is a project/economic activity included in the 'non-aligned list'?	N
Have any applicable additional or specific conditions associated with the 'aligned' project/economic activity been met?	N/A

<i>Alignment with the adaptation goals of Paris Agreement</i>	
Final project physical climate risk score	1
Evaluation of the climate risk and vulnerability context	N/A
Definition of climate resilience measures	N/A
Appraisal of broader climate resilience context	N/A

GET attribution

EBRD will participate in the issuance of EUR 160 million bonds, which will be independently certified as compliant with the Green Bond Principles established by the International Capital Markets Association.

As a certified Green Bond, as per the GET Handbook, the GET attribution is 100%.

Climate-related financial risk

Climate-related financial risk (if relevant for 7 or above)	
Final physical climate risk score for the key counterparty of risk	1
Evaluation of the physical climate risk for the key counterparty of risk (if different from the borrower)	N/A
Final carbon transition risk score for the key counterparty of risk	7 (initial score)
Evaluation of carbon transition risks for the key counterparty of risk	<p>The project was initially flagged as higher risk for Carbon Transition as the sector code 'Electric Utilities' is a high risk sector, given that power generation falls within the scope of this sector code. However, the counterparty for this specific transaction is the high-voltage (HV) network operator. It is acceptable risk from a Carbon Transition perspective, because:</p> <ul style="list-style-type: none"> - It does not own any power generation facilities, and is thus not exposed to carbon prices.

	<ul style="list-style-type: none"> - No major reconfiguration/decommissioning of HV network would be needed for low-carbon grid: More than 50% of power generated in the network is from renewables (hydropower) with the remainder combined heat and power (CHP) facilities close to major urban load centres. This means that even if the CHPs are decommissioned, a major reconfiguration of the HV network wouldn't be needed. - As a regulated monopoly that passes through all costs to end consumers (representing approximately 10% of end user tariff), if they were forced to make any investments to reconfigure HV network, it should not impact bottom line as costs could be recouped.
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A financial model incorporating low-carbon transition was not needed for this transaction as the rationale provided above indicates that the transaction has a low carbon transition Risk.

ANNEX 5 – LATVIA BOND MARKET

Baltic Regulated market – Bonds listings on Nasdaq Riga

Name	Issue date	Maturity date	Size	CCY
Latvenergo 0.5% 7Y green bond	17.05.2021	17.05.2028	50,000,000	EUR
mogo 3Y 11% bond	01.03.2021	31.03.2024	30,000,000	EUR
Elko Grupa 6% 5Y bond	12.02.2021	12.02.2026	20,000,000	EUR
Latv Gov. 7-year T-bond 57018	03.07.2020	03.07.2027	80,000,000	EUR
Latv Gov. 2-year T-bond 55010	20.03.2020	20.03.2022	401,500,000	EUR
Storent 8% 4Y bond	30.12.2019	19.10.2023	4,870,500	EUR
DelfinGroup 14% 3Y bond	15.11.2019	25.11.2022	5,000,000	EUR
Latv Gov. 5.5-year T-bond 57017	05.07.2019	31.01.2025	390,001,000	EUR
Latvian Gov. 5-year T-bond 57016	02.11.2018	02.11.2023	250,000,000	EUR
Altum 1.3% 7Y bond	07.03.2018	07.03.2025	45,000,000	EUR
Latv Gov. 5.5-year T-bond 57015	12.01.2018	12.05.2023	270,000,000	EUR
Citadele banka 5.5% 10Y bond	24.11.2017	24.11.2027	20,000,000	EUR
Altum 1.3% 7Y green bond	17.10.2017	17.10.2024	20,000,000	EUR
NHC FXD EUR 161022	16.10.2017	16.10.2022	10,000,000	EUR
Citadele banka 6.25% 10Y bond	06.12.2016	06.12.2026	40,000,000	EUR
DelfinGroup 14% 5Y bond	19.10.2016	25.10.2021	5,000,000	EUR
AgroCredit Latvia 7% bond	08.06.2016	31.12.2026	6,000,000	EUR
Latv Gov. 5.5-year T-bond 57014	27.05.2016	27.01.2022	156,180,000	EUR
Moda Kapitals 5Y bond	15.09.2015	15.11.2025	3,310,000	EUR
Latvenergo 1.9% 7Y green bond	10.06.2015	10.06.2022	100,000,000	EUR
Latv Gov. 10.5-year T-bond 58005	27.04.2012	27.10.2022	64,541,465	EUR

As of 02 September 2021, Source: Nasdaq Baltic

- Nasdaq Riga is the only regulated secondary securities market in Latvia. It maintains regulated, open and efficient market infrastructure. 21 bonds with total size of EUR ca.2 billion are listed on the Nasdaq Riga stock exchange. Among 21 bonds, 7 bonds are the government bonds and 14 are corporate bonds.
- Average size of bonds on the exchange is EUR 90 million, but it decrease to EUR 25 million for the corporate bonds average excluding the T-bonds.
- 3 green bonds are listed on the Nasdaq Riga exchange. Latvenergo has been issued 2 green bonds in 2015 and 2021, and Altum issued 1 green bond in 2017. On Nasdaq Baltic market, 7 green bonds are listed in total; 3 in Latvia, 4 in Lithuania.

ANNEX 6 – PROJECT PROCUREMENT

Procurement classification – *Public, sub-sovereign*

[REDACTED]

The Client's capacity assessment related risk: “Low”

AST has to undertake procurement in accordance with the legislation of the EU and the Republic of Latvia. The key principles of the Company's procurement are based on the requirements of Directives 2014/24/EU and 2014/25/EU of the European Parliament and the Council and those of the Law on Procurement of Public Service Providers of the Republic of Latvia. The Company is committed to the most efficient use of funds and, in selecting suppliers, ensures competition and fair and equal treatment and follows the principle of transparency in procurement.

Decisions on procurement procedures are made by the Procurement Commission. The members of the Procurement Commission are autonomous in their decision, and subject to the provision of law and the Company's procurement policy. AST's policies include whistleblowing scheme in which any employee of AST is required to report internally or to the competent law enforcement authority of any influence on the procurement process. There is also a conflict of interest policy in which any employee of AST has a duty to suspend itself from the decision making if there is any conflict of interest. The Company's board does not participate in the Procurement Commission.

By applying PPAD's Procurement Capacity toolkit, the client's risk on procurement has been assessed as Low. All categories i.e. legal framework, organisation of procurement function, support/control systems, staffing, record keeping, procurement planning, procurement cycle, general assessment of the client, and project risk have been assessed.

Contracts risk assessment “Low”

EBRD's green bond investment proceeds will be allocated to refinancing tranche and part of the capex tranche represented by reconstruction and upgrades of existing transmission assets.

Refinancing tranche proceeds will go against 3 already completed contracts, which were co-financed by the EU and competitively tendered in accordance with the Public Service Providers Procurement Law. The team has reviewed the procurement process summary and available procurement documentation and found no major areas of concern.

Capex tranche will cover the following low-value supply and installation contracts planned for implementation in 2022: (1) reconstruction of 110 kV switchboards of existing electricity substations, and (2) replacement of 110 kV restricted availability access and DVS of existing electricity substations.

Project implementation arrangements:

AST will manage all procurement activities under the project and will arrange supervision of works by their experienced project managers and engineers.

Procurement arrangements:

Goods, works and services financed from the Bank's proceeds will be procured using competitive tendering procedures in accordance with the requirements of para 3.10 of Section III, Article 3 of the Bank's Procurement Policies and Rules (PPR) for public sector operations. It is expected that the value of contracts to be procured will be below EUR 250,000 for goods and services and EUR 7.5 million for works and supply and installation. The contracts allocated for finance meet the requirements of para 3.10 of the Bank's PPR which states that alternative procurement procedures in accordance with national law may be the most economic and efficient method in the case of small contracts value; geographically scattered works; goods and works available locally at prices less than the international market; or when the nature and scope of contracts are unlikely to attract foreign competition; and all these apply to the project contracts. The Company will procure the contracts using the national e-procurement system, which is based on the national public procurement rules and regulations applicable to AST. [REDACTED].