

Financial Report

Management Report

This Management Report covers both the requirements pursuant to Art. 961c CO (Code of Obligations) in connection with the statutory financial statements as well as the provisions on the «Annual Report» relating to the financial statements in accordance with Swiss GAAP FER (Swiss GAAP FER framework concept, paragraphs 7 and 34).

Regulatory business model

Legal and regulatory environment

The electricity industry's value chain can basically be divided into the following areas: electricity generation, electricity transmission, electricity distribution and electricity consumption. As the owner and operator of Switzerland's extra-high-voltage grid, Swissgrid is responsible for electricity transmission.

The high investments for the construction of the transmission system, rising economies of scale (in view of falling marginal costs) and high irreversible costs result in a natural monopoly in the area of electricity transmission. This has been structured as a legal monopoly by the legislator based on the Electricity Supply Act (StromVG) and the Electricity Supply Ordinance (StromVV).

The Federal Electricity Commission ElCom oversees compliance with the Electricity Supply Act and the Electricity Supply Ordinance. It is the independent state regulatory authority in the electricity industry and is allowed to issue rulings where necessary, against which there is a right of appeal to the Federal Administrative Court with the possibility of appeal to the Federal Supreme Court.

Given the public interest in the secure national supply of electricity, the resulting legislation and relevant supervision by the regulator, Swissgrid's business activities are overwhelmingly subject to strict regulation.

Business activity

As the National Grid Company, Swissgrid is responsible for the non-discriminatory, reliable and efficient operation of the transmission grid as well as its sustainable and efficient maintenance. The renovation and demand-driven expansion of Switzerland's extra-high-voltage grid are also considered amongst the company's most important tasks.

Swissgrid also provides additional services, such as balance group and congestion management or ancillary services (AS) as part of the European and Swiss grid operations. In addition to representing national interests, Swissgrid makes an important contribution to ensuring the secure supply of electricity for Switzerland.

Cost-plus regulation

Swissgrid's legal mandate and business activities expose the company to costs that can be passed on to the lower grid levels and end consumers in the form of tariff revenues if the regulator deems the costs to be chargeable. ECom has the right to verify ex post the chargeability of Swissgrid's costs for tariff-setting purposes.

Chargeable costs include the operating and capital costs of maintaining a secure and efficient grid. Chargeable costs also include an adequate operating profit. As a result, this is referred to as «cost-plus» regulation: «cost» stands for the cost recovery principle and «plus» stands for the operating profit.

Chargeable operating and capital costs

Chargeable operating costs include the costs for services directly related to the operation of the grid. Examples include costs for maintaining the grid, costs for providing the ancillary services, personnel expenses, costs for materials and third-party supplies as well as direct income taxes.

Chargeable capital costs include depreciation/amortisation and imputed interest. The amount of imputed interest is directly dependent on the assets required to operate the grid (invested operating assets, IOA) and the applicable regulatory interest rate ($WACC_{t+0}$). $WACC_{t+0}$ means that the WACC specified for this year also applies to the current financial year.

In particular, the IOA consists of the transmission grid assets (including construction in progress), intangible assets as well as the net current assets determined on a monthly basis.

Volume- and tariff-related timing differences

Swissgrid calculates the required tariff revenues ex ante based on budgeted costs (operating and capital costs). Volume and price differences between the «actual» situation for a year and the «budgeted» situation for the same year regularly lead to differences between the actual costs and actual income for a year. These differences are referred to as volume- and tariff-related timing differences and are rectified over the coming years. If effective costs exceed the tariff revenues for the same year, this results in a deficit. This deficit can be eliminated over subsequent years by increasing the tariff.

By contrast, if tariff revenues exceed effective costs for the same year, this results in a surplus, which must be used to reduce tariffs over subsequent years.

Volume- and tariff-related timing differences are also subject to interest at the WACC rate and have an impact on capital costs. In contrast to the IOA, volume- and tariff-related timing differences are subject to interest at $WACC_{t+2}$. Deficits increase capital costs, while surpluses reduce them.

Profit regulation

The legal framework in place for Swissgrid means that the EBI (earnings before interest) of the regulated business area is essentially a multiplication of the invested operating assets (IOA) with the capital cost rate ($WACC_{t+0}$) and the interest applied to the volume- and tariff-related timing differences ($WACC_{t+2}$). Additional profits may arise from Swissgrid's unregulated business area.

The EBI is then used to compensate Swissgrid's stakeholders via interest on liabilities and return on equity (dividends and/or profit retention). The cost-plus regulation therefore leads to a return in the

amount of the capital cost rates to be applied.

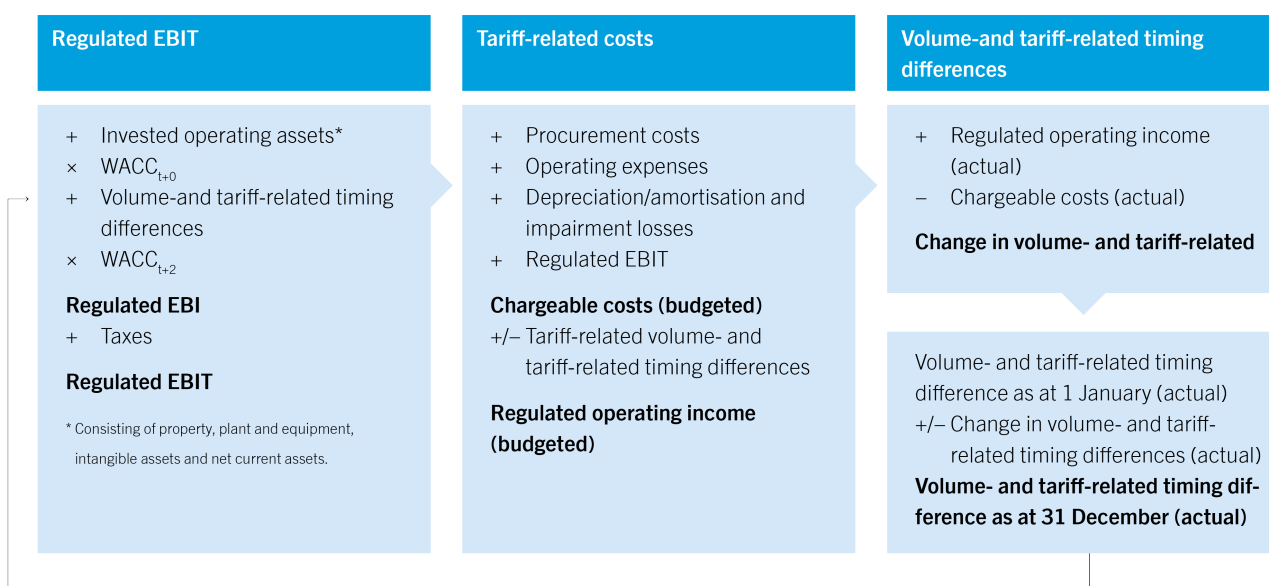
Imputed capital cost rate (WACC)

The WACC is an imputed interest rate defined annually based on the electricity supply legislation. It applies equally to all grid operators.

The WACC is calculated methodically taking account of the current Best Practice guidelines provided by the Federal Department of the Environment, Transport, Energy and Communications (DETEC). The methodology was developed specifically for the regulation of electricity grid operators and intends to ensure security of investment for these operators. With regard to the financing structure, the WACC calculation assumes an equity share of 40 per cent and a borrowed capital share of 60 per cent. Specific thresholds apply for the individual capital cost parameters.

As the WACC represents an imputed interest rate for the electricity industry, Swissgrid's actual capital costs are not included in the tariff calculation. On the other hand, this means that Swissgrid is responsible for determining how the imputed interest received via the tariffs is distributed to shareholders and lenders.

Illustration of the regulatory business model



Business performance (values pursuant to Swiss GAAP FER)

Procurement costs

At CHF 417.5 million, procurement costs are CHF 189.0 million higher than the previous year's value of CHF 228.5 million. This increase is primarily due to higher costs of CHF 161.4 million for control power provision and AS energy in the general ancillary services segment as well as higher procurement costs of CHF 23.3 million for active power loss. The increase in these costs is primarily due to rising electricity prices in the second half of 2021. In the grid utilisation segment, additional remuneration to former transmission system operators rose by CHF 24.6 million compared to the previous year. By contrast, national redispatch costs in the grid utilisation segment and expenses for grid enhancement in the

general ancillary services segment decreased by CHF 13.4 million and CHF 5.4 million respectively in relation to 2020.

Operating expenses and depreciation/amortisation

Operating expenses rose by CHF 3.6 million year on year, from CHF 224.8 million to CHF 228.4 million.

At CHF 94.5 million, costs for materials and third-party supplies remained unchanged from the previous year. In the 2021 financial year, remuneration for easements, including easement management services performed by third parties, declined by CHF 7.8 million year on year. By contrast, expenses for projects, advisory services and non-cash benefits increased due to the implementation of Strategy 2022 measures. The implementation of Strategy 2022 includes measures to secure the supply of electricity and improve the safety of people, systems and the environment. For the same reason, personnel expenses increased by CHF 4.4 million compared to the previous year. The annual average number of full-time equivalents in 2021 amounts to 582.4 FTE (previous year: 540.4 FTE).

The scheduled depreciation/amortisation on property, plant and equipment and intangible assets amounted to CHF 179.0 million in 2021, an increase of CHF 24.2 million on the previous year due to the rise in non-current assets.

Revenue and volume- and tariff-related timing differences

For the 2021 financial year, net turnover across all segments amounts to CHF 715.1 million. This represents an increase of CHF 126.9 million in relation to the previous year's figure of CHF 588.2 million.

The rise in turnover is predominantly due to the CHF 65.3 million increase in tariff revenue as well as higher income from auctions for the reduction of chargeable grid costs of CHF 61.1 million in the grid utilisation segment. In addition, the general ancillary services segment recorded growth in income of CHF 28.9 million from balance group balance energy. By contrast, tariff income in the active power loss segment decreased by CHF 29.0 million.

In the 2021 financial year, the operating business activities reported net deficits (cumulative surpluses less cumulative deficits) of CHF 279.7 million (previous year: CHF 107.9 million). In particular, the grid utilisation and general ancillary services segments posted deficits of CHF 122.6 million and CHF 150.6 million respectively due to the higher procurement costs.

As at 31 December 2021, a net deficit of CHF 326.3 million exists (previous year: CHF 55.1).

EBIT, financial income and net income

Earnings before interest and taxes (EBIT) from activities relating to the Federal Electricity Supply Act (StromVG) are equivalent to the interest applied to the assets required to operate the transmission system using the weighted average cost of capital rate (WACC) for the current year under review (= $WACC_{t+0}$) and the interest applied to the volume- and tariff-related timing differences using the weighted average cost of capital rate of $WACC_{t+2}$ plus income taxes. The weighted average cost of capital rates for 2021 ($WACC_{t+0}$) and 2023 ($WACC_{t+2}$) defined by the Federal Department of the Environment, Transport, Energy and Communications (DETEC) for the 2021 financial year remain unchanged at 3.83%. In 2021, EBIT increased by CHF 87.6 million from the previous year's value of CHF 116.7 million to CHF 204.3 million. The higher EBIT is due in particular to regulatory effects arising from the final remuneration paid for the grid takeovers. Due to the interest of CHF 30.3 million to be

paid for previous years in connection with the grid takeovers, financial expenses rose to CHF 53.5 million (previous year: CHF 26.0 million). Net income in 2021 amounts to CHF 106.2 million, up from the previous year's figure of CHF 75.7 million.

Balance sheet and cash flow statement

Total assets (excluding fiduciary positions) increased by CHF 449.5 million compared to the previous year to CHF 3.522 billion. The absolute equity base was again strengthened by the positive net income less dividends paid. Adjusted for the balance sheet items held on a fiduciary basis and volume- and tariff-related timing differences, the equity ratio on 31 December 2021 amounts to 35.7%, as compared to 39.1% on 31 December 2020. The decrease in the equity ratio is due to the higher total assets and to early refinancing to cover liquidity requirements at the beginning of 2022.

In 2021, cash flow from operating activities amounts to CHF 172.2 million, an increase of CHF 34.3 million compared to the previous year's value. This increase is due to higher net cash inflows from operating activities.

Cash flow from investing activities amounts to CHF 203.9 million in the year under review; a CHF 59.0 million increase on the previous year. This is attributable to higher net investments in property, plant and equipment and intangible assets. Despite the ongoing coronavirus pandemic, Swissgrid managed to make important progress on the grid construction projects relating to the «Strategic Grid 2025» (including the «Chamoson – Chippis» and «Pradella – La Punt» projects), thereby increasing the level of investment.

In 2021, cash flow from financing activities amounts to CHF 104.2 million (previous year: CHF –22.0 million). This was due to the refinancing measures implemented in 2021, with three bonds totalling CHF 360 million.

Risk assessment

Risk management is an integral part of effective and prudent corporate management for Swissgrid. Swissgrid's risk management covers the entire organisation, not including its subsidiaries and shareholdings. It is based on the established ISO 31000 and COSO ERM standards and meets the requirements of corporate governance as well as the requirements under Swiss law.

Objectives

The Risk Management unit assists managers at all tiers in consciously dealing with risks. This includes expedient and transparent reporting as well as managing an appropriate risk management system. Swissgrid fosters the deliberate management of risks at all levels of the company.

Organisation

The Board of Directors has defined the governance requirements for risk management and delegated its implementation to the CEO. The head of Enterprise Risk Management manages the risk management process, provides the methods and advises the operating units on risk management.

Process

The risk assessment takes place twice a year. The key risks are identified and assessed as part of a multi-stage process that includes the evaluation of risks based on the probability of their occurrence

and the extent of their impact, as well as the definition of strategies to manage said risks.

Risk monitoring, including the effectiveness and level of implementation of the measures taken, is performed as part of regular risk updates. The Executive Board and the Board of Directors receive the results of the risk assessment and the risk updates in the form of a standardised report.

Risk situation

The coronavirus pandemic is not just a risk to employee health, but also to the operation of the transmission system. The risk drivers include a shortage of employees in critical functions. In response, Swissgrid acted early to protect these employees in particular and to make up for any shortfalls.

Besides the new risks stemming from the pandemic, the other risks remain relevant for Swissgrid. The drivers for these risks are natural influences, the national and international political and regulatory environment as well as personnel and technical factors. Digitisation is enabling more efficient operation of the transmission grid, but also involves risks to grid and system security and therefore to the security of supply, given the increasing dependence on systems.

The key risk factors are:

European and regulatory environment

Swissgrid's role remains challenging at a national and international level. Due to the breakdown in negotiations on a framework agreement, the conclusion of an electricity agreement cannot be expected within a reasonable period of time. Consequently, the Swiss electricity system finds itself increasingly excluded from important processes affecting grid security in Europe. This leads to higher unscheduled flows of electricity through the Swiss grid and jeopardises both system stability and import capacity in the medium term. There is also the risk of exclusion from the European control energy partnerships as well as from ENTSO-E, the European Network of Transmission System Operators. Swissgrid is developing technical solutions and negotiating private-law agreements with other transmission system operators to ensure the stability of the grid, but is reliant on political support in this respect. Success is not guaranteed as there are political factors to resolve that fall outside the control of Swissgrid. Private-law agreements between transmission system operators are not an adequate substitute for an electricity agreement in the long term.

Security of supply

A wide-scale supply outage would cause enormous economic damage. As a result, Swissgrid must ensure that the transmission grid is available to supply electricity at all times. It is therefore essential to have an intact grid infrastructure and to secure the availability of IT and communication systems. Meeting these prerequisites can be jeopardised by, for example, technical problems, natural disasters, operating errors and criminal actions. Among other measures, Swissgrid mitigates these risks by implementing redundancies and standardised processes to eliminate faults in grid systems and in system operations. Adequate training and development of personnel ensures that employees respond appropriately.

In 2021, there were several challenging situations in the European electricity system that could have led to wide-scale supply outages if the outcome had not been favourable. As part of its cooperation within ENTSO-E, Swissgrid, in its role as Coordination Center South, investigated the events in association with the other European transmission system operators and derived measures to avoid such

situations as far as possible or to be able to deal with them more effectively.

Security of supply also depends on the availability of control and redispatch services to balance short-term deviations between production and consumption, and to control grid congestion. Swissgrid therefore works continuously to optimise the Swiss market for ancillary services, and cooperates with transmission system operators in neighbouring countries to increase market liquidity.

Swissgrid takes precautions to protect the infrastructure against physical attacks. These include securing buildings and plants as well as access control and monitoring.

The threat of cyber-attacks is steadily rising due to the speed at which technology changes (which potential attackers also exploit), the countless possible modes of attack, as well as growing system integration across companies. To reduce this risk, Swissgrid is continuously developing its processes and systems to detect cyber threats early and defend itself against them.

Swissgrid has emergency procedures in place in the highly unlikely event that infrastructures or systems fail permanently or the grid can no longer be controlled.

Grid capacity

Important activities relating to the «Strategic Grid 2025» continue to be hampered by protracted approval processes and numerous objections. This makes it more difficult to eliminate grid congestion. Swissgrid is striving to establish dialogue, particularly with local residents, during the approval process. However, given the ever-decreasing acceptance of overhead lines, Swissgrid still has to factor in objections and delayed approval processes.

The progressive ageing of existing components represents another risk to grid capacity. Swissgrid therefore systematically records the condition of its plants and prioritises modernisation measures accordingly.

Personnel safety

Swissgrid's operation and maintenance of the extra-high-voltage infrastructure involves risks to personnel safety. People can be seriously injured while performing their work. To minimise this risk to the greatest extent possible, Swissgrid systematically identifies present dangers, implements targeted protective measures, trains its own employees and instructs contractor employees so they can independently identify the dangers posed at plants and respond accordingly. Systematic controls on construction sites help to ensure compliance with site safety precautions.

Financial risks

Swissgrid's activities mean that it is exposed to various financial risks. These include liquidity, foreign currency, interest rate and counterparty risks.

Liquidity is ensured at all times by continuous planning and monitoring of the funding requirements, maintenance of minimum liquidity levels and the provision of confirmed bank credit facilities.

Foreign currency risk is reduced through natural hedging and forward exchange transactions. The hedging strategy is reviewed periodically and updated as needed.

The risk of interest rate changes is reduced by staggering the maturities and establishing a balanced

financing mix. Derivative financial instruments are deployed for further mitigation if necessary.

Financial counterparties are constantly reviewed, assigned individual limits and monitored. Operational counterparties are regularly monitored.

Future prospects

Strategic outlook

The energy sector in Switzerland is undergoing a transformation: the lack of planning reliability and the move towards decentralised electricity generation are leading to new requirements for transmission grid operations. Intelligent technologies can be very useful in this increasingly complex environment, for example to optimise forecasts in grid operations or to integrate small and flexible energy resources into the energy system that can be used to ensure grid stability. Changes in electricity generation also require an adjustment of the grid infrastructure so that grid operators can guarantee security of supply in the future. At the same time, the EU and Switzerland are modifying the political and regulatory requirements for the electricity industry. The EU is pursuing the goal of decarbonising the energy industry and creating a single European electricity market. As part of the European interconnected grid, Switzerland is directly affected by these developments.

In order to tackle these changes and trends, in 2018 Swissgrid launched Strategy 2022, which is now in its final year of implementation. The strategy aims to achieve the following long-term corporate objectives: a high level of safety and security for employees and the plants, a consistently stable and available transmission grid, the optimisation of the grid by taking innovative technical, structural and market-based measures, as well as efficient and effective business activities.

The «safety first» principle applies at Swissgrid. The Safety Culture Ladder, an assessment method that measures general safety awareness, was introduced to improve safety in the company. Swissgrid is aiming to achieve certification in 2022. The company is also continuing projects to improve physical protection and cyber-security. At the same time, the requirements of the revised Data Protection Act are being implemented.

In order to ensure a high level of security of supply in the future, Swissgrid is committed to maintaining close cooperation with its European partners. The aim is to prevent or at least delay the exclusion of Swissgrid from important European platforms and bodies due to the lack of an electricity agreement. In 2022, the focus will also be on measures in the areas of business continuity management and disaster recovery. Several radio relay links will be installed for the emergency communication network in the course of the next year.

In order to optimise the existing and future grid, Swissgrid is consistently pursuing the continued development of plant management decided on in 2018 with the aim of increasing investment in infrastructure. Two important projects to ensure security of supply will soon be commissioned: the line between Chamoson and Chippis and the connection to the Nant de Drance pumped storage power plant. This will allow energy generated from Valais hydropower to be transported to consumption centres in central Switzerland. Swissgrid is also promoting various digitisation initiatives to increase management efficiency and effectiveness. Over the next year, Swissgrid will also start planning its Strategic Grid 2040 on the basis of the «Scenario Framework Switzerland» published in autumn 2021.

Its goal is to increase efficiency and effectiveness not only in the management of the grid, but throughout the entire company. This will also involve replacing the enterprise resource planning system with an intelligent, integrated «end-to-end» solution. The project will continue to be implemented in 2022.

In the course of the next year, Swissgrid will complete the development of its Strategy 2027, which will be published in the autumn. It will focus partly on sustainability within the company. In 2022, Swissgrid will develop its vision and future strategy for corporate social and environmental responsibility as part of its 2027 corporate strategy.

Research and development

Swissgrid collaborates with national and international research institutions to ensure that it can continue performing its duties safely and cost-effectively in the future. Its project portfolio is aligned with its strategic goals, and consists of internal activities and projects being conducted in cooperation with universities and other Swiss partners.

Financial outlook

Grid investments

Investment volumes are expected to remain high due to the need to achieve a sustainable energy future and carry out the measures defined in the «Strategic Grid 2025» report. Permits for power line construction and modification continue to pose a major challenge. The budget has therefore been assigned a lower likelihood of realisation to take delays into account. Consequently, investments in the grid are expected to increase by between CHF 175 million and CHF 275 million a year over the medium term.

Operating costs

Swissgrid continues to implement its Strategy 2022, as communicated in the spring of 2018. This includes efficiency increases as well as measures to secure the supply of electricity and improve the safety of people, systems and the environment. Implementing these measures will lead to a rise in operating costs.

EBIT and net income

Based on the regulatory business model, EBIT is directly dependent on the invested operating assets (IOA) and the weighted average capital cost rate (WACC). The WACC communicated by the Federal Department of the Environment, Transport, Energy and Communications (DETEC) for 2022 remains unchanged at 3.83%. Due to one-off regulatory effects arising from the final remuneration paid in 2021 for the grid takeovers, lower EBIT and a lower net income are expected in 2022.

In accordance with the dividend policy approved by the Board of Directors, the income generated will be retained in the long term on a pro rata basis depending on the equity ratio and the financing situation. This safeguards Swissgrid's long-term financial stability.