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). To strengthen the supply of electricity in Switzerland, the Ordinance on the Establishment of a Hydropower Reserve (WResV) was also enacted in February 2023.

The Federal Electricity Commission ElCom oversees compliance with StromVG, StromVW and WResV. 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 European and Swiss interconnected 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. ElCom 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. The chargeable costs according to StromVG and StromVV 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. The cost recovery principle applies to the chargeable costs according to WResV.

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 according to StromVG and StromVV 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. Volume- and tariff-related timing differences resulting from the implementation of the specified measures from WResV are not subject to interest.

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.

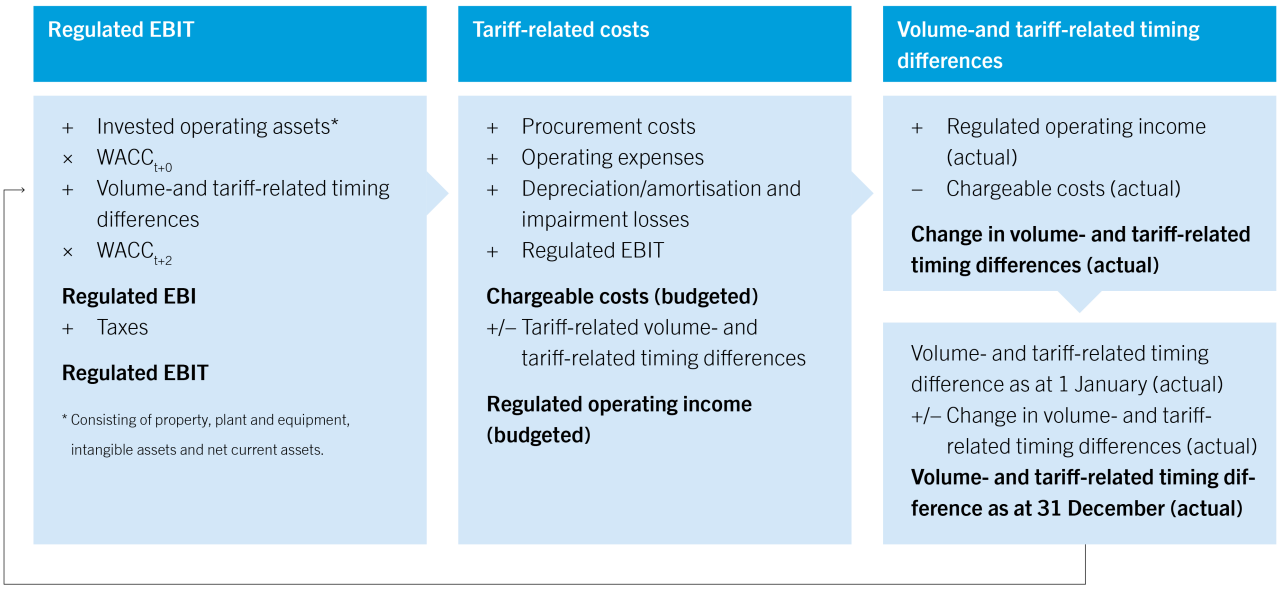
Imputed capital cost rate (WACC)

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 866.2 million, procurement costs are CHF 448.7 million higher than the previous year's value of CHF 417.5 million. This increase is primarily due to higher costs of CHF 345.0 million for control power

provision and for AS energy in the general ancillary services segment as well as higher procurement costs of CHF 156.7 million for active power loss. The higher costs are mainly attributable to the persistently high electricity prices caused by geopolitical developments and the limited power plant capacities. In contrast, costs in the grid usage and reactive energy segments fell by a total of CHF 47.9 million. In addition to lower costs for national redispatch and costs for the procurement of reactive energy, no additional remuneration was paid to former transmission system owners in 2022.

Operating expenses and depreciation/amortisation

Operating expenses rose by CHF 22.2 million year on year, from CHF 228.4 million to CHF 250.6 million. The increase is mainly due to the consistent implementation of Strategy 2022 and the resulting higher costs in materials and third-party supplies and in personnel expenses. The implementation of Strategy 2022 included measures to secure the supply of electricity and improve the safety of people, systems and the environment. The annual average number of full-time equivalents in 2022 amounts to 630.9 FTE (previous year: 582.4 FTE).

The scheduled depreciation/amortisation on property, plant and equipment and intangible assets amounted to CHF 155.7 million in the reporting year, a decrease of CHF 23.3 million in relation to the previous year. This decline is mainly attributable to assets that had already been fully depreciated in the previous year.

Revenue and volume- and tariff-related timing differences

For the 2022 financial year, net turnover across all segments amounts to CHF 987.1 million. This represents an increase of CHF 272.0 million in relation to the previous year's figure of CHF 715.1 million. The rise is due to higher tariff revenues in the grid usage segment (CHF 115.1 million), higher income from balance group/balancing energy in the general ancillary services segment (CHF 73.6 million) and higher auction income to cover the chargeable costs of the transmission system (CHF 74.6 million). Based on the ElCom ruling issued on 8 November 2022, the auction income received in 2022 was allocated for the first time not only to the grid usage segment, but also to the general ancillary services and active power loss segments.

In the 2022 financial year, the operating business activities reported net deficits (cumulative deficits less cumulative surpluses) of CHF 370.7 million (previous year: CHF 279.7 million). In particular, the general ancillary services and active power loss segments posted deficits of CHF 346.9 million and CHF 134.3 million respectively due to the higher procurement costs. As at 31 December 2022, a net deficit of CHF 747.7 million exists (previous year: CHF 326.3 million).

EBIT, financial income and net income

Earnings before interest and taxes (EBIT) from activities relating to the Electricity Supply Act (StromVG) are equivalent to the interest applied to the assets required for grid operations 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 defined by the Federal Department of the Environment, Transport, Energy and Communications (DETEC) for the 2022 financial year are 3.83% for 2022 ($WACC_{t+0}$) and 4.13% for 2024 ($WACC_{t+2}$). In 2022, EBIT decreased by CHF 79.1 million from the previous year's value of CHF 204.3 million to CHF 125.2 million. Financial expenses fell to CHF 14.7 million (previous year: CHF 53.5 million) due to the further partial repayment of convertible loans at the beginning of 2022 and the interest to be paid for the previous year in connection with the grid takeovers. Net income in 2022 amounts to CHF 96.4 million, down from the

previous year's figure of CHF 106.2 million.

Balance sheet and cash flow statement

Total assets (excluding fiduciary positions) increased by CHF 314.7 million compared to the previous year to CHF 3'836.5 billion. The absolute equity base was further 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 2022 amounts to 33.9%, as compared to 35.7% on 31 December 2021. The decrease in the equity ratio is due to the higher total assets resulting from the increase in volume- and tariff-related timing differences as well as to early refinancing to cover liquidity needs.

In 2022, cash flow from operating activities amounts to CHF -149.3 million, a decrease of CHF 321.5 million compared to the previous year's value. The decline is due to the high procurement costs from operating activities. On the one hand, with a gross investment volume of CHF 257.4 million, Swissgrid has again realised more investments than in the previous year.

On the other hand, the auction income received for the maintenance and expansion of the transmission grid has also increased, which is why cash flow from investing activities of CHF -3.9 million was generated in 2022 (previous year: CHF -203.9 million).

To cover liquidity requirements, financial liabilities rose by CHF 120.4 million compared to the previous year. After deduction of the dividend and interest paid, cash flow from financing activities stood at CHF 53.4 million in the reporting year (previous year: CHF 104.2 million).

Risk assessment

Risk management is an integral part of effective and prudent corporate management for Swissgrid. It 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 risk of a power shortage is rising due to the conflict in Ukraine and the associated loss of Russian gas imports to Europe, as well as the low availability of French nuclear power stations. The situation can worsen as a result of persistent dry weather and a «Dunkelflaute» in Europe, i.e. a period without any wind or photovoltaic production. This is especially true in the winter months, when Switzerland is dependent on electricity imports.

The resulting massive distortions on the European energy markets increase the likelihood that the volume of energy on offer could be insufficient. In order to keep the grid stable and supply it with the necessary volume of electrical energy at all times, Swissgrid implements the following measures to strengthen security of supply, partly also on behalf of the federal government:

– Early procurement of sufficient control energy to keep the generation and consumption of energy in the electricity grid constantly balanced in the short term.
– Temporary increases in the operating voltage on selected lines in the transmission system to increase transfer capacity in emergency situations.
– Creation of energy reserves outside the market (hydropower reserve in the event of extraordinary shortage situations and an additional energy reserve using reserve power plants).
– Preparations to operate a national virtual reserve power plant from emergency power units.

In addition to the increased risk associated with security of supply and financial liquidity (see the «Financial risks» section), the existing 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. Digitalisation is enabling more efficient operation of the transmission grid, but also involves risks to grid and system security and therefore to security of supply, given the increasing dependence on systems. The measures taken during the coronavirus pandemic and the epidemiological development have meanwhile led to an easing of the risk to the health of employees, which also has a positive effect on the operation of the transmission system. 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 aspects to resolve at a political level 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. Consequently, Swissgrid must

keep the transmission system available for the supply of 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 the recent past, there have been several challenging situations in the European electricity system that could have led to large-scale supply outages. 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 power 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. As far as approval processes are concerned, Swissgrid relies above all on dialogue with local residents. However, given that the acceptance of overhead lines is often low, 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 plans 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, 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 local inspections help to ensure compliance with safety precautions on building sites.

Financial risks

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

Depending on the financial volume and timing, the financial implementation of the measures envisaged by the federal government – in particular the hydropower reserve and the reserve power plants – may mean that Swissgrid has to provide interim financing for these resources, which are to be funded via tariff revenues. Swissgrid therefore took measures at an early stage to ensure liquidity at all times by means of intensified continuous planning, close monitoring of the funding requirements, an increase in 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

In 2023, Swissgrid is launching its Strategy 2027, which marks the beginning of a new, five-year strategy period. The last ten years have been shaped by the transfer of the grids from the former owners and the subsequent development and consolidation phase.

Swissgrid has defined five closely interrelated strategic priorities for its new strategy. Four strategic priorities already existed as part of Strategy 2022: «Security of Supply», «Grid Transfer Capacity», «Operational Excellence» and «Safety & Security». A new priority, «Innovation & Digitalisation», has now also been added.

A comprehensive analysis of the strategic areas of action, as well as detailed information on the five priorities, can be found under Strategy 2027.

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 in order to take delays into account. Consequently,

investments in the grid are expected to increase by between CHF 200 million and CHF 290 million a year over the medium term.

Operating costs
Swissgrid successfully implemented its Strategy 2022, as communicated in the spring of 2018, by the end of the reporting year. This has enabled the company to establish a solid basis from which to start tackling the challenges it faces in a rapidly changing energy system with its new Strategy 2027. 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 2023 remains unchanged at 3.83%. Consequently, an EBIT or net income in line with 2022 is expected for 2023.

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.