SPHERA FRANCHISE GROUP SA

CONSOLIDATED DIRECTORS' REPORT

Prepared in accordance with Ministry of Public Finance Order no. 2844/2016

Year ended 31 December 2018

21 MAR. 2019

Signed for identification

All amounts in RON thousand, unless specified otherwise

1. CORPORATE INFORMATION

Sphera Franchise Group SA together with its subsidiaries: US Food Network SA ("USFN"), US Food Network SRL Italy ("USFN Italy"), US Food Network SRL Moldova ("USFN Moldova, California Fresh Flavours SRL ("Taco Bell") and American Restaurant System SA ("ARS") form "the Group" (or "SFG").

Sphera Franchise Group SA ("the legal Parent", "Sphera" or „Company") was incorporated on 16 May 2017 by the shareholders of USFN and ARS as a joint stock company and is registered at No. 239 Calea Dorobanti, Bucharest, Romania. Sphera Franchise Group SA is listed on Bucharest Stock Exchange.

The Group operates quick service and takeaway restaurant concepts (a chain of 88 restaurants) under the Kentucky Fried Chicken ("KFC"), spread across Romania as well as in the Republic of Moldova and in Italy. The Group also operates a chain of pizza restaurants (23 restaurants as at 31 December 2018) as well as pizza delivery points (22 locations as at 31 December 2018) under the Pizza Hut ("PH") and Pizza Hut Delivery ("PHD") brands, spread across Romania, one chain of restaurants under the "Taco Bell" brand (5 restaurants as at 31 December 2018) and one restaurant under Paul brand, in Romania. The Group's number of employees at 31 December 2018 was 5,514 (31 December 2017: 4,492).

The purpose of the Group reorganization that took place in 2017 and resulted in the establishment of Sphera as the legal parent company of US Food Network SA (USFN), American Restaurant System SA (ARS), US Food Network SRL (USFN Italy or Italian subsidiary), US Food Network SRL (USFN Moldova or Moldavian subsidiary) and California Fresh Flavors SRL (Taco Bell) was to ensure a better coordination of activities and enhance value creation, by taking advantage of the synergies at group level and by achieving economies of scale. In terms of activities, Sphera took over gradually until the end of September 2017 certain activities as well as employees from USFN and ARS and renders to the benefit of the Group entities services such as management services, marketing support, development, sales support, human resources and other services.

2. GROUP STRUCTURE

Details of the Group consolidated subsidiaries at 31 December 2018 and 31 December 2017 are as follows:

Company name	Country of incorporation	Field of activity	Control 31 December 2018	Control 31 December 2017
US Food Network SA	Romania	Restaurants	99.9997%	99.9997%
American Restaurant System SA	Romania	Restaurants	99.9997%	99.9997%
California Fresh Flavours SRL	Romania	Restaurants	99.9900%	99.9900%
US Food Network SRL	Moldova	Restaurants	80.0000%	80.0000%
US Food Network SRL	Italy	Restaurants	100.0000%	100.0000%

Sphera has become the parent company of USFN and ARS on 30 May 2017, following the contribution by shareholders of USFN and ARS of 99.9997% of the shares in the two companies in exchange for shares in Sphera. On 8 June 2017 and 14 June 2017, Sphera purchased the shares held by USFN in US Food Network SRL (Republic of Moldova) and respectively US Food Network SRL (Italy).

USFN was incorporated in 1994 as a joint stock company and is registered at No. 28-30 Gheorghe Magheru Boulevard, Bucharest, Romania. For the purpose of preparing IFRS consolidated financial statements, USFN has been identified as being the acquirer of ARS on 30 May 2017, in accordance with the requirements of IFRS 3.

ARS' was incorporated in 1994 as a joint stock company and is registered at No. 5-7 Calea Dorobantilor Street, Bucharest, Romania.

The Moldavian subsidiary was incorporated in 2008 as a limited liability company and is registered at No. 45 Banulescu Bodoni Street, Chisinau, Republic of Moldova. The Group owns 80% of the company's shares.

The Italian subsidiary was incorporated in 2016 as a limited liability company and is registered at No. 6 Via Pietro Paleocapa Street, Milano, Italy. The Group owns 100% of the company's shares.

The Group's new subsidiary, California Fresh Flavors SRL ("Taco Bell"), was incorporated as a limited liability company on 19 June 2017 is registered at No. 239 Calea Dorobanti, Bucharest, Romania. Sphera holds 9,999 shares of its 10,000 shares (99.99% holding).

3. SHAREHOLDERS AND ISSUED CAPITAL

The shareholders of Sphera at 31 December 2018 and 31 December 2017, respectively are: Tatika Investments Ltd. (27.33%), Computerland Romania SRL (formerly named M.B.L. Computers SRL) (20%), Wellkept Group SA (16.34%), Anasa Properties SRL (10.99%) and free float (25.34%).

	31 December 2018	31 December 2017
Authorised shares		
Ordinary shares of 15 RON each	38,799,340	38,799,340
Share capital (RON thousand)	581,990	581,990

Starting November 9, 2017, 25.34% of the Group's shares (representing 9.831.753 shares), were admitted for trading on the Bucharest Stock Exchange following to a secondary public offer initiated by the shareholders Lunic Franchising and Consulting Ltd. and Computerland Romania SR (formerly named M.B.L. Computers SRL).

4. CORPORATE GOVERNANCE

The Group adhered to the Corporate Governance Code issued by the Bucharest Stock Exchange and applies the principles of corporate governance provided by the Code.

The Group has taken and will continue to take the professional, legal and administrative steps necessary for ensuring compliance with the provisions of the Code.

More details about the compliance with the principles and recommendations stipulated under the Corporate Governance Code issued by the Bucharest Stock Exchange will be presented in the Group's Annual Report.

All amounts in RON thousand, unless specified otherwise

5. MANAGEMENT OF THE GROUP

Company is managed by the Board of Directors. Its members are appointed for a mandate of 2 years.

The structure of the Board of Directors as of 31 December 2018 was the following:

Name	Date of appointment	Title	Role
Cristian Osiac	16 May 2017	Chairman of the BoD	Executive member
Lucian Hoanca	25 October 2018	Member of the BoD	Non-executive member
Mark Nicholas Hilton	16 May 2017	Vice-Chairman of the BoD	Executive member
Silviu Gabriel Cârmaciu	16 May 2017	Member of the BoD	Non-executive member
Ion Marius Nasta	16 May 2017	Member of the BoD	Non-executive member
Stere Constantin Farmache	26 April 2018	Member of the BoD	Independent member
Razvan Stefan Lefter	16 November 2018	Member of the BoD	Independent member

On 26 April 2018, the General Shareholders Meeting decided to appoint Mr. Stere Constantin Farmache for the vacancy of an independent member of the Board of Directors of the Company following the resignation from independent director mandate of Elyakim Davidai for a period equal to the remaining period until the expiry of the mandate of the vacant position respectively 5 October 2019.

On 12 September 2018, Stylianos Bairaktairis announced his resignation from the position of Director, as member of the Board of Directors of the Company, effective from 25 October 2018.
As a result of the vacancy of the Director position, on 4 October 2018, the Board of Directors decided on the appointment of Mr. Lucian Hoanca as „ad-interim" Director of the Company, member of the Board of Directors, starting with 25 Ocotber 2018. The mandate shall be valid until the date on which the General Shareholders Meeting decides to appoint a member of the Board of Directors.

On 4 October 2018, Kostantinos Mitzalis notified the Company about his resignation from the position of Director, member of the Board of Directors, effective on 16 November 2018.
Starting with 16 November, Mr. Razvan Stefan Lefter is appointed as „ad-interim" Director of the Company, member of the Board of Directors for a priod of 6 months or until the General Shareholders Meeting shall appoint the new member of the Board of Directors, whichever occurs first.

The Board of Directors delegates the management of the Company to managers who fulfil their functions based on mandate contracts. The list of persons holding management positions is presented below:

Name	Title	Date of Appointment
Mark Nicholas Hilton	Chief Executive Officer (CEO)	16 May 2017
Daniel Palita	Interim Chief Financial Officer (CFO)	4 October 2018
Cristian Osiac	Chief Development Officer (CDO)	15 June 2017
Călin Viorel Ionescu	Chief Operating Officer (COO)	29 August 2017
Oana Monica Eftimie	Chief Marketing Officer (CMO)	29 August 2017

Starting with 4^{th} October 2018, the Board of Directors of the Company has appointed Mr. Daniel Palita as "ad-interim" Chief Financial Officer, following the resignation of Mr. Stylianos Bairaktaris from the position of Chief Financial Officer effective as of 3^{rd} October 2018.

Consultative committees

The BoD established an Audit Committee and a Nomination and Remuneration Committee. Each of the Audit Committee and the Nomination and Remuneration Committee comprises three members of the BoD, of which one is elected chairman. All members of the Audit Committee are non-executive BoD members. The main duties and responsibilities of the committees are presented in the Annual Report.

6. PRINCIPAL SCOPE OF BUSINESS

The Group's franchised foodservice business was launched in 1994 with the opening of the first Pizza Hut location, which was followed by the opening in 1997 of the first KFC location, both in Bucharest. As at 31 December 2018, the Group operates 139 restaurants, of which 88 KFC restaurants (76 restaurants located in Romania, 2 restaurants located in the Republic of Moldova and 10 restaurants in Italy), 45 Pizza Hut units (of which 22 are delivery units), 5 Taco Bell units and_one restaurant under Paul brand. Through USFN (Romania), with consolidated restaurant sales of RON 586 million in 2018, we are the second largest restaurant group in the quick-service restaurant sector in Romania and, through ARS (Romania), with restaurant sales of RON 123 million in 2018, we are the largest restaurant group in the full-service restaurant sector in Romania.

Our business is conducted through the following segments:
- Quick-service restaurants - through our KFC restaurants (in Romania, the Republic of Moldova, and Italy) and Taco Bell restaurants (in Romania);
- Full-service restaurants - through our Pizza Hut Dine-In restaurants in Romania;
- Delivery restaurants - through our Pizza Hut delivery units in Romania.

KFC is the leading chicken restaurant chain in Romania in terms of both total sales and number of restaurants. The first KFC restaurant in Romania opened in 1997 in Bucharest and, at the end of 2018, there were 76 KFC restaurants in Romania. In 2008, we opened the first KFC restaurant in the Republic of Moldova, where we currently operate two restaurants (both in Chisinau), while in 2017 we opened our first two restaurants in Italy, where we currently operate ten restaurants spread accros the northern region of Italy.

Of the 76 KFC restaurants operating in Romania as at 31 December 2018, 49 are food court locations (in malls or commercial centres), 14 are inline (street locations), while another 13 are Drive-Thru locations. In 2018, KFC Romania has also lunched the delivery activity. KFC delivery services has extended in Bucharest and Cluj and now operate 16 stores in Bucharest (covering 70% of the city) and 5 stores outside Bucharest (3 in Cluj and 2 in Oradea) with growing contribution to sales.

In our KFC restaurants, we sell food and beverages products either individually or part of a price-attractive bundle labelled "menu". Generally, the menus include three main components: a portion of a chicken-based product (sandwiches, wrappers or pieces of chicken meat), a medium-sized portion of French fries and a medium-sized non-alcoholic drink. For an additional price, our customers can choose to opt for the "Go Large" version of the menu, which consists of large-sized portions of French fries and non-alcoholic drink. A dipping sauce is also offered in some menu offers. Whereas menus are normally sized for one person, we also offer products, called Buckets, that are targeted for group consumption (normally, up to four persons). Buckets generally consist of higher number of chicken meat pieces and some include portions of French fries and non-alcoholic drinks.

Pizza Hut is the largest casual dine-in restaurant chain in Romania in terms of both total sales and number of restaurants. The first Pizza Hut Dine-In restaurant opened in 1994 in Bucharest and, as at 31 December 2018, there were 23 Pizza Hut Dine-In restaurants across the major cities of Romania. In 2008, we opened the first delivery restaurant, and by the end of the year 2018, our Pizza Hut Delivery network totalled 22 restaurants.

Of the 23 Pizza Hut Dine-In restaurants operating in Romania as at 31 December 2018, 20 are located near food courts with our dedicated seating (in malls or commercial centres) and 3 are inline (street locations). At the same time, 12 out of the 22 Pizza Hut Delivery restaurants were located within commercial centres, while the remaining 10 were inline locations.

In our Pizza Hut restaurants, we primarily sell pizza (a wide range of traditional and proprietary recipes, on a variety of dough types, such as pan, classic, thin, Italian, cheesy bites, crown crust) and pasta, other main-course products (such as burgers and ribs) as well as beverages (primarily non-alcoholic) and deserts.

All amounts in RON thousand, unless specified otherwise

7. FINANCIAL RESULTS

Consolidated results for the years ended 31 December 2018 and 31 December 2017 are presented below:

	2018	2017
Restaurant sales	771,197	573,175
Restaurant expenses	668,018	480,647
Restaurant operating profit	**103,179**	**92,528**
General and administration expenses, net	73,048	55,925
Operating profit	**30,130**	**36,603**
Finance result	2,996	(1,942)
Profit before tax	**27,135**	**34,661**
Income tax expense	2,874	3,233
Profit for the period	**24,262**	**31,428**
EBITDA	**51,637**	**51,424**
Normalized EBITDA	**72,359**	**65,626**

Consolidated sales of Sphera reached RON 771.2 million for the year 2018, representing an increase of 34.5% compared to the previous year. The main drivers for this performance were the growth in the sales of USFN Romania (KFC restaurants) (+21.5% Y/Y), which had a contribution of 18.1pp in the consolidated sales growth rate, and the consolidation of ARS (Pizza Hut restaurants) sales starting with June 2017, which contributed 9.8pp in the consolidated sales growth rate. Our KFC operations in Italy contributed 4.6pp in the consolidated sales growth rate, while Taco Bell operations in Romania contributed another 1.6pp in the consolidated sales growth rate.

Consolidated operational expenses reached RON 668.0 million in the year 2018, representing an increase of 39.0% compared to the previous year. As percentage of sales, operational expenses increased by 2.8pp year-on-year to 86.6% in the year 2018, driven mainly by a 1.8pp increase in the cost of labour and a 1.2pp increase in other operating expenses, while being partly offset by a 0.3pp decrease in cost of food and materials.

General and administration (G&A) expenses reached RON 73.0 million in the year 2018 (9.5% of sales), up 30.6% compared to previous year (9.8% of sales). Excluding non-recurring expenses, G&A expense reached 52.6 million in the year 2018 (6.8% of sales), up 25.3% compared to the previous year (7.3% of sales).

Non-recurring expenses included in the G&A category amount to RON 20.7m, of which RON 11.5m represents a provision for potential liabilities (VAT and late penalties) that Sphera recognised upon receiving the draft report issued by the tax authorities on 27 February 2019, following the tax audit performed at USFN RO by the fiscal authorities for the periods 2013-2017 (VAT) and 2012-2016 (income tax), RON 8.31m represents an impairment loss in relation with the goodwill recorded on the acquisition of ARS, while another RON 0.95m refer to the compensations claimed in court and paid to a former employee who has suffered injuries in a work accident.

On a stand-alone basis, G&A expenses of the Parent company include an impairment loss of investment in ARS in amount of RON 19.8 million; this impairment loss may be reversed in the future financial years, subject to a better performance of the subsidiary.

All amounts in RON thousand, unless specified otherwise

Net profit reached RON 24.3 million in the year 2018, being 22.8% lower than in the previous year. The net profit margin decreased 2.3pp to 3.1% of sales in the year 2018, in line with the reduction of operating profit margin.

	2018	2017
Operating profit	**30,130**	**36,603**
Adjustments to bridge operating profit to EBITDA:		
Depreciation and amortization included in restaurant expenses	20,458	13,942
Depreciation and amortization included in general and administration expenses	1,049	879
EBITDA	**51,637**	**51,424**
Non-recurring general and administration expenses	20,722	14,202
Normalised EBITDA	**72,359**	**65,626**

Normalized EBITDA advanced 10.3% Y/Y to RON 72.4 million in the year 2018, while EBITDA increased 0.4% Y/Y to RON 51.6 million. Normalized EBITDA margin fell 2.1pp to 9.4% in the year 2018, mainly as a result of a 2.8pp decrease in the restaurant operating profit margin and a 0.5pp improvement in the normalized G&A expenses (as percentage of sales).

A summary of consolidated financial position as of ended 31 December 2018 and 31 December 2017, respectively is presented below:

	31 December 2018	%	31 December 2017	%
Non-current assets	229,173	65%	176,123	71%
Current assets	122,979	35%	73,291	29%
Total assets	**352,152**	100%	**249,609**	100%
Total equity	**128,826**	37%	**104,544**	42%
Non-current liabilities	91,536	26%	42,191	17%
Current liabilities	131,790	37%	102,874	41%
Total liabilities	**223,326**	63%	**145,064**	58%
Total equity and liabilities	**352,152**	100%	**249,609**	100%

Consolidated total assets increased by 41% Y/Y to RON 352.2 million as of 31 December 2018, driven by a 30% Y/Y increase in non-current assets (mainly as a result of the opening of 25 stores) and a 68% in current assets (mainly as a result of higher cash and short-term deposits).

Total liabilities advanced 54% Y/Y to RON 223.3 million as of 31 December 2018, of which 56% were accounted for by interest-bearing loans (up 92% Y/Y to RON 124.5 million, principally to finance the development of the new stores) and another 40% were accounted for by trade and other payables (up 9% Y/Y to RON 87.4 million.

Consolidated total equity grew by 23% Y/Y to RON 128.8 million, as a result of the net profit achieved by the group during the year 2018.

8. KEY FACTORS AFFECTING THE GROUP'S RESULTS OF OPERATIONS

The Group's results of operations have been and are expected to continue to be affected by a number of key factors.

General economic environment in the markets

The Group's results of operations are affected by specific local economic conditions in the markets and geographic areas in which it operates. Such conditions include levels of employment, commodity inflation, real disposable income, private consumption, the availability of consumer credit, consumer confidence, applicable taxes, and consumer willingness to spend. In an unfavourable economic environment with a decrease in disposable income, the Group's customers may reduce the frequency with which they dine out or order-in or may choose more inexpensive dining options. This trend is however offset by the general affordability of our products, as customers may substitute the Group's products for other, more expensive, options. Positive economic conditions, in contrast, tend to increase consumer demand for the Group's products. Changes in general economic conditions therefore affect customer traffic, average ticket price and the Group's ability to pass through cost increases to customers.

Competitive environment

The Group operates in a highly competitive market, particularly with respect to food quality, price, service, convenience and concept, which in turn may be affected by considerations such as changes in consumer preferences. The Group competes against international chains, as well as many national, regional and local businesses in the quick-service, casual dine-in and delivery/takeaway restaurant sectors not only for customers, but also for management and store employees, suitable real estate sites and qualified sub-franchisees. This competition can put downward pressure on product prices and demand for the Group's products as well as upward pressure on wages and rents, resulting in reduced profitability.

Price risk

Cost of sales represents the most significant expense of the Group. Gross margin is affected by a number of factors, including movements in the cost of sales (including with respect to the prices of raw materials), the extent to which the Group can negotiate favourable prices and rebates from suppliers as well as the mix of products that it sells from time to time.

The Group seeks to procure its principal inputs from multiple suppliers, in the event that the Group's primary suppliers cannot deliver the components in the contracted amounts and specifications, the Group's requirements exceed the Group's minimum contracted amounts or the Group is subjected to unanticipated price increases. Prices of the Group's raw materials are generally set by market conditions and the Group is not always able to pass these changes along to the Group's customers, particularly in the short term. The Group seeks to manage factors which put pressure on the Group's gross margin. For example, the Group maintains relationships with additional suppliers.

Payroll

Cost of labour represent our second most important expense and was the fastest growing expense item at restaurant level. It is expected that personnel costs to grow proportionally with the growth of the number of the restaurants and our restaurant revenue complemented by appropriate increase in sales prices. Factors that influence fluctuations in the labour costs include minimum wage and payroll tax legislation, the frequency and severity of labour-related claims, health care costs, the performance of our restaurants, new openings and whether new employees are fixed overhead costs or are restaurant hires.

Marketing and advertising activities

The Group's marketing and advertising activities are an essential part of attracting new customers as well as retaining existing customers. Marketing is particularly important for the Group to communicate its product innovation and price promotion programs to customers and to reinforce the Group's brand awareness, build the Group's image and drive customer volumes. According to the franchise agreements signed so far, the Group is obliged to spend at least 5% of its restaurant sales on marketing and advertising activities.

The effectiveness of the marketing and advertising activities can vary from one year to another and from one campaign to another, depending on the products under promotion, the quality of our communication as well as on the ability of our employees to communicate to customers the ongoing campaigns and promote trade-up products.

The Group also monitors closely the expenditure and frequency of marketing and advertising campaigns by the Group's competition and seeks to maintain a relatively constant presence in the market.

Consumer preferences

Consumer preferences in the quick-service, casual dine-in and delivery/takeaway foodservice segments are affected by a range of factors, including consumer tastes, national, regional and local economic conditions and demographic trends. For instance, prevailing health or dietary preferences may cause consumers to avoid fast-food products or pizza products offered by the Group in favour of foods that are perceived to be healthier. Changes in consumer preferences can significantly impact demand for the Group's products, but this impact may be somehow limited by our exposure to multiple segments of the foodservice sector.

The Group seeks to maintain the appeal of its products to customers through product innovation, characterized by frequent introduction of new product offerings, and the consumer reaction to new product launches can affect the Group's sales.

Accordingly, the Group's results of operations are affected by the Group's success against the Group's competitors in the quick-service, casual dine-in and delivery/takeaway foodservice segments, which is dependent on a variety of factors, including the comparative attractiveness and taste of the Group's products, perceived product and service quality and the availability of comparable products from its competitors. The pricing of the Group's products, and in particular, the timing and terms of specially-priced offers to customers, can have a significant impact on both the volume of the Group's sales and the Group's margins, as well as the Group's market share against competitors.

9. FINANCIAL INSTRUMENTS RISK MANAGEMENT

The Group's principal financial liabilities comprise loans and borrowings, including finance leases and trade and other payables. The main purpose of these financial liabilities is to finance the Group's operations. The Group's financial assets are represented by loans, trade and other receivables, and cash and short-term deposits that derive directly from its operations, as well as long-term deposits to guarantee rent payables.

The Group is exposed to interest rate risk, foreign exchange rate risk, credit risk and liquidity risk. The Group's senior management oversees the management of these risks. The Group's senior management ensures the Group's financial risk activities are performed under appropriate procedures and that financial risks are identified, measured and managed in accordance with Group risk appetite.

Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. Trade and other receivables and payables are non-interest-bearing financial assets and liabilities. The borrowings are usually exposed to interest rate risk through market value fluctuations of interest-bearing long-term and short-term credit facilities. Interest rates on the Group's debt finance are variable. Changes in interest rates impact primarily loans and borrowings by changing either their future cash flows (variable rate debt). Management policy is to resort mainly to variable rate financing. However, at the time of rising new loans or borrowings management uses its judgment to decide whether it believes that fixed or variable rate would be more favourable to the Group over the expected period until maturity.

The Group does not hedge its interest rate risk.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's financing activities, as the financing contracted by the Group is Euro based. The vast majority of revenues and expenses, trade and other receivables and payables is in RON.

The Group monitors the currency risk by following changes in exchange rates in currencies in which its intercompany balances and external debts are denominated. The Group does not have formal arrangements to mitigate its currency risk.

Credit risk

The Group is not significantly exposed to credit risk as the majority of its sales are on a cash basis. The Group's credit risk is primarily attributed to trade and other receivables and balances with banks. The carrying amount of trade and other receivables, net of allowance for impairment and deposits for rent guarantee as per statement of financial position plus balances with banks, represent the maximum amount exposed to credit risk. Management believes that there is no significant risk of loss to the Group beyond the allowances already recorded.

The Group invests cash and cash equivalents with highly reliable financial institutions. The Group has only plain vanilla deposits with reputable banks, none of which has experienced any difficulties in 2018 or up to the date of these consolidated financial statements. The majority of cash is transacted through and placed with Alpha Bank Romania, member of Alpha Bank Group from Greece and Banca Romana de Dezvoltare (BRD), a member of Societe Generale Group from France, as well as with Unicredit Bank Italy. The long-term credit rating of Alpha Bank Greece is Caa2 as provided by Moody's rating agency, no credit rating being available for its Romanian subsidiary. The long-term credit rating of BRD is Baa3, while the one for Unicredit is Baa1, both provided by Moody's

There is no significant concentration of credit risk in respect of trade and other receivables due to the fact that sales are based mainly on cash and credit card payments. Therefore, there are no formal policies in the Group to manage credit risk for trade receivables. The Group's credit risk is primarily attributed to loans and receivables from related parties, for which the probability of losses is considered remote.

Liquidity risk

The Group has adopted a prudent financial liquidity management approach, assuming that sufficient cash and cash equivalents are maintained and that further financing is available from guaranteed funds from credit lines.

At 31 December 2018, the Group had available 47,449 of undrawn uncommitted borrowing facilities (31 December 2017: 25,556), thus being able to respond to any unforeseen higher cash outflow needs.

Capital management

Capital includes the equity attributable to the equity holders of the parent.

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions and the requirements of the financial covenants. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares.

All amounts in RON thousand, unless specified otherwise

The Group may monitor capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Group does not have a target gearing ratio, as the overall gearing is low. The Group includes within net debt, interest bearing loans and borrowings, financial trade and other payables, less cash and cash deposits.

	31 December 2018	31 December 2017
Interest-bearing loans and borrowings	124,456	64,712
Financial trade and other payables	57,615	46,909
Less: cash and short-term deposits	90,665	52,655
Net debt	**91,406**	**58,966**
Equity	128,826	104,544
Capital and net debt	**220,232**	**163,510**
Gearing ratio:	42%	36%

The Group's capital management, amongst other things, aims to ensure that it meets financial covenants attached to the interest-bearing loans and borrowings that define capital structure requirements.

No changes were made in the objectives, policies or processes for managing capital during the years ended 31 December 2018 and 31 December 2017.

Fair values

The Group has no financial instruments carried at fair value in the statement of financial position.

The carrying amount of the interest-bearing loans and borrowings approximate their fair value. Management estimates that the margin applicable over Euribor at the balance sheet date would be similar to the ones at the dates of each previous withdrawal, due to the fact that the Group maintained over the past years a low gearing ratio and a stable financial condition, and also based on statistics published by the National Bank of Romania.

Financial instruments which are not carried at fair value on the statement of financial position also include deposits to guarantee rent, trade and other receivables, cash and cash equivalents, and trade and other payables.

The carrying amounts of these financial instruments are considered to approximate their fair values, due to their short-term nature (in majority) and low transaction costs of these instruments.

10. INTERNAL CONTROL

The Group has implemented an internal control system, which includes activities implemented in order to prevent or detect undesirable events and risks such as fraud, errors, damages, noncompliance, unauthorized transactions and misstatements in financial reporting.

The existence of a control environment forms the basis for an effective internal control system. It consists of the definition and adherence to group-wide values and principles (e.g. business ethics) and of organizational measures (e.g. clear assignment of responsibility and authority, commitment to competence, signature rules and segregation of duties).

Sphera's internal control system covers all areas of Group operations with the following goals:

- Compliance with laws and internal regulations
- Reliability of financial reporting (accuracy, completeness and correct disclosure)
- Prevention and detection of fraud and error
- Effective and efficient business operations.

11. NON-FINANCIAL TOPICS AND DIVERSITY POLICY

Corporate Social Responsibility
Sphera Group has been actively involved in social-related activities for the last ten years and, on the back of the sustained growth and profitability there is a firm commitment to further consolidate as a socially responsible Company. One of our CSR strategic pillars is children's education, which is complemented through several different initiatives as presented on the Company's website www.spheragroup.com.

Environmental protection
The Company's philosophy is to minimise the impact on the environment and leave the smallest footprint possible. There is a strong commitment to create a sustainable business, starting from the way of source the food products to the design, packaging of the final products and how the restaurants are built.

The Company is committed to safety and quality and, in the meantime, to the preservation and protection of the nature and its resources by using only what is necessary, reduce waste and focus each day to enhance the livelihoods of the Company's employees and surrounding communities.

Training and career development for own employees
There is a firm commitment to offer employees the chance for a continuous learning opportunity and personal development that will allow them to continue their career development.

All our new employees go through a thorough training process for familiarizing with overall standards, understand the business and operations as well as the job-specific procedures.

There is an actively sought to create training programs that address not only the job skill set necessary to perform day-to-day tasks within restaurants, but also extended skills such as active responsibility, accountability, time keeping, customer service, communication skills and team work. The training programs across the various brands and geographies that the Group operates come to ensure an effective and decentralized control structure and create an organizational culture that drives workforce engagement.

Diversity policy
Company has developed an internal culture which promotes equal opportunities and diversity in all its processes and functions. Although formal policies are not yet in function, management is guided by the following principles:

- Equal opportunities and fair treatment, meaning no unjust discrimination must exist in recruitment, retention and development of all employees;
- Diversity strategy, built upon inclusion and diversity in what regards open communication, multiples languages spoken, multicultural experience, adherence to equal opportunities principles etc.;
- Equal opportunities, meaning that employees seek and are provided with adequate support for their development, employees with disabilities are provided with necessary accommodation.

Performance evaluation
Compensation of employees is linked with performance. The performance of each employee is evaluated based on measurables indicators. In addition, managers are appraised based on some indicators measuring their abilities to observe principles concerning equal opportunities and adequate management of employees' particular needs and behaviours. Allocation of tasks and projects are done objectively without any bias. Human resources processes support these goals.

12. OTHER INFORMATION

a) Predictable development of the Group

Network rollout

In order to attract new customers and consolidate the brand's market share, the Group plans to continue the expanation of the restaurant network. Over the medium term, the Group intends to keep the rollout of new stores to an annual average of approximately 25 stores. As a result, new store openings have been a significant driver of the Group's revenue growth and will continue to materially affect the results of operations for the foreseeable future.

A significant component of future network rollout will be the development of the restaurant network in the North-Eastern part of Italy. During the first half of the year 2017, the Group have signed two development agreements with Yum! for opening at least 32 KFC stores within five years. During 2018, the Group has opened 8 new stores in Italy consolidating the brand position on the Italian market.

In 2017 the Group signed a new franchise agreement with Yum! and brought on the Romanian market the Taco Bell brand with the commitment to open 10 Taco Bell restaurants within the following three years. In 2018, the Taco Bell network was extended from 2 stores to 5.

Performance of existing restaurants

The growth of our revenues over the past period was driven almost equally by opening of new restaurants and the strong like-for-like performance of our existing restaurants. KFC was the main contributor to this performance, both in terms of store count and year-on-year growth rates.

In the following years, we expect the like-for-like performance to be influenced positively by the continuous improvement in the purchasing power of the population, higher propensity for dining-out or delivery ordering, increased awareness of our brands across the territories we operate and negatively by the number and speed with which we open new units in cities where we are already present, as well as by the increased competition

b) Environmental matters

As of 31 December 2018, the Group incurs no debts relating to anticipated costs for environmental aspects. The Group does not consider that costs relating to environmental aspects are significant.

13. NON-FINANCIAL STATEMENT

In accordance with legal requirements, the Company will publish the Non-financial Statement no later than six months after the reporting date, 31 December 2018, as part of Annual Report.

14. COMMITMENTS AND CONTINGENCIES

Operating lease commitments — Group as lessee

The Group has entered into operating lease agreements for the premises of most of its restaurants and several vehicles and equipment. The lease terms are between five and ten years, with very few agreements exceeding ten years period. The contract period of the operating lease agreements for vehicles and equipment does not exceed five years term. Future minimum rentals payable under non-cancellable operating leases are disclosed in the financial statements.

Finance leases

The Group has finance leases for vehicles. The Group's obligations under finance leases are secured by the lessor's title to the leased assets as disclosed in the consolidated financial statements.

Other commitments

Per the Romania new network development plan signed in October 2017, the Group has agreed with KFC Europe to open a minimum of 39 new KFC locations (out of which 29 standard format restaurants and 10 smaller format restaurants meaning rural drive-thru or an agreed small box design) during the years 2018-2022 (out of which 6 units in 2018). Should the Group fail to achieve these targets, the Group will pay KFC Europe a penalty for each such location; the Group has not paid such penalties to date. In 2018, the Group opened 8 new KFC stores in Romania, exceeding the committed development plan.

Per the Romania new network development plan concluded with Pizza Hut Europe (Master Franchisor) in October 2017, the Group has agreed to open a minimum of 34 outlets (restaurants and pizza delivery) during the years 2017- 2021 (out of which 5 locations in 2018). Should the Group fail to achieve these targets, the Group will pay PH Europe Sarl a penalty for each such location; the Group has not paid such penalties to date. In 2018, the Group extended the Pizza Hut network with 6 new stores (1 PH unit and 5 PHD units), exceeding the committed development plan.

Per the Romania network development plan concluded with TB International Holdings II SARL (the Franchisor) in April 2017, the Group has agreed to open a minimum of 10 Taco Bell restaurants during the years 2017- 2019 (2 restaurants in 2017, 3 restaurants in 2018 and 5 restaurants in 2019). In 2018, the Group increased Taco Bell network by 3 new stores, in line with the committed development plan.

Per the Italy network development plan, the Group has agreed in October 2016 (Tri Veneto region) and August 2017 (Piemonte region) with KFC Europe to open a minimum of 25 KFC locations during the years 2017- 2021 in the Northern part of Italy. Should the Group fail to achieve these targets, the Group will pay KFC Europe a penalty for each such location; the Group has not paid such penalties to date. In 2018, the Group extended the Italian network with 8 new locations, exceeding the commitment plan.

Bank letter of guarantees

The Group has issued bank letters of guarantee in favour of suppliers as at 31 December 2018 in amount of 10,449 (31 December 2017: 8,650).

Other contingencies

Taxation

The interpretation of the text and practical implementation procedures of the tax regulations could vary, and there is a risk that certain transactions could be viewed differently by the tax authorities as compared to the Group's treatment.

The tax legislation, especially in Romania, was subject to significant changes and contradictory interpretations, which may apply retroactively. Moreover, in practice, the tax authorities can take a strong approach and assess additional tax liabilities and related late payment penalties based on their individual interpretations of the tax legislation. As a result, penalties and delay payment interest could result in a significant amount payable to the state.

Contingent liabilities may arise in relation to additional tax assessments that may be imposed by the tax authorities as a result of reviews performed. Corporate tax returns can be subject to review by tax authorities within a 5-year period in Romania and Italy and a 4-years period in Republic of Moldova. Recently, there has been an increase in audits carried out by the tax authorities.

As of the date of these financial statements, the Group's Romanian subsidiary, US Food Network SA is under a tax audit from Romanian fiscal authorities. Management has reassessed the risk and considers that the subsidiary might be charged with additional tax liabilities and related interest and late payment penalties for which a provision for taxes has been recognised in the consolidated financial statements as at 31 December 2018.

Transfer pricing

According to the applicable relevant tax legislation in the countries in which the Group operates, the tax assessment of related party transactions is based on the concept of market value for the respective transfers. Following this concept, the transfer prices should be adjusted so that they reflect the market prices that would have been set between unrelated companies acting independently (i.e. based on the "arm's length principle"). It is likely that transfer pricing reviews will be undertaken in the future in order to assess whether the transfer pricing policy observes the "arm's length principle" and therefore no distortion exists that may affect the taxable base of the tax payers.

The Group has prepared transfer pricing files.

Legal proceedings

During the period, the Group was involved in a small number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of Management, based on legal advice, there are no current legal proceedings or other claims outstanding which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in these consolidated Financial Statements.

On behalf of Board of Directors,

Cristian Osiac

Chairman of the Board

21 MAR. 2019

Signed for identification