SPHERA FRANCHISE GROUP SA

CONSOLIDATED DIRECTORS' REPORT

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

31 December 2017

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 72 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 (22 restaurants as at 31 December 2017) as well as pizza delivery points (17 locations as at 31 December 2017) under the Pizza Hut ("PH") and Pizza Hut Delivery ("PHD") brands, spread across Romania, one chain of restaurants under the "Taco Bell" brand (2 restaurants as at 31 December 2017) and one restaurant under Paul brand, in Romania. The Group's number of employees at 31 December 2017 was 4,492 (31 December 2016: 2,942).

The purpose of the Group reorganization that 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 105 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 2017 and 31 December 2016 are as follows:

Company name	Country of incorporation	Field of activity	Control 31 December 2017	Control 31 December 2016
US Food Network SA	Romania	Restaurants	99.9997%	Parent
American Restaurant System SA	Romania	Restaurants	99.9997%	n/a
California Fresh Flavours SRL	Romania	Restaurants	99.9900%	n/a
US Foods 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.

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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 2017 are Tatika Investments Ltd. (27.33%), M.B.L. Computers SRL (20%), Wellkept Group SA (16.34%), Anasa Properties SRL (10.99%) and free float (25.34%).

	31 December 2017
Authorised shares (Sphera)	
Ordinary shares of 15 RON each	38,799,340
Share capital (RON thousand)	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 M.B.L Computers SRL

The shareholders of USFN as of 31 December 2016 were Lunic Franchising and Consulting Ltd. (22.34%), Tatika Investments Ltd. (27.33%), M.B.L. Computers SRL (23%), Wellkept Group SA (16.34%) and Anasa Properties SRL (10.99%).

	31 December 2016
Authorised shares (USFN)	
Ordinary shares of 0.25 RON each	380,000
Share capital (RON thousand)	95
Hyperinflation (RON thousand)	95

4. CORPORATE GOVERNANCE

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

The Company 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 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 a fost the following:

Name	Date of appointment	Title	Role
Cristian Osiac	16 May 2017	Chairman of the BoD	Executive member
Stylianos Bairaktaris	16 May 2017	Member of the BoD	Executive member
Mark Nicholas Hilton	16 May 2017	Member 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
Elyakim Davidai	5 October 2017	Vice-Chairman of the BoD	Independent member
Konstantinos Mitzalis	5 October 2017	Member of the BoD	Independent member

On 6 February 2018, Mr. Elyakim Davidai resigned from its independent director mandate within the Board of Directors of the Company, for personal reasons.

Starting 9 February 2018, the Group has appointed Mr. Stere-Constantin Farmache as "ad-interim" independent member of the Board of Directors. The nomination is valid for a 3-month period, or until the date the Company's Ordinary General Shareholders Meeting shall appoint the new member of the Board Of Directors, whichever occurs first.

The BoD 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
Stylianos Bairaktaris	Chief Financial Officer (CFO)	6 October 2017
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

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 2017, the Group operates 113 restaurants, of which 72 KFC restaurants (68 restaurants located in Romania, 2 restaurants located in the Republic of Moldova and 2 restaurants in Italy), 39 Pizza Hut units (of which 17 are delivery units) and 2 Taco Bell units. Through USFN (Romania), with consolidated restaurant sales of RON 482 million in 2017, we are the second largest restaurant group in the quick-service restaurant sector in Romania and, through ARS (Romania), with restaurant sales of RON 112 million in 2017, we are the largest restaurant group in the full-service restaurant sector in Romania.

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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 2017, there were 68 KFC restaurants in Romania (70 as at 15 March 2018). 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 (one in Verona and the other one in Mestre, located in the metropolitan city of Venice).

Of the 68 KFC restaurants operating in Romania as at 31 December 2017, 45 are food court locations (in malls or commercial centres), 14 are inline (street locations), while another 9 are Drive-Thru locations. In the Republic of Moldova, we operate one food court restaurant and one inline restaurant, while both restaurants in Italy are food court locations. All our inline and Drive-Thru locations offer seating area.

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 2017, there were 22 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 2017, our Pizza Hut Delivery network totalled 17 restaurants.

Of the 22 Pizza Hut Dine-In restaurants operating in Romania as at 31 December 2017, 19 are located near food courts with our dedicated seating (in malls or commercial centres) and 3 are inline (street locations). At the same time, 8 out of the 17 Pizza Hut Delivery restaurants were located within commercial centres, while the remaining 9 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.

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7. FINANCIAL RESULTS

Consolidated results for the years ended 31 December 2017 and 31 December 2016 are presented below:

	2017	2016
Restaurant sales	573,175	417,535
Restaurant expenses	480,647	339,314
Restaurant operating profit	**92,528**	**78,221**
General and administration expenses, net	55,925	22,975
Operating profit	**36,603**	**55,246**
Finance result	(1,942)	(730)
Profit before tax	**34,661**	**54,516**
Income tax expense	3,233	5,783
Profit for the period	**31,428**	**48,733**
EBITDA	**51,424**	**65,070**
Normalized EBITDA	**65,626**	**65,070**

Consolidated sales of Sphera reached RON 573.2 million for the year 2017, representing an increase of 37.3% compared to the previous year. The main drivers for this performance were the growth in the sales of USFN Romania (KFC restaurants) (+17.7% Y/Y), which had a contribution of 17.4pp in the consolidated sales growth rate, and the consolidation of ARS (Pizza Hut restaurants) sales starting with June 2017, which contributed 15.9pp in the consolidated sales growth rate. Our KFC operations in Italy, which were launched at the end of March, contributed 3.0pp in the consolidated sales growth rate, while our Taco Bell operations in Romania, which were launched in October, contributed another 0.7pp in the consolidated sales growth rate.

Consolidated operational expenses reached RON 480.6 million in 2017, representing an increase of 41.7% compared to the previous year. As percentage of sales, operational expenses increased by 2.6pp year-on-year to 83.9% in 2017, driven mainly by a 2.5pp increase in the cost of labour, a 0.7pp increase in rent expenses and 0.5pp increase in other operating expenses, which were partly offset by a 1.6pp decrease in cost of food and materials. The main reason for the variation of these expenses was due to the consolidation of ARS results into Sphera and to a lesser extent by the opening of KFC stores in Italy and of Taco Bell in Romania, with a combined impact of 1.6pp on the increase in the consolidated restaurant operating expenses (as percentage of sales).

Net profit reached RON 31.4 million in 2017, being 35.5% lower than in the previous year. The reduction in the net profit margin, by 6.2pp to 5.5% of sales in 2017, was driven by the 6.8pp decrease in the operating profit margin and was partly offset by the reduction in the income tax expense, which was down 44% Y/Y to RON 3.2 million. The main reason for the reduction in the income tax expense was the change in the profit tax system to a flat tax per restaurants' commercial area.

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	2017	2016
Operating profit	**36,603**	**55,246**
Adjustments to bridge operating profit to EBITDA:		
Depreciation and amortization included in restaurant expenses	13,942	9,234
Depreciation and amortization included in general and administration expenses	879	590
EBITDA	**51,424**	**65,070**
Non-recurring general and administration expenses	14,202	
Normalised EBITDA	**65,626**	**65,070**

EBITDA is one of the key performance measures monitored by senior management.
For the year ended 31 December 2017, EBITDA was normalized to exclude the non-recurring general and administration expenses: management bonus (12,154), legal fees (681), professional commercial services (652), audit and advisory services (534) and other fees (181); no such exclusions were necessary for the period ended 31 December 2016.

EBITDA reached RON 51.4 million in 2017, being 21% lower than in the previous year, while normalized EBITDA (adjusted for non-recurring expenses) reached RON 65.6 million in 2017, being 1% higher compared with the previous year.
Operating profit reached RON 36.3 million in 2017, being 33.7% lower than in the previous year. The drop in the EBITDA margin (by 6.6pp to 9.0% in 2017) and operating profit margin (by 6.8pp to 6.4% in 2017) was mainly due to the increase in the general and administration expenses (up 4.3pp) and to a lesser extent by the increase in the restaurant operating expenses (by 2.6pp), as described before.

General and administration expenses reached RON 55.9 million in 2017 (9.8% of sales), up 143% compared to previous year (5.5% of sales). Of the RON 33 million increase in this expense category, RON 10.6 million came from the consolidation of ARS, USFN Italy and CFF operations, while another RON 14.2 million were accounted for by non-recurring expenses related to the Group's reorganization process (management bonus, audit and advisory services, legal fees and other fees).

A summary of consolidated financial position as of ended 31 December 2017 is presented below:

	31 December 2017	%	31 December 2016	%
Non-current assets	176,123	71%	54,246	45%
Current assets	73,291	29%	65,399	55%
Total assets	**249,609**	100%	**119,645**	100%
Total equity	**104,544**	42%	**58,253**	49%
Non-current liabilities	42,191	17%	16,304	14%
Current liabilities	102,874	41%	45,088	38%
Total liabilities	**145,065**	58%	**61,392**	51%
Total equity and liabilities	**249,609**	100%	**119,645**	100%

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). On this basis, the consolidated financial statements of SFG are a continuation of the consolidated financial statements of USFN and the comparative consolidated financial position as of 31 December 2016 presents the financial position of the USFN Group (USFN together with USFN Italy and USFN Moldova being the "USFN Group").

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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.

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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.

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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 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 2017 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 Caa3 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 2017, the Group had available 25,556 of undrawn committed borrowing facilities (31 December 2016: 50,323), 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.

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, trade and other payables, less cash and cash deposits.

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	31 December 2017	31 December 2016
Interest-bearing loans and borrowings	64,712	22,426
Financial trade and other payables	46,906	26,167
Less: cash and short-term deposits	52,655	48,968
Net debt	**58,963**	**(375)**
Equity	104,544	58,292
Capital and net debt	**163,507**	**57,917**
Gearing ratio:	36%	n/a

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 2017 and 31 December 2016.

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.

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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.

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Ernst & Young Assurance Services S.R.L.
2 6. MAR. 2018
Signed for identification

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 expand the restaurant network. Over the medium term, the Group intends to accelerate 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. In the longer term, it is expected that the store network potential to continue to increase, mainly on the back of the further expected growth of the Romanian economy, with positive impact on nominal and real-terms personal disposable income, but also of further migration of the population from the rural areas towards larger cities.

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.

At the same time, the Group's management is looking for opportunities to add more food concepts into the Group's portfolio, which would be complementary to the current offer. In 2017 the Group signed a new franchise agreement with Yum! and brought on the Romanian market the famous Taco Bell brand with the commitment to open 10 Taco Bell restaurants within the following three years.

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 2017, the Company incurs no debts relating to anticipated costs relating to environmental aspects. The Company 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 2017, 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. The lease terms are between five and ten years. 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. Should the Group fail to achieve these targets, the Group will pay KFC Europe a penalty equivalent to the initial franchise rights fee for each such location and an assumed continuing fee of USD 5,000 per month until the earlier of the eventual opening date or the end of the subsequent year. The Group will remain obliged to construct and open any outstanding outlet in the subsequent year to the year in which the target has not been met. The average initial rights fee is in amount of 190.

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 2017). Should the Group fail to achieve these targets, the Group will pay PH Europe Sarl a penalty equivalent to the initial franchise rights fee for each such location and an assumed continuing fee of USD 5,000 per month until the earlier of the eventual opening date or the end of the subsequent year. The Group will remain obliged to construct and open any outstanding outlet in the subsequent year to the year in which the target has not been met. The average initial rights fee is in amount of 190 for a PH restaurant and 100 for a PHD location.

Per the Romania network development plan concluded with TB International Holdings II SARL (the Franchisor), 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). Should the Group fail to achieve these targets, the Franchisor may terminate the incentives granted to the group (a reduction in franchise rights payable by the Group of 4% of each restaurant's turnover for the first year and 2% for the second year).

Per the Italy network development plan, the Group has agreed with KFC Europe to open a minimum of 25 KFC locations during the years 2017- 2021 in the Northern region of Italy. In 2017 the Group has opened two locations. Should the Group fail to achieve these targets, the Group will pay KFC Europe a penalty equivalent to the initial franchise rights fee for each such location. The average initial rights fee is in amount of 200.

Bank letter of guarantees

The Group has issued bank letters of guarantee in favour of suppliers as at 31 December 2017 in amount of 8,650 (31 December 2016: 5,257).

15. SUBSEQUENT EVENTS

After 31 December 2017, the Group opened two new KFC Drive-Thru restaurants: KFC Olteniței and KFC Botoșani.

On 6 February 2018, Mr. Elyakim Davidai resigned from its independent director mandate within the Board of Directors (BoD) of the Company, for personal reasons. Starting 9 February 2018, the Group has appointed Mr. Stere-Constantin Farmache as "ad-interim" independent member of the Board of Directors. The nomination is valid for a 3-month period from BoD decision date, or until the date the Company's Ordinary General Shareholders Meeting shall appoint the new member of the Board of Directors, whichever occurs first.

On 21 February 2018 the Board of Directors has approved a new addendum to be signed with Alpha Bank Romania SA to existing credit facility contract, in order to increase the Group's credit limit to EUR 36,186 thousand up from EUR 20,630 thousand.

On 7 March 2018, it was approved the closing of one branch from Constanta meant to develop a new PHD store which is not going to be materialised.

On 21 March 2018 the Board of Directors has approved/validated, subject to shareholders' future approval, the following:

- Covering accumulated losses from 2017, as reflected in the annual financial statements of Sphera as at 31 December 2017 in a total amount of 10,196, by decreasing the subscribed and paid up share capital of the Company from 581,990 to 571,795 by reducing the nominal value of the Company's shares from 15 RON to 14.7372 RON.
- Decrease of the subscribed and paid up share capital of the Company from 571,795 to 525,731 by reducing the nominal value of the Company's shares from 14.7372 RON to 13.5500 RON, followed by the restitution to shareholders of a part of their contribution, pro-rata with their holding in the paid up share capital of the Company and calculated equally for each share. Thus, Company's shareholders as per shareholders registry at the record data for the decrease will receive 1.1872 RON/share.
- Relevant data for share capital decrease are:
    - 9 November 2018 as record date for the share capital decrease, for the identification of the shareholders to whom the effects of the share capital increase shall apply;
    - 9 November 2018 as ex date; and
    - 29 November 2018 as payment date for the amount representing part of the contributions to the share capital which will be restituted to the Company's shareholders;
- The implementation of a long-term incentive plan for Board members, key management personnel and other eligible employees of the Group. Under this plan the beneficiaries will receive share options (with zero exercise price) if they will meet certain key performance indicators, that are yet to be established. Accordingly, the long-term incentive plan may have a certain dilutive effect on earnings per share starting 2018;

- The provision of a non-refundable amount of 405,956.63 EUR to US Food Network S.r.L (Italy) to cover the statutory accounting loss of the financial year ended 31 December 2017;

- Statutory financial statements and Administrator's Report of US Food Network SRL (Republic of Moldova) for the financial year ended 31 December 2017 and distribution of entire profit for the financial year 2017 as dividends to associates.

On behalf of Board of Directors,

Cristian Osiac

Chairman of the Board