

**SPHERA FRANCHISE GROUP SA**

**DIRECTORS' REPORT**

**31 December 2017**

**SPHERA FRANCHISE GROUP SA**  
**DIRECTORS' REPORT**  
**FOR THE PERIOD FROM 16 MAY TO 31 DECEMBER 2017**

*All amounts in RON thousand, unless specified otherwise*

**1. PRESENTATION OF THE COMPANY**

Sphera Franchise Group SA ("Sphera" or "the Company") was incorporated on 16 May 2017 as a joint stock company and is registered at No. 239 Calea Dorobanti, Bucharest, Romania. The Company renders management and support services such as marketing support, development, sales support, human resources and other services to its subsidiaries.

As at 31 December 2017, the Company has the following investments in subsidiaries:

<b>Company name</b>	<b>Country of incorporation</b>	<b>Field of activity</b>	<b>Share interest % 31 December 2017</b>
US Food Network SA	Romania	Restaurants	99.9997%
American Restaurant System SA	Romania	Restaurants	99.9997%
California Fresh Flavours SRL	Romania	Restaurants	99.9900%
US Foods Network SRL	Moldova	Restaurants	80.0000%
US Food Network SRL	Italy	Restaurants	100.0000%

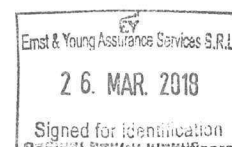
Sphera Franchise Group SA together with its subsidiaries are referred hereinafter as "SFG" or "the Group".

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.

Sphera Franchise Group SA has become the parent company of US Food Network SA (USFN) and American Restaurant System SA (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) and on 19 June 2017 it was incorporated California Fresh Flavours SRL.

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 Flavours 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 the activities of management and support, as well as 105 employees from USFN and ARS. As at 31 December 2017, the Company has 124 employees.

Sphera's core value proposition centres around the following four pillars, which over the years have contributed to the strong operating performance of the group and track record, based on the following value drivers: (1) the internationally recognizable and successful brands that the Group operates in the portfolio, (2) the successful selection of key locations for the roll-out of our restaurant network, (3) strong marketing efforts and partnerships, and (4) product quality and positioning.



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## **2. CORPORATE GOVERNANCE**

Before the admission of the shares to trading on the spot regulated market operated by Bucharest Stock Exchange, the Company was required to comply with corporate governance regime established mainly by the Companies Law. Starting 9 November 2017, the Company is required to comply with a more extensive framework of corporate governance rules, among which is the BSE Corporate Governance Code (applicable to all listed issuers as of 4 January 2016).

The Company and its board members comply with the corporate governance regime, more details regarding the corporate governance are presented on the Company's website [www.spheragroup.com](http://www.spheragroup.com), in the published Prospectus and in the Group's Annual Report.

### **2.1 SHAREHOLDERS AND ISSUED CAPITAL**

	<b>31 December 2017</b>
<b>Authorised shares (Sphera)</b>	
Ordinary shares of 15 RON each	38,799,340
Share capital (RON thousand)	581,990

The shareholders of Sphera at 31 December 2017 are Tatika Investments Ltd. (27.33%), M.B.L. Computers SRL (20%), Wellkept Company SA (16.34%), Anasa Properties SRL (10.99%) and free float (25.34%).

Starting November 9, 2017, 25.34% of the Sphera's shares (representing 9.831.753 shares) have been admitted for trading on the Bucharest Stock Exchange, Premium Category following to a secondary public offer initiated by the selling shareholders Lunic Franchising and Consulting Ltd. and M.B.L Computers SRL.

Information regarding shareholders' rights is public and can be found in the published Prospectus of the Company.

### **2.2 COMPANY MANAGEMENT**

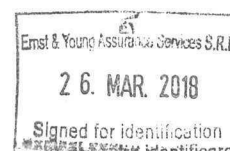
Company is managed by the Board of Directors. Its members are appointed for a mandate of 2 years.

The structure of the Board of Directors as of 31 December is the following:

<b>Name</b>	<b>Date of appointment</b>	<b>Title</b>	<b>Role</b>
Cristian Osiac	16 May 2017	Chairman of the BoD	Executive member
Stylianios Bairaktaris	16 May 2017	Member of the BoD	Executive member
Mark Nicholas Hilton	16 May 2017	Member of the BoD	Executive member
Silviu Gabriel Cârmăciu	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.



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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:

<b>Name</b>	<b>Title</b>	<b>Date of Appointment</b>
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 main duties and responsibilities of the committees are presented in the Company's public Prospectus and in the Annual Report of the Group.

## **2.3 INTERNAL CONTROL**

The Company 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 the Company' 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.

## **2.4 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](http://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.

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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**

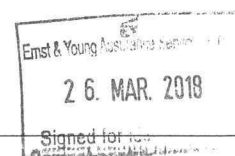
Compensation of employees is linked with performance. The performance of each employee is evaluated based on measurable indicators. In addition, managers are appraised based on some indicators measuring their abilities to observe principles concerning equal opportunities and adequate management of employees'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

**3. FINANCIAL RESULTS**

Company's results for the period from 16 May to 31 December 2017 are presented below:

	<b>2017</b>
Revenue	12,420
Payroll and employee benefits	21,101
Other expenses	2,424
<b>Operating loss</b>	<b>(11,105)</b>
Financial result	(110)
<b>Profit before tax</b>	<b>(11,215)</b>
Income tax credit	1,600
<b>Net loss for the period</b>	<b>(9,615)</b>
<b>EBITDA</b>	<b>(11,083)</b>
<b>Normalized EBITDA</b>	<b>(6)</b>

Revenue refer to management and support services provided to its subsidiaries, such as: marketing support, development, sales support, human resources and other services. For calculating the price of services rendered, the Company applies a mark-up of 10% to cost of service, determined based on benchmark analysis as requested by transfer pricing legislation.



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The structure of other expenses is presented below:

	<b>2017</b>
Third-party services	1,076
Advertising	210
Other taxes	195
Rent	91
Banking charges	10
Travel expenses	346
Office supplies	213
Depreciation	22
Insurance	73
Miscellaneous expenses	188
<b>Total</b>	<b>2,424</b>

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 expenses: management bonus on the listing of Sphera's shares (10,544), legal fees (219), audit and advisory services (146) and other fees (168).

	<b>2017</b>
<b>Operating loss</b>	<b>(11,105)</b>
Depreciation and amortization	22
<b>EBITDA</b>	<b>(11,083)</b>
Non-recurring expenses	11,077
<b>Normalised EBITDA</b>	<b>(6)</b>

Net loss of the period amounted to RON 9,615. This was due to the non-recurring expenses incurred in relation to reorganization of the group and public listing (enumerated above).

In what regards the financial position, the main elements of the balance sheet as of 31 December 2017 are detailed below:

	<b>31 December 2017</b>
<b>Assets</b>	
Non-current assets	602,701
Current assets	14,957
<b>Total assets</b>	<b>617,658</b>
 Equity and liabilities	
<b>Total equity</b>	<b>571,795</b>
 Non-current liabilities	16,660
Current liabilities	29,203
<b>Total liabilities</b>	<b>45,863</b>
<b>Total equity and liabilities</b>	<b>617,658</b>

Besides cash, current assets refer mainly to amounts invoiced to related parties for management and support services provided during the period. Current and non-current liabilities are also in relation to one of its subsidiaries, US Food Network SA.

Ernst & Young Assurance Services  
**26. MAR. 2018**  
 Signed for identification

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Non-current assets comprise mainly investments in subsidiaries (594,222). List of entities owned by the Company is presented in section 1. Other non-current assets refer to receivables from third parties, property, plant and equipment and deferred tax asset recognized for the fiscal loss carried forward.

#### **4. FINANCIAL INSTRUMENTS RISK MANAGEMENT**

The Company's principal financial liabilities comprise a loan from its subsidiary and trade and other payables. The main purpose of these financial liabilities is to finance the Company's operations. The Company's financial assets are represented by investment in subsidiaries, trade and other receivables, and cash and cash equivalents that derive directly from its operations

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

##### **Interest rate risk**

Sphera'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 Company's debt finance are fixed. Changes in interest rate do not impact loans and borrowings to third parties either since future cash flows are not affected by such changes in interest rates. In connection to loans granted or obtained from related parties, management policy is to resort mainly to fixed rate financing. However, at the time of rising or granting new loans or borrowings management shall use its judgment to decide whether it believes that fixed or variable rate would be more favourable to the Company over the expected period until maturity.

##### **Foreign currency risk**

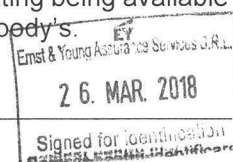
Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company's exposure to the risk of changes in foreign exchange rates relates primarily to the Company's financing activities, as the financing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

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

##### **Credit risk**

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss. The Company's credit risk is primarily attributed to loans and receivables from related parties, for which the probability of losses is considered remote. The carrying amount of trade and other receivables, plus balances with banks, represent the maximum amount exposed to credit risk.

The Company collaborates with highly reliable financial institutions. The majority of cash is transacted through and placed with Alpha Bank Romania, member of Alpha Bank Company from Greece and Banca Romana de Dezvoltare (BRD), a member of Societe Generale Company from France. 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 provided by Moody's.





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### **Liquidity risk**

The Company 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 Company had available 15,802 of undrawn committed borrowing facility from US Food Network SA, thus being able to respond to any unforeseen higher cash outflow needs.

### **Capital management**

Capital includes the equity attributable to the Company's shareholders.

The primary objective of the Company'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 Company manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, the Company may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares.

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

	<b>31 December 2017</b>
Interest-bearing loans and borrowings	16,660
Financial trade and other payables	29,203
Less: cash and short-term deposits	5,747
<b>Net debt</b>	<b>40,116</b>
Equity	571,795
<b>Capital and net debt</b>	<b>611,911</b>
Gearing ratio:	7%

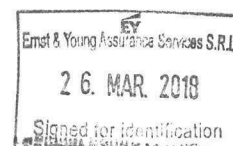
### **Fair values**

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

The carrying amount of the interest bearing loans and borrowings and receivables from loans granted to related parties approximates their fair value (level 3 measurement).

Financial instruments which are not carried at fair value on the statement of financial position also include 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 (level 3 measurement).





## **5. COMMITMENTS AND CONTINGENCIES**

As at 31 December 2017, the Company has no significant commitments and contingencies.


## **6. EVENTS AFTER THE REPORTING PERIOD**

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.

On 21 February 2018 the Board of Directors has approved the contracting of a credit facility granted by Alpha Bank within the existing credit facility of the Group, to which Sphera Franchise Group SA becomes a borrower, co-debtors and real guarantor alongside its subsidiaries. The addendum will increase the Group's credit limit to EUR 36,186 thousand up from EUR 20,630 thousand, out of which the Company will use a sub-limit of EUR 4,000 thousand for financing the development costs of the Italian subsidiary and a sub-limit of EUR 1,000 thousand as revolving working capital facility.

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

- Covering accumulated losses from 2017, as reflected in the annual financial statements of the Company 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:
  - o 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;
  - o 9 November 2018 as ex date; and
  - o 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. 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;

  
Ernst & Young Assurance Services S.R.L.  
**26. MAR. 2018**  
Signed for identification  
Carmen-Bianca Dumitrescu

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- The provision of a non-refundable amount of 405,956.63 EUR to its subsidiary 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 its subsidiary 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

