



НИС а.д. Нови Сад / NIS j.s.c. Novi Sad
Народног фронта 12 / Narodnog fronta 12
ОДБОР СКУПШТИНЕ АКЦИОНАРА / SHAREHOLDERS' ASSEMBLY BOARD
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**REPORT OF THE SHAREHOLDERS' ASSEMBLY BOARD
FOR SUPERVISION OF OPERATIONS AND PROCEDURES FOR REPORTING TO THE
SHAREHOLDERS of NIS j.s.c. NOVI SAD
FOR THE PERIOD JUNE 2019 – APRIL 2020**

Pursuant to Article 329, paragraph 1, item 16, of the Companies Law and Article 8.23 of the Articles of Association of NIS j.s.c. Novi Sad, for the purpose of reporting to Shareholders at the Shareholders' Ordinary (Annual) Meeting, the Shareholders' Assembly Board for Supervision of Operations and Procedures for Reporting to the Shareholders, within the scope of its authorizations and competencies, hereby submits the following report for the NIS j.s.c. Novi Sad Shareholders' Annual Meeting (hereinafter "Shareholders' Meeting"), scheduled for June 2020:

- **Giving opinion on reporting on accounting and financial reporting practices in NIS j.s.c. Novi Sad and in its subsidiaries**

Shareholders' Assembly Board for Supervision of Operations and Procedures for Reporting to the Shareholders (hereinafter "SA Board") monitored the application of the accounting practice and financial reporting practice, analysed annual and quarterly financial and consolidated financial statements and reports on business operations, discussed them with management and received explanations, giving opinion that mentioned reports could be reviewed on meetings of the competent authorities. Financial reports are prepared in compliance with the regulations of the Republic of Serbia, as well as with the International Financial Reporting Standards, and the reports on business operations in compliance with the Corporate Governance Code. Accounting policies, applied during preparation of the annual financial statements for 2019, were disclosed in detail in the notes to financial statements for 2019, on which the independent auditor gave its positive opinion.

SA Board for supervision analysed quarterly business reports and the annual business analysis report and in respect of such reports, SA Board prepared its comments, which it discussed with the management, and provided recommendations for improving the quality of the reporting process such as including additional information in such reports which would enable more detailed analysis of operations and regular reporting to members of the Board of Directors appointed by the minority shareholders. SA Board actively participated in the analysis of Business plan and provided its opinions to the management, stating that in the course of its preparation, Business plan has to be based on realistic presumptions and the observed inconsistencies have to be adjusted in order to provide that parameters stated in the Business plan present the realistic picture of developments on the market.

SA Board also proposed closer cooperation with the management in respect of the Business plan preparation process.

SA Board also analysed financial statements of the subsidiary companies of NIS in the Republic of Serbia and abroad and gave the opinion that such financial statements, which are included in consolidated financial statements, may be discussed at the meetings of the competent bodies.

SA Board for Supervision monitored and analysed the operations of the subsidiary companies abroad on a regular basis and provided suggestions to the Board of Directors on measures to be taken to improve the operation of such companies, by drawing its attention to the losses continually generated by foreign assets in Bulgaria and Romania thus preventing repayment of loans granted, whilst the subsidiary company in B&H achieved positive effects of the business activities. Total amount of loans invested in foreign assets, with pertaining interests, and cumulative losses of the subsidiary companies were disclosed in the financial statements of NIS j.s.c. Considering that large amounts of funds were invested in the operation of foreign assets, SA Board warned about the continuous losses of these companies, year after year, at the meetings the company's management and through periodic analysis of operation which included questions and suggestions for the management.

SA Board paid special attention to the operation of the subsidiary company in Bulgaria and proposed the audit to be performed of its operations by the Internal Audit. SA Board repeatedly drew the attention to and asked questions about the purchase of petrol stations and land plots for petrol stations as well as purchase and operation of the Kostin Brod Warehouse. Having in mind the foregoing as well as analyses completed by the Internal Audit, the management of NIS appointed a new management in order to avoid the bad management practices and enhance the business of the subsidiary company. Report of the new management on the measurements taken did not project any significant enhancement of the business and three potential scenarios on business activities of this subsidiary company were suggested in December 2019, when the management recommended the current business activities to be retained, illiquid assets to be sold and the it was clearly stressed that return of the loan granted in the form of credit, not even on the long-term basis was not possible.

The applied accounting policies were aligned with the legal regulations of the Republic of Serbia and, correspondingly, the financial statements of the Company were aligned with the regulations as well. Based on the aforesaid, SA Board passes its opinion to the Shareholders' Assembly that all financial statements and Reports on business operations for 2019 to be adopted by the Shareholders' Assembly, are authentic and complete.

- **Reporting on NIS's business operations and compliance of NIS j.s.c. Novi Sad business activity with legal and other requirements of regulatory bodies and monitoring of the contracts entered into with related parties in terms of the Companies Law**

The SA Board monitored business operations of NIS on regular basis, by means of analysing documents delivered for review and giving opinions. The aforesaid documents include business plans, reports on business operations, reports on post-investment monitoring, contracts with related parties involving personal interest, reports on contracts in the value exceeding EUR 5 million, as well as other documents related to business operations of the Company.

The SA Board monitored the selection of contractors performing works and the process of realization of the Bottom of the Barrel project, asked questions of importance regarding the project in respect of which it received requested documentation. Representatives of the Board repeatedly indicated that there was the need for the contracting and realisation of the Bottom of the Barrel Project to be implemented by applying methodology applied to other investment projects in NIS. Deviations from prescribed standards and procedures for procurement of equipment and services, where the powers to implement the Project have been transferred to the Project Management Group, which leaves room for subjectivity and arbitrariness in decision-making process and may result in the selection of a contractor the justification of which, in terms of pricing and technology, is not obvious. For this reason, SA Board organised meetings with the management and continued to monitor the course of realisation and implementation of the Bottom of the Barrel Project, including the workover of the refinery, continually stressing the importance of the quality of works and adherence to the defined deadlines, all in line with the legislation of the Republic of Serbia, and also kept the members of the Board of Directors representing the minority shareholder (RS) informed on all activities related to the Project on the regular basis.

Since the start of the Bottom of the Barrel process, the management of Project Office reported to the representatives of the minority shareholders, in the form of regular monthly and weekly reports, on the degree of completion of the Bottom of the Barrel Project. At the moment, there are some delays in time schedule of the Project according to the report issued by the Project Office.

The Business plan for 2020 states the deadlines for completion of the Bottom of the Barrel Project which are highly optimistic according to the opinion of the SA Board, which was reported to the management. SA Board noted that deadlines for mechanical readiness (28.02.2020), readiness for commissioning (31.03.2020) and beginning of commercial exploitation of the facility (01.05.2020), as also stated in the Annual Report on NIS performance for 2019 have not been met. At the meeting with representatives of the management held in the Refinery on 11.03.2020, new deadlines for the aforesaid activities were presented to SA Board, i.e. deadline for mechanical readiness as of 04.07.2020, as well as deadline for readiness for commissioning and beginning of commercial exploitation of the facility as of 20.08.2020. Representatives of the SA Board are of the opinion that the said deadlines are less probable due to completion of the necessary attestation and technical documentation (ATD). Passport of the Project mapped out the commercial exploitation of the facility for 2019, and its postponement for 2020, according to the evaluation of the management has negative effect in the amount of 1.8 billion dinars.

Capital workover was planned for February-March 2019, and the accompanying activities were to be divided between the Refining Block and Bottom of the Barrel Project Office for the purpose of merging the future Bottom of the Barrel plant with the rest of the refinery (primary MHC plant). It was planned for the Project Office to undertake activities related to the workover of the Refinery until 30th March 2019. Due to delays in workover, the Refinery was opened for commercial operations on 6th May instead of 8th April 2019. Due to the Refinery overhaul extension, the unplanned downtime was 28 days and the additional downtime due to the meltdown of the Klaus facility was 15 days which in total is 43 days of unplanned downtime of the Refinery, resulting in the negative financial effect for the Company. According to estimations of the management, such negative financial effects in 2019 amount to 3.6 billion dinars. During the year, the SA Board noted the management in writing and on meetings that deviations from the prescribed procedures of equipment procurement and contracting the overhaul works caused complications such as unplanned downtime of the Refinery and requested all data related to the overhaul including calculation of the negative financial effect to be presented to representatives of the minority shareholder.

There was another meltdown of the Claus facility in the Refinery over the period April-May, as happened before, for which SA Board requested explanations from the management for reasons of the another meltdown. The commercial exploitation of the facility shall start on 10.05.2020.

SA Board for Supervision analysed the contracts for sale of oil products with binding schedule of delivery which are worth more than 100 million EUR which were submitted to the Board for approval and which were also included in the quarterly reports and which are worth more than 5 million EUR. SA Board insisted on aligning such contracts with the pricing policy and aligning the pricing policy enacted by the Sales and Distribution Block with other normative acts in place in NIS. SA Board for Supervision believes that Commercial Policy must be strictly observed i.e. persons responsible for commercial activities are not allowed to make special decisions containing formulations for "exceptional cases", which are not envisaged by the pricing policy. SA Board also insisted that commercial policy by no means cannot be founded on personal positions of individuals and, when forming sale prices of oil products formulation saying "the price is covering only one part of costs of the trade and could be lower than the transfer price" is not acceptable but in case of approval of price lower than the transfer price there must be a positive analysis of all individual potential sale defined by the model of optimization planning where feasibility has to be confirmed.

Position of representatives of SA Board is that the pricing policy has to be aligned with the commercial policy as defined in the internal document PO-04.00.01 i.e. in form which implies the **absence of ambiguous interpretation of terms and conditions**, and transparent and identical implementation in respect of all buyers. They also insisted on adherence to adopted commercial

policies with the aim to improve transparency of company's operations and preserve its competitiveness in the oil products wholesale market.

Through analyses and letters to the management as well as on the meetings held together with members of the Board of Directors representing the minority shareholder (RS), representatives of SA Board actively participated in evaluation of the current business activities of the Company and gave opinions about ongoing significant issues which influence the operations of the Company, such as facilitating a mutually acceptable solution regarding the suggestion of the management to move the business centre of the Company to rented premisses, not owned by the Company; FCC facility modernisation; problems in the aviation fuel chain of supply; and also more transparent presentation of status, assessment of requirements and procedures of hiring of foreign citizens by the Company.

The SA Board gave opinion on the defined ponders, targets and amtargets within production contracts as well as on the management assessments of the fulfilment of targets in compliance with the methodology, in order to determine overall evaluation within the MBO system. Regarding the above, the SA Board asked specific questions to which adequate answers were given by the management and the management accepted certain positions of SA Board related to fulfilment of targets.

When performing these activities, the SA Board cooperated with the Audit Commission of the Board of Directors and its members attended all meetings of the Audit Commission. Members of the SA Board for Supervision also attended all meetings of the Board of Directors.

- **Monitoring work of the Independent Auditor in terms of competence, independence, and skills of the Independent Auditor of NIS j.s.c. Novi Sad**

SA Board for Supervision monitored the work of the independent auditor and noted that the independent auditor conducted the audit professionally, in compliance with procedures set forth by the International Standards on Auditing. Based on the data obtained through the monitoring of work and cooperation with the Independent Auditor, the SA Board determined that the Independent Auditor conducted the audit efficiently and expressed positive opinion on annual individual and consolidated financial statements for 2019, prepared in compliance with the regulations of the Republic of Serbia, as well as on financial statements prepared in accordance with the International Financial Reporting Standards.

Independent auditor also submitted a special report containing findings and observations acquired in the course of audit which are of importance for the improvement of Company's operations.

The Audit Commission, with which the SA Board cooperated on a regular basis, is also in charge of monitoring the work of the Independent Auditor. The Audit Commission prepared its Report, which includes the observation that the independent auditor is qualified and independent from the Company's management and that the audit was completed in a high-quality manner and in accordance with the International Standards on Auditing.

The SA Board reviewed the management's proposal regarding the election of the auditor of its financial statements, which suggest that the auditing company KPMG d.o.o. Beograd should be elected for the auditor of financial statements for 2020. The SA Board gave its positive opinion on draft Decision on the Election and gave its recommendation to the NIS j.s.c. Novi Sad Shareholder's Assembly Board to elect KPMG d.o.o. Beograd as the Auditor of Financial Statements of NIS j.s.c. Novi Sad for the year 2020.

- **Decision on Profit Distribution for 2019**

The SA Board reviewed the proposal under the Decision on Profit Distribution for 2019, dividend payment, and determining the total amount of retained profits of NIS j.s.c. Novi Sad. By this draft of the Decision it was proposed to pay up dividends to shareholders in the amount of 30% of the generated profit shown in the 2019 Income statement of NIS j.s.c. Novi Sad. The Agreement for Sale and Purchase of shares of NIS stipulates that the payment of the dividends shall be made in the amount of up to minimum 15% of the generated profit, and the NIS j.s.c. Novi Sad Dividend Policy states that “the Dividend policy is based on balanced approach that takes into account the need to retain earnings for the purpose of financing future investments as well as the return on equity and dividend payout ratio. When proposing dividends, the Company’s management takes into consideration a range of factors, including the financial position, investment plans for the upcoming period, loan repayment schedules, macroeconomic environment and legal requirements. Any of these factors alone or combined, if significant enough, may influence the proposed dividend payment”. However, taking into consideration the ongoing situation at the market, low prices of the barrel of crude, virus pandemic and potentially negative economic effects in the future which would be consequences of significantly reduced sale, SA Board gave its opinion that the payment of the dividends shall be made in the amount of 25%, identically as in the previous year, which was accepted by the management of the Company.

- **Cooperation with the Internal Audit**

The SA Board monitored activities of the Internal Audit by reviewing its Activity Plans and individual audit completion reports and gave its proposals for performance of audit of individual areas of business. The SA Board is of the opinion that internal audits have been conducted and reports prepared in accordance with standards of the professional practice. Having analysed the business activities of NIS and its subsidiaries, the SA Board gave recommendations to the Internal Audit to conduct audits of business activities of some subsidiaries and business processes, whenever they observed risks, which require management's attention. Having reviewed results of the conducted internal audits, the SA Board learned that the recommendations to the Internal Audit were justified. Based upon findings of the Internal Audit, the management took adequate measures to correct the unsatisfactory performance and to improve the efficiency of business operations.

- **Other activities of SA Board**

For the purpose of monitoring the Company’s business activity, the SA Board hired a chief expert and two experts to monitor business activity and implementation of the strategy, who prepared layouts for analysis financial statements, analysis of the 2020 Business Plan, analysis of proposed investment decisions and Report on post-investment monitoring as well as for regular business operations monitoring. The SA Board reported their findings and opinions to the members of the Board of Directors. Members of the SA Board for Supervision took part in the work performed by the Commission for Crude Oil Purchase/Sale. Likewise, they attended other meetings they were invited to.

CHAIRMAN OF SA BOARD
