

**ECONOMIC DEPARTMENT**  
**NO. 2229/17.07.2018**

**TO,**

**SNGN ROMGAZ SA MEDIAS**  
**GENERAL MEETING OF SHAREHOLDERS**

**SUBSTANTIATION NOTE**  
**OF THE**  
**RECTIFIED 2018 INCOME AND EXPENDITURE BUDGET**

The rectification of the Income and Expenditure Budget for 2018 was driven by the change of the titleholder of Underground Gas Storage Licence No. 1942/22.01.2014 – for carrying out the operation of the underground gas storage system provided under ANRE (Romanian Energy Regulatory Authority) Resolution No. 151/22.01.2014, from SNGN Romgaz SA Mediaș (hereinafter referred to as “the Company”) to **SNGN Romgaz SA- Filiala de Înmagazinare Gaze Naturale Depogaz Ploiești SRL** (hereinafter referred to as “the Subsidiary”). In compliance with ANRE Resolution no. 474/30.03.2017 on modifying the Resolution of ANRE President no. 2588/31.12.2015, changing the titleholder of Licence no. 1942/2014 into SNGN Romgaz SA- Filiala de Înmagazinare Gaze Naturale Depogaz Ploiești SRL is effective as of **April 01, 2018**.

Starting with April, 1, 2018 the underground gas storage activity was taken over and performed by the Subsidiary.

Under these circumstances, it is requisite to rectify the income and expenditure budget for 2018 approved under Resolution no. 3/2018 of OGMS, budget that was substantiated by the underground gas storage activity performed by Ploiesti branch.

**I. The substantiation** of the 2018 Income and Expenditure Budget and of the 2019 - 2020 forecast was based on the laws concerning:

*~ implementation of International Financial Reporting Standards by the companies whose securities are traded on a regulated market;*

*~ strengthening of the financial discipline and establishing the expenses for salaries and wages in the 2018 budget, at the level of economic operators where the state or administrative territorial units are sole or majority shareholders or hold directly or indirectly a majority participation;*

*~ profit allocation by the national companies and trade companies fully or majority state owned, as subsequently amended and supplemented;*

*~ implementation of the Fiscal Code provisions;*

*~ layout and structure of the income and expenditure budget, as well as its related substantiation annexes;*

Resolution No. 9 /2019 of the Company's Board of Directors approved the separation model of the underground gas storage activity, and the Company's Board of Directors approved the lease agreement for the assets under Resolution No. 12/2018.

The budget rectification is in compliance with GD no. 26/2013 on *strengthening of the financial discipline of economic operators where the state or the local government entities are the sole or majority shareholders or own directly or indirectly major participation*, according to article 10), paragraph (2) letter f), stating that economic operators can rectify the income and expenditure budget "*under other circumstances required by the law*" and according to letters b) and d) because the gross profit is reduced and total expenses related to RON 1000 total income increase.

## **II. Outline and substantiation of the indicators included in Romgaz 2018 rectified Income and Expenditure Budget draft**

This current budget is based on the economic-financial indicators achieved in the first quarter of 2018, the period when the subsidiary was included in the company's structure. The indicators achieved in Q1 2018 were adjusted with the proposals of the departments, divisions, directions and branches for the period April – December 2018.

The gas storage activity for the period April –December is performed by the subsidiary, and the relationship between the company and subsidiary is contractual in nature, similar to other third party clients/suppliers relationships.

As the 2018 budget rectification proposal does not include the gas storage activity for the period April–December, a comparison of the 2018 rectified budget with the previous years is irrelevant.

### **1. Substantiation of Income**

The substantiation of the main income categories of the income and expenditure budget is based on the forecasted evolutions of the gas demand and delivery price, the production programs, program of the import gas acquisition and delivery.

Revenues of the Electricity Production Branch (SPEE Iernut) are generated from the electricity production and delivery as well as from other field related services.

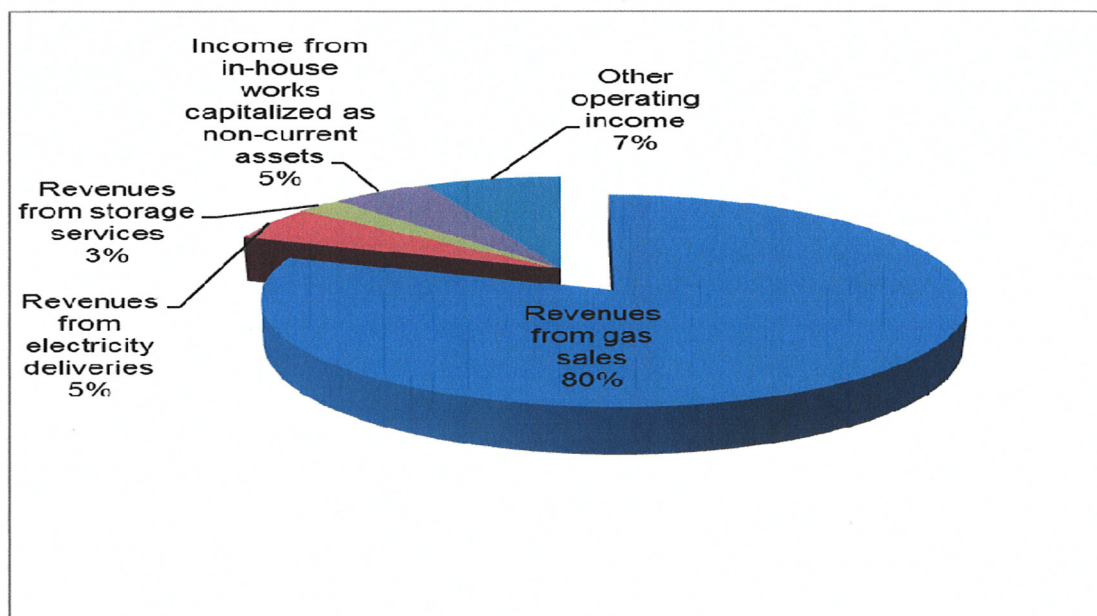
Besides the main revenue categories, revenue is also recorded from other activities such as: service provision for third parties (transportation, gas dehydration and compression, rental of goods, chemical analyses, sale of condensate, and sale of goods).

### **Operating Income**

Operating income of **RON 4,742,706 thousand** is estimated to be by 3.58% higher than the budget approved for 2018.

The structure of operating income based on the 2018 rectified budget is shown in the figure below:





Operating income is detailed in the table below:

Item no.	RON thousand	Approved 2018, Res. No 3/2018 of OGMS	Rectified proposal 2018	Ratio rectified /approved %
1	Revenues from Romgaz gas sales delivered from own production (excluding joint ventures, and gas for electricity production)	3 422 531	3 596 052	105.07%
2	Revenues from joint ventures	123 502	128 970	104.43%
3	Revenues from import gas deliveries	26 473	79 149	298.98%
4	Revenues from electricity deliveries	300 621	249 758	83.08%
5	Revenues from storage services*)	338 203	111 555	32.98%
6	Income from in-house works capitalized as non-current assets	246 061	246 055	100.00%
7	Other operating income	121 412	331 167	272.76%
8	<b>Total operating income</b>	<b>4 578 804</b>	<b>4 742 706</b>	<b>103.58%</b>

\*)The rectified budget includes revenues from storage services provided to third parties in Q1 2018 and revenues from storage tariffs for its own production delivered to clients during the period April – December 2018.

Revenues from Romgaz gas delivered from own production (excluding gas from joint ventures and gas for electricity production) were determined based on the gas quantities estimated to be delivered

to clients in April-December, based on the quantities delivered in Q1 and on the average delivery price of gas from current production and withdrawn from UGSs.

*Revenues from joint ventures* represent the value of natural gas delivered under joint-ventures and which correspond to Romgaz participating interest.

*Revenues from import gas deliveries* represent the value of natural gas purchased from import and resold by Romgaz to own clients.

*Revenues from delivered electricity* were determined based on the quantities of delivered electricity and on the estimated average delivery price in Q1 and on the estimated prices for April-December.

*Revenues from underground gas storage services* are generated from services supplied for gas injection and withdrawal into/from UGSs and for capacity booking and changes in inventories for Q1, as well as from revenues representing the equivalent value of such services – only for own gas - in April - December.

*Income from in-house works capitalized as non-current assets* represents the value of works performed in-house.

*Other operating income* represents income from distribution, rentals, condensate deliveries, other services provided.

**Financial income** in amount of **RON 30.281 thousand** is generated by the interest received from banks for the company's cash placed in bank deposits and state bonds.

## 2. Substantiation of expenditures

*Operating expenses* are classified in the following main chapters:

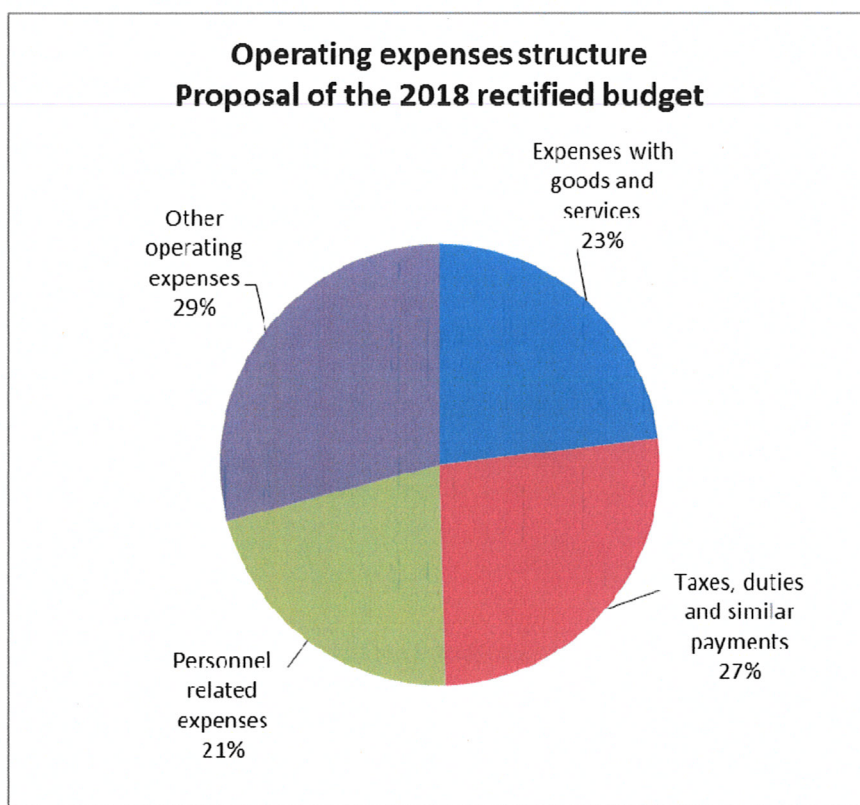
- A. Expenses with goods and services;
- B. Expenses with taxes, duties and similar payments;
- C. Personnel related expenses;
- D. Other operating expenses.

RON thousand	Approved 2018 acc. to OGMS Resolution no.3/2018	Rectified proposal year 2018	Ratios (%)
	<b>2</b>	<b>3</b>	<b>4=3/2*100</b>
<b>A. Expenses with goods and services, out of which:</b>	<b>462 367</b>	<b>780 705</b>	<b>168.85%</b>
A1.Expenses with inventories	292 893	357 955	122.21%
A2.Expenses with services supplied by third parties	37 698	31 388	83.26%
A3.Expenses with other services	131 776	391 362	296.99%



RON thousand	Approved 2018 acc. to OGMS Resolution no.3/2018	Rectified proposal year 2018	Ratios (%)
	<b>2</b>	<b>3</b>	<b>4=3/2*100</b>
supplied by third parties			
<b>B Expenses with taxes, duties and similar payments</b>	<b>751 693</b>	<b>893 718</b>	<b>118.89%</b>
<b>C. Personnel related expenses</b>	<b>752 544</b>	<b>720 252</b>	<b>95.71%</b>
<b>D. Other operating expenses</b>	<b>997 575</b>	<b>983 342</b>	<b>98.57%</b>
<b>Total Operating Expenses</b>	<b>2 964 179</b>	<b>3 378 018</b>	<b>113.96%</b>

Graphic representation of operating expenses divided on the 4 chapters:



**A. Expenses for Goods and Services:**

For this expense category (A) of RON 780,705 thousand, we estimate an increase of 68.85% as compared to the approved budget, mainly influenced by:

- ~ Exceeding the gas quantity purchased from import and delivered in Q1 (RON 53,165 thousand). These expenses generated a proportional increase of revenues;

- ~ Increase of expenses related to gas transmission and distribution for the clients requesting such services to be contracted by the company with the service providers. These expenses were also included in the approved budget but in chapter “D”. These expenses are also found at income in the same amount;
- ~ Changing the company’s accounting policy related to the manner of recoding costs with seismic surveys and geological, geochemical and geophysical surveys. These will be recorded at expenses for goods and services starting with the 2018 budget rectification, being removed from investment expenses. The investment program approved in the initial budget will decrease by this amount further to the budget rectification.

The company’s efforts towards mitigation of the natural decline of the gross gas production incur inventories-related expenses, each branch having consumption norms specific for the branches’ scope of activity.

Chapter A also includes “expenses with third party services” estimated at a share required for ensuring the operation continuity under safety conditions. The highest share relates to the maintenance and repair of equipment specific for the natural gas extraction activity. This category includes well inspection and repair works, buildings, constructions, equipment, machinery, compressor manifold, and partial or total replacement of elements or part of elements of such equipment.

Expenses with services supplied by third parties consist of expenses with partners, commissions, fees, legal services, protocol, advertisement and publicity, sponsorship, transportation, employee transportation and relocation, security, organization restructure design, employee training, natural gas transmission and distribution services, expenses with seismic surveys.

### ***B. Expenses for Taxes, Duties and Similar Payments***

This expense chapter records an increase of 18.89% as compared to the approved budget, as a result of:

- ~ Calculating the petroleum royalty using a price based on the average quotation of the previous month from the Central European Gas Hub from Baumgarten, Austria;
- ~ Increase of the average gas delivery price used for calculating the windfall tax.

These expenses include royalty calculated as percentage from the physical production, from condensate (RON 384.9 million), windfall tax (RON 497.4 million), land and building taxes, total permitting, licencing and environment taxes (RON 7.9 million).

### ***C. Personnel-related Expenses:***

Personnel-related expenses were substantiated based on:

- ~ **Government Emergency Ordinance no. 26/2013** on strengthening the financial discipline at the level of economic operators where the state or administrative territorial units are sole or majority shareholders or hold, directly or indirectly, a majority share, as subsequently amended and supplemented;
- ~ **Law no. 227/2015** - Fiscal Code as subsequently amended and supplemented;
- ~ **Law no. 2/2018** on the State Budget for year 2018;
- ~ **Labour Code**;
- ~ **Collective Labour Agreement**

Law no. 2/2018 of the State Budget for 2018 provides at Chapter III “Final Dispositions” art. 58, para (1)-(5) the government’s policy coordinates on the salary policy for 2018.

The provisions on applying the index of growing the labour productivity, on the increase of salaries related expenses apply to the operators that “exceeded the level of overdue payments planned for the end of 2017”, pursuant to letter a) paragraph (1) of Article 58; these provisions do not apply to SNGN Romgaz SA.

Pursuant to Article 58, paragraph (1), letter (b) of the State Budget Law no. 2/2018 “the economic operators that did not exceed the level of overdue payments planned for the end of 2017 may increase salaries related expenses provided that these operators do not plan overdue payments in 2018”. This does not apply to SNGN Romgaz SA.

State Budget Law for 2018 does not include limitations as regards the increase of salaries related expenses for the operators that do not record overdue payments.

The fact that in 2018 the provisions of the state budget law are not applied when preparing the personnel related expenses is an opportunity to analyse the possibility to increase salaries in order to incentivize and to maintain the professional employees.

Personnel related expenses are by 4.29% lower than approved in the initial budget for 2018, as a result after separating the storage activity starting with the 1<sup>st</sup> of April by transferring the personnel from Ploiesti branch to the subsidiary, from the respective date.

The number of employees forecasted for the end of 2018 is 5.923, and the average number is 5.877 employees.

#### ***D. Other operating expenses***

This chapter records a decrease of expenses estimated in the rectified budget compared to the budget approved for 2018 (by 1.43%) generated mainly by the decrease of adjustments and provisions.

The chapter includes expenses with non-current assets, other expenses not included in the previous chapters, tangible and intangible assets depreciation, adjustments and provisions.

#### **IV. 2018 Profit Distribution Proposal**

Profit distribution was made in the 2018 budget proposal in compliance with the provisions of *GO no. 64/2001 on profit distribution at fully or majority state owned national companies, trade companies*, as subsequently amended and supplemented. The net profit distribution rate to shareholders is 50%, and the undistributed difference is allocated to own development sources.

**V. Level of overdue receivables** estimated for the end of 2018 is of RON 1.194.626 thousand.

**VI. Level of Arrears is estimated to RON 0.**

**VII. Investment Program** of RON 1.500.000 thousand lei is completely self-financed and it is estimated at 105.000 thousand lei below the approved programme for 2018 as a result of the company’s accounting policies modification, respectively, the transfer of expenses with seismic surveys, geological, geochemical and geophysical surveys to operating expenses.

The priorities of ROMGAZ 2018 rectified Investment Program are focused on projects aiming to compensate the natural decline of the gas production, by way of:

- continuing geological research works through new exploratory drillings and geological and geophysical surveys to discover new natural gas reserves;
- development of the production potential by ensuring new capacities for the already existent facilities (drilling of exploitation wells, compressor units, booster compressors, modernization and refurbishment of the already existing units), improving the performances of the existing facilities and equipment, in order to increase the operational safety, reduce energy consumptions and enhance efficiency of gas reservoir production;
- increasing the underground natural gas storage capacity, flexibility and security of operation for the already existent storages;
- modernization and refurbishment of workover rig equipment and installations as well as acquisition of high performance equipment and installations specific for the main activity;
- specific machinery acquisition to ensure technological transportation and maintenance of the main activity, as well as maintaining optimum conditions of road infrastructure in gas fields.

### VIII. Summary of Main Indicators

	RON million	2018 budget approved by OGMS Resolution no.3/2018	Rectified Budget Proposal 2018	Ratios rectified budget/ approved %	Budget proposal 2019	Budget proposal 2020
1	Total income	4 592.4	4 773.0	103.9%	4 680.7	4 584.8
2	Total expenses	2 987.9	3 407.3	114.0%	3 333.1	3 268.7
3	<b>Gross result</b>	1 604.4	1 365.7	85.1%	1 347.6	1 316.1

### IX. Indicator Forecast for 2019 - 2020

The 2019 – 2020 forecast rests on those assumptions underlying the substantiation of the 2018 budget, the market demand and conditions.

**We would like to emphasize that the indicators forecasted for 2019 and 2020 are indicative only and are not the final indicators of the company's performance for the respective years; they are going to be updated in accordance with the law in force when preparing the income and expenditure budgets for each of the respective years.**

***ROMGAZ Board of Directors endorsed the Rectified Income and Expenditure Budget Proposal for 2018 and the forecast for 2019 – 2020 in the meeting of July 16, 2018.***

**In accordance with Article 4 paragraph (1) letter d) of Government Ordinance no. 26/2013, we hereby request the Ordinary General Meeting of Shareholders to approve the 2018 Individual Rectified Income and Expenditure Budget.**



The following annexes are part of the Income and Expenditure Budget:

- Annex 1: 2018 Rectified Income and Expenditure Budget (including estimations for 2019 – 2020); only the column related to the current year is published, in accordance with O.M.F.P. no. 3145/2017.
- Annex 2: Detailed information on the economic-financial indicators included in the income and expenditure budget and their quarterly distribution;
- Annex 3: Total Income Stage of Completion;
- Annex 4: Investment Program, Equipment and Financing Sources;
- Annex 5: Measures to Improve Gross Result and Reduction of Outstanding Payments.

The data for years 2019 -2020 from Annex 1 and Annex 2-5 are not public. These may be reviewed only by Romgaz shareholders at the headquarters, daily between 10 am – 2 pm; the shareholders may address questions in compliance with the procedure described in the Convening Notice of the Ordinary General Meeting of Shareholders (OGMS) on...*AUG., 23<sup>th</sup>*...2018.

**CHAIRMAN  
OF THE BOARD OF DIRECTORS  
Dorin-Liviu Nistoran**



**ENDORSED,**

**CHIEF EXECUTIVE OFFICER  
Adrian Volintiru**



**CHIEF FINANCIAL OFFICER  
Andrei BOBAR**



**RECTIFIED INCOME AND EXPENDITURE BUDGET FOR 2018  
SNGN ROMGAZ SA MEDIAS**

RON thousand

		INDICATORS	Row no.	2018 Budget proposal
0	1	2	3	4
I.		<b>TOTAL INCOME (Row1=Row2+Row5+Row6)</b>	1	<b>4 772 987</b>
	1	Total operating income out of which:	2	4 742 706
		a) subsidies, according to legal provisions in force	3	
		b) transfers, according to legal provisions in force	4	
	2	Financial income	5	30 281
	3	Extraordinary income	6	
II		<b>TOTAL EXPENSES (Row7=Row8+Row20+Row21)</b>	7	<b>3 407 297</b>
	1	Operating expenses, out of which:	8	3 378 018
	A.	expenses for goods and services	9	780 705
	B.	expenses for taxes, duties and similar payments	10	893 718
	C.	personnel-related expenses, out of which:	11	720 252
	C0	expenses for salaries and wages (Row 13+ Row14)	12	671 791
	C1	expenses for salaries	13	602 473
	C2	expenses for bonuses	14	69 318
	C3	other personnel expenses, out of which:	15	1 238
		expenses with termination benefits	16	
	C4	expenses for the mandate contract and for other management and control bodies, committees and commissions	17	3 345
	C5	expenses with contributions owed by the employer	18	43 879
	D.	other operating expenses	19	983 342
	2	Financial expenses	20	29 279
	3	Extraordinary expenses	21	
III		<b>GROSS RESULT (profit/loss)</b>	22	<b>1 365 690</b>
IV		<b>PROFIT TAX</b>	23	<b>242 459</b>
V		<b>PROFIT AFTER DEDUCTION OF PROFIT TAX, out of which:</b>	24	<b>1 123 231</b>
	1	Legal reserve	25	
	2	Other reserves representing fiscal facilities provided by law	26	
	3	Coverage of accounting loss from previous years	27	
	4	Establishing equity finance for projects co-financed from foreign loans, and establishing sources for reimbursement of installments, payment of interest rates, charges and other costs related to such loans.	28	
	5	Other distributions provided by law	29	
	6	Accounting profit after deduction of the amounts provided at Rws. 25, 26, 27, 28 and 29.	30	1 123 231
	7	Profit share payable to employees within the limit of 10% of the net profit, but not more than one monthly average base salary paid by the economic operator during the reference financial year	31	28 000
	8	Minimum 50% payments to the state budget or local budget in case of autonomous companies, or as dividends paid to shareholders in case of national companies and companies which are fully state-owned or where the state is the major shareholder, out of which:	32	575 616
	a)	- dividends to the state budget	33	402 931
	b)	- dividends to the local budget	33 a	
	c)	- dividends to other shareholders	34	172 685



		INDICATORS	Row no.	2018 Budget proposal
0	1	2	3	4
	9	Profit not allocated to rws. 31-32 is allocated to other reserves and represents the company's own equity finance	35	547 616
VI		INCOME FROM EUROPEAN FUNDS	36	
VII		ELIGIBLE EXPENSES FROM EUROPEAN FUNDS, out of which:	37	
	a)	expenses for materials	38	
	b)	expenses for salaries	39	
	c)	expenses for services	40	
	d)	expenses for promotion and advertising	41	
	e)	other expenses	42	
VIII		INVESTMENT FINANCING SOURCES, out of which:	43	1 500 000
	1	Allocations from the budget, out of which:	44	
		budget allocations related to payments of previous years commitments	45	
IX		INVESTMENTS	46	1 500 000
X		SUPPORTING DATA	47	
	1	Forecasted no. of employees at the end of the year	48	5 923
	2	Total average number of employees	49	5 877
	3	Average monthly income per employee (RON/ person) determined on basis of salary-related expenses	50	8 819
	4	Average monthly income per employee (RON/ person) determined on basis of salary expenses recalculated under the Annual Law of the State Budget	51	7 387
	5	Labour productivity in financial units per total average number of employees (thousand RON/person) (Rw.2/Rw.49)	52	807
	6	Labour productivity in financial units per total average number of employees recalculated under the Annual Law of the State Budget	53	807
	7	Labour productivity in physical units per total average number of employees (thousand RON/person)	54	
	8	Total expenses related to RON 1 000 total income (Rw.7/Rw.1)x1000	55	714
	9	Outstanding payments	56	
	10	Overdue accounts receivables	57	1 194 626

CHIEF EXECUTIVE OFFICER  
ADRIAN CONSTANTIN VOLINTIRU



CHIEF FINANCIAL OFFICER,  
ANDREI BOBAR