

NR.6128/22.02.2018

TO,

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

**SUBSTANTIATION NOTE  
ON  
THE 2018 INCOME AND EXPENDITURE BUDGET**

**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;*

**II. The assumptions for preparing** the income and expenditure budget are based on the „ Main macroeconomic indicators forecast 2017 – 2021” – the winter version – February 2, 2018, as published by the National Prognosis Commission.

The official inflation and exchange rate forecast for 2018, 2019, 2020, according to the National Prognosis Commission, are shown in the table below:

|   | 2018        | 2019        | 2020        |
|---|-------------|-------------|-------------|
| <b>Index of consumer price – annual average</b> | <b>3.7%</b> | <b>2.3%</b> | <b>2.2%</b> |
| <b>Exchange rate RON/Euro - annual average</b>  | <b>4.59</b> | <b>4.58</b> | <b>4.56</b> |
| <b>Exchange rate RON/USD - annual average</b>   | <b>3.82</b> | <b>3.82</b> | <b>3.80</b> |

### III. Outline and substantiation of the indicators included in Romgaz 2018 Income and Expenditure Budget

#### 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, gas storage in underground facilities, program of the import gas acquisition and delivery program.

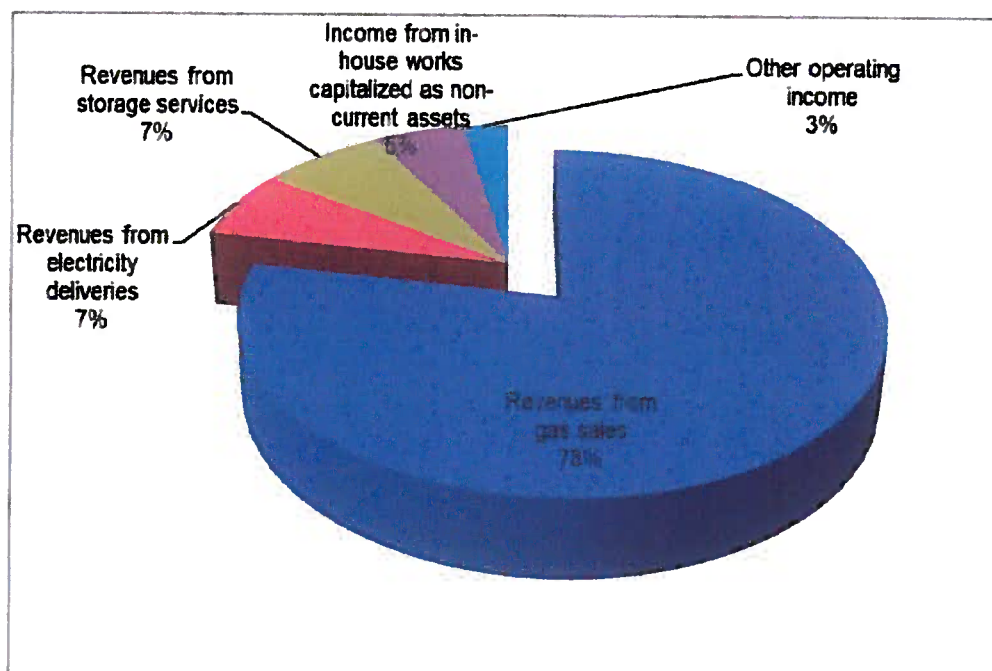
Revenues of the Electricity Production Branch (SPEE Iernut) are generated from the electricity production and delivery as well as from other field related services.

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

#### Operating Income

Operating income of **RON 4,578,803 thousand** is estimated to be by 8.1% lower than the 2017 preliminary ones.

The structure of operating income for 2018 is shown in the figure below:



Operating income is detailed in the table below:

| Item no. | RON thousand  | 2017 Preliminary | Budget proposal 2018 | Ratio 2018 Budget/Preliminary 2017 % |
|----------|---|------------------|----------------------|--------------------------------------|
| 1        | Revenues from Romgaz gas sales delivered from own production (excluding joint ventures, and gas for electricity production) | 3 383 231        | 3 422 531            | 101,16%                              |
| 2        | Revenues from joint ventures  | 128 831          | 123 502              | 95,86%                               |
| 3        | Revenues from import gas deliveries   | 29 280           | 26 473               | 90,41%                               |
| 4        | Revenues from electricity deliveries  | 420 036          | 300 621              | 71,57%                               |
| 5        | Revenues from storage services  | 433 733          | 338 203              | 77,97%                               |
| 6        | Income from in-house works capitalized as non-current assets  | 218 577          | 246 061              | 112,57%                              |
| 7        | Other operating income  | 367 804          | 121 412              | 33,01%                               |
| 8        | <b>Total operating income</b>   | <b>4 981 491</b> | <b>4 578 803</b>     | <b>91,92%</b>                        |

*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 2018 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 the estimated average delivery price.*

*Revenues from underground gas storage services were determined based on services supplied for gas injection and withdrawal into/from UGSs and for capacity booking and changes in inventories.*

*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 13,550 thousand** is generated by the interest received from banks for the company's cash placed in bank deposits and state bonds. This income is anticipated to be below the previous year's income as a result of decreasing bank interests.

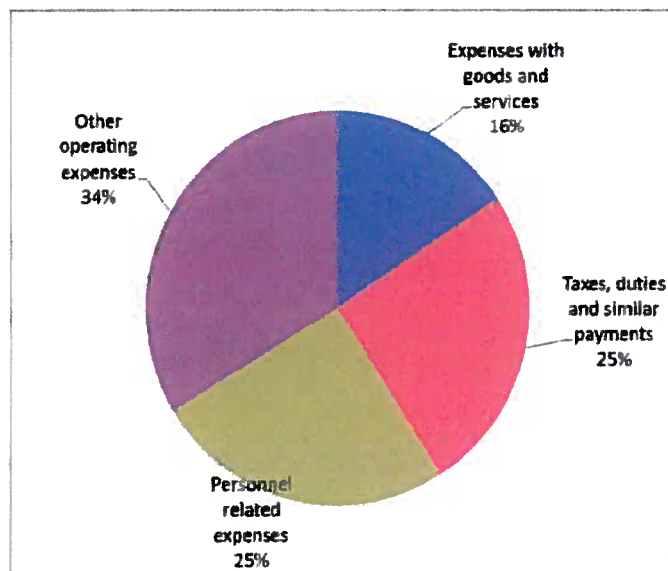
## 2. Substantiation of expenditure

*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   | 2017 Preliminary | Budget 2018      | Ratios (%)     |
|--|------------------|------------------|----------------|
|  | 1                | 2                | 3=2/1          |
| <b>A. Expenses with goods and services, out of which:</b>  | <b>406 493</b>   | <b>462 367</b>   | <b>113.75%</b> |
| A1. Expenses with inventories                              | 287 903          | 292 893          | 101.73%        |
| A2. Expenses with services supplied by third parties       | 30 573           | 37 698           | 123.30%        |
| A3. Expenses with other services supplied by third parties | 88 016           | 131 776          | 149.72%        |
| <b>B Expenses with taxes, duties and similar payments</b>  | <b>687 413</b>   | <b>751 693</b>   | <b>109.35%</b> |
| <b>C. Personnel related expenses</b>                       | <b>679 843</b>   | <b>752 544</b>   | <b>110.69%</b> |
| <b>D. Other operating expenses</b>                         | <b>1 013 030</b> | <b>997 575</b>   | <b>98.47%</b>  |
| <b>Total Operating Expenses</b>                            | <b>2 786 779</b> | <b>2 964 179</b> | <b>106.37%</b> |

Graphic representation of operating expenses divided on the 4 chapters:



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

For this expense category (A) of RON 462,367 thousand, an increase of 13.8% is forecasted as compared to the achievements of 2017, influenced mainly by the increase of the scheduled volume of in-house works relating to intangible assets and to maintenance works.

The amount planned for 2018 is lower than the amount approved in the last year's budget.

The actions, activities and operations, which were not performed during 2017, for this category of expenses, influenced the increases forecasted for 2018, due to the need to carry these out for performing the current activities of the company.

The increase of the gross gas production in 2018 as compared to the 2017 forecasted production (by 1.8%) generates a consumption increase of materials, spare parts, technological consumption, inventory items, fuel.

The mitigation of the natural decline of the gross gas production incurs inventories-related expenses, each branch having consumption norms specific for the branches' scope of activity.

A significant share in expenses for goods and services is held by the value of pipes, tubing, wellheads, foaming agents, cement, spare parts for the maintenance of gas compressors and gas drying stations.

Expenses in connection with third party services will increase by 23.3% as compared to 2017 being at a level required for ensuring the operation continuity under safety conditions. The highest share relates to the maintenance and repairs 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 in connection with third party services consist of expenses in connection with partners, commissions, fees, legal services, protocol, advertisement and publicity, sponsorship, transportation, employee transportation and relocation, security, organization restructure design, employee training, etc.

#### ***B Expenses for Taxes, Duties and Similar Payment***

These expenses include royalty calculated as percentage from the physical production, from condensate, from gas storage services (RON 301.7 million), windfall tax (RON 435.5 million), land and building taxes, total permitting, licencing and environment taxes (RON 14.5 million).

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

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 the 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.

Not applying the provisions of the state budget law when preparing the 2018 personnel related expenses of companies that recorded profit, 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 10.7% higher than forecasted for 2017, this increase is generated by applying the 3.7% inflation ratio and by the increase of the average number of employees.

The number of employees forecasted for the end of 2018 is 6358, and the average number is 6302 employees.

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

This chapter records a decrease of expenses estimated for 2018 (by 1.5%) 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 has been 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 1,239,626 thousand.

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

**VII. Investment Program** of RON 1,605,000 thousand is completely self-financed.

The priorities of ROMGAZ 2018 Investment Program are focused on projects aiming to compensate the natural decline of the natural 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;
- preserving the underground natural gas storage capacity, flexibility and security of operation for the already existent storages and building up new capacities;
- 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    | Preliminary 2017 | Budget Proposal 2018 | Ratios 2018 Budget/ 2017 Preliminary % | Budget proposal 2019 | Budget proposal 2020 |
|---|----------------|------------------|----------------------|--|----------------------|----------------------|
| 1 | Total income   | 5 004,6          | 4 592,4              | 91,76%                                 | 4 610,4              | 4 557,4              |
| 2 | Total expenses | 2 807,3          | 2 987,9              | 106,43%                                | 3 004,2              | 2 986,6              |
| 3 | Gross result   | 2 197,3          | 1 604,4              | 73,02%                                 | 1 606,2              | 1 570,8              |

### IX. Indicator Forecast for the Period 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 Income and Expenditure Budget Proposal for 2018 and the forecast for 2019 – 2020 in the meeting of February 22, 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 Income and Expenditure Budget.**

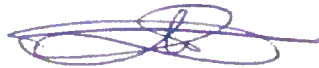
The following annexes are part of the Income and Expenditure Budget:

- Annex 1: 2018 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, as well as in compliance with the procedure described in the Convening Notice of the Ordinary General Meeting of Shareholders (OGMS) on *March 29, 2018*.

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



**ENDORSED,**

**DIRECTOR GENERAL  
Corin Emil Cindrea**



**CHIEF FINANCIAL OFFICER  
Andrei BOBAR**





2018 INCOME AND EXPENDITURE BUDGET

RON thousand

|      |    | INDICATORS  | Row no. | 2018 Budget proposal |
|------|----|---|---------|----------------------|
| 0    | 1  | 2   | 3       | 4                    |
| I.   |    | <b>TOTAL INCOME (Row1+Row2+Row5+Row6)</b>   | 1       | 4 592 354            |
|      | 1  | Total operating income out of which:  | 2       | 4 578 804            |
|      |    | a) subsidies, according to legal provisions in force  | 3       |                      |
|      |    | b) transfers, according to legal provisions in force  | 4       |                      |
|      | 2  | Financial Income  | 5       | 13 550               |
|      | 3  | Extraordinary Income  | 6       |                      |
| II.  |    | <b>TOTAL EXPENSES (Row7+Row8+Row20+Row21)</b>   | 7       | 2 987 935            |
|      | 1  | Operating expenses, out of which:   | 8       | 2 984 179            |
|      | A. | expenses for goods and services   | 9       | 482 367              |
|      | B. | expenses for taxes, duties and similar payments   | 10      | 751 693              |
|      | C. | personnel-related expenses, out of which:   | 11      | 752 544              |
|      | C0 | expenses for salaries and wages (Row 13+ Row14)   | 12      | 704 636              |
|      | C1 | expenses for salaries   | 13      | 628 591              |
|      | C2 | expenses for bonuses  | 14      | 76 046               |
|      | C3 | other personnel expenses, out of which:   | 15      | 1 238                |
|      |    | expenses with termination benefits  | 16      |                      |
|      | C4 | expense for the mandate contract and for other management and control bodies, committees and commissions  | 17      | 3 192                |
|      | C5 | expenses with contributions owed by the employer  | 18      | 43 478               |
|      | D. | other operating expenses  | 19      | 997 575              |
|      | 2  | Financial expenses  | 20      | 23 758               |
|      | 3  | Extraordinary expenses  | 21      |                      |
| III. |    | <b>GROSS RESULT (profit/loss)</b>   | 22      | 1 604 419            |
| IV.  |    | <b>PROFIT TAX</b>   | 23      | 288 610              |
| V.   |    | <b>PROFIT AFTER DEDUCTION OF PROFIT TAX, out of which:</b>  | 24      | 1 315 809            |
|      | 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 instalments, 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      | 1 315 809            |
|      | 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      | 29 528               |
|      | 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      | 672 568              |
|      | a) | - dividends to the state budget   | 33      | 470 798              |
|      | b) | - dividends to the local budget   | 33 a    |                      |
|      | c) | - dividends to other shareholders   | 34      | 201 770              |
|      | 9  | Profit not allocated to rws. 31-32 is allocated to other reserves and represents the company's own equity finance   | 35      | 643 040              |
| VI.  |    | <b>INCOME FROM EUROPEAN FUNDS</b>   | 36      |                      |
| VII. |    | <b>ELIGIBLE EXPENSES FROM EUROPEAN FUNDS, out of which:</b>   | 37      |                      |
|      | a) | expenses for materials  | 38      |                      |
|      | b) | expenses for salaries   | 39      |                      |

RON thousand

|      |    | INDICATORS   | Row no. | 2018 Budget proposal |
|------|----|--|---------|----------------------|
| 0    | 1  | 2  | 3       | 4                    |
|      | c) | expenses for services  | 40      |                      |
|      | d) | expenses for promotion and advertising   | 41      |                      |
|      | e) | other expenses   | 42      |                      |
| VIII |    | INVESTMENT FINANCING SOURCES, out of which:  | 43      | 1 605 000            |
|      | 1  | Allocations from the budget, out of which:   | 44      |                      |
|      |    | budget allocations related to payments of previous years commitments   | 45      |                      |
| IX   |    | INVESTMENTS  | 48      | 1 605 000            |
| X    |    | SUPPORTING DATA  | 47      |                      |
|      | 1  | Forecasted no. of employees at the end of the year   | 48      | 6 358                |
|      | 2  | Total average number of employees  | 49      | 6 302                |
|      | 3  | Average monthly income per employee (RON/ person) determined on basis of salary-related expenses   | 50      | 8 588                |
|      | 4  | Average monthly income per employee (RON/ person) determined on basis of salary expenses recalculated under the Annual Law of the State Budget | 51      | 7 176                |
|      | 5  | Labour productivity in financial units per total average number of employees (thousand RON/person) (Rw.2/Rw.48)                                | 52      | 727                  |
|      | 6  | Labour productivity in financial units per total average number of employees recalculated under the Annual Law of the State Budget             | 53      | 727                  |
|      | 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      | 651                  |
|      | 9  | Outstanding payments   | 56      |                      |
|      | 10 | Overdue accounts receivables   | 57      | 1 239 626            |

DIRECTOR GENERAL,  
CORIN EMIL CINDREA



CHIEF FINANCIAL OFFICER,  
ANDREI BOBAR