

NR. 8773/24.03.2017

TO,

**SNGN ROMGAZ SA MEDIAS
GENERAL MEETING OF SHAREHOLDERS****SUBSTANTIATION NOTE
ON
THE 2017 INCOME AND EXPENDITURE BUDGET****I. The substantiation of the 2017 Income and Expenditure Budget and of the 2018 - 2019 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 2017 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 Medium Term Forecast 2016 – 2020” – the autumn version 2016, as published by the National Prognosis Commission. Inflation and exchange rates forecasted for 2017, 2018, 2019 are shown in the table below:

	2017	2018	2019
Index of consumer price – annual average	1.9%	2.5%	2.3%
Exchange rate RON/Euro - annual average	4.46	4.44	4.42
Exchange rate RON/USD - annual average	3.99	3.96	3.95

III. Outline and substantiation of the indicators included in Romgaz 2017 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.

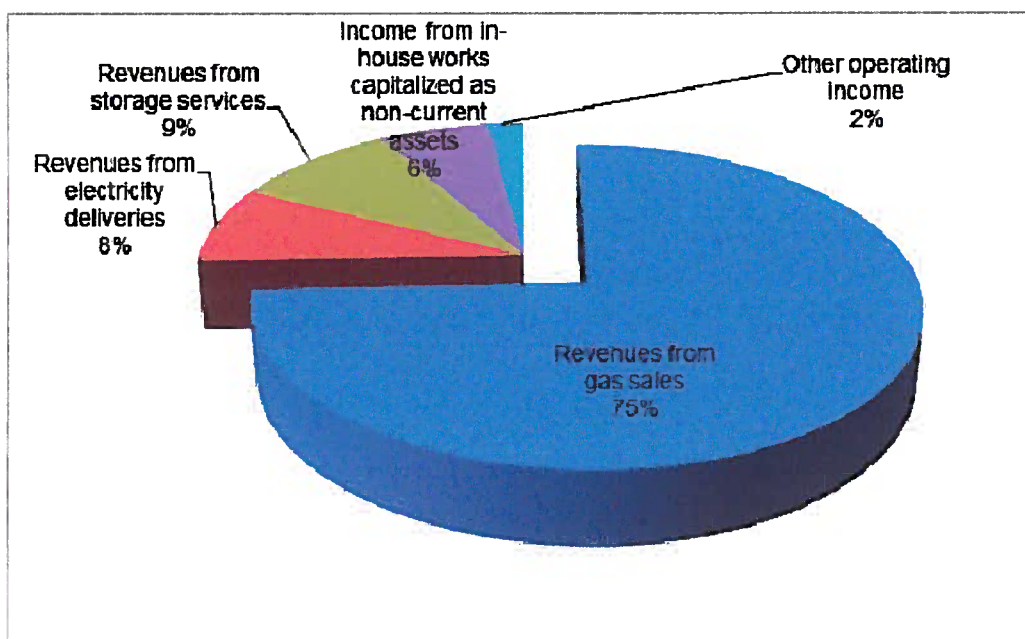
Revenues of the Electricity Production Branch (SPEE Iernut) are generated from the electricity production and delivery as well as from other field related services.

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 in amount of **RON 3,983,916 thousand** is estimated to be by 0.2% higher than the forecast for 2016.

The structure of operating income for 2017 is shown in the figure below:



Operating income is detailed in the table below:

Item no.	RON thousand	2016 Preliminary	Budget proposal 2017	Ratio 2017 Budget/Preliminary 2016 %
1	Revenues from Romgaz gas sales delivered from own production (excluding joint ventures, and gas for electricity production)	2 558 848	2 856 472	111.63%
2	Revenues from joint ventures	108 323	103 946	95.96%
3	Revenues from import gas deliveries	10 885	5 967	54.82%
4	Revenues from electricity deliveries	310 267	315 793	101.78%
5	Revenues from storage services	371 308	373 731	100.65%
6	Income from in-house works capitalized as non-current assets	180 813	249 034	137.73%
7	Other operating income	434 493	78 974	18.18%
8	Total operating income	3 974 936	3 983 916	100.23%

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 2017 and on the average delivery price of gas from current production and withdrawn from UGSs for both household and non-household consumption.

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 reservation 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 7,063 thousand** is generated by the interests 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.

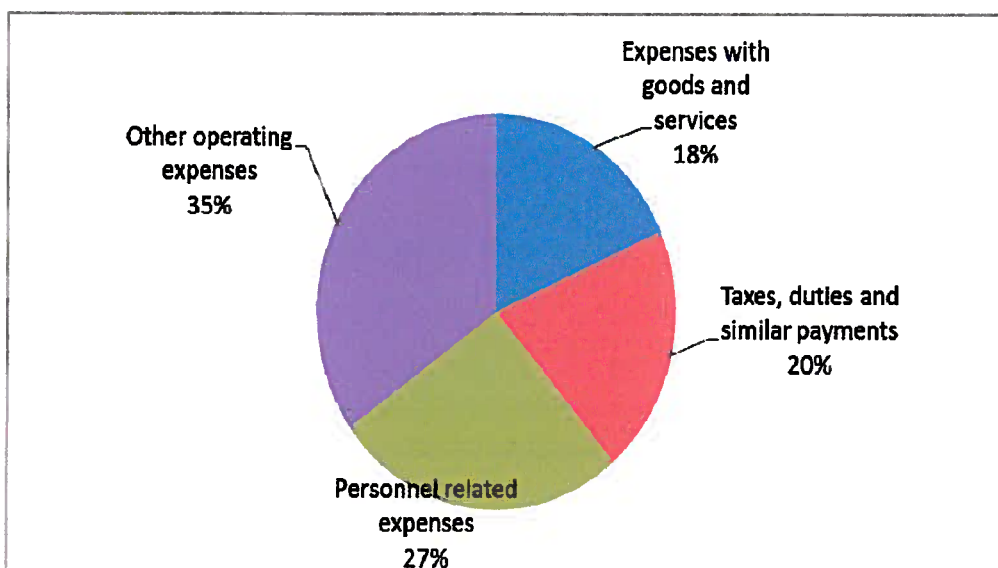
2. Substantiation of expenditure

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	2016 preliminary	Budget 2017	Ratios (%)
	1	2	3=2/1
A. Expenses with goods and services, out of which:	327 045	483 722	147.91%
A1. Expenses with inventories	204 612	318 637	155.73%
A2. Expenses with services supplied by third parties	27 533	38 741	140.70%
A3. Expenses with other services supplied by third parties	94 899	126 345	133.14%
B Expenses with taxes, duties and similar payments	603 769	536 280	88.82%
C. Personnel related expenses	607 203	697 245	114.83%
D. Other operating expenses	1 159 712	922 875	79.58%
Total Operating Expenses	2 697 728	2 640 122	97.86%

Graphic representation of operating expenses divided on the 4 chapters:



A. Expenses for Goods and Services:

For this expense category (A) of RON 483,722 thousand, an increase of 48% is forecasted as compared to the achievements of 2016, influenced mainly by the high scheduled volume of in-house works relating to intangible assets and to maintenance works.

2016 has been a year with events uncharacteristic for the company's business, namely the decrease of gas demand leading to the shutdown of compressor stations and shut-in of wells from gas fields. Therefore it is not relevant to report all indices for year 2016.

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 40.7% as compared to 2016 and the forecast is 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 repairs, inspection and refurbishment works for buildings, construction, 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 251.3 million), windfall profit tax (RON 267.8 million), land and building taxes, total permitting, licencing and environment taxes (RON 17.2 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;

~ **Law no. 218/2016** on amending art.3 para (1) of Law no.142/1998 on granting luncheon vouchers;

~ **Law no. 6/2017** on the State Budget for the year 2017;

~ **Labour Code;**

~ **Collective Labour Agreement**

Law no. 6/2017 of the State Budget for 2017 provides at Chapter III "General Dispositions" art.59, para (1)-(6) the government's policy coordinates on the salary policy for 2017. But para (7) of the same article provides that:

(7) the provisions of paragraphs (1)-(6) do not apply to economic operators that cumulatively fulfil the following conditions:

- a) did not record in the last 2 consecutive years gross losses;*
- b) complied with the level of overdue payments approved by the 2016 income and expenditure budget;*
- c) do not plan gross losses for 2017."*

SNGN Romgaz SA Medias falls within the provisions of this paragraph; therefore, it did not apply the provisions of paragraphs (1)-(6) of the State Budget Law for preparing the 2017 income and expenditure budget.

Not applying the provisions of the state budget law when preparing the 2017 personnel related expenses of companies that recorded profit, is an opportunity to analyse the possibility to increase salaries in order to motivate and to maintain the specialized personnel.

The expenses for salaries and wages are higher by 13.2% as compared to the 2016 preliminary ones, increase generated by the increase of the luncheon voucher value, of the average number of employees and increase of the base salary.

The number of employees forecasted for the end of 2017 is 6329, and the average number is 6310 employees.

D. Other operating expenses

This chapter records a decrease of expenses estimated for 2017 (by 20.4%) 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 amortization, adjustments and provisions.

IV. 2017 Profit Distribution Proposal

Profit distribution has been made in the 2017 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 2017 amounts to RON 1,066,834 thousand.

VI. Level of Arrears is estimated to RON 0.

VII. Investment Program in amount of RON 1,143,000 thousand is completely self-financed.

The priority directions of ROMGAZ 2017 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 exploration 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 special well operation and intervention equipment and installations, as well as acquisition of high performance equipment and installations specific for basic activity;
- specific machinery acquisition to ensure technological transportation and maintenance of the base activity, as well as maintaining optimum conditions of road infrastructure in gas fields.

VIII. Summary of Main Indicators

	RON million	Preliminary 2016	Budget Proposal 2017	Ratios 2017 Budget/ 2016 Preliminary %	Budget proposal 2018	Budget proposal 2019
1	Total income	3 997.6	3 991.0	99.83%	3 979.9	4 100.4
2	Total expenses	2 716.8	2 660.2	97.92%	2 645.9	2 766.1
3	Gross result	1 280.8	1 330.8	103.90%	1 334.0	1 334.3

To be noted that the expense reduction ratio is lower than the estimated income reduction ratio for 2017 as compared to the preliminary for 2016.

IX. Indicator Forecast for the Period 2018 - 2019

The 2018 – 2019 forecast rests on those assumptions underlying the substantiation of the 2017 budget, the market demand and conditions.

We would like to emphasize that the indicators forecasted for 2018 and 2019 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 budgets for each of the respective years.

ROMGAZ Board of Directors endorsed the 2016 Income and Expenditure Budget Proposal for 2017 and the forecast for 2018 – 2019 in the meeting of March 23, 2017.

In accordance with Article 4 paragraph (1) item d) of the Government Ordinance 26/ 2013, we hereby request the Ordinary General Meeting of Shareholders to approve the 2017 Income and Expenditure Budget.

The general frame regarding the Income and Expenditure Budget comprises the following annexes:

- Annex 1: 2017 Income and Expenditure Budget (including estimations for 2018 – 2019); only the column related to the current year is published, in accordance with O.M.F.P. 20/2016.

- 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 columns related to years 2018 -2019 from Annex 1 and Annex 2-5 are not public. These may be reviewed only by Romgaz shareholders at the headquarters, daily between 10am – 2pm, as well as in compliance with the procedure described in the Convening Notice of the Ordinary General Meeting of Shareholders (OGMS) on April 25, 2017.

**CHAIRPERSON
OF THE BOARD OF DIRECTORS
Dumitru CHISALITA**



ENDORSED,

**DIRECTOR GENERAL
Virgil Marin DUMITRA**



**CHIEF FINANCIAL OFFICER
Andrei BOBAR**



2017 INCOME AND EXPENDITURE BUDGET

RON thousand

		INDICATORS	Row no.	2017 Budget proposal
0	1	2	3	4
I.		TOTAL INCOME (Row1=Row2+Row5+Row6)	1	3 990 979
	1	Total operating income out of which:	2	3 983 916
		a) subsidies, according to legal provisions in force	3	
		b) transfers, according to legal provisions in force	4	
	2	Financial income	5	7 063
	3	Extraordinary income	6	
II		TOTAL EXPENSES (Row7=Row8+Row20+Row21)	7	2 660 227
	1	Operating expenses, out of which:	8	2 640 122
	A.	expenses for goods and services	9	483 722
	B.	expenses for taxes, duties and similar payments	10	536 280
	C.	personnel-related expenses, out of which:	11	697 245
	C0	expenses for salaries and wages (Row 13+Row14)	12	546 245
	C1	expenses for salaries	13	480 286
	C2	expenses for bonuses	14	65 959
	C3	other personnel expenses, out of which:	15	1 233
		expenses with termination benefits	16	
	C4	expenses for the mandate contract and for other management and control bodies, committees and commissions	17	3 314
	C5	expenses for social security, special funds and other legal obligations	18	146 452
	D.	other operating expenses	19	922 875
	2	Financial expenses	20	20 105
	3	Extraordinary expenses	21	
III		GROSS RESULT (profit/loss)	22	1 330 752
IV		PROFIT TAX	23	246 179
V		PROFIT AFTER DEDUCTION OF PROFIT TAX, out of which:	24	1 084 573
	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	1 084 573
	6a	Profit to be distributed from previous years	30 a	200 000
	6b	Total profit to be distributed (30+30a)	30b	1 284 573

RON thousand

	INDICATORS	Row no.	2017 Budget proposal
0	1	2	3
			4
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	23 061
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	653 817
a)	- dividends to the state budget	33	457 672
b)	- dividends to the local budget	33 a	
c)	- dividends to other shareholders	34	196 145
9	Profit not allocated to rows 31-32 is allocated to other reserves and represent the company's own equity finance	35	630 756
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	
VII I	INVESTMENT FINANCING SOURCES, out of which:	43	1 143 000
1	Allocations from the budget, out of which:	44	
	budget allocations related to payments of previous years commitments	45	
IX	INVESTMENTS	46	1 143 000
X	SUPPORTING DATA	47	
1	Forecasted no. of employees at the end of the year	48	6 329
2	Total average number of employees	49	6 310
3	Average monthly income per employee (lei/ person) determined on basis of salary-related expenses	50	6 592
4	Average monthly income per employee (lei/ person) determined on basis of salary expenses (Rw.13/Rw.49)/12*1000	51	6 343
5	Labour productivity in financial units per total average number of employees in current prices (thousand lei/person) (Rw.2/Rw.49)	52	631
6	Labour productivity in physical units per total average number of employees (finished goods quantity/person)	53	753
7	Total expenses related to lei 1 000 total income (Rw.7/Rw.1)x1000	54	667
8	Outstanding payments	55	
9	Overdue accounts receivables	56	1 066 834



CHIEF FINANCIAL OFFICER

ANDREI BOBAR