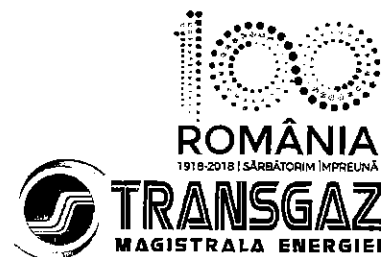




**SOCIETATEA NAȚIONALĂ DE TRANSPORT
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No. 3555/23.01.2018

Submitted for approval in the OGMS of 5 March 2018

REPORT on the approval of the revenue and expense budget for 2018 and of the estimations for –2019 - 2020

SUMMARY

The draft revenue and expense budget for 2018 and the estimations for 2019-2020 were approved in the Board of Administration meeting of 26 January 2018.

The substantiation of the draft was based on the programmes for NTS design, maintenance, rehabilitation, supply of materials and spare parts; programmes for the provision of services; the provisions of the Collective Labour Contract; the legislation in force; based on the quantities of gas estimated to be transmitted and the expected capacity bookings.

No.	ITEM	2017 REB	Estimated in 2017	2018 REB
0	1	2	3	4
1.	TOTAL REVENUE, of which:	2.205.866	2.009.067	2.518.898
	<i>2017 REB comparison</i>		-8,92%	14,19%
	<i>Estimated in 2017 comparison</i>			25,38%
1.1.	Operating revenue before the construction activity according to IFRIC 12	1.577.348	1.873.210	1.475.267
1.2.	Financial revenue	30.826	48.793	33.810
1.3.	Revenue before the construction activity according to IFRIC 12	597.692	87.064	1.009.821
2.	TOTAL COST	1.834.295	1.380.299	2.264.187
	<i>2017 REB comparison</i>		-24,75%	23,44%
	<i>Estimated in 2017 comparison</i>			64,04%
2.1.	Operating costs before the construction activity according to IFRIC 12	1.226.596	1.283.653	1.239.366
2.2.	Financial costs	10.007	9.581	15.000
2.3.	Cost of assets constructed according to IFRIC 12	597.692	87.064	1.009.821
3.	GROSS PROFIT	371.571	628.768	254.711
	<i>2017 REB comparison</i>		69,22%	-31,45%
	<i>Estimated in 2017 comparison</i>			-59,49%
4.	Tax on profit	59.742	115.649	41.553
5.	NET PROFIT	311.829	513.119	213.158
	<i>2017 REB comparison</i>		64,55%	-31,64%

	Estimated in 2017 comparison			-58,46%
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PROPOSAL:

The approval of the draft revenue and expense budget for 2018 and of the estimations for –2019 - 2020, according to GO 26/21 August 2013, Art.4 (1) (d) and to the applicable Articles of Incorporation of Transgaz, Chapter IV, Art.15 (3)(c).

General considerations regarding REB preparation

Considering GO 26/21 August 2013, as further amended and supplemented, *'on strengthening the financial discipline at the level of the economic operators where the state or the territorial administrative units are unique or majority shareholders or hold a majority directly or indirectly'*, regulating:

- Art. 6, paragraph (1)¹ *The economic operators under Art.4, paragraph (1), letter d), whose shares are accepted to trade on a regulated market, as well as their affiliates submit, according to the law the revenue and expense budget and the substantiation annexes, prepared according to the applicable laws, to the General Meeting of the Shareholders, for approval, following the prior consulting of the trade unions, and publishes the revenue and expense budget including the amount for the current year within 60 days from the entering into force of the annual law on the state budget or from the date of approval of the village, town, Bucharest district, County, Bucharest local budgets, as appropriate.*
- **Art. 7, paragraph (1) annually, the state budget law establishes salary policy objectives on which economic operators base revenue and expense budget indicators.**
- Art. 9, paragraph (1) *Economic operators consider, without limitation the following when substantiating the revenue and expense budget:*
 - a) *Compliance with the Government's and administrative-territorial units' policy on improving the economic and financial performance of the operators;*
 - b) compliance with the salary policy objectives set by the annual state budget law;**
 - c) the specific performance criteria and the quantified objectives for the reduction of payments and outstanding debts, the reduction of losses, the increase in profit and turnover and the labour productivity growth provided in the mandate contracts, stable in relation to the management strategy of the Board of Administration//Supervisory Board and the management plan of the directors / members of the directorate of economic operators.**

for the substantiation of the Revenue and Expense Budget of SNTGN Transgaz SA it is necessary to comply with the Government's policy on enhancing the economic and financial performance and of the salary policy objectives approved under the State Budget Law.

The Revenue and Expense Budget for 2018 is substantiated compliant with the provisions of:

- Law 2/3 January 2018 of the state budget for year 2018, Art.58 (1) (b);
- GO 26/21 August 2013, as further amended and supplemented, *'on strengthening the financial discipline at the level of the economic operators where the state or the territorial administrative units are unique or majority shareholders or hold a majority directly or indirectly'*,

- Ministry of Public Finance Order 3145/5 December 2017 *on the form and structure of the revenue and expense budget and of the annexes for the substantiation of the budget*;
- ANRE Order 32/21 May 2014 *on the approval of the Gas Transmission Regulated Revenue, Total Revenue and Regulated Tariff Setting Methodology*;
- ANRE Order 31/6 July 2016 *on the amendment and supplementing of the methodology for setting the regulated revenue, the total revenue and the regulated tariffs for the gas transmission activity, approved by the ANRE Order 32/21 May 2014*;
- ANRE Order 34/19 July 2016 *on the approval of the Methodology for transmission capacity booking and tariff setting for natural gas transmission services through the Isaccea – Negru Vodă gas transmission pipelines*;
- Regulation EU 312/2014 *establishing a Network Code on Gas Balancing of Transmission Networks*;
- ANRE Order 160/2015 *amending and supplementing the Network Code for the National Gas Transmission System, approved by ANRE President Order 16/2013*;
- ANRE Order 85/2017 *on the approval of the Methodology for the calculation of the neutrality tariffs for balancing, including their allocation to the network users of the gas transmission network*;
- *Trading Companies' Law 31/1990, republished, as further amended and supplemented*;
- GEO 90/2017 *on some fiscal and budgetary measures, the amendment and completion of some legal acts and the prorogation of some time limits*.

The draft revenue and expense budget for 2018 was submitted for consultation to the financial management control according to Government Resolution 1.151/2012 approving the Methodological rules on the organization and exercise of the financial management control, and to the trade unions.

Expense substantiation was based on the following:

- estimated inflation ratios and/or exchange rates projected according to the **Medium-term forecast for the period 2017-2021 - the autumn forecast of the National Commission for Prognosis**, for those costs which by their nature have an approximately linear evolution;
- technical regulations in force;
- programme for NTS modernization and development (Investments), design, maintenance and rehabilitation, supply of materials and spare parts;
- service providing programs (security and safety, training, consulting, etc.);
- normative acts that are in force regarding legislated costs (contribution to social insurance, health insurance, unemployment benefit, transmission licence fee, royalty for the concession of the transmission system, tax on special constructions etc.);
- operating costs for financial services for the procurement of shares, made by Transgaz for the association with Reganosa and other partners for participation in the privatization process for the procurement of 66% of the shares of the gas transmission operator DESFA of Greece, according to the EGMS Resolution 1/19 January 2018 on the approval of the association between SNTGN Transgaz SA and Regasificadora del Noroeste SA of Spain (Reganosa) for participating in the second stage of the procurement process for a 66% share in DESFA;
- costs of social activities under the Collective Labour Contract;

Under Art. 1 of GEO 8/2009 on granting holiday vouchers approved as amended and supplemented by Law 94/2014, stipulating that 'As of the entering into force of this emergency ordinance, for the recovery and maintenance of the working capacity of the employees, the employers hiring personnel under an individual labour contract may legally grant vouchers, hereinafter referred to as holiday vouchers' correlated with the provisions of the CLC in force, regarding the substantiation of the 2018 REB and of the estimations for 2019-2020, no holiday voucher costs were substantiated, being taken into account the rights of the employees in line with Art.189 of the current Collective Labour Contract in force regarding the partial settlement of tickets for rest and treatment.

- technological consumption costs were established based on:
 - an estimate of the specific consumption in the gas compressor stations, technological loss due to discharge as a result of new pipe couplings and planned repairs, differences due to measurement errors, etc.;
 - a purchase price of gas under Gas Selling-Buying Contract 473/15 September 2017 (contract price: RON 79/MWh) to which the estimated unitary excise was added.
- costs of purchase of gas for NTS balancing according to ANRE Order 160/2015 amending and supplementing the Network Code for the National Gas Transmission System, approved by ANRE President Order 16/2013 and ANRE Order 1/18.01.2016;
- the expense related to the tax on the monopoly - according to Art. 22 of GEO 90/2017 *on some fiscal and budgetary measures, the amendment and completion of some legal acts and the prorogation of some time limits* providing 'The period under Art. 6 of Government Order 5/2013 on the establishment of special tax measures of the natural monopoly activities in the electricity and natural gas domains, approved as further amended and supplemented, shall be extended until 31 December 2018, included';
- The following were considered at the substantiation of the personnel costs:
 - establishing the calculation basis at the current level of the basic salary, bonuses and benefits granted to the employees under the Collective Labour Contract in force in the Company and the individual labour contract applicable;
 - a basic salary indexation by 20% from January 2018 for applying by TRANSGAZ of GEO 79/08.11.2017 for the amending and supplementing of Law 227/2015 on the Tax Code, without the diminishing of the net revenue of the employees;
 - a basic salary indexation by 2,5 % from October 2018, according to Art. 146 of the Collective Labour Contract in force in the Company;
 - the provision of a fund amounting to RON 19.627,9 thousand for granting compensations for the continuation of the voluntary turnover of approximately 300 employees. This fund was calculated for the estimated number of employees, at the level foreseen at Art. 47 of the Collective Labour Contract. The provision of these funds represents an increase in the cost of personnel over the short term, but over the long term it triggers benefits from the reduction of the cost with the relevant employees, employed under individual labour contracts for an indefinite period;
 - employing new personnel for the jobs created for BRUA and Moldova projects, whose salary fund will be settled in part from the funds received from the European Union and which will be cancelled after the completion of the projects. The funds provided for this purpose in the amount of RON

23.423,2, thousand were assigned to staff salary costs, being the kind employed for business expansion. Out of this amount RON 9.369,3 thousand will be reimbursed from the funds received from the EU for the achievement of these projects.

- fixed-term employment of personnel on 70 positions in 2018. Such positions will be occupied mainly by experts and advisers needed for the operating and analysis activities regarding the structure of the gas market consumptions and of the European funds granting necessary for the implementation of the projects for the upgrading of the NTS and related facilities. For these 70 position having an employment duration of 12 months in 2018 salary cost funds amounting to RON 4.311 thousand were foreseen;
- the granting of birth, marriage, retirement and death benefits in accordance with the provisions of applicable Collective Labour Contract;
- the amounts necessary for the granting of the food vouchers in nominal value of RON 15 in 2018.
- expenses incurred on behalf of an employee related to voluntary pension schemes, up to an amount representing the RON equivalent of 400 EUR in a financial year, for each participant. The collective labour contract in force under Art. 62(4) foreseen the EUR 400/employee ceiling in a financial year;
- cost of voluntary health insurance premia up to an amount representing the RON equivalent of EUR 250 in a financial year, for each participant. The collective labour contract applicable at the level of the Company foresees under Art.62 (5) the EUR 250/employee ceiling in a financial year;
- the provision of the sums necessary to bear part of the cost of the treatment and rest benefits, including transport for the Company employees and their family members according to Art. 189 of the collective labour contract in force;
- expenses representing the participation of employees in the Company's profit under G.O. 64/2001 on profit distribution in national companies, companies publicly owned or controlled and the autonomous regies, as further amended and supplemented corroborated with Art. 141 of the Collective Labour Contract in force within the company;
- a fund of RON 3.434,9 thousand for compensations regarding the continuation of employee redundancy on some positions which will be eliminated as a result of the organizational redesigning of some of the Company's activities. This fund was calculated for an estimated number of 50 employees, according to Art. 47 of the CLC. The provision of these funds represents an increase in the cost of personnel in the short term, but in the long term it is intended the obtaining of advantages by reducing the costs with the relevant employees, employed under individual labour contracts for an indefinite period of time;
- other costs of personnel for the monthly payment of the land assessment committee for 7 members, according to the resolution of the Board of Administration.

Revenue substantiation was determined considering:

- the gas quantities estimated to be transmitted (including the quantities transmitted for storage) and the capacity booking estimated for 2018 – 2020;
- the gas quantities estimated to be procured for the physical balancing of the National Transmission System;
- the regulated transmission tariffs approved by the ANRE under Order 74/2 August 2017 on the approval of the regulated revenue, total revenue and transmission tariffs for the transmission of gas

through the National Transmission System for the period 1 January 2018 - 30 September 2018, and for the period 1 October 2018 - 31 December 2020 based on the methodology approved by ANRE Order 32/2014 modified by ANRE Order 31/2016; the value of the international gas transmission service was estimated

- according to the existing contracts concluded with Gazprom Export Ltd for lines 2 and 3;
- based on the transmission capacities estimated for line 1 and of the regulated transmission tariffs approved by ANRE by Order 73/2 August 2017 on the mending of Annex 2 of ANRE Order 40/2016 on the approval of the total revenue and of the transmission tariffs for the gas transmission activity related to the Isaccea 1 – Negru Voda 1 transmission pipelines.
- Following the commissioning of the project *Interconnection of the national gas transmission system with the international gas transmission pipeline T1 and reverse flow Isaccea*, the Isaccea 1 – Negru Vodă 1 transmission pipeline will be part of the National Transmission System and the provisions of the methodology approved by ANRE Order 32/2014 will be applied at the entry/exit points as of 1 October 2019.

The assumptions at the basis of the substantiation of the economic and financial indicators for the period 2018-2020 are as follows:

Based on these assumptions the following economic and financial indicators resulted:

Tag no	Item	MU	2018	2019	2020
1.	Average annual inflation index	%	3,10	2,30	2,20
2.	Exchange rate	lei/EURO	4,55	4,54	4,52
3.	Exchange rate	lei/USD	4,06	4,05	4,04
4.	Transmitted gas quantity (including injection in underground storage)	MWh	136.788.276	146.509.108	167.380.882
5.	The average transmission tariff	lei/MWh	7,59	6,85	6,96
6.	Technological consumption procurement price	lei/MWh	79,30	79,30	79,30

Thousand RON

No.	Indicators	2018 REB	Estimated for 2019	Estimated for 2020
1.	TOTAL REVENUE, of which:	2.518.898	4.173.760	2.901.513
1.1	Operating revenue before the construction activity according to IFRIC 12	1.475.267	1.454.334	1.635.479
1.2	Financial revenue	33.810	30.932	46.858
1.3	Revenue from the construction activity according to IFRIC 12	1.009.821	2.688.494	1.219.176
2.	TOTAL COST, of which:	2.264.187	3.871.038	2.665.976
2.1	Operating costs before the construction activity according to IFRIC 12	1.239.366	1.180.267	1.313.677
2.2	Financial costs	15.000	2.277	133.124

No.	Indicators	2018 REB	Estimated for 2019	Estimated for 2020
2.3	Cost of assets constructed according to IFRIC 12	1.009.821	2.688.494	1.219.176
3.	GROSS PROFIT	254.711	302.722	235.537
4.	TAX ON PROFIT	41.553	44.827	34.592
5.	NET PROFIT	213.158	257.895	200.945

The evolution of the economic and financial indicators during the estimated period is influenced by:

- The estimated commissioning of investment objectives;
- the progress of the National Transmission System rehabilitation and maintenance works;
- the evolution of the costs regarding the procurement of gas for technological consumption;

Profit distribution was determined taking into account the provisions of G.O. 64/2001 on profit distribution in national companies, companies publicly owned or controlled and the autonomous municipal companies, as further amended and supplemented and of the specifications approved by MPF Order 144/2005 approving the Specifications for the determination of the amounts subject to profit distribution according to G.O. 64/2001 on profit distribution in national companies, companies publicly owned or controlled and the autonomous municipal companies, approved as amended by Law 769/2001, as further amended and supplemented as follows:

- no amounts were distributed to legal reserves as they are currently constituted under the quota of 20% of the share capital, according to Art.183, paragraphs (1) and (2) of the Law 31/1990, as further amended and supplemented, and the share capital is not expected to change;
- employees participation in the profit was determined within the limit of the monthly average base salary estimated per employee in the year for which the participation is granted, per average number of employees, obtained in the ended financial year;
- dividends to shareholders were determined according to MPF Order 144/2005, by applying 50% to remaining net profit after its recompletion with the amount of the cost representing the participation in profit, with which it was affected the gross profit before taxation;
- retained earnings for setting up own financing sources, was determined as the difference between the net profit to be distributed and the profit proposed to be allocated according to GO 64/2001.

The analysis of the 2018 REB economic and financial indicators as compared to the 2017 estimations

The 2018 REB indicators compared to the 2017 estimations are as follow:

thousand RON

No.	Item	Estimated in 2017	2018 REB	Variation
0	1	2	3	4=3/2-1
1.	TOTAL REVENUE, of which:	2.009.067	2.518.898	25,38%
1.1.	Operating revenue before the construction activity according to IFRIC 12	1.873.210	1.475.267	-21,24%

No.	Item	Estimated in 2017	2018 REB	Variation
1.2.	Financial revenue	48.793	33.810	-30,71%
1.3.	Revenue from the construction activity according to IFRIC 12	87.064	1.009.821	1059,86%
2.	TOTAL COST:	1.380.299	2.264.187	64,04%
2.1.	Operating cost before the construction activity according to IFRIC 12	1.283.653	1.239.366	-3,45%
2.2.	Financial cost	9.581	15.000	56,55%
2.3.	Cost of constructed assets according to IFRIC 12	87.064	1.009.821	1059,86%
3.	GROSS PROFIT	628.768	254.711	-59,49%
4.	TAX ON PROFIT	115.649	41.553	-64,07%
5.	NET PROFIT	513.119	213.158	-58,46%

I. **The revenue from the operation activity before the construction activity according to IFRIC 12** amounting to **RON 1.475.267 thousand** is lower by **RON 397.343 thousand** as compared to the 2017 estimated revenue, which is a decrease by 21%, mainly due to:

- *The decrease of the revenues from the international gas transmission activity by RON 8.015 thousand due to the fluctuations in the exchange rate of the currency provided in the contracts concluded with Gazprom Export Ltd. And to the regulation of the transmission on the pipeline Isaccea 1 – Negru Voda 1 in line with the provisions of NERA Order no 34/2016 regarding the *Methodology for transmission capacity booking and setting gas transmission tariffs related to the gas transmission services through the gas transmission pipelines Isaccea – Negru Voda*;*
- the decrease of the revenue from gas transmission by **RON 282.968 thousand**, due to two factors:
 - the decrease of the commodity charge by **RON 120.828 thousand** on account of the decrease in the share of the commodity charge in the regulated revenue from 40% to 35% and to the decrease in the estimated gas quantities to be transmitted in 2018;
 - the decrease of the capacity booking component by **RON 162.140 thousand** on account of the invoicing of the amount of the surplus of booked capacity in 2017 amounting to RON 115.345 thousand in line with art 3 para (6) of NERA Order no 1/18.01.2016 (revenues which are not present in the following years) and of the decrease of the booked capacity by 24.343.017 MWh.
- The decrease in the revenues from the NTS balancing by **RON 105.164 thousand** on account of the estimation of a gas quantity intended for NTS balancing lower than the one predicted for 2017. When estimating the gas quantity for NTS balancing, the historical consumption data recorded in winter months/depending on temperature, as well as the last quantity purchased by Transgaz on the Stock Exchange for NTS Physical Balancing (in the winter 2015/2016);
- The increase in other operating revenues by **RON 1.796 thousand**.

Regarding the annual evolution of revenue from gas transmission it is worth highlighting the following aspects:

Gas transmission is regulated by the National Energy Regulatory Authority (ANRE). According to the methodology for setting the regulating revenue, the costs savings of the transmission operator in a gas year and the additional revenue obtained in a gas year diminish the regulated revenue approved in the following gas years. In other words, the more effective the company is in reducing costs, the more the revenues from gas transmission will be reduced in the coming gas years.

According to ANRE Order 32/21 May 2014 *on the approval of the Gas Transmission Regulated Revenue, Total Revenue and Regulated Tariff Setting Methodology* the following are also considered at the determination of the annual regulated revenue:

- the correction component of the total revenue for the previous years;
- the correction component of the technological consumption for the previous years;
- the efficiency gain redistribution component obtained by the transmission operator in the first year of the regulatory period by the transmission system users in the first year of the following period (the savings obtained by the transmission operator regarding some cost items as compared to the levels approved by ANRE must be kept by the transmission operator over a period of 5 years; then they are redistributed to users by the diminishing of the annual regulated revenue with these savings).

All these provisions of the methodology may determine the reduction of the revenues from the transmission activity and hence the charges related to them with beneficial effects upon the users of the transmission system.

The application of the provisions of the methodology mentioned above determined, to a large extent, the decrease in revenues from gas transmission in 2018 compared to the level achieved in 2017.

Thus the regulated revenue approved for the period 1 October 2017 - 30 September 2018 recorded decreases mainly on account of the consideration of the redistribution component of the economic efficiency gain during the period July 2012 - June 2013 in the amount of RON -112.099 thousand and of the component correction of the total income in the amount of RON -173.098,51 thousand.

The estimated revenue from the gas transmission activity for 2018, according to the tariffs approved by ANRE for the period 1 October 2017 - 30 September 2018 the estimated charges based on existing regulations for the fourth quarter of 2018 is RON 1.038.125 thousand, by RON 282.968 thousand less compared with 2017 preliminary. This determines a decrease in labour productivity in 2018 as compared to 2017 by about 20%.

Considering the aspects mentioned above, we believe that the provisions of the Instructions for completing the REB approved by the Order no. 3145 /5.12.2017 of the Ministry of Public Finance, Annex 6 par.II.6 according to which *'the total income and expenses are estimated, so the index related to the increase in total expenses usually does not exceed the total income growth index'* cannot be applied for Transgaz whose activity is regulated at a rate of approx. 80%.

EU Regulation 312/2014 establishing a network code on the gas transmission networks balancing provides uniform balancing rules at European level, reflecting the specific needs of the transmission system and take into account the levers of the operators for balancing the transmission systems.

According to the Regulation mentioned above the role of the system operator is to perform balancing activities based on non-discriminatory market principles through the purchase/sale of natural gas quantities required for balancing. The system operator does not record gains or losses as a result of conducting the balancing activity.

The provisions of the Regulation mentioned above are taken over in the ANRE Order no.16/2013 on the approval of the Network Code for the National Gas Transmission System modified by ANRE Order no.160 /2015, which states in Article 83 (2) that *"to ensure the safe operation of the NTS, the TSO should have enough gas for system balancing as natural gas stored in pipelines and/or as balancing gas stored in underground storages, and to take NTS balancing actions including by conducting sales and/or purchasing transactions for the natural gas quantities required to balance the system in a transparent, non-discriminatory manner, by using market mechanisms"*.

When estimating the gas quantity for NTS balancing, the historical consumption data recorded in winter months/depending on temperature, as well as the last quantity purchased by Transgaz on the Stock Exchange for physical balancing of the NTS (in the winter of 2015/2016) . Such gas will be procured in 2018 as needed to balance fluctuations in gas flow and to keep pressure levels at levels that allow safe and efficient operation of the NTS.

II. Operating expenses before the construction activity according to IFRIC12 amounting to **RON 1.239.365,57 thousand** are by **RON 44.288 thousand** lower than the preliminary ones related to 2017, which represents their decrease by 4%, determined mainly by:

a) Savings especially in the following expense elements:

1. expenses with the royalty for the concession of the NTS lower by **RON 28.382 thousand** on account of the decrease in the revenue from gas transmission;
2. the cost of gas procurement for NTS balancing lower by **RON 105.164 thousand** according to ANRE Order no.16/2013 approving the Network Code for the National Gas Transmission System modified by ANRE Order no.160/2015. Because according to the provisions of EU Regulation 312/2014 the system operator does not record gains or losses as a result of conducting balancing activities the revenues and expenses related to such activities were grounded in the draft of the revenue and expenses budget in the same amount.
3. Other material expense and ancillary materials lower by **8.927 thousand**;
4. Other operating expenses lower by **RON 27.726 thousand** mainly on account of the adjustment of the provisions for the impairment of the current assets (-60.917 thousand);

b) Overruns mainly to the following expense elements:

1. Expenses related to services executed by third parties higher by **RON 49.393 thousand**;
2. The cost related to the technological consumption higher by **RON 22.652 thousand**, mainly due to gas quantity higher as compared to 2017 by 19% (192.955 MWh);
3. Personnel salary expenses higher by **RON 39.315 thousand** mainly on account of the provision in 2018 of the funds for the payment of the salaries of the personnel employed for the BRUA and Moldova projects, and of the salary expenses necessary for awarding the compensations provided for in the Collective Labour Contract for voluntary turnovers;

III. **The gross result** estimated for 2018 is of **RON 254.711 thousand**, by RON 374.057 thousand (59%) lower than the preliminary one for 2017.

IV. **The tax on profit** was calculated taking into account:

- ☛ The influence of the provisions for risks and expenses and of the provisions for the depreciation of current assets;
- ☛ The influence of the expenses related to the participation of the employees to the profit related to 2017 and of the rights related to the mandate contract to be paid in the following year;
- ☛ Sponsorship expenses granted within the legal limit (Law 227/2015 - Tax Code Art. 25 (4) let. i) of 0,5% of the turnover, but not more than 20% of the tax on profit.

Planning the investment financial effort related to 2018-2020

The total expenses for investment include funds for NTS development and modernization works, for the procurement of shares in the European operators in the field the amounts necessary for the repayment rates on loans employed by the company to finance the investments which were not covered from own sources and the amounts required for the payment of guarantees related to the removal from the statute of agricultural land.

The sources for financing investment expenses are:

- Own sources including the amortization and the amounts distributed from the net profit to finance investments according to G.O. no. 64/2001 regarding profit distribution to national companies and companies owned or majority state owned, as well as the autonomous administrations, as amended and supplemented;
- the attraction of funds from the banking system;
- Amounts resulting from the absorption of European funds;
- Unused own resources from previous years and other sources.

The investment expenses were determined based on:

- The modernization and development investment program for 2018 and estimates for the period 2019-2020;
- The design software for investment works for 2018;
- The 10 years national transmission system development program.

For the procurement of shares in European operators in the field the association of Transgaz and Regasificadora del Noroeste SA (Reganosa) in Spain was approved by the Decision no 1/2018 of the GESM for the participation in the second stage of the procurement of the share of 66% in DESFA and by the Decision of the Board of Administration no 49/2017 the necessary sources for the procurement of the shares in Î.S Vestmoldtransgaz was approved. In this context the following sources were substantiated for:

- The procurement of shares within the Î.S Vestmoldtransgaz,
- The coverage of the necessary investments for the construction of the gas transmission pipeline Ungheni-Chisinau,

- The coverage of the maximum cap of Transgaz' contribution related to the acquisition of the 66% stake in DESFA;
- The coverage of the estimated costs to be incurred for the acquisition of the 66% stake in DESFA subsequent to the submission of the offer (covered by Transgaz as a loan or share capital);

The 10-year National Transmission System Development Plan includes large-scale projects aimed at reconfiguring the natural gas transmission network, namely:

- Development on the territory of Romania of the National Gas Transmission System on the Corridor Bulgaria - Romania - Hungary - Austria
- Development on the Romanian territory of the Southern Corridor for taking-over gas from the Black Sea shore;
- Interconnection of the national gas transmission system with the T1 international gas transmission pipeline and reverse flow Isaccea;
- NTS developments in the North - Eastern area of Romania in order to improve gas supply of the area and to ensure the transmission capacities to/from the Republic of Moldova;
- Extension of Bulgaria - Romania - Hungary - Austria two-way natural gas corridor (BRUA Phase 3);
- Project on new NTS developments for taking-over gas from the Black Sea shore;
- Romania-Serbia Interconnection - interconnection of the national gas transmission system with the similar gas transmission system in Serbia;
- Upgrading GMS Isaccea 1 and GMS Negru Voda 1.

The current development plan for the Romanian gas transmission system includes large-scale projects aimed at reconfiguring the natural gas transmission network, which, although extensive and complex, was conceived at a time when the emphasis was on the gas supply to large consumers and their access to concentrated resources mostly in the centre of the country and in Oltenia as well as the only import source.

When identifying the necessary projects to be developed in the national gas transmission system the onset was the main requirements that it has to ensure in the current dynamics of the regional gas market. In view of the latest developments and trends in the field of gas transmission routes at European level, the profiling of two new sources of gas supply is obvious: the Caspian Sea gas and the recently discovered Black Sea gas.

Thus, the projects planned by the company envisage:

- ensuring an adequate degree of interconnectivity with neighbouring countries;
- creating gas transmission routes at regional level to ensure gas transmission from different new sources of supply;
- creating the necessary infrastructure for taking over and transmitting gas from the Black Sea offshore blocks for the purpose of their capitalization on the Romanian market and other markets in the region;
- extension of the gas transmission infrastructure to improve gas supply to deficit areas;
- creating a single integrated market at EU level.

In this context, it is very important that Transgaz implements the projects in a very short period of time to connect the Central European markets to such resources and to redefine itself as an important gas transmission operator.

By ensuring the connection between different gas supply sources and the European market, these investment projects contribute to the achievement of the European Union's goals, the main benefits of which can be summarized as follows:

- Integration of the gas market and interoperability of the gas transmission systems in the region;
 - Price convergence in the region;
 - Eliminating congestion in gas transmission on the Bulgaria-Romania-Hungary direction;
 - Increasing the flexibility of the European gas transmission system by the construction of bi-directional flow interconnections;
 - Through the interconnection of the Bulgaria - Romania - Hungary - Austria corridor with the Black Sea, the access of Romania and the European Union to a new gas source will be ensured;
 - Increasing competition on the European gas market by diversifying sources, transmission routes and by the active companies in the region;
 - Increasing the security of gas supply;
 - Reducing dependence on Russian gas imports;
- Urging the development of the renewable energy at regional level (especially wind and solar energy) considering the possibility to use gas as a back-up renewable energy option which leads to the significant increase in the sustainability of the proposed projects.

The progress in the implementation of major investment projects of Transgaz SA, requires the performance of parallel steps to ensure the financing of the 10-year National Transmission System development plan. During 2019-2020 the company aims at attracting funds from the banks to complement the necessary financing.

The synthesis of the capital expenditure for the period 2018-2020 as well as its financing is indicated below:

** thousand RON **

No.	Item	2018	2019	2020	Total
					2018-2020
0	1	2	3	4	5=2+3+4
I.	Investment expenses, of which:	1.879.730	2.963.774	1.255.620	6.099.124
1.1.	Investments	1.860.205	2.891.188	1.252.908	6.004.301
1.2.	Capitalized interest	4.246	72.586	0	76.832
1.3	Loan repayment	0	0	2.712	2.712
1.4	Guarantees for the lands	15.278	0	0	15.278
II.	Financing sources, of which:	2.245.381	2.963.774	1.255.620	6.099.124
2.1.	Own sources, of which:	234.824	231.709	244.520	711.053
	-amounts from the net profit	100.573	122.924	94.449	317.946
	- amortization	160.218	134.598	190.361	485.177
2.2.	European funds	120.044	358.325	229.845	708.214
2.3.	Bank loans	616.833	2.008.088	765.977	3.390.899
2.4.	Receipts from the guarantees for the lands			15.278	15.278
2.5.	Surplus/deficit from previous years	1.273.679	365.651	0	1.273.679
III.	SURPLUS/DEFICIT(II-I)	365.651	0	0	0

Other additional information

1. The substantiation of the remunerations related to the Director General, the members of the Board of Administration and the Chief Financial Officer

According to the relevant Mandate Contracts in effect, the remuneration of the Director General, of the non-executive members of the Board of Administration (BoA) and of the Chief Financial Officer consists of a monthly fixed allowance and a variable benefit.

During the period when GEO 109/2011 as amended is applicable in the form which is effective as at the date of the mandate contracts' approval, the monthly fixed allowance due to the non-executive members of the Board of Administration may not exceed twice the means of the monthly gross average salary output over the last twelve months relevant for the mandator's branch of activity reported by the National Statistics Institute before the appointment of such mandators and, as for the Member of the BoA also acting as Director General, executive administrator, the monthly gross fixed allowance may not exceed 6 (six) times the means of monthly gross average salary output over the last 12 months relevant for the company's branch of activity, reported by the National Statistics Institute before the appointment of the mandatory.

Additionally to the monthly fixed gross allowance, the members of the BoA, the Director General and the Chief Financial Officer are entitled to an annual variable benefit.

According to GEO 109/2011 (art. 37, paragraph (2)) on corporate governance, as amended by Law 111/2016 for the approval of GEO 109/2011, the value of the variable benefit due to the non-executive members of the BoA may not exceed maximum 12 monthly fixed allowances; therefore, as far as the non-executive members of the BoA are concerned, the annual variable allowance component was substantiated within the limit of 12 monthly fixed allowances.

The variable benefit for the Director General and the Chief Financial Officer was substantiated based on the recommendations of a benchmarking study on remuneration conditions underlying similar positions in fully or partially state-owned companies operating in the same branch of activity in Romania and other EU countries.

The maximum lawful amount of the variable benefit over the term of the mandate contract may be amended pursuant to Decision no 22/2016 of the Romanian Government on the approval of Methodological rules for the approval of GEO 109/2011 on the corporate governance of public enterprises, Annex 2, Chapter II, section 5 – *"The Methodology for revising the variable component of the non-executive and executive administrators' remuneration"*.

The annual variable remuneration = the value of the variable remuneration established based on the study x the indicator achievement total degree.

The total degree of the key performance indicator achievement (TD_{KPI}) is the weighted average by the weighing factor related to each KPI of each KPI achievement degree.

KPIs are annually assessed based on the annual audited financial statements and other verification tools.

Pursuant to art. 18 of GEO 90/2017, the gross remunerations of the administrators and of the Chief Financial Officer established under the mandate contracts and based on the recommendations of a benchmarking study on remuneration conditions underlying similar positions in fully or partially state-owned companies operating in the same branch of activity in Romania and other EU countries were re-

calculated to be aligned with the new social contributions under Law 227/2015 on the Fiscal Code, i.e. increased by 20%.

2. The substantiation of the economic-financial indicators which are facing material changes as compared to the previous year

- The increase in the energy and water expenses (20%) due to the increase in electricity consumption because of the new objectives' being connected to the power supply network to be put into operation (technology nodes, SCADA system, metering regulating stations);
- The increase in the expenses related to the maintenance and repair by RON 49.393 thousand (245,73%) due to the increase in the maintenance program for 2018.

The program for the scheduled repairs to pipelines for 2018 includes mainly: the works started and unfinished under the relevant program of 2017, the works under the program for 2017 but which were not promoted to execution (mainly due to the lack of the execution documentation or permits) and the new works proposed as a result of events/abnormalities /incidents occurred during the previous years and that need to be resolved in 2018. All the works were initiated as a necessity by the design themes underlying the execution based on the FEED or reports for the assessment of the pipelines by means of diagnostic methods (external or by intelligent pig). Out of the works proposed under the program, most of them are substantiated by projects endorsed by the T.E.C of Transgaz;

- The increase in the insurance premium expenses comprising expenses related to insurance policies for buildings part of Transgaz' assets, civil liability, motor vehicle liability and car insurance of the company's administrators, with a forecasted increase by 39,60%. This increase is justified by the extension of the company's fleet and by the increase in the motor vehicle liability and car insurance policies;
- Increase in the expenses related to the company's collaborators. Such expenses are related to the land assessment committees. According to GD no. 834/1991 on the establishment and assessment of lands owned by state-owned companies, as amended, Transgaz is undergoing the process for the certification of the title on the lands part of the company's assets.
Pursuant to art. 2 of Criteria no. 2665/28.02.1992 issued by the Ministry of Finance and published in the Official Journal no. 54/31.03.1992 on the establishment and assessment of lands owned by state-owned companies, as amended, the committee for the assessment and establishment of the lands being part of Transgaz' assets was appointed by order of the relevant minister.
Pursuant to art. 29(2) of the Criteria, as amended By Amendments no. 21541/8392/NN/15.10.1998 issued by the Ministry of Finance and published in the Romanian Official Journal, Part I no. 437/1998 *"the members of the committee for the establishment and assessment of lands owned by state-owned companies, appointed under GD no. 834/1991 as amended, will receive as at the date when the certificate certifying the land title has been issued an allowance of up to the half gross salary as approved by the Board of Administration."* The company's BoA, by Decision no. 35/10.11.2015, art. 7, approved the monthly gross allowance due to the assessment committee members.
- The increase in expenses with the commissions and fees by 251,20%. Such expenses consist mainly of expenses for legal advice (RON 18.400 thousand), representing consultancy, assistance and the legal representation of a law firm with international expertise in the Community

competition law, approved by the Resolution of the EGMS no 10/2017 and consultancy, assistance and the legal representation needed to implement the European regulations in force and future incidence in the company's business, the implementation of rules relating to the financing of energy infrastructure by CEF mechanism and providing legal expertise in international and European regulations, approved by the EGSM Decision no.2 / April 29, 2014;

- Increase in the business entertainment, advertising and publicity expenses by 38,88%, considering the large scale events to be organised in 2018: "the Annual GIE Conference", "10 years of trading on Bucharest Stock Exchange", "the Dispatching Meeting" as well as the improvement and promotion of the brand leveraging, the expansion of the PR and information activities in relation with the company's partners and collaborators, the improvement of the company's visibility and recognition in the national and international business environment.
- Increase in the security assurance expenses (45.56%). The increase in the security related budget is a result of the requirements determined under the analysis of the risks associated with the physical security and temporary work sites prepared in 2017, as follows:
 - The increase in the national minimum wage which represented an increase by 38.1 of the renegotiated tariff substantiation base
 - The estimation by Medias Subsidiary of 8-10 Mobile Work-Site/year-type objectives to be protected by security guards on a temporary basis during the periods of such objectives' operation
- Increase in the expenditure on the maintenance and operation of computer technology (117,34%) due to the supplementation of the GMOIS platform maintenance costs and the increase in the value of the subscription for the Software Assurance services related to the Microsoft;
- Expenses on the annual tariff related to the license for the operation of the gas transmission system were calculated based on the gas quantities estimated to be transported in 2018, on the tariff approved by Order no. 118/2016 of the Romanian Energy Regulatory Authority (ANRE) on the approval of tariffs and money contributions and on the money contributions charged by ANRE in 2017.
- The increase in other expenses with services performed by third parties (34,09%). Such expenses were substantiated based on the program for other services performed by third parties and include the financial services for the acquisition of shares in relevant operators of Europe amounting to 1.287,6 thousand Euro, expenses estimated to be made by Transgaz in relation to the association with Reganosa and other partners, by the time the bid for participating in the acquisition of a 66% stake in DESFA, Greece has been submitted – such expenses not being part of the achievements for 2017.
- Sponsorship expenses (33,33%). For 2018, Transgaz is planning to grant sponsorships to the institutions located on the route of the company's major projects: BRUA, Black-Sea Podisor and the project for the Development of the NTS in the North-Eastern part of Moldova.

We would like to mention that the programs for NTS upgrading and development (Investments), maintenance and NTS rehabilitation, materials and spare parts supply and the program related to other services performed by third parties, which substantiated the abovementioned expenses were approved

by Decision no. 50/2017 of the Board of Administration and the design programme is to be made subject to the approval of the BoA to be convened on 26 January 2018.

3. Substantiation of the economic-financial indicators which are facing material changes as opposed to the plan of administration

Art. 9, paragraph (1) (c) of GO 26/2013 as amended contemplates as follows:

"Upon the substantiation of the Revenue and Expense Budget, the economic agents envisage, without being limited to, the following:

c) quantified specific performance criteria and objectives for the reduction of payments and outstanding receivables, reduction of loss, increase in profit, turnover and labour output as provided for in the mandate contracts established in relation with the administration strategy of the Board of Administration/Supervisory Board and the management plan of the economic agents' directors/members of the board of directors."

According to art. 58 (5) of Law 2/2018 on the State Budget for 2018 it is required that *"upon the determination of the salary expenses, the necessity to comply with the level of the performance indicators resulted from the administration plans prepared pursuant to the applicable laws shall be considered."*

The level of the indicators *"Operating expenses (except depreciation, balancing, construction and provisions for asset depreciation and for risks and expenses) and EBITDA under the Administration Plan as approved by Decision no. 12/2017 of the General Ordinary Shareholders' Meeting was exceeded due to the following factors:*

- Increase in the tax expenses by **Lei 64,428**: upon the preparation of the Administration Plan the monopoly tax was not substantiated for 2018 – pursuant to art. 15 of GEO no. 99/2019 (effective as at the Administration Plan substantiation date) on the pay wage system related to the employees paid by public funds in 2016, on the extension of terms and fiscal-budgetary measures contemplating *"The Deadline under art. 6 of GO no. 5/2013 on the establishment of special measures for the taxation of natural monopoly activities in the power and gas sector, approved as amended, is extended by 31 December 2017"*.
- Increase in the tariff and fee expenses by **Lei 18.400 thousand**: no tariff and fee expenses were substantiated in the Administration Plan for 2018. Such expenses are mainly related to the legal consultancy for the European Commission's investigations against Transgaz and for the litigation which might arise from the investigations where Transgaz and the European Commission are parties.
- The expenses with the salaries of the personnel employed based on individual labour contract are recording an increase by **Lei 90.285 thousand** in the REB 2018 proposal as opposed to the amounts under the Administration Plan for 2018. This increase is due to the following factors:
 - Lei 62.395 thousand for the introduction of the employer due contributions into the employees' monthly gross revenues for the enactment of GEO no. 79/2017 on the amendment of Law no. 227/2015 on the Fiscal Code
 - Lei 19.627,9 thousand for granting of compensations under the Collective Labour Contract in respect of voluntary turnover calculated for 300 employees, including the due contributions;
 - Lei 2.330 thousand – the influence of the amounts necessary for the individual negotiations in 2018

- Lei 6.386 thousand - the influence of the basic salary and of the salary increases in 2017.
- Expenses with the gas technological consumption and loss higher by **Lei 16.342 thousand** because of the following two factors:
 - technological consumption gas related amount higher by 92.489 MWh (▲ 8%), with a negative influence of Lei 6.592 thousand
 - average acquisition price higher by 8,03 lei/MWh, with a negative influence by Lei 9.751 thousand
- The financial service expenses related to the acquisition of shares in relevant operators (gas transmission) of Europe amounting to **Lei 6.013 thousand** (Euro 1.287.600). Upon the preparation of the Administration Plan the conditions underlying the acquisition of shares in relevant operators in Europe were not clear and, therefore, financial service expenses related to the acquisition of shares in relevant operators of Europe were not substantiated in the Administration Plan for 2018.

The performance indicators approved by Decision no. 12/2017 of the General Ordinary Shareholders' Meeting will be revised by the time the REB 2018 proposal and estimations for 2019-2020 have been approved by the General Shareholders' Meeting.

4. Debt cost capitalization according to IAS 23

Transgaz employs bank loans in the period 2018 - 2020 for financing projects in the development plan, which is why, in accordance with IAS 23 "Borrowing Costs", the company capitalized interest and expense attributable to those loans.

According to the provisions of Transgaz' Articles of Incorporation, in force, Chapter V, art 20, par 1, letter m), **we would like to kindly ask the General Meeting of the Shareholders to approve the revenue and expense budget for 2018 and the estimates for 2019-2020**, according to the provisions of GO no. 26 on 21 August 2013, art. 4, par. 1, letter d) and of Transgaz' Articles of Incorporation, Chapter IV, art. 15, paragraph (3), letter (c).

Enclosures:

- The revenue and expense budget for 2018 and the estimates for 2019-2020: Annex no.1*;
- The detailing of the economic-financial indicators provided in the revenue and expense budget and their split by quarters: Annex no 2*,
- The execution rate of the total revenues: Annex no.3*;
- The investment program and sourcing of investment funding: Annex no.4*;
- Means to improve the gross result and the reduction of outstanding payments: Annex no. 5*;
- The revenue and expense budget for 2018: Annex no. 6.

****Note: Annexes 1 – 5 will not be made public.***

Chairman of the Meeting
MINEA NICOLAE

Economic operator: S.N.T.G.N. Transgaz S.A. Medias
 Headquarters: 1 C.I. Motas Sq., Medias
 VAT number: RO 13068733

REVENUE AND EXPENSE BUDGET
 for 2018

RON thousand

		INDICATORS	Row no.	REB 2018
0	1	2	3	5
I.		TOTAL REVENUE (row1=row2+row5a+row5+row6)	1	2,518,898
	1	Tota operating revenue before the construction activity according to IFRIC 12	2	1,475,267
		a) subsidies according to the applicable laws	3	
		b) transfers according to the applicable laws	4	
	2	Revenue from the construction activity according to IFRIC12	5a	1,009,821
	3	Financial revenue	5	33,810
	4	Extraordinary revenue	6	
II		TOTAL EXPENSE (row7=row8+row20+row20a+row21)	7	2,264,187
	1	Operating expense before the construction activity according to IFRIC12, of which:	8	1,239,366
		A. Expense with goods and services	9	349,959
		B. Expenses with taxes, charges and similar	10	209,940
		C. Expense with personnel, of which:	11	458,124
		C0 Salary-related costs (row13+row14)	12	420,935
		C1 Salary costs	13	372,134
		C2 Bonuses	14	48,801
		C3 Other personnel expense, of which:	15	3,435
		Compensation expense related to employees layoffs	16	3,435
		C4 Expense on mandate contract and other governing and control bodies, commissions and committees	17	4,970
		C5 Expense on employer contributions	18	28,785
		D. Other operating costs	19	221,341
	2	Cost of assets built according to IFRIC12	20a	1,009,821
	3	Financial costs	20	15,000
	4	Extraordinary costs	21	
III		GROSS RESULT (profit/loss)	22	254,711
IV		TAX ON PROFIT	23	41,553
V		ACCOUNTING PROFIT REMAINING AFTER THE DEDUCTION OF THE TAX ON PROFIT, of which:	24	213,158
	1	Legal reserves	25	
	2	Other reserves representing tax incentives provided according to the law	26	
	3	Covering accounting losses in the previous years	27	
	4	Establishment of own financial sources for the projects cofinanced by foreign loans as well as establishment of the sources necessary for the capital repayments, interest payment and other costs related to these foreign loans	28	
	5	Other assignments provided by law	29	
	6	Accounting profit left after the deduction of the amounts in row 25, 26, 27, 28 and 29.	30	213,158
	7	Employees share to the profit within the limit of 10% of the net profit, but no more than the level of an average monthly salary of the economic operator during the reference financial year	31	12,013

		INDICATORS	Row no.	REB 2018
0	1	2	3	5
	8	Minim 50 % payments to the State or local budget, for the autonomous companies, or dividends for the national companies or the entirely or partially owned-by the state companies, of which:	32	112,585
	a)	- dividends to the state budget	33	65,873
	b)	- dividends to the local budget	33a	
	c)	- dividends to other shareholders	34	46,712
	9	Profit not assigned for the destinations provided at row 31 - row 32 is assigned to other reserves and it is an own financing source	35	100,573
VI		INCOME FROM EUROPEAN FUNDS	36	
VII		ELIGIBLE COSTS FROM EUROPEAN FUNDS, of which:	37	
	a)	material costs	38	
	b)	salary costs	39	
	c)	service supply costs	40	
	d)	publicity costs	41	
	e)	other costs	42	
VIII		INVESTMENT FUNDING SOURCES, of which:	43	2,245,381
	1	Budget allocations	44	
		Budget allocations regarding payment of commitments from the previous years	45	
IX		INVESTMENT COSTS	46	1,864,452
X		SUBSTANTIATION DATA	47	
	1	No. of personnel estimated at the end of the year	48	4,529
	2	Total average no. of employees	49	4,605
	3	Average monthly income per employee (RON/person) determined based on the salary costs*)	50	7,069
	4	Average monthly income per employee (RON/person) determined based on the salary costs, re-calculated acc. to annual State Budget Law**	51	5,906
	5	Labour productivity in units of value per total average personnel (thousand RON/person) (row 2/row 49)	52	320
	6	Labour productivity in units of value per total average personnel re-calculated acc. to the annual State Budget Law	53	320
	7	Labour productivity in physical units per total average personnel (qty of finite products/person)	54	0.0000
	8	Total costs at RON 1000 total income (row 7/row 1)x1000	55	899
	9	Outstanding payments	56	0
	10	Outstanding debt	57	289,858

*) Row 50 = Row 154 of Substantiation Annex 2

**) Row 51 = Row 155 of Substantiation Annex 2

DIRECTOR GENERAL
Ion Sterian

DIRECTOR ECONOMIC
Lupean Marius