ENGIE Group Romania

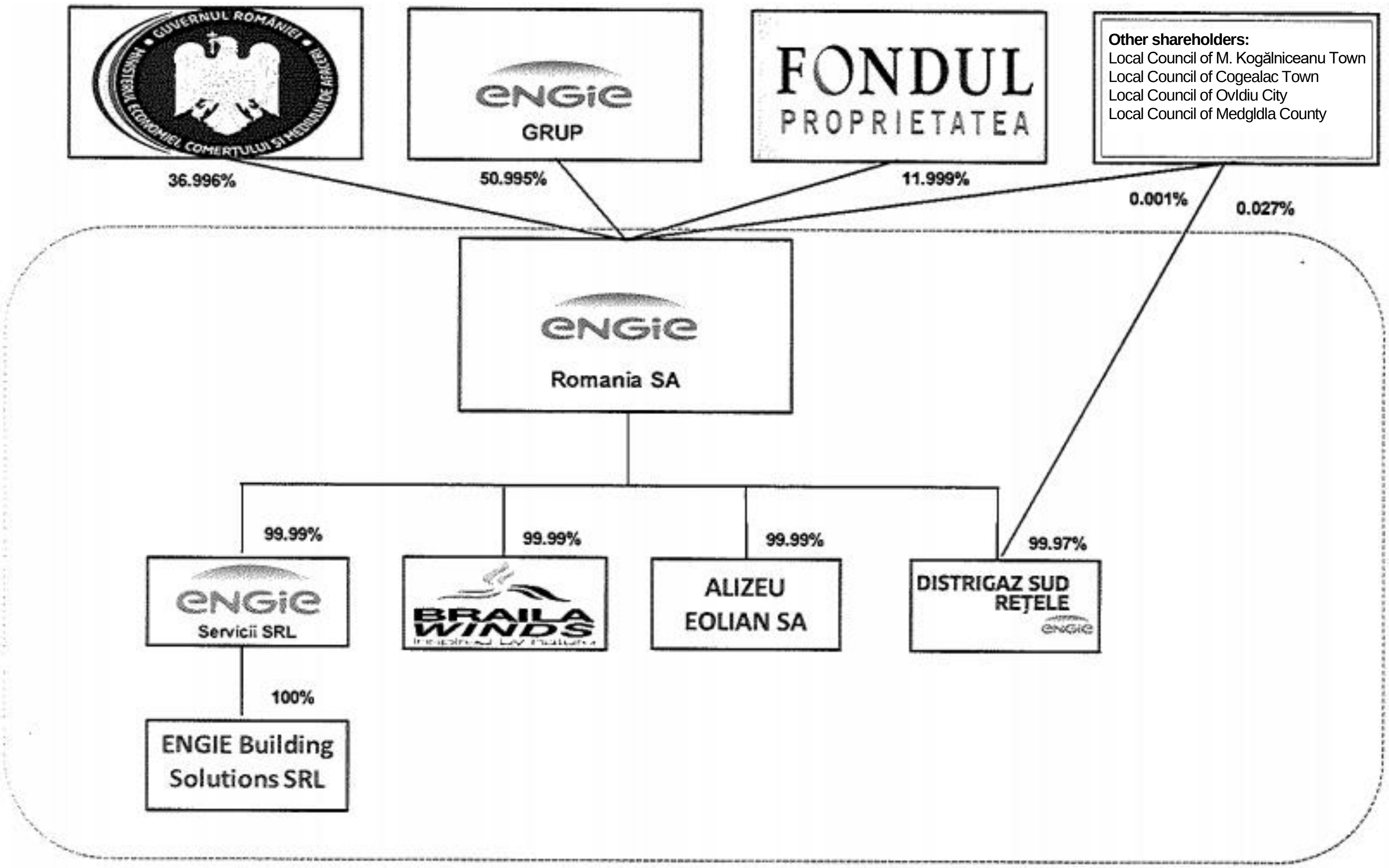
2018 Budget – ENGIE Romania, consolidated
2018 Budget – ENGIE Romania S.A.

December 2017

C3 - Restricted

Contents

Perimeter


GUVERNUL ROMÂNIEI
MINISTERUL ECONOMIEI COMERȚULUI ȘI MEDIULUI DE AFACERI
ENGIE
GRUP
FONDUL
PROPRIETATEA
Other shareholders:
Local Council of M. Kogălniceanu Town
Local Council of Cogealac Town
Local Council of Ovidiu City
Local Council of Medgidia County
36.996%
50.995%
11.999%
0.001%
0.027%
ENGIE
Romania SA
99.99%
99.99%
99.99%
99.97%
ENGIE
Servicii SRL
BRAILA WINDS
ALIZEU
EOLIAN SA
DISTRIGAZ SUD
REȚELE
ENGIE
100%
ENGIE Building
Solutions SRL

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Economic context and macroeconomic indicators

	Actual for 2016	Estimated for 2017	2018 Budget
Macroeconomic indicators			
Inflation	-0.5%	2.7%	3.2%
GDP increase	4.8%	5.5%	4.4%
Foreign exchange rates			
Average exchange rate RON / EUR	4.49	4.56	4.65
Average exchange rate RON / USD	4.06	4.09	3.92
Average annual gas price			
Imported gas price in USD/MWh	17.9	20.2	22.5
Imported gas price in RON/MWh	74.4	83.7	87.0
Price of locally sourced gas in RON/MWh – the regulated market	60.7	67.1	76.5

Source of macroeconomic indicators: ENGIE Group/BNR/Bloomberg

→ **Inflation:** Expectations are for an inflation rate increase as a result of the fiscal measures adopted by the Government (significant increases of salaries across the public sector), as well as an increase of salaries across the private sector (labour market tightening); the inflation level is, however, expected to be kept under control through the NBR intervention.

→ **Economic growth:** The main factors influencing economic growth in Romania during the 2017 - 2018 interval are retail trade, consumption and services, with a potential negative effect caused by exports and public investments. Following the 8.8% GDP increase during the 3rd quarter of 2017 — the highest in Europe, compared with the same period of the previous year, the World Bank revised la 5.5% the economic growth forecast for 2017. Whereas the easing of fiscal policies has determined an economic growth this year at the fastest pace since 2008, the lack of structural reforms, the inflation rate and trade deficit increases have brought along concerns in terms of economy overheating.

→ **Foreign exchange rates:** Throughout the month of November, the Romanian currency depreciated in relation to the Euro, reaching, on average, 4.63 RON/EUR, largely as a result of the trade deficit increase (an accelerated increase in imports compared with exports). According to the latest banking forecasts, the exchange rate is set to stabilise by the end of the year at 4.65 RON/EUR. The USD/RON exchange rate shall consolidate at, or below, the 4 RON threshold, while largely depending on the international context.

→ **Prices of locally sourced gas:** the price of locally sourced gas intended for household customers was set to 60 RON/MWh, to remain as such until the end of March 2017. Significant increases took place starting from 2017, following the deregulation of locally sourced gas prices for B2C customers. The prices of locally sourced gas are expected to stabilise around the 76 RON/MWh mark, with much higher prices in winter in order to secure consumption during peak periods.

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2017 highlights

→ **Regulated tariffs:** applied as of April 1

- Distribution tariffs decreased on average by 9.7%, primarily due to the higher distribution volumes in 2016 and the negative impact of inflation;
- Supply tariffs increased by 16% (+0.7 RON/MWh);
- The negative Delta CUG (gas unit cost) component of 3.12 RON/MWh was included in the final prices, due to the higher margins from gas sales obtained in 2015 and 2016;

→ **Asymmetrical deregulation of the gas market:**

- following the adoption of **GEO 64/2016**, the purchases prices of locally sourced gas for household customers were totally deregulated as of April 1, 2017, whereas the sale prices applied in relation to these customers remained regulated
- the gas cost estimated by ANRE and included in the final selling price is approximately 66 RON/MWh, compared with the average purchase cost of 74 RON/MWh **->** throughout 2017, a significant negative Delta CUG value was generated, and this situation shall be maintained until the selling prices applied to the regulated consumers shall be updated to accurately reflect the increase of the locally sourced gas purchase cost

→ **Gas purchase:** given the low liquidity of the market and the fact that the producers are not willing to sell additional gas quantities, ENGIE Romania is finding it difficult to cover its gas purchase needs for the incoming winter **->** a significant effect upon the purchase prices

→ **ELCEN Distribution/Outstanding debts:** the collection of amounts pertaining to current invoices has a 90-day payment deadline, as per the insolvency law; DGSR was selected as a member in the Creditors' Committee; the Reorganisation Plan has been halted **->** there still is a risk of not being able to collect the 165 mil. RON receivable outstanding since before the entity filed for insolvency

→ **The Network Code:** ENGIE Romania and Transgaz had a different interpretation of the provisions in the Network Code in regard to capacity overruns: Transgaz calculated the capacity overruns for each exit point, whereas the method used by ENGIE Romania was to offset the overruns with capacity underruns for all the exit points. ENGIE Romania formally requested a clarification from the regulatory authority (ANRE). At the end of May, ANRE dismissed the request from ENGIE Romania and, as a result, the additional capacity overruns were recorded in the results. ENGIE Romania challenged in court the ANRE decision on the capacity overruns

→ **WIEE litigation:** an agreement concluded with WIEE on the settlement of the dispute, stipulating the following terms: the payment of a compensation to WIEE, amounting to 9 mil. USD, and the signing of an addendum on the amendment of certain clauses in the Natural Gas Sales Agreement, applicable as of January 1, 2017

→ **Litigation:** unfavourable decisions in the context of two legal actions, however, the sentences are not conclusive and will be appealed:
→ Litigation in regard to the fire occurred in 2014 at Beirut restaurant: 7.2 mil. EUR in damages, of which 3 mil. EUR covered by a provision
→ Nicolae Apostol litigation — the gas explosion in 2005: 1.2 mil. EUR in damages, of which 0.7 mil. EUR covered by a provision

→ **Electricity price:** the electricity traded on the Romanian market had record prices throughout 2017, as a result of a mix of factors (elevated consumption, low energy production from renewable sources vs. an increase of energy production from conventional sources - coal). Although the exposure of ENGIE Romania was relatively low, the margins were negatively affected by record electricity purchase prices in 2017

→ **The climate effect:** low temperatures recorded during the January — April 2017 **->** sold and distributed volumes exceeding the budgeted ones

In conclusion, the 2017 results are under pressures exerted by the regulatory context (significant negative Delta CUG generated on the regulated market), the negative impact following the interpretation of the gas market operating rules (the Network Code) and the difficulties in contracting locally sourced gas to cover consumption, which could lead to a margin decrease.

In the case of the two wind farms, an additional impairment adjustment will not be deemed necessary considering that, in the calculation of the previous year, the provisions of the law amending the support scheme for energy from renewable sources, GEO 24/2017, had already been taken into account.

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Assumptions regarding the 2018 regulatory context

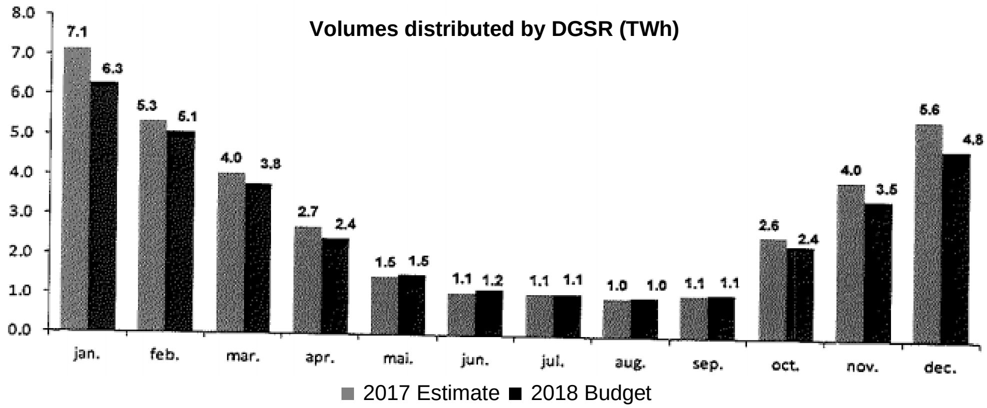
→ **Distribution:** the assumption used as a new substantiation period will take effect in 2018, resulting, therefore, in a decrease of the distribution tariffs, primarily due to:

- the additional gains obtained throughout 2017 (mainly the volume-related effect), estimated to be reimbursed over a 5-year period
- the impact of the low investment level in 2017, with a negative impact on the RAB (*regulated asset base*) level

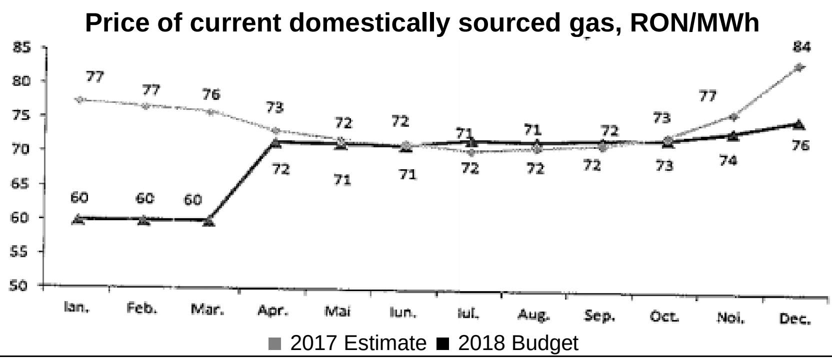
→ **The supply margin: forecasts indicate no increases in the selling price until April 2018, with the following outcomes:**

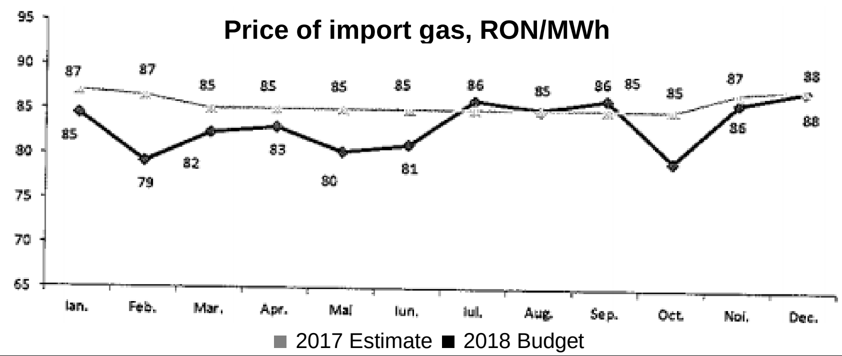
- ENGIE Romania will continue to reimburse to its customers the positive Delta CUG achieved in 2015 and 2016, until the end of the first quarter of 2018, via the negative unit component included in the final price, despite negative Delta CUG having been generated throughout 2017
- It is estimated that a significant amount of negative Delta CUG will be generated during the first quarter of 2018
- In order for ENGIE Romania to be able to cover the gas purchase costs, but also to gradually recover the Delta CUG amounts generated in the past, an assumption based on increasing the selling prices by 10% as of April 2018 was used. Keeping in mind the current regulatory context, chances are that this increase level will not be achievable **-> increased risk of delays in the recovery of Delta CUG generated in the past**
- Since the CUG component included in the final selling price was estimated so as to cover the gas purchase price, it is estimated that Delta CUG will no longer be generated as of April 2018
- **Following the revision of the assumptions on the gas purchase price for 2018 (following the preparation of the baseline scenario), the margin from gas sales could be negatively affected**

Gas supply – Main assumptions



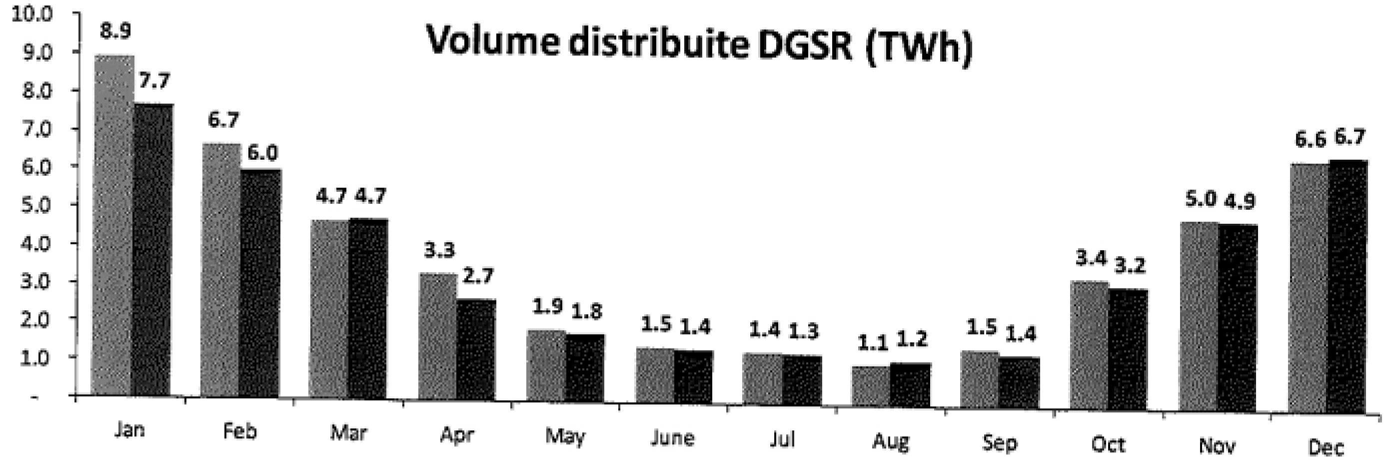
Lower sold volumes *(34.1 TWh vs. 37 TWh in 2017), primarily due to the effects of the climate recorded throughout 2017.*





The significant increase in the locally sourced gas price, following the deregulation of the locally sourced gas prices for B2C customers in April 2017.	*The price of import gas relies on the WIEE formula and on the RON/USD exchange rate forecasts.*

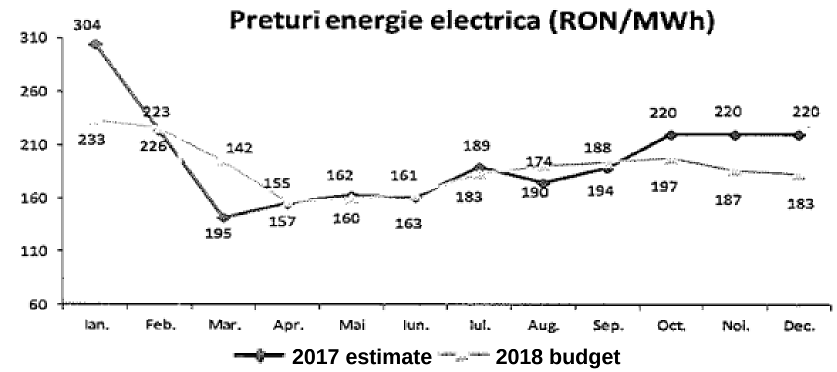
Distribution – Main assumptions

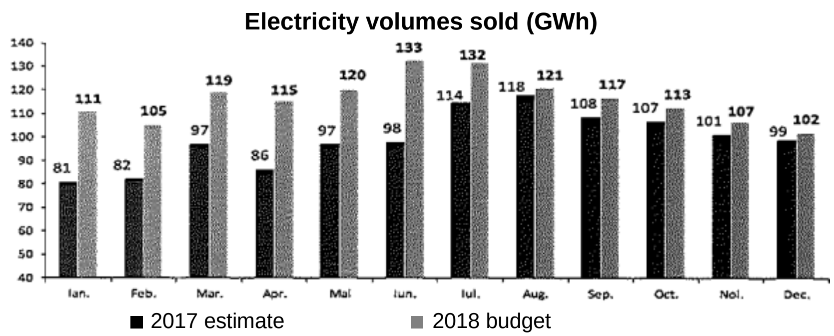


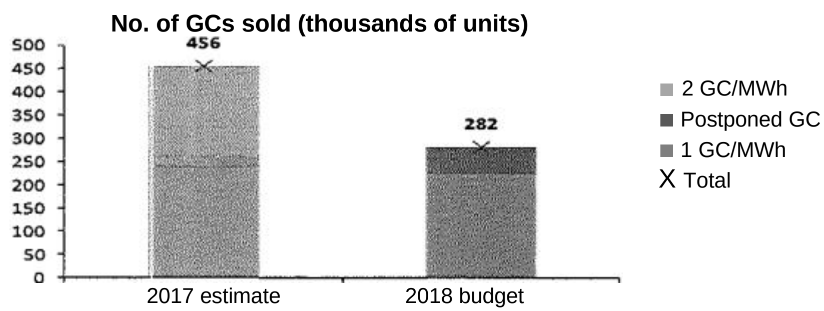
Volumes [TWh]	2017 Estimate	2018 Budget	2018 Budget vs 2017 Estimate	
			TWh	%
Distributed volumes, of which:	**46.0**	**43.0**	**-3.0**	**-6%**
Distributed for ENGIE	28.9	26.9	-2.3	-8%
Distributed for third parties	17.1	16.4	-0.7	-4%

- **Distributed volumes:** 2018 Budget vs. 2017 Estimate: a decrease by -3 TWh in 2018, considering the fact that 2017 was affected by the positive impact of the climatic effect.
- **The technological consumption** is estimated to remain steady at 1.2 TWh.
- It is estimated that the **natural monopoly tax** level in 2018 will reach 0.75 RON/MWh

Electricity – Main assumptions







- *The Romanian electricity market witnessed record prices throughout 2017 due to a mix of factors:*
  - *elevated consumption*
  - *low energy production from renewable sources (primarily hydroelectricity – due to the low Danube levels)*
  - *additional energy production from conventional sources (coal) intended to cover consumption*

- *The electricity prices are estimated to remain at high levels throughout 2018* **->** *significant pressure upon the suppliers, since an increase in purchase costs will decrease the margins.*

- *Higher sold volumes (1.4 TWh in 2018 vs. 1.2 TWh in 2017): stable increase of the sales across the SME segment and a growth of sales on the B2C market.*

- *A lower number of green certificates estimated to be sold throughout 2018, considering that in 2017 the second GC/MWh, tradable during the March – December 2017, was received*

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Consolidated outturns – ENGIE Group Romania

Mil. RON	2017 estimate	2018 budget	2018 budget vs 2017 estimate mil. RON	%
Revenues from gas supply	3,895.4	3,716.8	-178.6	-5%
Revenues from gas distribution – other suppliers	292.8	236.6	-56.3	-19%
Revenues from electricity supply	379.2	510.0	130.8	34%
Revenues from green certificates	61.8	34.5	-27.4	-44%
Revenues from services	76.4	105.0	28.5	37%
Other revenues	115.1	115.5	0.4	0%
Turnover	**4,820.9**	**4,718.3**	**-102.5**	**-2%**
Gas purchase costs	-3,164.8	-3,057.8	107.0	-3%
Electricity purchase costs	-374.0	-485.3	-111.3	30%
Gas margin	**730.7**	**659.0**	**-71.6**	**-10%**
Electricity margin	**5.2**	**24.7**	**19.5**	**4X**
OPEX	-713.1	-708.5	4.7	-1%
Amortisation	-186.6	-188.8	-2.2	1%
Provisions	4.6	-4.1	-8.7	-2X
Operating profit/loss	**386.9**	**273.9**	**-113.1**	**-29%**
Financial outturn	**-10.5**	**1.1**	**11.6**	**-110%**
Corporate income tax	-56.1	-47.4	8.6	-15%
Net outturn	**320.3**	**227.5**	**-92.8**	**-29%**

2018 budget vs. 2017 estimate: Net outturn lower by -92.8 mil. RON, -29%

❑ **Lower gas margin by -71.6 mil. RON,** primarily due to the lower distribution volumes in 2018 (the impact of the decrease in distribution tariffs starting from April 2017 and the estimated decrease starting from April 2018, as well as of the volume effect), the lower margin obtained on the free market (due to the increased competition), partially offset by the Delta CUG decrease on the regulated market (during the first quarter of 2018 vs. the entire 2017 and the impact of the estimated Delta CUG recovery starting from April 2018);

❑ **Lower revenues from gas distribution to third parties by -56.3 mil. RON**, reflecting the impact of the decrease in distribution tariffs and of the lower distributed volumes (the climatic effect in 2017);

❑ **Lower revenues from green certificates by -27.4 mil. RON**, considering that the year 2017 was positively influenced by the second tradeable GC received in 2017, starting from March, as well as by the elevated energy production levels;

❑ **Higher provisions**, of -8.7 mil. RON, primarily through the reversal of the provision related to WIEE in 2017 (+20.1 MRON), which offset the fact that provisions for litigations (Beirut, -9.2 mil. RON) and other provisions were set up);

effects partially compensated by:

❑ **Higher electricity margin by +19.5 mil. RON**, primarily due to estimates showing an increase in margins in 2018 (the 2017 margins were negatively affected by the increased purchase costs), as well as due to the estimated wholesales starting from 2018;

❑ **Higher revenues from services rendered by +28.5 mil. RON,** primarily due to activity development – B2C and B2B services;

❑ **Lower operational expenditure by +4.7 mil. RON**, primarily seen as the impact of the compensation paid to WIEE in 2017, an effect partially offset by the higher costs of materials (pertaining to the development of service activities) and the increase in staff expenditure, primarily due to the estimated increase in the number of employees);

❑ **Higher financial outturn by +11.6 mil. RON:** due to lower interest rates, since the issued bonds were reimbursed in November 2017

Consolidated CAPEX

Mil. RON	2017 estimate	2018 budget	2018 budget vs 2017 estimate	
Gross investments	**175.0**	**281.3**	**106.3**	**61%**
DGSR	151.4	228.4	76.9	51%
Engie ROMANIA	23.6	52.9	29.3	124%

Lower CAPEX in 2017 as a result of:

- **delays in obtaining permits for the works pertaining to the distribution network;**
- **postponements of IT investments and other projects related to buildings and cars.**

In 2018, estimates indicate a standardised level of investments pertaining to the distribution network, as well as the completion of IT projects and of other projects postponed in 2017.

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Individual financial outturns of ENGIE Romania S.A.

Mil. RON	2017 estimate	2018 budget	2018 budget vs 2017 estimate mil. RON	%
Revenues from gas supply	3,992.5	3,818.4	-174.2	-4%
Revenues from electricity supply	362.1	505.4	143.3	40%
Other revenues	632.9	595.4	-37.5	-6%
Turnover	**4,987.5**	**4,919.1**	**-68.4**	**-1%**
Gas purchase costs	-3,930.5	-3,739.7	190.8	-5%
Electricity purchase costs	-394.9	-519.7	-124.9	32%
Gas margin	**62.0**	**78.7**	**16.7**	**27%**
Electricity margin	**-32.8**	**-14.3**	**18.5**	**-56%**
OPEX	-327.4	-322.6	4.7	-1%
Amortisation	-160.9	-162.9	-2.0	1%
Provisions	20.9	0.0	-20.9	
Operating profit/loss	**194.7**	**174.2**	**-20.5**	**-11%**
Financial outturn	**-1.6**	**10.5**	**12.1**	**-7X**
Corporate income tax	-27.8	-29.8	-2.0	7%
Net outturn	**165.3**	**154.9**	**-10.4**	**-6%**

2018 budget vs. 2017 estimate: Net outturn lower by -92.8 mil. RON, -29%

- **Lower other revenues by -37.5 mil. RON**, primarily due to a decrease in the tariffs pertaining to the contract for the lease on DGSR assets (a decrease in distribution tariffs estimated in 2018), partially offset by an increase in revenues from services rendered;
- **Lower provisions by -20.9 mil. RON**, reflecting the impact of reversing the provision reserved for WIEE in 2017; it is estimated that no new provisions will be set up 2018
- **Higher gas margin by +16.7 MRON**, primarily due to the decrease in Delta CUG generated on the regulated market (during the first quarter of 2018 vs. the entire 2017 and the impact of the estimated Delta CUG recovery starting from April 2018);
- **Higher electricity margin by +18.5 MRON**, primarily due to estimates showing an increase in margins in 2018 (the 2017 margins were negatively affected by the increased purchase costs), as well as due to the estimated wholesales starting from 2018;
- **Lower operational expenditure by +4.7 MRON**, primarily seen as the impact of the compensation paid to WIEE in 2017, an effect partially offset by the increased value of the services rendered by ENGIE Servicii in 2018 and the increase in staff expenditure, primarily due to the estimated increase in the number of employees;
- **Higher financial outturn by +12.1 MRON**: due to lower interest rates, since the issued bonds were reimbursed in November 2017