

## **BOARD OF NOMINEES ANNUAL REPORT FOR 2016**

### **I. THE ROLE OF THE BOARD OF NOMINEES**

#### **INTRODUCTION:**

The Board of Nominees of Fondul Proprietatea SA (the “**Fund**” / “**Fondul Proprietatea**”) is a body created in accordance with the Fund’s Constitutive Act and with Article 224 para. (4) of National Security Commission’s Regulation no. 15/2004, which does not have an equivalent correspondence in the corporate body structure regulated by the Companies’ Law (“*For concluding the administration contract in case of an investment firm which is not self-managed, and also for verifying the unrolling of this contract, the general shareholding can appoint representatives*”).

The Board of Nominees consists of members appointed by Ordinary General Shareholders’ Meeting (“**OGM**”) for a mandate of 3 years, which upon expiry is automatically extended until the next OGM.

The members of the Board of Nominees shall be the persons designated by the Fund’s shareholders (and may themselves be shareholders) and shall hold adequate experience and qualifications to decide (if necessary, by assistance of an independent consultant) whether the transactions proposed by the Fund Manager, which require the approval of the Board of Nominees, are carried out for the benefit of the shareholders. The Board has a diligence and loyalty duty to the Fund, acting in the best interests of its shareholders.

The Board of Nominees shall meet at least quarterly. The convening of the meeting shall be made by the chairman of the Board of Nominees (selected by the members thereof), by a member of the Board of Nominees or by the Fund Manager. The meeting of the Board of Nominees shall assemble within 7 (seven) days of convening. The resolutions of the Board of Nominees shall be passed statutorily with a quorum representing the majority of the total members thereof, with the vote of the majority of the voting rights held by the members of the Board of Nominees.

According to the Constitutive Act, the main duties of the Board of Nominees are:

- (1) Following the information received from the Alternative Investment Fund Manager (“**AIFM / Fund Manager**”) with regard to the summoning of the ordinary and/or extraordinary general meeting of the shareholders requests, if it deems necessary, the insertion of supplementary matters in the text of the calling notice of the general meeting of shareholders;
- (2) Receives from the Alternative Investment Fund Manager the information in connection with the answers to the written requests submitted before the date of the general meeting of the shareholders, by the shareholders on topics regarding Fondul Proprietatea’s activity;
- (3) Receives from the Alternative Investment Fund Manager the annual financial statements, the annual activity report presented by the Alternative Investment Fund Manager and the financial auditors’ report, before being made available to the shareholders and analyses them, being able to formulate an opinion to be presented to both the Alternative Investment Fund Manager and the general meeting;

(4) Receives from the Alternative Investment Fund Manager for analysis the annual report and the management policy of Fondul Proprietatea and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders regarding such;

(5) Receives from the Alternative Investment Fund Manager for analysis the yearly income and expenditure budget before it is submitted to the approval of the general meeting of shareholders and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders regarding such;

(6) Receives from the Alternative Investment Fund Manager for analysis the strategy in accordance with the Fondul Proprietatea's investment policy before to be submitted to the approval of the general meeting of the shareholders and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders;

(7) Receives from the Alternative Investment Fund Manager for analysis and approves the framework for carrying out Fondul Proprietatea's operations, as well as any other Fondul Proprietatea's regulations issued by Alternative Investment Fund Manager according to legal provisions in force, capital market rules and regulations;

(8) Receives from the Alternative Investment Fund Manager for analysis the proposal to the ordinary general meeting of the shareholders for the conclusion of the financial audit agreement and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders;

(9) Reviews on a regular basis the investment policy of Fondul Proprietatea and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders as any time it deems necessary, but in any case, at least once a year to the annual ordinary meeting;

(10) Receives the report of the internal auditor and presents an opinion to the Alternative Investment Fund Manager and to the general meeting of the shareholders;

(11) Monitors the following, based on information and reports received from the Fund Manager:

- the list of all portfolio investments and percentage breakdown by each investment type;
- a list of major transactions occurring in the Fondul Proprietatea portfolio for the period under review;
- the total profit of the portfolio and comparison of profit with the appropriate market benchmark;
- comparison of the obtained profit with the initial objective;
- the extent of compliance with the investment policy, including, specifically, the degree to which any performance objectives set out therein are achieved, as well as any variations and actions taken to achieve such objectives and improve investment results;
- the performance evaluation report.

The Board of Nominee shall draft and present to the general meeting of the shareholders an annual report regarding the monitoring activity performed or a monitoring report for another period agreed by the general meeting of shareholders;

(12) Represents the general meeting of the shareholders in relation with the Alternative Investment Fund Manager from the communication point of view between the two corporate bodies, except for the cases expressly regulated by this constitutive act as a direct communication between the general meeting and the Alternative Investment Fund Manager;

(13) Verifies the report of the Alternative Investment Fund Manager and the exercise of the permanent monitoring over the management of Fondul Proprietatea by the Alternative Investment Fund Manager, and verifies if the operations carried on by the Alternative Investment Fund Manager are in compliance with the applicable law, the constitutive act and/or with any relevant decision of the general meeting of the shareholders;

(14) Under the conditions of art. 13 paragraphs (11) and (14) calls upon the general meeting of the shareholders;

(15) Participates to the meetings of the general shareholders' meetings and presents in this meeting reports in all cases provided by this constitutive act or with regard to any issue it deems to be relevant for the shareholders;

(16) Proposes to the general meeting of the shareholders the prior approval or rejection of the execution of contracts for acquiring, selling, exchanging or for creating pledges, having as subject non-current assets of Fondul Proprietatea, whose value exceeds, individually or cumulatively during a financial year, 20% of the total value of the non-current assets, less receivables;

(17) Recommends to the General Meeting of the Shareholders the termination of the management contract for the case when the Board of Nominees is considered is to the benefit of the shareholders.

(18) Recommends to the general meeting of the shareholders on any other issues the Board of Nominees is considered relevant to the shareholders.

(19) Following of proposal of Alternative Investment Fund Manager, recommends to the Extraordinary General Meeting of the Shareholders the appointment of the public offer intermediate, as well as on his remuneration , when it will become necessary that such a company be appointed related to the admission to trading of Fondul Proprietatea.

(20) Approves the delegation by the Alternative Investment Fund Manager of certain activities. The delegation shall be effective in accordance with the legal provisions in force.

(21) Is responsible for monitoring the Alternative Investment Fund Manager performance of the Investment Management Agreement.

The Constitutive Act also includes regulatory provisions with respect to the conflict of interest and confidentiality responsibilities of the members of the Board of Nominees.

Furthermore, the Board of Nominees will decide, within a reasonable period of time, upon any request submitted by the Fund Manager so as to permit the Fund Manager to perform its obligations.

### ***SHORT PRESENTATION OF THE BOARD OF NOMINEES' ACTIVITY FOR 2016:***

#### ***Meetings & Relevant Decisions***

In accordance with the provisions of Article 16 of the Constitutive Act of the Fund adopted by the Extraordinary General Shareholders Meeting Decision no. 5 of 29 November 2010 and the provisions of

Chapter III of the Regulation for organization and functioning of the Board of Nominees approved by the Board of Nominees' Decision no. 2 of 14 October 2010, as subsequently amended, there were 13 (thirteen) meetings of the Board of Nominees in 2015, as follows:

There were 13 meetings and conference calls of the Board of Nominees in 2016, as follows:

- 27 January 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 12 February 2016 – conference call (Members of the Board joining the conference call: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, and Mr. Mark Gitenstein)
- 2 March 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 26 April 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 7 June 2016 – conference call (Members of the Board joining the conference call: Mr Julian Healy – Chairman, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 3 August 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 11 August 2016 – conference call (Members of the Board joining the conference call: Mr Julian Healy – Chairman, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 6 September 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 21 September 2016 - conference call (Members of the Board joining the call: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 11 October 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 31 October 2016 – meeting (Members of the Board joining the meeting: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 14 November 2016 - conference call (Members of the Board joining the call: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)
- 14 December 2016 – conference call (Members of the Board joining the call: Mr Sorin Mîndruțescu – Chairman, Mr Julian Healy, Mr Steven van Groningen, Mr Piotr Rymaszewski and Mr Mark Gitenstein)

During 2016 there were no changes in the structure of Board of Nominees.

During 2016, the Board of Nominees issued a total number of sixty-one (61) resolutions. Among such, the most important ones referred to:

- ✓ The approval of amending the Internal Regulations of the Board of Nominees of Fondul

- Proprietatea SA;
- ✓ The approval of amending the membership of the Consultative Committees of Fondul Proprietatea;
  - ✓ The approval of the Guidance regarding the Evaluation of the Board of Nominees of Fondul Proprietatea S.A.;
  - ✓ The approval of the Nomination and Remuneration Policy of Fondul Proprietatea SA;
  - ✓ The approval of the Expense Reimbursement Internal Policy of Fondul Proprietatea SA;
  - ✓ The approval of the Portfolio Management and Administration Services Delegation Agreement to be signed between Franklin Templeton International Services S.à r.l., Luxembourg (the "Fund Manager") and Franklin Templeton Investment Management Limited (the "Investment Manager") in relation to Fondul Proprietatea SA.;
  - ✓ The approval of signing different arrangements for rendering various services to the Fund, including credit facility agreements, management agreements and sub-lease agreement;
  - ✓ The approval of the convening notices in relation to the General Shareholders Meetings held during 2016;
  - ✓ The prior approval of the decrease of the share capital of the Fund;
  - ✓ The prior approval of the buyback programmes of the own shares issued by the Fund;
  - ✓ The prior approval of the Fund's Sole Director Annual Report for 2015;
  - ✓ The prior approval of the profit allocation for 2015;
  - ✓ The prior approval of the amendments to the Fund's Constitutive Act;
  - ✓ The prior approval of the authorization of the sole director to execute any disposal acts over any holdings in the portfolio companies of Fondul Proprietatea S.A., which either individually or cumulatively during 2016 or 2017 financial year, for each year separately, exceed 20% of the total value of the non-current assets, less receivables;
  - ✓ The prior approval of the continuation of the mandate of the Alternative Investment Fund Manager and Sole Administrator;
  - ✓ The prior approval of Fondul Proprietatea's 2017 budget;
  - ✓ The prior approval for different arrangements related to the financial auditor, Deloitte Audit SRL
  - ✓ The approval of reimbursement of the expenses incurred by Franklin Templeton Investment Management Ltd. United Kingdom Bucharest Branch on behalf of Fondul Proprietatea.

## **II. THE OPINION OF THE BOARD OF NOMINEES REGARDING ANNUAL REPORT FOR THE YEAR END 31 DECEMBER 2016:**

### ***ANNUAL ACTIVITY REPORT PRESENTED BY THE FUND MANAGER***

According to the Financial Supervisory Authority ("FSA") Norm 39/2015, starting with the financial year ended 31 December 2015, IFRS is the basis of accounting for preparation of the financial statements of the Fund.

This section provides an overview on the main elements of the Fund's financial position and performance for the period ended 31 December 2016.

#### **Statement of Financial Position**

<b>RON million</b>	<b>31 December 2016</b>	<b>31 December 2015</b>
	<b>Audited</b>	<b>Audited</b>
Cash and current accounts	5.8	0.6



Deposits with banks	305.3	197.8
Treasury bills	781.4	20.0
Government bonds	328.6	59.0
Equity investments	9,992.2	11,800.7
Other assets	20.8	29.6
<b>Total assets</b>	<b>11,434.1</b>	<b>12,107.7</b>
Payables	27.1	18.7
Other liabilities	21.0	35.9
<b>Total liabilities</b>	<b>48.1</b>	<b>54.6</b>
Total equity	11,386.0	12,053.1
<b>Total liabilities and equity</b>	<b>11,434.1</b>	<b>12,107.7</b>

**Deposits with banks** as at 31 December 2016 and 31 December 2015 included bank deposits denominated in RON with maturities of up to one year, held with banks in Romania, **treasury bills** caption included treasury bills with discount, while **government bonds** caption comprised short-term government bonds with coupon, both denominated in RON, with residual maturities up to one year, issued by the Ministry of Public Finance of Romania.

The overall increase in liquid assets in 2016, of RON 1,143.7 million is mainly due to the cash inflows from the disposal of portfolio companies (entire holdings in Romgaz SA, E.ON Distributie Romania SA, E.ON Energie Romania SA and partial disposal of the holdings in OMV Petrom SA, Banca Transilvania SA and BRD Groupe Société Générale SA) in amount of RON 2,116.1 million and the dividends collected from portfolio companies during the period in amount of RON 351.3 million, net of tax. These were netted off mainly by the cash outflows for the payments in respect of the return of capital to shareholders (RON 512.4 million) and for funding the payment of the own shares acquired within the sixth and seven buy-back programmes (RON 674.2 million).

The decrease in **equity investments** of RON 1,808.5 million for the year ended 31 December 2016 is mainly due to the disposal of certain portfolio companies (entire holdings in Romgaz SA, E.ON Distributie Romania SA and E.ON Energie Romania SA and partial disposal of the holdings in OMV Petrom SA, Banca Transilvania SA and BRD Groupe Société Générale SA - total impact RON 2,250.1 million) and to a 10.0% decrease in value of the OMV Petrom SA share price (negative impact of RON 373.9 million), which were compensated by the net increase in the fair value of certain equity investments, following the revaluation process for unlisted portfolio companies, in total amount of approx. RON 960.0 million (mainly triggered by the increase in fair value for Hidroelectrica SA and CN Aeroporturi Bucuresti SA).

## Statement of Comprehensive Income

RON million	2016	2015
	Audited	Audited
Net gain on disposal of equity investments classified as available for sale	926.0	344.8
Gross dividend income	353.1	569.3
Reversal of impairment losses on receivables, net	17.9	17.6
Interest income	7.9	3.9
Net unrealised loss from equity investments at fair value through	(377.8)	(1,244.0)

<b>profit or loss</b>		
Net realised gain from equity investments at fair value through profit or loss	-	3.2
Net realised loss from disposal of non-current assets held for sale	(127.5)	-
Impairment losses on equity investments classified as available for sale	(122.4)	(90.5)
Other income/ (expenses), net*	(0.5)	1.8
<b>Net operating income/ (loss)</b>	<b>676.7</b>	<b>(393.9)</b>
Investment management and administration fees	(70.6)	(68.3)
Other operating expenses	(61.5)	(56.8)
<b>Operating expenses</b>	<b>(132.1)</b>	<b>(125.1)</b>
Finance costs	(0.3)	(2.5)
<b>Profit/ (Loss) before income tax</b>	<b>544.3</b>	<b>(521.5)</b>
Income tax expense	(97.3)	(43.6)
<b>Profit/ (Loss) for the year</b>	<b>447.0</b>	<b>(565.1)</b>
Other comprehensive income	100.7	212.4
<b>Total comprehensive income for the year</b>	<b>547.7</b>	<b>(352.7)</b>

\* Other items of income/ (expense), net included mainly the net loss from revaluation of government securities through profit or loss, net foreign exchange gain / (loss) and other operating income/ (expenses).

The main contribution to the profit recorded in 2016 was the net gain on disposal of equity investments available for sale, which was partially offset by the net loss from equity investments at fair value through profit or loss, impairment losses on equity investments available for sale and by the loss from disposal of non-current assets held for sale.

The **net gain on disposal of equity investments classified as available for sale** represents the difference between the proceeds from disposals and the carrying amount of the equity investments as at disposal date, plus the net unrealised gain related to these investments transferred from other comprehensive income to profit or loss upon their derecognition. The increase in this caption is mainly due to the disposal of several portfolio companies during 2016 (entire holdings in Romgaz SA, E.ON Distributie Romania SA and E.ON Energie Romania SA and partial disposal of the holdings in Banca Transilvania SA and BRD Groupe Société Générale SA).

**Gross dividend income** for the year ended 31 December 2016 included the dividend income earned from the Fund's portfolio companies, mainly from Hidroelectrica SA (RON 134.6 million), SDEE Transilvania Nord SA (RON 28.0 million), CN Aeroporturi Bucuresti SA (RON 27.4 million), SDEE Muntenia Nord SA (RON 26.9 million), SDEE Transilvania Sud SA (RON 26.3 million) and Electrica Furnizare SA (RON 24.5 million). The decrease compared to the previous year was mainly due to the decision of OMV Petrom SA not to distribute dividends in 2016, which was partially offset by the higher dividends received from other portfolio companies

**Interest income** is related to the deposits held with banks and to the short-term government securities.

The **net unrealised loss from equity investments at fair value through profit or loss** represents the unrealised losses from the negative change in fair value of equity investments classified at fair value through profit or loss, mainly OMV Petrom SA, as a result of the negative evolution of the share price for

this company in these years.

As at 30 September 2016 the Fund reclassified the part of its holding in OMV Petrom SA subject to the secondary public offering as non-current asset held for sale, in accordance with the requirements of IFRS 5 Non-current assets held for sale and discontinued operations. The offering was completed in October 2016 and the number of shares sold in the offer was 3,641,100,108 (representing approximately 6.4% of OMV Petrom SA share capital). The **net realised loss from disposal of non-current assets held for sale** for the year ended 31 December 2016 represents the difference between proceeds from disposal and the carrying amount of non-current assets held for sale as at reclassification date.

**Impairment losses on equity investments classified as available for sale** caption for year ended 31 December 2016 mainly relate to the holding in Complexul Energetic Oltenia SA (RON 62.8 million) and Nuclearelectrica SA (RON 44.2 million).

**The income tax expense** for year ended 31 December 2016 represents among others the partial reversal of the deferred tax asset recognised as at 31 December 2015, due to the fact that the deferred tax asset for the unused tax losses is recognised at the level of the deferred tax liability arising from the taxable temporary differences from equity investments. The income tax expenses in 2015 represents mainly the reversal of the deferred tax asset recorded as at 31 December 2014, as a result of the change of the Romanian fiscal legislation provisions.

The **investment management and administration fees** for the year ended 31 December 2016 included the base fee of RON 46.8 million (31 December 2015: RON 53.4 million) and the distribution fee of RON 23.8 million (31 December 2015: RON 14.9 million).

The **other comprehensive income** comprises the changes in fair value of equity investments available for sale, net of related deferred tax, where applicable.

#### Other operating expenses

RON million	2016 Audited	2015 Audited
Intermediaries and other fees related to disposal of portfolio holdings	33.2	8.9
FSA monthly fees	10.7	11.5
Depositary fees	0.8	1.3
Secondary listing expenses	-	16.6
Other expenses	16.8	18.5
<b>Other operating expenses</b>	<b>61.5</b>	<b>56.8</b>

**Intermediaries and other fees related to disposal of portfolio holdings** were higher in 2016 as compared to 2015, as a result of the costs with the sale of portfolio companies during 2016 (costs incurred in 2016 were related mainly to OMV Petrom SA, Banca Transilvania SA, BRD Groupe Société Générale SA and Romgaz SA).

The decrease in 2016 of the **FSA monthly fees** is mainly due to the decrease of the Fund's total NAV, the basis on which these fees are calculated.

In 2016 **other expenses** comprise mainly juridical consulting services, notary fees, services related to the promotional activities for the Fund, valuation services in relation with the Fund's portfolio and the



financial auditor's fees.

**Board of Nominees has reviewed the above presented financial statements and is satisfied that they correctly reflect in all material aspects the activity of the Fund during 2016.**

### ***FINANCIAL REPORT OF AUDITORS***

The Board of Nominees has reviewed Deloitte's audit report, which is presented together with the statutory financial statements. The Board has had the opportunity to discuss the report with Deloitte, and is pleased to note that the opinion is unqualified.

The audit opinion has an extended new form, following the requirements of the new audit standards adopted and it contains a clean audit opinion on the Fund's annual financial statements as at 31 December 2016. The most significant additional requirements in relation to the content of the audit report refer to the inclusion and description of key audit matters in order to outline those matters that, in the auditor's judgment, were of most significance in the audit of the financial statements.

The key audit matters included in the audit report are: Valuation of equity investments and Share capital presentation.

### **Profit appropriation proposal**

As per statutory financial statements prepared in accordance with the IFRS, the Fund recorded a net profit for the financial year ended 31 December 2016 of RON 446,969,856. The proposal for the appropriation of the net accounting profit for 2016 financial year in amount of RON 446,969,856 is as follows:

- RON 22,348,493 to legal reserve
- RON 424,621,363 will remain available to the Fund, the proposal being subject for GSM approval in accordance with the legislation in force.

The proposal is motivated by the fact that during 2017 there will be two returns of capital, one in March and one in June, of RON 0.05 per share each.

This proposal is subject to shareholders approval during the Annual Shareholders Meeting to be held on 25 April 2017.

### ***2016 BUDGET COMPARED TO ACTUAL RESULTS***

The Board of Nominees asked the Fund Manager to analyse the significant variances for the main categories of income and expenses of Fondul Proprietatea S.A. by comparing the budget for the year ended 31 December 2016 (approved by shareholders on 29 October 2015) to the audited actual results for the same period.

In accordance with FSA Norm 39/ 28 December 2015, starting with the annual financial statements for the year ended 31 December 2015, IFRS are the official accounting regulations (statutory basis of

accounting) for the entities authorised, regulated and supervised by the FSA – Financial Investments and Instruments Sector, including Fondul Proprietatea. Consequently, this actual versus budget analysis for the year end 2016 was prepared based on IFRS accounting records.

The result of this analysis has been reviewed by the Board of Nominees, which is satisfied with the explanations given for any significant variances.

According to the approval of shareholders regarding the 2016 Budget reallocations / reclassifications among the expense categories may take place during the year with the condition that the total of these expenses (excluding non-budgeted expenses such as: foreign exchange losses, expenses with provisions and impairment adjustments, expenses with disposal of financial assets, etc.) will meet the overall budgetary limits approved by the GSM.

Together with the approval of 2016 Budget in October 2015, the shareholders granted the Fund Manager the power to:

- exceed the expenses budgeted for investment management and administration fees;
- exceed the expenses budgeted for commissions and fees (FSA fees and Depositary bank fees), to the extent arising from the Fund's actual average NAV, the value of assets under custody and/ or volume of portfolio and buy-backs trades in 2016 being higher than the ones assumed in the 2016 Budget;
- incur on behalf of the Fund all expenses necessary (e.g. intermediary fees of brokers or investment banks, market authorities' fees, lawyers, public notaries, other advisors costs, as well as other related expenses, commissions or fees) related to the execution of acquisitions and disposals of equity investments or participation in share capital increases of portfolio companies;
- incur on behalf of the Fund all expenses related to the buy-back of the Fund's shares or the equivalent global depositary receipts corresponding to shares of the Fund and their subsequent cancellation (after the approval by shareholders), under any buy-back programme approved by shareholders;
- incur on behalf of the Fund any expenses related to bank loans/ credit facilities contracted by the Fund, with Board of Nominees approval;
- incur on behalf of the Fund any expenses related to the potential change of the fund manager and sole administrator of the Fund (expense incurred by the Board of Nominees);
- incur on behalf of the Fund any expenses resulting from the implementation of any regulation applicable to the Fund.

even if this will result in exceeding the total expenses approved in the 2016 Budget.

A detailed breakdown of the figures has been included in **Annex 1**. As certain categories of income and expenses cannot be budgeted (such as foreign exchange gains and losses, revenues and expenses from impairment adjustments, fair value changes, gains or losses and other expenses related to disposal of financial instruments, or other items of income/ expense), the income and expenses have been split into "budgeted" and "non-budgeted" categories.

## Results

### *Net result*

The *actual net profit* of the Fund for year ended 31 December 2016 of RON 447.0 million was slightly below the budgeted net profit of RON 454.0 million. The main contributor to the profit in 2016 was the net gain on disposal of equity instruments (RON 798.4 million) and this was partially offset by:

- The unrealised negative change in fair value of the equity investments classified at fair value through profit or loss (RON 377.8 million), principally OMV Petrom SA (the share price decreased of 10.0% during the period);
- The net expenses with impairment and provisions (RON 104.6 million).

### ***Income from current activity***

The 2016 *total income from current activity* of RON 1,165.9 million is significantly higher than the budgeted income of RON 567.5 million, due to the *non-budgeted income* of RON 804.8 million. This includes instruments classified as available for sale, fair value through profit or loss and non-current assets held for sale. The main disposals during 2016 were: the entire holding in Romgaz SA, E.ON Distributie Romania SA and E.ON Energie Romania SA and partial disposal of the holdings in OMV Petrom, Banca Transilvania SA and BRD Groupe Societe Generale SA.

The net gain on disposal of available for sale equity investments is calculated as the difference between the proceeds from disposal and the carrying amount of the equity investments as at disposal date, plus the related net unrealised gain transferred from equity (other comprehensive income) to profit or loss upon their de-recognition.

*Other non-budgeted income* category mainly includes the amounts reimbursed by The Bank of New York Mellon from the fees collected from GDR holders in amount of RON 3.7 million.

However, *excluding the non-budgeted income*, actual income from current activity is lower than the budget by RON 206.5 million or 36%, as a result of a lower level of dividends approved for distribution by the Fund's portfolio companies, the most significant impact being generated by OMV Petrom SA which did not distribute any dividends during 2016.

### ***Expenses from current activity***

During 2016, the actual *expenses from current activity* of RON 621.6 million are higher than the budgeted expenses of RON 113.4 million. The significant negative variance is due to *non-budgeted expenses* of RON 524.7 million, mainly represented by:

- *The net loss from equity instruments at fair value through profit or loss* of RON 377.8 million. These are principally related to OMV Petrom SA, as a result of the negative evolution of the share price of this company (total impact RON 373.9 million);
- *Net expenses with impairment adjustments and provisions* of RON 104.6 million, which are mainly related to the holding in Nuclearelectrica SA (RON 44.2 million), Complexul Energetic Oltenia SA (RON 62.8 million) and Posta Romana SA (RON 12.9 million);
- *Expenses related to disposal of portfolio holdings* of RON 33.7 million, please see above the list of 2016 disposals.

However, *excluding the non-budgeted expenses*, the actual expenses from current activity were lower than the budget by RON 16.5 million or 15%. The 2016 actual expenses are positively impacted by a lower VAT rate as compared to the rate used for 2016 budget preparation (20% vs. 24%).

*Third parties services providers' expenses* are lower than 2016 budget by RON 12.1 million or 13%. A detailed breakdown of this category is shown in **Annex 1**.

The main components of this expense category and variances versus budgeted amounts relate to:

- *Investment management and administration fees*, that are lower by 1% compared to the budgeted amounts;
- *Legal and litigation assistance expenses* which are below 2016 budget by RON 4.9 million (or 47%)
- *Other third party service providers' expenses* (see **Annex 1**): the budgeted amounts included financial and legal due diligence services for potential acquisition amounting to RON 2.7 million and for which no actual expenses were incurred during 2016.

The average actual Fund's average NAV during 2016 was lower than the average used in the 2016 budget assumptions, and this had a positive influence on the following expenses:

- *Commissions and fees* of RON 10.9 million which are lower by RON 1.2 million as compared to 2016 budget (mainly FSA fees);
- *Bank fees and distribution to shareholders fees (mainly Depository fees)* of RON 0.9 million which are lower by 0.6 million as compared to 2016 budget.

*Income tax expenses*, in amount of RON 97.3 million, represent among others the partial reversal of the deferred tax asset for the unused tax losses carried forward recognised as at 31 December 2015, which is recognised, at each reporting date, only to the level of the deferred tax liability arising from the taxable temporary differences.

### **III. PORTFOLIO INVESTMENT OF THE FUND:**

#### ***BOARD OF NOMINEES OPINION REGARDING THE INVESTMENT POLICY OF THE FUND AND THE DEGREE OF COMPLIANCE WITH THE INVESTMENT POLICY AND ANY CHANGES AND ACTIONS THAT LEAD TO TARGETTED RESULTS***

The investment objective of the Fund is the maximization of returns and per-share capital appreciation via investments mainly in Romanian equities and equity-linked securities. Details of the investment policy can be found in the Investment Policy Statement and Constitutive Act.

**The Board of Nominees believes that the Fund Manager was in compliance during 2016 with the applicable investment policy adopted by the Fund. At the same time, the Board shares the Fund Manager's view that at present the best way to implement the investment policy is to invest in the Fund's own shares.**

#### ***BOARD OF NOMINEES OPINION REGARDING THE PORTFOLIO INVESTMENT AND THE PERCENTAGE ACCOMPANYING EACH TYPE OF INVESTMENT AT THE END OF 2016***

The Board of Nominees holds frequent and detailed discussions on managing the Fund to maximize shareholder value. This includes developing a consistent approach for appropriate actions aimed at reducing the discount at which the Fund's shares are traded on the Bucharest Stock Exchange. In particular, the Board is supportive of the implementation of various Discount Control Mechanism techniques including buyback programmes, tender buybacks and the return of capital as the Fund's shares are trading at a deep discount and offer an attractive investment opportunity for the Fund and its non-selling shareholders. The Board also discusses at its meetings with the Fund Manager the potential

strategies for unlocking value of the individual unlisted investments. The Board has established an Audit and Valuation Committee, part of the role of which is to consider on a regular basis the appropriate valuation methodology for valuing the individual unlisted investments. The Board also discusses regularly with the Fund Manager appropriate ways of establishing relevant long-term fund management performance evaluation measurements.

## ***BOARD OF NOMINEES OPINION REGARDING THE SIGNIFICANT TRANSACTIONS OF THE FUND FOR 2016***

The most significant transactions of the Fund within the investment portfolio during 2016 were:

- In April the Fund sold its entire holding of 22,542,960 shares in Romgaz SA (20,286,910 in the form of ordinary shares and 2,256,050 in the form of GDRs);
- In June the Fund sold its entire participations in E.ON Distributie Romania SA (56,749,014 shares representing 18.3% of the company's share capital), and E.ON Energie Romania SA (9,903,524 shares representing 13.4% of the company's share capital);
- In October the Fund sold 3,641,100,108 shares in OMV Petrom SA via a secondary public offering, representing approx. 6.4% of the OMV Petrom's share capital, in the form of shares and GDRs (3,267,250,908 in the form of shares and 373,849,200 in the form of GDRs, where 1 GDR represents 150 ordinary shares).

The Board of Nominees is supportive of profitable, cash-generating portfolio divestments and buy-back transactions aiming at the increase of NAV per share and the decrease of the discount level.

## ***BOARD OF NOMINEES OPINION REGARDING KEY PORTFOLIO VALUATION DURING THE PERIOD***

At year end, valuation updates were prepared for 20 unlisted holdings, representing 99.7% of the total unlisted portfolio, with the assistance of KPMG Advisory and Ernst & Young Service. The valuation reports were prepared in accordance with the International Valuation Standards and the biggest increase compared to 31 December 2015 occurred for Hidroelectrica (RON 729.9 million) and CN Aeroporturi Bucuresti (RON 263.2 million). The full list of valuation reports impact for 2016 is included in Annex 2.

In terms of listed holdings, the most significant impact relates to OMV Petrom's share price, which had a negative evolution during the year with a decrease of 10% (net negative impact during the period of RON 373.9 million).

At the end of 2016 reporting date, the Fund assessed whether there is objective evidence of impairment for both listed and unlisted holdings. In performing the impairment test for the available for sale equity investments, the Fund considers all relevant factors, such as: significant or prolonged decline in fair value below cost, market and industry conditions, to the extent that they influence the recoverable amount of the equity investment, financial conditions and near-term prospects of the issuer, any specific adverse events that may influence the issuer's operations and recent losses of the issuer.



The biggest impairment losses booked by the Fund relate to CE Oltenia (RON 62.8 million) and Nuclearelectrica (RON 44.3 million).

#### **IV. THE OPINION OF BOARD OF NOMINEES REGARDING THE ANNUAL REPORT OF THE INTERNAL AUDITORS AND THE ANNUAL COMPLIANCE REPORT**

The Board of Nominees has reviewed the internal audit report prepared by Fondul Proprietatea's internal auditor, BDO and been informed about the internal audit performed by FTI, for the year 2016.

The overall objective of the report of the internal auditors was to assess whether the key risks relating to Fondul Proprietatea's operations are being managed in an appropriate manner and in compliance with applicable regulatory requirements and FTI policies and procedures.

The report has not identified any major deficiencies regarding the design and effectiveness of controls which were subject to the internal audit work.

The Board of Nominees received and reviewed the Annual Compliance Report prepared by the local compliance officer, addressing the management of the compliance risk within the company / fund.

The compliance report covered the activities performed by Franklin Templeton Investment Management Limited UK Bucharest Branch and Fondul Proprietatea S.A. in respect of compliance with applicable local rules and regulations and internal procedures.

No material compliance exceptions have been reported in 2016. In the BoN's opinion the compliance control, systems and processes have operated at an adequate level.

#### **V. THE GENERAL EVALUATION OF THE ACTIVITY OF THE FUND MANAGER FOR 2016 (REPORTING PERIOD)**

The Board of Nominees acknowledges the continuing promotion of the Fund to foreign and Romanian institutional investors undertaken by as the Investment Manager of Fondul Proprietatea.

The most notable activities during 2016 included:

- The GDR facility reaching the limit of 1/3 of the Fund's issued share capital, limit set by the regulations in force, in less than one year since the Fund's listing on the LSE;
- Successful placement of 22.5 million shares held in Romgaz SA (5.8% of the total shares issued by the company and 100% of the Fund's holding in the company), via an accelerated bookbuilding process on the BVB and LSE;
- Disposal of the entire E.ON holdings E.ON Distributie Romania SA (56,749,014 shares representing 18.3% of the company's share capital), and E.ON Energie Romania SA (9,903,524 shares representing 13.4% of the company's share capital);
- Gross distribution of RON 516.9 million to shareholders through the reduction of the nominal value of the Fund's shares from RON 0.90 per share to RON 0.85 per share;
- Completion of the third tender offer of 575 million shares (388.6 million in the form of shares and

186.4 million in the form of GDRs), at a purchase price of RON 0.8420 per share and the USD equivalent of RON 42.10 per GDR, executed in order to accelerate the sixth buy-back programme;

- Completion of the sixth buy-back programme for 891.8 million shares. The total value of the programme excluding transaction costs was RON 731.9 million, and the average share price was RON 0.8208 per share;
- Start of the seventh buy-back programme for 366.5 million shares<sup>1</sup>, equivalent to 3.40% of the Fund's issued share capital as at 31 December 2016;
- Update of the Annual Cash Distribution Policy to distribute at least RON 0.05 per share, on an annual basis, in the absence of exceptional market conditions or circumstances, subject to any restrictions under Romanian legal or tax regulations and subject to available funding;
- Partial sale of 3.6 billion shares in OMV Petrom SA via a secondary public offering executed on the BVB (3.3 billion ordinary shares) and LSE through GDR listing (373.8 million shares in the form of GDRs). The value of the transaction was RON 682.3 million and USD 19.2 million, and represented 6.4% of the company's share capital. The Fund reduced its stake from 18.99% to 12.57%, significantly increasing the company's free float from 9.4% to 15.8%;
- Continued efforts to promote the Fund and raise its visibility, as well as the visibility of the Romanian capital market, the local companies (listed or candidates for IPOs), and of Romania in general, in the key financial centres in the United States of America, Europe, and the Middle East;
- Continued close supervision of the insolvency process of Hidroelectrica and collaboration with the judicial administrator in charge of the Company's insolvency procedure (e.g. Hidroelectrica achieved record gross profits in 2016 of RON 1.51 billion);
- Continued advocacy for the listing of the largest SOEs in the Fund's portfolio (Hidroelectrica expected to be listed in H2 2017);
- Ongoing involvement in the implementation of the corporate governance standards, accountability, and responsibility of the management of SOEs, as well as proposing the introduction of share option plans for the boards and management of SOEs;
- Receipt of shareholders' approval for the extension of the mandate of FTIML as Fund Manager of Fondul Proprietatea;
- Record high participation from foreign institutional investors and analysts at the Romania Investor Days in London and New York, and Fondul Proprietatea Analyst and Investor Days in Bucharest;
- Continued transparent reporting on the Fund to shareholders and the public through ongoing communication and disclosure about the Fund and its underlying companies;
- Key shareholders' approvals:
  - The return of capital of RON 0.05 per share to shareholders, as proposed by the Sole Director;
  - Continuation of the mandate of FTIS as Fund Manager and Sole Director of Fondul Proprietatea;
  - Approval of the eighth buy-back programme to repurchase a maximum number of 10% of the issued share capital at the relevant time, starting with the date when the share capital decrease regarding the cancellation of the shares repurchased within the sixth buy-back programme is effective;
  - The approval of a special cash distribution of RON 0.05 per share, in addition to the annual cash distribution, payable to the Fund's shareholders starting 27 March 2017.

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<sup>1</sup> The limit of the buy-back programme is adjusted to maximum 10% of the issued share capital at the relevant time; for further details please see Subsequent Events section

**VI. RECOMMENDATIONS FOR SHAREHOLDERS:**

In view of the proposed points of the agenda of the annual GSM, the Board of Nominees would like to recommend to shareholders that they approve all the proposals of the Fund Manager submitted to this meeting.

Please note that this report is the annual report prepared based on article 17 of the Constitutive Act and that based on article 9.5 of the IMA that entered into force on 30 September 2014 the Board of Nominees will receive the Performance Report from the Fund Manager (the deadline for receiving it is 31 August 2017), and the Board will prepare and submit for the information of shareholders at the October GSM a review of the Performance Report (the BoN Review Report), evaluating the performance of the Fund Manager, as well as any other factors that it considers to be relevant for the decision of the October GSM regarding the continuation or termination of the Management Agreement and the Fund Manager's mandate.

**Mr. Sorin-Mihai MÎNDRUȚESCU, Chairman**

**Mr. Steven Cornelis van GRONINGEN, Member**

**Mr. Piotr RYMASZEWSKI, Member**

**Mr. Julian Rupert Francis HEALY, Member**

**Mr. Mark Henry GITENSTEIN, Member**

## Annex 1

### 2016 Budget versus Actual Results

	Budget 2016	Actual 2016	Variance	
	RON	RON	RON	%
<b>I. INCOME FROM CURRENT ACTIVITY</b>	<b>567,477,342</b>	<b>1,165,859,679</b>	<b>598,382,337</b>	<b>105%</b>
<b>Budgeted income</b>	<b>567,477,342</b>	<b>361,011,884</b>	<b>(206,465,458)</b>	<b>-36%</b>
Gross dividend income	567,477,342	353,070,538	(214,406,804)	-38%
Interest income	-	7,941,346	7,941,346	100%
<b>Non-budgeted income</b>	<b>-</b>	<b>804,847,795</b>	<b>804,847,795</b>	<b>n/a</b>
Net gain on disposal of equity instruments available for sale	-	798,433,149	798,433,149	n/a
Net foreign exchange gains	-	871,278	871,278	n/a
Other income	-	5,543,368	5,543,368	n/a
<b>II. EXPENSES FROM CURRENT ACTIVITY</b>	<b>113,433,457</b>	<b>621,631,474</b>	<b>508,198,017</b>	<b>448%</b>
<b>Budgeted expenses</b>	<b>113,433,457</b>	<b>96,890,419</b>	<b>(16,543,038)</b>	<b>-15%</b>
Third party service providers' expenses	91,517,283	79,466,902	(12,050,381)	-13%
Commissions and fees expenses (include FSA and Central Depository)	12,188,747	10,944,011	(1,244,736)	-10%
Investors relations expense	2,304,860	1,454,846	(850,014)	-37%
Board of Nominees & special administrators	1,218,000	1,207,531	(10,469)	-1%
PR expenses	1,543,774	984,114	(559,660)	-36%
Bank fees and distribution to shareholders fees (including Depository fees)	1,953,737	883,324	(1,070,413)	-55%
Amortisation expenses	558,978	267,244	(291,734)	-52%
Social security contributions	255,960	202,642	(53,318)	-21%
Insurance expenses	330,525	192,264	(138,261)	-42%
Rent expenses	68,560	65,977	(2,583)	-4%
Expenses with utilities	25,684	23,761	(1,923)	-7%
Other expenses	1,467,349	1,197,803	(269,546)	-18%
<b>Non-budgeted expenses</b>	<b>-</b>	<b>524,741,055</b>	<b>524,741,055</b>	<b>n/a</b>
Net loss from equity investments at fair value through profit or loss	-	377,839,664	377,839,664	n/a
Expenses with impairment adjustments and provisions, net	-	104,554,964	104,554,964	n/a
Expenses related to disposal of portfolio holdings	-	33,692,217	33,692,217	n/a
Net loss from other financial instruments at fair value through profit or loss	-	6,887,472	6,887,472	n/a
Finance costs	-	323,438	323,438	n/a
Other expenses	-	1,443,300	1,443,300	n/a
<b>III. GROSS PROFIT</b>	<b>454,043,885</b>	<b>544,228,205</b>	<b>90,184,320</b>	<b>20%</b>
IV. Income tax expenses	-	(97,258,350)	(97,258,350)	n/a
<b>V. NET PROFIT</b>	<b>454,043,885</b>	<b>446,969,855</b>	<b>(7,074,030)</b>	<b>-2%</b>
<b>VI. CAPITAL EXPENDITURE</b>	<b>431,354</b>	<b>19,639</b>	<b>(411,715)</b>	<b>-95%</b>
Intangible assets	431,354	19,639	(411,715)	-95%

**Detail of Third Party Services Providers' Expenses**

	<b>Budget 2016</b>	<b>Actual 2016</b>	<b>Variance</b>	
	<b>RON</b>	<b>RON</b>	<b>RON</b>	<b>%</b>
<b>Third party service providers' expenses</b>	<b>91,517,283</b>	<b>79,466,902</b>	<b>(12,050,381)</b>	<b>-13%</b>
Investment management and administration fees	71,359,366	70,609,840	(749,526)	-1%
Legal and litigation assistance	10,521,334	5,597,959	(4,923,375)	-47%
Portfolio holdings valuation	2,142,155	942,506	(1,199,649)	-56%
GSM organisation	744,000	543,480	(200,520)	-27%
External audit	540,071	524,843	(15,228)	-3%
Tax compliance & tax advisory expenses	539,911	409,860	(130,051)	-24%
Software maintenance and support fees	442,300	159,939	(282,361)	-64%
Trade Register and Official Gazette expenses	272,800	829	(271,971)	-100%
Internal audit	195,300	180,000	(15,300)	-8%
Other third party service providers' expenses	4,760,046	497,646	(4,262,400)	-90%



## Annex 2

Table of unlisted holdings valuation at 31 December 2016 versus 31 December 2015

	Portfolio company name	Value in 31 Dec 2016 NAV (RON Million)	Value in 31 Dec 2015 NAV (RON Million)	Impact on Total NAV (RON Million)	30 Dec 2016 NAV vs. 30 Dec 2015 NAV %
1	Hidroelectrica SA	3,383.99	2,654.13	729.86	27.50%
2	E-Distributie Banat SA*	599.90	624.00	(24.10)	-3.90%
3	E-Distributie Muntenia SA*	449.40	455.40	(6.00)	-1.30%
4	Engie Romania SA**	453.40	446.10	7.30	1.60%
5	E-Distributie Dobrogea SA*	380.20	401.20	(21.00)	-5.20%
6	CN Aeroporturi Bucuresti SA	761.00	497.84	263.16	52.90%
7	SDEE Muntenia Nord SA***	255.20	253.90	1.30	0.50%
8	SDEE Transilvania Sud SA***	246.20	222.30	23.90	10.80%
9	SDEE Transilvania Nord SA***	208.30	215.60	(7.30)	-3.40%
10	Societatea Nationala a Sarii SA	181.00	177.42	3.58	2.00%
11	CN Administratia Porturilor Maritime SA	216.00	175.11	40.89	23.40%
12	Electrica Furnizare SA	167.72	149.60	18.12	12.10%
13	Complexul Energetic Oltenia SA	0.00	62.84	(62.84)	-100.00%
14	ENEL Energie SA	75.50	76.60	(1.10)	-1.40%
15	ENEL Energie Muntenia SA	70.30	64.00	6.30	9.80%
16	Posta Romana SA	43.00	58.70	(15.70)	-26.70%
17	Zirom SA	25.51	23.27	2.24	9.60%
18	Plafar SA	2.16	1.91	0.25	13.10%
19	Aeroportul International Mihail Kogalniceanu - Constanta SA	1.70	1.57	0.13	8.30%
20	Aeroportul International Timisoara - Traian Vuia SA	3.63	2.61	1.02	39.10%
	<b>TOTAL</b>	<b>7,524.11</b>	<b>6,564.10</b>	<b>960.0100</b>	<b>14.60%</b>

Note: The table does not include E-On companies, which were sold during the year.

\*Starting with November 2016 Enel Distributie companies changed their names into E-Distributie Banat SA, E-Distributie Muntenia SA and E-Distributie Dobrogea SA

\*\*Starting with February 2016 GDF Suez Energy Romania SA changed its name into Engie Romania SA

\*\*\*Starting with 2016 year end Electrica Distributie companies changed their names into SDEE Muntenia Nord, SDEE Transilvania Sud, SDEE Transilvania Nord