

EURO Insol

**Causes and circumstances leading to
Hidroelectrica's
insolvency**

General Data

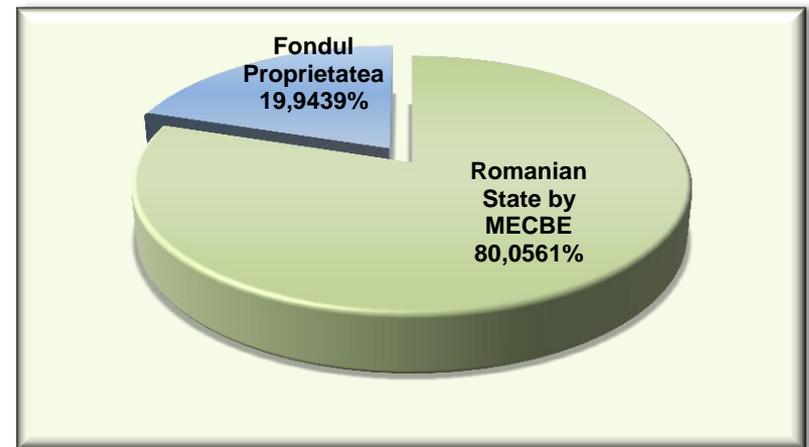
Following Hidroelectrica's request, Bucharest Court Civil Section VII, by concluding session delivered on 20.06.2012 in 22456/3/2012 file, ordered the opening of insolvency proceedings under the Law 85 / 2006, as amended and supplemented has appointed Euro Insol SPRL as trustee.

Hidroelectrica is a joint stock company established under the Government Decision no. 627/13 July 2000, following the reorganization of the National Electricity Company and is registered at the Trade Register of the Bucharest under number J40/7426/2000 Series A no, 733887 issued on 10.08.2000.

Company has registered office in Bucharest, sector 2, in 3 Constantin Nacu Street, and fiscal identification number 13267213.

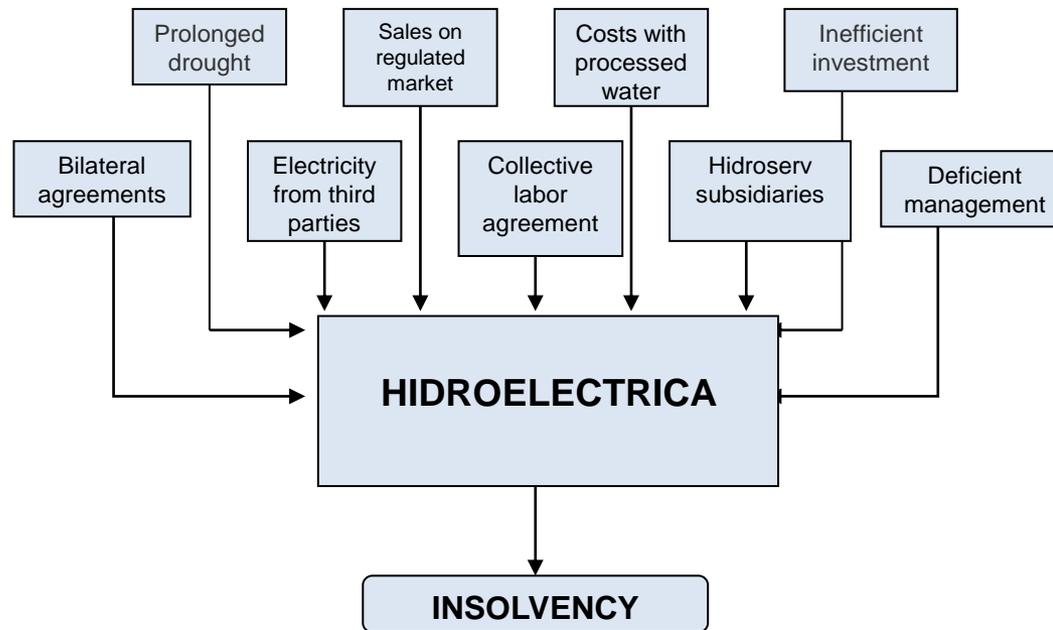
Company's subscribed and paid in share capital is of 4,475,643,070 RON, owned by Romanian State represented by Ministry of Economy, Commerce and Business Environment with 80,0561 % and 19,9439 % by SC Fondul Proprietatea SA

All company shares are ordinary and nominative shares, issued dematerialized, as book entry securities with a par nominal value of 10 RON / share.



Insolvency clauses

Until the completion of this report, the trustee has identified the following causes that contributed to the insolvency of the Hidroelectrica.



Other sales of electricity

The main transactions described in this group of sales are related to thermal producers, Transelectrica on Balancing market, members of Balance Responsible Part (BRP), Next Day Market (NDM) and direct consumers.

Transactions with thermo producers Cet Arad SA, Cet Brasov SA, Complexul Energetic Craiova SA, Complexul Energetic Rovinari SA, Complexul Energetic Turceni SA, Electrocentrale București, Electrocentrale Deva and Nuclearelectrica were conducted under contracts of sale of electricity between producers.

Transactions on Balance Market (BM) are conducted under balancing market participation agreements signed with Transelectrica (mandatory for all electricity market participant). These transactions resulting from the discharge and loading orders issued by the National Dispatch Center and are brought to the Hidroelectrica attention by OPCOM with Monthly closing notes.

Transactions with members of Balance Responsible Part (BRP) are performed under service contracts concluded with each member BRP that Hidroelectrica as balancing responsible parties has represented in the market.

Between January 2009 - May 2012 the turnover from the sale of electricity on market segments mentioned above was in vale of 1,469,787,577 RON, the equivalent of 6,433,951 MWh, representing approx, 10% of the total amount of electricity sold during that period, the average selling price being in value of 228,44 lei / MWh,

Electricity bilateral contracts

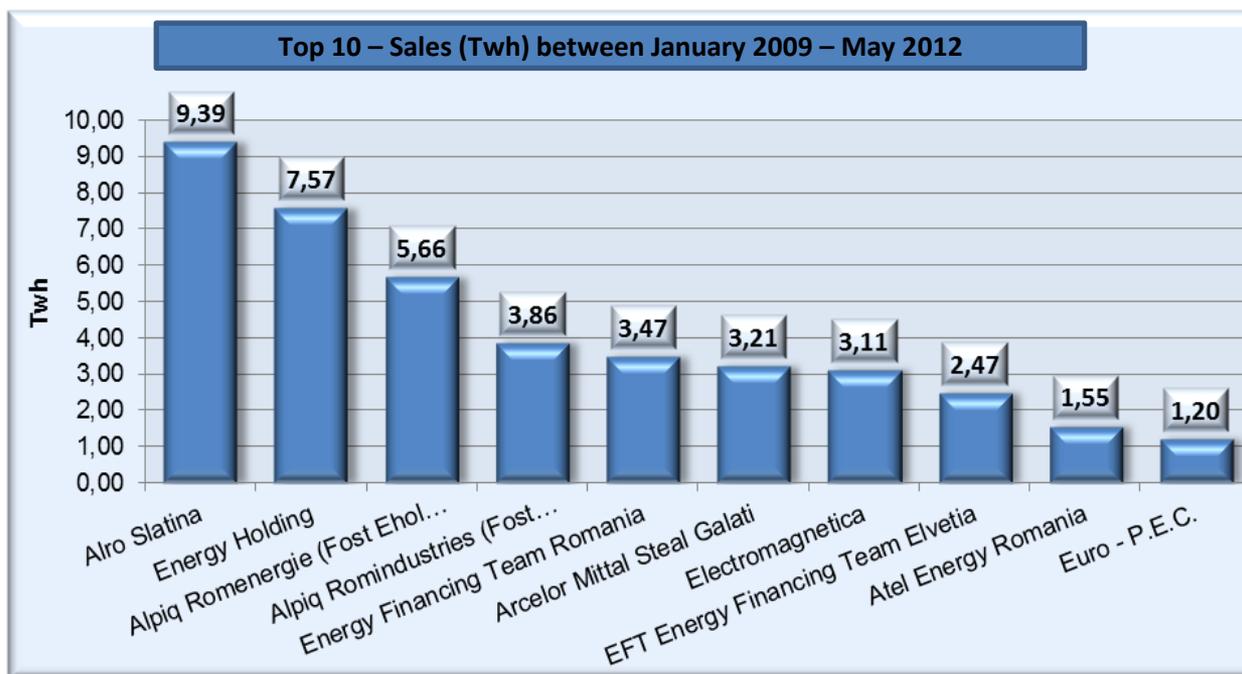
Electricity sold on free market

In January 2009 - May 2012 the turnover from the sale of electricity on the free market was in value of 5,541,196,706 RON, the equivalent of 45,049,761 MWh, representing 69% of the total amount of electricity sold during that period, average selling price is of 123 RON/ MWh,

Year	Quantity (Mwh)	% Market	% Total sales	Value without VAT (RON)	Average price RON/ Mwh
2009	12,970,718	28.79%	19.96%	1,402,043,889	108.09
2010	15,965,829	35.44%	24.57%	2,003,126,442	125.46
2011	12,891,972	28.62%	19.84%	1,711,713,812	132.77
31.05.2012	3,221,242	7.15%	4.96%	424,312,563	131.72
Total	45,049,761	100%	69.32%	5,541,196,706	123.00

Electricity bilateral contracts

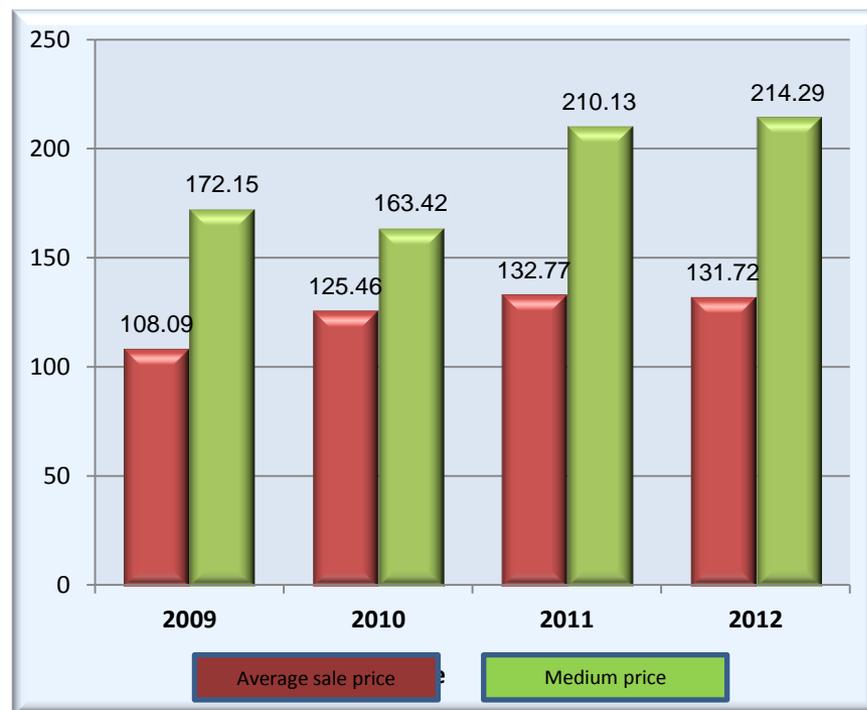
Top sales of first 10 clients representing together 92.1% of total sales on free market for period January 2009 – May 2012:



Electricity bilateral agreements

A comparative analysis of average annual price arising from the bilateral agreements concluded by the Hidroelectrica with annual average price on central market of bilateral contracts presents that between January 2009 - May 2012 Hidroelectrica registered a loss of 2,700,118,197 RON, equivalent of 635,283,698 Euros, calculated at the average exchange rate RON/ Euro published by the National Bank of Romania for each year and for the first five months of current year.

The above mentioned loss of **Euro 635,283,698**, refers to the lack of income calculated by reference to central market of bilateral agreements, even if these losses are not registered in the profit and loss account of the debtor company. **Moreover, if we extend the analysis to the entire duration of the bilateral agreements concluded by the Hidroelectrica, we find that by practicing a lower selling price than the reference price of NDM, loss of income lies around 1,100,000,000 euro.**



Regulated market

Electricity sales on regulated market

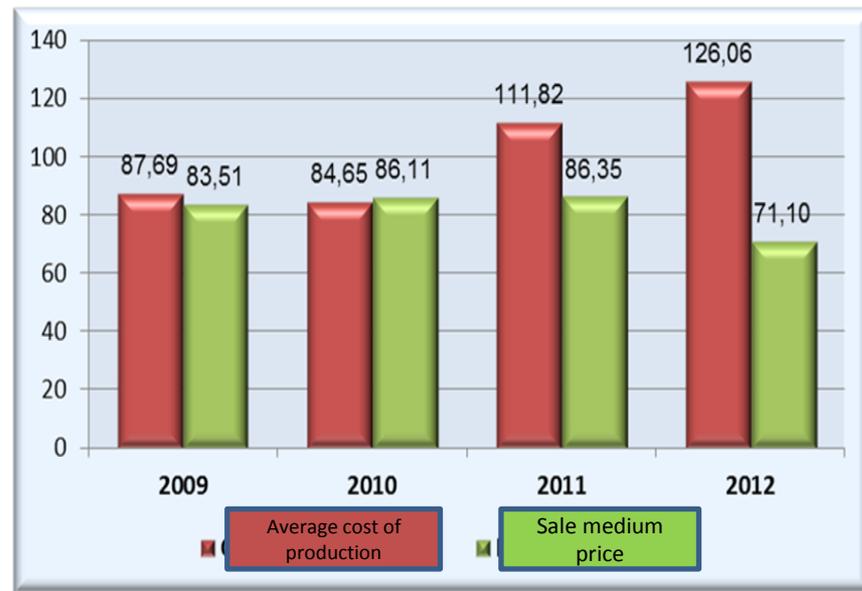
The average selling price on the regulated market for the entire period between January 2009 and May 2012 was of 83,58 Euro / MWh and sales of own production of electricity is as follows:

Specification	2009	2010	2011	31.05.2012	Total
Production for sales (Mwh)	15,128,359	19,350,758	14,303,608	5,450,467	54,233,192
Sales of Regulated market (Mwh)	3,880,042	4,091,574	3,868,726	1,663,063	13,503,405
Sales of regulated market from own production (%)	26%	21%	27%	31%	25%

The share of electricity sales on the regulated market represents 26% of its output in 2009 which decreased to 21% in 2010 due to higher production amid a favorable conjuncture in terms of hydraulicity and registered an increase in 2011 to 27% and 31% respectively in the first five months of this year.

Regulated market

The analysis of turnover achieved on the regulated market in January 2009 - May 2012, taking into account the quantity of electricity sold from own production, namely 13,5 TWh, the average selling price and average cost of production, results in a loss amounting 200,202,425 RON, the equivalent of 46,259,250 Euro, calculated at the average exchange rate RON/ Euro published by the National Bank of Romania for each year and for the first five months of current year.

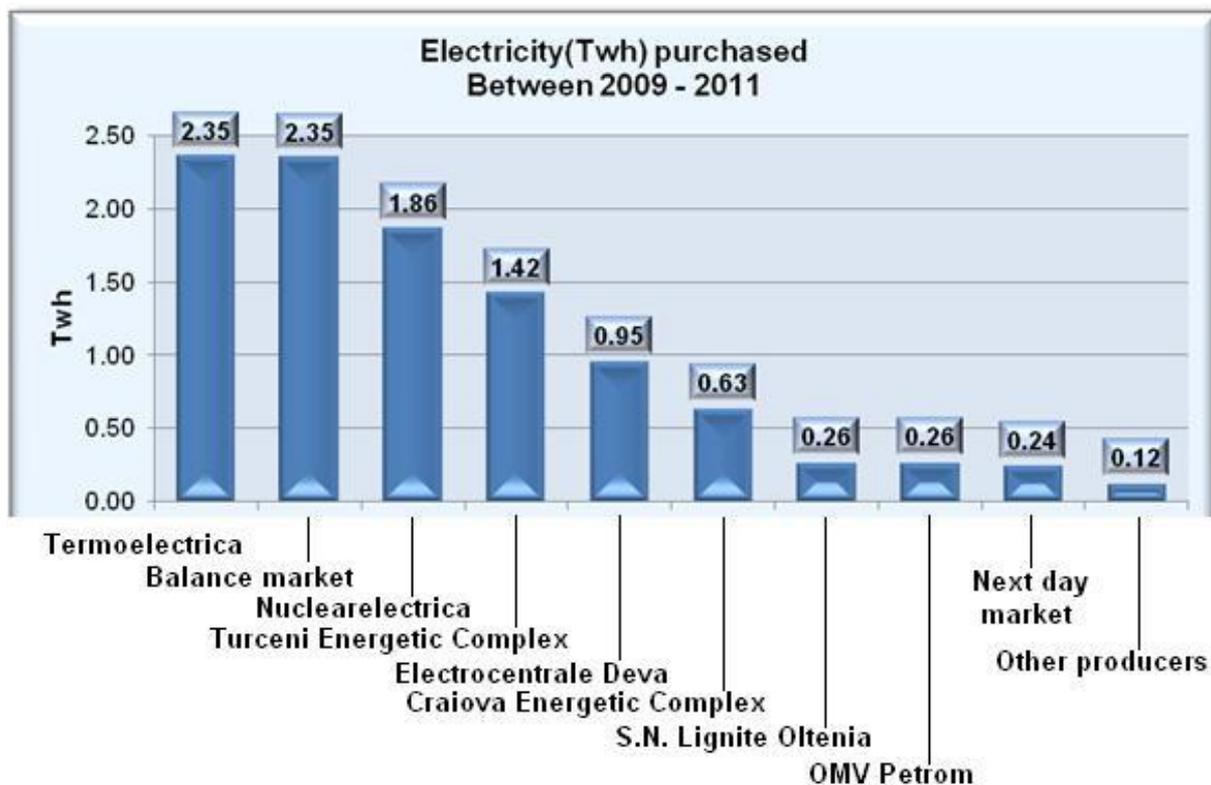


Estimates related to production levels achievable in 2012 specify that the share of electricity sales on the regulated market tends to increase by 50% due to the significant decrease in production as a result of prolonged drought, which, based on a current price of sale, will increase profitability indicators depreciation and financial balance of the Hidroelectrica.

Electricity from third parties

Expenses with electricity purchased from third parties

During 2009 - 2011 Hidroelectrica purchased electricity from third parties in the amount of 1,788,222,477 RON, the equivalent of 10,46 TWh, as shown in the chart below:



Electricity from third parties

The analysis of the quantities of electricity purchased each year, show that approx. 31% of the total amount, or 2,378,189 MWh, was purchased in 2010, an year accounted for Hidroelectrica as very good year in terms of hydraulicity and production of electricity, so the performance of the contracts concluded with other electricity producers on prices and quantities determined, mainly aimed to financially support the respective manufacturers, especially those producing electricity in plants from which Hidroelectrica purchased approx. 75% of the total quantity in 2009-2011, by internalization these additional costs in Hidroelectrica's performance indicators.

In the same period 2009-2011, under mutual aid agreements with insurance role and sale contracts, Hidroelectrica sold a total of 267,396 MWh, out of which 78,865 MWh to Nuclearelectrica and 188,531 MWh to other producers, transactions in which by comparing production costs to selling price, achieve positive margin amounting to 21,035,107 RON, equivalent of 4,993,212 €.

We analyzed transactions in which Hidroelectrica had the quality of seller to other producers and the transactions in which Hidroelectrica as reseller of the quantities purchased from the respective manufacturers, firstly in relation to production costs and selling prices, at purchase prices and average sales prices prevailing in bilateral contracts, and secondly resulting in real terms a loss of 561,825,218 RON, equivalent of 132,813,458 Euro, calculated at the average exchange rate RON/ Euro published by the National Bank of Romania each year separately.

Processed water

Expenditures with processed water

According to balances prepared by the debtor, in January 2009 - May 2012 expenditures with water and its development expense are as follows:

Description	2009	2010	2011	31.05.2012
Expenditures regarding processed water (RON)	71,218,333	125,314,459	303,036,185	129,028,797
Variation- fix base 2009		76.0%	325.5%	
Variation- chain base		76.0%	141.8%	
Share in total operating expenses (%)	3.1%	4.5%	10.5%	13.9%
Share in turnover (%)	2.9%	3.8%	10.0%	12.3%

As a result of the application of GD no,1202/2010, Hidroelectrica's expenditure regarding processed water has registered and increased by 76% in 2010 compared to 2009 and by 325,5% in 2011 compared to the same year 2009.

In these circumstances, the share cost of processed water in operating expenses increased from 3,1% in 2009 to 4,5% in 2010 and to 10,5% in 2011 so that in the first five months of 2012 to represent 13,9% of operating expenses.

The absolute increase in the cost of processed water in 2010 compared to 2009 was of 54,096,126 RON and in 2011 compared to 2009 with 231,817,853 RON.

Processed water

We should mention that Hidroelectrica delivers on the regulated market about 30% of its electricity production under a price regulated by the National Authority for Energy Regulatory (NAER), price that in accordance with art. 76 of Law no. 13/2007 should be established so as to cover justified costs of the activities of production, transmission, distribution and supply of electricity and environmental development expenses and a reasonable profit share.

Furthermore, in 2012 NAER established a regulated quantity of 5,5 TWh, 1 TWh more than in 2011 and simultaneously contract sales price decreased from 98,4 USD / MWh to 72,27 Euro / MWh, and due to lowering production as a result of prolonged drought in the past two years, the share of deliveries on the regulated market tends to rise to 50% and reducing the selling price lead to a deadlocking economically and financially situation .

In addition to the above, we find that for Hidroelectrica G.D. 1202/2010 updates specific contributions to management of water resources, increasing processed water rate 4.23 times, respectively 0.26 RON/1000 m³ (tariff established by Government Decision no. 328/2010) to 1.1 RON / 1000 m³, meaning an increase of 323%, while the said Act has come into effect from the publication and delivery prices could not be altered either in regulated sector or free market sector and has significantly contributed to reducing cash flow and the ability of the debtor to meet its payment obligations at maturity, all leading to the appearance of insolvency,

Drought in the last two years

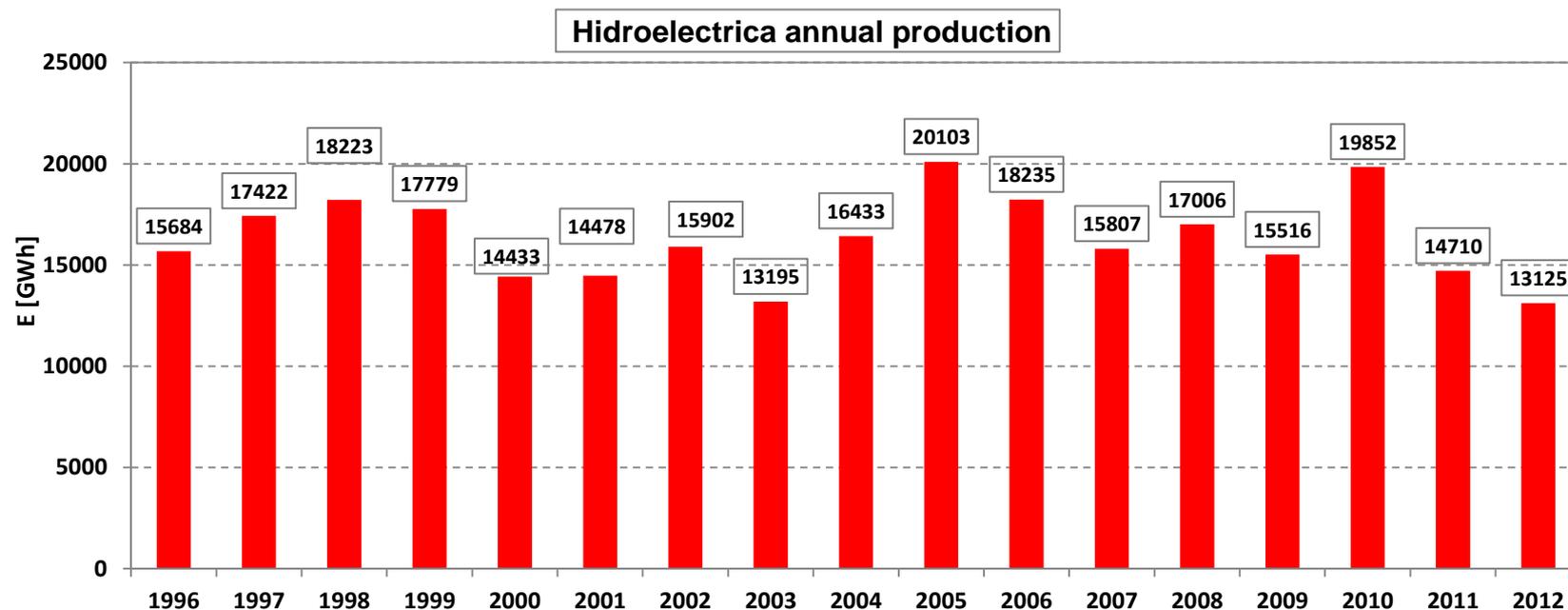
Hydroelectrica has faced since April 2011 a deficient hydrological regime that culminated with activation of force majeure clause that affected all electricity supply contracts between 30.09.2011 – 30.04.2012.

Hydro-geological drought has started in 2011 and has continued in the second half of 2012 being necessary to adopt urgent measures to protect the hydro resources, resources that are now essential to ensure the safety of the National Power System. Thus, the debtor is undergoing a period of two consecutive years of severe drought, similar to the years 1946-1947.

Hydraulicity forecast received by the company for the period August to December 2012 estimates a severe drop so running the forecasted flow capacities led to an estimated annual electricity production of approx. 13 TWh lower than 2011, the year was extremely dry and that there were produced 14.6 TWh,

Given the poor hydrological regime installed in late June and continued throughout July and taking into account the weather forecasts issued by NMA and those developed by ECMWF (which estimates a low deficient rainfall in the next two months and close to normal for October-December) can be estimated that poor hydrological regime may be extended until the end of 2012, with greater severity in August and September, this influencing negatively the annual electricity production of 2012 estimated at approx.13 TWh as shown in the chart below :

Drought in the last two years



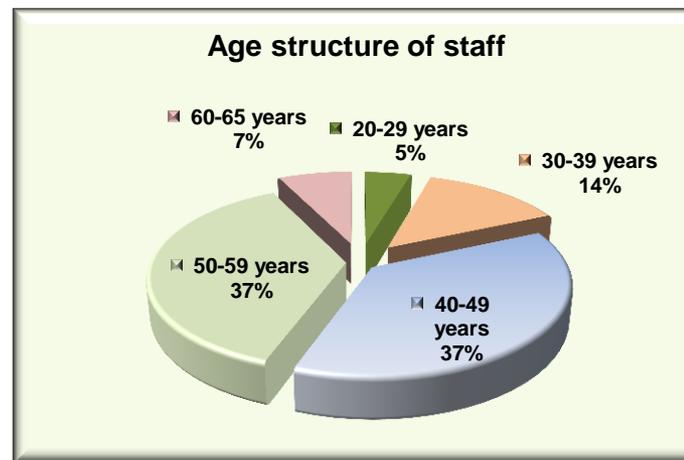
In conclusion, poor hydrological regime that Hidroelectrica has faced since April 2011 and which continued in the second half of 2012 and hydraulicity forecast for the period August to December 2012 predicting a severe drop in production capacity (approximately 13 TWh - comparable to historically minimum historical average recorded in 2003), represents one of the causes of Hidroelectrica insolvency.

Human resources

On 20.06.2012, the date of starting insolvency proceedings were registered 5,239 labor contracts with a total gross wage employment and monthly bonuses negotiated at 20,944,716 RON as follows:

Subsidiary	No. of employees	Gross salaries	Total negotiated bonuses	Total gross negotiated rights
Executive	262	1,241,789	588,815	1,830,604
Bistrița	595	1,430,684	763,415	2,194,099
Buzău	344	823,983	399,103	1,223,086
Caransebeș	194	492,119	247,201	739,320
Cluj	318	819,098	429,082	1,248,180
Curtea de Argeș	666	1,657,320	866,906	2,524,226
Hațeg	358	861,615	478,781	1,340,396
Oradea	290	739,682	406,644	1,146,326
Porțile de Fier	487	1,228,148	722,873	1,951,021
Râmnicu Vâlcea	553	1,433,201	830,703	2,263,904
Sebeș	241	629,687	327,126	956,813
Sibiu	316	752,077	384,112	1,136,189
Slatina	328	847,317	424,907	1,272,224
Târgu Jiu	287	764,185	354,143	1,118,328
Total	5,239	13,720,905	7,223,811	20,944,716

Regarding the ratio between men and women on 20.06.2012, were employed 943 women and 4296 men and age structure of staff is as follows:



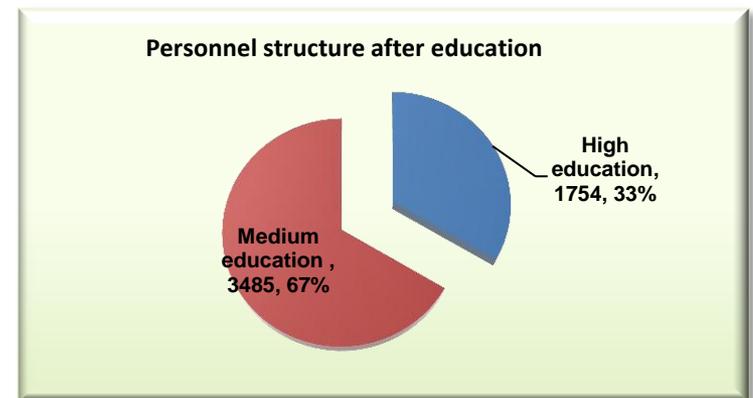
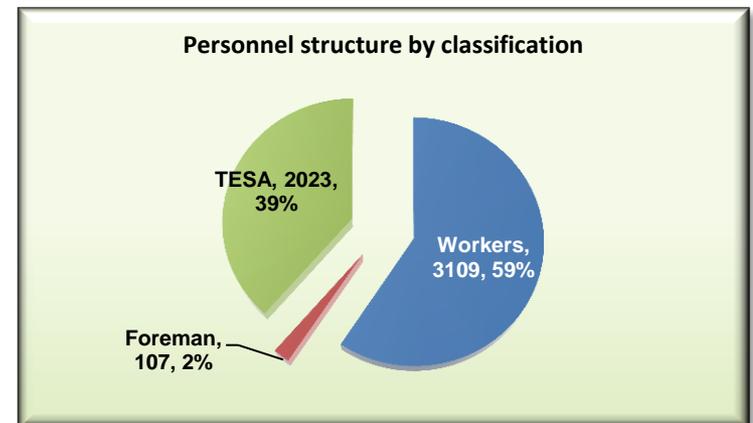
As shown in the chart above, only 19% of those employed are aged under 40 and 81% of all persons employed are aged over 40 years. Thus, 37% of those employed are aged between 40 and 49 years, the same proportion is found in people aged between 50 and 59 years and 7% were aged over 60 years.

Human resources

Analyzing the structure of personnel in terms of age, by 2015 a total of 282 people will retire, out of which 121 personnel operating the hydroelectric plants, 163 TESA personnel, 153 and 8 people of other staff, and the effect of applying the Collective Agreement in relation to staff that will retire, the costs that Hidroelectrica will have to pay will be significant.

Regarding the personnel, on 20/06/2012, the date of opening of insolvency proceedings, 59% of employed people were workers, 2% foremen and 39% TESA. From this point of view we believe that TESA personnel scheme is oversized and taking into account the level of employment and the bonuses negotiated for this segment, we find existence of undue pressures on operating costs with negative effects on performance indicators for Hidroelectrica.

Hidroelectrica's staff structure, depending on personal training, comprises 33,48% with higher education and 67% with high school education. Out of the 1754 people with higher education, 76,10% are engineers, 15,87% economists and the remaining 8.02% personnel with higher education in other categories,

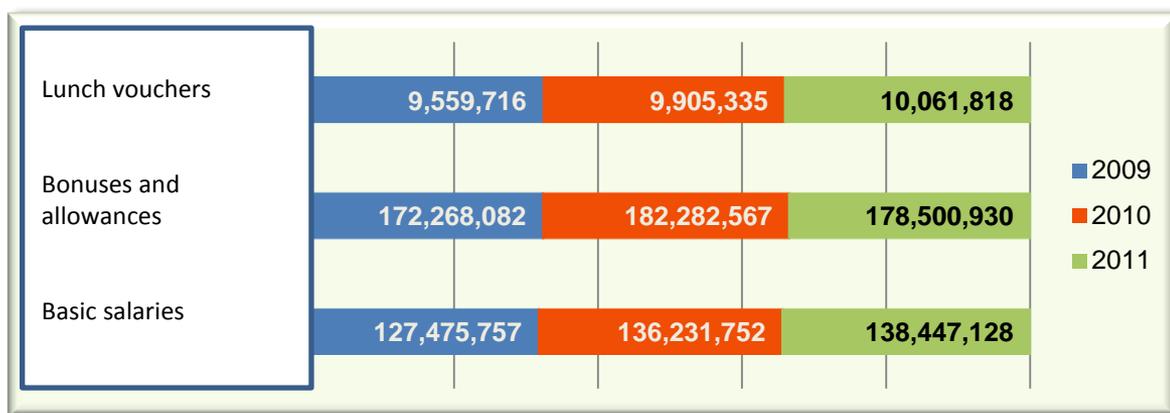


Personnel expenditures

Personnel expenditures

According to extracts from balance sheet prepared by the debtor during the years 2009 - 2011 and correlated with the profit and loss financial statements for that period, staff costs in terms of salaries, allowances, gross expenses and lunch vouchers, were 309,305,564 RON in 2009, to 328,421,664 RON in 2010, registering an increase of 6.18% compared to 2009 and 327,011,887 RON in 2010, as follows:

- RON-				
Indicator	2009	2010	2011	Total
Base salaries	127,475,757	136,231,752	138,447,128	402,154,637
Bonuses, allowances and similar	172,268,082	182,282,567	178,500,930	533,051,579
Lunch vouchers	9,559,716	9,905,335	10,061,818	29,526,869
Total cheltuieli	309,305,564	328,421,664	327,011,887	964,739,115



Personnel expenditures

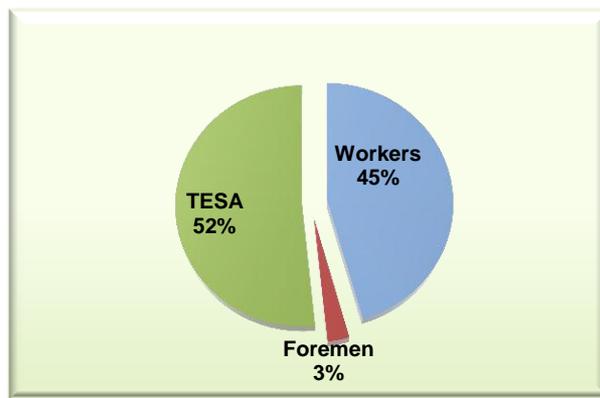
Rate of personnel cost expenditures, according to above vales are as follows:

Indicator	2009	2010	2011	Total
Base salaries	41,21%	41,48%	42,34%	41,69%
Bonuses, allowances and similar	55,70%	55,50%	54,59%	55,25%
Lunch vouchers	3,09%	3,02%	3,08%	3,06%
Total expenditures	100,00%	100,00%	100,00%	100,00%

The data presented above highlight the relative uniformity of the three components included in the cost of salaries and wages to employees during the period 2009-2011,

Basic wage structure categories and the percentage of each category is as follows:

Specification	2009	2010	2011	- RON- Total
Workers	58,134,965	60,543,738	60,300,830	178,979,533
Foremen	3,488,527	3,854,917	3,420,698	10,764,142
TESA	65,852,265	71,833,097	74,725,600	212,410,962
Total	127,475,757	136,231,752	138,447,128	402,154,637



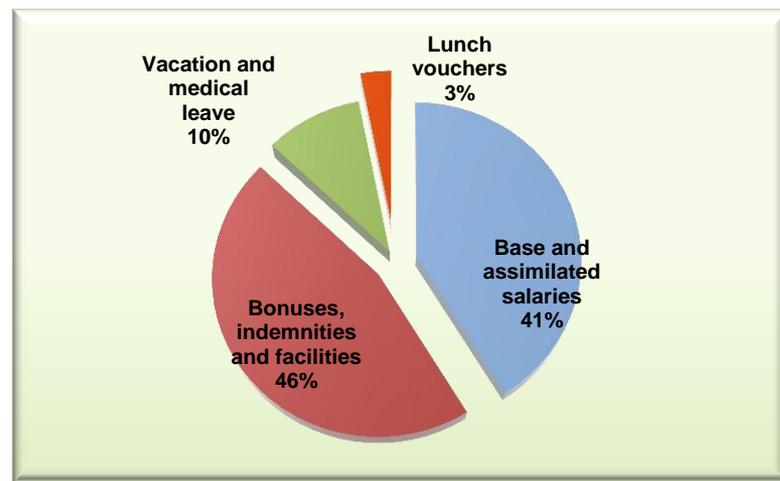
Personal expenditures

Structure of expenditures bonuses, indemnities and similar are as follows:

- RON-

Expenditures	2009	2010	2011	Total
Salaries	127,475,757	136,231,752	138,447,128	402,154,637
Bonuses	69,326,084	74,239,100	75,316,753	218,881,937
Additions / decrease	0	-131	-524	-655
Allowances vacations	28,421,704	29,720,870	30,238,240	88,380,814
Medical leave allowances	1,861,029	1,139,452	1,040,077	4,040,558
Facilities	65,146,497	70,536,170	71,497,779	207,180,446
Indemnities	7,489,559	6,578,674	361,489	14,429,722
Other assimilated expenses	23,209	68,432	47,116	138,757
Total	299,743,839	318,514,319	316,948,058	935,206,216

As shown in the chart below, from the total expenditure on wages and salaries to employees, the share of wages for time worked is about 41% while the share of bonuses, allowances and vouchers granted is about 59%, which in our opinion represents an obvious imbalance in the structure of expenditures,



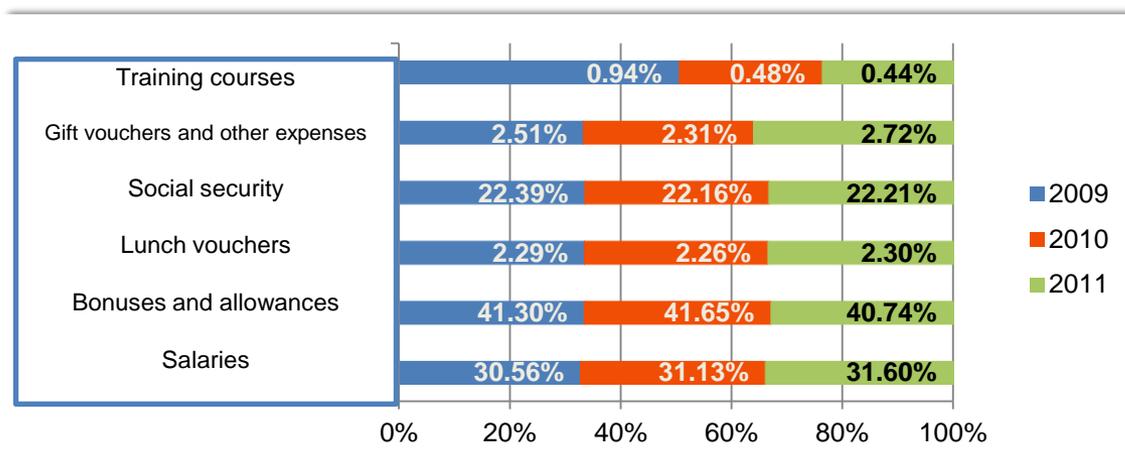
Personnel expenditures

Summary of all expenses incurred in connection with staff in 2009-2011, including employers' social insurance and training costs, less expenses incurred in traveling to the place of training programs is as follows:

Indicator	2009	2010	2011	Total
Salaries	127,475,757	136,231,752	138,447,128	402,154,637
Bonuses and indemnities	172,268,082	182,282,567	178,500,930	533,051,579
Lunch vouchers	9,559,716	9,905,335	10,061,818	29,526,869
Salary fund and associates - Total	309,303,555	328,419,654	327,009,876	964,733,085
Employer social security	93,378,011	96,982,021	97,325,330	287,685,362
Lunch vouchers and other costs	10,467,183	10,125,405	11,905,255	32,497,843
Social security and other costs - Total	103,845,194	107,107,426	109,230,585	320,183,205
Salaries, insurances and other costs - Total	413,148,749	435,527,080	436,240,461	1,284,916,290
Professional training	3,922,059	2,109,337	1,935,012	7,966,408
Personnel expenditures- Total	417,070,808	437,636,417	438,175,473	1,292,882,698

Total personnel costs recorded in 2011, not including training costs, represent 436.2 million RON and the budget for 2012, approved by Government Decision 277/03.04.2012 stipulates an amount of 461.5 million RON.

Personnel expenditures



In conclusion, given that:

- average personnel costs in 2011, including the costs of salaries, allowances, bonuses and other similar items, the cost of employer contributions to social security and training costs, is approximately 1,643 Euro / month / employee;
- the total expenditure on wages and salaries to employees, the share of wages for time worked is about 41% while the share of bonuses, allowances and vouchers granted is about 59%, which is an obvious imbalance in the structure of expenses;
- debtor's turnover decreased in 2011 by 60 million euro compared to 2010 and recorded same downward trend in 2012 as a result of prolonged drought in the past two years;
- debtor is experiencing financial difficulties,

Trustee deems necessary immediate measures to reduce personnel costs leading to appreciation of performance indicators and a reduction in cash outflows.

Effects of the collective labor agreement

Analysis reveals a collective labor imbalance between the rights of employees and the rights of society. It should be easily seen that the employees have a variety of tools to force management decisions, essential contractual balance is breach by favoring employees, detrimental to the interests of the debtor company.

Thus, after renegotiations resulting in 16 additional acts concluded within a period of 5 years, resulted an exorbitant annual fund size salaries, which amounted in 2011 to **438,177,484 RON**. These staff costs, including salaries rights, bonuses and other benefits, training costs, supplies, etc., except travel expenses, have a significant share in total operating expenses (**14.7%**) and turnover (**14.1%**),

Of this amount, in 2011 only 138,447,128 RON represented basic salaries, the difference being made up of bonuses (75,613,753 RON) and other facilities (71,497,779 RON), consisting for example in: holiday bonuses (30,426,077 RON), costs with special events (2,437,609 RON), value of electricity supplied according to the collective Labour

Agreement (8,932,081 RON), anniversaries (3,812,542 RON), Energetician Day bonus (6,853,370 RON), expenditures on lunch vouchers to employees (10,061,818 RON), training costs for employees (1,935,012 RON). In fact, the share of basic pay for time worked in total revenues earned by employees is about 41%, while 59% of revenues consist of bonuses, indemnities, allowances and vouchers, which represent an imbalance in structure of these expenses.

For all these expenses, the employer's contribution to social insurance budget for 2011 was in the amount of 97,325,330 RON.

Effects of the collective labor agreement

Impressive number of bonuses, incentives, allowances, awards and grants (70 such benefits) that employees actually receive, on monthly basis, represent an income 300% higher than the basic salary. For example, according to the payroll for June 2012, an employee whose basic salary is of 7.938 RON, obtains an income of 23,737 RON for the month, so 200% more than wage employment.

For a driver (driver, Class 32 stage T0 salary is 2,766 RON and the actually achieved salary is 7.705 RON; for another driver, driver with the same class and salary step above mentioned, the salary is of 2,766 RON and salary income realized in June 2012 is 9,993 RON, so with over 250% the salary range.

Many of bonuses and benefits overlap, causing employees to receive two or more times the exact same benefits, but whose name are different: bonus loyalty, anniversary to loyalty, bonus for night shift, while decreasing working time – pursuant to article 126 of the Labour Code provides that for work at night should offer either a salary increase or a decrease in working time, increase mobility plus travel allowance which is itself treated as a bonus, lunch vouchers with a value of 10,094,000 RON for 2012, gift vouchers of 877,000 RON for 2012, according to G.D. 277/2012, and others.

Unreasonable is the provision of the collective agreement providing that if partial early retirement, the employee will receive an award calculated on partial early retirement date equal to twice the value of reduction resulting from multiplying monthly pension determined by reference to the stage of contributions made and the difference between the number of months from the date on which the actual retirement until the person meets the standard retirement age.

Effects of the collective labor agreement

This provision is doubly prejudicing the company: on the one hand, because it gives a bonus to an employee who performs no work (compared, for example, to an employee who retires at retirement age, and whose bonus is lower - although it performs the work) and on the other hand given the enormous amount of this bonus.

For example, after starting the insolvency proceedings, an employee of Hidroelectrica which served as secretary of the Department of Secretariat, Public Relations and Communications requested early retirement and the decision issued by the Pension Fund established a penalty of 44.25% for failure conditions on retirement age, specifically, it was established that the employee should receive 792 RON instead of 1,421 RON pension for the complete pension contribution.

According to that provision of the collective labor contract, Hidroelectrica is required to pay **twice the difference** between the pension and pension penalty throughout the entire period between date of retirement and age conditions, namely, in the particular case, for 55 months, the amount which Hidroelectrica must pay the employee at retirement is 110,926 RON representing loyalty bonus, formed from for retirement allowance (12 gross basic salary - 41,736 RON) and 69,190 RON (629 RON x 2 x 55 months). If the state apply penalties for early retirement, Hidroelectrica rewards this antisocial, immoral and counterproductive behavior with enormous amounts. A total of 1500 employees of the debtor qualify for early retirement, which would lead to a major impact on costs and cash flow.

To fire an employee is conditioned to receiving a legal opinion given by the Union; this procedure is likely to maintain artificially inflated an establishment plan, which no longer corresponds to the current needs of Hidroelectrica and translates into an unnecessary expense and burden.

Effects of the collective labor agreement

Training expenses (1,935,012 RON for 2011) should be translated into a more efficient activity of each employee who received different training courses, but as the company's financial analysis show, productivity declined instead of growing. This may be either because Hidroelectrica allocated for training of employees amounts too large for the real needs of professional training or that the training courses held in the country or abroad were actually holidays or paid days off in addition to those already negotiated by collective agreement.

Personnel's plan is inflated, especially on segments not directly related to electricity production: in the personnel's plan, TESA segment register a number of **2023 employees**, with a share of **39%** of all employees, because of this inflated scheme on unproductive segments has reached when the average productivity per employee to be so low and so the profitability to be negative.

The salary fund is manifestly disproportionate to the economic condition of society and the productivity of employees, especially in poor hydrological conditions which the company has faced since April 2011, culminated with activation of force majeure clause between 30.09 2011 – 30.04.2012.

Under these conditions, personnel expense represent over Euro 100 million in 2011, a cost that contributed to the imbalance of the debtor's patrimony, with a share of 14.7% in operating costs, or 14.1% of turnover as noted above, this amount is only 138,447,128 RON base salaries and the difference is made up of bonuses, vouchers and other facilities - employees income consists of 41% of salary, the remaining of 59% representing bonuses and other allowances.

Hidroserv Subsidiaries

Government Decision no. 857/2002 regarding reorganization of Commercial Production in Hydroelectric Power "Hidroelectrica" – SA published in the Official Gazette, Part I, No. 632 of 27.08.2002, established 8 subsidiaries of Hidroelectrica SA, by reorganizing repair hydro plants within its structure units owned by Hidroelectrica capital of the 8 branches are as follows:

No.	Subsidiary	City	Address
1	Hidroserv Bistrița	Piatra - Neamț	2-4 Locotenent Drăghiescu Street
2	Hidroserv Cluj	Cluj - Napoca	1 Taberei Street
3	Hidroserv Curtea de Argeș	Curtea de Argeș	1 Barajului Street
4	Hidroserv Hațeg	Hațeg	38 bis Progresului Street
5	Hidroserv Porțile de Fier	Drobeta Turnu Severin	2 Calea Timișoarei
6	Hidroserv Râmnicu Vâlcea	Râmnicu Vâlcea	269 Calea București
7	Hidroserv Sebeș	Sebeș	9 Alunului Street
8	Hidroserv Slatina	Slatina	158 B Tudor Vladimirescu Street

The 8 branches are Romanian legal entities which are organized and operated in accordance with applicable laws and memorandums of their own and their share capital is established by taking a portion of the assets and liabilities of SC Hidroelectrica SA, based on the balance sheet prepared on 30 June 2002.

Hidroserv subsidiaries

The main activity of the subsidiaries represent the ancillary services and other service activities by performing acts of trade as provided by law and may also perform complementary and related activities to support core business, according to legislation and their own bylaws.

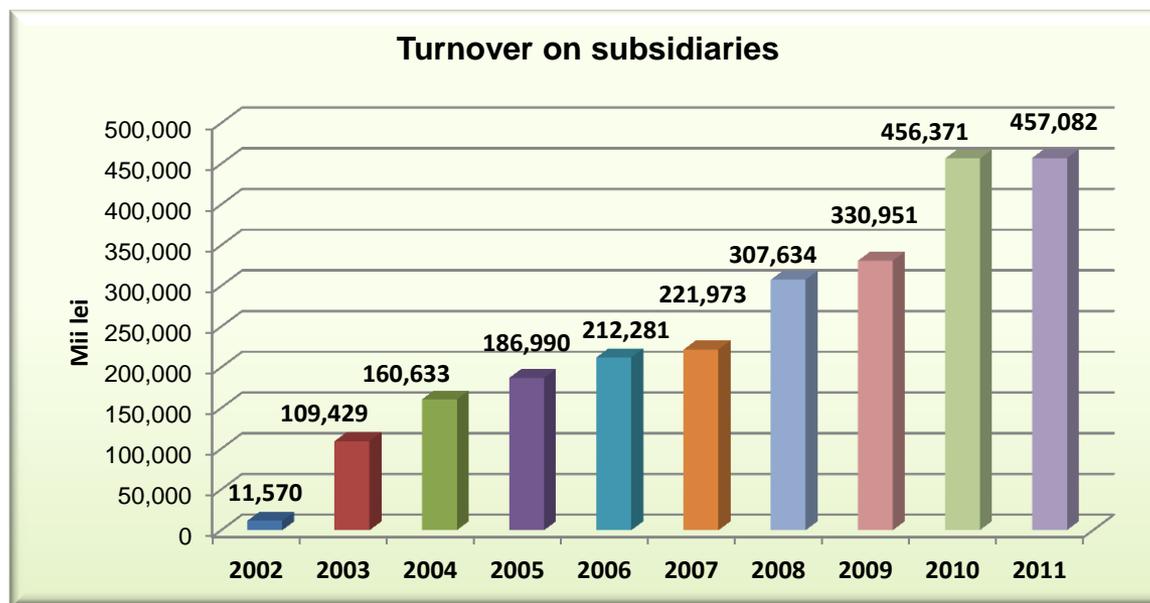
Regarding the contractual relationship between Hidroelectrica and Hidroserv Subsidiaries, service contracts and execution of repair works are completed by Hidroelectrica through its branches and subsidiaries as beneficiary for repair and service, as executor.

Contracts contain terms and conditions, differing only in the specific subject of each contract, price, certain conditions of the performance bond and damages.

The performance bond is 5% of the contracted work or services, but shall be granted only where the work or services are outsourced to third parties of Hidroserv subsidiaries outside Hidroelectrica group. Hidroserv subsidiaries do not warranted for any work performed thus there is no possibility of their penalty for culpable failure.

Indirect costs rates and Hidroserv subsidiaries overheads that are applied to currency supply and subsequently work on settlement work situations, have values between 65% and 90% for indirect costs of department and 22% to 32% for general, which leads to significant increases in the amount of benefits and hence the costs incurred by Hidroelectrica.

Hidroserv subsidiaries



In 2011, turnover in all Hidroserv subsidiaries was in the amount of 457,082,179 RON, the equivalent of 107,855,820 Euro, calculated at the average rate of 4.2379 RON / EUR exchange rate of the National Bank of Romania.

In the same year 2011, the amount of 92,365,900 RON, the equivalent of 21,795,205 EURO calculated at the rate of exchange of 4.2379 RON / EUR published by the National Bank of Romania, representing 20.21% of the total work contracted by Hidroelectrica subsidiaries, was subcontracted by Hidroserv subsidiaries to other parties.

We emphasize that the procedures for subcontracting work to third parties were not applied to GD 34/2006, the affiliated subsidiaries controlled 100% by Hidroelectrica and recorded a turnover rate of over 95% in relation to Hidroelectrica, not considered contracting parties in this case.

Hidroserv subsidiaries

The analysis of maintenance work carried out by the eight Hidroserv subsidiaries, are the following:

- Number of existing staff on 31.12.2008 was 2,364 and in June 2012 their number reached 2,529, representing an increase of approximately 7%;
- Shares of department and overheads are applied to currency supply and subsequently work on settlement work situations have values between 65% and 90% for indirect costs and 22% to 32% for overheads higher than the market average, which increased the amount of benefits unduly made by these entities and therefore increase maintenance costs incurred by Hidroelectrica.
- The high cost of operating Hidroserv subsidiaries is highlighted by the fact that in most cases they have participated in a tender procedure for acquisition of works on competitive market bids were rejected as uncompetitive, being ranked last.
- Turnover over the years has faced an upward trend on 31.12.2011 reaching a value of 457,082,179 RON, the equivalent of 107,855,820 EURO, calculated at the rate of exchange of 4.2379 RON / EUR published by the National Bank of Romania. We emphasize that the turnover of Branches is made almost entirely with branches Hidroelectrica.
- Maintenance works frequency and scale decreased in the period since the date of incorporation Hidroserv subsidiaries to the present, as a result of refurbishment and modernization programs undertaken within Hidroelectrica subsidiaries, while paradoxically, employment in Hidroserv subsidiaries have increased.

In consideration of the above mentioned, the trustee believes that inefficient way of organizing and operating Hidroserv subsidiaries, with major consequences for the costs incurred by Hidroelectrica, is one of the causes that led to the insolvency of the debtor

Based on the above, the trustee considers necessary the reorganization of subsidiaries, solution considered is that of internalizing the Factories Repair in Hidroelectrica subsidiaries in accordance with the following principles:

- Reducing the number of staff at a level adapted to the new conditions of organization and operation of these activities enabling specific principles to minimize costs and better management of resources;
- Payment of executive staff based on quality of works, following deadlines and labor work of situations drawn, accepted in advance by the beneficiaries of the work. Thus it will be interested to contract works with third parties to provide their income and availability to cover expenses and pay maturing obligations, and default payroll.
- Payment of indirect personnel according to Plant's result;
- Reducing the share of indirect costs up to a maximum of 15 to 20% to reduce the pressure on the cost of work performed, being possible through significant reduction in management and leadership structure. Also, we should point out that such a form of organization removes the profit share of 5%, currently applied by the Subsidiaries.
- The main advantages of such an organization of maintenance activities is derived primarily from cost reduction and more efficient control of works in terms of Hidroelectrica resource allocation.

Hidroserv subsidiaries

Another way to restructure and effectiveness its Hidroserv subsidiaries, consists in the merging of the 8 subsidiaries into a single company that would develop such human and technical capabilities that might undertake any maintenance or refurbishment work regardless of its complexity.

According to the trustee, reorganization of subsidiaries' activity should begin in the near future, with the implementation of preparatory measures, so that by the end of current year this operation to be completed and lead to removing losses on this segment and thus improve economic and financial indicators with a direct and immediate assets maximization of Hidroelectrica.

Major investments with small hydropower component

Investment targets when energy component is secondary and whose funding is now the exclusive responsibility of Hidroelectrica have generated, among other things, financial imbalances in society leading ultimately to one of the causes of insolvency.

These investment objectives have as main functions:

- Tranche of flood mitigation;
- Protection of the population, settlements and agricultural land;
- Providing water supply for population supply, industry and irrigation;
- Retention solid flow in dead volume accumulation.

Schemes with secondary energy component are divided into two categories, namely:

- those taken from the former Ministry of Electricity and
- those taken from the former National Council of Water

Schemes initial promoted by the Ministry of Electricity are the following:

- HPA Făgăraș-Hoghiz, Acumularea Veneția with HPP Hoghiz
- HPA Surduc Siriu, Căderea Cireșu-Surduc, Acumularea Cireșu with HPP Surduc; Căderea Surduc-Nehoiașu with HPP Nehoiașu II
- HPA Valea Sadului, Acumularea Valea Sadului with HPP Valea Sadului, HPP Turcinești, HPPCurtișoara;
- HPA Rastolița, Acumularea Rastolița with HPP Rastolița

Major investments with small hydropower component

The trustee proposes two types of financing and completion of investments previously mentioned:

- Hidroelectrica's completion of these accumulations. This possibility requires preparation of feasibility studies to substantiate volumes Sadu Valley lakes, Cireșu, Hoghiz Rastolita on principles of efficiency. Hidroelectrica will promote the MECBE Government decisions, which approve new energy technical indicators (Pi, Em and total volume of the lake and useful), basing on criteria of economic efficiency improvement possibility of financing such schemes.
- Funding from State Budget to achieve volume accumulation as originally approved, means they should be taking these investments by the Ministry of Environment and Forests, the Romanian Waters National Agency based on government decision and resource provision by RWNA for these accumulations useful volumes that were approved as originally designed, is certain that Hidroelectrica no longer supports this funding, revenue arising from the sale of electricity produced in such plants and for these accumulation is not sufficient.

In the scheme of refurbishing Romanian inland rivers promoted by Waters National Agency previous to 1990 and that are currently completed by Hidroelectrica, even though the energetic function is secondary, we should mention Pascani accumulation, on Siret River with **Pascani HEP (12 MW)**,

Investment objective "Accumulation Pascani" in Iasi county was approved as multifunctional water management objective by Decree No. 403/26.12.1985 to stage 'study and touch control', after which was prepared the conceptual design that was approved by Decision of the Council of Ministers in 1986.

The investment objective fits in the national program to ensure safe and stable production schedule of complex framework of Siret river basin, contributing to the transfers of flow from Siret river to areas deficient in water source surrounding it, in order to achieve an accumulation of volume of 68.7 million, cubic meters to ensure the following uses:

- Source of water for irrigating an area of 46,000 ha in Iasi and Neamt counties ;
- Flow of 1.0 m³ / d water for power zone Fălticeni, **Târgu Frumos** etc,

Major investments with small hydropower component

Investment objective "Hydroelectric power Pascani on Siret river" was approved by the State Council Decree No. 24/1989 for energy recovery achieved by the failure of Pascani dam.

Until 2006 the two financing investment objectives for hydroelectric scheme on the River Siret including accumulation and HEP Pascani was achieved by initial beneficiaries' contribution respectively Hidroelectrica and national administration "Romanian Waters".

GD 866/28 June 2006 approved free transfer of investment objective, on going, "Accumulation Pascani" located in Iasi county, in the administration of the Ministry of Environment and Water Management - National Administration "Romanian Waters" in the administration of the Ministry Economy and Trade - Company for Production of Electricity "Hidroelectrica" SA

Investment "Accumulation Pascani" Iasi county, and "hydroelectric power plant on the River Siret Pascani" unite as a single investment objective as "hydro power Pascani". The goods results after completion of the investment objective "Pascani hydro power" which by their nature, are part of the public domain, according to Law, 213/1998 public property and its legal status, as amended and supplemented, shall be included in the inventory of state public property.

Importantly, the GD 866/2006 expressly provides that funding of remaining works on hydro power investment to Pascani objective will be by Hidroelectrica own sources and other legally constituted sources.

Thus, the main source of funding this investment objective is from Hidroelectrica income, which is contrary to the economic purpose for which Hidroelectrica was established as a company, namely to conduct commercial activities for obtaining profit.

Between 01.01.2007 – 30.06.2012 Hidroelectrica provided to finance investment objective Pascani HEA a total of 312.07 million RON, out of which for Pascani Accumulation an amount of 278.85 million RON.

Major investments with small hydropower component

At the date of this Report, physical studies realized at Pascani HEA represent only 45%, the remaining being estimated at approximately 561.97 million RON out of which for Pascani Accumulation is required the amount of 452.45 million RON.

In current circumstances, given the lower production due to water deficiency, and linked to increased amount of energy delivered to the regulated market at a price below cost, Hidroelectrica does not have the resources to continue funding exclusively from own sources to achieve in Pascani Accumulation as originally designed and approved.

Given these considerations, in accordance with Article 4 of GD 866/28.06.2006, trustee proposed legal establishment of other sources, according to state budget law, namely the Romanian Government should allocate investment funds needed for the completion of Pascani accumulation in value of 425.45 million RON, according to complex functions envisaged in the original project promotion.

Hidroelectrica would continue to fund from own sources only for the Pascani HPP, funding would amount to 109.52 million RON from 561.97 million RON as it is now estimated the total investment. Such an approach would allow Hidroelectrica to channel and use financial resources to conduct its business to supply electricity production for profit and not to finance investment objective social function.

To those exposed, we appreciate that one of the causes of insolvency was a legal obligation imposed to Hidroelectrica by various acts of self-financed investment objective, with historical origins, considering energy component as a secondary component, Hidroelectrica's contribution so far representing 926,354,609 RON.

Deficient management

Major management deficiencies are found primarily in the situations described above, identified as the main causes that led to the insolvency, of course except those economic circumstances that the entity could not control or influence, such as drought or unfavorable legal framework .

Except the above facts, below are some issues that have come to our attention when preparing this report:

Construction of revenues and expenses budget and its execution

Since establishing the budget, both for 2011 and for 2012, Hidroelectrica provides expenditure levels, that according to the trustee, do not take into account the economic reality and financial possibilities of company to support them, knowing that the company recorded a decline in turnover and experiencing financial difficulties due to prolonged drought .

Severe drought in 2011, which led to a significant decrease in turnover and hence of revenues, determines an appropriate response to management the proper meaning restructuring costs to consider these issues. Furthermore, certain expenses, including expenses with personnel, have an increasing trend, which not only leads to debt which required cash outflows but creates major tax consequences which we present below.

Even if art 2, paragr 2) of GD 277/03.04.2012 approves the budget of revenues and expenditures for 2012, states that the company can make total costs in proportion to the degree of achievement of total revenues, and we believe that through the company's budget is assured a real balance of income and expenditure, given that during 30.09.2011 – 30.04.2012 was activated the force majeure clause and hydraulicity forecast for 2012 was by no means favourable to the company.

Deficient management

In 2012, drought has a major impact on production that reached a deficit level of only 13 TWh to 15.6 TWh budgeted level and thus to a decrease in revenues of 800 million, representing a 26.5% decrease against the budgeted level. In such a situation, it is obvious that the costs must be resized by all means to provide the necessary framework for the reorganization of the debtor.

Personnel costs

Regarding average personnel costs in 2011, including the costs of salaries, allowances, bonuses and other similar facilities, the cost of employer contributions to social security and training costs, is approximately 1.643 EUR / month / employee.

The total expenditure on wages and salaries with employees, the share of wages for time worked is about 41% while the share of bonuses, allowances and vouchers granted is about 59%, which is an obvious imbalance in the structure of costs .

Total personnel costs recorded in 2011, not including training costs were in value of **436.2 million RON**, with 0.7 million RON higher than in 2010, **while the turnover decreased in 2011 by over 253 million RON compared to 2010** and recorded same downward trend in 2012, as a result of prolonged drought in the last two years.

Deficient management

Non-deductible expenses for tax

Results of gross and net tax due for the period 2008-2011 is presented as follows:

Indicators	2008	2009	2010	2011
Total revenues	2,666,485,715	2,522,426,453	3,411,605,227	3,184,994,680
Total expenditures	2,586,297,759	2,456,918,411	3,021,350,320	3,145,384,736
Gross result	80,187,956	65,508,042	390,254,907	39,609,944
Tax on profit	15,069,866	17,130,793	97,886,907	33,165,678
Net result (profit / loss)	65,118,090	48,377,249	292,368,000	6,444,266
Average of income tax in gross result (%)	18.8%	26.2%	25.1%	83.7%

As shown, the percentage of income taxes resulting from tax reporting calculated by company, the gross result varies between about 19% and 25-26% in 2008-2010 and **in 2011 reached a value of 83.7%**.

The above situation occurs primarily as a result of expenses incurred beyond the limits allowed by the Tax Code that are not recognized in profit tax.

For the financial year ended on 31.12.2011, financial exercise deflect significantly from previous periods resulting:

- **accounting gross profit was 39,609,944 RON;**
- **deductible expenses in fiscal terms were of 186,961,388 lei**, expenses presented in detail at point 9.3.c) of the present report;
- taxable income amount to 26,662,650 RON and the tax deduction related to increase the legal reserve amounts to 1,647,885 RON.

Deficient management

- Income tax on 31.12.2011 by applying all tax regulations worth 217,715,517 RON which was calculated a tax of 34,834,483 RON;
- net of the amount of 1,668,805 RON representing sponsors, private grants, within the limit established by the Tax Code, income tax due for 2011 worth 33,165,678 RON;

This leads to **a situation where the share of corporate tax accounting profit result to be 83.7% and the amounts due to the state budget in the form of tax to be higher than 20 million RON than a normal situation.**

Regarding the gross profit amounting 39,609,944 RON reflected in the financial statements prepared on 31.12.2011, we mention that given that all expenses have been recognized for this financial year, namely:

- 10,704,646 RON, necessary adjustment for receivable to CET Braşov
- 138,772,888 RON, difference of depreciation

The company reported a gross loss in value of 109,867,590 RON and the total loss, taking into account income tax expense, would have been at least 143 million RON.

Deficient management

Other aspects

Following are some key issues related to the management of assets and expenditures:

- The last revaluation carried out by the company was held on 31.12.2009 and targeted only construction and equipment (machinery and work equipment). In the context of market's continuous decline after 2009, we have found a fiscal overload related to tax due to local budgets for buildings covered tax under the Tax Code.
- Delays in recovery, high permeability to borrowers who recorded arrears and often not counting interest and / or appropriate penalties;
- On 31.05.2012, the inventory was of 109.5 million RON, registering an increase of about 38% from 31.12.2010, out this total, the spare parts having a value of 89,239,953 RON, representing a share of 82%;

Given the value of existing inventories on 31.05.2012 and their age, particularly the nature of spare parts inventory, we consider that the debtor has immobilized large funds in stocks, beyond its total consumption, with negative effects cash flows and a high exposure to the risk of depreciation of these stocks.

- Hospitality expenses, donations and sponsorships, fleet expenses and other expenses unrelated to the business of the company exceed the financial possibilities;
- Assuming detrimental investments for the company, either on maintenance or refurbishment sides or due to oversized market prices.

Deficient management

Thus, considering the above statements together but not limited, we estimate that such management generated effects and represents an important contribution in the development of insolvency.

However we admit that expenditures and the problems arising from the application of a collective agreement, onerous to the company, as a result of Union's pressure, and totally ignoring economic reality and company's financial difficulties resulted in increased production and thus reducing revenue and earnings .

General data

The main object of activity, according to the coding approved by Order 337/2007 (CAEN classification, 2) is considered CAEN code 3511 - Production of electricity.

Hidroelectrica SA, as member of the electricity market, operate under licenses granted by NAER and is one of the largest domestic producers of electricity with a market share of approximately 24.5% and the main producer of ancillary service at a rate of about 74% of the total national services.

Although is an electricity producer with the lowest costs in Romania, Hidroelectrica is always subject to a high risk of non-insurance of raw material (water) and from this point of view electricity production estimates for periods longer than one calendar month register high degree of uncertainty.

Hidroelectrica has faced a period of two consecutive years of drought and extreme hydraulicity forecast for the period August to December 2012 estimates a severe drop, so that forecasted capacities led to an estimated annual electricity production of about 13 TWh, lower than 2011, while year was extremely dry producing 14.6 TWh. That is way, starting 01.08.2012 force majeure clause was activated.

Under these unfavorable conditions, the trustee has started from the beginning of the procedure, initiatives to reduce contractual obligations with at least 1 TWh / year, a quantity NAER allocated in previous year 2011, increasing regulated prices for production cost to 125 RON/ MWh, and renegotiate all contract on the open market in order to obtain more advantageous conditions, first a price close to market price benchmark for Next Day Market.

Subsidiaries

Hidroelectrica is made up of 13 subsidiaries, without legal status

Electricity production activity within the Hidroelectrica 13 subsidiaries takes place in 274 plants with 580 hydropower units with an installed capacity of 6,351,80 MW and a production capacity of 17.5 TWh per year

Since its establishment (2000), the company provided a power output of the plants from 23.2% (very dry in 2003) to 33.7% (wet year 2005) of the total Romanian electricity.

With regard to ancillary services, Hidroelectrica provides over 60% of secondary necessary control reserves, over 80% of tertiary required reserve and 100% of reactive power drawn from the mains charged or secondary band voltage control .

No.	Subsidiary
1	Hydropower Bistrița
2	Hydropower Buzău
3	Hydropower Curtea de Argeș
4	Hydropower Cluj
5	Hydropower Hațeg
6	Hydropower Porțile de Fier
7	Hydropower Râmnicu Vâlcea
8	Hydropower Sebeș
9	Hydropower Slatina
10	Hydropower Târgu Jiu
11	Hydropower Oradea
12	Hydropower Caransebeș
13	Hydropower Sibiu

Analysis of the patrimony

Company's status analysis was based on financial and accounting documents prepared and provided by the debtor, on the assumption that they provide a true picture of the economic and financial situation.

In 2009-2011, Hidroelectrica financial statements were audited by KPMG Audit SRL, view expressed with reservations, the same for each year. The opinion took into account the following aspects :

- The Company has entered into loan agreements with various banks and pursuant these contracts the company must meet certain conditions including, inter alia, financial indicators calculated based on the company's financial statements prepared in accordance with International Financial Reporting Standards (IFRS), which situation so as indicated by the auditor in his report were not available at the time of the report, which are being prepared
- Failure to meet the conditions stipulated in loan agreements, including those relating to financial indicators, could result in early repayment of these loans and therefore certain duties should be presented as current liabilities, without affecting the equity of the company audited
- In the auditor's opinion, except for the possible effects of the above, the consolidated financial statements fairly present the financial position and unconsolidated results and cash flow.

Analysis of patrimony

On 31.05.2012, date of last balance sheet, the structure was as follows:

	- RON-	
Assets	31,05,2012	%
Intangible assets	5,069,224	0.02%
Tangible assets	20,256,159,704	97.24%
Financial assets	60,408,208	0.29%
FIXED ASSETS	20,321,637,136	97.55%
Inventory	109,526,442	0.53%
Receivables	307,103,302	1.47%
Short term investments	11,795,247	0.06%
Cash	70,869,163	0.34%
CURRENT ASSETS	499,294,154	2.40%
Prepayment	10,688,974	0,05%
TOTAL	20,831,620,264	100.00%

	- RON-	
Liabilities	31,05,2012	%
Share capital	4,475,627,400	21.48%
Revaluation reserves	10,973,291,012	52.68%
Reserves	1,037,211,908	4.98%
Reported result	4,796,381	0.02%
Current result	989,731	0.00%
EQUITY	16,491,916,432	79.17%
Public patrimony	39,208,376	0.19%
Short term loans	2,021,005,150	9.70%
Long term loans	1,996,706,520	9.58%
TOTAL LIABILITIES	4,017,711,670	19.29%
Other liabilities	282,783,786	1.36%
TOTAL	20,831,620,264	100.00%

Analysis of patrimony

Cash and cash flows of loans on 31.05.2012, compared to 31.12.2011 are as follows:

- RON-

Description	Debit 31.12.2011	Credit 31.12.2011	Debit 31.05.2012	Credit 31.05.2012
Bank accounts in RON	64,489,056		50,810,723	
Bank accounts in foreign currency	10,629,130	12,224	2,412,788	12,224
Settlement amounts	309,978		16,109,838	
Interests to be paid		80,306		80,306
Interests to receive	46,918		42,354	
Short term loans (credit lines)		736,431,619		850,725,185
Cash in RON	339,412		373,451	
Cash in foreign currency	55,034		36,949	
Total	75,869,527	736,524,149	69,786,103	850,817,714
Net treasury		(660,654,622)		(781,031,611)

Analysis of patrimony

Receivables

On 31.05.2012, Hidroelectrica receivables were in value of **307,103,301 RON**, representing:

- Trade receivables in value of **296,026,236 RON**;
- Receivables to affiliated entities in value of **1,451,706 RON**;
- Other receivables in value of **9,625,360 RON**,

Structure of trade receivables during period under discussion is as follows:

				RON
Elements	31.12.2009	31.12.2010	31.12.2011	31.05.2012
Suppliers- debtors to provide services	1,949,199	14,006,709	838,314	1,066,475
Clients	133,613,734	196,858,831	67,919,333	145,163,161
Uncertain or under litigation clients	4,885,400	4,232,751	4,232,423	4,232,423
Clients - invoices	66,964,855	81,313,233	279,010,082	157,878,207
Adjustment for depreciation of receivables - clients	(5,015,307)	(7,675,594)	(12,314,031)	(12,314,031)
Total	202,397,882	288,735,930	339,686,121	296,026,236

Evolution of trade receivables	31.12.2010	31.12.2011	31.05.2012
Fix base 2009	42,66%	67,83%	46,26%
Chain base	42,66%	17,65%	-12,85%

We note the significant increase in trade receivables at the end of 2011 and increasing their risk of non-recovery, impairment of receivables held to customers amounting to 12,314,031 RON, up by about 60% compared to the end of 2010.

Operating activities

Operating activities

Structure of revenues from operating activities in RON:

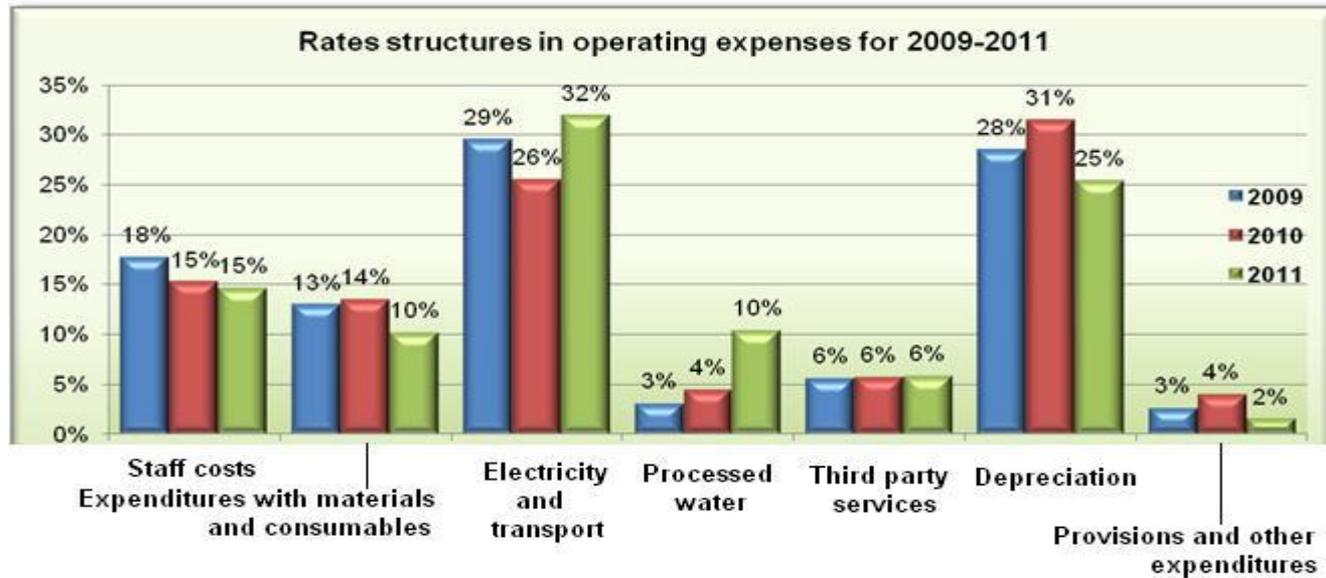
Indicators	2008	2009	2010	2011	31.05.2012
Sold production	2,441,276,505	2,417,603,556	3,268,205,779	3,017,497,114	1,045,429,768
Revenues from sale of goods	2,271,281	3,196,408	5,494,310	3,094,460	3,059,359
Net turnover	2,443,547,786	2,420,799,964	3,273,700,089	3,020,591,574	1,048,489,127
Capitalized production	95,963	286,090	157,219	3,520,106	3,370
Other revenues from exploitation	164,570,363	45,097,349	13,216,561	22,937,737	5,041,216
Revenues from operations- Total		2,466,183,403	3,287,073,869	3,047,049,417	1,053,533,713

Synthetic situation of production, purchase and sale of electricity between January 2009 – May 2012:

In/ Out	2009	2010	2011	2012
Pproduction (Mhw)	15,516,403	19,852,095	14,709,507	5,656,908
Technological consumption (Mwh)	-388,044	-501,337	-405,899	-206,441
Production for sale (Mwh)	15,128,359	19,350,758	14,303,608	5,450,467
Purchases (Mwh)	3,159,376	3,185,845	4,110,629	404,036
Total Ins Mwh	18,287,735	22,536,603	18,414,237	5,854,503
Regulated Market (Mwh)	3,880,042	4,091,574	3,868,726	1,663,063
Competition Market (Mwh)	12,970,718	15,965,829	12,891,972	3,221,242
Other sales (Mwh)	1,446,499	2,481,887	1,508,881	996,684
Total Outs Mwh	18,297,259	22,539,290	18,269,579	5,880,989
Closure Mwh	9,524	2,687	-144,658	26,486

Operating expenses

Rates structure in operating expenses during the period January 2009 - May 2012 :



Within operating expenses came to our attention following expenditure or expenditure groups by their size considered to have a significant impact on operating result :

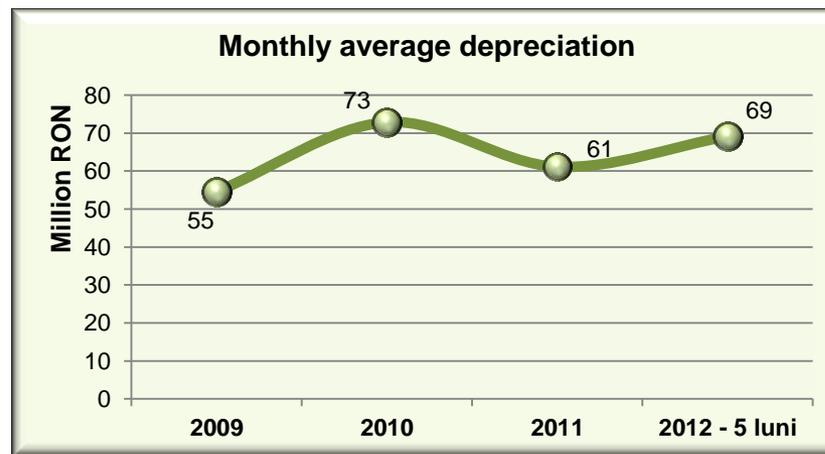
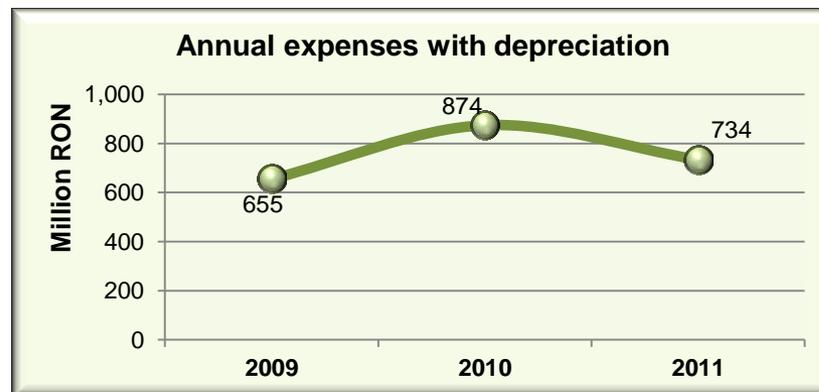
- Water connected expenses
- Electricity purchased from third parties
- Personnel connected expenses
- Depreciation of fixed assets

Depreciation

In 2011, depreciation was adjusted to the nature of all tangible assets that have failed to function or not function at normal technical parameters.

Thus, in October 2011 Hidroelectrica adjusted the related amortization of fixed assets mentioned above for the entire period January to October 2011 and continued this accounting treatment until April 2012 inclusive, citing as the basis for the adjustment of the state of force majeure during October 2011 - April 2012. As a result of this accounting treatment, depreciation monthly average decreases from approx. 72.8 million RON in 2010 to approximately 61 million RON in 2011 and then increased to about 69 million RON in 2012, with the change in accounting treatment .

Under these conditions, the impact on financial statements prepared on 31.12.2011 was to reduce depreciation expense in value of 138,772,888 RON and distortion with the same amount of default result shown in the profit and loss.



Financial activity

Financial revenues and expenses

Structure of financial expenditures and revenues for the period :

- RON-

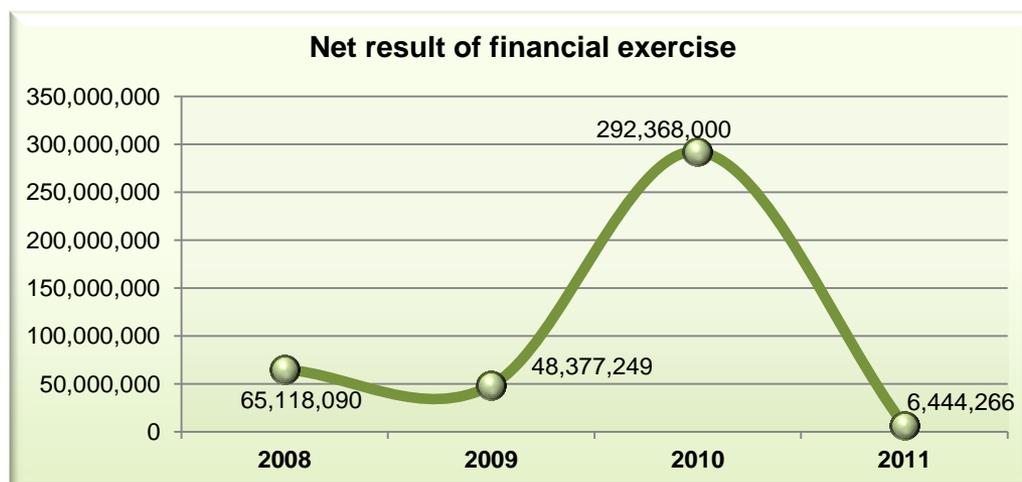
Indicators	2008	2009	2010	2011	31.05.2012
Income from investments	1,103,827	1,105,844	1,089,112	6,652,236	
Income from other investments and loans part of the assets	5,073				
Interests	5,192,875	2,068,090	1,632,549	2,253,494	904,098
Foreign exchange differences and other financial incomes	51,969,828	53,069,116	121,809,697	129,039,533	11,056,308
Total financial expenditures	58,271,603	56,243,050	124,531,358	137,945,263	11,960,406
Interest expenditures	74,896,517	69,131,684	85,420,482	102,926,484	37,636,385
Expenditures with foreign exchange rates and other financial expenditures	109,780,288	83,560,215	151,645,939	156,568,004	86,520,162
Total financial expenditures	184,676,805	152,691,899	237,066,421	259,494,488	124,156,547
Financial result profit / loss	(126,405,202)	(96,448,849)	(112,535,063)	(121,549,225)	(112,196,141)

Financial revenues are mainly from of foreign exchange differences which in 2011 represented about 94% of the total financial income.

Recorded financial expenses come mainly from foreign exchange differences and interest expense, which in 2011 is about 60% and about 40% of total financial expenses.

Results of financial exercises

Net result



The financial year ended on 31.12.2011, has register a number of issues with impact on the income statement, the gross result and net result, we present issues summarized below:

Adjustments for depreciated receivables

Taking into consideration that:

- On 29.06.2011 Hidroelectrica had an outstanding debt, amount and due in the value of 18,724,743 RON to SC Centrala Electrică de Termoficare Braşov SA, receivables from invoices issued during 2009-2011 and unpaid at maturity.
- Regarding file 8207/62/2011, Braşov Court, Commercial and Administrative Section, by sentence 155/CC/29.06.2011 decided to open the insolvency procedure against SC Centrala Electrică de Termoficare Braşov SA;

Results of financial exercises

- In the years prior to the opening of insolvency proceedings against CET Brasov, Hidroelectrica recorded on account of his claim impairment expenses in value of **8,020,097 RON**.

Towards:

- Hidroelectrica quality of unsecured creditor in insolvency proceedings opened against CET Brasov to claim the debt in value of 18,724,743 RON with no real chances for its recovery;
- Accounting regulations compliant with Directive IV of the European Economic Community and Directive VII of the European Economic Communities, approved by OMPF 3055/2009, with subsequent amendments

We find that at the end of the financial year 2011, Hidroelectrica has not recorded adjustments in the expenses to be imposed in the value of 10,704,646 RON, namely the difference between the value of its receivable to CET Brasov of 18,724,743 RON and value of adjustments in value of 8,020,097 RON, already established in previous years, led to distorted results presented in the financial statements.

Depreciation expenses

In 2011, depreciation was adjusted to the nature of all tangible assets that have failed to function or did not functioned at normal technical parameters.

Thus, in October 2011 Hidroelectrica adjusted the related amortization of fixed assets mentioned above for the entire period January to October 2011 and continued this accounting treatment until April 2012 inclusive, citing as the basis for the adjustment the state of force majeure for period October 2011 - April 2012.

From this point of view we consider that in the financial statements of the company, the depreciation shall be calculated and recognized in profit or loss account in accordance with point 110 of MPFO 3055/2009 and the tax depreciation calculated on the basis of Law 571/2003 regarding the Fiscal Code and the implementing rules, thus separating the accounting treatment for tax treatment.

Financial exercises results

Pursuant to section 110 of accounting regulations with European Directives approved by MPFO 3055/2009, as amended and supplemented, **calculating and recording depreciation should not cease as long as there are interruptions in the use of depreciable fixed assets** and where tangible assets are placed in storage, depending on the adopted accounting policy, the entity recording depreciation expense or an appropriate adjustment for depreciation expense.

Under these conditions, the impact on financial statements prepared on 31.12.2011 was to reduce depreciation expense in value of 138,772,888 RON and distortion with the same amount of default result shown in the profit and loss account.

Fiscal result

Indicators	2008	2009	2010	2011
Total revenues	2,666,485,715	2,522,426,453	3,411,605,227	3,184,994,680
Total expenditures	2,586,297,759	2,456,918,411	3,021,350,320	3,145,384,736
Gross result	80,187,956	65,508,042	390,254,907	39,609,944
Income tax	15,069,866	17,130,793	97,886,907	33,165,678
Net result(profit / loss)	65,118,090	48,377,249	292,368,000	6,444,266
Share of income tax in the gross result (%)	18.8%	26.2%	25.1%	83.7%

As shown, the percentage of income taxes resulting from tax reporting company if calculated the gross result varies between about 19% and 25-26% in 2008-2010 and **in 2011 reached a value of 83.7%**,

Financial exercises results

Regarding the calculation presented above, we find the following :

- **Gross accounting profit is in value of 39,609,944 RON;**
- Hidroelectrica indebtedness is less than 3, for which interest expenses and costs of exchange rate differences on loans are fully deductible for tax purposes;
- **Expenses not deductible for tax purposes is the total value of 186,961,388 RON;**
- Taxable income amount has a value of 26,662,650 RON and the tax deduction related to increase the legal reserve is in value of 1,647,885 RON;
- Taxable profit on 31.12.2011 by applying all tax regulations worth 217,715,517 RON for which was calculated a tax of 34,834,483 RON;
- The company has a deduct tax payment in the amount of 1,668,805 lei representing sponsorship, private grants, within the limits stipulated by the Tax Code so that tax for the year 2011 worth 33,165,678 RON;

Summarizing the above results that gross profit sheet on 31.12.2011 was in value of 39,609,944 RON and the non-deductible expenses for tax purposes were 186,961,388 RON, so that taxable profit was 217,715,517 RON, hence resulting a calculated income tax in value of 34,834,483 RON.

This leads to **a situation where the share gross accounting income tax profit to be 83.7% and the amounts due to the state budget in the form of income tax to be higher than 20 million RON from a normal situation.**

Financial exercises results

Recalculated accounting result

In relation to the MPFO 3055/2009 for the approval of accounting regulations with European Directives, Hidroelectrica was required to recognize in the profit and loss account prepared on 31.12.2011 the receivable adjustment expense held to CET Brasov in value of 10,704,646 RON and depreciation expense in value of 138,772,888 RON.

Profit and loss account prepared by the Hidroelectrica on 31.12.2011 presents a gross profit in value of 39,609,944 RON against which the trustee believes that while the above expenditures were made, **the company would have reported gross book value loss in value of 109,867,590, as follows:**

Indicators	2011
Total revenues	3,184,994,680
Total expenditures	3,145,384,736
Gross result of financial statements	39,609,944
Expenditures with adjustment of receivable to CET Brasov	10,704,646
Depreciation expenditures	138,772,888
Revised gross result	(109,867,590)

Without taking into account that in a situation such tax would have been higher by that certain limited deductibility costs are calculated by reference to the gross profit accounting (e.g. entertainment costs) and while the company had reported loss that had become fully deductible. However, we appreciate that **total loss reflected in the financial statements prepared on 31.12.2011 would have been at least in value of 143 million RON.**