



**ENDORSED**

**CHIEF EXECUTIVE OFFICER**



**Ioan Rosca**

A handwritten signature in blue ink, appearing to be 'Ioan Rosca', with the date '29.02.2016' written to its right.

**REVIEW OF THE KEY ELEMENTS OF  
THE INCOME AND EXPENSE BUDGET  
FOR THE YEAR 2016**

**ELECTRICA Distribuție Transilvania Sud SA**

## 1. General Presentation

Electrica Distributie Transilvania Sud (EDTS) is a Brasov based distribution subsidiary of Electrica

- National market share (Volume): 13.2% (2014 ANRE Report)
- Area covered: 34,071 km<sup>2</sup>
- Users: 1.1 mn (B2016)
- Headcount: 1,720 (B2016) compared to 1,818 (B2015)

### Financial information:

- Slight decrease in revenue due to a 10% decrease of average tariff balanced by an increased estimated quantity of energy to be distributed
- 8.35%, RON 11,879 th. respectively, increase of operating result in 2016 budget compared to 2015 budget
- Increase of 15.37% in net profit, RON 16,974 th. respectively, in 2016 budget compared to 2015 budget

### The coverage of EDTS

EDTS : 1.1 million users



EDTS fulfils the role of distribution operator in the the Southern Transylvania region, Brasov, Alba, Sibiu, Mures, Harghita and Covasna counties, operating with transformer stations and transmission lines with voltages of 0.4 kV and 110 kV.

The company is the statutory undertaker of the concession agreement for the period of 49 years, agreement available until 2054, with the possibility of extension for a period equal to maximum half of this period (24.5 years) and holds exclusive distribution license no. 465 for this region, valid until 2027 with the possibility of extension.

## 2. Regulated activity

### General information

Electricity distribution is a regulated activity in Romania and specific tariffs applicable to distribution services must be approved by ANRE (Regulatory Authority for Energy, in Romanian *Autoritatea Națională de Reglementare în domeniul Energiei*) under a “tariff basket-price-cap” mechanism as established by Order no. 31/2004 (applicable in the first regulatory period 2005-2007), no. 39/2007 (applicable in the second regulatory period 2008-2012), no. 51/2012 (applicable in the transition year 2013) and no. 72/2013 (applicable in the third regulatory period 2014-2018), supplemented and amended by Order no.146/2014, Order no.112/2014 and Order no.165/2015.

The “tariff basket-price-cap” methodology plans to reduce income fluctuations and avoid significant fluctuations in the electricity prices charged to consumers. The tariff model is based on the principle of remuneration through tariffs of controllable costs recorded by the distribution operator, the Distributor’s main source of profit being the rate of return on capital invested in the distribution activity.

Tariffs are adjusted annually based on operational performance, including the amount of electricity distributed, the quantity and price for electricity acquisition to cover network losses, non-controllable costs, the difference between the estimated and the actual reactive energy, depreciation and realization of previously estimated capital expenditures, the difference between the estimated and the actual income from other activities, as well as the difference between the values of the assets rentability determined by reducing the return on assets (RRR) from 8.52% to 7.7%.

Through ANRE Order no. 165/2015 the methodology for electricity distribution services tariffs was changed, by eliminating the maximum percentage for tariffs decrease, but keeping the limit in case of the distribution tariffs increase.

The distribution operators must comply with the methodology approved by ANRE, referring to the distribution segment, their purpose being to reach or even exceed the targets set by ANRE.

### The main objectives considered by EDTS in 2016 mainly refer to:

- Obtaining a profit for the regulated activity, at least at the level of regulated return, the estimate is 119 mil. RON, therefore higher than 113.4 mil. RON (i. e.:  $7.7\% \times 1.473 \text{ bn. RON}$ , the average value of estimated RAB);
- Achieving and exceeding target indicators imposed by ANRE
- Starting with 2016 the implementation of a program of technical and economic efficiency efficiency increase that will lead efficiency indicators to the level of other companies in the sector.

### The main investments of EDTS include the following:

- Upgrading existing network infrastructure;
- Development of the network for connection of new consumers;
- Investments in networks and smart metering system;
- Automation of distribution system and implementing SCADA for substations

The following table summarizes the investment program to ensure the commissioning program approved by ANRE

Table 1: Investment program

Indicator	Budget 2015	Budget 2016	B2016 vs B2015
Investment program*	259	265	2.3%
Value of commissioned fixed assets (real terms)	180	220	22.2%
Value of commissioned fixed assets (nominal terms)	189	230	21.7%

\* Investment program includes capitalized repairs

Based on the investment program, EDTS forecasts a decrease in cost of network losses (CPT), as follows:

Table 2: EDTS network losses decreasing program (%)

CPT	Budget 2015	Regulated 2015	Budget 2016	Regulated 2016
HV	1.08%	1.08%	1.05%	1.05%
MV	4.07%	4.07%	4.16%	4.16%
LV	16.90%	16.90%	16.10%	16.10%
<b>Total</b>	<b>12.06%</b>	<b>11.40%</b>	<b>10.97%</b>	<b>10.97%</b>

For 2016 budget, EDTS have considered the following quantities of energy distributed:

Table 3: Distributed quantities (MWh)

Quantity distributed [MWh]	Budget 2015	Budget 2016	%
HV	870,000	874,782	0.5%
MV	2,141,287	2,452,843	14.5%
LV	2,370,948	2,569,400	8.4%
<b>Total</b>	<b>5,382,235</b>	<b>5,897,025</b>	<b>9.6%</b>

The energy quantity forecasted to be distributed in 2016 used to substantiate the budget is 5,897,025 MWh, with 514,790 MWh higher than 2015 budget. The forecast amounts of energy to be distributed was based mainly on data contained in National Commission for Prognosis report (autumn version) for the Central region. According to the above mentioned document total GDP economy growth in the Central region is 4.2%, but the increase for the industry is 5.2%. It is to be mentioned that the emergence of large consumers is expected in the licence area (e.g. Holzindustrie, Star Transmission, etc.) and the development of a strong housing sector, especially in Brasov, Sibiu and Mures counties.

Starting 1 January 2016, electricity distribution tariffs approved by ANRE are as follows (RON/MWh):

Table 4: Distribution tariffs

Year	ANRE Order no.	HV	MV	LV
<b>2015*</b>	156/2014	23.41	46.85	122.39
<b>2016**</b>	171/2015	21.22	42.36	108.44

\*Official Gazette no. 933/21.12.2014

\*\* Official Gazette no. 940/18.12.2015

In 2016 the tariffs approved by ANRE registered a significant decline, reduction by 9.9% of average tariff, 9.35% for high voltage level tariff, 9.58% for medium voltage tariff and 11.4% for low voltage tariff.

### 3. OPERATING RESULTS

Table 5: Selected financial information from the income and expense budget 2016 prepared in accordance with OMF 1802/2014

*Th. RON*

Row No.	No.	Indicator	2015 Budget	2016 Budget	B. 2016 vs B. 2015 (diff.)	B. 2016 vs B. 2015 (%)
1	I	<b>Total revenues (1.1+1.2)</b>	<b>737,261</b>	<b>729,940</b>	<b>(7,321)</b>	<b>-1%</b>
2	1.1	Revenue from energy	658,546	656,053	(2,493)	0%
3	1.2	Other operating revenue	78,715	73,887	(4,828)	-6%
4	A	Variable costs - Total	166,835	163,989	(2,846)	-2%
5	1	Expenses with purchased energy to cover CPT	166,835	163,989	(2,846)	-2%
6	B	Operating and maintenance costs - Total	302,031	291,097	(10,935)	-4%
7	1	<b>Controllable Operating and maintenance costs – Total, out of which:</b>	<b>249,705</b>	<b>238,318</b>	<b>(11,387)</b>	<b>-5%</b>
8		Layoff expenses	4,227	4,227	-	0%
9	2	<b>Non-Controllable Operating and maintenance costs – Total, out of which:</b>	<b>52,326</b>	<b>52,778</b>	<b>452</b>	<b>1%</b>
10		Taxes related to layoff expenses	973	973	-	0%
11	C	Regulated depreciation - Total (1+2+3)	136,427	139,365	2,938	2%
12	II	Total costs (A+B+C)	605,293	594,451	(10,842)	-2%
13	III	Distribution costs without CPT (B+C)	438,458	430,462	(7,996)	-2%
14	IV	Gross profit - regulated(I-II)	131,968	135,489	3,521	3%
15	V	Revenue for subsidies for investments	35,766	39,752	3,986	11%
16	VI	Operating costs not included in the calculation of the regulated revenue	161,894	160,460	(1,434)	-1%
17	7	Accounting depreciation	135,737	146,451	10,714	8%
18	IX	Total operating revenues (I+V)	773,027	769,692	(3,335)	0%
19	X	Total operating expenses (II-C+VI)	630,760	615,546	(15,214)	-2%
20	XI	<b>Operating income (IX-X)</b>	<b>142,267</b>	<b>154,146</b>	<b>11,879</b>	<b>8%</b>
21	XII	Financial revenue - Total	6,300	6,300	0	0%
22	XIII	Financial costs - Total	6,450	6,450	0	0%
23	XIV	<b>Financial income</b>	<b>(150)</b>	<b>(150)</b>	<b>0</b>	<b>0%</b>
24	XV	Extraordinary income	-	-	-	-
25	XVI	Total revenue, according to the financial statements (IX+XII)	779,327	775,992	(3,335)	0%
26	XVII	Total expenses, according to the financial statements (X+XIII)	637,210	621,996	(15,214)	-2%
27	XVII I	<b>Gross profit, according to the financial statements (XVI-XVII)</b>	<b>142,117</b>	<b>153,996</b>	<b>11,879</b>	<b>8%</b>
28	XIX	Income tax	31,703	26,608	(5,095)	-16%
29	XX	<b>Net profit, according to the financial statements</b>	<b>110,415</b>	<b>127,388</b>	<b>16,974</b>	<b>15%</b>

## Revenues

According to the budget for 2016, EDTS estimates total operating revenues in amount of RON 769,692 th., by RON 3,335 th. below 2015 budget.

It is estimated that in 2016 the revenues from electricity distribution activity will decrease by RON 2.493 th., to RON 656,053 th. from RON 658,546 th. budgeted for 2015, respectively by 0.38% below the 2015 plan. This variation is due to the decrease by 10% of the average tariff, almost totally offset by the increase by 9.6% of the estimated quantity to be distributed in 2016.

## Purchased energy

In 2016 the cost of electricity purchased to cover network losses is estimated to be RON 163,989 th. by RON 2,846 th. lower than budgeted for 2015. The company estimates in 2016 an increase of the acquisition price of the energy to cover the network losses compared to 2015, due to the producers' prices increase and to the expansion of the energy exports.

The cost of electricity purchased represents 22.5% of total revenue projected for 2016, compared to 22.6% budgeted for 2015.

## Salaries costs and other employee benefits

In 2016, the estimated expenses with salaries and other employee benefits, including the amounts of layoffs payments will increase by RON 2,289 th., or 1.9%, to RON 124,680 th. from RON 122,391 th. planned for 2015.

Through a business reorganization and/or restructuring process, the number of employees in the company will be reduced by 4%, leading to a cost reduction of salaries and other employee benefits.

The current employee structure and the planned structure scheduled for the end of 2016.

Table 6: The trend of personnel numbers, 2016

	EDTS
Personnel at the beginning of the year 2016	1,795
Change in personnel number	-75
<b>Personnel at the end of the year 2016</b>	<b>1,720</b>

As a percentage of revenues, salary costs and other employee benefits planned to be 16% in 2016, the same compared to 2015 budget.

## Repairs, maintenance and materials

In 2016, costs with repairs, maintenance and materials will decrease by RON 2,179 th., or 4%, to RON 58,776 th. from RON 60,946 th. planned for 2015. This decrease is mainly due to the reduction of maintenance costs according to the investment program approved by ANRE.

## The accounting depreciation

In 2016 the depreciation/ amortization of tangible and intangible assets, which is the component of operating costs not included in the calculation of regulated revenue, will increase by RON 10,714 th., or 7.9%, reaching RON 146,451 th. compared to RON 135,737 th. budgeted in 2015. This increase is mainly due to the investment program implemented in 2015.

As a percentage of revenues, the depreciation and the value adjustments on tangible assets will represent 20.1% in 2016 vs. 18.4% in 2015.

### Other operating expenses

Other operating expenses are estimated to decrease in 2016, by 10%, to RON 116,922 th. compared with RON 129,588 th. planned for 2015.

As a percentage of revenues, other operating expenses represent 15.2% in 2016, compared to 16.8% in 2015 budget.

### Operating profit

As a result of the above mentioned factors, in 2016 the operating profit will increase by RON 11,879 th., or 8%, to RON 154,146 th. from RON 142,267 th. budgeted in 2015. At the same time, operating profit margin projected for 2016 is 20% compared to 18% budgeted in 2015.

### Profit before tax

Profit before tax will increase in 2016 by RON 11,879 th., or 8%, to RON 153,996 th. from RON 142,117 th. budgeted in 2015.

### Income tax

In 2016, income tax expense will decrease by RON 5,095 th., or 16%, from RON 31,703 th. planned in 2015 to RON 26,608 th. planned for 2016.

### Net profit for the period

As a result of the above mentioned factors, in 2016 the net profit is estimated to increase by RON 16,974 th., or 15.4%, to RON 127,388 th. from RON 110,415 th. budgeted for 2015. Net profit margin will increase in 2016 to 17.5% compared with 15% budgeted in 2015.

## 4. Key factors, directions and significant market trends influencing the operating results of EDTS

The Board of Directors makes a distinction between the key factors, significant market trends and directions that they cannot control and those they can control (although often only to a limited extent).

Key factors, directions and significant market trends that the Board of Directors cannot control include:

- (i) General regulatory and legal framework in which the company operates, including policies of ANRE;
- (ii) Distribution and supply tariffs regulated by ANRE;
- (iii) Cost of purchased electricity;
- (iv) Macroeconomic trends in the Romanian economy and
- (v) Demand for electricity.

Key factors and directions that the Board of Directors can control at least partially, include the capital investments and operating expenses of EDTS.

An important part of business strategy of the company's Management includes the implementation of an Investment Plan, mainly in the distribution segment. EDTS's operations require significant capital investments, mainly in connection with Electrica power distribution segment.

EDTS's assets require periodic refurbishments and upgrades to improve its operating efficiency. Any delays in the implementation of the Investment Plan, amendments thereof, or any increase of the budget may have a costly impact on future investments of EDTS and EDTS's operations, financial situation and development prospects.

The capital investments will have the expected positive impact on results from operations to the extent that they are recognized in the RAB by ANRE and considering the rate of return approved by the regulatory authority.

CFO

**Iuliana ANDRONACHE**

