



**ENDORSED**

**CHIEF EXECUTIVE OFFICER**



**Ioan Rosca**

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

**ELECTRICA DISTRIBUTIE TRANSILVANIA NORD S.A.**

## 1. General presentation

Electrica Distributie Transilvania Nord (EDTN) is a Cluj-Napoca based distribution subsidiary of Electrica SA:

- National market share (Volume): 11.6% (2014 ANRE Report)
- Area covered: 34,160 km<sup>2</sup>
- Users: 1.24 mn (2016 Budget)
- Headcount: 1,780 (2016) compared to 1,911 (2015)

### Financial information:

- Increase in revenue as compared to 2015, due to an increasing quantity of energy projected to be distributed although the average distribution tariff decreases by 7%;
- Increase of operating result by RON 28 million, 19% respectively, in 2016 budget compared to 2015 budget;
- Increase of 21% in net profit, RON 25 million respectively

### The coverage area of EDTN

EDTN: 1.2 million users



EDTN fulfils the role of energy distribution operator in Transilvania Nord region, Cluj, Maramures, Satu Mare, Salaj, Bihor si Bistrita-Nasaud counties, operating with substations, transformer stations and transmission lines with voltages from 0,4 kV to 110 kV.

The company is the statutory undertaker of a concession agreement for a period of 49 years (since 2005), with the possibility of extension for a period equal to half of this period (24.5 years) and holds exclusive distribution licence no. 453 for this region which will still be valid until 29 April 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 EDTN in 2016 mainly refer to:

- Obtaining a profit for the regulated activity, at least at the level of regulated return: the 2016 budget is 126 mil. RON, therefore higher than 113,7 (i. e.:  $7.7\% \times 1.476$  bn. RON, the average evaluate of estimated RAB);
- Achieving and exceeding target indicators imposed by ANRE;
- Implement a program since 2016 to increase efficiency technical and economic efficiency indicators that lead to the level of others companies in the sector.

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

- Upgrading existing network infrastructure;
- Development of the network for connection of new users;
- Investments in networks and smart metering system;
- Automation of the electricity distribution system and implementation of SCADA system in transformer substations.

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

Table 1: Investment programs for EDTN [million RON]

Indicator	Budget 2015	Budget 2016	B2016 vs B2015
Investment program	273	269	-1.47%
Value of commissioned fixed assets (real terms)	184	223	21.20%
Value of commissioned fixed assets (nominal terms)	194	234	20.62%

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

Table 2: EDTN network losses decreasing program (%)

Network Loss	Budget 2015	Regulated 2015	Budget 2016	Regulated 2016	B 2016 vs B 2015
<b>HV</b>	1.12	1.08	1.04	1.04	-7.14%
<b>MV</b>	4.50	4.50	4.30	4.30	-4.44%
<b>LV</b>	12.27	12.16	11.80	11.60	3.83%
<b>Total</b>	<b>11.31</b>	<b>11.48</b>	<b>10.96</b>	<b>10.96</b>	<b>-3.09%</b>

Energy distribution forecast:

Table 3: Distributed quantities (MWh)

	Budget 2015	Budget 2016	B2016 vs B2015
<b>HV</b>	522,617	574,391	9.91%
<b>MV</b>	1,712,489	1,864,431	8.87%
<b>LV</b>	2,490,238	2,736,851	9.90%
<b>Total</b>	<b>4,725,344</b>	<b>5,175,673</b>	<b>9.53%</b>

The forecasted quantity to be distributed during 2016, used to substantiate the budget, is of 5,175,673 MWh, 450,329 MWh higher than the 2015 budget (4,725,344 MWh), i.e. an increase of 9.53%.

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

Table 4: Distribution Tariffs [RON/MWh]

	2015*	2016**	Variation
<b>HV</b>	21.10	19.93	-5.55%
<b>MV</b>	47.34	44.27	-6.49%
<b>LV</b>	112.15	103.54	-7.68%
<b>Average</b>	<b>125.25</b>	<b>116.74</b>	<b>-6.79%</b>

\*Source: Official Gazette no. 933/21 Dec 2014, ANRE Order no. 155/2014/15 December;

\*\*Source: Official Gazette no. 940/18 Dec 2015, ANRE Order no. 173/2015/14 December.

In 2016, the tariffs approved by ANRE have significantly decreased, by 6.79% in average tariff, by 5.55% for high voltage tariff, by 6.49% for medium voltage and by 7.68% 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

		<i>th. RON</i>				
Row No.	No.	Indicator	2015 Budget	2016 Budget	B. 2016 vs B. 2015 (diff.)	B. 2016 vs B. 2015 (%)
	0	1	2	3	4=3-2	5=3/2-1
1	1	<b>Operating revenues, total (1=1.1+1.2)</b>	<b>648,575</b>	<b>665,239</b>	<b>16,664</b>	<b>3%</b>
2	1.1.	Revenue from energy	604,527	618,904	14,377	2%
3	1.2.	Other operating revenues	44,048	46,335	2,287	5%
4	A	Variable costs - Total	132,487	132,263	(224)	0%
5	1	Electricity costs for covering NL	115,341	112,927	(2,414)	-2%
6	B	Operating and maintenance costs - Total	271,093	272,930	1,837	1%
7	1	<b>Controllable operating and maintenance costs – Total, out of which:</b>	<b>228,521</b>	<b>227,556</b>	<b>(965)</b>	<b>0%</b>
8		Layoffs expense	5,222	7,200	1,978	38%
9	2	<b>Non-controllable operating and maintenance costs – Total, out of which:</b>	<b>42,572</b>	<b>45,374</b>	<b>2,802</b>	<b>7%</b>
10		Taxes related to layoffs expense	1,108	1,643	535	48%
11	C	Regulated depreciation - Total	124,926	130,515	5,589	4%
12	II.	<b>TOTAL COSTS (A+B+C)</b>	<b>528,506</b>	<b>535,708</b>	<b>7,202</b>	<b>1%</b>
13	III.	Distribution costs without NL (B+C)	396,019	403,445	7,426	2%
14	IV.	Gross profit - regulated (1.1+1.2-II)	120,069	129,531	9,462	8%
15	V.	Revenue from subsidies for investments	34,765	40,500	5,735	16%
16	VI.	Operating costs not included in the calculation of the regulated revenue	133,687	126,874	(6,813)	-5%
17	7	Accounting depreciation	133,000	131,000	(2,000)	-2%
18	IX.	Total operating revenues (1+V)	683,340	705,739	22,399	3%
19	X.	Total operating expenses (II-C+VI)	537,267	532,067	(5,200)	-1%
20	XI.	<b>Operating income (IX-X)</b>	<b>146,073</b>	<b>173,672</b>	<b>27,599</b>	<b>19%</b>
21	XII.	Financial revenues- Total	1,785	1,443	(342)	-19%
22	XIII.	Financial costs- Total	3,444	2,694	(750)	-22%
23	XIV.	<b>Financial income</b>	<b>(1,659)</b>	<b>(1,251)</b>	<b>408</b>	<b>-25%</b>
24	XV.	Extraordinary income	-	-	-	-
25	XVI.	Total revenue, according to the financial statements	685,125	707,182	22,057	3%
26	XVII.	Total expenses, according to the financial statements	540,711	534,761	(5,950)	-1%
27	XVIII.	<b>Gross profit, according to the financial statements</b>	<b>144,414</b>	<b>172,421</b>	<b>28,007</b>	<b>19%</b>
28	XIX.	Income tax	24,065	26,785	2,720	11%
29	XX.	<b>Net profit, according to the financial statements</b>	<b>120,349</b>	<b>145,636</b>	<b>25,287</b>	<b>21%</b>

## Revenues

According to the 2016 budget, EDTN estimates total operating revenues of RON 705,739 th., increasing by 3% from RON 683,340 th. in 2015.

It is estimated that in 2016, revenues from electricity distribution will increase by RON 14,377 th., to RON 618,904 th. from RON 604,527 th. in 2015, respectively 2.38% compared with the 2015 budget. This evolution is mainly due to the increased estimated electricity quantity to be distributed even if there was a significant reduction of the tariffs set by ANRE for 2016.

## Purchased electricity

In 2016, the expenses for electricity purchased for covering network losses is projected to remain at the same level of RON 132 million as provided in the 2015 budget. It is planned to achieve the target set by ANRE for 2016 (10.96%), so the quantity of electricity purchased for covering network losses in 2016 is of 647 GWh, increasing with 24 GWh compared to the quantity from 2015 budget.

The cost of electricity purchased will represent 17% of revenues in 2016 compared to 17.8% as of in 2015 budget.

## Salaries costs and other employee benefits

In 2016, the estimated expenses with salaries and other employee benefits, including the amounts of layoffs payments (voluntary leaves) will increase by RON 14.014 th., or 12%, to RON 133,257 th. from RON 119,243 th. planned for 2015.

The cost of salaries and other employee benefits will represent 18.9% of revenues in 2016, compared to 17.5% as provided by 2015 budget.

Through a business reorganization and/or restructuring process through individual or collective lay-offs, the number of employees will be reduced by 5.3%.

The table below presents employee structure as scheduled provided by 2015 Budget, as well as the planned structure scheduled for end of 2016:

Table 6: Personnel number evolution

	EDTN	Variation
Number of personnel at the end of 2015 scheduled	1,880	
Variation in personnel number	-100	-5.32%
<b>Number of personnel at the end of 2016</b>	1,780	
Average number of personnel per year	1,830	

## Repairs, maintenance and materials

In 2016, costs with repairs, maintenance and materials will decrease by RON 6,420 th. or 12%, to RON 48,600 th. from RON 55,020 th. provided in 2015 budget. This decrease is mainly due to the reduction of maintenance costs, correlated with the investment program.

### Accounting depreciation

In 2016, expenses with tangible assets depreciation and intangible assets amortization, amounting to RON 131,000 th., component of operating costs not included in the calculation of regulated revenue, will remain almost at the level provided by 2015 budget, representing 25% of the total expenses of 2015 budget as well as the 2016 budget.

### Other operating expenses

Other operating expenses show a decreasing trend, in 2016 representing RON 91.241 th. as compared to RON 97,018 th. as provided by the 2015 budget.

As a percentage of revenues, other operating expenses represent 12.9% in 2016, as compared to 14.2% as provided by the 2015 budget.

### Operating profit

As a result of the above mentioned, in 2016, operating profit will increase by RON 27,599 th., or 19%, to RON 173,672 th. from RON 146,073 th., as provided by the 2015 budget. At the same time, operating profit margin is of 26.1% in 2016 as compared to 22.5% according to the 2015 budget.

### Profit before tax

Profit before tax will increase by RON 28,007 th. in 2016, or 19.44%, to RON 172,421 th. from RON 144,414 th. as provided by 2015 budget.

### Income tax

In 2016, income tax of EDTN is estimated to increase by RON 2,720 th., or 11%, to RON 26,785 th. from RON 24,065 th. as provided by 2015 budget.

### Net profit for the period

As a result of the above mentioned, in 2016 net profit is estimated to increase by RON 25,287 th., or 21%, to RON 145,636 th. from RON 120,349 th. in 2015. Net profit margin will increase in 2016 to 20.6% compared to 17.6% calculated at the end of 2015.

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

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 EDTN 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 EDTN.

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

