





ENDORSED

CHIEF EXECUTIVE OFFICER

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

ELECTRICA DISTRIBUTIE MUNTENIA NORD S.A

## 1. General Presentation

Electrica Distributie Muntenia Nord SA (“EDMN”) is a Ploiesti based distribution subsidiary of Electrica.

- National market share (Volume): 15% (2014 ANRE Report)
- Area covered: 29,756 km<sup>2</sup>;
- Users: 1.3 mn (B2016);
- Headcount: 1,888 (B2016) compared to 2,028 (B2015);
- Financial information:
  - 7% decrease in revenue compared to B2015 due to 14% decrease of average tariff;
  - 11% decrease in operating profit in 2016 budget compared to 2015 budget

The coverage of EDMN



EDMN fulfils the role of distribution operator in Muntenia Nord region (Prahova, Buzau, Dambovita, Braila Galati and Vrancea counties), operating with transformer stations and power lines with voltages from 0.4 kV to 110 kV.

The company is the statutory undertaker of a concession agreement for 49 years (since 2005), with the possibility of extension for 24.5 years period, and it holds the Distribution Licence no.455/29.04.2002 (updated by Decision no.2 777/ 17.12.2014), exclusive for this region. The Licence is 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 EDMN in 2016 mainly refers to:

- Obtaining a profit for the regulated activity, at least at the level of regulated return: the estimate is 125.4 mil. RON, therefore slightly higher than 125.3 mil. RON (i. e.:  $7.7\% \times 1.62 \text{ bn. RON}$ , 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 EDMN include the following:

- Upgrading and modernizing of existing network infrastructure;
- Development of the network for connection of new users;
- Investments in automation of the distribution system and smart metering system;
- Development and integration of IT systems at EDMN level and creating a common data center at the Group level;
- Development of EDMN communication network.

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

Table 1. Investment program

*million RON*

| Investments  | Budget 2015 | Budget 2016 | B2016 vs B2015 |
|--|-------------|-------------|----------------|
| Investment program                                 | 247         | 253         | 2.4%           |
| Value of commissioned fixed assets (real terms)    | 171         | 205         | 19.9%          |
| Value of commissioned fixed assets (nominal terms) | 180         | 220         | 22.2%          |

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

Table 2: EDMN network losses decreasing program (%)

| Losses       | Budget 2015   | Regulated 2015 | Budget 2016   | Regulated 2016 |
|--------------|---------------|----------------|---------------|----------------|
| HV           | 1.02%         | 1.02%          | 1.00%         | 1.00%          |
| MV           | 6.10%         | 6.10%          | 5.90%         | 5.90%          |
| LV           | 14.30%        | 14.30%         | 14.00%        | 14.00%         |
| <b>Total</b> | <b>10.44%</b> | <b>10.44%</b>  | <b>10.03%</b> | <b>10.03%</b>  |

The estimated quantity of distributed energy in 2016, in order to substantiate the budget is 6,878,199 MWh, increasing by 475,397 MWh, compared to the quantity for 2015 (6,402,802 MWh), or 7.4%.

The increasing of the distributed quantities is presented in the table below:

Table 3: EDMN forecasted distributed quantities (MWh)

|              | Budget 2015      | Budget 2016      | %           |
|--------------|------------------|------------------|-------------|
| HV           | 1,790,023        | 1,902,347        | 6.3%        |
| MV           | 2,015,249        | 2,191,586        | 8.7%        |
| LV           | 2,597,530        | 2,784,266        | 7.2%        |
| <b>Total</b> | <b>6,402,802</b> | <b>6,878,199</b> | <b>7.4%</b> |

Starting with 01 January 2016 the distribution tariffs for electricity approved by ANRE are as follows (RON/MWh):

Table 4: Specific tariffs for distribution service (RON/MWh)

| Year          | ANRE Order no. | HV    | MV    | LV     |
|---------------|----------------|-------|-------|--------|
| <b>2015*</b>  | 154/15.12.2014 | 18.47 | 42.84 | 138.61 |
| <b>2016**</b> | 172/14.12.2015 | 15.93 | 36.67 | 118.78 |

\*Source: Official Gazette no. 933/21 Dec 2014

\*\*Source: Official Gazette no. 940/18 Dec 2015

### 3. OPERATING RESULTS

Table 5: Selected financial information from the revenue 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>754,986</b> | <b>716,885</b> | <b>(38,102)</b>            | <b>-5%</b>             |
| 2       | 1.1    | Revenue from energy  | 711,333        | 665,068        | (46,266)                   | -7%                    |
| 3       | 1.2    | Other operating revenue  | 43,653         | 51,817         | 8,164                      | 19%                    |
| 4       | A      | Variable costs - Total   | 196,751        | 176,403        | (20,347)                   | -10%                   |
| 5       | 1      | Expenses with purchased energy to covered CPT                                  | 196,751        | 176,403        | (20,347)                   | -10%                   |
| 6       | B      | Operating and maintenance costs - Total  | 298,258        | 299,514        | 1,256                      | 0%                     |
| 7       | 1      | <b>Controllable Operating and maintenance costs – Total, out of which:</b>     | <b>250,654</b> | <b>249,468</b> | <b>(1,185)</b>             | <b>0%</b>              |
| 8       |        | Layoffs expense  | 5,494          | 6,000          | 506                        | 9%                     |
| 9       | 2      | <b>Non-controllable operating and maintenance costs – Total, out of which:</b> | <b>47,603</b>  | <b>50,046</b>  | <b>2,443</b>               | <b>5%</b>              |
| 10      |        | Taxes related to layoffs expense   | 1,166          | 1,273          | 107                        | 9%                     |
| 11      | C      | Regulated depreciation - Total (1+2+3)   | 108,402        | 114,671        | 6,269                      | 6%                     |
| 12      | II     | Total costs (A+B+C)  | 603,410        | 590,589        | (12,822)                   | -2%                    |
| 13      | III    | Distribution costs without CPT (B+C)   | 406,660        | 414,185        | 7,526                      | 2%                     |
| 14      | IV     | Gross profit - regulated(I-II)   | 151,576        | 126,296        | (25,280)                   | -17%                   |
| 15      | V      | Revenue for subsidies for investments  | 17,000         | 21,000         | 4,000                      | 24%                    |
| 16      | VI     | Operating costs not included in the calculation of the regulated revenue       | 111,478        | 114,358        | 2,880                      | 3%                     |
| 17      | 7      | Accounting depreciation  | 106,798        | 110,845        | 4,047                      | 4%                     |
| 18      | IX     | Total operating revenues (I+V)   | 771,986        | 737,885        | (34,102)                   | -4%                    |
| 19      | X      | Total operating expenses (II-C+VI)   | 606,486        | 590,276        | (16,211)                   | -3%                    |
| 20      | XI     | <b>Operating income (IX-X)</b>   | <b>165,500</b> | <b>147,609</b> | <b>(17,891)</b>            | <b>-11%</b>            |
| 21      | XII    | Financial revenue - Total  | 3,000          | 4,000          | 1,000                      | 33%                    |
| 22      | XIII   | Financial costs - Total  | 3,000          | 4,000          | 1,000                      | 33%                    |
| 23      | XIV    | <b>Financial income</b>  | <b>0</b>       | <b>0</b>       | <b>-</b>                   | <b>-</b>               |
| 24      | XV     | Extraordinary income   | 0              | 0              | -                          | -                      |
| 25      | XVI    | Total revenue, according to the financial statements (IX+XII)                  | 774,986        | 741,885        | (33,102)                   | -4%                    |
| 26      | XVII   | Total expenses, according to the financial statements (X+XIII)                 | 609,486        | 594,276        | (15,211)                   | -2%                    |
| 27      | XVII I | <b>Gross profit, according to the financial statements (XVI-XVII)</b>          | <b>165,500</b> | <b>147,609</b> | <b>(17,891)</b>            | <b>-11%</b>            |
| 28      | XIX    | Income tax   | 26,480         | 23,617         | (2,863)                    | -11%                   |
| 29      | XX     | <b>Net profit, according to the financial statements</b>                       | <b>139,020</b> | <b>123,992</b> | <b>(15,029)</b>            | <b>-11%</b>            |

## Revenues

According to the 2016 budget, EDMN estimates total operating revenues of RON 737,885 th., decreasing by 4% compared to RON 771,986 th. in 2015, determined by the reduction by 14% of the average distribution tariff, according to ANRE Order no.172/14.12.2015.

It is estimated that in 2016, the revenues from electricity distribution will decrease by RON 46,266 th., to RON 665,068 from RON 711,333 th. in 2015, or by 7%, even if is planned a 7.4% growth in the distributed energy quantity and an increase of RON 5,400 th. of reactive energy revenue.

## Purchased electricity

In 2016, the cost of the electricity purchased to cover the network losses is estimated to decrease by RON 20,347 th., or by 10%, to RON 176,403 th. from RON 196,751 th. in 2015. This variation is mainly caused by the reduced estimated energy acquisition price and also the decrease of the quantity by 0.6%, to 887,316 MWh in 2016 from 892,738 MWh in 2015.

At the cost of the electricity purchased covering network losses estimate, it was took into account to achieve the target regarding losses imposed by ANRE (10.03%), and the contribution in losses of the amount of electrical energy distributed supplementary to the 2013 forecast.

The cost of the electricity purchased will represent 24.6% of 2016 revenues, compared to 26.1% 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 1,160 th., or by 0.8%, to RON 136,478 th. from RON 135,318 th..

The variation is partially due to the increase of the estimated layoffs expense and related social contributions by RON 614 th. to RON 7,273 th. in 2016, from RON 6,660 th. in 2015, or by 9%, corresponding to a number of 102 leaving employees.

Estimates of the personnel at the end of 2016

Table 6: The trend of personnel numbers, 2016

|  | EDMN         |
|--|--------------|
| Personnel at the beginning of the year 2016  | 1,990        |
| Personnel number changes                     | -102         |
| <b>Personnel at the end of the year 2016</b> | <b>1,888</b> |
| Average number of personnel per year         | 1,914        |

As a percentage from revenues, the salary expenditures and other employee benefits will represent 18.6% in 2016 compared to 17.6% in 2015.

## Repairs, maintenance and materials

In 2016, the expenditures with repairs, maintenance and materials will increase by RON 769 th., or by 1%, to a value of RON 55,627 th. from RON 54,857 th. in 2015.

### Other operating expenses

Other operating expenses are estimated to decrease by 2%, to RON 108.268 th. from RON 110.756 th. in 2015 budget.

As a percentage of revenues, other operating expenses will be 14.7% in 2016 versus 14.4% in 2015.

### Accounting depreciation

Accounting depreciation and value adjustments on tangible assets, in 2016 are higher by RON 4,047 th. compared to 2015, or by 3.8%. This increase is due to the investment program.

As a percentage of revenues, the depreciation and the value adjustments on tangible assets will represent 15.5% in 2016 vs. 14.1% in 2015.

### Operating profit

As a result of the above mentioned, in 2016 operating profit will decrease by RON 17,891 th. or by 11%, to RON 147,609 th. from RON 165,500 th. in 2015.

At the same time, 2016 operating profit margin is of 20.6%, compared to 21.9% according to the 2015 budget.

### Profit before tax

The profit before tax decreases by RON 17,891 th., or by 11%, to RON 147,609 th. from RON 165,500 th. in 2015.

### Income tax

In 2016, the income tax is estimated to decrease by 11%, to RON 23,617 th. from RON 26,480 th. in 2015.

### Net profit for the period

As a result of the above mentioned, in 2016 the net profit is estimated to decrease by RON 15,029 th., or by 11%, to RON 123,992 th. from RON 139,020 th. in 2015.

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

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).

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

- (i) General regulatory and legal framework in which the EDMN operates, including ANRE policies;
- (ii) Distribution and supply tariffs regulated by ANRE;
- (iii) Cost of the purchased electricity;
- (iv) The macroeconomic tendencies in the Romanian economy and
- (v) The demand for electricity.

The key factors and the directions that the Board of Directors can control at least partially, include the capital investments and operating expenditures of EDMN.

An important part of the business strategy of the company's Management includes the implementation of an Investment Plan, mainly in the distribution segment. EDMN's operations require significant capital investments. EDMN's assets require periodic refurbishments and upgrades to improve the operating efficiency of the company. 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 EDMN and EDMN operations, on financial situation and on development prospects.

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

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