



ROMGAZ

Societatea Nationala de Gaze Naturale ROMGAZ S.A. ~~Medias Romania~~



IDENTIFICATION DETAILS ON REPORT AND ISSUER

Preliminary annual report according to Article 227 from Law 297/2004

Financial year: **2016**

Report date: **February 16, 2017**

Name of the Company: **Societatea Nationala de Gaze Naturale (SNGN) ROMGAZ SA**

Headquarter: **Medias, Constantin I. Motas Square, no.4, code 551130**

Telephone/fax number: **004-0269-201020 / 004-0269-846901**

Fiscal Code: **RO14056826**

Trade Registry No: **J32/392/2001**

Subscribed and paid in share capital: **RON 385,422,400**

Regulated markets where the issued securities are traded: **Bucharest Stock Exchange (BVB), London Stock Exchange (LSE)**

PRELIMINARY ANNUAL REPORT

**(issued based on unaudited individual financial statements, prepared in compliance with the International Financial Reporting Standards)
ON THE ECONOMIC AND FINANCIAL ACTIVITY
OF SNGN ROMGAZ SA during 2016**

OVERVIEW

SNGN Romgaz SA is a Romanian natural gas producer and supplier, its core business segments being: gas exploration and production, gas supply, underground gas storage and electricity production.

In 2016, the Company faced multiple challenges, the financial results were influenced by the decrease of natural gas prices, decrease of demand (especially in Q1) caused by a mild winter, strong competition against import gas due to some unclear regulations.

During the year, the measures undertaken aimed to increase the efficiency of the operations in the context of a continuous deterioration of market conditions. Thus, the reservoir portfolio and the natural gas stock have been strictly managed, maintaining unaffected the production potential and continuing to increase the efficiency of recompletion operations and production rehabilitation of the main fields. In this context, we mention that the period for exploration operations on the main blocks was extended with another 5 years doubled by the largest discovery over the last 30 years, Caragele.

Against the decrease of the volume of sales by approx. 17% mainly due to the decreased demand for storage and the competition with the import gas, the company succeed to increase the margins fulfilling the promise as regards the net profit of RON 1 billion by improving the structure of sales on the two market segments. The efficiency program led to fulfilling the objective not to record new outstanding receivables and to cashing the entire equivalent value of the sold gas volumes.

Summary of the main indicators for the 4th Quarter (Q4) and for the full year 2016:

☞ **The Net Profit recorded in Q4 was RON 311 million, an increase by 42.1% as compared to the same period of the previous year (Q4 2015) and more than 3 times higher than the previous quarter (Q3 2016). This result has been generated by optimising trades and gas stocks, so that electricity sales and sales from the storage activity have been added to the revenue from trading the internal produced natural gas.**

The Net Profit Margin was in Q4 30.8% and the EBIT margin at the level of 35.4% - far beyond the values recorded in Q4 2015 and Q3 2016.

☞ **In 2016, we have fulfilled and even exceeded the budget projection** related to the Net Profit, reaching the forecasted value of RON 1,025 million;

☞ **Trading gas from internal production** aimed to securing a balanced portfolio of customers, to reducing the risk related to payment defaults and to being present on the free market to ensure price flexibility;

☞ **Revenue from natural gas storage activities have increased by 3.9%** being estimated at RON 345.36 million as a result of selling in 2016 of a large gas quantity from the storages;

☞ **Revenue from electricity sales** reached RON 336 million, decreasing only by 5.7% although in January 2016 the nominal production capacity of CTE Iernut has been reduced by 25% by complying with the planned dry conservation of 2 units; the electricity production reached a market share of 2.57%;

☞ **The profitability margins have in 2016 the same ascending trend:** Net Profit Margin was 30.0% and EBIT Margin 36.9% (as compared to 29.5% and 35.2% respectively for the previous year); **the objective to have "Zero new overdue trade receivables" has been fulfilled;**

☞ Concurrently, EBITDA remains at a significant level of 46.0% related to the revenue, and EBITDAX (EBITDA before operating expenses) is estimated at RON 1,823 million – at a margin of 53.4%;

☞ In 2016 Romgaz performed intensive exploration activities in the deep onshore area that led to **the largest hydrocarbon discovery** of the last 30 years of approximately 25-27 bln. cm;

☞ **The external audit of Romgaz natural gas reserves and contingent resources**, performed by the American company DeGloyer&MacNaughton, confirmed an extremely favourable level of resources and reserves as of December 31, 2015, as well as an average reserves replacement ration of 83% for the period 2013-2015, such value being above the target of 70%;

☞ **Predictable considering the report issued at 9 months, the total investments of 2016** were in amount of RON 497.7 million, lower than those recorded in 2015 (RON 938 million), further to a decrease of investments planned for surface exploration, decrease of investments in joint ventures and postponing some works due to difficulties occurred in the preparatory activity (obtaining lands, approvals, agreements, authorisations) and modification of the public procurement legislation.

PHYSICAL INDICATORS

The realised natural gas production was influenced by the dynamics of gas demand and the level of natural gas stocks recorded at the end of the storage cycle.

The table below shows a comparison of the main indicators related to gas and condensate production, recompletions and workovers and petroleum royalty:

Q3/2016	Q4/2016	Q4/2015	Δ%	Main Indicators	2016	2015	Δ%
0.837	1.185	1.428	-17.0	Gross gas production (bln. cm)	4.219	5.563	-24.1
0.009	0.016	0.021	-23.4	Technological consumption (bln.cm)	0.054	0.079	-30.7
0.827	1.169	1.407	-16.9	Delivered gas production (bln.cm)	4.165	5.484	-24.1
1,201	1,023	2,756	-62.9	Condensate production (tonnes)	5,864	10,947	-46.4
54	38	41	-7.3	Recompletions + workover (no)	173	183	-5.5
18.047	16.842	15.526	8.5	Recompletions +workover (million cm)	217.089	185.768	16.9
37.60	26.88	27.19	-1.1	Expenses for up-downhole recompletion operations + workover (RON million)	140.48	143.03	-1.8
0.054	0.084	0.106	-20.4	Petroleum royalty (bln. cm)	0.292	0.406	-28.1
36.84	59.05	79.02	-25.3	Petroleum royalty (RON million)	208.82	297.59	-29.8

The preliminary natural gas quantities produced, supplied, injected in/withdrawn from the underground storages (UGS) and the electric power production for January to December 2016 in comparison to 2015 are described in the table below:

Item no.	Specification	Year 2014	Year 2015	Year 2016	Indices
0	1	2	3	4	5=4/3x100
1	Total - gross production, out of which:	5,663.9	5,562.7	4,219.4	75.9%
1.1.	* Internal gas production	5,469.0	5,359.7	4,068.0	75.9%
1.2.	* Schlumberger partnership (100%)	194.9	203.1	151.3	74.5%
2	Technological consumption	81.3	78.5	54.5	69.4%
3	Net internal gas production (1.-1.2.-2.)	5,387.7	5,281.1	4,031.6	76.0%
4	Internal gas volumes injected in storages	564.8	738.4	414.7	56.2%
5	Internal gas volumes withdrawn from storages	601.0	409.5	462.6	113.0%
6	Differences resulting from GCV	9.8	16.1	4.5	28.0%
7	Volumes supplied from Internal production (3.-4.+5.-6.)	5,414.1	4,936.1	4,057.0	82.2%
8.1	Gas sold in storages	-	-	79.2	-
8.2	Gas supplied to Iernut and Cojocna Power Plants from Romgaz gas	445.0	527.0	463.7	88.0%
9	Volumes supplied from Internal production to the market (7.+8.1.-8.2)	4,969.1	4,409.1	3,672.5	83.3%
10	Natural gas from partnerships*) - total, out of which:	180.6	168.9	149.0	88.2%
	*Schlumberger (50%)	97.5	101.5	75.7	74.6%
	Raffles Energy) (37.5%)	0.8	0.5	0.3	60.0%
	Amromco) (50%)	82.3	66.9	73.0	109.1%

Item no.	Specification	Year 2014	Year 2015	Year 2016	Indices
0	1	2	3	4	5=4/3x100
11	Purchased internal gas volumes	17.7	17.1	11.2	65.5%
12	Sold Internal gas volumes (9.+10.+11.)	5,167.4	4,595.1	3,832.7	83.4%
13	Supplied internal gas volumes (8.2+12.)	5,612.4	5,122.1	4,296.4	83.9%
14	Supplied import volumes	81.1	3.0	6.8	226.7%
15	Gas supplied to Iernut and Cojocna Power Plants from other sources	-	-	4.8	-
15	Total gas supplies (13.+14.+15.)	5,693.5	5,125.1	4,308.0	84.1%
*	Invoiced UGS withdrawal services	1,915.4	1,656.7	1,440.9	87.0%
*	Invoiced UGS injection services	1,737.0	1,673.1	1,367.4	81.7%

ECONOMIC-FINANCIAL INDICATORS

The economic-financial indicators are calculated based on unaudited individual preliminary financial statements and may be different from the actual results of the audit.

The Company's revenue is mainly generated by the sale of natural gas (domestic and import), by the underground gas storage services and by the electricity production.

Summary of unaudited individual comprehensive income for the year ended December 31, 2016

Description	Preliminary Q4 2016 (thousand lei)	Preliminary 2016 (thousand lei)	Actual Q4 2015 (thousand lei)	Actual 2015 (thousand lei)	Variation Q4 (%)	Variation 2016-2015 (%)
1	2	3	4	5	6=[(2/4)-1]x100	7=[(3/5)-1]x100
Revenue	1,010,348	3,411,868	1,119,577	4,052,684	-9.8	-15.8
Cost of commodities sold	(3,552)	(49,878)	(7,020)	(40,228)	-49.4	24.0
Investment income	4,094	22,117	9,418	44,185	-56.5	-49.9
Other gains and losses	(60,629)	(468,217)	(105,369)	(318,903)	-42.5	46.8
Changes in inventory	(52,564)	20,963	8,264	138,181	n/a	-84.8
Raw materials and consumables used	(13,174)	(54,632)	(19,328)	(78,262)	-31.8	-30.2
Depreciation, amortization and impairment	45,412	(311,012)	(264,700)	(793,598)	n/a	-60.8
Employee benefit expense	(141,887)	(498,270)	(152,899)	(511,647)	-7.2	-2.6
Finance cost	(4,544)	(18,275)	(6,700)	(20,302)	-32.2	-10.0
Exploration expense	(172,846)	(253,348)	(42,395)	(42,395)	307.7	497.6
Other expenses	(275,850)	(881,705)	(300,244)	(1,040,670)	-8.1	-15.3
Other income	27,399	361,149	35,457	79,793	-22.7	352.6
Profit before tax	362,207	1,280,760	274,061	1,468,838	32.2	-12.8
Income tax expense	(50,990)	(255,841)	(55,107)	(274,553)	-7.5	-6.8
Profit for the year	311,217	1,024,919	218,954	1,194,285	42.1	-14.2
EBITDA	312,704	1,569,670	529,354	2,218,285	-40.9	-29.2
EBITDA margin (%)	31.0	46.0	47.3	54.7	-34.5	-15.9

Description	Preliminary Q4 2016 (thousand lei)	Preliminary 2016 (thousand lei)	Actual Q4 2015 (thousand lei)	Actual 2015 (thousand lei)	Variation Q4 (%)	Variation 2016-2015 (%)
1	2	3	4	5	6= $\frac{(2/4)-1}{100}$	7= $\frac{(3/5)-1}{100}$
EBITDAX	485,550	1,823,018	571,749	2,260,680	-15.1	-19.4
EBITDAX margin (%)	48.1	53.4	51.1	55.8	-5.9	-4.2
EBIT	358,116	1,258,658	264,654	1,424,687	35.3	-11.7
EBIT margin (%)	35.4	36.9	23.6	35.2	49.9	4.9
EPS (lei)	0.81	2.66	0.57	3.10	42.1	-14.2

Revenue

In 2016, Romgaz estimates revenue of RON 3.41 billion compared to RON 4.05 billion achieved in 2015, a decrease of 15.8% due to the negative influence of weather conditions, drastic decrease of gas demand in the key sectors, competition against import gas, unfavourable fiscal framework for competition on the natural gas market.

As compared to Q3 2016, in Q4 2016 the following can be observed: an increase by 99.98% of revenue from gas sales from internal production, increase by 111.88% of revenue from electricity, an increase by 38.5% of revenue from the underground storage activity.

Cost of Commodities Sold

In 2016, cost of commodities sold increased by 24.0%, due to an increase by 9.8% of the cost of commodity gas sold and the increase by 33% of costs generated by negative imbalances on electricity balancing market.

Investment Income

In 2016, investment income decreased by 49.9%, to RON 22.12 million, compared to RON 44.12 million in 2015, driven by the reduction of interest rates of the cash placed in bank deposits and state bonds.

Other Gains and Losses

In 2016 the Company estimates a net loss of RON 468.22 million mainly as a result of recording allowances for doubtful debts as regards one of the Company's most important customer.

Following entering into insolvency of that customer, in order to conduct the insolvency proceedings and to protect the Company's interests, in 2016 penalties for late payments were invoiced; these penalties were won in court in accordance with a non-final court decision, and they relate to receivables that were paid off in kind in 2013. Bearing in mind the uncertainty of cashing such amount, an equivalent allowance for doubtful debts was created that offsets the income from penalties invoiced to that customer. The income from such penalties is included in "Other Income".

Other Gains and Losses also includes the loss from write-off of fixed asset amounting to RON 108.06 million. This loss is compensated by the resuming at income the impairment set up for these assets over the previous periods, the effect in the result of the reviewed period being insignificant. Resuming the impairment for fixed assets at income is reflected in Depreciation, Amortization and Impairment.

Another influence on the estimated loss of RON 468.22 million is due to payment of some amounts further to ANAF investigation (National Agency for Fiscal Administration) carried out in 2014. The control was conducted on income tax for the period 2008 - 2013 and VAT for the period 2009-2013. Following this investigation and the complaints submitted by the Company, the amount to be paid was of RON 18.85 million. By Q3 2016, the Company set up a provision for

litigations in amount of RON 15.87 million and such the amount was paid only in Q4 2016. In 2015, the Company sued ANAF, and on the date of publishing the preliminary results for 2016 the process was under trial. Considering these aspects and the fact that the Company regards the payment made as not due, in Q4 2016 a receivable of RON 18.85 million was recorded and impairment for the same value was registered due to ongoing litigation. Such loss is partially annulled by resuming at income the provision for litigation in amount of RON 15.87 million which is reflected at "Other Expenses".

Changes in Inventory

Changes in inventory are estimated to have decreased in the year ended on December 31, 2016 as compared to the previous year, due to the following factors:

- the gas volumes injected in the storage during 2016 have been smaller by 43.8% as compared to the volumes injected in 2015;
- gas volumes withdrawn from the storage in the current year have increased by 12.97% as compared to the previous year;

Raw Materials and Consumables Used

The estimated cost of raw materials has been in 2016 lower than in the previous year, especially due to the decrease of expenses with fuel.

Depreciation, Amortization and Impairment

These expenses include expenses with depreciation of non-current assets in amount of RON 527.94 million (2015: RON 560.07 million) and net impairment income in amount of RON 216.93 million (2015: net impairment expenses of RON 233.53 million).

The decrease of expenses with depreciation is generated by the decrease of the natural gas production during the analysed period, the production wells being depreciated depending on the ratio between production and reserves.

As regards the net impairment income, it offsets the exploration expenses of RON 253.35 million representing exploration drilling projects abandoned in 2016 for which the Company has set up impairments in the previous periods (the most significant exploration project refers to abandoning Rapsodia block operated in partnership with Lukoil. The Decision of the National Agency for Mineral Resources on the termination of the petroleum agreement for exploration-development-production in EX-29 Est Rapsodia block has been published in the Official Gazette in December 2016). Moreover, this net impairment income compensates the loss from the write-off of tangible assets, as previously mentioned. Therefore, the effects of abandoning the negative exploration drilling projects and the write-off of fixed assets reflected in the financial results of the year are insignificant.

Exploration expense

In 2016 exploration expenses recorded an increase of 497.6% as compared to the previous year. As mentioned at "Depreciation, Amortization and Impairment" the effect of these expenses was offset by the reversal of the impairment set up in previous periods.

Other expenses

In 2016, other expenses recorded a decrease as compared to the previous year by 15.3% reaching RON 881.71 million, as compared to RON 1,040.67 million in 2015. The decrease of such expenses is due to the decrease of petroleum royalty expenses (decrease estimated at RON 83.6 million) and of the tax on additional revenue, such revenues being obtained as a result of deregulating prices in the gas sector (decrease estimated at RON 75.84 million) as a result of reducing gas deliveries.

Other income

The company recorded in 2016 other income of RON 361.15 million. This amount includes income from late payment penalties invoiced to clients for not paying on due date the amount of RON 291.56 million, the most significant amount relates to one of the Company's largest customers. An allowance has been set up for this amount considering the insolvency of such customer, the allowance has been reflected at "Other gains and losses".

Summary of Statement of Individual Financial Position as of December 31, 2016 (unaudited)

INDICATOR	Preliminary 31.12.2016 (thousand lei)	Actual 31.12.2015 (thousand lei)	Variation (%)
1	2	3	4=(2-3)/3x100
Non-current assets			
Tangible assets	5,787,106	5,996,460	-3.5
Other intangible assets	399,068	399,859	-0.2
Investments in subsidiaries	1,200	1,200	0.0
Investments in associates	121	163	-25.8
Other financial investments	69,657	70,080	-0.6
Other financial assets	-	29,300	-100.0
TOTAL NON-CURRENT ASSETS	6,257,152	6,497,062	-3.7
Current assets			
Inventories	575,982	559,784	2.9
Trade and other receivables	828,610	601,065	37.9
Other financial assets	2,892,751	2,146,827	34.7
Other assets	141,390	139,612	1.3
Cash and cash equivalents	280,686	740,352	-62.1
TOTAL CURRENT ASSETS	4,719,419	4,187,640	12.7
TOTAL ASSETS	10,976,571	10,684,702	2.7
Equity and Liabilities			
Capital and reserves			
Share capital	385,422	385,422	0.0
Reserves	3,020,152	2,581,853	17.0
Retained earnings	6,270,927	6,724,947	-6.8
TOTAL EQUITY	9,676,501	9,692,222	-0.2
Non-current liabilities			
Retirement benefit obligation	119,986	102,959	16.5
Deferred tax liabilities	40,123	62,589	-35.9
Provisions	194,048	200,855	-3.4
TOTAL NON-CURRENT LIABILITIES	354,157	366,403	-3.3
Current liabilities			
Trade and other payables	568,794	186,937	204.3
Current income tax liabilities	60,019	90,838	-33.9
Advance income	4,924	-	n/a
Provisions	50,437	28,779	75.3
Other liabilities	261,739	319,523	-18.1
TOTAL CURRENT LIABILITIES	945,913	626,077	51.1
TOTAL LIABILITIES	1,300,070	992,480	31.0
TOTAL EQUITY AND LIABILITIES	10,976,571	10,684,702	2.7

Non-current assets

The total non-current assets decreased by 3.7% (namely RON 239.91 million), due to the net depreciation and amortization of fixed assets larger than investments in new assets. Moreover, on December 31, 2016 the Company did not have bank accounts with a maturity date over 1 year, explaining the decrease of the line "Other financial assets".

Current assets

The current assets recorded an increase of 12.7% as compared to the previous year, as a result of the variations below:

- trade receivables increased by 37.9% compared to December 31, 2015, as a result of the improvement of the policy on reducing the credit risk related to sales made by the Company. Therefore, the Company has concluded gas sales contracts that are secured either by the advance payment of deliveries, or by letters of bank guarantees. As a consequence the impairment related to sales decreased in 2016 as compared to the previous year, the most significant allowance being recorded further to invoicing penalties to a client that became subsequently insolvent.
- other financial assets, cash and cash equivalents recorded a 10% variation as compared to the previous year and include cash in bank, fixed period deposits and state bonds.

Capital and reserves

Company reserves increased by RON 438.30 million as of December 31, 2016 representing the allocation of part of the 2015 net profit to the development fund (RON 335.94 million) and of part of the current period profit (RON 83.26 million) further to the application of the fiscal facility pursuant to Law 227/2015 on the Fiscal Code.

Retained earnings decreased by RON 454.02 million further to allocating the net profit of the previous year as approved by the General Meeting of Shareholders, the positive effect being generated by the value of 2016 net profit.

Non-current liabilities

Non-current liabilities decreased as of December 31, 2016 compared to the previous year mainly due to a decrease of the deferred income tax liability. The deferred income tax is calculated in compliance with the requirements of the International Financial Reporting Standards and it is not a chargeable liability.

The provision for benefits granted for retirement and other benefits has been updated on December 31, 2016 by actuarial methods. The increase by RON 17.03 million is due to renegotiating the Collective Labour Agreement applicable at the Company.

Current liabilities

Trade payables and other payables increased on December 31, 2016 by 204.3% as compared to the previous year following the increase of the advances paid by clients for the gas deliveries. At the time the gas balance for November and December 2016 will be finalized these advances will be settled with the invoices issued to the clients for the two months (trade liabilities record the estimated income for the two months in amount of RON 698.37 million).

Short term provisions have increased by RON 21.66 million as of December 31, 2016 as a result of recording the profit share payable to employees. This liability has been recorded in 2015 at Other Liabilities.

The decrease of other liabilities as of December 31, 2016 by 18.1%, namely RON 57.78 million is due to the decrease of liabilities related to the tax on additional revenue obtained further to the deregulation of prices in the gas sector, the decrease of the petroleum royalty and the liabilities related to output VAT.

CHIEF EXECUTIVE OFFICER,

Virgil Marius Măteș



CHIEF FINANCIAL OFFICER,

Andrei Bobar