

Submitted to analysis and endorsement in the BoA meeting dated 25th January 2017 and OGMS approval dated _____

No. _____

APPROVED,
Chairman of the Board of
Administration

WEILER Dan

SUBSTANTIATION NOTE

regarding approval of the General Meeting of Shareholders of the 2017 Income and Expenditure Budget of Conpet S.A. and the estimates for 2018-2019

The substantiation of the indicators within the draft 2016 Income and Expenditure Budget and the estimates for the period 2018-2019, were grounded on the principles of “prudence” and “going concern”, under economic efficiency conditions in sizing the financial resources needed for the financing the entire business.

At the preparation of the Income and Expenditure Budget for the year 2017 the followings were taken into consideration:

- The provisions of the Government Ordinance no. 26/2013 regarding the reinforcement of the financial discipline at the level of economic operators to which the State or the administrative - territorial divisions act as unique or majority shareholders or hold directly or indirectly a majority participation, with subsequent amendments and additions;
- The provisions of the Order of the Ministry of Public Finance 20/7th January 2016 for the approval of the format and structure of the income and expenditure budget, as well as the substantiation annexes thereof, with subsequent amendments;
- The provisions of the Collective Labour Agreement of Conpet in force;
- The applicable legislation and legal regulations;
- The quantities of crude oil, rich and condensate gas communicated for transport by the main clients holding 99% of the turnover;
- The preliminary achievements of the company regarding 2016 Income and Expenditure Budget;



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- The proposals of specialized Directions/Departments for the year 2017 regarding the investment programs, maintenance, the provision of the occupational safety and health, security of the National Transport System, environmental protection, professional training, etc.

A. THE DRAFT INCOME AND EXPENDITURE BUDGET FOR THE YEAR 2017

(Annex no. 1)

The economic and financial indicators set forth in Annex no. 1 of the Income and Expenditure Budget advanced for 2017 are detailed in annex no. 2 and are to be found in the structure as follows:

I. TOTAL INCOME

The company's income is being achieved mainly out of the supply of the transport services, both by the Crude Oil National Transport System, concessioned based on the oil concession agreement, as well as by railway for the oil areas not connected to the major transport pipelines.

In the 2017 budget the total revenues amount for 412.101 thousand Lei, lowering by 1% compared to the revenues estimated to be achieved in 2016 and include:

I.1. Operating revenues amounting 409.586 thousand Lei, 0.7% lower than the predicted for 2016, representing 99.4% of the total income. At the determination of the operating revenues were considered the revenues from the company's core business, respectively pipeline and railway transport services, the revenues achieved from secondary activities (rental of goods) and other operating revenues.

The structure and substantiation manner of the operating revenues is set forth as follows:

I.1.1 The sales revenues budgeted for the year 2017 amount for 373.485 thousand Lei, in the following structure:

Sales Revenues	MU	Predicted /Achieved 2016	Draft Income and Expenditure Budget for 2016	Diff. Income and Expenditure Budget 2017-predicted 2016	2017 Income and Expenditure Budget/predicted 2016
Sales revenues-total, of which:	thousand Lei	380,368	373,485	-6,883	98.19%
<i>transport revenues</i>	<i>thousand lei</i>	378,575	363,955	-14,620	96.14%
<i>rental revenues</i>	<i>thousand Lei</i>	1,231	1,244	13	101.06%
<i>Revenues from other activities related to turnover (pipe sale, shunting, resupply of thermal power, other activities)</i>	<i>thousand Lei</i>	561	8,286	7,725	1477.01%

The volume and structure of the income out of sold production contained in the draft 2017 Income and Expenditure Budget were substantiated considering, mainly, the quantities of crude

oil and rich gas contracted with OMV Petrom, Petrotel Lukoil and Rompetrol-Petromidia to be transported to refineries in 2017 and the transport tariffs, therefore:

Average fee for the transport on the Country subsystem

According to Order no.32/2016 for the period 9th February 2016-present 79,75 lei/tonne.

The fees practiced on the Import Subsystem are the ones approved by Order no. 32/2nd February 2016 of ANRM, starting with 9th February 2016. The fees apply on refineries, by steps, on intervals of transported quantities, as follows:

Quantity (to)	Arpechim	Ploiesti Basin	Petromidia
0 – 100 000	38.85	38.00	8.00
>100 000	16.60	16.00	7.33

1.1.1.1 The transport revenues have been sized according to the quantities communicated by clients for 2017, as follows:

TRANSPORTED QUANTITIES	MU	Achieved /Estimated 2016	2017 Draft Income and Expenditure Budget	Diff. 2017 Income and Expenditure Budget-estimated 2016.	2017 Income and Expenditure Budget/ Predicted 2016
COUNTRY SUBSYSTEM QUANTITIES, of which:	tons	3,685,087	3,518,975	-166,112	95.49%
OMV PETROM	tons	3,685,087	3,518,975	-166,112	95.49%
IMPORT SUBSYSTEM QUANTITIES, of which:	tons	3,393,256	2,945,183	-448,073	86.80%
PETROTEL LUKOIL	tons	2,752,943	2,365,183	-387,760	85.91%
ROMPETROL-PETROMIDIA	tons	74,693	80,000	5,307	107.11%
OMV PETROM, of which:	tons	565,620	500,000	-65,620	88.40%
SPILL	tons	352,313	0	-352,313	0
TOTAL TRANSPORTED QUANTITIES	tons	7,078,343	6,464,158	-614,185	

Transport income	MU	Achieved /Estimated 2016	2017 Draft Income and Expenditure Budget	Diff. 2017 Income and Expenditure Budget-estimated 2016.	2017 Income and Expenditure Budget/ Predicted 2016
1. Country Subsystem transport services revenues, of which:	thousand Lei	296,077	282,272	-13,805	95.34%
1.1 Transport revenues	thousand Lei	293,487	280,638	-12,849	95.62%
1.2 Additional transport revenues	thousand Lei	2,591	1,634	-957	63.07%
2. IMPORT Subsystem transport services revenues, of which:	thousand Lei	82,498	81,683	-815	99.01%
2.1 Transport revenues, of which:	thousand Lei	82,498	81,683	-815	99.01%

PETROTEL LUKOIL	thousand Lei	70,385	62,043	-8,342	88.15%
ROMPETROL-PETROMIDIA	thousand Lei	592	640	48	108.19%
OMV PETROM, of which:	thousand Lei	11,521	19,000	7,479	164.92%
SPILL	thousand Lei	3,407	0	-3,407	0
2. Additional transport revenues	thousand lei	0	0	0	0
TOTAL –Transport services revenues, of which:	thousand Lei	378,575	363,955	-14,620	96.14%
Transport services revenues	thousand Lei	375,984	362,321	-13,663	96.37%
Additional transport revenues	thousand Lei	2,591	1,634	-957	63.07%

In the 2017 budget, were provided additional revenues amounting 1.634 thousand Lei representing transport services with insulated boilers.

I.1.1.2 The revenues from other activities related to turnover represent revenues from pipe sales resulted from the disuse of the rich gas and crude oil pipelines (discard, etc.), rental of tangible and intangible goods - Conpet property, tanks shunting services, resupply of thermal power etc. and are being estimated based on the fees in the concluded contracts and the achievements predicted for the year 2016.

I.1.2 Other operating revenues predicted in 2017 draft budget, amounting 35.976 thousand Lei, include: stock rich gas sale, as well as from the recognition as income of the expenses related to the depreciation of the fixed assets financed from the modernization quota.

The detailed situation of other operating revenues included in the 2017 budget, amounting 35.976 thousand Lei, compared to the revenues achieved/estimated for 2016, is presented as follows:

Other operating revenues	MU	Achieved / Estimate d 2016	2017 Draft Income and Expenditure Budget	Diff. 2017 Income and Expenditure Budget-estimated 2016.	2017 Income and Expenditure Budget/ Predicted 2016
Other operating revenues, of which:	thousand Lei	31,919	35,976	4,057	112.71%
recognition as income from the modernization quota	thousand Lei	27,662	31,598	3,936	114.23%
stock rich gas sale	thousand Lei	990	1,165	175	117.68%
other revenues	thousand Lei	3,267	3,213	-54	98.33%

I.2 The financial revenues provided for the year 2017 amount 2.515 thousand Lei (65% of the achievements estimated for 2016) and include financial revenues achieved out of interests related to the placement of the liquid assets into savings accounts and other financial instruments (government securities as treasury bills and government bonds).

II. TOTAL EXPENSES

The volume and structure of the total expenses included in the Draft Income and Expenditure Budget for the year 2017 have been sized according to the level of the revenues programmed to be achieved and the programs elaborated at the company's level by the specialized directorates / departments corresponding to the planned activities, such as: maintenance, investments, studies, provision of occupational safety and health, installations security, environmental protection, professional training etc., so that the company's business be performed under economic efficiency conditions and under safe operation conditions of the Crude Oil National Transport System (CONTS).

The overall expenses forecasted in the draft Income and Expenditure Budget for the year 2017 amount for 328.901 thousand Lei, registering a decrease by 2.5% compared to the achievements predicted in 2016, under the reduction level of the total income with 1% and include:

II.1 The operating expenses amounting for 328.785 thousand Lei representing 97,5% of the value estimated for 2016, include the expenses meant for the safe operation and functioning of the crude oil, rich gas, condensate and ethane National Transport System.

The main categories of operating expenses forecasted in the 2017 Income and Expenditure Budget, are the following:

- ✓ **The stocks expenses** are being substantiated based on the supply program developed for the provision of the necessary resources for maintenance activities, provision of occupational safety and health, installations security, environmental protection and safe operation conditions of the Crude Oil National Transport System (CONTS), as well as for the auxiliary and administrative activities. For the year 2017 they are being provided for the amount of 17.049 thousand Lei.
- ✓ **The third parties services expenses** represent 5.129 thousand Lei, (with an increase of 26% compared to 2016). The highest rate of the total expenses of the kind (55%) is being represented by the services of maintenance and repairs necessary for providing safe conditions of operation of the Crude Oil National Transport System;
- ✓ **The insurance premiums** expenses are budgeted to the amount of 676 thousand Lei, with an increase of 19% compared to 2016, the result of the increase of the Civil Liability Insurance (RCA) and Fully Comprehensive Car Insurance Policy (CASCO) insurance premiums for 2017;

- ✓ **Protocol, advertising and publicity expenses** are estimated at the same level as in 2016 (300 thousands lei).
- ✓ **Sponsorship expenses** are estimated at 600 thousands lei, determined at the rate of 32% of the deductibility limit laid down in the tax code (5‰ of the turnover, but no more than 20% of the corporate tax).
- ✓ **Expenses with duties, taxes and similar levies**

Within this category of expenses, the oil royalty holds a significant share (96%) and it is being calculated according to the quantity transported through the pipelines and to the transports fees.

Oil royalty estimate is as follows:

Criteria no.	Transportation subsystems	Quantities in tons	Basis for calculating the royalty (thousands lei)	%	Royalty value (thousands lei)
1	Transportation subsystem country pipelines	2,487,359	198,367	10%	19,837
2	Transportation subsystem import	2,945,183	81,683	10%	8,168
total					
		5,432,542	280,050	10%	28,005

- ✓ **Personnel expenses** forecasted for 2017 are in total amount of 111,960 mii lei, representing 99.5% as compared to 2016 predicted achievements, including: salaries, bonuses expenses representing social expenses corresponding to the ones laid down by art. 25 of Law no. 227/2015 (financial assistance for birth mother, financial assistance for burial expenses, financial assistance for serious or incurable diseases, the equivalent value of touristic services and/or treatment, including the transportation and other social expenses granted within the deductibility limit when calculating the corporate tax, the employees profit-sharing and other rights laid down in the Collective Labour Agreement. At the same time, the expenses related to mandate contracts for the managers and for the chief executive officer consisting of fixed and variable allowances.
- ✓ **Other operating expenses** are forecasted in total amount of 97,494 thousands lei, 2.5% under the level of the achievements estimated for 2016 and are made up of:
 - **The expenses related to the settlement of the** modernization quota in amount of 50,324 thousands lei represents 14% of the collected transport revenues, weighing approximately 52% in the total “other operating expenses” and are meant for the rehabilitation and modernization of the assets belonging to the State public domain.

- **Expenses with the depreciation of the tangible and intangible assets** are estimated in amount of 44,809 thousands lei, representing 46% of the overall operating expenses;
- **Other expenses related to the period** in amount of 2,361 thousands lei, representing: judicial stamp fees, fees perceived by the trade registry office, CNVM, fees for environmental protection and water management, net value of the adjustments and depreciations, etc.

II.2 Financial expenses are being estimated at the amount of 116 thousands lei and comprise unfavourable differences in the exchange rate related to the foreign exchange payments and revaluation of the foreign currency cash balance.

III. GROSS PROFIT

The company has budgeted the end of 2017 financial year with a gross profit in amount of 83,200 thousands lei, registering an increase of 5.6 compared to the achievements predicted for 2016.

IV. CORPORATE TAX

The expenses related to the corporate tax, in amount of 14,247 thousands lei have been determined pursuant to the provisions of the Law no. 22712015 regarding the tax code. The estimation of non-deductible tax expenses and non-taxable income when calculating the corporate tax for the year 2017 was performed based on the predicted achievements of the year 2016 and the expenses included in the draft budget for the year 2017.

Non-deductible tax expenses are being budgeted in amount of 8,496 thousands lei and represent the expenses with adjustments and provisions, including the provision related to the employees profit-sharing for 2016 and other non-deductible expenses.

At the calculation of the corporate tax for the year 2017, the taxation of the reserves resulting from the revaluation of fixed assets elaborated after 1st January 2004 was also considered,.

Corporate tax expense were estimated as follows:

Elements	Amount (thousands lei)
Gross accounting profit	83,200
Elements similar to income (reserves from taxable revaluation)	+ 7,695
Non-taxable income	- 6,597
Non-deductible expenses, such as	+ 8,496
<i>expenses with adjustments and provisions</i>	6,986
<i>sponsorship expenses</i>	600
<i>other non-deductible expenses</i>	910
Taxable profit	92,794
Corporate tax 16%	14,847

Corporate tax after deducting sponsorship expenses	14,247
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We note that CONPET SA reached the deductibility limit laid down by art. 22 par. (1) of the tax code, the legal reserve being represented in proportion of 20% by the subscribed and paid in share capital.

V. THE ACCOUNTING PROFIT THAT REMAINED AFTER THE DEDUCTION OF THE CORPORATE TAX

The net profit forecasted in the 2017 Income and Expenditure Budget, in amount of 68,953 thousands lei is proposed for the allocation pursuant to the provisions of Government Ordinance 64/2001 regarding the allocation of profit to national expenses, national and commercial companies whose capital is wholly or majority State-owned fully, according to the dividend policies of the Management Board, as follows:

- a. 85% dividends due to shareholders;
- b. 10% employees profit-sharing;
- c. 5% financing sources.

VI-VII. INCOME AND EXPENSES FINANCED BY EUROPEAN FUNDS

For 2017, the company has not provided operating activities financed by European funds.

VIII. FINANCING SOURCES FOR INVESTMENTS

The investment projects forecasted for 2017 are in amount of 64,269 thousands lei, according to Annex 4 to the Income and Expenditure Budget and have as financing sources the modernization quota (50,451 thousands lei) and other own sources (13,818 thousands lei).

IX. INVESTMENT EXPENSES

CONPET SA Investment Program for 2017 (Annex no. 4) has been substantiated based on the provisions of the company's Management Plan and the priorities laid down by the Minimal Investment Program annexed to the concession contract.

The main investment objectives included in the 2017 Investment Program are detailed below:

Criteria no.	Name of the objective	2017 Program (thousands lei)
	Grand total, out of which:	64,269
I	PUBLIC DOMAIN	51,317
1	Pipelines rehabilitation, namely:	23,960
1,1	Pipeline replacement	20,815
1,2	Safe disposals	3,145
2	Modernization and monitoring of the cathodic protection system at central and sector level, corresponding to the crude oil transport pipelines Ticleni-Ploiesti, F1 and F2	1,453

Criteria	Name of the objective	2017
3	Modernization and monitoring of the cathodic protection system related to import and domestic NTS – design	425
4	Modernization and monitoring of the cathodic protection system related to domestic NTS – execution	4,000
5	Pilot system for the detection and location of product leaks from crude oil transport major pipelines system Videle Poiana Lacului-Siliste-Ploiesti	400
6	Expertise and technical support	50
7	Tanks	3,230
8	Energetic works	7,250
9	Telecommunication works	500
10	Modernization of pumping systems	1,200
11	Ramp modernization	1,225
12	Buildings, stations fencing	339
13	Automated works and SCADA	598
14	Other works	1,127
15	Projects, Studies, Technical Expertise	160
16	Independent Facilities and Equipment	5,400
II	OPERATING AREA	12,952
A	Investment objectives, namely:	8,656
1	Pipelines rehabilitations	1,375
2	Water feed	180
3	Buildings, stations fencing	2,282
4	LDH and rail tanks	250
5	Energetic works	225
6	Other works	4,314
7	Intangible investments	30
B	Independent Facilities and Equipment	4,296

X. SUBSTANTIATION DATA

Outstanding payments and liabilities

The level of outstanding payments estimated for 2017 in the Income and Expenditure Budget draft is zero.

The level of outstanding liabilities estimated for 2017 in the Income and Expenditure Budget draft reaches 322 thousands lei, 6% lower than the ones estimated to be achieved in 2016.

PERFORMANCE INDICATORS PROVIDED IN THE MANAGEMENT PLAN

The achievement degree of the annual global performance indicator for 2017, determined based on the performance indicators provided in the Management Plan, the share of each indicator and the budget provisions, as compared to the aimed targets is of 100%.

The structure and level of performance indicators is as follows:

Crt.no.	Objective/ Performance Indicator	Performance Objective	MU	estimate 2016	2017		Budget Achievement vs. targets (%)	Weighting coefficient	% vs. targets
					targets as per objectives	Budget proposal			
0	1	2	3	4	5	6	7	8	9=7x8
1	EBITDA	1% increase as compared to the previous level of the preceding year for 2014 and 2.5% for 2015-2017	thousand RON	117,497	120,434	125,610	104.30%	25.00%	26.07%
2	Decrease of operating expenses	1.5% reduction as compared to the previous level of the preceding year starting 2015, when the level recorded in 2014 is smaller or equals the one recorded	%	88.67%	87.34%	88.00%	99.24%	25.00%	24.81%
3	Labour productivity growth	Increase of the average revenue per employee by 3% per year the average of 2014-2017	thousand RON/person	247	254	245	96.46%	25.00%	24.11%
4	Decrease in the total number of technical breakdowns	4% reduction, on average, per year, as compared to the level of 116 technical breakdowns registered in 2013	no. of technical breakdowns	30	29	29	100.00%	10.00%	10.00%
5	Enhance visibility on the BSE	Active tracking, by the brokerage houses, of CONPET evolution, materialized in analysis reports prepared by analysts working therein (50% weight in the indicator) for 2014 - 1 brokerage firm in TOP 10 as per the classification established by the BSE at the issue date of the report/for 2015&2017 – 2 brokerage companies in TOP 10 according to the classification established by the BSE at the issuing date of the report; Holding the position in Top 25 issuers according to capitalization given that there will not be considered the new companies to be included in the 1st Tier of Bucharest Stock Exchange during the examined period 2014-2017 (50% weight in the indicator)	% in 100%	100%	100%	100.00%	100.00%	15.00%	15.00%
TOTAL -Achievement of the performance indicators									
									100.00%

BUDGETARY ESTIMATES FOR THE PERIOD 2018 - 2019

At the sizing of the budgetary estimates provided in the model-Annex no. 1 of 2018-2019 Income and Expenditure Budget, the following aspects were considered:

- The macroeconomic data provided by the National Prognosis Commission regarding the inflation forecasted for 2018 and 2019;
- The substantiation of the Income and Expenditure Budget draft for 2017;
- The provisions stipulated in CONPET S.A. Collective Labour Agreement in force;
- The legislation and the applicable regulations in force;
- The quantities of crude oil, rich gas and condensate communicated by the main clients holding 99% of the turnover.

CLIENT	U.M.	YEAR 2018	YEAR 2019
OMV PETROM, out of which:	To		
Country system	To	3,938,286	4,133,056
Import subsystem	To	3,638,286	3,583,056
PETROTEL LUKOIL	To	300,000	550,000
ROMPETROL PETROMIDIA	To	2,650,151	2,445,473
	To	80,000	80,000
Total	to	6,668,437	6,658,529

The gross profit estimated for the period 2018-2019 reaches 80,500 thousands lei, respectively 80,600 thousands lei.

The net profit forecasted in the Income and Expenditure Budget related to 2018-2019 (2018: 66,815 thousands lei, , 2019:66,898 thousands lei) is being proposed for distribution according to the provisions of Government Ordinance no.64/2001 regarding profit allocation to national enterprises, national companies and commercial enterprises wholly or majority State-owned, according to the dividend policy of the Management Board, as follows:

- 85% dividends due to shareholders;
- 10% employees profit-sharing;
- 5% financing sources.

The 2017 Income and Expenditure Budget draft has been subject to the financial management control, according to Government Decision no. 1151/2012 for the approval of the Methodological norms regarding the way of organizing and exercising the financial management control.

Pursuant to art. 15 par. (3) letter g) of the Articles of Incorporation of Conpet SA updated on 29th November 2016 by the O.G.M.S. no 3/29th November 2016, we submit the Income and Expenditure Budget draft for 2017 and the estimates for the period 2018-2019, as well as its annexes, to the approval of the Ordinary General Meeting of the Shareholders.

Director General
Engineer Ilasi Liviu

Economic Director
Economist Toader Sanda