



FGSZ

A MOL-CSOPORT TAGJA

FGSZ Ltd ANNUAL REPORT 2018

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1. Overview



High-pressure natural gas pipeline system of **5782 km**



Telecommunication cable network of **7229 km**



3 natural gas transmission regions



6 compressor stations



25 entry points



Nearly **400** gas delivery stations



Close to **700** employees

EBITDA HUF million

2014	58 180
2015	59 988
2016	54 934
2017	53 843
2018	50 030

Total transported volume (15 °C) million m³

2014	14 064
2015	13 093
2016	14 953
2017	16 075
2018	20 940

- Operations in line with the EFQM Excellence Model
- European Union ITO Certification
- ISO 9001:2008 certified Quality Management System
- ISO/IEC 27001:2013 certified Information Security Management System
- ISO 50001:2011 certified Energy Management System
- MSZ EN ISO 3834-2:2006 certified Management System for Welding Operations
- MSZ EN ISO/IEC 17025:2005 Accredited Calibration Laboratory

FGSZ RBP data:

- 8 registered TSO members
- 113 registered network users
- More than 5 300 000 successful auctions





2. Our Activity

FGSZ Földgázszállító Zrt. (hereinafter referred to as FGSZ) is the largest transmission system operator in Hungary, performing its activity under market conditions regulated by law. Beside the domestic natural gas transmission, FGSZ is also engaged in transit activities to Serbia and indirectly to Bosnia-Herzegovina, as well as it conducts transmission activities towards Romania, Croatia, Ukraine and – through the network of MGT Zrt. – towards Slovakia. The security of supply of Hungary is inseparable from the energy security of the CEE region and whole Europe.

Therefore, FGSZ is committed to enhance the flexibility and the security of supply of the regional natural gas market. Its developments aim to establish new routes and to strengthen the existing connections, in order to ensure access to the new resources and to exploit the possibilities for trade. FGSZ supports incremental developments which facilitate the more efficient utilization of the existing network.

Our Company operates in accordance with the applicable EU legislation at all times, and FGSZ is one of the first certified independent transmission operators (ITO) in Europe.

REGIONAL BOOKING PLATFORM (RBP)

The Regional Booking Platform (RBP) of FGSZ is an IT application developed in accordance with the EU network code governing the capacity allocation mechanisms used in natural gas transmission networks and with other relevant EU and national legislation. The capacity allocation application enables capacity allocation procedures and secondary capacity trading, among other services. Today it is used by seven further transmission system operators throughout the EU besides FGSZ: Eustream (Slovakia), Transgaz (Romania), Plinacro (Croatia), MGT (Hungary), Bulgartransgaz (Bulgaria), DESFA (Greece) and Gas Connect Austria (Austria).



3. People Focus

The key fundamental values of the corporate culture of FGSZ are:

- safety,
- efficiency,
- partnership
- modernism,

which manifest in the prudent and committed work of our employees, the direct and open communication as well as in our efforts for performance and continuous development on a day-to-day basis.

Our results are due to our prepared and responsible co-workers who are the key resources of our Company. We regularly measure their commitment and ask for their opinion on our processes and the circumstances affecting their work.

The continuous renewal of technologies and high-level operating safety call for the regular further training of our employees. In addition to the execution of our scheduled training programs, we support our employee's aspirations in broadening their professional expertise and increasing their knowledge.

An integral element of our corporate culture is the high esteem we hold for our colleagues and the conscious professional succession.





4. Our Infrastructure

We perform our tasks as an independent transmission operator (ITO) defined in the European Union's Directive 2009/73/EC. Being worthy of our traditions in the sector, our Company's infrastructure is among the most modern facilities in Europe. Via our high-pressure transmission system featuring high-level automation, natural gas is transported in the required quality and at the necessary pressure for continuous supplies to system users.

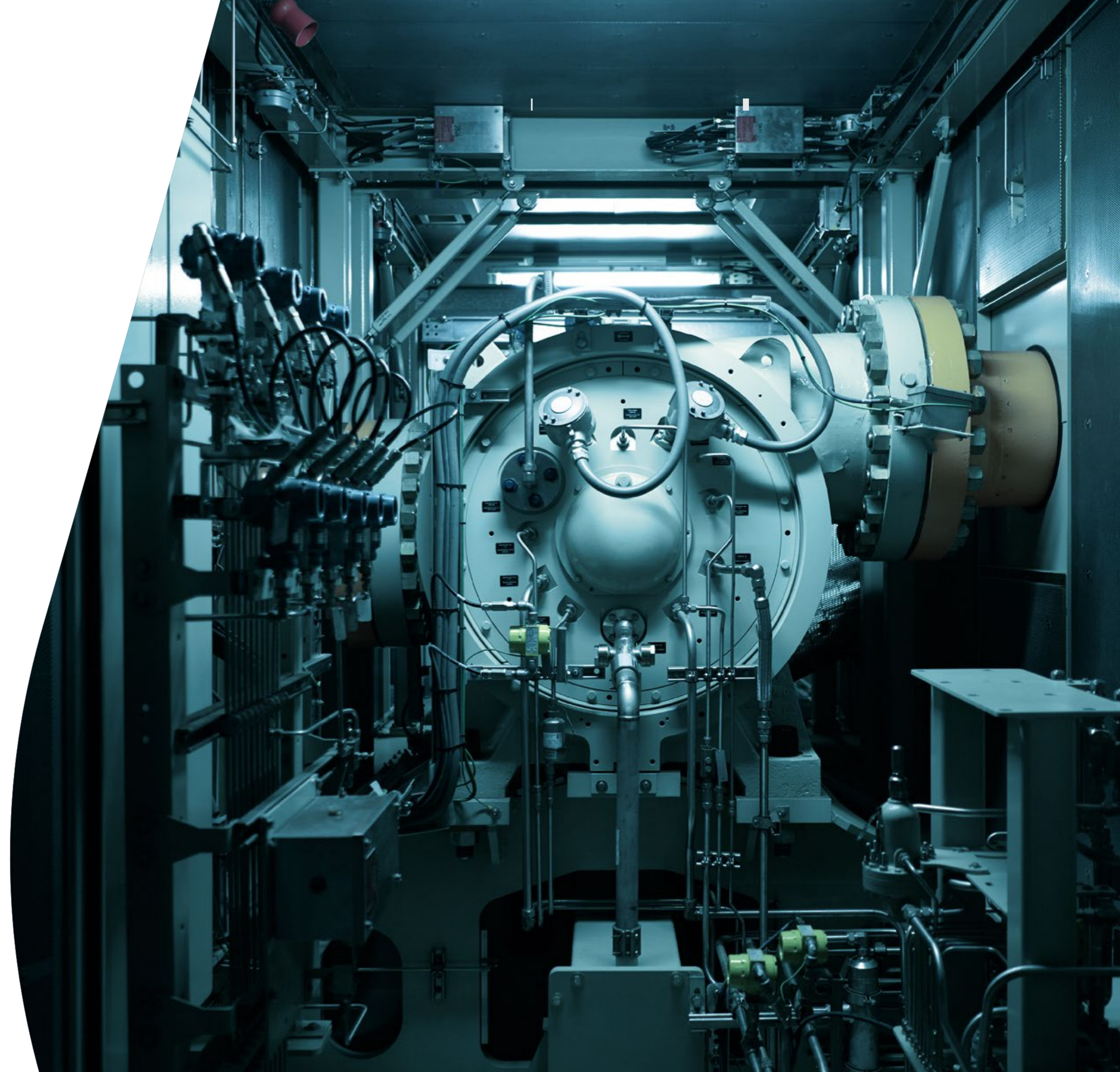
Sourced both from domestic production and foreign supplies, natural gas is received and delivered at 25 domestic and 4 cross-border entry points of our high-pressure natural gas transmission pipeline network, as well as at nearly 400 exit points, including 5 cross-border exit points. At each of these entry- and exit points, we have a close focus on the application of the quality control protocols defined in the effective legal regulations and the proper observation of validated measurement requirements.

The safe and continuous operation of our 5782 kilometer-long system encompassing the entire country is served by the cooperation of 3 natural gas transmission regions and 6 compressor stations, as well as coordination provided from the system management center of Siófok.

Our Company is responsible for the required odourization of the natural gas supplied to the consumers for safety purposes, the continuous control of the quality of natural gas, as well as the appropriate measurement of the quantitative and quality-related properties of the gas transferred to our partners in conformance to the transparent, most stringent international standards.

The natural gas volumes that cover the current industrial and household demands are supplied to the consumers via gas delivery stations that ensure supplies to the connected operators, as well as industrial and power plant consumers under increased and continuous control.

The consumer demands that seasonally fluctuate as a result of Hungary's continental climate call for the provision of considerable excess gas volumes during the winter by our Company, and those are satisfied with reliance on underground gas storage facilities connected to our high-capacity natural gas transmission network at five points.





5. HSE

Our objectives set in the field of health protection, safety engineering and environmental protection are based on our absolute respect for human life and natural values.

The safeguarding of natural values is not merely an important goal for us, but it is indeed an integral part of our corporate culture, and therefore we want to rely on the energy market advantage that is inherent in the extremely favourable ecological footprint of natural gas transmission in the future as well. We consciously strive to reduce the pressure on the environment in the course of our investments, as well as upon operating and liquidating our facilities.

We regard the systemic utilization of renewable energy resources as equally serving environmental sustainability and energy security. To this end, we make all efforts to enable our network to accept any biogas inventories appearing in the domestic natural gas market in conformance to the regulatory environment that determines our activities.

During the realization of our HSE strategy, beside regular health counselling and information, we have a strong focus on systemic improvement of ergonomic conditions at our workplaces and during our operations.

6. Quality Operations – Integrated Management System

The efficient operation of our Company is ensured by the Integrated Management System (IMS), comprising the integrated operation of eight subsystems.

The Managerial Supervision session regarding the 2017 IMS was held on 3 April 2018, where the Management was provided with information on last year's IMS events and where it adopted the decisions and targets for the year 2018.

KEY IMS EVENTS OF 2018:

1. Introduction of the new ISO 9001:2015 certified Quality Management System (QMS);
2. Renewal of ISO 50001:2011 certified Energy Management System (EMS);
3. Successful maintenance of ISO 27001:2013 certified Information Security Management System (ISMS) during the course of the SGS audit;
4. Successful obtainment of MSZ EN ISO 5167-2 certification (measurement of measuring sections and orifices) for the sites in Miskolc and Kecskemét beyond our Calibration Laboratory Management System (CLMS) accreditation;
5. Approval of the report compiled on the amendments of the rules concerning the Technical Security Management System (TSMS) by the MBFSZ (Mining and Geological Survey of Hungary);
6. Successful closure of the audit of the Welding Management System (WMS) of ÉMI-TÜV Süd Kft.;
7. Successful closure of the IT security supervision of the invoicing system by HUNGUARD;
8. Introduction of the SCC work safety system for pressure drilling activity;





7. Key Projects of 2018

IT DEVELOPMENTS

As a result of a three-year development project, further business applications of RBP and FGSZ – thus including the IT Platform and the Trading Platform – were completely renewed in 2018.

Furthermore, the website of FGSZ was renewed as well, where up-to-date information is provided for our business partners and those interested in our Company. Several administration applications were also developed, supporting our employees in performing their work quickly and efficiently.

INVESTMENTS

The first phase of the Romanian-Hungarian gas transmission corridor development – as part of the BRUA gas pipeline project, a significantly important development with regard to the security of supply to Central Eastern Europe – progressed as scheduled in 2018.

The construction of the pipeline of nearly 3 kms branching off the Algyő-Kiskundorozsma DN600 pipeline providing supply for the city of Szeged was successfully carried out as our own investment, providing an excellent opportunity to expand our Company's investment and project management competencies with valid practical experience.

WORK EQUIPMENT

The vehicle fleet of FGSZ was completely renewed in 2018, and the replacement of IT equipment (phones, computers, printers) was successfully launched as well.

CORPORATE IMAGE

The logo and the image elements of FGSZ were renewed in 2018 as an important step to demonstrate our Company's commitment to quality and innovation.

8. Key Financial and Business Data

	Year 2018 (HUF million)	Year 2017 (HUF million)	Year 2018/2017 (%)
Net sales revenues	101 396	101 418	99,98
EBITDA	50 030	53 843	92,92
Operating profit	32 438	36 361	89,21
Profit before taxes	29 439	35 879	82,05
Profit after taxes	28 820	32 883	87,64
Operational cash-flow	1 491	34 611	4,31
Fixed assets	262 894	268 777	97,81



The business year 2018 was successful for our Company from a financial perspective, an achievement supported by the stable ownership background, the high-quality infrastructure and the result-oriented operation. However, adverse changes in the regulatory environment and growing operating expenses (particularly in the case of variable costs) exerted substantial pressure on the operating profit, resulting in a 11% decline (HUF 32.4 billion) compared to the preceding year.

Our net sales revenue was mainly the result of the transmission of 20.94 billion cubic meters of natural gas, as well as the gas traffic related to the maintenance of the system balance. Our total sales revenue for year 2018 is nearly identical to the result realised in the preceding year.

Our sales revenues from the domestic, regulated transmission activity fall short of the amount realised in the preceding year:

- Following the cut in 2017, the Hungarian Energy and Public Utility Regulatory Authority (MEKH) further – and significantly – decreased the regulated gas transmission fees (meaning an average capacity fee reduction of 23%) as of 01/10/2018, thereby significantly impacting the amount of sales revenues that can be realised.

At the same time, as of 1 January 2017 our Company is no longer allowed to recognise any volume fee revenues after the volume of stored natural gas.

- In total, our Company realised the same volume of regulated transmissions compared to the preceding year. The domestic transmission volume was lower (by 9% YoY), in conformity with the warmer winter months. The lower volume of gas storage activities (compared to the base year) was counterbalanced by the volume of excess transmissions to wards Croatia and Ukraine, which grew even further in 2018 following the extraordinary level realised in 2017.
- The impact of the decreasing volume of annual capacity bookings was not fully counterbalanced by the higher demand for short-term bookings.

Our revenue from non-regulated transit transmissions reached almost the same level as in the preceding year:

- The non-regulated transmissions towards Serbia and Bosnia were realized nearly at the same level as in the preceding year (-2% YoY).
- The adverse impact of lower transmitted volumes on the sales revenue was largely counterbalanced by the impact of changes in FX rates.



Developments in the external environment adversely impacted the operating expenses.

- The changed transmission conditions as well as the realised significant excess transmission demand entailed an increase in the own gas use of the transmission system, which was realised in a substantial excess demand for compressor operations. The volume of recognised gas loss was slightly favourable compared to the preceding year, due to the Company's actions and investments aimed at reducing the loss.
Due to the changes in the world market gas price, the purchase prices of own gas further increased compared to the previous year, reinforcing the unfavourable effects of the increasing gas use.
- The pressure boosting contract signed in the previous years had expired in 2017. Our Company conducted continuous negotiations with the Ukrainian partner but did not enter into any new contract in 2018; as a result, we did not realise any pressure boosting fee in 2018. FGSZ ensured its adaptation to the transmission conditions and the fulfilment of demand by means of additional compressor usage, which also resulted in the increase of our own gas use costs.
- In view of other operating expenses, in order to partly counterbalance the changes in the external environment, FGSZ maintained and continued the strict control of operating costs, and as a result such expenses were incurred on a slightly lower level than in the preceding year.

It is a statutory liability of our Company to maintain the balance between the gas source and the gas consumption, which we ensure by so-called balancing gas sale and purchase as a transaction on which the Company cannot realise any profit under the applicable regulations. The balancing natural gas turnover – along with the corresponding realised sales revenues and expenses – showed a significant increase of 29.7% in 2018 compared to 2017.





The result on financial operations was HUF -3.0 billion in 2018, which predominantly resulted from the interests paid on loans from affiliated undertakings and other loans (HUF -2.3 billion) and exchange gains realised in the course of balancing FX receivables and liabilities (HUF -1.2 billion).

As a result of the lower operating profit/loss and the slightly higher loss on financial operations, the Company's profit before tax was lower by 17.9% compared to the preceding year, amounting to HUF 29.4 billion in 2018.

The HUF 2.0 billion (0.7%) decrease in the balance sheet total was predominantly explained by the decrease in fixed assets. This decrease was caused by the fact that the depreciation recognised in 2018 exceeded the value of realised investments. In response to the adverse external conditions, the Company exerted strict control of the investments as well, mainly projects essential for maintaining the technical standard of the transmission system were implemented in the business year, along with other projects determined by the applicable regulations.

The Company spent HUF 9.4 billion on investments in 2018, including the new IT Platform application installed in 2018 and the launched construction (phase 1) of the Romanian-Hungarian transmission corridor (ROHU), both representing great value and significant role.

The Company forecasts a decrease in the economic indicators for 2019 compared to 2018, with similar level of demand for natural gas transmission and consumption. We do not expect any further significant decrease in gas transmission fees from 1 October 2018. However, they will exert their effects for the next full business year. In 2019 the current two-player domestic natural gas transmission market is expected to become a single-player one as a result of the acquisition of Magyar Gáz Tranzit Zrt; however, our Company has no information at the moment on the potential changes in the regulatory requirements.

The Management of FGSZ continues to maintain its current strict cost management and seeks the opportunities to improve its internal efficiency to counterbalance the adverse effects of the regulatory and economic environment. The Company makes additional efforts towards the accomplishment of its regional strategic goals, which is the guarantee of meeting the expectations of the shareholders.





9. Contacts

FGSZ operates a Customer Service Office for its contracted partners. Should you have any queries relating to the use of natural gas transmission and system operation services, please do not hesitate to contact us.

CUSTOMER SERVICE CENTRE

Registered address:

H-8600 Siófok, Tanácsház u. 5., 322/B office.

Mailing address: H-8601 Siófok, Pf. 102.

Telephone: +36 (84) 505-117

Fax: +36 (84) 505-592

E-mail: info@fgsz.hu

Office hours:

Tuesday, Thursday: 1.00–4.00 p.m.

Monday, Wednesday, Friday: closed

SYSTEM OPERATION CENTRE

Telephone: +36 (84) 505-777

Fax: +36 (84) 505-217

Nomination/matching/interruptions:

nomdisp@fgsz.hu

Transmission flow control:

flowcontrol@fgsz.hu

The Information Office will reply to queries relating to pipeline construction projects and other issues with respect to the Company's activities.

INFORMATION OFFICE

Registered address:

H-8600 Siófok, Tanácsház u. 5., 322/B office

Mailing address: H-8601 Siófok, Pf. 102.

Office hours:

Tuesday, Thursday: 7.30–10.00 a.m.

Monday, Wednesday, Friday: closed

For daily operative matters, please contact our 24/7 dispatching service.

CLIENT SUPPORT RELATED TO RBP, IP, KP, TSODATA, IPDATA

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E-mail: bsp@fgsz.hu or rbp@fgsz.hu

Available 7/24

The website of our Company is accessible at www.fgsz.hu

The information included in this publication reflects the current state of affairs as of December 2018.