NATURAL GAS CAN DO MORE WE CAN TOO

Annual Report 2016

VNG – Verbundnetz Gas Aktiengesellschaft

   

VNG GROUP

HIGHLIGHTS

VNG Group key financial data

		2016	2015
EBITDA*	€ million	204	163
EBIT*	€ million	84	–54
Earnings after tax	€ million	40	–53
Funds from Operations (FFO)**	€ million	287	224
Cash flow from operating activities	€ million	205	376
Long-term net debt***	€ million	517	579
Balance sheet equity	€ million	642	590
Equity ratio	%	26	24

* inclusive tax refund for exploration costs of VNG Norge AS

** FFO: Result for the period adjusted by non-cash-effective expenses and income as well as profits and losses from the disposal of fixed assets

*** Net financial liabilities plus long-term provisions less inventories which can be sold in the short-term

VNG Group key performance data

		2016	2015
Number of employees at year-end		1,289	1,441
Gas sendout	billion kWh	362	372
Length of pipeline system at year-end	km	7,000	7,000
Capacity of underground gas storage facilities at year-end	billion m^3	2.5	2.5

As at December 31, 2016

HIGHLIGHTS

Shareholders of
VNG – Verbundnetz Gas Aktiengesellschaft

EnBW Energie Baden-Württemberg AG, Karlsruhe, Germany	74.21 %
VNG Verbundnetz Gas Verwaltungs- und Beteiligungsgesellschaft mbH, Erfurt*, Germany	21.58 %
SWE Stadtwerke Erfurt GmbH, Erfurt, Germany	4.21 %

* Trustee for eight utilities and municipal companies
Annaberg-Buchholz | Chemnitz | Dresden | Hoyerswerda | Leipzig | Lutherstadt Wittenberg | Neubrandenburg | Rostock

As at December 31, 2016

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THE VNG GROUP

6–17

NATURAL GAS CAN DO MORE. WE CAN TOO.

In the current environment, despite the expansion of renewable energies, Germany will fall substantially short of its climate targets.

We, the VNG Group, are convinced: over the short- to mid-term, the climate goals can only be achieved by increasing the use of natural gas in all sectors, as natural gas can do more.

With its low CO_2 emissions and high efficiency, natural gas provides substantial potential for the reduction of CO_2 in the heating market, in the production of electricity as well as in mobility. Furthermore, natural gas is readily available, flexibly controllable and also has very high acceptance among users.

We are doing our utmost to more firmly anchor natural gas as the climate protection motor of the energy transition. Our experience from the first energy transition in the 1990s will help us in this process. At that time, natural gas was the key for a modern energy system.

As an active designer of the second energy transition, we are convinced of natural gas as it provides for quick and affordable climate protection.

Naturally, in the future, we will also strive to utilise opportunities which arise on the road to a decarbonised energy system. Our gas network and gas storage can provide a portion of the required core infrastructure as it is well suited for the transportation of renewable energy, for its storage and for use across sectors.

THE VNG GROUP IS AN IMPORTANT STAKEHOLDER IN THE ENERGY TRANSITION

NATURAL GAS IS ECONOMICALLY VIABLE AND SOCIALLY ACCEPTABLE

NATURAL GAS PROVIDES SUBSTANTIAL CO_2 REDUCTION POTENTIAL

NATURAL GAS HAS A VERY HIGH LEVEL OF ACCEPTANCE

NATURAL GAS IS READILY AVAILABLE AND FLEXIBLE

THE GAS INFRASTRUCTURE SUPPORTS DECARBONISATION

vng-gruppe.de/en/natural-gas-can-do-more-we-can-too

VNGGROUP

THE VNG GROUP

The VNG Group, headquartered in Leipzig, with approx. 1,300 employees is a horizontally and vertically integrated group of companies which operates in the European gas sector with more than 20 fully consolidated companies in eight countries. The core business, natural gas, is broken down into four business areas: Exploration & Production, Gas Trading & Service, Gas Transport and Gas Storage. VNG – Verbundnetz Gas Aktiengesellschaft, as the parent company of the VNG Group, is also responsible for the gas trading business. VNG Norge AS concentrates on the exploration and production of natural gas off the coast of Norway and Denmark. ONTRAS Gastransport GmbH, an independent transmission system operator, independently and non-discriminatorily markets Germany's second largest high pressure network while VNG Gasspeicher GmbH offers the storage capacities of several underground gas storage facilities in central and northern Germany throughout Europe. Companies in the VNG Group also provide numerous products and services for the natural gas infrastructure and applications which are related to the core business.

vnggroup.eu

VNG GROUP'S FULLY CONSOLIDATED SUBSIDIARIES

EXPLORATION & PRODUCTION

VNG Norge AS, Stavanger, Norway

VNG Danmark ApS, Copenhagen, Denmark

TRANSPORT

ONTRAS Gastransport GmbH, Leipzig, Germany

GDMcom Gesellschaft für Dokumentation und Telekommunikation mbH, Leipzig, Germany

GEOMAGIC GmbH, Leipzig, Germany

INFRACON Infrastruktur Service GmbH & Co. KG, Leipzig, Germany

OSG ONTRAS Servicegesellschaft mbH, Leipzig, Germany

STORAGE

VNG Gasspeicher GmbH, Leipzig, Germany

TRADE

VNG – Verbundnetz Gas Aktiengesellschaft, Leipzig, Germany

ENERGIEUNION GmbH, Schwerin, Germany

G.EN. Gaz Energia Sp. z o.o., Tarnowo Podgórne, Republic of Poland

goldgas GmbH, Eschborn, Germany

goldgas GmbH, Vienna, Austria

goldpower GmbH, Walluf, Germany

HANDEN Sp. z o.o., Warsaw, Republic of Poland

SPIGAS S.r.l., La Spezia, Italy

VNG Austria GmbH, Gleisdorf, Austria

VNG Energie Czech s.r.o., Prague, Czech Republic

VNG-Erdgascommerz GmbH, Leipzig, Germany

VNG Italia S.r.l., Bologna, Italy

VNG Slovakia, spol. s r.o., Bratislava, Slovak Republic

GROUP CENTER

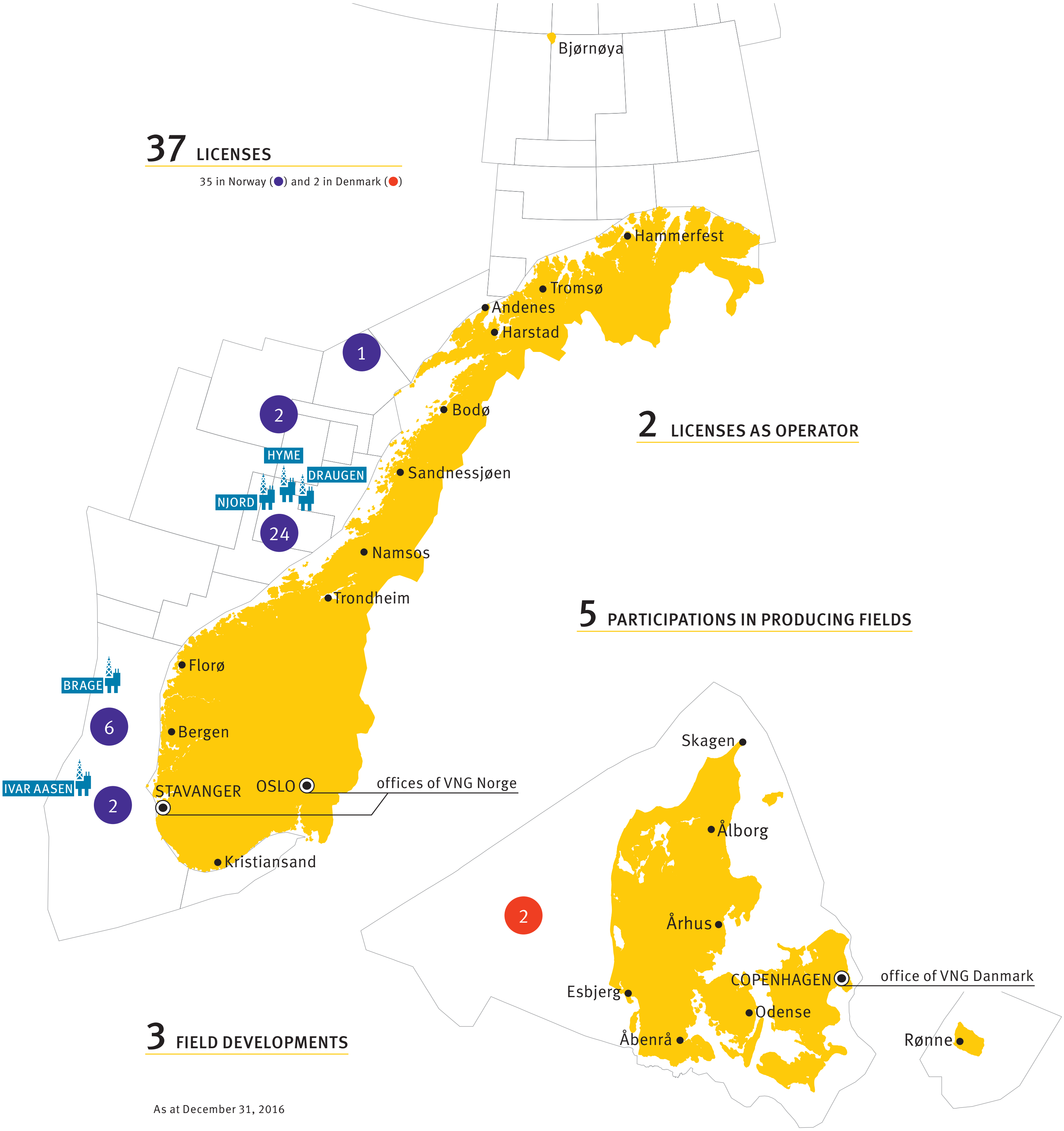
BALANCE VNG Bioenergie GmbH, Leipzig, Germany

Leipziger Biogasgesellschaft mbH, Leipzig, Germany

MBG Mitteldeutsche Biogasgesellschaft mbH, Leipzig, Germany

As at December 31,2016

EXPLORATION & PRODUCTION



37 LICENSES

35 in Norway (●) and 2 in Denmark (●)

2 LICENSES AS OPERATOR

5 PARTICIPATIONS IN PRODUCING FIELDS

3 FIELD DEVELOPMENTS

As at December 31, 2016

VNG NORGE AS

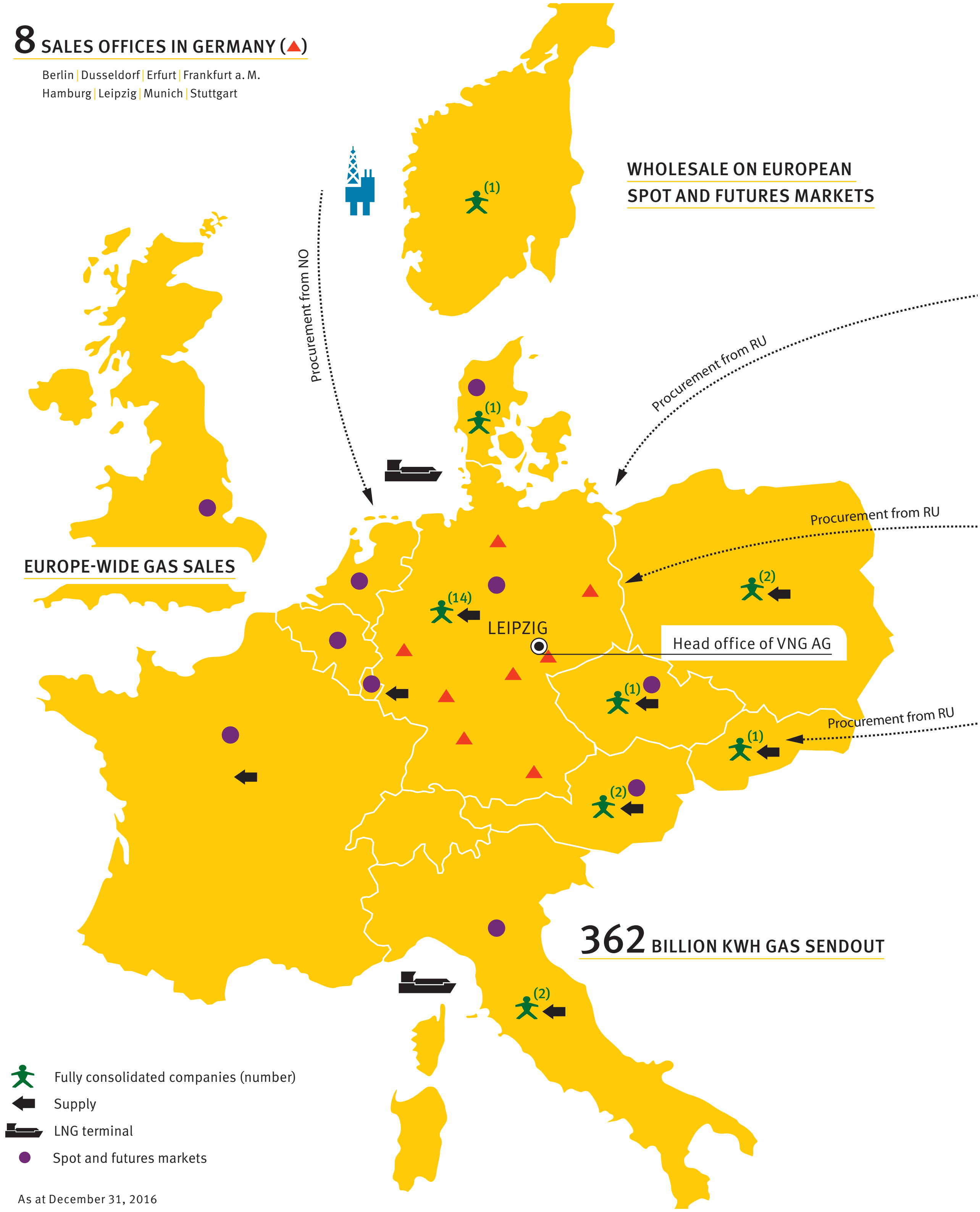
VNG Norge AS (VNG Norge) and its subsidiary, VNG Danmark ApS, with registered offices in Stavanger and Copenhagen, search for and produce natural gas and oil off the coast of Norway and Denmark. The high environmental and safety standards associated with production along with the short transport routes to the focus regions, make North Sea natural gas attractive to the VNG Group over the long-term as an own, additional and environmentally friendly resource. This is linked closely to the development of new options for competitive and flexible products by the trading companies. The E&P companies in the VNG Group manage an extensive license portfolio as well as participations in producing fields. Deposits which have, in the meantime, been discovered in Norway, are currently being prepared for production. As such, since December 2016, VNG Norge is also participating in the production of the newly developed oil and gas field Ivar Aasen.

vng.no

GAS TRADING

8 SALES OFFICES IN GERMANY (▲)

Berlin | Dusseldorf | Erfurt | Frankfurt a. M.
Hamburg | Leipzig | Munich | Stuttgart



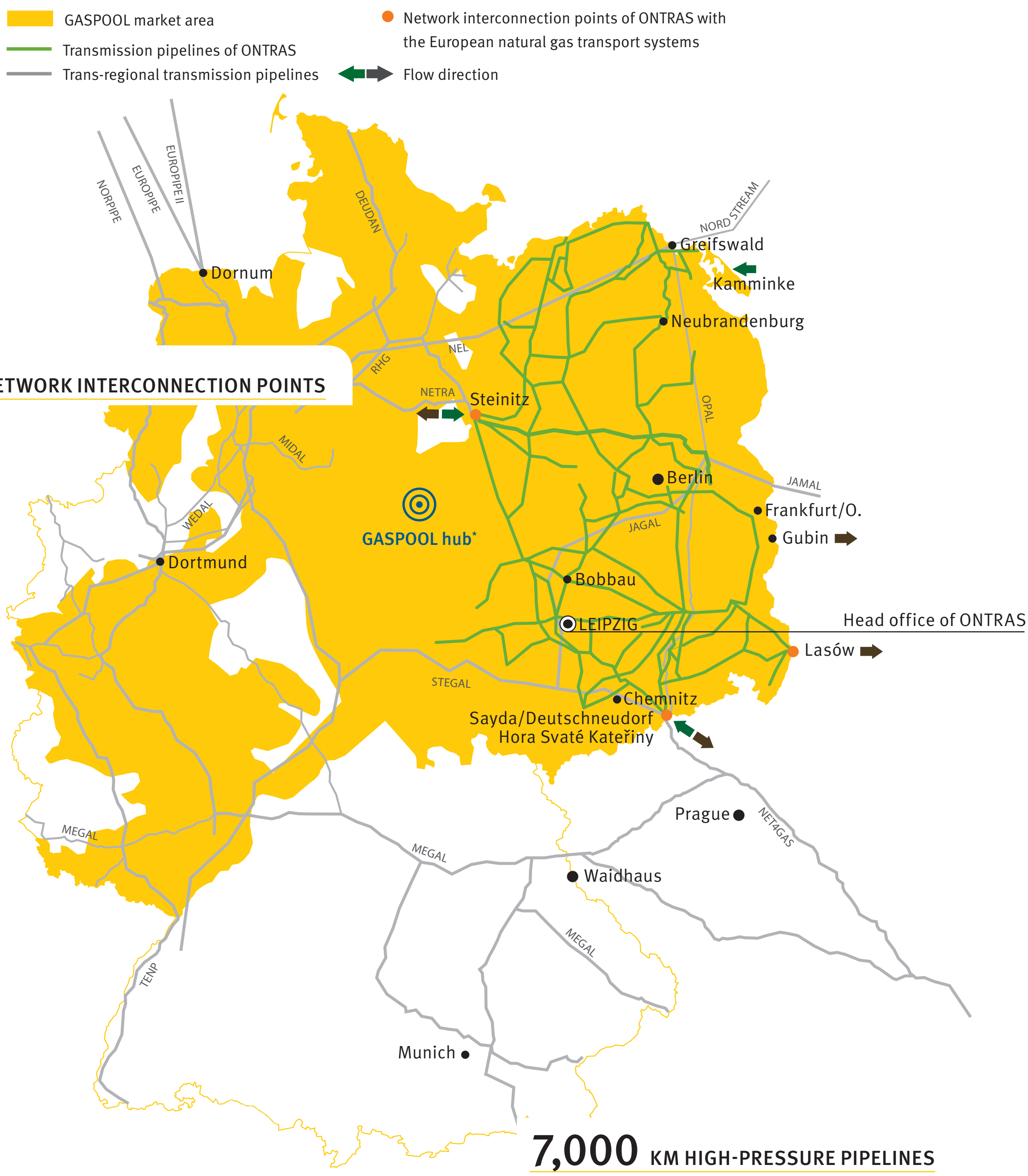
As at December 31, 2016

VNG – VERBUNDNETZ GAS AKTIENGESELLSCHAFT

VNG – Verbundnetz Gas Aktiengesellschaft (VNG AG), with its head office in Leipzig, is the parent company of the VNG Group. With companies and participations in six European countries, it is also responsible for the gas trading business. The sales organisation which spans Germany handles the entire customer base from utility companies, dealers, industry, power plants and commercial enterprises to, via goldgas GmbH, Eschborn, household customers. VNG AG obtains natural gas from highly diversified international and renewable sources. Long-term procurement contracts are closely interlinked with trade on the European spot and futures markets. The products and services provide VNG AG's customers with a high degree of security, flexibility and efficiency.

vng.de

TRANSPORT



450 NETWORK INTERCONNECTION POINTS

7,000 KM HIGH-PRESSURE PIPELINES

130 DOWNSTREAM NETWORK OPERATORS

As at December 31, 2016

* Trading partners who have a balancing group at their disposal in the GASPOOL market area can conduct trading transactions at the GASPOOL hub. The GASPOOL hub is not allocated to any physical entry or exit point and enables the purchase and sale of gas quantities without booking any capacity.

ONTRAS GASTRANSPORT GMBH

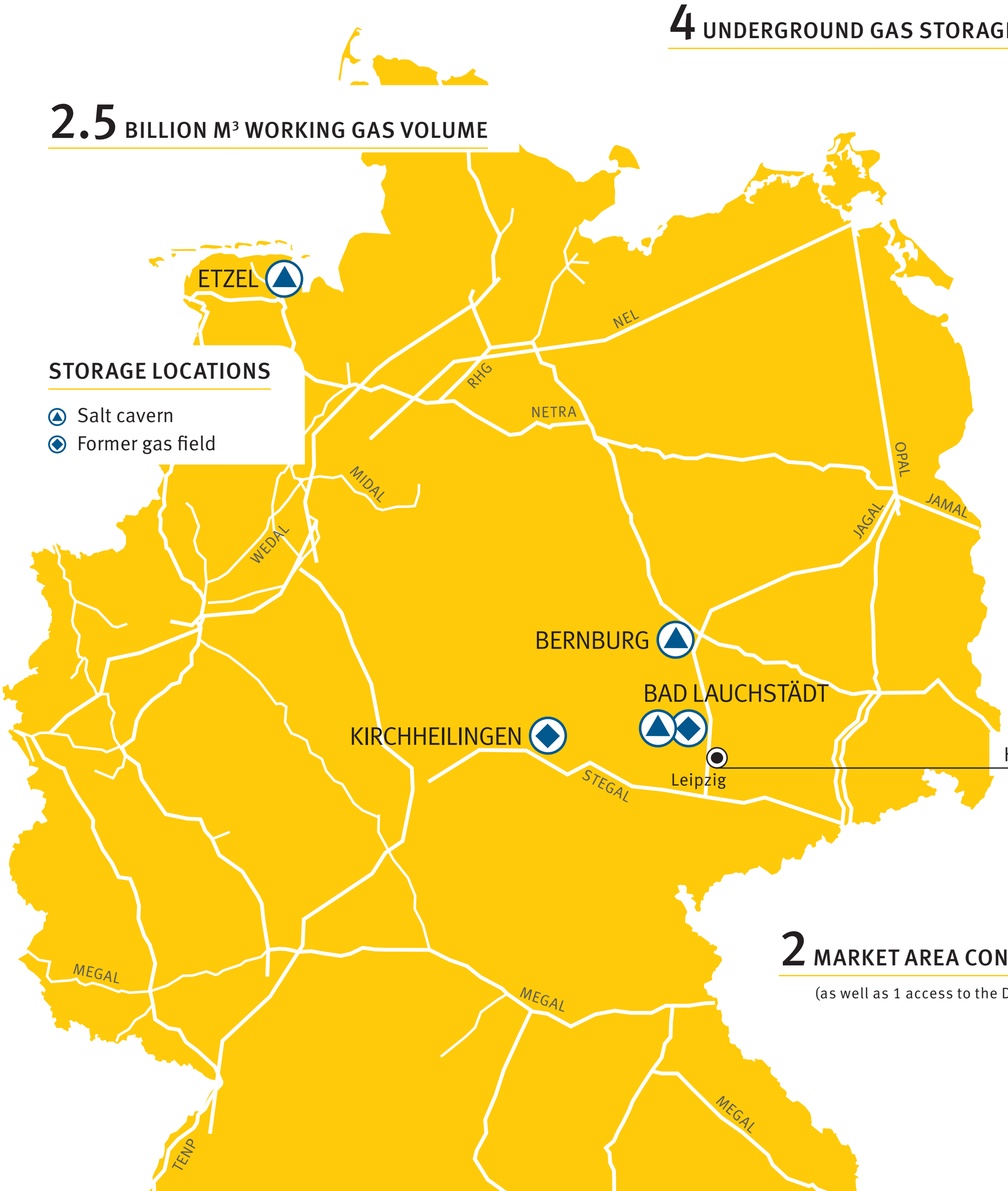
ONTRAS Gastransport GmbH (ONTRAS), based in Leipzig, is the independent transmission system operator in the VNG Group. As co-founder and shareholder of the GASPOOL market area within the European grid system, the company operates approximately 7,000 kilometres of high pressure pipelines. ONTRAS is responsible for all measures associated with the needs based optimisation, strengthening, expansion as well as safeguarding of supply. ONTRAS' core business comprises the marketing of transport capacities to approximately 450 network interconnection points via PRISMA, the platform of European network operators, as well as the organisation of gas transport together with approximately 130 downstream network operators. In addition, ONTRAS has bundled network related services for transport customers, dealers, regional network operators and connectees in its service company, INFRACON. As a stakeholder in the energy transition and as a transmission system operator which would like to make its infrastructure viable for the future, ONTRAS is increasingly engaging in own projects as well as in cooperations involving the feed-in of bio-methane, the generation and use of synthetic gas on the basis of wind energy (power-to-gas), gas as a propellant (CNG/LNG) and the energy efficiency of its own infrastructure.

ontras.com

STORAGE

4 UNDERGROUND GAS STORAGE FACILITIES

2.5 BILLION M³ WORKING GAS VOLUME



STORAGE LOCATIONS

- Salt cavern
- Former gas field

2 MARKET AREA CONNECTIONS

(as well as 1 access to the Dutch network)

WORKING GAS VOLUME IN MILLION M³

151	Etzel
180	Kirchheilingen
2,186	VGS storage hub*)

*) Bernburg: 1,039 million m³, including 92 million m³ leasehold cavern;
Bad Lauchstädt: 1,147 million m³

As at December 31, 2016

VNG GASSPEICHER GMBH

VNG Gasspeicher GmbH (VGS), with its head office in Leipzig, operates storage facilities at four locations in central and northern Germany. The company markets storage capacities across Europe totalling 2.5 billion cubic meters. All storage locations are connected to the GASPOOL market area. In addition, the northern German Etzel location is linked to NetConnect Germany (NCG). Customers are thereby provided with secure access to important European trading markets. VGS know-how across the band-width of underground gas storage–from the operation of storage facilities, project management, and the marketing of capacity to the provision of measurement services and operational handling. With its storage facilities along with flexible storage options for natural gas and increasingly also for renewable energies, VGS' services are an important component in a sustainable renewable energy supply.

vng-gasspeicher.de

FOREWORD OF THE EXECUTIVE BOARD

20–21

FOREWORD OF THE EXECUTIVE BOARD

Dear shareholders and business partners, dear friends of the company,

2016 was a year marked by changes. The Group initiated far-reaching restructuring of its own accord which was unavoidable due to the changes in the environment. We are pleased that the business development of the VNG Group led to the substantially improved positive results of Euro 40 million, subsequent to the negative results in 2015 (loss of Euro 53 million).

All operating areas contributed to our successful business development. Trade was able to optimise its portfolio management and was able to make good use of opportunities in the end user business. As was the case in prior years, the business area Transport, which operates in a stable regulatory environment, positively contributed to Group results. The E&P business was exposed to volatile oil prices. To offset this, we focussed our exploration activities on important projects. We continue to be faced with a difficult economic environment in the Storage business area. In 2016 we were, however, able to successfully adjust processes thereby leading to improvements in results.

The overall positive business development demonstrates that the VNG Group is pursuing a promising course. In 2017 we must also work to position the VNG Group in a manner viable for the future in the changing energy market. This is not possible from one day to the next—this requires a willingness to change, resolve and patience.

What did we achieve in 2016?

The program, already introduced in 2015 to increase profitability, was consequentially continued in 2016. In the past year, this program provided significant contributions to earnings and is thereby contributing to making the VNG Group more competitive. Along with sustainable earnings measures, numerous cost savings measures were also necessary. These included a reduction in headcount. In conjunction with the Works Council, we were able to implement this in as socially responsible a manner as possible without compulsory redundancies. We hereby explicitly thank the Works Council.

On the basis of the transformation initiated in 2016, we have established a foundation on which we can build in 2017. As a company, we have become more agile and flexible and, with EnBW AG as new strong principal shareholder alongside our municipal shareholders, we have a shareholder group which has confidence in our business model and our location in Leipzig. We are currently in a good starting position for a realignment which not only reflects the economic environment but also considers the challenging energy policy and social framework.

At the latest in conjunction with the conclusion of the Paris Climate Change Agreement in 2015, the word ”decarbonisation“ is on everyone's lips. With the debate surrounding the Climate Action Plan 2050 in Germany, in 2016 the public also focussed on the mid- to long-term structure of energy and climate policy. We support the social consensus achieved in Paris as well as the goals of the Climate Action Plan 2050, are putting all of our efforts into contributing the advantages of our energy source—natural gas, and are thereby seeking to contribute to the achievement of the goals.

We can state with certainty that natural gas is the most environmentally friendly fossil fuel with the lowest CO_2 emissions and the lowest CO_2 avoidance costs. On the basis of these characteristics, natural gas is an ideal enabler in a renewable energy system. But not only that. In a decarbonised world, gas and our gas infrastructure will continue to play a very important role. Already today, the gas networks and storage provide substantial potential in terms of transporting and storing the volatile renewable energy. We have summarised the opportunities and potential in our new guiding principle ”Natural gas can do more. We can too“. On this basis, we more firmly entrench natural gas in the public eye and in the political arena.

What does all of this mean for the VNG Group in 2017?

We will consequentially utilise additional earnings potential and, in terms of costs, will act in a judicious manner. At the end of 2016 we began the strategy process ”VNG 2030+“ with the goal of developing a more concrete vision. It is our goal, still in this year, to develop our strategic perspectives through the year 2030 and beyond. We achieved a lot in the past year. Now, the task is to build on this in 2017, to improve and to develop entrepreneurial responses to our intensive competition.

Finally, we thank our employees. Their perseverance made it possible to take important steps on this rocky road and will also make it possible to master the upcoming challenges.

The Executive Board

Bodo Rodestock
Board Member,
Finance/Human Resources

Ulf Heitmüller
Chairman of the
Executive Board

Hans-Joachim Polk
Board Member,
Infrastructure/Technical Affairs

REPORT OF THE SUPERVISORY BOARD

24–25

REPORT OF THE SUPERVISORY BOARD

The Executive Board regularly, comprehensively and promptly informed the Supervisory Board both orally and in writing as to the development and the position of the company as well as regarding significant business transactions. On the basis of these reports, extensive consultations and the information provided, the Supervisory Board monitored the Executive Board and, in particular, considered the development of the business areas, the financial position of the company, questions around financial, investment and personnel planning as well as all measures which, pursuant to the articles of incorporation, require the approval of the Supervisory Board.

In the 2016 financial year, the Supervisory Board held a total of four meetings. The individual meetings focussed on the company's results of operations as well as the program implemented by the Executive Board in financial year 2015 in order to boost profitability. The Supervisory Board has also intensively considered the earnings situation as well as the measures implemented by the Executive Board. The meetings of the Supervisory Board also focussed on the acquisition of production licenses in the Norwegian Sea, VNG Norge AS' participation in various exploration activities in the Norwegian Sea as well as the participation in the field development of the oil and natural gas discovery of Pil in the PL 586. The Supervisory Board also addressed the gas trading activities of VNG, in particular the management of gas trading contracts, as well as developments in the business area Gas Storage. Furthermore, the company's other investments involvement, including restructurings under company law, were also extensively discussed. The Supervisory Board approved the sale of shareholdings of one company and the acquisition of shares in two companies.

On the basis of these discussions and also the reports and information provided by the Executive Board, the Supervisory Board has satisfied itself as to the propriety of senior management.

KPMG AG Wirtschaftsprüfungsgesellschaft, Leipzig has audited the annual financial statements and the consolidated financial statements prepared by the Executive Board for the period ending December 31, 2016 as well as the combined management report and Group management report for the 2016 financial year including the accounting records as well as compliance with the accounting regulations pursuant to Section 6b (3) of the EnWG, and has issued an unqualified auditor's report. An audit in accordance with Section 53 of the Haushaltsgrundsätzegesetz (HGrG) [German Budgetary Principles Act] has also been carried out for VNG – Verbundnetz Gas Aktiengesellschaft. The audit reports were distributed to all members of the Supervisory Board. The Supervisory Board has noted and approved the results of these audits.

The Supervisory Board has examined and analysed the annual financial statements and consolidated financial statements along with the combined management report and Group management report as well as the report regarding the audit pursuant to Section 53 of the HGrG. This examination did not lead to the identification of any objections. The auditor attended the meeting of the Supervisory Board at which the financial statements were discussed and reported to the Supervisory Board on the most significant results of its audit. The Supervisory Board approved the annual financial statements and consolidated financial statements prepared by the Executive Board for the period ending December 31, 2016. The annual financial statements have thus been approved.

The Supervisory Board concurs with the recommendation of the Executive Board with respect to the use of the balance sheet profit.

Mr Dennis Rohde laid down his mandate as Supervisory Board member at the end of April 15, 2016. Furthermore, Messrs. Günther Boekhoff, Matthias Brückmann, Holger Hanson, Dr Torsten Köhne, Alexander Freiherr von Ledebur, Detlef Nonnen, Kristof Ogonovski, Josef Rahmen, Thiemo Röhler and Björn Thümler laid down their mandates as Supervisory Board members at the end of May 30, 2016.

Pursuant to the resolution of the shareholders' meeting on May 30, 2016, Ms Gunda Röstel as well as Messrs. Markus Baumgärtner, Oliver Brünnich, Dr Martin Fleckenstein, Hans-Peter Floren, Hans-Joachim Herrmann, Dr Martin Konermann, Dr Norbert Menke, Michael Raida, Dr Jörg Reichert and Dr Bernd-Michael Zinow were appointed as members of the Supervisory Board.

At the meeting of the Supervisory Board on June 16, 2016, Dr Norbert Menke was elected as the first Vice Chairman of the Supervisory Board.

Mr Ulf Heitmüller laid down his office as Chairman of the Supervisory Board as of the end of August 31, 2016 and also stepped down from the Supervisory Board.

Pursuant to the resolution of the shareholders' meeting on September 5, 2016, Mr Thomas Kusterer was appointed as a member of the Supervisory Board.

At the extraordinary meeting of the Supervisory Board on September 5, 2016 Mr Thomas Kusterer was appointed as Chairman of the Supervisory Board. In the same meeting, the Supervisory Board appointed Mr Ulf Heitmüller as Chairman of the Executive Board of VNG – Verbundnetz Gas Aktiengesellschaft with effect from October 1, 2016. The previous Chairman of the Executive Board, Dr Karsten Heuchert, laid down his office as Chairman of the Executive Board as of the end of September 30, 2016, and also stepped down from the Executive Board.

On October 9, 2016, Dr Karsten Heuchert passed away. The Supervisory Board commemorates his great dedication as well as his accomplishments for the common good. It will hold its memories of Dr Karsten Heuchert in the highest esteem.

The Supervisory Board expresses its appreciation to the members of the Supervisory Board who have stepped down for their cooperation in an atmosphere of mutual trust as well as their tremendous commitment.

The Supervisory Board acknowledges and thanks the Executive Board as well as all employees for the work done in financial year 2016.

The Supervisory Board

Leipzig, March 10, 2017

Thomas Kusterer
Chairman

MANAGEMENT REPORT AND GROUP MANAGEMENT REPORT FOR FINANCIAL YEAR 2016

28–47

MANAGEMENT REPORT AND GROUP MANAGEMENT REPORT FOR FINANCIAL YEAR 2016

A. IMPORTANT STEPS IN THE REALIGNMENT

Financial year 2016 was very demanding for the VNG Group as well as the employees. Due to changes in the economic and political environment, the Group carried out a reorganisation process on the basis of its own initiative. This was unavoidable. A program initiated in the prior year to increase profitability began to lead to the desired results in 2016. Despite the negative impact of non-recurring items, the EBIT[1)] of € 84 million (in the prior year negative EBIT of € 54 million) represented a substantial improvement in results as well as in terms of the outlook for positive business development for the VNG Group. Giving consideration to taxes and interest, the consolidated net income amounted to € 40 million (in the prior year consolidated net loss of € 53 million).

In a stable regulatory environment, the business area Transport again made a substantial positive contribution to Group results. In wholesale, in a fiercely competitive market environment, opportunities attributable to portfolio management were utilised to generate noticeable improvements in results. The end-user business is proving to be an important and promising earnings pillar. On the other hand, despite measures to improve results, the business area Storage adversely impacted the results of operations due to substantial charges for risk provisions. While a reduction of exploration activities in the business area Exploration & Production (E&P) also contributed to the improvement in Group results in 2016, this may have long-term implications on the economic success of this business area. As was the case in the prior year, due to the uncertainty with respect to future development, substantial valuation adjustments to the shareholding in VNG Norge AS were required in the financial statements of VNG AG. As such, VNG AG's negative EBIT of € 36 million was substantially lower than that of the Group even though it was better than that of the prior year (negative EBIT of € 98 million).

1) Including tax refund for exploration costs of VNG Norge AS

In 2016 the VNG Group took important steps to establish a good starting position for the Group's realignment. The program to improve profitability will be continued in the future with a high degree of intensity, so as to develop new business opportunities in the short- to mid-term and to realise efficiency potential. The new agility developed by both the employees and the organisation supports this process. Currently, the Group's strategy with a view to 2030 and beyond is being fundamentally revised. In all of its thought processes and strategic decision making, the VNG Group remains firmly convinced that natural gas will continue to be required in the future for the safe, economic and environmentally friendly provision of energy. In the Climate Plan 2050, policy makers have also acknowledged the potential of natural gas as a source of energy.

B. THE VNG GROUP—AN OVERVIEW

1. Current business model

The VNG Group participates in the entire value chain of the German and European gas sector thereby allowing it to develop differing growth potential in a dynamic market environment. The core business is currently structured in the business areas E&P, Transport, Storage and Trade. The Group's scope of consolidation includes 24 Group companies in eight countries. The parent company, VNG AG, is primarily responsible for corporate and service functions as well as gas trade.

Business area E&P: In the search for and production of oil and natural gas, the VNG Group is currently focussing on the Norwegian continental shelf and the Danish North Sea. At the end of 2016, VNG Norge AS (VNG Norge) held shares in 35 licenses in Norway and, via VNG Danmark ApS, two licenses in Denmark. The Norwegian subsidiary is operating manager of the two own discoveries, Pil & Bue, which are currently being developed and have promising resource potential. In addition, VNG Norge is participating in the producing fields Draugen, Njord, Hyme, Brage and Ivar Aasen. The establishment of a self-sufficient business necessitates the sustainable strengthening of the asset portfolio via participation in licensing rounds, the successful progression of projects from the exploration stage through to development and production as well as investments in deposits already developed. As a result of the current economic environment, VNG Norge is, however, currently focussing on existing production and development projects and has deferred the development of additional resources.

Business area Transport: ONTRAS Gas Transport GmbH (ONTRAS) has a decisive influence on the activities in VNG Group's business area Transport. As an independent transmission system operator, ONTRAS provides for the reliable transportation of gas through Germany's second-largest pipeline network encompassing more than 7,000 kilometres of pipeline and approx. 450 network interconnection points. The economic success of the transport business is, primarily, impacted by the regulatory framework conditions. On the basis of network-related services as well as the development of innovative solutions in conjunction with renewable energies, valued added beyond the regulated business is generated.

Business area Storage: As the third-largest storage operator in Germany, VNG Gasspeicher GmbH (VGS) builds, operates and sells underground storage with a current total capacity of 2.5 billion m³ at its locations in central and northern Germany. VGS hereby focuses on its efficient as well as economically viable core storage facilities as a result of which its Buchholz facility is being decommissioned. As a reflection of demand, storage products are being further developed, costs are being optimised and all opportunities are being utilised to, for example, utilise the infrastructure as storage for renewable energy.

Business area Trade: The VNG Group is active in all relevant markets and stages of the value chain within Europe. The business area Trade is broken down into the segments wholesale and end-user, each differentiated based on activities in Germany and abroad. The wholesale business—in particular via VNG AG—comprises the classic sales business with redistributors, municipal utility companies, industrial and power plant customers as well as the management of the portfolio of procurement and sales contracts along with transport and storage capacities. ENERGIEUNION GmbH provides access to the German electricity wholesale market and benefits from established portfolio management services with respect to energy trade. Further contributions to results in wholesale are provided by Group companies in Italy, Austria, Poland, the Czech Republic and the Slovak Republic. In addition to wholesale, an earnings pillar which is growing in importance to the VNG Group is the end-user business—in particular via goldgas GmbH (goldgas) and the newly acquired GAZPROM Marketing & Trading Retail Germania GmbH (now goldpower GmbH; goldpower). With additional companies in Austria and Poland, the VNG Group has a foreign and domestic end-user portfolio. In addition, minority shareholdings, in particular with respect to the end-user area, provide contributions to trading results.

2. Strategic orientation and goals

Intensive and fundamental strategic review: the economic environment and energy policy objectives make a fundamental review of the strategic positioning of the VNG Group imperative. The VNG Group has intensified this process with the goal of developing a Group-wide strategy which will serve as the roadmap through 2030 and beyond. In view of investment cycles it is imperative that, already today, concrete answers are provided as to the business focus for the upcoming decades. In the political environment, guidelines are also being established which will have a major impact on the future use of natural gas and thereby on the business model. Within the scope of the strategic process, the strategies of the business areas are subject to review, success factors are investigated and strategic options as well as new business opportunities for the future structure of the VNG Group are being developed. The following premises form part of the strategic considerations:

- Natural gas will also be required to provide safe, economic and environmentally friendly energy in the upcoming decades. The discussion with respect to the climate protection plan has, however, shown that the development of a long-term decarbonised energy world will also be accompanied by the reduction in the use of natural gas. The VNG Group will actively position itself with respect to this development and will define its future role.

- Despite the difficult environment, the VNG Group with its four core business areas E&P, Transport, Storage and Trade, has a good starting point, to achieve reasonable earnings in the future on the basis of strategic decisions. Along with the assets, the potential of the VNG Group includes the extensive experience, the know-how and the newly acquired agility of the employees and the organisation. Therefore the guiding principle of the VNG Group is: "Natural gas can do more. We can too."

- The new strategic direction of the VNG Group must correspond with the financial strategy. A solid business model is a key base for the business activities of the VNG Group, in particular for access to the capital markets and trading partners and thereby for a higher level of flexibility in terms of decision-making. Activities to date are thereby up for discussion should they not achieve the required profitability and contribute to sustainably improved results.

- In 2016, EnBW Energie Baden-Württemberg AG (EnBW) acquired the majority of VNG AG. Overall, the VNG Group will benefit from its new strong principal shareholder, which, from the beginning, demonstrated confidence in the business model and the location in Leipzig. The VNG Group is to develop as a centre of competence with respect to gas within the EnBW Group and is, as such, for the most part independently developing the current new strategic orientation. Nonetheless, both companies are very intensively assessing in which areas they can better cooperate in the future for the benefit of both sides.

Program to increase profitability: The permanent fundamental changes in the environment are also addressed by the resolute implementation of the program already initiated in the prior year to increase profitability. The program has developed to become an important management tool for the VNG Group and, over the short- to mid-term, aims to develop new business opportunities, to reduce personnel costs as well as non-personnel costs and to establish efficient personnel and organisational structures. The first important measures were already implemented in the prior financial year. All further measures in the program are being pursued with a high degree of intensity and their implementation is continuously being monitored. On this basis, undesirable developments can be addressed early.

Financial performance indicators and goals: The financial strategy of the VNG Group is geared to sustainable business practices, provides transparent financial guiding principles and reassesses the viability of the strategic direction. In retrospect, this made it possible in the past to act based on sound judgement which, despite all of the challenges, has provided the VNG Group with a very solid financial starting base. For example, a comparatively low level of long-term financial debt provides room to temporarily exceed individual goals set. The financial strategy is based on the following core goals: appropriate dividends for the shareholders; avoiding risks which pose a threat to the company; generating positive cash flows; an appropriate rate of return; and safeguarding solid creditworthiness. Against this background, the VNG Group and its business areas are primarily managed on the basis of key performance indicators with respect to results such as EBIT including tax refund and consolidated results as well as the cash flow measure FFO[2]. In addition, the long-term net debt and equity ratio are relevant.

Non-financial performance indicators and goals: In addition to adhering to safety, environmental and quality standards, the satisfaction and confidence of the employees, the customers and all other business partners are important foundations for economic success. For this reason they are given high priority in the further development of the core business areas and are regularly assessed using instruments such as employee and customer surveys. The guiding

[2] Funds from operations, i.e. consolidated results adjusted for non-cash expenses/income as well as gains/losses from the disposal of fixed assets.

principle of the VNG Group encompasses the common values partnership, openness, entrepreneurship and responsibility. This is intended to provide for confidence and stability while also serving as a measure against which the Group is measured.

For the VNG Group social responsibility means much more than successfully asserting itself in competition and providing viable jobs for the future. As a regionally based Group, selected projects and initiatives are supported to strengthen the common good. For more than 15 years the Verbundnetz der Wärme (Network of Warmth Initiative) has pursued the goal of generating public awareness for volunteers in all social fields of action, acknowledging their achievements and encouraging their emulation. In addition, in 2016, the VNG Foundation again supported numerous projects and initiatives in the areas of science and education, arts and culture as well as charitable commitment.

3. VNG Group companies

The business areas manage the respective Group companies. The investment portfolio is aligned with VNG Group's strategic direction and is continuously optimised. As such, in 2016, as part of its growth strategy in the area of electricity, goldgas acquired the end-user business which is now known as goldpower. VNG AG merged its subsidiaries HANDEN Sp. Z o.o. (HANDEN) and VNG Polska Sp. z o.o. The merged companies operate under the name HANDEN. HANDEN is responsible for VNG Group‘s energy trading business in Poland and serves as the toehold into neighbouring markets. As a first step in the growth strategy with respect to the end-user segment in Italy, VNG Italia S.r.l. acquired 20 per cent of the shares of CANARBINO S.p.A. (CANARBINO) in exchange for 20 per cent of its shares in SPIGAS S.r.l. and a cash contribution. The entirety of the shares of ECG Erdgas-Consult GmbH (ECG; now EXXETA GmbH) were sold. Additional information with respect to the investment portfolio is included in the notes to the financial statements of VNG AG and the VNG Group.

The fully consolidated companies of the VNG Group

EXPLORATION & PRODUCTION
VNG Norge AS, Stavanger, Norway
VNG Danmark ApS, Copenhagen, Denmark

TRANSPORT
ONTRAS Gastransport GmbH, Leipzig
GDMcom Gesellschaft für Dokumentation und Telekommunikation mbH, Leipzig
GEOMAGIC GmbH, Leipzig
INFRACON Infrastruktur Service GmbH & Co. KG, Leipzig
OSG ONTRAS Servicegesellschaft mbH, Leipzig

STORAGE
VNG Gasspeicher GmbH, Leipzig

TRADE
VNG – Verbundnetz Gas Aktiengesellschaft, Leipzig
ENERGIEUNION GmbH, Schwerin
G.EN. Gaz Energia Sp. z o.o., Tarnowo Podgórne, Republic of Poland
goldgas GmbH, Eschborn
goldgas GmbH, Vienna, Austria
goldpower GmbH, Walluf
HANDEN Sp. z o.o., Warsaw, Republic of Poland
SPIGAS S.r.l., La Spezia, Italy
VNG Austria GmbH, Gleisdorf, Austria
VNG Energie Czech s.r.o., Prague, Czech Republic
VNG-Erdgascommerz GmbH, Leipzig
VNG Italia S.r.l., Bologna, Italy
VNG Slovakia, spol. s r.o., Bratislava, Slovak Republic

GROUP CENTRE
BALANCE VNG Bioenergie GmbH, Leipzig
Leipziger Biogasgesellschaft mbH, Leipzig
MBG Mitteldeutsche Biogasgesellschaft mbH, Leipzig

4. Personnel and organisational development

Headcount development: As at December 31, 2016, the VNG Group had a total of 1,289 employees in the parent company and in the fully consolidated subsidiaries (in the prior year: 1,441 employees). As such, the Group continues to be an important employer in the region and beyond. A number of, in part, offsetting effects have contributed to the development in terms of headcount.

Adjustments to personnel and organisational structure: Adjustments were made to the personnel and organisational structures to maintain the competitiveness of the VNG Group. In the prior financial year, on the basis of constructive cooperation between management, the employees and the employee representatives, important steps were already implemented. The organisational changes include a leaner organisation with clear responsibilities in all areas, a clear separation of operating, managing and service providing units as well as a structural reorganisation of the business areas Trade and Storage. As a result of the restructuring, headcount will decline noticeably, by approx. 30 per cent, in 2016 and subsequent years in the business areas Trade, Storage and in corporate functions. This will be achieved in a socially responsible manner without compulsory redundancies. The primary factors which led to the decline in employees in the Group were the reduction in headcount at the parent company from 394 in the prior year to 335 employees now along with the sale of the shares in ECG. Simultaneously, the Group invested in stable and growing business areas, as a result of which headcount increased, due in particular to increases in the business area Transport as well as the acquisition of the current goldpower.

The restructuring, which encompassed virtually the entire Group, makes it essential that all employees are extremely flexible and willing to takeover new or different tasks. In this adjustment process, a core task will continue to be developing well trained and highly motivated employees for the Group and, in conjunction with them, to shape the future of the VNG Group. In this manner the knowledge, creativity and ideas will be utilised to intensively drive forward the large-scale strategy process within the VNG Group.

Work environment: In addition to promoting personal and professional skills, providing flexible work hours and allowing for mobile working, the VNG Group also supports its employees in health related issues as well as in providing for compatibility of work and family life. In 2016, VNG AG, ONTRAS and VGS were again awarded the certificate of the Hertie Foundation recognising them as family-friendly businesses.

Corporate governance statement: The ”Corporate Governance Statement“ pursuant to Section 289a of the HGB is disclosed on the website of VNG AG.

5. Research, development and innovation

VNG Group’s research and development—from Gas Transport and Gas Storage to applications in the generation of electricity and heat—strives to fully exploit the potential of natural gas thereby making this source of energy even more attractive.

Activities in the infrastructure areas: In 2016 ONTRAS and VGS again carried out research and development work to modernise their technical equipment and to develop new innovative, efficient and environmentally friendly technologies. For example, VGS has continued its long-term scientific and technological cooperation with the GAZPROM Group to optimise the mode of operations of the surface facilities at the Bernburg location.

ONTRAS and VGS also analyse the technical and economic feasibility of possibilities to utilise the transport and storage infrastructure for renewable energy. From the perspective of the VNG Group, power-to-gas is an important option for the future with respect to sustainable energy supply. As such, the Group is active at the national and European level. Within the scope of the HYPOS research project, ONTRAS and VGS along with other partners are assessing the suitability of the infrastructure for the transportation and storage of hydrogen. In its efforts to increase energy efficiency, ONTRAS developed a mobile biogas compressor for which it was honoured for efficiency with a prize from the German Gas Sector for Innovation and Climate Protection 2016 [Deutsche Gaswirtschaft für Innovation &

Klimaschutz] by the working group for the economical and environmentally friendly use of energy.

Innovative activities: Convincing new business ideas in the energy sector are also supported by VNG Innovation GmbH as a strategic partner for start-up companies. The focus of investing activities lies in the areas of energy efficiency, energy storage, energy conversion, digitalisation, mobility and sustainability. As such, in 2016, VNG Innovation GmbH participated in akvola Technologies GmbH, whose efficient water treatment systems can also be utilised for the production of oil and gas. With its investment in Eigenheim Manager GmbH, the VNG Group is supporting the expansion of the end-user business and is expanding its know-how in the digital area.

Activities in the E&P business area: VNG Norge carries out the research and development work with respect to hydrocarbon deposits which is typical for the E&P business. By nature, the focus of the research work is on the continuous identification, development and production of such deposits.

Activities in the German-Russian Commodities Forum [Deutsch-Russisches Rohstoff-Forum]: At the 9th German-Russian Commodities Conference in Dusseldorf, VNG AG and other representatives from industry, science and politics discussed current challenges in the sector, safety and environmental issues as well as possibilities with respect to cooperation at the university level in the areas energy and raw materials.

C. ECONOMIC REPORT

1. Market environment

Overall economic development: The economic development in Germany was comparable to that of the prior year. The gross domestic product in Germany increased by 1.9 per cent. The economic institutes expect the gross domestic product to grow by 1.4 per cent in Germany in 2017 and growth at a similar level in the Eurozone.

Development of the energy sector: Despite increased energy efficiency, the use of natural gas in the generation of heat and electricity again increased substantially, by more than 10 per cent, in comparison with the prior year, thereby noticeably exceeding the increase of approx. 1.6 per cent in primary energy consumption in Germany. The growth in renewable energy of close to 3 per cent slowed; the use of coal and nuclear energy is declining. Along with the comparatively cool weather conditions during the heating season, the positive image of natural gas led to continuous growth in demand. Natural gas is, by far, the most important energy source in the heating market. Almost half of all residences in Germany are heated with natural gas. Approx. 150,000 residences with natural gas applications were added in 2016. As per a current survey conducted by the Bundesverband der Energie- und Wasserwirtschaft e.V. [(German) Association of Energy and Water Industries] 90 per cent of all heating customers would again decide in favour of natural gas respectively natural gas/solar.

Price development: The VNG Group is subject to a wide range of market-related factors such as the development of raw material prices, exchange rates and the level of interest rates. These factors can have an impact on the development of business as well as on the valuation of significant assets. After the **price of oil** reached its lowest point at the end of January 2016 (Brent: USD 27.26/barrel), there was a reversal in course. On the basis of expectations as to the decline in the excess supply by the end of 2016, the price of oil increased gradually but continuously in the first half of 2016. The development was initially supported by the continuous decline in the production of shale oil in the USA and discussions with respect to the "freeze" in the production of oil between OPEC countries and non-OPEC countries. Short-term and unexpected production downtimes (Canada) supported the price increase. After the reduction of the oversupply began to slow in the summer of 2016, renewed discussions as to the "freezing" of oil production supported the oil market. Subsequent to the OPEC countries and non-OPEC countries agreeing to limit production in the first half of 2017, from the beginning of December the price of oil remained at a level in excess of USD 50/barrel. Despite the continuous increase in the price of oil, the average price for Brent of USD 45.10/barrel was below the 2015 average of USD 53.60/barrel.

In terms of European gas trading, the mild winter and the high gas flows from Norway and Russia initially led to further substantial declines in the **price of natural gas** in the spot and futures markets. The increase in the price of oil, lower LNG supply, a renewed reduction in production quantities for the Dutch Groningen field as well as a number of planned and unplanned maintenance activities in Norwegian gas fields contributed to the fact that the declining trend in natural gas prices came to a stop at the end of April 2016. In the subsequent months the gas prices were fairly stable prior to the start of a sustainable increase from the middle of September attributable to storage restrictions in Great Britain (Rough storage), missing LNG deliveries and cool weather. On the Dutch trading point TTF, the leading market in continental Europe, the day-ahead prices in 2016 were € 14/MWh on average, and were thus substantially lower than the corresponding prior year amount of € 19.80/MWh.

The seasonal differences in gas prices, which are important for the management and valuation of the storage capacities, stabilised at a low level. Time and again temporary market developments contributed to the fact that the **summer-winter-spread** (SWS) showed slight upwards tendencies. In the first quarter of 2016, the high storage levels and thereby the corresponding low demand for gas deliveries in the summer drove the SWS to almost € 2.00/MWh. The storage restriction in Great Britain and the market uncertainty as to the level of the LNG deliveries in the winter of 2016/2017, contributed to the fact that, subsequent to the temporary decline of the SWS to € 1.20/MWh in the early fall of 2016, it again increased to in excess of € 1.70/MWh. The high storage withdrawals in the fourth quarter of 2016, in turn, again put pressure on the SWS. Overall, for 2016, the average SWS amounted to € 1.45/MWh (in the prior year: € 1.50/MWh).

The **level of interest** remained very low. In particular, in the second half of 2016, the value of the **euro** weakened against the **Norwegian Krone** (NOK) as well as against the **US Dollar** (USD). While the NOK as the currency for oil benefited substantially from the fixed oil price, the strength of the USD in comparison with the euro reflected the different monetary policy decisions of the Fed and ECB. On average, the 2016 USD/€ exchange rate was virtually unchanged at USD 1.107/€, as compared with the USD 1.110/€ in 2015. The NOK/€ exchange rate was quoted at an average of NOK 9.291/€ in 2016 as compared with NOK 8.950/€ in 2015.

2. Energy policy

With the signing of the Paris Agreement on Climate Change in December 2015, decarbonisation and energy efficiency emphatically moved onto the political agenda in the financial year just ended. In Germany, the structure of the now resolved upon 2050 Climate Protection Act became a major focus of the debate on energy policy. The Federal government thereby acknowledges the role and the potential of natural gas with respect to the realisation of substantial reductions in carbon dioxide emissions over the short- and mid-term. Nonetheless, over the long-term, it is to be expected that future climate policy instruments and measures will also seek to substantially reduce the use of fossil fuel in all sectors. On this basis policies will directly impact the economic environment of the VNG Group thereby intensifying the already existent market developments. As such, the VNG Group is actively participating in the energy policy debate to achieve a long-term position for natural gas as a source of energy in the future and to position itself as a partner for renewable energy.

The climate protection plan places particular importance on power-to-gas. It is therefore probable that, in the upcoming years, policies will provide an environment in which private sector stakeholders can further develop these storage options. The VNG Group has the required assets and can thereby actively participate in this market over the middle and long-term.

As is already the case with respect to the national strategy framework for the extension of the infrastructure for alternative fuels, the climate protection plan also emphasises the special role of natural gas (CNG/LNG) in the reduction of emissions attributable to mobility. With respect hereto, the focus is primarily on supplying heavy commercial vehicles as well as ships thereby, on the one hand, reducing the environmentally harmful carbon dioxide emissions while, on the other hand, reducing the pollution attributable to nitrogen oxide and sulphur dioxide which are harmful to health.

3. Business development

a) Exploration & Production

Economic development: Towards year-end the price of oil made recovered to a level in excess of USD 50/ barrel. Nonetheless, the economic conditions in the E&P business remain challenging. At the beginning of the year the market environment had deteriorated further. In 2016, in response to the decline in prices, oil and gas producing companies increasingly limited investing activities and sought to save costs. VNG Norge also focussed on existing production and development projects, postponed the construction of additional resources and implemented a strict cost efficiency program. Equipment operators and service providers take account of these developments by virtue of substantial cost reductions so that, over the mid-term, lower exploration and development costs are to be expected. Furthermore, in terms of results, the price development will, in part, be compensated by the specifics of the Norwegian tax system.

In 2016 the cost savings contributed to the improvement in results. Nevertheless, the reduction in exploration activities can, over the long-term, have consequences with respect to the required sustainable reserves and resource base. As such, the further development of the E&P business is being reassessed within the scope of the ongoing strategy process. As a result of uncertainties with respect to the future development, substantial valuation adjustments again became necessary with respect to the value of the participation in VNG Norge in the stand-alone financial statements of VNG AG. In the financial statements of the VNG Group in which individual assets are recorded for which, in part, substantial losses were provided for in the past, no noteworthy write-downs were necessary.

Quantities produced and sales: In relation to its share, in 2016, VNG Norge extracted approximately 1.0 million BOE of oil (in the prior year: 1.4 million BOE) as well as approximately 128 million kWh of gas (in the prior year: 396 million kWh). The decline in comparison with the prior year was attributable to the cancelled quantities of the Njord and Hyme fields (structural alteration work at the Njord site) as well as declines in production at Draugen. In addition to the declines in quantities, price effects also led to lower sales in the E&P business area totalling € 39 million (in the prior year: € 69 million). The lower sales also led to lower costs attributable to production.

Development projects: The license consortium has resolved that, the oil and gas discoveries Pil & Bue will be extracted via the production platform Njord. On this basis the planning work for the investment and development of the Pil field can be carried out with VNG Norge serving as operational manager. Production is to begin in 2021. The two fields Snilehorn and Solsort are also in development. The Ivar-Aasen field in the Norwegian North See began producing crude oil and natural gas in December 2016. The development of the field in which VNG Norge holds a participation of 3 per cent developed in accordance with schedule. As such, during the summer, the platform modules and residential units could successfully be installed on the steel base. In addition, the offshore work with the final installations and the connection of the Ivar-Aasen field with the Edvard Grieg platform was completed.

Exploration activities: In 2016 the exploration activities were substantially reduced. With a share of 2.5 per cent VNG Norge participated in exploratory drilling in the prospect ”Njord-Nordflanke“, which led to discoveries of oil and gas. In contrast, a drilling in the prospect Lorry, in which VNG Norge holds a 20 per cent share, did not provide evidence of resources.

Maintenance and modernisation work: The Njord platform was taken out of production in June 2016 for planned maintenance and modernisation work. This is expected to increase the stability of the platform. Inspections revealed that the platform was in a good technical condition as a result of which no unscheduled repairs are to be expected.

b) Transport

Economic development: In an increasingly dynamic environment, ONTRAS was again able to make a substantial positive contribution to the results of VNG AG and to those of the VNG Group. The business development is determined by ONTRAS which is organised as a certified independent network operator. As a transmission system operator, ONTRAS has been subject to incentive regulation since 2010. As was the case for the first regulatory period, the (German) Federal Network Agency [Bundesnetzagentur] certified ONTRAS an efficiency of 100 per cent for the period from 2013 through 2017.

Development and expansion of the network: In August 2016, subsequent to a construction period of eleven months, two new parallel gas pipelines were completed in the Lausitz, each with a length of approximately 35 kilometres. They serve to sustainably provide for the supply of natural gas in the regions Freiberg, Dresden, Bautzen, Zittau and Görlitz as well as for bordering regions in Poland. Along with other German transmission system operators, ONTRAS is required to provide a joint network development plan for gas ("NEP“) in every even calendar year so as to provide for supply reliability as well as the needs based expansion of the gas infrastructure. As a result of a successful appeal by a network operator against the resolution of the Federal Network Agency with respect to the scenario framework for the NEP 2016, the NEP 2016 submitted on April 1, 2016 will only be available in its final form in mid-2017. It is not to be expected that there will be any investment obligations for ONTRAS.

c) Storage

Economic development: The differences between summer and winter prices for natural gas, as a significant indicator for the value of flexibility and thereby for storage capacity, stabilised at a low level during the financial year, even though temporary upward tendencies could successfully be utilised to improve earnings. As such, the storage fees attainable in the market remain subject to fierce competitive pressure. Despite the start of decommissioning of individual storage locations in Germany, a recovery of the gas price spread is not expected in the mid-term. In this strained market environment VGS is sticking to its goal of being the leader in terms of costs and innovations. VGS is currently implementing various measures to align the future cost structure to the development of the spread and thereby to the recoverable fees. Beginning in 2016 processes were adjusted, the organisational structure was streamlined and services were optimised. Over the mid-term this will lead to the reduction of personnel which is to be completed in a socially responsible manner. In addition, to further reduce costs, a storage zone involving the underground storage facilities in Bad Lauchstädt and Bernburg was established. Additional contributions to earnings are to be generated by virtue of the implementation of an own online marketing platform "easystore“, by permanently developing new storage products and by searching for viable business areas for the future.

Development of storage capacities: With its underground storage facilities in central and northern Germany, VGS currently has a working gas volume of approx. 2.5 billion m³. The underground storage facilities were fully utilised in the storage year. The investing activities are characterised by focussed and reduced investments in existing property, plant and equipment as well as by the completion of expansionary projects which were already contractually committed. VGS is thereby concentrating on its economic and efficient core assets. All options are being considered for the remaining assets without prejudging outcome. Currently, VGS is continuing the dismantling and decommissioning process in Buchholz as planned. Pursuant to the decommissioning concept, the dismantling of all surface and underground equipment is to be completed by 2022. Approval for the closure plan was applied for in the summer of 2016 at the State Office for Mining, Geology and Raw Materials [Landesamt für Bergbau, Geologie und Rohstoffe].

VGS seeks to identify consensual solutions in commercial negotiations with its project partners in storage facilities operated jointly with partners, so as to economically optimise the projects. To the extent that the negotiations did not lead to a result, VGS felt compelled to assert its claims by initiating arbitration proceedings, which are currently still ongoing. On the basis of current developments and insights with respect to one proceeding, VGS has established a loss provision in the 2016 financial statements.

In addition, VGS is also participating in the development and operation of the underground gas storage facility ”Katharina“ together with Gazprom export LLC via Erdgasspeicher Peissen GmbH (EPG). Initial caverns have already been transferred to ongoing operations. Development work is expected to continue until 2024.

d) Trade

Development in German wholesale: In comparison with the prior year, the results in the wholesale segment improved significantly. As such, the volatility in market prices could be utilised to generate additional contributions to results by virtue of the active portfolio management. Further potential with respect to results could be exploited in conjunction with the management of booked storage capacities. Nonetheless, the market environment remains challenging and commodity trade has low margins. In the 2016 financial statements appropriate provisions were recorded for future risks.

Organisational restructuring: To strengthen its own competitive position, the business area Trade was streamlined in 2016 and organisationally realigned. As such, among others, procurement, trading and portfolio management were merged within the new unit Asset-Management. The focus of the activities is thereby on the optimal management of all contracts and positions as well as storage and transport assets, hedging to protect sales margins and active trading with flexible products to generate additional contributions to results. New trading and sales products could, in the short-term, thereby be introduced in the market and settled in a controlled manner. In addition, the sales organisation was more efficiently organised to further expand the customer base and to react to the increasingly complex customer wishes with customised products and services.

Development of end-user business: In addition to the wholesale business, the end-user business is growing in importance as a pillar for the results of the VNG Group. goldgas along with the end-user business in the foreign trading companies account for this portion of the business area. In the financial year just ended, goldgas was able to retain its customer base in the gas sector while, on the basis of the acquisition of the end-user business which now operates within goldpower, also growing substantially in the electricity sector. As at the balance sheet date, goldgas and goldpower had almost 100,000 gas customers and in excess of 100,000 electricity customers. Further investment projects for inorganic growth (distribution companies for electricity and gas) were identified, analysed and acquisition negotiations were initiated. The underlying goal is to make use of economies of scale by bundling customer service and billing. As a result of the intensification of competition, along with actual energy distribution, products and services are growing in importance. Correspondingly, systematic product development and innovation management is being established. Along with the continuous optimisation of their processes, the companies are continuing the optimisation of their distribution channels. The positive results of the end-user business in Germany exceeded expectations.

Developments in wholesale and end-user business abroad: By virtue of the close cooperation with VNG AG’s Trade business area, the subsidiaries in Eastern Europe have access to the more liquid western European wholesale markets and can also offer modern sales products in markets which are not as competitive. Overall, in the financial year just ended, the foreign trading companies have solidified their market position and, for the most part, contributed positively to consolidated net income. In addition, HANDEN focussed on the development of the end-user business for gas and electricity as well as on prequalifying for possible supply to the Ukraine. The end-user business in Italy was further strengthened with the participation in CANARBINO.

Send-out and procurement: In 2016, the gas send-out of the VNG Group totalled 362 billion kWh (in the prior year: 372 billion kWh). Broken down by customer segments, the gas send-out was distributed as follows:

Sales by customer segment		2016	2015
Redistributors	billion kWh	111.9	102.6
Industry and power stations	billion kWh	43.7	42.2
Trading companies	billion kWh	200.7	222.3
End-users	billion kWh	5.4	5.3

Broken down on the basis of markets, sales developed as follows:

Sales by sales market		2016	2015
Germany	billion kWh	84.1	84.1
Foreign	billion kWh	35.3	33.7
Spot and futures markets	billion kWh	242.3	254.6

VNG Group's primary foreign sales regions continue to be in Italy, Luxembourg and Poland. In financial year 2016, VNG AG's gas send-out declined to 301 billion kWh (in the prior year: 323 billion kWh). The VNG Group sourced gas totalling 363 billion kWh (in the prior year: 370 billion kWh) broken down as follows:

Supply sources		2016	2015
Russia	billion kWh	56.0	57.0
Norway	billion kWh	23.5	42.8
Spot/ futures markets and other	billion kWh	283.1	269.9

The quantities sourced from Norway declined substantially as a long-term contract with one supplier was discontinued in the summer of 2016.

D. NET ASSETS, FINANCIAL POSITION AND RESULTS OF OPERATIONS

1. VNG Group's economic position

a) Overall assessment

In comparison with the prior year, the operating results and the outlook with respect to the positive future development of the business of the VNG Group as well as that of VNG AG improved substantially. This development was supported by measures included in the program to improve earnings which have already been implemented. The Group generated an EBIT of € 84 million (in the prior year negative EBIT of € 54 million). After giving consideration to taxes and interest, the consolidated net income totalled € 40 million (in the prior year loss of € 53 million). As was the case in the prior year, extraordinary negative effects impacted results, all the more underlining the operational achievements.

In particular, VNG Group's **key performance indicators** developed as follows:

		VNG Group	
		2016	2015
EBITDA including tax refund	€ million	204	163
EBIT including tax refund	€ million	84	−54
Consolidated results	€ million	40	−53
FFO	€ million	287	224
Cash flow from operating activities	€ million	205	376
Long-term net debt*	€ million	517	579
Equity ratio	%	26	24

*) Net financial liabilities plus long-term provisions less inventories which can be sold in the short-term

Of these key performance indicators, the earnings related indicators EBIT and consolidated net income as well as the free cash flow from operations (FFO) are the most important performance indicators for the VNG Group. In comparison with the prior year, they changed for the following reasons: the business area Gas Transport, in a stable regulatory environment, again made a noteworthy positive contribution to consolidated net income; the wholesale area, in a fiercely competitive market environment, utilised opportunities arising from portfolio management to substantially improve results. The end-user business is proving to be a pillar for results with growing importance. In contrast, despite measures to improve earnings, in the business area Storage, risk provisioning again negatively impacted the results of operations. A reduction in exploratory activity along with further optimisation efforts contributed to the improved results in the E&P business area.

Analogous to the development in terms of results, the FFO also improved. As it was not impacted by non-recurring items, the improvement was even more substantial thereby more clearly highlighting operating performance. The operating cash flows could be utilised for the further repayment of financial liabilities. Both the VNG Group and VNG AG have a sound net asset position with a solid equity ratio.

On the basis of the positive development of the results of operations, VNG Group's expectations with respect to 2016 were exceeded. In comparison with the budget for this financial year, the key performance indicator EBIT was exceeded by approximately 20 per cent while consolidated net income and FFO more than doubled.

b) Results of operations

On the one hand, VNG Group's income statement reflects the positive results of operations. On the other hand, non-recurring items attributable to impairment charges as well as the recording of provisions for onerous contracts continue to impact the business area Storage (in total € 57 million) and the consolidated results, as do onerous contracts in the business area Gas Trading (€ 19 million) as well as in corporate functions (€ 15 million).

The VNG Group's **sales** of € 7.2 billion were substantially lower than those of the prior year (€ 9.4 billion). They were primarily attributable to the sale of gas and electricity by the business area Trade. The decline in sales was primarily attributable to lower sales prices as a result of market developments. In comparison with sales, the **cost of materials** declined overproportionately as a result of which the gross profit improved. Furthermore, exploration costs declined. Lower production activity in the E&P business area also led to lower depreciation. In addition, lower total impairment charges were recorded in the business areas Storage and E&P. **Other operating income and expense** as well as **personnel costs** also declined. The **income from participating interests**, which is primarily impacted by the at-equity valuation of associated companies, is only slightly lower than in the prior year. In comparison with the prior year the **interest results** improved. This was due primarily to lower interest expense in conjunction with the unwinding of discounting of provisions. In comparison with the prior year the **tax income** declined as, analogous to the lower exploration activity, substantially lower income resulted from tax refunds. In addition, in total, income attributable to the change in deferred taxes was lower.

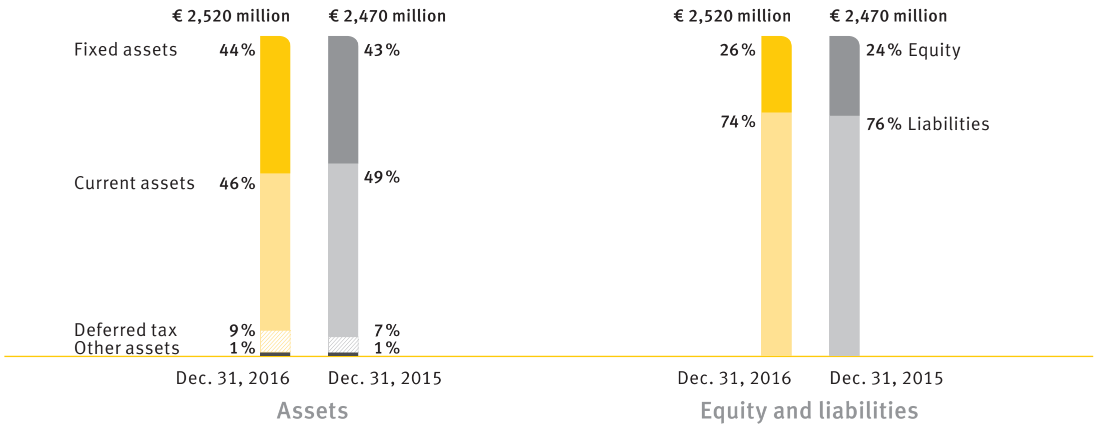
c) Financial position

		2016	2015
Cash and cash equivalents at the beginning of the period	**€ million**	**26**	**41**
Funds from operations (FFO)	*€ million*	*287*	*224*
Other changes (in particular working capital)	*€ million*	*–82*	*152*
Cash flow from operating activities	*€ million*	205	376
Cash flow from investing activities	*€ million*	–108	–155
Cash flow from financing activities	*€ million*	–71	–236
Cash and cash equivalents at the end of the period	**€ million**	**52**	**26**

Due to the development of the results of operations, VNG Group's **FFO** improved by € 63 million to € 287 million. The FFO of the VNG Group was also higher than that of VNG AG as the former includes all of the results of the fully consolidated subsidiaries which have a cash effect, which, in particular with respect to ONTRAS and VGS, exceed the income from participating interests included in the stand-alone financial statements. In contrast to the development of the FFO, the **cash flow from operating activities** of € 205 million was substantially lower than in the prior year (€ 376 million). This was attributable to the fact that, in 2016, far less working capital could be released as it was held in inventory and receivables. **Net cash out flows for investing activities** amounted to approximately € 108 million (in the prior year € 155 million). The cash outflows primarily relate to network and exploration assets as well as investments in the EPG, which were lower than in the prior year. Furthermore, additional shares of GasLINE Telekommunikationsnetzgesellschaft deutscher Gasversorgungsunternehmen mbH & Co. KG (GasLINE) were acquired. The cash flows from investing activities include cash effective dividends from companies in which participating interests are held (€ 22 million; in the prior year: € 29 million) and interest received (€ 3 million, in the prior year: € 3 million). Reflected in the **cash flow from financing activities** are VNG Group‘s repayments of financial liabilities to external financing partners totalling approximately € 62 million as well as interest payments made totalling approximately € 28 million (in the prior year: € 31 million). Lausitzer und Mitteldeutsche Bergbau-Verwaltungsgesellschaft mbH (LMBV) contributed € 19 million to the financing of a pipeline in the Lausitz. The companies in the VNG Group were, at all times, solvent. As at December 31, 2016, credit lines totalling € 1.2 billion were not utilised.

d) Net assets

The **balance sheet structure** of the VNG Group changed as follows in comparison with the prior year:



VNG Group’s **balance sheet total** increased by approximately € 50 million in comparison with the prior year balance sheet date respectively by 2 per cent to € 2,520 million. On the one hand, primarily in the infrastructure areas and in the E&P business area, capital expenditures exceeded depreciation. On the other hand, deferred tax assets attributable to tax loss carryforwards in Norway were to be considered. Offsetting this, despite higher storage quantities, lower market prices led to lower inventories and receivables.

Due to the positive results, VNG Group’s **equity ratio** increased by 2 percentage points to 26 per cent in comparison with the prior year.

2. Economic position of VNG AG

a) Results of operations

VNG AG’s results of operations were characterised by the operating results of the wholesale trading business and the personnel and non-personnel costs required for this as well as by the income and expenses attributable to corporate services and functions. Furthermore, many operating activities are carried out by the Group’s subsidiaries, in particular ONTRAS, VGS and VNG-Erdgascommerz GmbH (VNG-EC), as a result of which the profit and loss transfers with these Group companies along with expenses attributable to required adjustments to the values of participations determine VNG AG's results of operations. In contrast to the consolidated income statement, VNG AG's results from participating interests held only conveys limited insights as to the Group's business activities.

With a negative **EBIT** totalling € 36 million (in the prior year: negative € 98 million) VNG AG's results of operations improved. In particular, improvements in VNG AG's operating trading activities contributed to this development. Nonetheless, the EBIT achieved in 2016 was substantially lower than expected, as a significant impairment was recorded for the shares held in VNG Norge. At € 77 million, this was, however, lower than in the prior year (€ 99 million). As was the case in the prior year, the provisions recorded by VGS negatively impacted VNG AG's results from participating interests held due to the profit and loss transfer agreement also contributing to the deviation from budget. Due to the improvement in the interest results and higher tax expenses, a **net loss** of € 56 million (in the prior year net loss of € 102 million) was realised.

b) Financial position

		2016	2015
Cash and cash equivalents at the beginning of the period	**€ million**	**5**	**9**
Funds from operations (FFO)	*€ million*	*116*	*82*
Other changes (in particular working capital)	*€ million*	*−253*	*−62*
Cash flow from operating activities	€ million	−137	20
Cash flow from investing activities	€ million	160	354
Cash flow from financing activities	€ million	−17	−378
Cash and cash equivalents at the end of the period	**€ million**	**11**	**5**

Due to the development of the operating results, in particular with respect to wholesale activities, VNG AG's **FFO** improved by € 34 million to € 116 million. In contrast to the development with respect to FFO and in comparison with the prior year, the cash flow from **operating activities** led to substantially higher cash outflows. As such, the reduction in working capital was substantially lower in 2016 as this is held in inventories and receivables. As in the prior year, the cash flow from operating activities does not include any income from participating interests. These are reflected in FFO. These cash inflows from profit and loss transfers and dividends from subsidiaries and other participating interests are presented within the **cash flow from investing activities**. In comparison with the prior year, they declined by € 217 million to € 175 million. The distribution in 2015 was still impacted by an extraordinarily high cash effective prior year result at VNG-EC attributable to the sale of Erdgasversorgungsgesellschaft Thüringen-Sachsen mbh (EVG). As in the prior year, the **cash outflows for investing activities** (net of € 33 million; in the prior year: € 54 million) were attributable to equity contributions as well as additions to loans, in particular to VNG Norge, along with the acquisition of additional shares of GasLINE. The cash flows from investing activities include interest received of € 18 million (in the prior year: € 15 million). The total cash flows from investing activities amounted to € 160 million (in the prior year: € 354 million).

As was the case in the prior year, the **financing activities** included additional repayments of liabilities to external financing partners totalling € 127 million. In contrast, the cash pool liabilities increased by € 130 million. In 2015 there was a substantial decline in cash pool balances and a dividend was distributed to the shareholders for 2014 leading to substantially higher cash outflows.

c) Net assets

In comparison with the prior year the **balance sheet total** declined by € 91 million respectively 4 per cent to € 2,052 million. This was, on the one hand, attributable to the impairment charge against the shareholding in VNG Norge included in **fixed assets**. On the other hand, despite an increase in storage quantities, lower market prices led to a reduction of **inventories and receivables**. The balance sheet structure with respect to fixed assets and current assets was virtually unchanged.

In comparison with the prior year balance sheet date, the **equity ratio** declined by 2 percentage points to 31 per cent.

E. SIGNIFICANT EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

There were no events subsequent to the balance sheet date of significance with respect to the assessment of the net assets, results of operations and financial position of VNG AG respectively VNG Group.

F. OPPORTUNITIES AND RISKS REPORT

1. Group-wide risk management system

The VNG Group has a comprehensive risk management system, which includes all business areas and all Group companies, to continuously ensure that a well-balanced relationship is maintained between opportunities and risks. On the basis of company specific policies with respect to risk management as well as comprehensive and detailed reporting, the principles of Group risk management are implemented in the individual companies and business areas. In addition to the operational measurement and monitoring of risks, a comprehensive inventory is completed twice each year in which the opportunities and risks of all Group companies are systematically recorded in terms of a deviation from the corresponding budgeted results, assessed and are, aggregated at Group level. The assessment of the valuation of the portfolio of participating interests correspondingly flows into the overall risk assessment. In addition to the regular risk assessment reporting methods, there is also an ad-hoc reporting system on the basis of defined benchmarks which provides for the early identification of deviations from budget and thereby changes with respect to the opportunities/risks portfolio.

2. Operational opportunities and risks

With its core business areas involving the product natural gas, the VNG Group has established a diversified base. This positioning serves to diversify risks while simultaneously allowing for the utilisation of opportunities in a dynamic market environment. Timely reactions to current changes in the economic and legal environment affecting the core business are possible and the corresponding opportunity and risk potential is identified and assessed. On the basis of the expected results, the opportunity and risk profiles for 2017 virtually offset. The opportunities and risks associated with the operational trading business are primarily driven by market prices. The risks in the infrastructure areas are primarily limited to the risks associated with operating the technical equipment. These are, however, for the most part covered by insurance. In addition, in prior years, substantial scheduled depreciation and impairment charges were recorded against the carrying values of the assets in the infrastructure areas and in the E&P business area as a result of which the risks have declined substantially.

Other than the general business risks, there are currently no identifiable risks which could have a substantial and sustainable negative impact on the net assets, financial position and results of operations of VNG AG and VNG Group.

a) Opportunities and risks in the E&P business area

The VNG Group holds a balanced portfolio of licenses in the exploration phase and increasingly also in the development and production phases. During the course of 2016, a number of exploratory licenses were, however, returned to the Norwegian government. They will have to be replaced in the future. Among others, risks lie in exploratory drillings being dry. As the licenses are increasingly further developed, these risks tend to become less significant. The results of the business area are very dependent on the development of the market price of natural gas and oil. Giving consideration to the still low production quantities, the maximum deviations in 2017 in comparison with planned results would be in the lower two digit million range. Over the mid-term, it is expected that prices will stabilise and recover to up to USD 80/barrel in 2020. Nonetheless, the overriding goal with respect to both the management of the exploration portfolio as well as in the development of the discoveries to date, is to only pursue those projects which are economically viable in a market environment with low raw material prices. The underlying scenarios give consideration to the current developments with respect to exchange rates as well as raw material prices. Overall, with respect to the composition of its portfolio, the VNG Group is concentrating on prospects in which risks are manageable, is seeking holdings in licenses which are, in terms of financing required and implications for results, commensurate for the risks involved and is working with experienced partners within the framework of syndicates.

Environmental and accident related risks are avoided by securing insurance customary for the sector. In addition, cooperation with experienced operating managers and companies plays an important role in complying with the environmental, health and safety standards in Norway and Denmark which are stringent when compared internationally. VNG Norge also provides for compliance with these standards via internal regulations and regular training and development of the workforce.

b) Opportunities and risks in the Transport business area

The economic development of ONTRAS is heavily dependent on the regulatory framework and the resulting permissible revenue caps. It is expected that, in the third regulatory period from 2018 to 2022, ONTRAS will again be certified with an efficiency value of 100 per cent. By restrictively regulating the equity interest rates, beginning in 2018, the revenue caps will, however, decline. In ONTRAS' opinion, the determination did not give consideration to all legally relevant circumstances. As such, ONTRAS has appealed the determination. ONTRAS continues to take advantage of the opportunities provided by the regulated transport market and also utilises all opportunities to provide services in the unregulated energy infrastructure sector. In view of the energy policy challenges of a CO_2 neutral energy future, there is a long-term opportunity for the continued use of the German gas infrastructure in a step by step conversion from natural gas to renewable gases. By linking the sectors electricity, heating, mobility and industry, it may be possible to develop an economically sensible and cost effective solution utilising the gas infrastructure. All of these activities are bundled under "ONTRAS, going green". As such, ONTRAS is participating in the Green Gas Initiative, in which seven European network operators and suppliers have joined forces to further advance the CO_2 neutral gas supply by 2050.

ONTRAS continuously carries out all necessary refurbishing and modernisation measures on its technical equipment, so as to maximise reliability in the network thereby providing for the contractually stipulated supply of gas to the downstream networks and end users. The technical safety and availability of the transmission systems with the corresponding installations was also provided for at all times in financial year 2016. In 2017 the risks are, for the most part, also limited to operating the technical equipment. Other than this, there are only limited commercial risks as the current regulatory period includes 2017.

c) Opportunities and risks in the Storage business area

The intensity of competition has, among others, led to an increasing share of short-term storage bookings. The volatile and simultaneously declining market price developments lead to uncertainty with respect to the future sale of storage capacities and the revenues attainable from these capacities. With respect to 2017, these risks are, however, low as a substantial portion of the storage capacities have already been sold.

The VNG Group is addressing market developments with product innovations, demandoriented investment decisions, decommissioning storage facilities which are not efficient and economically viable, as well as measures to improve efficiency. In response to the demand situation, cost structures are being further optimised and the organisation is being structured in line with market requirements. In addition, there are opportunities to utilise the existing infrastructure as storage for renewable energy. In storage facilities operated together with partners, VGS seeks to achieve mutually acceptable solutions in negotiations with its project partners so as to economically optimise the projects.

As is the case in the business area Transport, in 2017 risks from the operation of the technical equipment account for the bulk of the risk profile. For the most part, these are, however, insured. Furthermore, the ongoing maintenance and monitoring of the underground gas storage on the basis of technical as well as internal regulations along with the regular assessment of the condition of all underground and surface equipment, provide for a high technological safety standard consistent with mining law. VGS' high quality standards are provided for on the basis of annual training plans designed to provide for the ongoing qualification of the workforce and service providers as well as regular internal and external audits.

d) Opportunities and risks in the Trading business area

Opportunities and risks in the trading business are primarily attributable to price volatility with respect to the raw material markets. Along with changes in the market price level, price differences between the European gas trading hubs and price spreads between seasonal forward products are important risk factors. In addition, temperature developments—in particular in the winter period—can have an impact on trading results. The positions in procurement and sales contracts across the companies are pooled in a complete portfolio, continuously monitored and managed. In addition to natural hedging effects within the portfolio, specific hedging strategies are used to limit negative developments with respect to results. These take account of the respective risk factors and may include derivative financial instruments. The activities in the business area Trade are carried out giving consideration to a concrete risk and loss limiting framework for operating activities prescribed by a risk strategy for the Group. On the basis of the budgeted results, the proportion of opportunities and risks in 2017 is virtually even. With respect to the specified risk factors, maximum deviations from budgeted earnings could be in the lower double digit level in terms of millions of euro.

VNG AG has a structurally diversified procurement portfolio closely aligned to the market. The existing contracts are managed by the company itself or are used to hedge the overall portfolio. On the sales side, the VNG Group continuously develops new products and additional distribution channels in both the traditional wholesale business as well as for the end-user segment. In addition, the VNG Group consistently and continuously utilises the market opportunities as well as those in the spot and futures markets to optimise the overall portfolio.

The significant credit risks result from natural gas supply and trading contracts with national and international business partners. Credit risks also result from financial instruments concluded to hedge exchange rate risks, raw material price risks as well as interest risk positions. Assessments as to the creditworthiness of business partners (customers and suppliers, trading partners as well as financial institutions) are made within the scope of established credit risk management on the basis of available information using processes customary in the market. They are also continuously monitored. Credit risks are managed using common safeguarding instruments (e.g., guarantees). In addition, the customer portfolio is covered by a credit risk insurance policy.

In addition to the existing trading regulatory requirements attributable to EMIR (European Market Infrastructure Regulation) and REMIT (Regulation on Energy Market Integrity and Transparency), which are adhered to within the Group, the VNG Group continuously monitors the development of additional requirements. In particular, satisfying the requirements of MAR (Market Abuse Regulation) and MiFiD II (Markets in Financial Instruments Directive) are currently the focus of attention and have already been implemented to the extent required.

The trading business and the continuous changes in the framework conditions place great demands on the stability, reliability and flexibility of the business processes. By continuously monitoring the processes and further developing the business IT systems, the VNG Group provides for a high level of process reliability and is continuously working on further improvements. In particular, the IT architecture is being further developed with the goal of supporting closed front-to-back processes, further automating the processes in the trading business and simultaneously completely incorporating quantitative model libraries to value complex trading portfolios.

In 2016, VNG AG‘s information security management system (ISMS) was again certified pursuant to internationally recognised standards. TÜV Nord certified that VNG AG satisfies a high level of IT safety standards. The ISMS establishes regulations and procedures within the company which permanently define the information security of critical IT and trading processes, continuously manages, monitors and improves these.

3. Group-wide compliance management system

The VNG Group has a Group-wide compliance management system (CMS). This system seeks to ensure that all employees conduct themselves in compliance with all legal requirements so as not to pose a risk to the confidence of customers, business partners, shareholders and the general public in the VNG Group. In addition to organisational precautions and regulations, there is also an extensive reporting system as well as goal-orientated training for employees. The effectiveness and appropriateness of the CMS was assessed by an auditing company and certified. Pursuant hereto, the regulations and measures of the CMS are deemed suitable, to provide reasonable assurance that risks with respect to significant violations of laws and internal regulations in the areas corruption prevention, cartel law and trade regulation within the VNG Group are identified in a timely manner as well as to prevent such violations of regulations.

4. Financial risk management

In comparison with the prior year, the financial risk structure of the VNG Group is virtually unchanged. The Group is, in particular, exposed to risks from changes in raw material prices, exchange rates and interest rates as well as credit risks. The company’s fundamentally conservative orientation is reflected in its systematic financial risk management. The functions trading, clearing and financial risk controlling are organisationally segregated.

The sole purpose of the standard derivative financial instruments used as part of financial risk management is to hedge existing risks in underlying transactions. Commodity futures are used to manage price risks arising from gas procurement and sales contracts. Statistical risk measures are utilised for the daily measurement and monitoring of these risks. Potential changes in the present value of the trading portfolio are limited. To the extent possible, all of the VNG Group’s foreign currency exposure is concentrated and completely hedged within VNG AG. Contracts with Group companies outside the Eurozone are, in principle, concluded in the local currency of these companies. Foreign currency future contracts and natural portfolio hedging are the primary hedging instruments. VNG AG has an active interest rate risk management in which all interest risks are regularly assessed. Derivative financial instruments are also used for management purposes. In addition, we refer to the supplementary explanations in the notes to the financial statements of VNG AG as well as those of the VNG Group with respect to the use of financial instruments and the establishment of valuation units. As a result of adequate liquidity reserves in the form of committed credit lines as well as by optimising the allocation of liquidity within the Group, solvency is provided for at all times. The core financing elements are a sound syndicated loan and promissory note loans with various financing partners. The multi-year rolling liquidity plan regularly determines the future peak financing requirements, which, as of the balance sheet date, even under risk scenarios, were covered by adequate financing sources.

G. OUTLOOK

Development of results: For 2017, VNG AG has budgeted a positive EBIT and positive overall results in the middle double digit million euro range and the VNG Group has budgeted a slight improvement in results in comparison with 2016. An improvement is to be expected as, on the one hand, financial year 2016 was negatively impacted by substantial non-recurring items in the financial statements of

VNG AG and the VNG Group. On the other hand, the positive outlook is based on the following assumptions: EBIT in the E&P business area will further improve as a result of additional efficiency measures, a reduction of exploration activities as well as the expected development of the price of oil. Stable results are also expected in the business area Transport in 2017. In the Storage business area measures to adjust the cost structure to the development of the spread and thereby to improve the results of operations will be consequentially continued. On the basis of the new organisational structure (efficient sales structure, excellence in portfolio management), the business area Trade has established the prerequisites so as to be able to quickly and effectively utilise the opportunities in the trading markets. In addition, further improvements in procurement as well as the rigorous optimisation of processes and costs will contribute to an improvement of results. The end-user business remains an important pillar with increasing contributions to results.

In all business areas the prospects for continued positive business developments are also supported by the intensive implementation of the program to increase profitability. Possible strategic decisions may, however, have a significant impact on the future net assets, results of operations and financial position.

Cash flow development: For 2017, VNG AG and the VNG Group budgeted substantially lower funds from operations than were achieved in 2016. As was the case in the past, the expected cash flow from operating activities may be subject to significant fluctuations due to the development of working capital in the trading business as of the balance sheet date. This continues to have a significant impact on the Group's net debt.

Investing activities: Due to the strained situation with respect to the development of results, the VNG Group has invoked a restrictive capital spending policy. The Group's investments are concentrated in the business areas E&P and Transport. In the E&P business area the financing required for this is reduced by the Norwegian tax system. In particular, those capital expenditures planned in the business area Transport from the year 2018 onwards increasingly comprise investments necessary to safeguard the transmission pipelines. The investing activities in the Storage business area focus on significant non-personnel investments in existing equipment as well as contractually committed expansionary plans. In the Trading business area further investments are to be made in growth driven acquisitions in both the domestic and foreign market.

CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 2016

Assets

	Notes	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
A. Fixed assets			
I. Intangible assets		85,775	74,835
II. Property, plant and equipment		725,640	720,316
III. Financial assets		314,096	279,396
		1,125,511	**1,074,547**
B. Current assets			
I. Inventories	1	245,628	255,853
II. Receivables and other assets	2	856,437	917,288
III. Cash and cash equivalents		51,761	25,503
		1,153,826	**1,198,644**
C. Special account relating to the recording of provisions pursuant to Section 17 (4) of the DMBilG		**2,219**	**2,219**
D. Prepaid expenses		**6,925**	**10,481**
E. Deferred tax assets	3	**231,254**	**184,503**
		2,519,735	**2,470,394**

Equity and liabilities

	Notes	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
A. Equity			
I. Subscribed capital	4	328,000	328,000
II. Retained earnings	5	283,882	316,042
III. Profit participation capital		0	772
IV. Equity difference from foreign currency translation	6	3,451	–1,648
V. Consolidated balance sheet profit/loss		20,000	–52,809
VI. Non-controlling interests		7,138	0
		642,471	**590,357**
B. Special items		**1,663**	**2,565**
C. Provisions	7	**602,717**	**490,135**
D. Liabilities	8	**1,180,980**	**1,330,414**
E. Deferred income		**7,727**	**6,377**
F. Deferred tax liabilities	9	**84,177**	**50,546**
		2,519,735	**2,470,394**

CONSOLIDATED INCOME STATEMENT FOR THE PERIOD FROM JANUARY 1 TO DECEMBER 31, 2016

	Notes	Jan. 1– Dec. 31, 2016 €'000	Jan. 1– Dec. 31, 2015 €'000
1. Sales	10	7,213,871	9,402,655
2. Changes in work in progress		–551	1,197
3. Other own work capitalised		8,018	4,031
4. Other operating income	11	71,509	110,167
		7,292,847	9,518,050
5. Cost of materials	12	6,856,434	9,137,389
6. Personnel expenses	13	112,442	122,886
7. Depreciation of property, plant and equipment and amortisation of intangible assets	14	119,504	216,692
8. Other operating expenses	15	151,685	161,770
9. Financial result	16	–22,828	–24,148
10. Earnings before taxes		**29,954**	**–144,835**
11. Income from taxes on income	17	11,984	93,661
12. After tax results		**41,938**	**–51,174**
13. Other taxes		1,717	1,635
14. Consolidated net income/net loss for the year		**40,221**	**–52,809**
15. Loss attributable to other shareholders		428	0
16. Loss carryforward		52,809	0
17. Withdrawal from retained earnings		32,160	0
18. Consolidated balance sheet profit/loss		**20,000**	**–52,809**

VNG – VERBUNDNETZ GAS AKTIENGESELLSCHAFT, LEIPZIG NOTES TO THE 2016 CONSOLIDATED FINANCIAL STATEMENTS

(Recorded in district court Leipzig, HRB 444)

I. GENERAL DISCLOSURES

The consolidated financial statements of VNG – Verbundnetz Gas Aktiengesellschaft, Leipzig (VNG), were prepared in accordance with the provisions of the German Commercial Code [Handelsgesetzbuch] (HGB) the German Stock Corporation Act [Aktiengesetz] (AktG), the Act on the Preparation of Deutschmark Financial Statements [D-Markbilanzgesetz] (DMBilG) and the German Accounting Standards [Deutscher Rechnungslegungs Standard] (DRS).

These consolidated financial statements for the period ending December 31, 2016 were prepared as socalled ”fast close“ financial statements. In particular, the limited time available for the preparation of the financial statements (fast close) led to the use of estimating procedures in December. All of the information available at the time when the financial statements were prepared served as the basis for these estimates.

For clearer and more effective presentation, individual items of the balance sheet and the income statement are grouped together; these items are separately explained in these notes to the financial statements. The disclosures to the balance sheet and income statement items required by law and the disclosures which may either be presented on the balance sheet itself or in the notes to the financial statements are also presented separately in the notes.

The total cost method, pursuant to Section 275 (2) of the HGB, was used for the preparation of the income statement.

Due to the revision of Section 277 (1) of the HGB within the scope of the Accounting Directive Implementation Act [Bilanzrichtlinie-Umsetzungsgesetzes] (BilRUG) which went into effect on July 23, 2015, the prior year figures of individual line items of the income statement are not comparable. The amounts which would have resulted in the prior year had Section 277 (1) of the HGB in the version of the BilRUG been applied, are disclosed in the explanations of the individual line items.

Information on the consolidated group

German companies included in the Group:

	Shareholding Direct holding %	Indirect holding %	Name and registered office of the company
1	100.00		BALANCE VNG Bioenergie GmbH, Leipzig
2	100.00		goldgas GmbH, Eschborn
3	100.00		ONTRAS Gastransport GmbH, Leipzig
4	100.00		VNG-Erdgascommerz GmbH, Leipzig
5	100.00		VNG Gasspeicher GmbH, Leipzig
6		100.00	ENERGIEUNION GmbH, Schwerin
7		100.00	GDMcom Gesellschaft für Dokumentation und Telekommunikation mbH, Leipzig
8		100.00	GEOMAGIC GmbH, Leipzig
9		100.00	goldpower GmbH, Walluf [1]
10		100.00	INFRACON Infrastruktur Service GmbH & Co. KG, Leipzig
11		100.00	Leipziger Biogasgesellschaft mbH, Leipzig
12		100.00	MBG Mitteldeutsche Biogasgesellschaft mbH, Leipzig
13		100.00	OSG ONTRAS Servicegesellschaft mbH, Leipzig

[1] formerly Gazprom Marketing & Trading Retail Germania GmbH, Walluf

Foreign companies included in the Group:

	Shareholding Direct holding %	Indirect holding %	Name and registered office of the company
14	100.00		HANDEN Sp. z o.o., Warschau (Republic of Poland)
15	100.00		VNG Austria GmbH, Gleisdorf (Austria)
16	100.00		VNG Energie Czech s.r.o., Prague (Czech Republic)
17	100.00		VNG Italia S.r.l., Bologna (Italy)
18	100.00		VNG Norge AS, Stavanger (Norway)
19	100.00		VNG Slovakia, spol. s r.o., Bratislava (Slovak Republic)
20		100.00	G.EN. Gaz Energia Sp. z o.o., Tarnowo Podgórne (Republic of Poland)
21		100.00	goldgas GmbH, Vienna (Austria)
22		100.00	VNG Danmark ApS, Copenhagen (Denmark)
23		80.00	SPIGAS S.r.l., La Spezia (Italy)

Associated companies valued at equity in the consolidated financial statements

German associated companies:

	Shareholding Direct holding %	Shareholding Indirect holding %	Name and registered office of the company
24	22.67		GasLINE Telekommunikationsnetzgesellschaft deutscher Gasversorgungsunternehmen mbH & Co. Kommanditgesellschaft, Straelen
25		50.00	Erdgasspeicher Peissen GmbH, Halle (Saale)
26		40.00	Untergrundspeicher- und Geotechnologie-Systeme Gesellschaft mit beschränkter Haftung, Mittenwalde
27		25.10	EMB Energie Mark Brandenburg GmbH, Potsdam
28		24.60	MITGAS Mitteldeutsche Gasversorgung GmbH, Halle (Saale)
29		23.38	Stadt- und Überlandwerke GmbH Luckau-Lübbenau, Luckau

Foreign associated companies:

	Shareholding Direct holding %	Shareholding Indirect holding %	Name and registered office of the company
30		49.00	Nitrianska teplárenská spoločnosť, a.s., Nitra (Slovak Republic)
31		20.00	CANARBINO S.p.A., Sarzana (Italy)

The balance sheets and income statements required to be disclosed pursuant to DRS 8 for significant associated companies were electronically submitted to the (German) Federal Gazette, and can be obtained via the company register (www.unternehmensregister.de).

Other companies pursuant to Section 313 (2) Number 4 of the HGB

	Shareholding Direct holding %	Shareholding Indirect holding %	Name and registered office of the company	Equity capital €	Net income or loss for the year €	
32	100.00		MGMTree GmbH, Leipzig	60,000	-	1) 10)
33	100.00		VNG Erste Beteiligungsgesellschaft mbH, Leipzig	34,995	0	2) 10)
34	100.00		VNG Innovation GmbH, Leipzig	124,327	−673	3) 10)
35	22.67		GasLINE Telekommunikationsnetz-Geschäftsführungsgesellschaft deutscher Gasversorgungsunternehmen mbH, Straelen	63,511	1,249	4) 11)
36	10.00		Deutsche Flüssigerdgas Terminal offene Handelsgesellschaft, Essen	0	−371,174	4) 5)
37	10.00		DFTG – Deutsche Flüssigerdgas Terminal Gesellschaft mbH, Essen	130,000	0	4) 6)
38		100.00	Bioenergie Grimma GmbH, Leipzig	25,000	-	10) 12)
39		100.00	EnergieFinanz GmbH, Schwerin	848,208	12,593	4) 10)

	Shareholding Direct holding %	Indirect holding %	Name and registered office of the company	Equity capital €	Net income or loss for the year €	
40		100.00	VNG-Erdgastankstellen GmbH, Leipzig	25,000	0	7) 10)
41		50.00	lictor GmbH, Leipzig	197,952	26,964	4) 11)
42		37.34	caplog-x GmbH, Leipzig	667,927	467,927	4) 11)
43		32.00	store-x Storage Capacity Exchange GmbH i.L., Leipzig	467,623	167,623	4) 11)
44		28.00	SPIGAS CLIENTI S.r.l., La Spezia (Italy)	164,810	47,109	8) 11)
45		16.67	GASPOOL Balancing Services GmbH, Berlin	3,850,855	1,247,041	4)
46		15.58	gasmotive Deutsche Erdgastankstellen GmbH & Co. KG i.L., Berlin	260,804	−10,258	4)
47		15.20	Biomethan Schöpstal Verwaltungs-GmbH, Schöpstal	78,092	6,628	4)
48		12.55	Stadtwerke Rostock Aktiengesellschaft, Rostock	110,328,880	0	4) 9)
49		7.01	Eigenheim Manager GmbH, Leipzig	-	-	
50		6.60	Biomethan Schöpstal GmbH & Co. KG, Schöpstal	2,908,263	3,009	4)
51		3.00	akvola Technologies GmbH, Berlin	−153,619	−200,129	4)
52		1.33	PRISMA European Capacity Platform GmbH, Leipzig	376,431	114,543	4)

1) Established in 2016. Subscribed capital and, to the extent they exist, retainded earnings
2) Formely VNG Vertreibs-GmbH Thüringen/Bayern, Erfurt. There is a profit and loss transfer agreement with VNG.
3) Disclosure for abridged financial year Dec. 31, 2015.
4) Disclosure pursuant to financial statements as at Dec. 31, 2015.
5) Annual results are distributed to the OHG shareholders on the basis of their holdings.
6) There is a profit and loss transfer agreement with Deutsche Flüssigerdgas Terminal offene Handelsgesellschaft.
7) There is a profit and loss transfer agreement with VNG-Erdgascommerz GmbH.
8) Disclosure pursuant to financial statements as at Sep. 30,2015.
9) There is a profit and loss transfer agreement with Rostocker Versorgungs- und Verkehrs-Holding GmbH.
10) Inclusion is omitted pursuant to Section 296 (2) of the HGB.
11) No at equity valuation pursuant to Section 311 (2) of the HGB.
12) Established in 2016. Equity as per establishment; capital increase of €5k as at Dec. 30, 2016 in exchange for limited partner's share in Bioenergie Grimma GmbH & Co. KG, Grimma (equity Dec. 31, 2015: 459,944 €; results 2015: 167,137 €)

II. INFORMATION WITH RESPECT TO CONSOLIDATION METHODS

Balance sheet date

The consolidated financial statements as well as the stand-alone financial statements of the companies included in the Group were prepared as at December 31, 2016.

Principles of consolidation

Fully consolidated companies

The stand-alone financial statements of the subsidiaries included in the consolidated financial statements of VNG are prepared in accordance with the statutory regulations and uniform accounting policies and procedures applicable at VNG. To provide for the application of uniform accounting principles, reconciliation statements (commercial balance sheet II) are prepared for the foreign subsidiaries included in the Group.

The equity of the subsidiaries is consolidated in accordance with the revaluation method specified in Section 301 of the HGB. There are no material differences between the carrying amount method pursuant to Section 301 (1) Sentence 2 No. 1 of the HGB (old version), which was applied until 2003, and the revaluation method. Pursuant to Section 309 (1) of the HGB, the goodwill arising from initial consolidation is amortised systematically over the expected useful life; up to and including the 2009 financial year, such goodwill was netted against retained earnings pursuant to Section 309 (1) Sentence 3 of the HGB (old version). If the differences were attributable to profits retained in previous years, they were added to the Group's retained earnings.

Receivables, liabilities as well as income and expenses between companies included in the consolidated financial statements were eliminated. Intercompany profits and losses are, in principle, eliminated.

Foreign currency translation within the Group is carried out pursuant to Section 308a of the HGB. The financial statements of foreign subsidiaries included in the consolidated financial statements are translated using the modified reference date rate method.

In financial year 2016, **HANDEN Sp. z o.o.**, Warsaw (Republic of Poland), was merged into **VNG Polska Sp. z o.o.**, Tarnowo Podgórne (Republic of Poland). On the day of the merger, VNG Polska Sp. z o.o. in HANDEN Sp. z o.o. was renamed. Subsequent to the merger, the company is based in Warsaw.

As a result of a trade of 20 per cent of its shares in **SPIGAS S.r.l.,** La Spezia (Italy) as well as a cash contribution of € 2.7 million into CANARBINO S.p.A., Sarzana (Italy), VNG Italia S.r.l., Bologna (Italy), received 20 per cent of the shares of CANARBINO S.p.A..

The acquisition of the shares of Gazprom Marketing & Trading Retail Germania GmbH, Walluf (now **goldpower GmbH**), which provides electricity to end-users, resulted in goodwill of € 360k. This goodwill is being amortised on the straight-line basis over a period of one year.

In addition, in financial year 2016, **MGMTree GmbH**, Leipzig, and BALANCE Verwaltungs-GmbH, Leipzig (now **Bioenergie Grimma GmbH**), were founded. Due to their minor importance to the net assets, financial position and results of operations of the Group, pursuant to Section 296 (2) of the HGB, neither company was included in the consolidated financial statements.

All of the shares held in **ECG Erdgas-Consult GmbH**, Leipzig, were sold. The profit arising upon deconsolidation amounted to € 2,866k.

Associated companies

The initial equity valuation of all companies is determined using the book value method pursuant to Section 312 (1) sentence 1 of the HGB. Any goodwill resulting from the initial valuation is amortised on a scheduled basis over its expected useful life. Pursuant to Section 312 (2) of the HGB in conjunction with Section 309 (1) of the HGB (old version), the goodwill which resulted prior to December 31, 2009 is amortised as scheduled over a useful life of 20 years.

The carrying amount of the goodwill was € 21,750k as at the balance sheet date. The negative consolidation differences of € 1,682k were recorded in the Group's retained earnings to the extent that they result from profits retained in prior years. Intercompany profits or losses were, in principle, only eliminated in the case of upstream transactions; DRS 8 was not applied in the case of downstream transactions. The valuation methods applied by the associated companies were not adjusted to those applicable at VNG.

Due to the new version of Section 312 (5) sentence 3 of the HGB within the scope of the Bil-RUG in conjunction with Section 306 of the HGB, deferred taxes were retrospectively recorded for temporary differences between the values of the assets and liabilities recorded on the commercial balance sheet and those recorded on the tax balance sheet attributable to the application of the equity method.

In financial year 2016, additional shares amounting to 0.67 per cent respectively 2.00 per cent were acquired in **GasLINE Telekommunikationsnetzgesellschaft deutscher Gasversorgungsunternehmen mbH & Co. Kommanditgesellschaft**, Straelen, thereby increasing the shareholding to 22.67 per cent.

Within the scope of the initial inclusion of the shares of **CANARBINO S.p.A.** as at May 18, 2016, goodwill totalling € 3,479k was identified. This is being amortised on the straight-line basis over one year.

In addition, with effect from December 19, 2016, all of the shares (50 per cent) held in **Heizkraftwerk Halle-Trotha GmbH**, Halle (Saale), were sold.

In conjunction with the deconsolidation of ECG Erdgas-Consult GmbH, Leipzig, all of the shares held in **Robotron | ECG solutions GmbH**, Dresden, (50 per cent) were disposed of on March 4, 2016.

III. ACCOUNTING AND VALUATION PRINCIPLES

Fixed assets

Natural gas/oil production licenses and capitalised exploration costs are recorded at their acquisition costs less performance-related amortisation (units of production method). Costs incurred for geological and geophysical surveys are immediately recorded as an expense on the income statement. Use was made of the allowed alternative treatment specified in Section 248 (2) of the HGB whereby internally developed intangible assets are recorded for exploration costs. Accordingly, exploration costs are recognised at their costs of production pursuant to Section 253 (1) Sentence 1 in conjunction with Section 255 (2a) Sentence 1 of the HGB. The company capitalises all permissible exploration costs that are incurred in the financial year in which the oil or gas reserves, the extraction of which will probably be commercially viable, are discovered. Goodwill is amortised on a scheduled basis over its expected useful life. The remaining intangible assets are measured at their acquisition costs less straight-line amortisation. The useful lives customary in operations range from three to five years.

Property, plant and equipment is recorded at acquisition or production cost giving consideration to appropriate material and production overhead costs as well as the amortisation and depreciation of fixed assets pursuant to Section 255 (2) of the HGB. The acquisition or production costs of buildings and other structures are systematically reduced by straight-line depreciation. Up to and including the 2009 financial year, technical equipment and machinery, other equipment as well as furniture, fixtures, and office equipment were, in principle, depreciated using the declining-balance method. Upon initial application of the German Financial Reporting Modernisation Act [Gesetz zur Modernisierung des Bilanzrechts] (BilMoG) as at January 1, 2010, the allowed alternative treatment pursuant to Section 67 (4) Sentence 1 of the Act Introducing the German Commercial Code [Einführungsgesetz zum Handelsgesetzbuch] (EGHGB) was applied whereby the previous valuations applying declining-balance depreciation were retained. Had straight-line depreciation been applied in 2016, additional depreciation of € 3,431k would have resulted. Beginning in 2010, newly acquired property, plant and equipment is depreciated using the straight-line method. For domestic subsidiaries, the depreciable lives for property, plant and equipment correspond with their expected useful lives and are based on the useful lives specified by tax regulations. Investment subsidies received in previous years were recorded in a special item which is released in instalments consistent with the depreciation of the subsidised assets.

Construction cost subsidies are deducted from the value of the asset. Low-value assets with acquisition costs of up to € 150 are recorded as an expense in the year of addition. A collective item is recorded for low-value property, plant and equipment with acquisition costs of up to € 150 but not exceeding € 1,000. This collective item is depreciated on the straight-line basis over a period of five years.

If the fair values of individual components of property, plant and equipment are lower than their corresponding carrying amounts, additional impairments are recognised if the reduction in value is expected to be of a permanent nature. If the reasons for the recording of the impairment are no longer applicable, corresponding reversals of write-downs are recognised.

Shares in affiliated companies and other participating interests are recorded at their acquisition cost respectively at their lower fair value. Shares in associated companies are measured at the lower of their equity value or fair value. The equity value is based on financial statements which are, in principle, prepared in accordance with the accounting and valuation principles of the HGB. In accordance with Section 312 (5) Sentence 1 of the HGB, no adjustments are made to the Group's uniform accounting policies. If the reasons for the recording of the impairment are no longer applicable, corresponding reversals of write-downs are recognised. Loans are recorded at their nominal amount.

Current assets

Raw materials, consumables and supplies are valued at their average acquisition costs. The last-in first-out (LIFO) method, using the monthly inventory layer principle, was applied for the valuation of gas inventory presented as merchandise. Prepayments made are recorded at their nominal value. The strict lower of-cost-or-market principle pursuant to Section 253 (4) of the HGB was applied to the valuation of inventories.

Work in progress is recorded at the capitalisable production costs.

Emission rights received for no consideration (fair value of € 114k) are recorded at a memo value. They will be used in their entirety for planned emissions in 2017. Emission rights acquired for consideration are carried at the lower of acquisition cost or market value as determined by the exchange price at the closing date and will be used for respective emissions in 2017. Energy efficiency certificates acquired for consideration are recorded at their acquisition costs respectively at their lower fair value and will be utilised in 2017 and 2018.

Receivables and other assets are recorded at their nominal value. Sufficient specific allowances are recorded for identifiable risks. A lump-sum provision is recorded to provide for the general credit risk.

Cash and cash equivalents are recorded at their nominal values.

Prepaid expenses

This line item comprises disbursements made prior to the balance sheet date representing expenses for a specific period after the balance sheet date.

Equity

Equity is recorded at its nominal value.

Provisions

Provisions are recognised for uncertain liabilities and onerous contracts at the settlement amount considered necessary as determined by prudent business judgement. Provisions cover all identifiable risks.

Provisions with a term of more than one year are discounted over their remaining term using an average discount rate which, in the case of retirement obligations, is determined on the basis of the previous ten years and in the case of other provisions, is based on the prior seven financial years. As per a legislative decree for discounting pursuant to Section 253 (2) Sentence 4 of the HGB, the average discount rates published by the Deutsche Bundesbank [German Federal Reserve] are applied. The allowed alternative treatment with respect to the discounting of provisions with a remaining term of less than one year is not applied.

Provisions for pensions and similar obligations are determined on the basis of actuarial reports using the projected unit credit method. Provisions for pensions are valued on the basis of the ”Richttafeln 2005 G“ (actuarial tables) of Prof. Dr Klaus Heubeck taking expected future salary increases as well as pension adjustments into consideration to the extent that they apply. Pension obligations are discounted in accordance with Section 253 (2) Sentence 2 of the HGB at the average market interest rate for an assumed remaining term of 15 years (4.01 per cent p. a.; prior year balance sheet date 3.89 per cent p. a.).

On March 17, 2016, the ”Law regarding the implementation of the residential property lines of credit and to change commercial regulations“ and thereby the changes to the valuation principles for pension provisions, in particular the implementation of the 10 year average interest rate rather than the seven year average interest rate for discounting as well as for the introduction of a prohibition with respect to distributions for the difference, took effect. The difference between the measurement of the pension provision using the 10-year average interest rate and the seven-year average interest is to be disclosed pursuant to Section 253 (6) sentence 3 of the HGB. The difference amounted to € 2,151k as at the balance sheet date.

As at the balance sheet date, provisions for semi-retirement obligations are recorded for semi-retirement agreements concluded on the basis of the block model. For recognition in accordance with German commercial law, due to their nature, the top-up amounts were, in their entirety, charged as an expense. Semi-retirement provisions are valued in accordance with actuarial principles on the basis of an interest rate of 3.23 per cent p. a. (prior year balance sheet date 3.89 per cent p. a.) and the ”Richttafeln 2005 G“ (actuarial tables) of Prof. Dr Klaus Heubeck. Annual wage and salary increases of 3 per cent were assumed in the determination of the semi-retirement provisions.

A special account attributable to the recording of provisions required in the DM opening balance sheet due to the initial application of Section 249 (1) Sentence 1 of the HGB was recorded on the asset side of the balance sheet; this is written off in accordance with the utilisation or reversal of these provisions.

Additions to long-term provisions are recorded on the income statement on the basis of the net presentation method to the extent that provisions of this type are recorded for the first time.

The effects on profit or loss arising from a change in the discount rate are disclosed in the financial result.

Liabilities

Liabilities are recorded at their settlement amount.

Deferred income

Cash received prior to the balance sheet date comprising income for a specific period subsequent to the balance sheet is presented here.

Foreign currency translation

Foreign currency transactions are, in principle, recorded at the average spot exchange rate in effect when they are initially recorded.

Long-term receivables denominated in foreign currencies are, where required, written down to the lower average spot exchange rate as at the balance sheet date (imparity principle). Short-term foreign currency receivables (with a remaining term of one year or less) as well as cash and cash equivalents or other current assets denominated in foreign currencies are translated at the average spot exchange rate as at the balance sheet date.

Long-term liabilities denominated in foreign currencies are, where required, carried on the basis of the higher average spot exchange rate as at the balance sheet date (imparity principle). Short-term foreign currency payables (with a remaining term of one year or less) are converted at the average spot exchange rate as at the balance sheet date.

Contingent liabilities denominated in foreign currencies are converted at the average spot exchange rate on the balance sheet date.

Deferred taxes

Deferred taxes are recorded for differences between the balance sheet valuations in the commercial and tax balance sheets to the extent that such differences are expected to reverse in future financial years with an impact on tax. In addition, deferred tax assets are recorded for existing losses carried forward to the extent that they are expected to be offset against income within the next five years. Deferred tax assets and deferred tax liabilities are not netted.

The calculation of the deferred tax assets and deferred tax liabilities is based on the relevant tax rate of the respective Group companies.

IV. NOTES TO THE CONSOLIDATED BALANCE SHEET

Fixed assets

The breakdown of fixed assets shown on the balance sheet and changes in the fixed assets are detailed in the statement of changes of fixed assets (appendix to the notes to the financial statements).

Current assets

(1) Inventories

	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
Raw materials, consumables and supplies	8,345	7,909
Work in progress	879	2,916
Merchandise	234,292	243,818
Emission rights and energy efficiency certificates	1,559	799
Advance payments made	553	411
	245,628	**255,853**

As at December 31, 2016, the application of the LIFO method resulted in a difference of € 29,596k pursuant to Section 284 (2) No. 3 of the HGB (December 31, 2015: € 21,524k).

(2) Receivables and other assets

	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
Trade receivables	726,973	725,284
Receivables from affiliated companies	14,858	1,167
Receivables from companies in which a participating interest is	27,779	48,800
Other assets	86,827	142,037
(of which with a remaining term in excess of one year)	*14*	*510*
	856,437	**917,288**

€ 14,648k (December 31, 2015: € 1,148k) of the receivables from affiliated companies comprise trade receivables while € 174k (December 31, 2015: € 0k) comprise financial investments within the scope of cash management and € 36k (December 31, 2015: € 19k) are tax receivables.

In addition, receivables from companies in which participating interests are held include trade receivables totalling € 24,661k (December 31, 2015: € 47,400k) as well as interest receivable of € 3,118k (December 31, 2015: € 1,400k).

The other assets include receivables from the fiscal authorities due to input tax refund claims totalling € 61k (December 31, 2015: € 253k) which legally only arise after the balance sheet date. In addition, the other assets include restricted accounts for margin services totalling € 5,130k.

(3) Deferred tax assets

Deferred tax assets are attributable to temporary differences in balance sheet amounts, tax loss carry forwards as well as other tax differences which are allowable abroad. The temporary differences are mainly attributable to the different measurements determined in commercial balance sheets and tax balance sheets for property, plant and equipment, inventories as well as other provisions. Company specific tax rates of 19–78 per cent were used as the basis for calculating deferred taxes.

Equity

The breakdown and development of equity is presented in the statement of changes of equity.

(4) Subscribed capital

The share capital of the parent company amounts to € 328 million and consists of 128,000,000 no-par value shares.

(5) Retained earnings

	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
Statutory reserve pursuant to Section 150 (2) of the AktG	32,800	32,800
Other retained earnings	251,082	283,242
	283,882	**316,042**

Within the scope of the preparation of the consolidated financial statements as at December 31, 2016, € 32,160k was withdrawn from retained earnings. On May 18, 2017, the Executive Board will recommend to the annual general meeting of the shareholders that the balance sheet profit/loss of € 20,000k presented in the financial statements of VNG as at December 31, 2016 be distributed in its entirety.

(6) Equity difference from foreign currency translation

The equity difference from foreign currency translation (€ 3,451k) is attributable to the translation of the foreign currency financial statements of the subgroup of HANDEN Sp. z o.o., Warsaw (Republic of Poland), VNG Energie Czech s.r.o., Prague (Czech Republic), VNG Norge AS, Stavanger (Norway), and VNG Danmark ApS, Copenhagen (Denmark) which are included in the consolidated financial statements.

Liabilities

(7) Provisions

	Dec. 31, 2016 €'000	Dec. 31, 2015 €'000
Provisions for pensions and similar obligations	24,502	24,340
Provisions for taxes	24,228	14,356
Other provisions	553,987	451,439
	602,717	**490,135**

Pursuant to Article 28 (1) Sentence 2 of the EGHGB, provisions for indirect pension obligations to be settled by a provident fund were not presented on the balance sheet. The deficit between the present values of the indirect pension obligations of the provident fund and the cash and cash equivalents held by the provident fund as at December 31, 2016 was € 3,982k.

The other provisions mainly comprise obligations for shutting down underground storage facilities, pipelines and drilling rigs. Additionally, provisions were recorded for outstanding invoices, risks in connection with the gas business, human resources, onerous contracts and for other uncertain liabilities.

(8) Liabilities

	Dec. 31, 2016 €'000	Remaining term up to 1 year (prior year) €'000	Remaining term 1–5 years (prior year) €'000	Remaining term more than 5 years (prior year) €'000	Dec. 31, 2015 €'000
Liabilities to banks	296,583	138,530 (115,060)	154,509 (240,272)	3,544 (4,639)	359,971
Advance payments received on account of orders	4,646	4,646 (15,029)	0 (0)	0 (0)	15,029
Trade payables	652,748	650,862 (714,329)	1,886 (366)	0 (0)	714,695
Liabilities to affiliated companies	15,167	15,167 (3,004)	0 (0)	0 (0)	3,004
Liabilities to companies in which a participating interest is held	12,416	12,416 (10,484)	0 (0)	0 (0)	10,484
Other liabilities	199,420	57,959 (86,451)	16,565 (13,265)	124,896 (127,515)	227,231
(thereof taxes)	*30,403*	*30,403 (33,080)*	*0 (0)*	*0 (0)*	*33,080*
(thereof social security contributions)	*1,098*	*1,098 (1,330)*	*0 (0)*	*0 (0)*	*1,330*
	1,180,980	**879,580 (944,357)**	**172,960 (253,903)**	**128,440 (132,154)**	**1,330,414**

The liabilities to affiliated companies comprise trade payables (€ 14,916k; December 31, 2015: € 777k), losses taken over as a result of profit and loss transfer agreements (€ 189k; December 31, 2015: € 777k), financial investments within the scope of cash management (€ 62k; December 31, 2015: € 1,417k) as well as outstanding contributions (€ 0k; December 31, 2015: € 33k).

The liabilities to companies in which a participating interest is held comprise outstanding contributions not yet called (€ 9,295k; December 31, 2015: € 8,200k) as well as liabilities for goods and services received (€ 3,121k; December 31, 2015: € 2,284k).

Promissory notes (€ 75,000k; December 31, 2015: € 76,000k) are presented within other liabilities. Liabilities of € 4,924k (December 31, 2015: € 5,471k), due to the fiscal authorities, legally only arise after the balance sheet date.

Liabilities to banks of € 9,492k are mainly secured by registered land charges.

(9) Deferred tax liabilities

Deferred tax liabilities are primarily attributable to temporary differences resulting from different values presented on commercial balance sheets and tax balance sheets for intangible assets and property, plant and equipment as well as the non-recognition, for tax purposes, of the special account relating to provisions recorded pursuant to Section 17 (4) of the DMBilG. Company-specific tax rates ranging from 19–78 per cent served as the basis for the calculation of the deferred tax liabilities.

Contingencies

Contingent liabilities to be reported pursuant to Section 251 of the HGB amount to € 1,560k. They comprise a guarantee for an associated company.

Based on information currently available, no claim is expected to arise from the contingent liability, as the underlying obligation is expected to be satisfied by the company involved.

Other financial commitments

The other financial obligations pursuant to Section 314 (1) No. 2a of the HGB amount to € 200 million of which € 125k are either attributable to subsidiaries which are not included in the consolidated financial statements or to associated companies. These primarily comprise obligations arising from leasing/rental and service agreements, purchase commitments as well as payment obligations for the use of transport and storage capacities. Long-term contracts have been concluded with suppliers to secure the gas and electricity required. The quantities to be procured under these agreements amount to 1,019 billion kWh gas as well as 4 billion kWh of electricity.

V. NOTES TO THE CONSOLIDATED INCOME STATEMENT

(10) Sales

The sales realised in financial year 2016 were primarily generated in the gas sector. 89 per cent of sales were realised in Germany with 11 per cent generated in other European countries. For the purpose of simplicity, sales on the spot/futures markets were, in their entirety, allocated to domestic sales.

Had Section 277 (1) of the HGB in the version of the BilRUG been applied in the prior year, sales totalling € 9,417,002k would have been recorded.

(11) Other operating income

The other operating income includes income from foreign currency translation of € 1,991k (2015: € 4,715k).

In addition, income attributable to other accounting periods (€ 45,017k) is also included; this mainly relates to credit notes for previous years, releases of provisions, disposals of fixed assets as well as the reversals of write-downs of fixed assets.

Had Section 277 (1) of the HGB in the version of the BilRUG been applied, other operating income totalling € 63,440k would have been recorded in the prior year.

(12) Cost of materials

	2016 €'000	2015 €'000
Cost of raw materials, consumables and supplies and of purchased merchandise	6,633,270	8,955,178
Cost of purchased services	223,164	182,211
	6,856,434	**9,137,389**

In the financial year, exploration costs of € 15,477k were incurred; of this amount, € 8,967k has been capitalised.

Had Section 277 (1) of the HGB in the version of the BilRUG been applied, the cost of materials recorded in the prior year would have totalled € 9,115,274k.

In the prior year, expenses totalling € 32,380k associated with energy taxes were included within the costs of materials. On the basis of the new definition of Section 277 (1) of the HGB in the version of the BilRUG, they are included in sales in financial year 2016.

(13) Personnel expenses

	2016 €'000	2015 €'000
Wages and salaries	92,129	100,733
Social security costs, costs for pensions and support	20,313	22,153
	112,442	**122,886**

Personnel expenses include expenses incurred for retirement benefits totalling € 4,234k (2015: € 4,825k).

(14) Amortisation of intangible assets and depreciation of property, plant and equipment

Impairment charges totalling € 40,129k (in the prior year € 113,730k) were recognised pursuant to Section 253 (3) Sentence 3 of the HGB. This is mainly attributable to the impairment of storage facilities due to the expected permanent reduction in value.

(15) Other operating expenses

Other operating expenses include expenses (€ 32k; in the prior year: € 13,972k) resulting from foreign currency translation.

Had Section 277 (1) of the HGB in the version of the BilRUG been applied, the other operating expenses recorded in the prior year would have totalled € 151,505k.

(16) Financial result

	2016 €'000	2015 €'000
Income from participating interests	2,078	1,626
Profit/loss from associated companies	10,676	12,466
Income from loans recorded as financial fixed assets	3,114	2,462
Other interest and similar income (thereof from affiliated companies €0k; in the prior year € 0k)	1,679	1,882
Income from the absorption of losses	0	0
Expenses from losses taken over	227	819
Impairments of financial assets	151	0
Interest and similar expenses	39,997	41,765
	–22,828	**–24,148**

Interest expense includes an amount of € 8,730k (in the prior year € 13,186k) attributable to the unwinding of the discounting of provisions.

(17) Taxes on income

In addition to municipal trade tax and corporation tax, this item includes income of € 12,632k due to the net change in deferred taxes as well as a tax refund from the Norwegian government for exploration costs of VNG Norge totalling € 25,434k. Taxes on income include € 1,321k for tax revenues attributable to other accounting periods.

Overview of the development of the deferred tax balances:

	Jan. 1, 2016 in €'000	Change in €'000	Dec. 31,2016 in €'000
Deferred tax assets	184,503	46,751	231,254
Deferred tax liabilities	50,546	33,631	84,177

The changes in the deferred tax assets and liabilities also include effects attributable to foreign exchange as well as to the scope of consolidation.

VI. DERIVATIVE FINANCIAL INSTRUMENTS AND VALUATION UNITS FOR THE HEDGING OF INTEREST RATES AND EXCHANGE RATES

Within the scope of its business activities, the VNG Group is exposed to currency and interest rate risks. These are primarily hedged using derivative financial instruments. The derivatives are not exchange-traded (so-called OTC) instruments, with contract parties of sound financial standing in the banking sector. In particular, they include currency futures and interest rate swaps. The use of derivatives is subject to uniform standards and stringent internal controls and is restricted to hedging VNG's operating business as well as related investments and financing transactions. The objective of using derivative financial instruments is to reduce the magnitude of fluctuations in terms of results as well as inflows and outflows of cash attributable to changes in exchange rates and interest rates. The use of currency and interest derivatives for speculative purposes is not permitted.

Derivative financial instruments are regularly used to hedge underlying transactions when existing receivables or payables are denominated in foreign currencies or when planned transactions are denominated in foreign currencies and to hedge the risk of changes in interest rates in connection with loans. If the statutory requirements are met, valuation units pursuant to Section 254 of the HGB are established. The effective portions of the valuation units established are presented on the balance sheet applying the net hedge presentation method. The effectiveness of hedging relationship as at each balance sheet date is assessed both prospectively and retrospectively using appropriate methods (in particular the critical term match method). The basis for the effectiveness of a valuation unit is the correspondence in the parameters of the underlying and hedging transactions relevant to valuation. Loss peaks are recognised as expenses.

As at the balance sheet date, VNG held the following derivative financial instruments with respect to currencies and interest rates.

	Dec. 31, 2016 Nominal volume €'000	Dec. 31, 2016 Positive market values €'000	Dec. 31, 2016 Negative market values €'000
Foreign currency derivatives			
Foreign currency futures	275,723	1,718	90
Interest rate derivatives			
Interest rate swaps	224,500	1,624	2,096
	500,223	**3,342**	**2,186**

The market values of derivative financial instruments are dependent on the development of the underlying market factors. Individual market values were determined with reference to market data available as at the balance sheet date using common market valuation methods. Currency futures are carried at the future exchange rate as at the balance sheet date. Market values are determined by discounting future cash flows. Futures exchange rates are determined with reference to current exchange rates giving consideration to the premiums and discounts for futures. Interest rate swaps are valued using recognised methods of analysis giving consideration to the interest rate structure curve as at the balance sheet date.

Valuation units to hedge foreign currency risks

VNG's loans receivable from Group companies denominated in NOK, DKK, USD and PLN, which are hedged in the stand-alone accounts using currency futures contracts and which form part of a valuation unit pursuant to Section 254 of the HGB, are eliminated in the consolidated financial statements as part of the consolidation of intercompany balances. The currency future contracts have a nominal value of € 259,163k. The positive fair values total € 1,703k while the negative fair values total € 86k.

To hedge against foreign currency risks in pending transactions in the gas trading business totalling CZK 275 million, foreign currency future contracts with a nominal value of € 10,220k were concluded with external partners. The terms of these contracts correspond with the expected due dates of the underlying transactions. As at the balance sheet date, the foreign currency futures contracts had a positive fair value of € 8k and a negative fair value of € 4k.

Furthermore, foreign currency future contracts were concluded to hedge bank balances in PLN with a nominal value of € 6,340k; the positive fair value was € 7k.

Valuation units to hedge interest rate risks

Interest rate swaps totalling € 74,500k were used for financial liabilities in order to benefit from the declining interest rates. The fixed-interest loans have a term through 2018. Furthermore, over time, financial liabilities bearing variable interest rates totalling € 75,500k were hedged against the risk of interest rate changes by means of interest rate swaps. The corresponding loans have a term through 2018 and 2020 respectively. The nominal value of the interest rate swaps corresponds with the loan liability of € 150,000k. In each case, the interest rate swaps form a micro-hedge with the loans. The effectiveness of the hedges is assessed prospectively and retrospectively. As the cash inflows and outflows offset, the interest rate swaps are, in principle, not reflected on the balance sheet. As at the balance sheet date, positive fair values of € 1,624k were offset by negative fair values of € 1,331k.

Furthermore, the financial liabilities with fixed-interest included in a valuation unit totalling € 74,500k and the fixed-interest receiver swaps were hedged against a renewed increase in interest rates by means of fixed-interest payer swaps. These derivatives were not included in the valuation unit and had a negative fair value of € 765k as at the balance sheet date. As at December 31, 2016, a provision for onerous contracts is recorded at the amount of the negative market value.

VII. ACCOUNTING FOR TRADING ACTIVITY

Gas trading portfolio

In the gas trading business, the VNG Group is exposed to the risk of price volatility with respect to raw materials. These risks are actively limited using natural hedging effects in existing sales, procurement, storage and transport contracts as well as with appropriate hedging transactions. Within the framework of the portfolio management, the aggregate position comprising the subtotal of the individual segments of the gas trading, is continuously monitored and managed. The corresponding contract portfolios are allocated to transactions, which are linked in terms of timing and substance, and the risks are managed together. This relates exclusively to transactions which are not included in valuation units pursuant to Section 254 of the HGB, nor were they concluded for the purpose of own trading.

Pursuant to the risk management approach implemented by VNG for gas trading transactions, valuation of those transactions included in contract portfolios is not based on the item-by-item valuation approach as specified in Section 252 (1) numbers 3 and 4 of the HGB. The valuation is based on the portfolio and is broken down by year of delivery separately for the gas portfolio of VNG and that of its subsidiaries. For years of delivery in which a negative portfolio value is calculated, corresponding provisions for onerous contracts are recorded. If the value for the respective year is positive, the amount is not further considered.

As at the valuation date, all yearly layers of the portfolios of VNG and its subsidiaries led to a positive amount. As such, no provisions were necessary for onerous contracts attributable to the gas trading business.

Commodity swaps are also utilised in the gas trading portfolio to limit market price risks resulting from gas procurement contracts that are formula based. These are not exchange-traded instruments (so-called OTC) with contract parties of sound financial standing in the banking sector. The use of these instruments is subject to uniform standards and stringent internal controls and is limited to hedging the operating business. Other than within the strictly limited scope in the energy trading business, the use of commodity derivatives for speculative purposes is not permitted. As at the balance sheet date, the nominal volume of the transactions with a term through 2017 totalled € 518,643k. Positive market values of € 88,851k are offset by negative market values of € 17,061k.

Valuation units for physical electricity and gas trading transactions

Pursuant to Section 254 of the HGB, one subsidiary establishes valuation units at the portfolio level for pending physical electricity and gas trading transactions. The risk-compensating effect of the procurement and sales contracts of the respective trading type in the calendar year is aggregated in the portfolios; open risk positions are measured based on fair value. The fair values depend on the development of the underlying market factors. Fair values were determined with reference to market data as at the valuation date using standard market methods. Procurement and sales contracts are measured reflecting the precise hour using an hourly price-forward curve (HPFC) generated based on the market data available as at the final trading day of the year. This valuation of the contracts is netted, and results in the pending position recognised on the balance sheet date. The following pending transactions were included in the portfolio valuation units as of the balance sheet date:

	Nominal value €'000
Electricity	
Procurement contracts	96,152
Sales contracts	96,371
Gas	
Procurement contracts	58,036
Sales contracts	58,183

The net hedge presentation method is used in the presentation of the effective portions of the valuation units on the balance sheet; under this method, offsetting changes in value do not affect the balance sheet or income statement. To the extent that the valuation of the open risk positions of the pending procurement and sales contracts included in the electricity and gas portfolios result in negative balances, provisions are determined and recorded in order to cover loss peaks, applying the principle of imparity. Positive balances are not recognised on the balance sheet.

From the subsidiary's perspective, on the balance sheet date, there were positive fair values for pending transactions for the portfolio valuation unit gas for the years 2017 to 2019 of € 149k. For the portfolio valuation unit electricity, there was a negative fair value for pending transactions of € 143k for the years 2017 to 2019. As at the balance sheet date, these were recorded within provisions for onerous contracts.

VNG's own trading portfolio

In addition, within the scope of gas trading activities, VNG AG has an own trading portfolio with procurement and sales transactions, which are recorded on the basis of valuation units pursuant to Section 254 of the HGB. The gas procurement contracts which are traded within strict risk limits with a nominal value of € 496,468k and the gas sales contracts with a nominal volume of € 496,378k are combined on the portfolio basis. As at the balance sheet date, overall, for all yearly layers, positive market values total € 163k while negative market values total € 94k. The negative market value changes (ineffectiveness) led to a provision for valuation units totalling € 94k. The maximum remaining term of the transactions included in the valuation units is

27 months. The effectiveness of the hedging relationship is assessed prospectively and retrospectively based on the defined risk figures to manage the own trading portfolio (value-at-risk). Other than that, the regulations for VNG as presented above with respect to valuation units for the hedging of foreign currencies and interest rates are analogously applied for own trading.

VIII. CASH FLOW STATEMENT

The cash flow statement was prepared in accordance with the principles of DRS 21.

The cash and cash equivalents of € 51,761k comprise the cash in hand and cash at banks of all German and foreign companies included in the consolidated financial statements.

IX. BREAKDOWN AND DEVELOPMENT OF GROUP EQUITY

The statement of changes of equity for financial year 2016 is presented pursuant to the principles of DRS 22.

X. OTHER DISCLOSURES

Employees

In the 2016 financial year, the parent company, VNG, employed an average of 361 persons. This figure included 355 white-collar employees and six blue-collar workers. In addition, the company employed an average of nine persons in the passive phase of semi-retirement and nine vocational trainees. Those companies fully consolidated in the consolidated financial statements employed an average of 973 employees. Of these, 859 were white-collar employees, 103 were blue-collar workers and eleven were temporary employees/student trainees. At the fully consolidated companies, an average of 25 persons were in the passive phase of semi-retirement and eight persons were vocational trainees.

Fees and services of the auditowr

On April 12, 2016, the ordinary general meeting of VNG appointed KPMG AG Wirtschaftsprüfungsgesellschaft, Leipzig, as the auditor. The audit fees charged for the 2016 financial year comprise the fees for the audit of the consolidated financial statements as well as for the audit of the financial statements of VNG and its German subsidiaries and amounted to € 504k. The fees for other certification or valuation services amounted to € 30k. Furthermore, € 3k related to tax consultancy services.

Subsequent events report

There were no significant events subsequent to the balance sheet date.

MEMBERS OF THE EXECUTIVE BOARD

Dr Karsten Heuchert	**Chairman, Trading Department** (until September 30, 2016)
Ulf Heitmüller	**Chairman, Trading Department** (from October 1, 2016)
Hans-Joachim Polk	**Executive Board Member Infrastructure/Technology**
Bodo Rodestock	**Executive Board Member Finance/Human Resources**

COMPOSITION OF THE SUPERVISORY BOARD

Thomas Kusterer (from September 5, 2016)	**Chairman** Member of the Executive Board of EnBW Energie Baden-Württemberg AG
Dr Norbert Menke (from May 30, 2016)	**1st Vice Chairman** Managing Director of LVV Leipziger Versorgungs- und Verkehrsgesellschaft mbH
Peter Leisebein	**2nd Vice Chairman** Chairman of the Works Council of VNG – Verbundnetz Gas Aktiengesellschaft
Markus Baumgärtner (from May 30, 2016)	Head of the value chain natural gas of EnBW Energie Baden-Württemberg AG
Oliver Brünnich (from May 30, 2016)	Chairman of the Executive Board of Stadtwerke Rostock AG
Joachim Ebert	Telecommunication Systems Engineer at GDMcom Gesellschaft für Dokumentation und Telekommunikation mbH
Dr Martin Fleckenstein (from May 30, 2016)	Independent consultant
Hans-Peter Floren (from May 30, 2016)	Business person
Johannes Hegewald	Foreman of the compressor station of the Bad Lauchstädt underground storage facility in VNG Gasspeicher GmbH
Hans-Joachim Herrmann (from May 30, 2016)	Managing Director of Stadtwerke Lutherstadt Wittenberg GmbH
Dr Martin Konermann (from May 30, 2016)	Managing Director Technology of Netze BW GmbH
Christina Ledong	Deputy Chairman of the Works Council of VNG – Verbundnetz Gas Aktiengesellschaft
Michael Raida (from May 30, 2016)	Management Consultant
Andreas Reichelt	Pipeline system technology officer of ONTRAS Gastransport GmbH
Dr Jörg Reichert (from May 30, 2016)	Head of Controlling & Risk Management at EnBW Energie Baden-Württemberg AG
Dr Reinhard Richter	Managing Director of DREWAG – Stadtwerke Dresden GmbH
Gunda Röstel (from May 30, 2016)	Managing Director of Stadtentwässerung Dresden GmbH

Dr Benno Seebach	Head of Strategic Network Planning at ONTRAS Gastransport GmbH
Petra Steuer	Scheduling employee at ONTRAS Gastransport GmbH
Dr Jochen Weise	Senior Advisor of Allianz Capital Partners GmbH
Dr Bernd-Michael Zinow (from May 30, 2016)	Head of the functional units Legal, Audit, Compliance & Regulatory at EnBW Energie Baden-Württemberg AG

Outgoing Supervisory Board members	
Günther Boekhoff (until May 30, 2016)	Honorary Mayor of the City of Leer
Matthias Brückmann (until May 30, 2016)	Chairman of the Executive Board of EWE Aktiengesellschaft
Holger Hanson (until May 30, 2016)	Chairman of the Management Board of Neubrandenburger Stadtwerke GmbH
Ulf Heitmüller (until August 31, 2016) Chairman of the Supervisory Board from January 1 until August 31, 2016	Chairman of the Executive Board of VNG – Verbundnetz Gas Aktiengesellschaft
Dr Torsten Köhne (until May 30, 2016)	Chairman of the Executive Board of swb AG
Alexander Freiherr von Ledebur (until May 30, 2016)	Investment manager at EWE Aktiengesellschaft
Detlef Nonnen (until May 30, 2016)	Former Commercial Director of eins energie in sachsen GmbH & Co. KG
Kristof Ogonovski (until May 30, 2016)	Speaker of the Oldenburg Chamber of Industry and Commerce
Josef Rahmen (until May 30, 2016)	Former Chairman of the Management Board of LVV Leipziger Versorgungs- und Verkehrsgesellschaft mbH
Thiemo Röhler (until May 30, 2016)	Attorney-at-Law
Dennis Rohde (until April 15, 2016)	Member of the German Bundestag
Björn Thümler (until May 30, 2016)	Member of the Regional Parliament of Lower Saxony

Emoluments of Corporate Bodies

The total emoluments of the Executive Board of VNG – Verbundnetz Gas Aktiengesellschaft, Leipzig, for the 2016 financial year amounted to € 1,270k (in the prior year: € 935k). The total emoluments of former Executive Board members and their surviving dependents in the 2016 financial year amounted to € 2,173k (in the prior year: € 1,082k). Provisions for ongoing pensions to former Executive Board members and their surviving dependents amounted to € 13,974k (in the prior year € 12,991k). A provision of € 117k (in the prior year € 112k) was recorded in the 2016 financial year for the emoluments of the Supervisory Board.

Notification pursuant to Section 20 (6) of the AktG

EWE Aktiengesellschaft, Oldenburg, notified us that, pursuant to Section 20 (5) of the AktG, it no longer directly holds any shares in VNG – Verbundnetz Aktiengesellschaft and that it thereby no longer directly holds more than one-fourth of the shares and voting rights in VNG – Verbundnetz Gas Aktiengesellschaft.

Ems-Weser-Elbe Versorgungs- und Entsorgungsverband, Oldenburg, Ems-Weser-Elbe Versorgungs- und Entsorgungsverband Beteiligungsgesellschaft mbH, Oldenburg, and Weser-Ems-Energiebeteiligungen GmbH, Oldenburg, each notified us that, pursuant to Section 20 (5) of the AktG, they no longer indirectly hold shares of VNG – Verbundnetz Gas Aktiengesellschaft and that they thereby no longer indirectly holds more than one-fourth of the shares and voting rights in VNG – Verbundnetz Gas Aktiengesellschaft.

EnBW Energie Baden-Württemberg AG, Karlsruhe, notified us that, pursuant to Section 20 (4) of the AktG, that it directly holds the majority of the shares and voting rights of VNG – Verbundnetz Gas Aktiengesellschaft and that it thereby holds more than one-fourth of the shares and voting rights of VNG – Verbundnetz Gas Aktiengesellschaft.

VNG Verbundnetz Gas Verwaltungs- und Beteiligungsgesellschaft mbH, Erfurt, notified us that, pursuant to Section 20 (5) of the AktG, it no longer holds more than one-fourth of the shares and voting rights of VNG – Verbundnetz Gas Aktiengesellschaft.

Consolidated financial statements

EnBW prepares consolidated financial statements for the most extensive as well as smallest group of companies in accordance with International Financial Reporting Standards (IFRS), as they are to be applied in the EU. The consolidated financial statements of EnBW, in which VNG is included as an associated company, will be electronically submitted to the operator of the [German] Federal Gazette and can be obtained via the company register (www.unternehmensregister.de).

Leipzig, January 27, 2017

VNG – Verbundnetz Gas Aktiengesellschaft

The Executive Board

Heitmüller	Polk	Rodestock

STATEMENT OF CHANGES OF CONSOLIDATED FIXED ASSETS

	Acquisition or production costs								
	Jan. 1, 2016	Additions to scope of consolidation	Additions	Foreign currency differences	Disposals	Elimination from scope of consolidation	Changes due to equity valuation	Reclassifications	Dec. 31, 2016
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
I. Intangible assets									
1. Concessions acquired for consideration, industrial property and similar rights and assets and licenses in such rights and assets	57,039	2,154	4,573	−35	4,189	295	0	1,155	60,402
2. Oil and natural gas production licenses	82,132	0	0	4,671	0	0	0	0	86,803
3. Exploration costs	60,159	0	8,967	3,135	0	0	0	−1,341	70,920
4. Advance payments made	1,311	0	1,509	0	105	0	0	−1,027	1,688
5. Goodwill	14,811	360	0	0	0	0	0	0	15,171
	215,452	2,514	15,049	7,771	4,294	295	0	−1,213	234,984
II. Property, plant and equipment									
1. Land, land rights and buildings including buildings on third-party land	122,778	0	111	−82	361	82	0	768	123,132
2. Technical equipment and machinery	2,364,330	0	61,784	10,203	13,965	0	0	88,577	2,510,929
3. Other equipment, fixtures, furniture and office equipment	51,532	406	2,709	125	972	1,217	0	360	52,943
4. Advance payments made and assets under construction	214,034	0	49,753	1,858	10,464	20	0	−88,492	166,669
	2,752,674	406	114,357	12,104	25,762	1,319	0	1,213	2,853,673
III. Financial assets									
1. Shares in affiliated companies	3,810	0	1,000	0	2,810	0	0	0	2,000
2. Participations in associated companies	136,669	0	45,783	0	0	0	−8,996	0	173,456
3. Participating interests	33,262	0	2	0	32	195	0	0	33,037
4. Loans to companies in which a participating interest is held	106,000	0	0	0	0	0	0	0	106,000
5. Other loans	347	0	0	0	2	0	0	0	345
	280,088	0	46,785	0	2,844	195	−8,996	0	314,838
	3,248,214	**2,920**	**176,191**	**19,875**	**32,900**	**1,809**	**−8,996**	**0**	**3,403,495**

Amortisation and depreciation									Carrying values	
Jan. 1, 2016	Additions to scope of consoli-dation	Additions	Foreign currency differences	Disposals	Elimination from scope of consoli-dation	Reclassi-fications	Reversal of impairment losses	Dec. 31, 2016	Dec. 31, 2016	Dec. 31, 2015
€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
43,674	149	7,857	−34	4,025	231	−4	0	47,386	13,016	13,365
82,132	0	0	4,671	0	0	0	0	86,803	0	0
0	0	0	0	0	0	0	0	0	70,920	60,159
0	0	0	0	0	0	0	0	0	1,688	1,311
14,811	0	209	0	0	0	0	0	15,020	151	0
140,617	149	8,066	4,637	4,025	231	−4	0	149,209	85,775	74,835
81,855	0	3,314	−15	333	82	252	0	84,991	38,141	40,923
1,863,021	0	66,229	5,435	12,408	0	436	7,133	1,915,580	595,349	501,309
36,139	379	4,563	159	885	885	13	11	39,502	13,441	15,393
51,343	0	37,332	−6	12	0	−697	0	87,960	78,709	162,691
2,032,358	379	111,438	5,573	13,638	937	4	7,144	2,128,033	725,640	720,316
0	0	0	0	0	0	0	0	0	2,000	3,810
575	0	0	0	0	0	0	0	575	172,881	136,094
117	0	151	0	0	0	0	101	167	32,870	33,145
0	0	0	0	0	0	0	0	0	106,000	106,000
0	0	0	0	0	0	0	0	0	345	347
692	0	151	0	0	0	0	101	742	314,096	279,396
2,173,667	**528**	**119,655**	**10,210**	**17,663**	**1,168**	**0**	**7,245**	**2,277,984**	**1,125,511**	**1,074,547**

The consolidated financial statements presented here are condensed. The following auditor's report was issued on the complete financial statements and Group management report, which is combined with the company's management report.

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by VNG – Verbundnetz Gas Aktiengesellschaft, Leipzig, comprising the balance sheet, the income statement, the cash flow statement, the statement of changes in equity and the notes to the financial statements together with the management report which is combined with the Group management report for the financial year from January 1 to December 31, 2016. The preparation of the consolidated financial statements and the Group management report in accordance with German commercial law are the responsibility of the company's Executive Board. Our responsibility is to express an opinion on the consolidated financial statements and on the Group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with Section 317 of the HGB and German generally accepted standards for the audit of financial statements promulgated by the German Institute of Public Auditors (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with German principles of proper accounting and in the Group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the Group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Executive Board, as well as evaluating the overall presentation of the consolidated financial statements and Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The Group management report is consistent with the consolidated financial statements, complies with the German statutory requirements and, as a whole, provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Leipzig, January 27, 2017

KPMG AG
Wirtschaftsprüfungsgesellschaft

Dr Flascha
Wirtschaftsprüfer
[German Public Auditor]

Hauptmann
Wirtschaftsprüfer
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IMPRINT

PUBLISHED BY
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EDITORIAL DEADLINE
February 17, 2017

DESIGN, LAYOUT AND PRODUCTION
Militzer & Kollegen GmbH, Leipzig

REPRODUCTION AND PRINTING
Sepio GmbH, Leipzig

PHOTOGRAPHS
Jakob Richter (p. 1) | Helge Hansen/VNG Norge (p. 1)
Eric Kemnitz (p. 1) | Torsten Proß/Jeibmann
Photographik (p. 1) | Jörg Gläscher (p. 21, 25)

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