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Annual Press Conference  
of  
VNG - Verbundnetz Gas Aktiengesellschaft  
for the 2014 Financial Year**

**“VNG is continually developing”**

Leipzig, March 5, 2015

## **Key message:**

“VNG is continually developing”

## **Key statements:**

- VNG completes the 2014 financial year with a good result
- Sendout remains stable
- The VNG Group as a whole is committed to security of supply and business success
- Profitable further development of the four key business areas
- Decisive breakthrough for the E&P business area in Norway in 2014
- Continuous expansion of business with consumers

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## **1. Welcome and introduction**

Good morning, ladies and gentlemen,

We are very pleased that you have come to this year's Annual Press Conference to inform yourselves about the 2014 financial year of the VNG Group. I will be reporting on last year, presenting our current position and discussing our approach for the future. Following my speech, my colleagues and I will of course be pleased to answer your questions.

2014 was a very special year for VNG. Once again, the 25<sup>th</sup> anniversary of the peaceful revolution showed us that the VNG Group in its present form would have been impossible without the physical and moral courage shown by people in the autumn of 1989. They achieved the establishment of a democratic system by peaceful means. This is why we will be able to celebrate the 25<sup>th</sup> anniversary of VNG as a joint stock company in June this year. 1989 was a defining year for us at VNG. We are committed to accepting challenges as an opportunity, to shaping change, to setting ourselves targets and to moving towards the future with determination – step by step.

Our profit for 2014 shows that we are on the right track. Despite the well-known challenges in the energy industry, we recorded a good figure. This was possible as a result of our highly motivated employees, our targeted strategies and a product that we find convincing.

Before I deal with our profit for the year in greater detail, I would like to take a look at the economic and political environment. This will give you an idea of the key factors which influenced our business activities.

## **2. Economic environment**

Following a strong first quarter, economic growth slackened significantly over the course of the year. The main reasons were disappointing developments in the global economy and the insecurity caused by greater geopolitical risks. A recovery became apparent in the last few months of the year. As a result, gross domestic product in Germany grew by 1.6 percent compared with the previous year. Economic institutes expect similar developments in 2015. The first chart shows the effects of the economic situation on energy consumption.

Last year, energy consumption in Germany fell by almost 5 percent. The drop in natural gas consumption was even sharper, at 14 percent. Especially the mild weather in the first and

fourth quarters of 2014 had a considerable impact on the heating market, which is one of the main drivers of natural gas consumption.

There were considerable fluctuations on financial and commodity markets, including the natural gas market. The falling gas price was the result of lower demand and continued high levels of supply.

The marked downward trend in oil prices was a result of the growing availability of oil from non-OPEC countries. In addition, interest rates once again fell and remain at a historic low. Furthermore, both the euro and the Norwegian kroner weakened against the dollar.

In addition to these economic developments, the energy policy environment was another key area of interest.

### **3. Energy policy environment**

In 2014, the energy transition was once again the main topic of discussion in the energy industry. Unfortunately, the year was largely characterised in energy policy terms by declarations of intent, plans of action and studies. This year, we expect legislators not only to provide clear signals for the implementation of the energy transition but also to take decisions. The objectives have already been defined quite clearly, both in the Energy Industry Act and in the coalition agreement in Germany. German energy supplies are to be affordable, secure and environmentally compatible. The key element of the strategy to achieve climate protection goals is a reduction in carbon dioxide emissions. However, the target and the tools to be used for achieving it are often confused. As a result, there have been exhaustive discussions on topics such as an increase in the share of renewable energies. It should be remembered that natural gas clearly has all the properties required for reaching climate protection targets rapidly and in a socially compatible way.

However, the fundamental decisions still need to be made!

By opting for natural gas, most consumers have already moved a step ahead of the politicians. Nevertheless, natural gas is still fighting to achieve the key position it deserves in the perception of politicians. This is despite the fact that environmentally compatible natural gas continues to be the fuel of choice on the heat energy market.

In the present situation, 72 percent of current natural gas users would still opt for natural gas. A further 18 percent would choose a combination of natural gas and solar energy. All in all, this means that 90 percent of natural gas customers are satisfied. This is the highest value since 2007. Natural gas is mainly associated with convenience, low acquisition costs and low consumption. It therefore beats other heating energies such as heat pumps, wood pellets or gas oil. Last year, there were even 110,000 new customers who chose natural gas.

It is gratifying to note that the German government is gradually turning its attention to the heating market, too. After all, this sector accounts for some 40 percent of final energy consumption and about a third of CO<sub>2</sub> emissions. It therefore offers considerable potential for carbon dioxide savings. In connection with the tax concessions which have been announced for building rehabilitation, the replacement of old heating systems is to receive support. These developments must be welcomed but they are still only proposals.

Action is certainly needed as a matter of urgency. On average, German heating systems are 18 years old. 36% of all systems were even installed before 1995 according to a BDEW study. Energy consumption in houses and flats could therefore be reduced rapidly and at low cost using advanced natural gas systems in combination with renewables. The use of decentralised cogeneration systems could also play a key role in this context.

Despite the ambitious expansion targets of the German government, no progress was made with cogeneration in 2014. On the contrary, the Renewable Energy Act levy on energy consumption for generating plants led to additional burdens for cogeneration plant operators. However, there is now some light at the end of the tunnel. Since January 2015, there has been a higher subsidy for mini-cogeneration plants with an electrical rating of up to 20 kilowatts. In addition, a bonus has been introduced for especially efficient cogeneration plants, such as those using fuel cells. The German government has given a clear signal in favour of cogeneration. Apparently, the government has also recognised the advantages of this modern plant technology, which have also been repeatedly emphasised by VNG.

An even greater step forward would be the implementation of the amendment to the Cogeneration Act that has already been announced. This would compensate for the financial burdens resulting from the Renewable Energy Act levy. On this basis, the German government could finally come one step closer to its target of 25 percent cogeneration by 2020. After all, it is possible to save up to 50 percent of CO<sub>2</sub> emissions with a cogeneration plant.

Car drivers and buyers are still waiting for the announced extension of the tax concession for natural gas as a motor fuel beyond 2018. This is one small example of the delay in implementing the measures required for the energy transition. This is why we need framework conditions which remain stable on a long-term basis. They would provide the security required for investments by consumers and companies.

However, energy policy was not the only area on which we focused last year. Security of supply was also extremely important. I have repeatedly said that we have always provided our customers with secure and reliable supplies of natural gas. We are still in a position to do

so. Security of supply is a top priority for the VNG Group as a whole. Thanks to the broad-based diversification of sources of supply and transport routes, high storage capacities and its own production, VNG remains extremely well-positioned for the long-term future.

Good relations with our partners in Norway and Russia also play their part in ensuring that we are always able to supply natural gas to customers in line with demand. European purchasing communities of the type which are currently being called for by several parties are unnecessary. They would undermine competitive structures that have grown over the decades. Even in times of crisis, the German gas industry and VNG have shown that the tools of the market economy function well. Especially against the backdrop of international tension, security of supply remains our strength and is part of our strategy.

#### **4. Strategic orientation**

In view of this energy industry environment, the question of our business model has been raised, not without reason. You can be sure that we are working on issues like this within the company. However, I am convinced that only a strategy developed jointly with our employees can lay the foundation for success.

During our strategy meetings, we have worked intensively on the business model of each individual business area. The results of these discussions confirmed that we will not be establishing a “bad bank”.

We are firmly convinced that our business areas Exploration & Production (E&P), Gas Trading, Gas Storage and Gas Transport provide the ideal basis for sustained business success. The VNG Group is committed to gradually and steadily improving these business areas.

With its four business areas, the VNG Group covers all aspects of natural gas, allowing the Group to diversify risks and harness various growth opportunities.

Our involvement in **E&P** is part of our growth-oriented strategy, aims to diversify sources of supply and strengthens our independence. With the exploration successes which were achieved, 2014 was the year of VNG Norge. We still see considerable potential in this area. The objective is to build up a balanced portfolio of exploration and development projects as well as producing fields. Step by step, we intend to reinforce our portfolio of gas and oil production licences and to make further investments in fields that have already been developed. This will round off our strategy.

The E&P business area of the VNG Group is to become a self-supporting business with stable contributions to profit in the long term. It is part of our provision for the future.

The profit from trading is influenced by the activities of VNG AG and the other trading companies and affiliates in Germany and other countries. The continuous expansion of business with consumers is part of our strategy – especially via the goldgas group. Close links with wholesale trading allow us to benefit effectively from synergies and generate further income. By coordinating and managing its portfolio of purchase, delivery, transport and storage contracts in a targeted way, the **VNG trading** business area exploits opportunities in a highly volatile market.

In contrast to purchasing, where we have opted for a blend of different sources of supply, our sales activities focus on Germany as our core market. At the same time, we are developing our activities in neighbouring European countries.

In the storage sector, **VNG Gasspeicher GmbH** (VGS) has decades of experience. This applies both to the development and operation of storage facilities and to the marketing of innovative storage products, for which demand is growing. As the third-largest storage facility operator in Germany, VNG Gasspeicher GmbH also contributes to the security of supplies and to network stability. Unfortunately, this strategic value is currently not adequately rewarded as a result of the oversupply of flexibility services. In the context of our strategic activities, we are focusing on a core portfolio with a sound financial basis that ensures high performance. The site analyses that were carried out clearly indicated that the Buchholz aquifer storage facility is not commercially viable. Some of the underground storage equipment has already been in operation for more than 40 years and has reached a critical age. The storage facility is no longer sufficiently flexible to meet injection and withdrawal customers' requirements in the long term. The permanent decommissioning of Buchholz underground storage facility is therefore unavoidable and represents the best strategic option.

The **ONTRAS** natural gas transmission system is and will remain a key factor in ensuring stability and success. It is of strategic importance for the VNG Group. This business area is largely defined by the regulatory framework and the interpretation of this framework by the Federal Network Agency. ONTRAS has a very good network of national and international organisations which allow it to participate in shaping the regulatory framework in a reasonable way. Within the leeway allowed by these possibilities, ONTRAS continues to optimise its transport business with a view to generating growing income despite the narrowly defined regulatory framework.

In 2014, VNG disposed of its shares in EVG - Erdgasversorgungsgesellschaft Thüringen-Sachsen mbH, a company mainly active in the gas transport field. This participation was no longer needed for strategic reasons as there were no significant synergy effects with ONTRAS.

At the beginning of the year, ONTRAS established INFRACON with a view to benefiting from market opportunities. INFRACON pools the company's entire service business in the field of energy infrastructure. In the service sector, ONTRAS is a pioneer among the German transmission system operators.

## **5. Net profit for the year**

As you can see, we are strategically very well positioned with our business areas. In all the business areas, we have highly competent personnel with many years of experience. Our employees work hard every day to ensure that the company is successful. This dedication also contributed to the good profit figure for 2014.

The net profit of the VNG Group for the year was €184 million (previous year: €89 million). VNG AG achieved a very good profit figure of €224 million (previous year: €174 million). However, both figures were strongly influenced by the sale of the participation in EVG.

The individual business areas made different contributions to the economic development of VNG. The gas transport business area continued to make a stable, positive contribution to the net profit and consolidated net profit for the year. In the E&P business area, we made considerable progress towards the development of a self-supporting business area within the VNG Group.

The hotly contested energy market continues to have an adverse effect on the results of the gas trading and gas storage business areas. However, the operating profit of the gas trading business area improved.

I will now turn to the development of the various business areas in 2014, starting with trading.

## **6. Gas trading**

As I have already mentioned, natural gas demand fell by 14 percent in 2014. Apart from economic developments and the mild winter, this fall was the result of higher energy efficiency. Sustained oversupply to European markets led to a significant fall in market prices. Competition on wholesale markets in Germany and other countries resulted in increased pressure on prices and margins.

These developments in market prices were the reason for the fall in sales. The sales of the VNG Group were down slightly at €10 billion (previous year: €11 billion). VNG AG recorded sales of €7.7 billion (previous year: €8.8 billion).

### **6.1 Sendout**

Nevertheless, the sendout of the VNG Group reached about the same level as in 2013, at 368 billion kWh (previous year: 362 billion kWh). Sendout to wholesale trading companies (200.5 billion kWh) and to industrial customers and power stations (63.2 billion kWh) rose. There was a fall in sales to resellers (99.6 billion kWh) and consumers (5.1 billion kWh) as a result of the mild winter.

Of the total sendout figure, Germany accounted for 24 percent, other countries for about 10 percent and European spot and futures markets for 66 percent.

Once again, the largest sales markets of the VNG Group outside Germany were Italy, Poland and Luxembourg.

The sendout of VNG AG in 2014 also remained at about the previous year's level, at 310 billion kWh.

Our presence in all the regions of Germany remains a key prerequisite for steady development and winning new customers. VNG has 10 sales offices throughout Germany. These regional sales structures create customer nearness. For example they helped us in winning Germany's largest ammonia producer, Stickstoffwerke Piesteritz, as a long-term customer again.

Another element of our strategy is the development of business with consumers in Germany and other countries. This is why our trading companies are represented in other European countries. On our domestic market, we are mainly strengthening consumer business via the goldgas group which we acquired last year. goldgas already supplies gas to about 157,000 residential and commercial customers in Austria and Germany. This company has high satisfaction values and also received the German Fairness Award in 2014.

Through the continuous development of customer-oriented products and services, we are successfully positioning ourselves on the market as a natural gas specialist. We offer our

customers assistance for portfolio management and also provide them with access to wholesale trading markets.

With our know-how and experience, we participate in the development of advanced natural gas technologies. For example, VNG AG is a partner in a research project of Leipzig University of Applied Sciences (HTKW) to compensate for rising power costs through the use of renewable energies and advanced cogeneration technology. The key element in the project is an intelligent, self-teaching control unit – an “energy manager”. The energy manager will distribute the power generated through the building and also provide interim storage. In 2014, this project received the German Gas Industry Award for Innovation and Climate Protection.

Demand for innovative products among our customers is steadily growing. The networking and control of building systems and domestic appliances is at the top of customers’ wish lists. Our turnkey SMART.home solution for municipal utilities and regional distribution companies provides greater convenience, security and energy efficiency. It was a highlight at the E-World industry trade fair.

I would now like to turn to procurement, another key element in the activities of our trading business area.

## **6.2 Procurement**

As in the previous year, the VNG Group purchased a total of about 365 billion kWh of natural gas.

Once again, most of this gas was purchased via VNG AG. At about 307 billion kWh (previous year: about 312 billion kWh), gas purchases by VNG AG were slightly below the figure for the previous year.

The optimisation of our portfolio again led to high purchasing volumes on spot and futures markets. In addition, long-term gas supplies from Russian and Norwegian sources were a key element in procurement. The contractual risks involved were significantly reduced by changing long-term contracts over to conditions approaching those in the marketplace. In detail, gas purchases by the VNG Group were as follows:

Under long-term contracts, the VNG Group took 57 billion kWh of natural gas (previous year: 64.8 billion kWh) from Russia and 43.9 billion kWh (previous year: 42.8 billion kWh) from Norway.

In Germany, the liquidity of wholesale natural gas trading has steadily grown over the past few years. Well-functioning wholesale markets are crucially important for competition and have been used intensively by VNG for several years. This is also reflected by our activities on European spot and futures markets. Once again, we purchased most of our gas on these markets. Purchases rose slightly to 263.6 billion kWh (previous year: 257.1 billion kWh).

Following trading, I would now like to turn to exploration and production. As I have already mentioned, we intend to develop these activities into a self-supporting business area.

## **7. Exploration & production**

Last year brought a breakthrough for VNG Norge and for our exploration & production business area as a whole.

This is especially clear from our above-average exploration success as an operator. This meant that we were once again able to build confidence in VNG Norge with partners and authorities.

Further proof of this recognition is the Explorer of the Year award in Norway, which we were delighted to receive. Last year, the Pil find surprised many because of its size and its very good reservoir properties. I am very pleased that our employees in Norway believed in this field and did a fantastic job. The Pil field is one of the most significant oil and gas finds made on the Norwegian Continental Shelf in recent years. In addition, the well drilled on the neighbouring Bue prospect led to a further highly promising exploration opportunity. It also seems that there could be further possibilities on the nearby Boomerang prospect. We will be investigating these possibilities in 2015 and 2016.

At the beginning of the year, we were granted six additional production licenses on the Norwegian Continental Shelf. This is further indication that VNG Norge has definitely arrived in exploration and production business in Norway.

Another key step was the purchase of a share in the producing Draugen oil field. This acquisition significantly expanded our reserve base. Apart from Draugen, we also hold shares in the Brage, Hyme and Njord producing fields. Repair work on the Njord platform was completed to schedule in the summer and it was therefore possible to continue oil and gas production from the platform.

Last year, we reached our highest production figure, at 1.45 million barrels of oil equivalent (BOE).

At this point, I would like to comment briefly on the oil price. The present developments in oil prices do not mean that we will need to adapt our objectives, especially in exploration & production. The present situation is the result of oversupply on the oil market. In our opinion, the current pressure on prices will be relieved in the medium term. This is confirmed by forecasts.

VNG has a licence portfolio that is also viable at lower oil prices.

## **8. Gas storage**

As with E&P, storage facilities are of long-term strategic importance for VNG. Together with trading and the transmission system, storage facilities ensure secure supplies to our customers. This also applies in the context of growing competitive pressure.

Unfortunately, the market is currently not prepared to pay an appropriate premium for security of supply. At the moment, the liquidity caused by oversupply is simply too high. However, this need not remain the case in the future. We expect a recovery in the storage market in the medium to long term.

VNG Gasspeicher GmbH (VGS) currently has a working gas capacity of about 2.7 billion m<sup>3</sup> at locations in central and north-east Germany. In the storage year, the capacity of these storage facilities was and is fully occupied. In October 2014, Erdgasspeicher Peissen GmbH, a joint venture with GAZPROM Germania, commissioned its third storage cavern. By 2024, a total of 12 caverns with a working gas capacity of about 600 million m<sup>3</sup> are to be developed.

An element in our storage strategy is the development of new products for the storage market, which is increasingly calling for innovative solutions. A good example is the “easystore” online product. This solution makes it easy for customers to combine working gas volumes with injection and withdrawal capacities.

The marketing of virtual storage capacities is also becoming increasingly important. In this field, VGS has developed its own product, “VP Speicher”. With this product, dealers book all capacities at the virtual trading point (VTP) rather than at the storage locations of VGS.

You will know that natural gas combines well with renewables. This also applies to our infrastructure. The storage of renewables could represent a further marketing opportunity for storage facilities. Renewables also open up new possibilities for gas transport.

## **9. Gas transport**

ONTRAS operates Germany's second-largest natural gas transmission system, with a total pipeline length in excess of 7,000 km, and is a key element in ensuring secure supplies of

natural gas. The company organises gas transport together with more than 130 downstream network operators.

ONTRAS regularly refurbishes and modernises its facilities to ensure the highest possible levels of reliability. In this context, the company started work last year on the replacement of the natural gas pipeline from Lauchhammer in Brandenburg to Weißig in Saxony. In the Lausitz region, ONTRAS will be constructing two natural gas pipelines this year. This will further improve the infrastructure in the region.

Over the past few years, non-regulated network services have become a key focus for ONTRAS. The company's affiliate INFRACON, established in January, offers engineering services, the operation of natural gas refuelling stations and the provision of data for CO<sub>2</sub> emissions trading.

I have now outlined the development of the VNG Group in the 2014 financial year. Motivated employees and the trust of our customers and business partners are the key factors in our business success.

The framework for activities is defined by a vision embodying the core values of partnership, openness, entrepreneurship and responsibility.

## **10. Responsibility**

Responsibility also includes social responsibility, which means more than achieving success in the energy sector and safeguarding future-oriented jobs.

For many years, the main focus of our social commitment has been on our networks ("Verbundnetze"). You will probably agree that volunteering plays a key role in the stability of our society. This was the main principle considered when our "Verbundnetz der Wärme" was established in 2001 and is more essential than ever before. This network now has more than 200 members and we hope that the number will continue to grow. One of the highlights of last year was the annual members' meeting, which was attended by the network's new patron, Matthias Platzeck, former Minister-President of Brandenburg.

We are committed to providing individual support for young people and to fostering their personal and professional skills. After all, these people are our future. This is why our VNG-Campus initiative continues to support exchanges between students and young scientists in Europe. In this context, TU Bergakademie Freiberg and Leipzig Graduate School of

Management (HHL) play a key role. VNG also cooperates with Leipzig University of Applied Sciences (HTWK), for example on a scholarship recognising outstanding performance by students.

Especially against the backdrop of international crises, it is important to continue discussions between specialists from industry, universities and politics. The German-Russian Raw Materials Forum puts this principle into practice. The seventh German-Russian Raw Materials Conference, held in Dresden, confirmed that there is a great need for personal communication and an exchange of opinions. More than 400 guests used this platform for dialogue which was held in April last year with significant support from VNG .

It has almost become commonplace to say that the energy transition cannot be successful without the local authorities. Last year, the “Verbundnetz für kommunale Energie” (VfKE) dealt with the role of municipal utilities in the energy transition. The discussions were mainly based on a study conducted with the support of VNG. In the course of the study, the municipal utilities stated that they were committed to the fundamental objectives of the energy transition, despite their critical assessment of the situation. At the same time, many of these utilities – unsurprisingly – called for politicians to take action faster and in a more coordinated and consistent way.

Close relations with local authorities are part of the corporate identity of VNG. This is confirmed by the large number of municipal utilities among our customers and by our list of shareholders, which has a strong municipal element in the form of VNG Verbundnetz Gas Verwaltungs- und Beteiligungsgesellschaft m.b.H. (VUB).

## **11. Outlook**

I would now like to turn to the outlook for the future:

The strong point of the VNG Group is our strategy with four business areas operating independently under one corporate umbrella. These business areas allow us to diversify risks and to exploit various growth potentials. Together, they ensure our business success, gradually taking us closer to our vision of being the preferred partner for natural gas in Europe.

Our financing partners also believe in our strategy. With the recent extension of our syndicated loan, we have laid a firm foundation for the sustained profitable development of

our business areas. Investment in these segments will safeguard the future of the Group and will be a prerequisite for further growth.

Our profit for the year in 2014 was dominated by the sale of EVG. As a result of this special effect, the net profit figures recorded by the VNG Group and VNG AG were considerably higher than the forecasts which had been made in 2013. We therefore expect lower profits in 2015.

We are convinced that there are considerable opportunities for our product, natural gas, in the marketplace, especially when politicians have created the framework required for the energy system of the future.

The past 25 years have shown that we are open to changes and grasp the opportunities which they offer. The courage also demonstrated by many VNG employees in calling for change in the autumn of 1989 and in shaping the process of change in the years that followed may serve us as an example.

For 2014, the Executive Board and the Supervisory Board will propose the payment of a dividend of €73 million to the shareholders at the Annual General Meeting.

We would like to thank the Supervisory Board and our shareholders for their support. Our objective is to achieve sustained long-term success for our shareholders. Stability is the best foundation for leading our company into a strong future.

We would like to thank our customers for the confidence they have placed in us and the Works Council for their constructive cooperation.

On behalf of the Executive Board, I would like to thank all our employees for their dedication. With them, we will be able to realise our vision for the future. Together we are continuing the process that started 25 years ago.

Thank you for your attention.