NET4GAS Group
Consolidated
Annual Report 2017

Contents

Andreas Rau
Chief Executive Officer,
NET4GAS, s.r.o.

Foreword by the CEO of NET4GAS

Ladies and Gentlemen,

Throughout 2017, the NET4GAS Group again provided uninterrupted gas transmission services to its customers. The excellent operational performance was also reflected in the zero lost time injury frequency attained by our employees and suppliers. In commercial terms, we have achieved solid financial results, and have successfully offered and marketed new gas transmission capacities.

In 2017, total gas volumes transported by NET4GAS amounted to 42.5 bcm. Of this, roughly 8.5 bcm went to the Czech Republic, a year-on-year increase of 0.2 bcm, due in particular to economic recovery and cold weather in the first calendar quarter. International transit accounted for the remaining volume.

The number of gas transmission contracts remained stable year-on-year and reached a total of almost 4,200. Contracts concluded at border points grew in the reported year and confirmed the continuing trend of short-term gas trade and high demand for reverse flow across the Czech Republic in the west-east direction.

All of the above translated into a solid consolidated operating profit for the 2017 fiscal year of CZK 4.2 billion.

Our BBB investment grade rating, with a stable outlook, was again affirmed by S&P Global Ratings and Fitch Ratings, which reflects the strength of our ability to fully meet our commitments in a timely manner and our readiness to execute planned long-term investments.

On 6 March 2017, we reached an important milestone. New cross-border capacity of up to 40 bcm per year for the period 2020–2039, connecting the German market area of Gaspool and the Czech Republic, and the Czech and Slovak market areas, was offered and successfully marketed at the binding European annual capacity auction. The marketed capacity represents the result of the joint efforts of the German TSOs Gascade and Ontras, the Slovak TSO eustream and NET4GAS. At the same time, it represents our obligation to invest in relevant new infrastructure in a timely manner. The total scope of investment in the Czech gas transmission system under a project designated as "Capacity4Gas" is estimated to reach several hundred million euros.

Thus, our new Capacity4Gas project to extend the transmission system in the Czech Republic entered its implementation phase in 2017, providing the Czech Republic with an opportunity to maintain its strong position as a European transit country, and thereby enhance the security of supply throughout the region.

On a European level, 2017 was a year of initiatives aimed at completing the European Energy Union, including efforts to restructure the gas market design, in which NET4GAS actively participated. In the course of 2018, these efforts will intensify, as several studies are to be elaborated and presented by the European Commission, setting the groundwork for new gas legislation.

The positive events of 2017 are encouraging. At the same time, they commit us to keep up the pace in the forthcoming years. We will continue in our mission to provide economically efficient, safe and reliable gas transmission services, and will help shape the European energy market in the context of the transition to a low carbon economy, promoting the use of natural gas as the most environmentally-friendly fossil fuel, as well as the increased use of other "green gases" in the long run.

On behalf of the management, let me express my thanks to our employees, who are our foundation stone and most valued resource, our long-term oriented investors, who safeguard the fulfilment of our strategy, our customers, for whom we provide our services 24/7, our suppliers, who help us implement our projects, and all other stakeholders, who support us in achieving our goals.

Consolidated Group Data

We secure operation of a flexible, demand-oriented transmission system and associated commercial and technical services.

Consolidated Group Data

The consolidated group (hereinafter referred to as "Group" or "NET4GAS Group"), for which this Consolidated Annual Report is elaborated, consists of the consolidating company NET4GAS, s.r.o. (hereinafter referred to as "NET4GAS" or "the consolidating company") and consolidated company BRAWA, a.s. (hereinafter referred to as "BRAWA" or "consolidated company").

Consolidating company

Company name	NET4GAS, s.r.o.
Identification number	272 60 364
LEI	529900ND5BL2CXRIPT15
Date of registration in the Commercial Register	29 June 2005
Address	Na Hřebenech II 1718/8, 140 21 Prague 4 – Nusle, Czech Republic
Stake in BRAWA, a.s.	100%

Consolidated company

Company name	BRAWA, a.s.
Identification number	247 57 926
Date of registration in the Commercial Register	10 November 2010
Address	Na Hřebenech II 1718/8, 140 21 Prague 4 – Nusle, Czech Republic

NET4GAS Company Profile

NET4GAS holds an exclusive gas Transmission System Operator (TSO) licence in the Czech Republic. The company secures the international transit of natural gas across the Czech Republic, domestic transmission of natural gas to partners in the Czech Republic and associated commercial and technical services.

- Operates more than 3,800 km of pipelines.
- Operates three border transfer stations, four compressor stations, and nearly a hundred transfer stations at the interface with domestic gas distribution.
- Is a member of the Czech Gas Association, the international organisations ENTSOG, GIE, EASEE-gas, and the IGU and Marcogaz working groups.
- Has more than 500 employees.
- Is one of the largest private corporate donors to nature conservation in the Czech Republic.
- Is committed to its corporate social responsibility.

NET4GAS Strategy

NET4GAS mission

Our mission is to secure economically efficient, safe and reliable gas transmission services for our customers 24 hours a day, 7 days a week, and to provide sufficient capacities in all relevant supply situations based on a non-discriminatory and transparent approach.

NET4GAS vision

As a Central European gas Transmission System Operator, NET4GAS will play an active role in connecting and integrating European energy markets to the benefit of Czech and other European customers.

Highly qualified employees are our company's foundation stone and most valued resource. Their team-oriented work and target-driven approach are major factors in the company's continuous development, which is clearly focused on the three strategic pillars of asset flexibility, operational excellence and new market design.

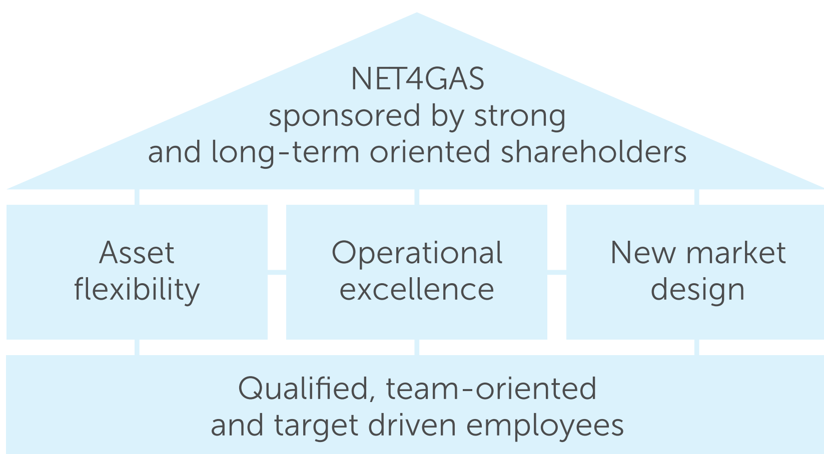
Along with the range of attractive capacity products we offer our customers, enhancing our asset flexibility by building and optimising new and existing cross-border interconnectors allows us to swiftly respond to changing gas flow patterns in Europe, while strongly supporting further market integration.

We strive for operational excellence to meet our customers' expectations and to manage the financial and operational demands resulting from increasing fluctuations in grid utilization, regulation and growing competition on energy markets.

We will continue to help shaping the European energy market in the context of the transition to a low carbon economy, and by doing so will contribute to the preservation and enhancement of functioning gas markets, especially in Central and Eastern Europe where we operate.

In achieving our vision and attaining our strategic goals, we receive major sponsorship from our strong and long-term oriented shareholders, who thus safeguard the fulfilment of our company strategy.

We are also fully aware of our corporate social responsibility, and we strictly follow an environmental policy committed to both present and future generations.



Ownership of NET4GAS

as of 31 December 2017

For the entire year 2017, NET4GAS was wholly owned by NET4GAS Holdings, s.r.o., which in turn is owned by a consortium formed by Allianz Infrastructure Czech HoldCo II S.à r.l. (50%) and Borealis Novus Parent B.V. (50%).

NET4GAS Supervisory Board

as of 31 December 2017

Kenton Edward Bradbury
Chairman of the Supervisory Board
Position held since: 24 June 2016
Member since: 1 July 2015

Andrew Cox
Member of the Supervisory Board
Member since: 11 May 2017

Jaroslava Korpancová
Member of the Supervisory Board
Member since: 2 August 2013

Lenka Kovačovská
Member of the Supervisory Board
Member since: 26 March 2015

Mikhail Nahorny
Member of the Supervisory Board
Member since: 1 July 2016

Changes in the NET4GAS Supervisory Board

In the course of 2017, several changes took place in the composition of the NET4GAS Supervisory Board. Under a letter dated 27 April 2017, Melchior Stahl resigned as Member of the Supervisory Board. His term of office expired on 10 May 2017. Under a decision of the sole shareholder of NET4GAS exercising the powers of the General Meeting, Andrew Cox was elected as a new Member of the Supervisory Board effective as of 11 May 2017. On 16 June 2017, Kenton Edward Bradbury was re-elected as Chairman of the Supervisory Board. No other changes occurred in the composition of the Supervisory Board in 2017.

NET4GAS Statutory Directors

as of 31 December 2017

Andreas Rau
Statutory Director and CEO
Position held since: 1 December 2013

Radek Benčík
Statutory Director and COO
Position held since: 1 October 2016
(NET4GAS Statutory Director continuously since 1 October 2011)

Václav Hrach
Statutory Director and CFO
Position held since: 1 March 2014

Changes in the NET4GAS Statutory Directors

No changes occurred in the composition of the NET4GAS Statutory Directors in 2017.

NET4GAS Audit Committee

as of 31 December 2017

Following the issue of investment securities accepted for trading on the regulated European market, NET4GAS has become a public interest entity within the meaning of Act No. 563/1991 Coll. on Accounting, as in effect, and is subject to the duty to establish an Audit Committee. The main responsibilities of the Audit Committee include monitoring the internal control system and the risk management system, overseeing the effectiveness of internal audit and securing its functional independence, monitoring the compilation of financial statements and consolidated financial statements, recommending the statutory auditor, assessing the independence of the statutory auditor and the audit company, evaluating the provision of supplementary services, and overseeing the conduct of mandatory audit.

The NET4GAS Audit Committee was established under a decision of the NET4GAS Statutory Directors on 31 May 2016.

Michal Petrman
Chairman of the Audit Committee
Position held since: 15 September 2016
Member since: 1 June 2016

Igor Lukin
Member of the Audit Committee
Member since: 1 June 2016

Mikhail Nahorny
Member of the Audit Committee
Member since: 1 June 2016

Stanislav Staněk
Member of the Audit Committee
Member since: 1 June 2016

Pavel Závitkovský
Member of the Audit Committee
Member since: 1 June 2016

Changes in the NET4GAS Audit Committee

In line with the statutes of the NET4GAS Audit Committee, Michal Petrman, Stanislav Staněk and Pavel Závitkovský were re-appointed as independent members of the Audit Committee effective as of 1 June 2017. On 15 September 2017, Michal Petrman was re-elected as Chairman of the Audit Committee. No changes occurred in the composition of the Audit Committee in 2017.

Services provided by the auditor PricewaterhouseCoopers Audit, s.r.o. – fee summary (CZK thousand)

Audit related services	2,544
Training related to new International Financial Reporting Standards	90
Agreed upon procedures related to subsidies received from the European Commission	110
Total	**2,744**

BRAWA Company Profile

BRAWA is the sole owner of the GAZELLE gas pipeline. This 166-kilometre pipeline, with a pipe diameter of DN 1400 and a design pressure of 85 bar, connects the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov. NET4GAS is the operator of the GAZELLE pipeline.

BRAWA Supervisory Board

as of 31 December 2017

Martin Kolář
Chairman of the Supervisory Board
Position held since: 20 September 2016
Member since: 1 July 2016
(in the Supervisory Board continuously since 20 March 2012)

Radek Benčík
Vice-Chairman of the Supervisory Board
Position held since: 20 September 2016
Member since: 1 July 2016
(in the Supervisory Board continuously since 20 March 2012)

Andreas Rau
Member of the Supervisory Board
Member since: 19 February 2016
(in the Supervisory Board continuously since 19 February 2014)

Changes in the Supervisory Board

No changes occurred in the composition of the Supervisory Board of BRAWA in 2017.

BRAWA Board of Directors

as of 31 December 2017

Jan Martinec
Chairman of the Board of Directors
Position held since: 11 November 2015
Member since: 7 July 2014

Miroslav Holý
Vice Chairman of the Board of Directors
Position held since: 11 November 2015
Member since: 1 November 2015

Changes in the Board of Directors

No changes occurred in the composition of the Board of Directors of BRAWA in 2017.

Shareholder of BRAWA

as of 31 December 2017

In 2017, BRAWA's sole shareholder was NET4GAS.

For more than 40 years, our net for gas has been connecting energy markets, guaranteeing the security and reliability of natural gas transmission.

Consolidated Report on Operations

Consolidated Report on Operations

Key Economic Events & Indicators

Refinancing and Deferment of Maturity of NET4GAS's Bank Financing

NET4GAS was able to take advantage of a favourable market situation and refinance its bank financing arrangement in 2017. In May 2017, credit lines maturing in 2018 and 2019 were replaced with new lines of credit with a five-year maturity. The total value of the company's debt has remained stable.

Confirmation of NET4GAS's BBB Credit Rating

At the end of June 2017, the rating agencies S&P Global Ratings and Fitch Ratings affirmed NET4GAS's long-term rating at the BBB investment grade with a stable outlook. The two ratings reflect the fact that NET4GAS possesses financial resources allowing the company to fully meet its current and future commitments in a timely manner, and that NET4GAS is prepared to execute planned long-term investments.

Economic indicators of the Group 2017

Selected indicators*	2017 (CZK million)
Revenue	7,397
Operating profit	4,196
Profit before taxation	3,253
Profit after taxation	2,634
Investments – capital expenditure to tangible and intangible assets	771

* according to IFRS as adopted by the European Union

Revenues, costs, profit

The Group's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll., on conditions for undertaking the business and for the execution of state administration in the energy sector and on changes to certain decrees (the "Energy Act").

In 2017, the Group achieved a profit before taxation of CZK 3,253 million. Profit after taxation was CZK 2,634 million.

The operating profit of the Group amounted to CZK 4,196 million in 2017.

The Group generated a profit from its core business operations – transit of natural gas and domestic transmission. Its total operating income amounted to CZK 7,436 million and total operating costs were CZK 3,240 million.

Asset structure

The total assets of the Group in 2017 amounted to CZK 45,234 million, of which non-current assets accounted for CZK 43,250 million, representing 96%. The main components of these assets were tangible fixed assets valued at CZK 43,147 million, intangible fixed assets valued at CZK 78 million and prepayments for acquisition of fixed assets.

As of 31 December 2017, current assets amounted to CZK 1,984 million, representing 4% of total assets. Roughly 32% of cash and 34% short-term financial assets consisted of current assets.

Investments

The Group invested a total of CZK 771 million in 2017. Of this, CZK 30 million was in intangible assets and CZK 741 million in tangible assets.

The most important investment that the NET4GAS Group made into tangible assets in 2017 was within the Capacity4Gas project, a total of CZK 189 million.

Structure of liabilities

The Group's equity in the year ended on 31 December 2017 amounted to CZK 9,230 million and accounted for approximately 20% of the Group's total liabilities.

Current and non-current liabilities amounted to CZK 36,004 million.

Non-current borrowings and other non-current liabilities (particularly bonds, bank borrowing, deferred taxes liabilities, and derivatives liabilities) accounted for approximately 96% of total liabilities; current liabilities accounted for approximately 4% of total liabilities.

Investment instruments

To secure a return on its available cash during 2017, the Group made use of term deposits and bills of note offered by leading banking institutions. No significant price, credit or liquidity risks were identified in connection with the instruments concluded, other than described in the consolidated financial statements, which are an integral part of this Consolidated Annual Report.

Research and development activities

The Group did not make any major expenditure into research and development in 2017.

Branches

Neither of the companies of the Group has branches in the Czech Republic or abroad.

BRAWA Operations

The core activity of BRAWA in 2017 was managing its property, the GAZELLE pipeline, and its lease to the transmission system operator NET4GAS.

NET4GAS Commercial Operations

NET4GAS secures economically efficient, safe and reliable gas transmission services for its customers 24 hours a day, 7 days a week and provides sufficient capacities in all supply situations based on a non-discriminatory and transparent approach.

In 2017, NET4GAS fulfilled its **contractual commitments** under 4,197 gas transmission contracts.

Total gas transmission in 2017 amounted to 42.5 billion m^3, of which 8.5 billion m^3 was for the Czech Republic. Compared to 2016, national transmission increased by 0.2 billion m^3, in particular as a result of economic recovery and cold weather in the first calendar quarter.

Based on the positive results of the market survey "Capacity4Gas", which showed a significant long-term market demand for additional capacity, and based on subsequent technical studies on the relevant gas infrastructure carried out by NET4GAS, **new cross-border capacity** between the German Gaspool market area and the Czech Republic, and the Czech and Slovak market areas was offered and successfully marketed at the annual PRISMA capacity auction on 6 March 2017. Based on the results of the auction, NET4GAS launched an investment into relevant new gas infrastructure in the Czech Republic (see NET4GAS Asset Development Projects).

NET4GAS Asset Operation and Maintenance Projects

In order to guarantee safe and reliable gas transmission, NET4GAS properly maintains and modernizes its transmission system using state-of-the-art technologies.

Over the course of 2017, NET4GAS continued to execute the **programme of upgrading compressor stations** with the aim of securing future demand for transmission capacity and ensuring a high operating safety standard. As regards transmission system maintenance, the company completed another stage of an **upgrade of the DN 500 pipeline** between Jiřice and Hněvice, including an upgrade of line valve stations, and carried out the **reconstruction of the DN 300** pipeline between Olešná and Barchov. Furthermore, the reported year saw the commencement of the **reconstruction of pipeline river crossings** in response to an expert assessment. To maintain a high standard of operating safety, particularly as regards cyber security, the company, inter alia, also **upgraded the software and hardware of the SCADA system** deployed in the dispatching centre.

NET4GAS Asset Development Projects

NET4GAS carefully plans its investment projects aimed at preserving high security of supply in the context of changing gas flow patterns in Europe and supporting further market integration.

With regard to the fact that a Europe-wide transmission capacity auction held in March 2017 provided binding confirmation of market demand for new long-term transmission capacity, NET4GAS launched the implementation phase of a new project designated **Capacity4Gas**. The objective of the project is to build new gas infrastructure within the NET4GAS transmission system, and to connect it to the planned EUGAL pipeline in Germany. The Capacity4Gas project aims to improve the security of supply in the Czech Republic, as well as throughout the entire Central and Eastern European region, and at the same time to further reinforce the Czech Republic's strategic role in international gas transit. The rationale behind the project is the increasing gap between supply and demand for natural gas in Europe. The Capacity4Gas project is executed in two stages, the completion of which is planned for 2019 and 2021.

The reported year saw an update of the **List of Projects of Common Interest** (PCI), introduced under Regulation (EU) No 347/2013 of the European Parliament and of the Council, which is to facilitate and accelerate the implementation of strategically important projects in the energy sector. As in previous years, the European Commission placed the Czech-Polish Gas Interconnector* ** and Bidirectional Austrian-Czech Interconnector (BACI) * ** projects on the PCI list (approval by the European Council and the European Parliament and the issue of the new PCI list are expected to take place in the first half of 2018). Both cross-border projects are part of the so-called north-south gas corridor in Central Europe. In 2017, NET4GAS continued to work on these projects, while a final decision on the investment has not been made.

In 2017, NET4GAS completed a **project that connected the Dolní Dunajovice underground gas storage** to the transmission system via a new measuring point in Horní Věstonice to allow gas to be transferred between the facility and the transmission system in two independent locations. The project consisted of building a new interconnection pipeline and a new measuring station.

During the year under review, a connection agreement was signed with a new directly connected customer, and work began on a project aimed at **connecting an industrial zone in Northern Moravia** to the transmission system. The project will consist of building a new interconnection pipeline and a new measuring station. Its execution is planned for the years 2018 and 2019.

* Co-financed by the European Union
Trans-European Energy Networks Program (TEN-E)

** Co-financed by the European Union
Connecting Europe Facility

NET4GAS Market Design Activities

NET4GAS helps shaping the European energy market in the context of the transition to a low carbon economy, and by doing so contributes to the preservation and enhancement of functioning gas markets, especially in Central and Eastern Europe where it operates.

The year 2017 was marked by **initiatives aimed at restructuring the gas sector**. NET4GAS actively participated in these initiatives by performing analyses and taking part in debates, both at the national and European levels, and in working groups of the European Network of Transmission System Operators for Gas (ENTSOG).

As part of an effort to **further integrate the Czech and Austrian natural gas markets**, 2017 saw NET4GAS continue to work together with Austria's and the Czech Republic's national regulatory authorities and with the transmission system operators in Austria (Gas Connect Austria GmbH) and Slovakia (eustream, a.s.). on the development of the TRU service (Trading Region Upgrade).

Human Resources

Highly qualified employees are NET4GAS's foundation stone and most valued resource.

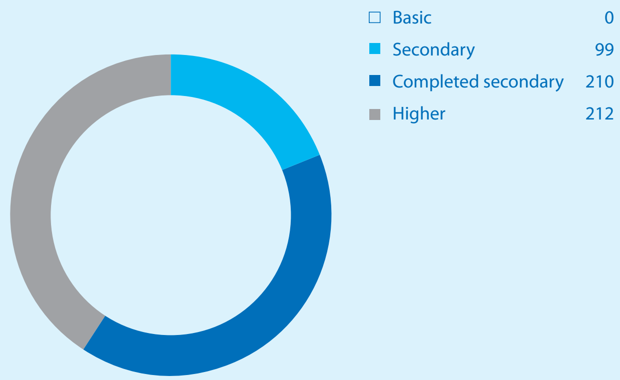
As of 31 December 2017, the number of employees working at NET4GAS was 521. 18% of employees working at NET4GAS were women, out of which 15% in managerial positions. As of 31 December 2017, BRAWA had no employees.

The standard of NET4GAS employees' working and social conditions is defined under a Collective Agreement valid 2015–2020. NET4GAS has also been developing special programmes in the area of its social policy. For example, it is helping young families with the process of returning to work, in particular by staying in contact with mothers during their parental leave, allowing them to actively participate in company projects even during this period, and not least of all by offering a home office option. And just as in previous years, in 2017 NET4GAS employees had an opportunity to obtain financial support for a pre-school which their children attend. NET4GAS also provided support for the employment of handicapped persons. Every job was given an assessment to determine its suitability or unsuitability for handicapped persons, and then advertised as such.

The education structure of NET4GAS employees has remained stable. In 2017, NET4GAS invested 1.7% of the company's annual personnel costs into the professional training of its employees. The average expenditure on training per employee was CZK 12,579.

NET4GAS also continued its programmes for students and graduates "Internship" and "Trainee", which are aimed at retaining specialist know-how and helping senior staff who are going into retirement pass on their experience to new employees (for more about how NET4GAS works with students see NET4GAS Corporate Philanthropy).

NET4GAS employee education structure
as of 31 December 2017



Health and Safety at Work

The NET4GAS Group focuses particular attention on health and safety at work. The "Health and Safety at Work and Fire Safety Policy" is actively enforced by both regular employees and supervisors at all management levels. The basic objective of the health and safety at work policy is that each employee returns home in the same state of health as they were in when they came to work.

Under a programme aimed at improving occupational health and safety, a number of new measures were implemented in 2017 above legal requirements, particularly in relation to work on gas infrastructure construction projects and to safety relating to the operation of motor vehicles. Efforts to maintain a safe working environment target all parts of the workplace, and apply not only to employees, but also to contractors.

There were no workplace accidents resulting in an incapacity to work in 2017, including the staff of contractors working on the Group's worksites. The high level of safety maintained presents the Group with a challenge and commitment in the forthcoming period.

Environmental Protection

Environmental protection is one of the highest priorities and is understood by the NET4GAS Group not only as fulfilment of legal requirements, but primarily as an issue of social responsibility. The Group is guided by the latest scientific findings and uses environmentally-friendly technology. Environmental protection is taken into account in all decisions and process implementation. The Group makes the effort to minimize the environmental burden caused by the transmission system.

In 2017, the Group complied with all statutory obligations regarding environmental protection. In line with the requirements of state administration and local government, designated operational facilities have developed plans for the event of an accident and the prevention according to the Water Act, although the stated plans fulfilled only the role of preventative measures in 2017 and did not have to be put into action, just as no environmental accidents occurred at any Group facilities. State administration and local government authorities which carried out audits stated in their final reports that the Group has complied with its obligations in relation to the valid legislation and the valid integrated permits.

The Group acts responsibly in regard to environmental protection, even going beyond what is required by law. For example, thanks to the operation of the mobile gas recovery compressor, which is used for pumping natural gas from a section of pipeline earmarked for repair and is unique on a European scale, 7,404,232 m^3 of natural gas was re-pumped in the transmission system in 2017 which for technical reasons would otherwise have had to be released into the atmosphere. Recycling, energy conservation and other environmentally-friendly activities were and continue to be an everyday part of the Group's operations. The Group also continued to support projects in the area of nature and environmental protection via its NET4GAS Closer to Nature programme (see NET4GAS Corporate Philanthropy).

Internal Control Principles

We have internal control principles in place as a preventive measure, and as a means to achieve better results.

Internal Audit

The essence of the internal audit is objective assurance and consultancy activity focused on adding value to improving processes and reducing possible risk. The Internal Audit is an integral component of the management and control system and an important tool for the continuous improvement of the NET4GAS Group. The Internal Audit is supervised by the Audit Committee.

Audit Committee

The Audit Committee is described in the section Consolidated Group Data.

Risk Management Committee

The NET4GAS Group manages its risk with due care and diligence. Risks are continuously identified, assessed from the point of view of their likely occurrence and the extent of potential damage and reported to the Risk Management Committee. Existing risks are continuously monitored and updated.

The Risk Management Committee's responsibilities include, in particular, discussing identified risks to the Group and approving strategies for managing them. It is also the Committee's task to regularly assess the overall risk to the Group.

Code of Conduct

The NET4GAS Group is conscious of its role in society and its responsibility towards all its stakeholders and the environment, in which it operates. It has therefore committed itself to a clear set of principles which form a framework for its activities in the business and social spheres defined by the Code of Conduct. The adherence of the Code of Conduct is monitored by the Compliance Officer.

The conduct of the Group and the employees is based on personal responsibility, honesty, loyalty, and respect for others, their safety and the environment. The Group supports the internationally declared human rights, promotes their protection and at the same time ensures that no violation of human rights occurs in the Group. It also acts against all forms of corruption, including extortion and bribery.

The Code of Conduct forms the basis for the creation of further internal documentation and every employee is acquainted with it. Moreover, annual reporting on the implementation of the Code of Conduct is introduced. In 2017, the Compliance Officer did not receive any notification of a violation of the Code of Conduct.

Ombudsman and Fraud Prevention

The Ombudsman is an independent position which chiefly involves collecting complaints and information relating to potentially fraudulent activities or to activities which are in conflict with the company's internal regulations or the law. The Ombudsman evaluates these submissions before convening an investigation committee, whose role is to make an independent assessment and evaluation and then propose corrective measures. The Ombudsman may also be contacted by parties outside the company. The position of Ombudsman is performed for the NET4GAS Group by an outside law firm. In 2017, the Ombudsman did not receive any submission.

We are aware of our social responsibility and therefore devote ourselves to corporate philanthropy.

NET4GAS Corporate Philanthropy

NET4GAS Corporate Philanthropy

An integral aspect of the good conduct of a modern company is its responsible relationship to local communities, the environment, its shareholders, suppliers and partners, and not least of all its own employees. And an integral part of the concept of corporate social responsibility is corporate philanthropy.

NET4GAS is aware of its corporate social responsibility. Therefore, in 2017 it continued devoting itself to corporate philanthropy and sponsorship, aimed at improving the living conditions where it operates, which is in the Czech Republic, in the following areas:

- NET4GAS Closer to Nature: nature and the environment protection
- NET4GAS Closer to Knowledge: education, training and research
- NET4GAS Closer to Regions: community development

NET4GAS Closer to Nature

Come to nature with us at www.closertonature.cz

NET4GAS is both a reliable and safe gas transmission system operator, and at the same time pursues a responsible policy aimed at protecting nature and the environment with respect to current and future generations. The commercial operations of the NET4GAS Group are very closely connected with the issue of nature conservation, as during both the construction and the operation of its gas infrastructure it must comply with strict environmental standards. In fact, its concern for the natural environment extends even beyond the requirements of legislation. This principle not only underlies the company's responsible entrepreneurship but is also the basis for its long-term strategy of corporate philanthropy and sponsorship, which has been implemented under the programme NET4GAS Closer to Nature since 2007. NET4GAS has been systematically providing long-term support to projects where a major aspect of sustainable development is expressed by precisely that motto – "Closer to Nature" – and can therefore be proud that it is one of the largest corporate donors in the field of nature conservation in the Czech Republic.

General partnership with the ČSOP

The general partnership between NET4GAS and the Czech Union for Nature Conservation (ČSOP) has pursued a clear and unchanging vision since the collaboration first began in 2007. And that is to present attractive and valuable natural sites to the public, and to use both education and fun as means to raise awareness about the reasons for their protection.

In 2017, NET4GAS and the ČSOP opened a further six sites of natural value to the public, bringing the total over their partnership to 86. The collaboration also focused on the renovation of existing sites, direct nature conservation projects and popularizing and promotional activities.

General partnership with the Young Environmentalists Association competitions

It is growing increasingly difficult in this day and age to encourage children and young people to develop a close relationship with nature. In 2017, NET4GAS therefore continued providing its support to the nationwide science and nature competitions Zlatý list ("Golden Leaf") and Ekologická olympiáda ("Ecological Olympiad") organised by the Young Environmentalists Association of the ČSOP as their general partner. Golden Leaf is a competition organized for primary school students, the Ecological Olympiad for students of secondary schools.

NET4GAS Closer to Knowledge

This second pillar of philanthropy and sponsoring has its foundation in the focus of NET4GAS on operational excellence delivered by a trained and qualified team. Sustainable development would be impossible without quality training, education, research and development. NET4GAS therefore supports these areas under its programme NET4GAS Closer to Knowledge.

In 2017, NET4GAS, inter alia, continued to develop its general partnership with the Department of Gaseous and Solid Fuels and Air Protection of the Faculty of Environmental Technology at the University of Chemistry and Technology Prague, and its partnership of the Czech Technical University in Prague. The cooperation included awarding motivational scholarships to exceptional students, specialist lectures and trips, consulting with students on their theses, and hiring students under the Internship and Trainee programmes (see Human Resources).

NET4GAS Closer to Regions

Long-term development and maintenance of the gas transmission system, which runs through almost every one of the regions of the Czech Republic, is a cornerstone of the NET4GAS Group's business operations. As a good neighbour, the company targets its third programme – NET4GAS Closer to Regions – on local development in the areas where it operates.

In 2017, NET4GAS was, for example, the main partner of the Voluntary Firemen of the Year contest for the fourth year in a row. The aim of the competition is to raise public awareness and prestige of volunteer firemen. Firefighters, both professional and volunteer, are a natural partner of NET4GAS while ensuring the safety and reliability of natural gas transmission.

NET4GAS Report on Relations

The Statutory Directors of NET4GAS, s.r.o. (hereinafter in this Report on Relations referred to as "Company") have drawn up, in accordance with the provision of the Section 82 of Act No. 90/2012 Coll., the Business Corporations Act (hereinafter referred to as "BCA"), the following Report on Relations covering the relations among the Company and controlling entities and among the Company and other entities controlled by the same controlling entities (hereinafter referred to as "Related Parties") during 2017 in all cases where the Company is aware of the existence of such Related Parties. This Report on Relations forms an integral part of the NET4GAS Group Consolidated Annual Report 2017 and is provided to the Company's shareholder for its review within the same period of time and under the same conditions as the Financial Statements.

1. Controlling entities

In the accounting period ended 31 December 2017, the Company was controlled:

a) directly by
NET4GAS Holdings, s.r.o., with its registered office at Na hřebenech II 1718/8, Nusle, Prague 4, 140 00, Czech Republic, ID No. 291 35 001, registered in the Commercial Register maintained by the Municipal Court in Prague, Section C, File No. 202655;

b) indirectly by
(i) Allianz Infrastructure Czech HoldCo II S.à r.l., with its registered office at L-2450 Luxembourg, boulevard F.D. Roosevelt 14, Grand Duchy of Luxembourg, registration number: B 175770, and (ii) Borealis Novus Parent B.V., with its registered office at 1011PZ Amsterdam, Muiderstraat 9, Kingdom of the Netherlands, registration number: 57412243, each of which is a shareholder of NET4GAS Holdings, s.r.o. with an ownership interest of 50%, and which together have the status of controlling entities in relation to NET4GAS Holdings, s.r.o. by virtue of Section 75(3) of the BCA.

2. Other Related Parties

The Company requested the above controlling entities to provide a list of any other entities controlled by the same controlling entities during the last accounting period, and the Statutory Directors of the Company have drawn up the present Report on Relations based on the information provided by these controlling entities and the other information at their disposal.

The structure of the relations among the controlling entities and the controlled entity and other Related Parties is set out in Annex No. 1 to this Report on Relations.

3. Role of the controlled entity, method and means of control

In 2017, the Company carried out its activities as an independent transmission system operator in accordance with Section 58b et seq. of Act No. 458/2000 Coll., on conditions for undertaking the business and for the execution of state administration in the energy sector and on changes to certain decrees (hereinafter referred to as "Energy Act"), and as such operated independently of controlling entities and other Related Parties.

NET4GAS Holdings, s.r.o., as the controlling entity and as the sole shareholder of the Company in the powers of the General Meeting exercised its rights and performed its obligations in respect of the Company in compliance with legislation, in particular as laid down in the BCA and the Energy Act.

4. Agreements concluded between the Company and Related Parties

The agreements concluded between the Company and controlling entities or Related Parties during the last accounting period are listed in Annex No. 2 to this Report on Relations. The agreements concluded in preceding accounting periods which were in effect during the last accounting period form Annex No. 3 to this Report on Relations.

5. Acts performed in the last accounting period at the instigation or in the interest of controlling entities or Related Parties in respect of assets exceeding 10% of the Company's equity amounting to CZK 922 million as per the last financial statements prepared as of 31 December 2017

In the last accounting period, the Company, in addition to concluding agreements as specified in Article 4 of this Report on Relations, also performed acts at the instigation or in the interest of controlling entities or Related Parties as specified in Annex No. 4 to this Report on Relations.

6. No damage

In the last accounting period, the Company incurred no damage as a result of agreements with controlling entities or Related Parties, or as a consequence of other acts or actions performed in the interest or at the instigation of the same, which were concluded or undertaken during the last accounting period or in any preceding accounting period. It has therefore not been necessary to secure compensation for damage or to conclude any agreements on such compensation.

7. Advantages and disadvantages resulting from relations with Related Parties

In the last accounting period, the relations among the controlling entities and Related Parties were an advantage for the Company in terms of the increased financial stability.

8. Confidentiality

None of the information contained in this Report on Relations constitutes a trade secret of the Company.

9. Conclusion

This Report on Relations was approved by the Company's Statutory Directors on 14 March 2018 and was submitted for review to the Company's Supervisory Board.

In Prague, on 14 March 2018

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

Annex No. 1
Structure of relations among controlling entities and Related Parties in the last accounting period

Allianz Infrastructure Czech HoldCo II S.à r.l. (50.00%) and Borealis Novus Parent B.V. (50.00%)

- **100.00 % NET4GAS Holdings, s.r.o.**
  - 100.00 % NET4GAS, s.r.o.
    - BRAWA, a.s.

Annex No. 2
Agreements concluded between the Company and controlling entities or Related Parties in the last accounting period

Contracting party	Agreement	Date of conclusion	Details
BRAWA, a.s.	Purchase agreement	2 February 2017	The subject matter of the agreement is a transfer of real estate of BRAWA, a.s. to NET4GAS, s.r.o.
BRAWA, a.s.	Purchase agreement	2 February 2017	The subject matter of the agreement is a transfer of real estate of BRAWA, a.s. to NET4GAS, s.r.o.
BRAWA, a.s.	Purchase agreement	2 February 2017	The subject matter of the agreement is a transfer of real estate of BRAWA, a.s. to NET4GAS, s.r.o.
BRAWA, a.s.	Amendment No. 1 to Lease agreement on 31 December 2012	15 February 2017	The subject matter of the amendment is an update of the WACC profit margin to a new level effective as of 1 January 2017.
NET4GAS Holdings, s.r.o. (multilateral agreement)	Funding agreement	9 June 2017	The subject matter of the agreement, concluded between NET4GAS, s.r.o. and the companies NET4GAS Holdings, s.r.o., Allianz Infrastructure Luxembourg I S.à r.l. and OMERS Administration Corporation, is a definition of the possibility of financing an investment project of NET4GAS, s.r.o. by NET4GAS Holdings, s.r.o.
NET4GAS Holdings, s.r.o.	Agreement on maturity and repayment of short-term loan tranche No. 02/2016 in connection with a loan agreement	16 June 2017	The subject matter of the amendment is a change in the maturity of a short-term loan.
NET4GAS Holdings, s.r.o.	Agreement on maturity and repayment of short-term loan tranche No. 03/2016 in connection with a loan agreement	16 June 2017	The subject matter of the amendment is a change in the maturity of a short-term loan.
NET4GAS Holdings, s.r.o.,	Set-off agreement	16 June 2017	The subject matter of the agreement is a set-off of mutual liabilities and receivables under loan agreements, distribution of profit and reduction of capital funds.
NET4GAS Holdings, s.r.o. **BRAWA, a.s.** (multilateral agreement)	Agreement Ref. No. ZBA/2017/07 on the provision of real unidirectional cash pooling	9 November 2017	The agreements lay down a framework for cash pooling in Czech currency (among NET4GAS, s.r.o. and the companies BRAWA, a.s. and NET4GAS Holdings, s.r.o.) and US dollars and euros (between NET4GAS, s.r.o. and NET4GAS Holdings, s.r.o.), the purpose of which is to optimise the use of funds within the Related Parties and to reduce transaction costs. The Agreement Ref. No. ZBA/2017/07 replaces the Agreement Ref. No. ZBA/2012/14 on 8 July 2013 as amended by Amendment No. 1 on 11 November 2013 in its entirety.
NET4GAS Holdings, s.r.o. (multilateral agreement)	Agreement Ref. No. ZBA/2017/08 on the provision of real unidirectional cash pooling	9 November 2017	
NET4GAS Holdings, s.r.o. (multilateral agreement)	Agreement Ref. No. ZBA/2017/09 on the provision of real unidirectional cash pooling	9 November 2017	

Orders of BRAWA, a.s. at NET4GAS, s.r.o.

- Reposting insurance premiums (three orders)
- Reposting insurance broker services (one order)

Annex No. 3

Agreements concluded between the Company and controlling entities or Related Parties in previous accounting periods and effective in the last accounting period

Contracting party	Agreement	Date of conclusion	Details
BRAWA, a.s.	Agreement on the provision of selected services as amended by Amendment No. 1 on 20 December 2013, Amendment No. 2 on 27 January 2014, Amendment No. 3 on 6 February 2015, Amendment No. 4 on 30 November 2015 and Amendment No. 5 on 30 December 2016	31 December 2012	The subject matter of this agreement is the provision of the following services by NET4GAS, s.r.o. to BRAWA, a.s.: GAZELLE project supervision, construction and assembly work within the construction, accounting, controlling, tax issues, payroll administration, cash-flow, risk management, insurance, facility management, purchasing and logistics, corporate affairs and network documentation.
BRAWA, a.s.	Lease agreement	31 December 2012	Under the agreement, BRAWA, a.s. leases gas infrastructure to NET4GAS, s.r.o., consisting primarily of the interconnector "High-pressure DN 1400 gas pipeline – Brandov BTS – Rozvadov" of approximately 160 km in length.
BRAWA, a.s.	Agreement on the provision of loans as amended by Amendment No. 1 on 16 July 2015	2 July 2013	
NET4GAS Holdings, s.r.o., BRAWA, a.s. (multilateral agreement)	Agreement Ref. No. ZBA/2012/14 on the provision of real unidirectional cash pooling as amended by Amendment No. 1 on 11 November 2013	8 July 2013	The agreements lay down a framework for cash pooling of Czech currency (among NET4GAS, s.r.o., BRAWA, a.s. and NET4GAS Holdings, s.r.o.) and US dollars and euros (between NET4GAS, s.r.o. and NET4GAS Holdings, s.r.o.), the purpose of which is to optimise the use of funds within the related parties and to reduce transaction costs. The Agreement Ref. No. ZBA/2012/14 as amended by Amendment No. 1 on 11 November 2013 was replaced by the Agreement Ref. No. ZBA/2017/07 on 9 November 2017 in its entirety.
NET4GAS Holdings, s.r.o. (multilateral agreement))	Agreement Ref. No. TBA/2013/16 on the provision of real unidirectional cash pooling	11 November 2013	
NET4GAS Holdings, s.r.o. (multilateral agreement)	Agreement Ref. No. TBA/2013/15 on the provision of real unidirectional cash pooling	11 November 2013	
NET4GAS Holdings, s.r.o.	Agreement on the provision of loans as amended by Amendment No. 1 on 16 January 2014, Amendment No. 2 on 21 March 2014 and Amendment No. 3 on 16 July 2015	11 November 2013	

Contracting party	Agreement	Date of conclusion	Details
NET4GAS Holdings, s.r.o.	Agreement on the provision of selected services	25 June 2015	The subject matter of the agreement is the provision of the following services by NET4GAS, s.r.o. to NET4GAS Holdings, s.r.o.: accounting, controlling, tax issues, cash-flow, contract management and PR service.

Annex No. 4

Acts performed in the last accounting period at the instigation or in the interest of controlling entities or Related Parties in respect of assets exceeding 10% of the Company's equity as per the last financial statements prepared as of 31 December 2017

Controlling entity or Related Party	Acts performed	Date	Details
NET4GAS Holdings, s.r.o.	Resolution of the sole shareholder of the Company	17 May 2017	The subject matter of the resolution is the authorisation to enter into agreements within the framework of the refinancing arrangement.
NET4GAS Holdings, s.r.o.	Resolution of the sole shareholder of the Company	30 June 2017	The subject matter of the resolution is the payment of a supplementary contribution other than a contribution to the registered capital.

Post Balance Sheet Events

No events have occurred subsequent to year-end that would have a material impact on the consolidated annual report for the year ended 31 December 2017.

Persons Responsible for the Consolidated Annual Report

We hereby declare on our honour that the information stated in this Consolidated Annual Report is true and that no material facts have been omitted or misstated.

In Prague, on 14 March 2018

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

Annex no. 1:
Consolidated Financial Statements

NET4GAS Group
Consolidated Financial Statements

prepared in accordance with International Financial Reporting Standards
as adopted by the European Union, 31 December 2017

Contents

NET4GAS Group
Consolidated Balance Sheet as at 31 December 2017

In millions of Czech crowns	Note	31 December 2017	31 December 2016
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	8	43,147	44,383
Intangible assets	9	78	89
Other non-current assets	10	25	9
Total non-current assets		**43,250**	**44,481**
CURRENT ASSETS			
Inventories	11	61	63
Trade and other receivables	13	324	303
Current income tax prepayments	26	248	11
Loans to related parties	12	5	652
Other non-financial assets	14	32	27
Other financial assets	15	683	–
Cash and cash equivalents	15	631	415
Total current assets		**1,984**	**1,471**
TOTAL ASSETS		**45,234**	**45,952**

EQUITY AND LIABILITIES			
EQUITY ATTRIBUTABLE TO SHAREHOLDERS OF THE PARENT COMPANY			
Registered capital	16	2,750	2,750
Capital contributions outside registered capital	16	3,364	6,631
Cash flow hedge reserve	16	465	(1,813)
Retained earnings		2,651	38
Total equity		**9,230**	**7,606**
NON-CURRENT LIABILITIES			
Other payables	21	13	8
Borrowings	17	26,988	27,761
Derivative financial instruments	28	835	2,478
Deferred income tax liability	26	6,789	6,330
Provisions	20	–	167
Accrued employee benefits	22	101	100
Other non-financial liabilities	22	7	15
Total non-current liabilities		**34,733**	**36,859**

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

In millions of Czech crowns	Note	31 December 2017	31 December 2016
CURRENT LIABILITIES			
Borrowings	17	299	286
Trade and other payables	21	517	524
Derivative financial instruments	28	209	292
Current income tax payable	26	–	176
Other taxes payable	19	18	20
Provisions	20	2	–
Accrued employee benefits	22	44	15
Other non-financial liabilities	24	182	174
Total current liabilities		**1,271**	**1,487**
Total liabilities		**36,004**	**38,346**
EQUITY AND LIABILITIES		**45,234**	**45,952**

14 March 2018

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2017

In millions of Czech crowns	Note	2017	2016
Revenue	6	7,397	9,280
Raw materials consumed	23	(302)	(450)
Services purchased and lease charges	23	(307)	(510)
Employee benefits	23	(440)	(510)
Depreciation and amortisation	8, 9, 23	(2,013)	(2,080)
Gains less losses on disposal of property, plant and equipment		–	3
Changes in fair value of derivatives, net		(37)	31
Foreign exchange differences, net	23	(100)	1
Other operating income		39	27
Other operating expenses	23	(41)	(36)
Operating profit		**4,196**	**5,756**
Finance income	24	4	8
Finance costs	25	(947)	(1,339)
Finance result (net)		(943)	(1,331)
Profit before income tax		**3,253**	**4,425**
Income tax expense	26	(619)	(3,008)
PROFIT FOR THE YEAR		**2,634**	**1,417**

Other comprehensive income / (loss)			
Items that may be subsequently reclassified to profit or loss			
Cash flow hedge	16	2,813	274
Income tax recognised directly in other comprehensive income – cash flow hedge	26	(535)	(52)
TOTAL OTHER COMPREHENSIVE INCOME FOR THE YEAR		**2,278**	**222**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**4,912**	**1,639**

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Changes in Equity for the year ended 31 December 2017

In millions of Czech crowns	Registered capital	Capital contributions outside registered capital	Cash flow hedges reserve	Retained earnings	Total
Balance as at 1 January 2016	**2,750**	**29**	**(2,035)**	**1,811**	**2,555**
Total comprehensive income					
Profit for the year 2016	–	–	–	1,417	1,417
Cash flow hedge – net of related tax effect	–	–	222	–	222
Total comprehensive income for the year	–	–	222	1,417	1,639
Transactions with owners					
Non-cash contribution outside registered capital (Note 16)	–	6,602	–	–	6,602
Dividends paid	–	–	–	(1,540)	(1,540)
Advance dividends paid	–	–	–	(1,650)	(1,650)
Balance as at 31 December 2016	**2,750**	**6,631**	**(1,813)**	**38**	**7,606**
Total comprehensive income					
Profit for the year 2017	–	–	–	2,634	2,634
Cash flow hedge – net of related tax effect	–	–	2,278	–	2,278
Total comprehensive income for the year	–	–	2,278	2,634	4,912
Transactions with owners					
Decrease of contribution outside registered capital (Note 16)	–	(3,622)	–	–	(3,622)
Contribution outside registered capital (Note 16)	–	355	–	–	355
Dividends paid	–	–	–	(21)	(21)
Balance as at 31 December 2017	**2,750**	**3,364**	**465**	**2,651**	**9,230**

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

NET4GAS Group
Consolidated Statement of Cash Flows
for the year ended 31 December 2017

In millions of Czech crowns	Note	2017	2016
Cash flows from operating activities			
Profit before tax		**3,253**	**4,425**
Adjustments for:			
Depreciation and amortisation	8, 9	2,013	2,080
Finance income	24	(4)	(8)
Finance costs	25	947	1,339
Gains less losses on disposals of property, plant and equipment		–	(3)
Other non-cash operating expenses / (gains)		(162)	(1)
thereof: – provision for penalty		*–*	*(39)*
– employee benefit provision		*29*	*47*
– release of unused provision		*(167)*	*–*
– other		*(24)*	*(9)*
Operating cash flows before working capital changes		**6,047**	**7,832**
Decrease / (Increase) in trade and other receivables	13, 14	(26)	(150)
Increase / (Decrease) in trade and other payables	21, 22	(20)	(240)
Decrease in inventories	11	2	2
Operating cash flows after changes in working capital		**6,003**	**7,444**
Interest paid	25	(614)	(1,021)
Interest received	24	1	11
Income tax paid	26	(1,108)	(733)
Net cash flows from operating activities		**4,282**	**5,701**
Cash flows from investing activities:			
Purchase of property, plant and equipment	8	(714)	(695)
Purchase of intangible assets	9	(30)	(33)
Proceeds from sale of property, plant and equipment		–	4
Repayments of loans provided to related parties*	12	–	4
Loans provided to related parties	12	5	(650)
Purchase of other financial assets	14	(683)	–
Net cash flows used in investing activities		**(1,422)**	**(1,370)**

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

In millions of Czech crowns	Note	2017	2016
Cash flows from financing activities:			
Payments of decreased contributions outside registered capital to the Company’s shareholder	16	(3,000)	–
Payments of increased contributions outside registered capital from Company’s shareholder	16	355	–
Dividends paid to the Company’s shareholder	16	–	(1,540)
Advance dividends paid to the Company’s shareholder	16	–	(1,650)
Repayments of borrowings*	17	(7,927)	(3,588)
Proceeds from borrowings	17	7,928	1,112
Net cash flows from financing activities		**(2,644)**	**(5,666)**
Net increase / (decrease) in cash and cash equivalents		**216**	**(1,335)**
Cash and cash equivalents at the beginning of the period	15	415	1,750
Cash and cash equivalents at the end of the period	**15**	**631**	**415**

* In 2016 a part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings, s.r.o. It was subsequently netted against receivable from capital contribution outside registered capital of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings, s.r.o. of CZK 1,898 million (Note 17).

The accompanying notes on pages 44 to 93 are an integral part of these consolidated financial statements.

NET4GAS Group Notes to the Consolidated Financial Statements

for the year ended 31 December 2017

1. NET4GAS Group and Its Operations – General Information

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union for the year ended 31 December 2017 for NET4GAS, s.r.o. (the "Company" or "NET4GAS") and its subsidiary BRAWA, a.s. (the "Subsidiary" or "BRAWA") (together the "Group" or "NET4GAS Group").

The Company was incorporated and is domiciled in the Czech Republic where is also the Group's principal place of business. The Company is a limited liability company. It was incorporated on 29 June 2005 and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. Identification number of the Company is 272 60 364.

The subsidiary BRAWA, a.s. (joint stock company) was incorporated on 10 November 2010 as 100% subsidiary of the Company and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. The Subsidiary's primary business activity is lease of GAZELLE gas pipeline to the Company. Identification number of the Subsidiary is 247 57 926.

The Group's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll. (the "Energy Act").

Since 2 August 2013 the Company is fully owned by NET4GAS Holdings, s.r.o. (the "NET4GAS Holdings"), incorporated in the Czech Republic, which is the Company's ultimate parent company. NET4GAS Holdings is a joint venture of two venturers: Allianz Infrastructure Czech HoldCo II S.à r.l. (50%) with its registered office in Luxembourg and Borealis Novus Parent B.V. (50%) with its registered office in the Netherlands.

The Statutory Directors of the Company:

As at 31 December 2017	As at 31 December 2016
Andreas Rau	Andreas Rau
Radek Benčík	Radek Benčík
Václav Hrach	Václav Hrach

The members of the Supervisory Board of the Company were as follows:

As at 31 December 2017	Function	As at 31 December 2016	Function
Jaroslava Korpancová	Member	Melchior Stahl	Member
Lenka Kovačovská	Member	Jaroslava Korpancová	Member
Kenton Edward Bradbury	Chairman	Lenka Kovačovská	Member
Mikhail Nahorny	Member	Kenton Edward Bradbury (from 24 June 2016)	Chairman
Andrew Cox (from 11 May 2017)	Member	Mikhail Nahorny (from 1 July 2016)	Member

Andrew Cox became member of the Supervisory Board on 11 May 2017 and the change was registered in the Commercial Register on 19 July 2017.

Melchior Stahl was terminated from Supervisory Board on 10 May 2017 and the change was registered in the Commercial Register on 19 July 2017.

About the Group. NET4GAS, s.r.o. is the exclusive gas transmission system operator in the Czech Republic, operating more than 3,800 km of gas pipelines. The Group is currently operating four compressor stations. The flow rate of the gas transmitted is measured at five border transfer stations (the Lanžhot, Brandov and Hora Svaté Kateřiny stations in the Czech Republic, and the Waidhaus and Olbernhau stations in the Federal Republic of Germany) and at almost a hundred national transfer stations. The NET4GAS transmission system has been specifically targeted in last few years for a number of new projects delivering additional transmission capacity and the greater diversification of transmission routes. These projects have included the construction of the GAZELLE high-pressure gas pipeline (DN 1400, put in operation in 2013), connecting the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov, and a project of a connection between the Czech and Polish transmission systems in Český Těšín. The entire NET4GAS transmission system can also be used for reverse flow, which means that it now has the capacity and technology to cope with natural gas transmission in any direction. The newest and largest project of the company is Capacity4Gas Project. This project will contribute to enhancing the security and gas supplies in the Czech Republic and in the entire CEE region. The objective of the Capacity4Gas project is to build new gas infrastructure, most of which is to be located in the Ústí and Pilsen regions. The aim of the project is to connect the gas infrastructure operated by NET4GAS to the planned EUGAL pipeline in Germany and to increase its capacity for the needs of gas supplies in the Czech Republic and further transit via Slovakia. The project shall be implemented in two stages, with completion scheduled for 2019 and 2021, respectively.

NET4GAS, s.r.o. is the successor to Tranzitní plynovod, n. p., Transgas, a.s. and RWE Transgas Net, s.r.o.

NET4GAS, s.r.o. founded BRAWA, a.s. as its subsidiary on 10 October 2010. Till 1 January 2013 BRAWA, a.s. was a dormant company. On 1 January 2013, under the legal reorganisation of NET4GAS's business, the GAZELLE pipeline was transferred to BRAWA and BRAWA became the sole owner of the GAZELLE pipeline. The GAZELLE pipeline is operated by NET4GAS.

Structure of the Group as at 31 December 2017 and 2016:

Name	Activity	Percentage of voting rights	Percentage of ownership	Country of registration
Subsidiary:				
BRAWA, a.s.	Owner of the GAZELLE natural gas pipeline which is rented to the Company	100%	100%	Czech Republic

With the effect from 2015, the accounting period of BRAWA ended on 30 November. Accounting period for year 2017 began on 1 December 2016 and ended on 30 November 2017. For the preparation of the Group's consolidated financial statements as at 31 December 2017 the actual BRAWA's transactions for January – December 2017 and balances as at 31 December 2017 were used.

Note
The consolidated financial statements have been prepared in Czech and in English. In all matters of interpretation of information, views or opinions, the Czech version of these consolidated financial statements takes precedence over the English version.

2. Operating Environment of the Group

The regulatory environment in the Czech Republic:

(a) Legal framework pertaining to the transmission system operator
The transmission system operator holds an exclusive gas transmission licence under the Energy Act, and its operations are regulated by the Energy Regulatory Authority (the "ERO").

The transmission system operator's rights and obligations are primarily derived from Section 58 of the Energy Act and are clarified in more detail in the related implementing legislation. The transmission system operator is also required to comply with obligations under the European legislation, in particular Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and the related implementing legislation.

NET4GAS Group
Notes to the Consolidated Financial Statements
for the year ended 31 December 2017

(b) Regulatory framework pertaining to the transmission system operator
Gas transmission prices are set annually by the ERO based on regulation methodology applicable in the regulatory period. Gas transmission prices for the next calendar year are usually published in an ERO's Pricing Decision by 30 November of the current year.

The 2017 gas transmission prices were established by ERO's Price Decision No 6/2016 from 25 November 2016 on Regulated Prices related to the gas supply a by its amendment No 1/2017 from 2 March 2017.

(c) Current regulatory period
The transmission system operator is currently subject to the IV. regulatory period, which began on 1 January 2016 and ends on 31 December 2020 (the ERO prolonged the original three year period by two years on 11 January 2018).

(d) Domestic transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for domestic gas transmission is based on a ceiling established for allowed revenues over a predetermined period (the revenue cap method). Domestic gas transmission prices are then derived from such defined allowed revenues. These prices consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(e) Transit transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for transit transmission relies on a price ceiling (of allowed prices) for a predetermined period (the price cap method). Allowed prices are set annually by the ERO based on a comparison of gas transmission prices in other relevant Member States of the European Union (benchmarking). These prices also consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(f) Unregulated part
Further to a decision of the ERO of 28 July 2011, the GAZELLE interconnecting pipeline was exempted from the obligation to grant third-party access at a regulated price under the conditions set out in the Energy Act.

3. Summary of Significant Accounting Policies

a) Basis of preparation
These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments) carried at fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented.

Preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Presentation currency. These consolidated financial statements are presented in Czech crowns ("CZK") which is also the functional currency of both companies of the Group.

b) Consolidation
Subsidiaries are those investees, including structured entities, that the Group controls because the Group (i) has power to direct relevant activities of the investees that significantly affect their returns, (ii) has exposure, or rights, to variable returns from its involvement with the investees, and (iii) has the ability to use its power over the investees to affect the amount of investor's returns.

Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date on which control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and all of its subsidiaries use uniform accounting policies consistent with the Group's policies.

c) Financial instruments – key measurement terms
Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

A portfolio of financial derivatives that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date. This is applicable for assets carried at fair value on a recurring basis if the Group:

(a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy; (b) it provides information on that basis about the group of assets and liabilities to the entity's key management personnel; and (c) the market risks, including duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities is substantially the same.

Fair value measurements are analysed in the fair value hierarchy level as follows (Note 31):

(i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based solely on observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the balance sheet.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

d) Classification of financial assets

Financial assets are classified in the following categories: (a) loans and receivables; and (b) financial assets at fair value through profit or loss.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments and are carried at amortized costs.

Financial assets at fair value through profit or loss, including financial derivatives are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The group designates certain derivatives as hedges of a particular risk associated with a fixed commitment or highly probable forecast transaction (cash flow hedge).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 31. Movements on the hedging reserve in other comprehensive income are shown in Note 16. The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

Cash flow hedge: The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the profit or loss within 'Finance costs' (in case of hedging of cash flows from revenues denominated in foreign currencies) or 'Changes in fair value of derivatives, net' (in case of hedging of cash flows from bonds issued denominated in foreign currency). Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of cross currency interest rate swaps hedging foreign exchange risk is recognised in the profit or loss within 'Revenue' (in case of hedging of revenues denominated in foreign currencies) or 'Finance costs' (in case of hedging of cash flows from bonds issued denominated in foreign currency).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in profit or loss when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recorded in other comprehensive income is immediately transferred to profit or loss within 'Foreign exchange differences, net'.

e) Classification of financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in profit or loss for the year (as finance income or finance costs) in the period in which they arise. Other financial liabilities are carried at amortised cost.

The Group designates certain financial liabilities as hedges of a particular risk associated with highly probable forecast transactions (cash flow hedge – Note 3d).

f) Initial recognition of financial instruments

Financial instruments not carried at fair value through profit or loss are initially recognized at fair value plus transaction costs. Financial instruments carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in profit or loss. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

The Group uses discounted cash flow valuation techniques to determine the fair value of cross-currency interest rate swaps and loans to related parties that are not traded in an active market. Differences may arise between the fair value at initial recognition, which is considered to be the transaction price, and the amount determined at initial recognition using the valuation technique. Any such differences are amortised on a straight line basis over the term of the cross-currency interest rate swaps and loans to related parties.

g) Derecognition of financial assets and financial liabilities

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

The Group derecognises financial liabilities only when the contractual liabilities of the Group are discharged, cancelled or expire. The difference between the carrying amount of a derecognised financial liability and the consideration paid is recognised in profit or loss.

h) Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required.

Significant spare parts are recognised and treated as property, plant and equipment.

Repairs and maintenance expenditures of tangible fixed assets are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

At the end of each reporting period management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use.

The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in profit or loss for the year.

When the Group recognises the cost of a replacement for part of the carrying amount of property, plant and equipment, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it was not practicable to determine the carrying amount of the replaced part, the Group used the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

i) Depreciation

Land is not depreciated. Construction in progress is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives
Buildings and constructions	30 – 70 years
Plant, machinery and equipment	4 – 40 years
Furniture and fittings	4 – 8 years
Motor vehicles	5 – 8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

j) Capitalisation of borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of assets that are not carried at fair value and that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when (a) the Group incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred on the specific borrowings less any investment income on the temporary investment of these borrowings are capitalised.

k) Leasing

Operating leases. Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss for the year on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

l) Intangible assets

The Group's intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks and licences.

Acquired computer software licences, patents and trademarks and other intangibles are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

m) Amortisation

Intangible assets are amortised using the straight-line method over their useful lives (unless the agreement or licence conditions state shorter or longer period):

	Useful lives
Software	3 years
Patents, and other licences	1.5 – 6 years
Development costs	6 years
Other intangible assets	6 years

n) Emission Rights

The Group receives free emission rights as a result of the European Emission Trading Schemes. The rights are received on an annual basis and in return the Group is required to return rights equal to its actual emissions. Therefore, a provision is only recognised when actual emissions exceed the emission rights received free of charge. The emission rights which were granted free of charge are carried at cost, i.e. at zero. When emission rights are purchased from third parties, they are measured at cost and treated as a reimbursement right. When emission rights are acquired by exchange and such an exchange is deemed to have the economic substance, they are measured at fair value as at the date when they become available for use and the difference between the fair value of rights received and cost of assets given up is recognised through profit or loss. The Group did not recognise any provision resulting from the gas emissions as at 31 December 2017 and 31 December 2016.

The amounts of emissions rights held in zero value by the Group were as follows:

In tons	31 December 2017	31 December 2016
Emission rights	391,912	403,619

o) Impairment of non-financial assets

Intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation and amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). Prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

p) Assets held for sale
Assets (or disposal groups) are classified as assets held for sale and stated at the lower of their residual amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Assets held for sale are not depreciated.

q) Taxes
Income tax
Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge / credit comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity (for example the effective portion of changes in the fair value of financial derivatives that are designated and qualify as cash flow hedges).

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

The Group controls the reversal of temporary differences relating to taxes chargeable on dividends from subsidiaries or on gains upon their disposal. The Group does not recognise deferred tax liabilities on such temporary differences except to the extent that management expects the temporary differences to reverse in the foreseeable future.

Value added tax
Output value added tax (VAT) related to sales is payable to tax authorities on the earlier of (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a net basis. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

r) Uncertain tax positions
The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognized based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

s) Inventories
Raw materials are mainly spare parts for the gas pipeline system. Purchased inventories are stated at the lower of cost and net realisable amount. Cost includes all costs related with its acquisition (mainly transport costs, customs duty, etc.). The weighted average cost method is applied for all disposals. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses. Significant spare parts are recognised and treated as property, plant and equipment.

t) Trade receivables
Trade receivables are carried at amortised cost using the effective interest method less relevant impairment.

u) Impairment of financial assets carried at amortised cost
Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and realizability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

– Any portion or instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;

– The counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;

– The counterparty considers bankruptcy or a financial reorganisation;

– There is adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account within the profit or loss for the year.

v) Prepayments
Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the

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goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

w) Cash and cash equivalents
Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

x) Dividends
Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note.

y) Advance dividends paid
The Group's decision to pay an advance dividend is reflected in the consolidated financial statements as a decrease in equity as of the date of the payment and is deducted from the balance sheet line – Retained earnings.

z) Borrowings
Borrowings are carried at amortised cost using the effective interest method.

At their initial recognition, all bank credits, loans and issued bonds are recorded at their purchase price corresponding to the fair value of the received cash funds, less the costs of obtaining the credit or loan or issue of bonds.

Amortised cost is determined by taking into account the costs of obtaining the credit or loan, as well as the discounts or bonuses received at the settlement of the liability.

The Group designates certain borrowings as hedges of a particular risk associated with a highly probable forecast transaction (cash flow hedge – Note 3d).

aa) Government and other grants
Grants from the government and European Commission are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Grants relating to the purchase of property, plant and equipment decrease directly the costs of the relevant asset.

bb) Trade and other payables
Trade payables are accrued when the counterparty performs its obligations under the contract and are carried at amortised cost using the effective interest method.

cc) Provisions for liabilities and charges
Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

dd) Financial guarantees
Financial guarantees are irrevocable contracts that require the Group to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. When the Group expects to receive recurring future premiums from an issued financial guarantee contract, the guarantee is recorded at the premium receivable at the inception of the contract and no receivable is recognised in respect of the future premium payments receivable. The premium receivable in one instalment is amortised on a straight line basis over the period covered by that instalment. At the end of each reporting period, the premium receivable in respect of the respective period is measured at its present value and the financial liability is measured at the higher of the remaining unamortised balance and the best estimate of expenditure required to settle the obligation at the end of the reporting period.

ee) Assets retirement obligations
The Group's transmission system is mainly constructed on the land owned by third parties. The current legislation requires the Company to incur the costs related to transmission system's operation and maintenance. The current Czech environmental and energy legislation does not set the obligation to liquidate the assets at the end of their useful life. Given the currently valid legislation management believes that there is no asset retirement obligation (dismantling and removing an item of property, plant and equipment) to be recognised in the financial statements.

ff) Foreign currency translation
The functional currency of each of the Group's consolidated entities is the currency of the primary economic environment in which the entity operates. The functional currency of the Company and its subsidiary is Czech crown ("CZK"), and the Group's presentation currency is also CZK.

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the Czech National Bank ("CNB") at the respective end of the reporting period. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CNB are recognised in profit or loss within finance or operating income or expenses. Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined. Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

gg) Revenue recognition
The Group recognises as revenue mainly income from fees collected for the gas transmission within and across the Czech Republic.

Revenue from gas transmission services is recognised on time proportional basis based on the reserved capacity, at the maximum on a monthly basis. Revenues are invoiced on a monthly basis (or shorter where applicable) and sales are shown net of VAT and discounts. Revenues are measured at the fair value of the consideration received or receivable.

Interest income is recognised on a time-proportion basis using the effective interest method.

hh) Employee benefits
Wages, salaries, contributions to the Czech state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and other services) are accrued in the year in which the associated services are rendered by the employees of the Group.

a) Pension obligations
A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the

current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

b) Termination benefits
Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits at the earlier of the following dates: (a) when the Group can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their present value.

c) Other long term benefits
Long-term employee benefits, such as long-term bonuses, and long service awards are accounted for measured using the projected unit credit method in the same way as defined benefit pension plan, with the exception that re-measurements (actuarial gains/losses) and related charges are recognised immediately through in profit or loss.

ii) Offsetting of financial assets and financial liabilities
Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) in the event of default and (iii) in the event of insolvency or bankruptcy.

jj) Segment reporting
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the Group. Segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

4. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Group makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Functional currency
Management assessed the relevant primary and secondary factors during the consideration about the Company's functional currency. The functional currency is the currency of the primary economic environment, in which the entity operates. The regulated sales prices of the Group are determined by ERO – the Czech regulatory authority and are defined in CZK. Majority of the entity's revenue stems from regulated sales. Majority of the operating expenses of the Group are influenced by CZK. Capital expenditures are twofold: regular capital expenditure safeguarding the existing system and its safeness; and large one off projects. The regular capital expenditure is almost entirely influenced by CZK, while the pricing of large one off projects is influenced by a mix of currencies (including CZK, EUR and other). The funds from financing activities are generated by a mix of currencies (including CZK, EUR and US Dollars). Although the entity's operations are influenced by a mix of currencies, management concluded that majority of the indicators support CZK as the functional currency of the Company. Functional currency of the company BRAWA is affected by the functional currency of NET4GAS, because BRAWA does not operate totally autonomously. It is actually more an extension of the Company's operation.

Classification of pipeline capacity contract
The Group entered into long-term contracts expiring on 1 January 2021 and 1 January 2035 whereby it provided majority of its GAZELLE pipeline capacity under 'ship or pay' basis. Management considered whether the contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Group's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract. The Group treats the pipeline as its property, plant and equipment and recognises revenue from the contract with the major customer in accordance with IAS 18.

New cross-border capacity was offered and successfully marketed at the annual capacity auction on March 6, 2017. The Company launched the implementation phase of a new project entitled Capacity4Gas. The objective of the project is to build new gas infrastructure within the NET4GAS transmission system. The Capacity4Gas project is executed in two stages, the completion of which is planned for 2019 and 2021. Management considered whether the new contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline DN 1400 is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Company's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract.

Transmission System Operator licence and gas pipelines
Considering the applicability of IFRIC 12 for the Group, management believes that the control requirements have not been met as the title will never be transferred to the government nor can the government control the operator's practical ability to sell or pledge the infrastructure and government is not controlling the construction process. Therefore the Group's system is classified as property, plant and equipment and is not treated as infrastructure used in public-to-private service concession arrangements.

Risk related to tax position – year 2016
NET4GAS was established by way of legal reorganisation of part of the business of RWE Transgas, a.s. ("RWE Transgas") due to the unbundling requirement under the so called Second Energy Package of the European Union, while part of the business of RWE Transgas was contributed to registered capital of NET4GAS. As a result of the unbundling process and related revaluation, the accounting carrying amounts of the gas transmission system under the Czech accounting legislation ("local GAAP") were significantly increased (based on an appointed appraiser's valuation) compared to their tax values (i.e. the historical cost based measurement rolled over from the tax books of RWE Transgas, which was the basis for tax depreciation). Due to the temporary differences between the

new carrying amounts and the tax values of the transmission system, the deferred tax liability was recorded in 2006 against equity of NET4GAS under local GAAP. ERO has approved the inclusion of accounting depreciation (based on the revalued amounts) of the gas pipeline system in the final price for the inland gas transmission services. It means that the regulated prices (taxable income) charged by NET4GAS to its customers have been increased by the effect of local GAAP accounting depreciation, while the original tax base has been based on the historical costs of the gas pipeline system only.

In 2015 NET4GAS applied the amended Income Tax Act, in which the provision of Section 23(4) (e) governs direct relation between tax non-deductible expenses and revenues. As a result of the change, part of the taxable income generated by the gas pipeline network was, in management's view, not taxable. Although the amended favourable rule was new, management was of the view that it was more likely than not, that the Company was able to sustain its position based on the amended law. The calculation of income tax charge for 2015 and deferred tax liability as at 31 December 2015 were based on this view.

Views of the expert audience and professional advisors developed during 2016. As a result of the development, management no longer keeps the view that it is more likely than not, that the Company sustains its position in connection with deferred tax liability position. Management decided to recognise deferred tax liability related to the temporary differences of pipeline network in full amount without taking into account the (potential) benefit of the provision of Section 23(4) (e). As a result of this change in management estimate the deferred tax liability was increased by CZK 2,125 million and the change was recognised as an expense (loss) in the previous period. This adjustment as a change in management view was a change in estimate in respect of deferred tax liability that was according to IAS 8 guidance recognised prospectively. It was neither a change in an accounting policy nor a correction of prior period error. Submitted income tax return for 2015 (filed on 24 October 2016, in extended deadline) reflected the revised management view.

In 2017 there was no impact of (potential) benefit of the provision of Section 23(4)(e) of the Income Tax Act on the Company.

Segments
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or a group of persons who allocates resources and assesses the performance of the Group. Recurring revenues are from the contracts with foreign and domestic customers. Information for CODM (the Company's Statutory Directors) who are responsible for allocating resources and assessing performance of the Group is prepared for the whole Group without any particular structuring. Management regularly obtain information with assessment of the split of revenue between the transit revenue and domestic transmission revenue. There is no profit measure, which would be based on similar basis. All profit measures used by the CODM are based on the results of the Group considered as one business unit. As a result, management consider the whole Group as one segment for the purpose of segment reporting.

Unpaid receivable – Arbitration court
Since October 2016, no monthly fees under one contract have been paid by a customer. An arbitration claim was filed on 26 April 2017 and the arbitration procedure is pending. It is assumed that at least until middle of 2018 no payments from this contract would be received. The Group believes it has a solid case and its chance of success is very good. The total unpaid receivable as of 31 December 2017 is CZK 129 million and is not impaired as the management believes that the receivable will be fully paid.

5. Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements

a) Adoption of new or revised standards and interpretations that are effective on or after 1 January 2017

Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017. The amended IAS 7 required disclosure of a reconciliation of movements in liabilities arising from financing activities.

No other new or revised standards and interpretations have material impact on the Group.

b) New standards and interpretations that have been issued and are mandatory for the annual periods beginning on or after 1 January 2018 or later

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2018 or later, and which the Group has not early adopted.

IFRS 9 "Financial Instruments: Classification and Measurement" (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

– Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

– Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

– Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

– Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

– IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

– IFRS 9 provides an accounting policy choice: entities can either continue to apply the hedge accounting requirements of IAS 39 (see chapter 6.8A), pending the macro hedging project being finalised, or they can apply IFRS 9. For the reporting period beginning on January 1, 2018, the Group has decided to continue with hedge requirements of IAS 39. The Group is considering the transition to IFRS 9 in the future.

– Due to the nature of the Group's operations and the types of financial instruments it holds, IFRS 9 is not expected to change the classification and measurement of the Group financial instruments.

– The Group performed analysis of IFRS 9 impact of the new model for the recognition of impairment losses for the financial statements as at 31 December 2017. The ratio of impaired assets to total revenues from the Group's business generating all profits is 0%. Of the value of short-term assets CZK 1,970 million, only CZK 137 million is included in overdue category (Note 13). Regarding the above mentioned, the Group does not expect IFRS 9 to have a significant impact on the financial statements.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

The management of the Group has completed an initial assessment of the potential impact of IFRS 15 on the Group's financial statements and does not expect that this new standard would have a material impact on the financial statements during its initial application. Due to the nature of the Group's operations and the types of revenue, IFRS 15 is not expected to change the timing and revaluation of the Group's revenues.

Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the Standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard.

IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Group is currently assessing the impact of the amendment on its consolidated financial statements.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). The interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) on the derecognition of a non-monetary asset or non-monetary liability arising from an advance consideration in a foreign currency. Under IAS 21, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transaction for each payment or receipt of advance consideration. IFRIC 22 only applies in circumstances in which an entity recognises a non-monetary asset or non-monetary liability arising from an advance consideration. IFRIC 22 does not provide application guidance on the definition of monetary and non-monetary items. An advance payment or receipt of consideration generally gives rise to the recognition of a non-monetary asset or non-monetary liability, however, it may also give rise to a monetary asset or liability. An entity may need to apply judgment in determining whether an item is monetary or non-monetary. Management is currently assessing the impact of the amendments on its financial statements.

No other new or revised standards and interpretations have material impact on the Group.

6. Segment Information

(a) Description of products and services from which each reportable segment derives its revenue

The Group is organised on the basis of one main business segment – Natural gas transmission (representing natural gas transmission services).

(b) Factors that management used to identify the reportable segments

Refer to the information in Note 4.

(c) Information about reportable segment profit or loss, assets and liabilities

The whole Group is considered as one reportable segment. Segment information for the reportable segment for the years ended 31 December 2017 and 31 December 2016 is set out below:

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In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	2017	**2016**
Revenues	7,397	9,280
Other operating income	39	27
Finance income	4	8
Total segment income	**7,440**	**9,315**
Raw materials consumed	302	450
Employee benefits	440	510
Depreciation and amortization	2,013	2,080
Services purchased and lease charges	307	510
Gains less losses on disposals of property, plant and equipment	–	(3)
Changes in fair value of derivatives, net	37	(31)
Foreign exchange differences, net	100	(1)
Other operating expenses	41	36
Income tax expense	619	3,008
Finance costs	947	1,339
Segment profit for the year	**2,634**	**1,417**
Segment other comprehensive income for the year	**2,278**	**222**
Segment total comprehensive income for the year	**4,912**	**1,639**
Capital expenditure	**771**	**680**

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	31 December 2017	**31 December 2016**
Total reportable segment Assets	**45,234**	**45,952**
Total reportable segment Liabilities	**36,004**	**38,346**

Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

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(d) Geographical information

Total revenues for geographical areas for which the revenues are material are reported separately and disclosed below.

The analysis is based on domicile of shippers (users of the transmission system that is operated by the Group in the Czech Republic).

In millions of Czech crowns	2017	2016
Czech Republic	1,566	1,850
Other EU countries	1,297	2,129
Non-EU countries	4,534	5,301
Total consolidated revenues from core activities	**7,397**	**9,280**

Capital expenditure for each individual country is reported separately as follows:

In millions of Czech crowns	2017	2016
Czech Republic	771	680
Total consolidated capital expenditure	**771**	**680**

The analysis is based on location of assets. Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(e) Major customers

Revenues from customers which represent 10% or more of the total revenues are as follows:

In millions of Czech crowns	2017	2016
Customer 1	4,885	5,659
Customer 2	1,117	1,390
Customer 3	406	1,274
Total revenues from major customers	**6,408**	**8,323**

Revenues comprise only revenues from core activities.

Entities known to the Group as being under common control are considered as a single customer.

7. Balances and Transactions with Related Parties

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Group is fully owned by NET4GAS Holdings and NET4GAS Holdings is the ultimate parent company of the Group.

The Group's balances and transactions with subsidiaries of ultimate parent of Allianz Infrastructure Czech HoldCo II S.à r.l. and subsidiaries of ultimate parent of Borealis Novus Parent B.V. are disclosed below within the category Subsidiaries of joint ventures' ultimate parents.

At 31 December 2017, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Loans to related parties (Note 12)		
NET4GAS Holdings, s.r.o.	–	5
Borrowings (Note 17)		
NET4GAS Holdings, s.r.o.	–	22

The income and expense items with related parties for the year ended 31 December 2017 were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Other revenues		
NET4GAS Holdings, s.r.o. – interest income	–	2
NET4GAS Holdings, s.r.o. – services	–	1

At 31 December 2016, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Loans to related parties (Note 12)		
NET4GAS Holdings, s.r.o.	–	652
Borrowings (Note 17)		
NET4GAS Holdings, s.r.o.	–	25

The income and expense items with related parties for the year ended 31 December 2016 were as follows:

In millions of Czech crowns	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses		
NET4GAS Holdings, s.r.o. – interest expense	–	1
Borealis Novus Holdings B.V. – interest expense	182	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	182	–
Other revenues / gains / received payments		
NET4GAS Holdings, s.r.o. – interest income	–	6
NET4GAS Holdings, s.r.o. – services	–	1

At 31 December 2017 and 2016 the Group did not have any other rights and obligations connected to related parties.

Key management compensation is presented below:

	2017		2016	
In millions of Czech crowns	Expense	Accrued liability	Expense	Accrued liability
Short-term benefits:				
– Salaries	57	4	47	4
– Short-term bonuses	15	14	14	14
– Current portion of long-term bonuses	–	–	–	8
Other long-term employee benefits:				
– Long-term bonus scheme	16	36	13	32
– Defined contribution benefits	5	3	5	3
Total	**93**	**57**	**79**	**61**

Short-term bonuses fall due wholly within twelve months after the end of the period in which management rendered the related services.

Key management represents Statutory Directors and managers directly reporting to them.

8. Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment were as follows:

In millions of Czech crowns	Freehold Land	Buildings and constructions	Plant and equipment	Construction in progress	Total
Cost at 31 December 2015	182	61,516	5,624	326	67,648
Accumulated depreciation	–	(17,396)	(4,490)	–	(21,886)
Carrying amount at 1 January 2016	**182**	**44,120**	**1,134**	**326**	**45,762**
Additions	–	–	–	634	634
Capitalised borrowing costs	–	–	–	13	13
Transfers	3	310	184	(497)	–
Disposals	–	(20)	–	–	(20)
Depreciation charge	–	(1,784)	(222)	–	(2,006)
Carrying amount at 31 December 2016	**185**	**42,626**	**1,096**	**476**	**44,383**
Cost at 31 December 2016	185	61,684	5,774	476	68,119
Accumulated depreciation	–	(19,058)	(4,678)	–	(23,736)
Carrying amount at 31 December 2016	**185**	**42,626**	**1,096**	**476**	**44,383**
Additions	–	–	–	732	732
Capitalised borrowing costs	–	–	–	9	9
Transfers	1	279	246	(526)	–
Disposals	–	(2)	(3)	–	(5)
Depreciation charge	–	(1,744)	(228)	–	(1,972)
Carrying amount at 31 December 2017	**186**	**41,159**	**1,111**	**691**	**43,147**
Cost at 31 December 2017	186	62,036	5,951	691	68,864
Accumulated depreciation	–	(20,877)	(4,840)	–	(25,717)
Carrying amount at 31 December 2017	**186**	**41,159**	**1,111**	**691**	**43,147**

The Group invested in 2017 a total of CZK 741 million in tangible assets. The most significant investment was within the Capacity4Gas project, a total of CZK 189 million. In 2017, the Group made resolution about continuance of operation of compressor stations and reassess their useful lives (Note 20). The impact on depreciation 2017 is a decrease of CZK 4 million.

As at 31 December 2017, construction in progress consists mainly of construction of Czech-Polish interconnector gas pipeline of CZK 308 million (31 December 2016: CZK 252 million). Upon completion, assets are expected to be transferred to buildings and constructions. Other items represent smaller projects.

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9. Intangible Assets

In millions of Czech crowns	Acquired software licences	Development costs	Other	Assets under construction	Total
Cost at 1 January 2016	416	57	24	32	529
Accumulated amortisation	(356)	(52)	(11)	–	(419)
Carrying amount at 1 January 2016	**60**	**5**	**13**	**32**	**110**
Additions	–	–	–	33	33
Transfers	43	–	2	(45)	–
Amortisation charge	(48)	(3)	(3)	–	(54)
Carrying amount at 31 December 2016	**55**	**2**	**12**	**20**	**89**
Cost at 31 December 2016	458	54	26	20	558
Accumulated amortisation	(403)	(52)	(14)	–	(469)
Carrying amount at 31 December 2016	**55**	**2**	**12**	**20**	**89**
Additions	–	–	–	30	30
Transfers	38	–	2	(40)	–
Amortisation charge	(36)	(2)	(3)	–	(41)
Carrying amount at 31 December 2017	**57**	**–**	**11**	**10**	**78**
Cost at 31 December 2017	496	54	28	10	588
Accumulated amortisation	(439)	(54)	(17)	–	(510)
Carrying amount at 31 December 2017	**57**	**–**	**11**	**10**	**78**

10. Other Non-Current Assets

In millions of Czech crowns	31 December 2017	31 December 2016
Advances for acquisition of fixed assets	25	9
Total other non-current assets	**25**	**9**

11. Inventories

In millions of Czech crowns	31 December 2017	31 December 2016
Raw materials	61	63
Total inventories	**61**	**63**

Raw materials are mainly spare parts for the gas transmission system.

There are no inventories valued at net realisable value as at 31 December 2017 and 2016.

12. Loans to Related Parties

In millions of Czech crowns	31 December 2017	31 December 2016
Corporate loans		
– denominated in Czech crowns	–	164
– denominated in Euros	5	488
Total loans provided	**5**	**652**

Loans to related parties are provided on the basis of the Loan agreement dated 11 November 2013 and are of short-term nature.

In June 2017, based on the resolution of sole shareholder of Company the loan provided to sole shareholder was set-off against the liability of Company from profit distribution and the return of the contribution to other capital fund (Note 16).

Interest rates related to loan to related parties are disclosed in Note 29, section interest rate risk.

Analysis by credit quality of loans outstanding is as follows:

In millions of Czech crowns	31 December 2017 Corporate loans	31 December 2016 Corporate loans
Neither past due nor impaired		
– NET4GAS Holdings, s.r.o. – parent company (without external rating)	5	652
Total neither past due nor impaired	**5**	**652**
Total loans provided	**5**	**652**

There are no collaterals related to the above mentioned loans.

Refer to Note 31 for the estimated fair value of each class of loans. Interest rate analysis of loans is disclosed in Note 29. Information on related party transactions is disclosed in Note 7.

13. Trade and Other Receivables

In millions of Czech crowns	31 December 2017	31 December 2016
Trade and estimated receivables	325	304
Less impairment loss provision	(1)	(1)
Total current trade and other receivables	**324**	**303**

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Analysis by credit quality of trade and other receivables is as follows:

In millions of Czech crowns	31 December 2017 Trade and estimated receivables	31 December 2016 Trade and estimated receivables
Neither past due nor impaired – exposure to		
– Between A- and BBB-*	167	238
– Not rated	21	47
Total neither past due nor impaired	188	285
Past due but not impaired		
– less than 30 days overdue	16	9
– between 30 – 60 days overdue	9	9
– 60 days or more overdue	111	–
Total past due but not impaired	136	18
Individually determined to be impaired (gross)		
– 360 days or more overdue	1	1
Total individually impaired	1	1
Less impairment provision	(1)	(1)
Total trade and other receivables	**324**	**303**

* Rating disclosed is equivalent credit rating from the third party rating agencies defined in the Network Code approved by ERO which is applicable for the Company.

14. Other Non-Financial Assets and Other Financial Assets

In millions of Czech crowns	31 December 2017	31 December 2016
Value-added tax prepaid	–	3
Prepayments for services	32	24
Total current non-financial assets	**32**	**27**

Other Financial Assets including credit quality are following:

In millions of Czech crowns	31 December 2017	31 December 2016
Deposit bills of exchange with original maturity of less than three months (A+ to A- rated)	300	–
Deposit bills of exchange with original maturity of less than six months (A+ to A- rated)	383	–
Total other financial assets	**683**	**–**

15. Cash and Cash Equivalents

In millions of Czech crowns	31 December 2017	31 December 2016
Bank balances available on demand	631	415
Total cash and cash equivalents	**631**	**415**

The credit quality of cash and cash equivalents balances may be summarised as follows:

In millions of Czech crowns	31 December 2017	31 December 2016
– A+ to A- rated	366	376
– BBB+ to BBB- rated	265	39
Total	**631**	**415**

16. Equity

The Company is a limited liability company. It has no issued share securities. The rights attributed to share in the equity correspond to the proportion in the ownership interest.

Dividends declared and paid or settled during the year were as follows:

In millions of Czech crowns	2017	2016
Dividends payable at 1 January	–	–
Dividends declared and paid or settled during the year	21	1,540
Dividends payable at 31 December	–	–

Advance dividends paid during the year were as follows:

In millions of Czech crowns	2017	2016
Advance dividends paid	–	1,650
Total advance dividends paid	**–**	**1,650**

All dividends were declared in Czech crowns and paid in a different currency mix (CZK, EUR and USD).

On 15 December 2016 the Statutory Directors of the Company decided about the advance dividend payment of CZK 1,650 million. The payment of the advance dividend is subsequently subject to approval of the general meeting of the sole shareholder of the Company dated 16 June 2017. The advance dividend payments are recognised as a decrease in equity as at the date of the payment.

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A description of the nature and purpose of each reserve is provided below the table.

In millions of Czech crowns	Capital contributions outside registered capital	Cash flow hedges	Total other reserves
Balance as at 1 January 2016	**29**	**(2,035)**	**(2,006)**
Revaluation – gross	–	(2)	(2)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	1	1
Deferred tax effect	–	(52)	(52)
Non-cash contribution outside registered capital	6,602	–	6,602
Balance as at 31 December 2016	**6,631**	**(1,813)**	**4,818**
Revaluation – gross	–	2,574	2,574
Reclassification to profit or loss (Revenues) – gross	–	228	228
Reclassification to profit or loss (Finance costs) – gross	–	11	11
Deferred tax effect	–	(535)	(535)
Contribution outside registered capital	(3,267)	–	(3,267)
Balance as at 31 December 2017	**3,364**	**465**	**3,829**

Capital contributions outside registered capital
Capital contributions outside registered capital comprises of cash and non-cash capital contributions that does not give rise to the registered capital.

Increase / decrease in Capital contributions outside registered capital:

Month/Year	In millions of Czech crowns	Comment to the settlement of the increase/decrease
July 2016	6,602	Netted against cessed receivable from loan to related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. to NET4GAS Holdings
Total increase in 2016	**6,602**	
June 2017	(622)	Netted against receivable from loans incl. interest to NET4GAS Holdings (cash-pooling)
June 2017	(3,000)	Cash payment
November 2017	355	Cash received*
Total decrease in 2017	**(3,267)**	

* For purpose of Capacity4Gas project funding there was concluded Funding agreement based on which the sole shareholder provided capital contribution outside registered capital.

Cash flow hedges
Cash flow hedges are used to recognize gains or losses on hedging instruments that are designated and qualify as cash flow hedges in other comprehensive income, as described in Note 3(d). Amounts are reclassified to profit or loss when the associated hedged transaction affects profit or loss.

17. Borrowings

In millions of Czech crowns	31 December 2017	31 December 2016
Short-term borrowings from related parties (cash pooling NET4GAS Holdings)	22	25
Current portion of bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 30 May 2022)	12	–
– CZK denominated bond (repayable on 28 January 2021)	129	117
– EUR denominated bond (repayable on 28 July 2021)	66	70
– EUR denominated bond (repayable on 28 July 2026) – issued in 2014	56	59
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	14	15
Non-current bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 30 May 2022)	7,061	5,736
– USD denominated bank borrowings (repayable on 28 July 2018)	–	1,381
– CZK denominated bond (repayable on 28 January 2021)	6,968	6,952
– EUR denominated bond (repayable on 28 July 2021)	7,627	8,055
– EUR denominated bond (repayable on 28 July 2026) – issued in 2014	4,060	4,291
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	1,272	1,346
Total borrowings – current	**299**	**286**
Total borrowings – non-current	**26,988**	**27,761**
Total borrowings	**27,287**	**28,047**

Bank borrowings and bonds
The Group borrowings as at 31 December 2016 have been constituted by bank borrowings acquired in 2014 and bonds issued in 2014 and 2015. In May 2017 CZK and USD bank borrowings due in 2018 were replaced by new CZK bank borrowing with the maturity until 30 May 2022. The total value of the Group's debt has remained stable, the currency mix has changed.

The Group acquired the committed revolving facility agreement in equivalent of EUR 80 million (CZK 2,043 million per Czech National Bank foreign exchange rate as at 31 December 2017). Further, the group acquired the Overdraft facility in the equivalent of EUR 20 million (CZK 511 million per Czech National Bank foreign exchange rate as at 31 December 2017. Both facility agreements might be utilized in CZK or EUR. During 2017 the Revolving facility agreement and Overdraft facility were drawn and repaid, as at 31 December 2017 were undrawn (as at 31 December 2016 Revolving facility and Overdraft facility were undrawn).

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Six banks with different share participated on the total bank borrowings as at 31 December 2017 (nine banks as at 31 December 2016).

The Group's right to lien its property in favour of another creditor is restricted.

Group's senior debts are all issued at pari-passu. The bank borrowings and bonds have no quantitative financial covenants. There are several qualitative covenants applied, i.e. negative pledge, change of control put and loss of finance put. Violation of these covenants can lead to immediate maturity of the debt.

Bank borrowings and bonds denominated in foreign currency represent a constituent of hedge accounting, which represents the hedging instrument for securing of foreign exchange risk associated with a highly probable forecasted future cash flows resulting from natural gas transmission revenues (cash flow hedge) – Note 29, Note 3d).

In May 2017 USD bank borrowing was repaid (was replaced by new CZK bank borrowing). The cumulative loss in equity (hedge accounting) remained in equity and will be recognised gradually in costs (based on effectivity test made at the date of redemption, till March 2030).

Bonds issued:

In millions of Czech crowns	Issue nominal value	Due date	Annual coupon repayment due date	31 December 2017	31 December 2016
Bond EUR, serial no. 1, ISIN XS1090450047	300,000,000 EUR	28 Jul 2021	Each 28.7. in arrears	7,693	8,125
Bond EUR, serial no. 2, ISIN XS1090449627	160,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	4,116	4,350
Bond CZK, serial no. 3, ISIN XS1090620730	7,000,000,000 CZK	28 Jan 2021	Each 28.1. in arrears	7,097	7,069
Bond EUR, serial no. 4, ISIN XS1172113638	50,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	1,286	1,361
Total bonds				**20,192**	**20,905**

Coupon rates to the above mentioned bonds are in range of 2.25% – 3.5% p.a. On 28 July 2014 bonds, serial no. 1 – 3, were accepted for trading on a regulated market of the Irish Stock Exchange PLC. The terms of issue of all above stated bonds have been approved by the decision of the Central Bank of Ireland. The 2015 bond, serial no. 4, was issued via private placement.

The fair value of borrowings is disclosed in Note 31.

18. Government and Other Grants

The Group obtained grants from European Commission for construction projects and deducted the grant value from the carrying amount of the related property, plant and equipment when all conditions attached to the grant were fulfilled.

In millions of Czech crowns	31 December 2017	31 December 2016
Grants	7	15

In 2017 the Group received a grant of CZK 2 million. The Group complied with all attached condition and therefore the amount of CZK 10 million was deducted from the carrying amount of property, plant and equipment in 2017 (2016: CZK 1 million).

19. Other Taxes Payable

In millions of Czech crowns	31 December 2017	31 December 2016
Other taxes payable within one year comprise:		
Property and other taxes	6	8
Social and health insurance	12	12
Other taxes payable – current	**18**	**20**

20. Provisions for Liabilities and Charges

Movements in provisions are as follows:

	2017		2016	
In millions of Czech crowns	Current	Non-current	Current	Non-current
Carrying amount at January 1	**–**	**167**	**40**	**177**
Additions charged to profit or loss	2	–	–	2
Unused amounts reversed	–	(167)	–	(12)
Amounts used during the year	–	–	(40)	–
Carrying amount at December 31	**2**	**–**	**–**	**167**

The non-current provisions as at 31 December 2016 were primarily set aside for restructuring on selected compressor stations (expected to be utilised in year 2021).

New cross-border capacity was offered and successfully marketed at the annual capacity auction on 6 March 2017 – a result of the joint efforts between the transmission operators in the Federal Republic of Germany, the Czech Republic and the Slovak Republic. Based on the results of this auction, The Group is ready to invest into relevant new gas infrastructure in the Czech Republic in the upcoming years. In connection with this construction, the Group made resolution about continue of operation of these compressor stations, reassessed their useful lives and released the provision for liquidation and the provision for restructuring – termination payments to employees.

21. Trade and Other Payables

In millions of Czech crowns	31 December 2017	31 December 2016
Trade payables for purchased property, plant and equipment	150	145
Trade payables – other	98	106
Accrued liabilities for purchased property, plant and equipment	53	20
Accrued liabilities – other	68	111
Received deposits from customers	147	139
Other financial liabilities	1	3
Total financial payables within trade and other payables – current	**517**	**524**
Other payables	13	8
Total financial payables within other payables – non-current	**13**	**8**

22. Accrued Employees Benefits and Other Non-Financial Liabilities

In millions of Czech crowns	31 December 2017	31 December 2016
Accrued employee benefits		
– Salaries and bonuses	25	31
– Defined contribution costs	44	15
– Untaken holiday costs	12	7
Prepayments received	132	130
Other non-financial liabilities	13	6
Total accrued employee benefits and other non-financial liabilities – current	**226**	**189**

In millions of Czech crowns	31 December 2017	31 December 2016
Accrued employee benefits – other long-term benefits	101	100
Grant prepayments received (Note 18)	7	15
Total accrued employee benefits and other non-financial liabilities – non-current	**108**	**115**

23. Expenses

In millions of Czech crowns	2017	2016
Raw materials consumed*	302	450
Salaries	*297*	*338*
Statutory and private pension contribution	*143*	*172*
Employee benefits	440	510
Depreciation and amortisation	2,013	2,080
Repairs and maintenance services	*141*	*137*
Flexibility service costs	*–*	*25*
IT & Telecommunications expenses	*95*	*98*
Consultancy and advisory services	*61*	*74*
Lease charges	*64*	*52*
Marketing	*20*	*21*
Other services	*(73)*	*103*
Services purchased and lease charges	307	510
(Gains) on disposal of fixed assets	–	(3)
Losses / (gains) on derivative financial instruments	37	(31)
Foreign exchange differences, net	100	(1)
Other expenses	41	36
Total operating expenses	**3,240**	**3,551**

* Represents mainly consumption of natural gas.

24. Finance Income

In millions of Czech crowns	2017	2016
Interest income on other financial assets	3	7
Other finance income	1	1
Total finance income recognised in profit or loss	**4**	**8**

25. Finance Costs

In millions of Czech crowns	2017	2016
Net foreign exchange differences on financing activities	257	262
Interest expense	621	1,016
Other finance costs	69	61
Total finance costs recognised in profit or loss	**947**	**1,339**

26. Income Taxes

For details about the risks related to tax position refer to Note 4.

(a) Components of income tax expense

Income tax expense / (credit) recorded in profit or loss comprises the following:

In millions of Czech crowns	2017	2016
Adjustment in respect of current income tax from prior year	–	48
Current income tax expense	695	928
Deferred income tax expense / (credit)	(76)	2,032
Income tax expense for the year in statement of profit or loss	**619**	**3,008**

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Group's 2017 and 2016 income is 19%. The reconciliation between the expected and the actual tax charge is provided below.

In millions of Czech crowns	2017	2016
Profit before tax	**3,253**	**4,425**
Theoretical tax charge at statutory rate of 19%:	618	841
Tax effect of items which are not deductible or assessable for income tax purposes:		
– Non-deductible expenses	–	6
Difference between current income tax provision and final current income tax return	–	48
Other effects	1	(12)
Increase in deferred tax liability – change in estimate (Note 4)	–	2,125
Income tax expense for the year	**619**	**3,008**

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and tax regulation in the Czech Republic give rise to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

In millions of Czech crowns	1 January 2017	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2017
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(6,810)	100	–	(6,710)
Impairment provision for receivables	–			
Other liabilities; tax deductible in different period	24	7	–	31
Provisions for liabilities and charges	31	(31)	–	–
Cash flow hedges	425	–	(535)	(110)
Net deferred tax asset/(liability)	**(6,330)**	**76**	**(535)**	**(6,789)**

Management estimates that net deferred tax liabilities of CZK 6,775 million (2016: CZK 6,330 million) are recoverable in more than twelve months after the end of the reporting period.

The tax effects of the movements in the temporary differences for the year ended 31 December 2016 were:

In millions of Czech crowns	1 January 2016	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2016
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,781)	(2,029)	–	(6,810)
Impairment provision for receivables	1	(1)	–	–
Other liabilities; tax deductible in different period	24	–	–	24
Provisions for liabilities and charges	33	(2)	–	31
Cash flow hedges	477	–	(52)	425
Net deferred tax asset/(liability)	**(4,246)**	**(2,032)**	**(52)**	**(6,330)**

(d) Tax effects in the other comprehensive income

Disclosure of tax effects relating to cash flow hedge reserve (see also Note 16):

	31 December 2017			31 December 2016		
In millions of Czech crowns	Before tax	Tax effects	After tax	Before tax	Tax effects	After tax
Cash flow hedge	575	(110)	465	(2,238)	425	(1,813)
Other comprehensive income for the period	**575**	**(110)**	**465**	**(2,238)**	**425**	**(1,813)**

27. Contingencies and Commitments

Operating lease commitments in respect of lease agreements for offices Kavčí hory Office Park and car fleet are as follows:

In millions of Czech crowns	2017	2016
Not later than 1 year	73	44
Total operating lease commitments	**73**	**44**

Capital expenditure commitments. As at 31 December 2017 the Group has contractual capital expenditure commitments in respect of property, plant and equipment totalling CZK 477 million (31 December 2016: CZK 274 million) mainly related to project Capacity4Gas of CZK 289 million and Czech-Polish Interconnector gas pipeline of CZK 80 million (31 December 2016: CZK 125 million).

Guarantees. The Group did not recognise any obligations from financial guarantees as at 31 December 2017 and 2016.

Assets pledged and restricted. In connection with the Group's bank borrowings, the Group's right to lien its property in favour of another creditor is restricted.

Compliance with covenants. The Group is subject to certain qualitative covenants related to its borrowings. Non-compliance with such covenants may result in immediate maturity of the debt. The Group was in compliance with covenants at 31 December 2017 and 31 December 2016.

Other contingent liabilities. The Group did not recognise any significant contingent liabilities as at 31 December 2017 and 2016.

28. Derivative Financial Instruments

The table below sets out fair values, at the end of the reporting period, of currencies receivable or payable under cross currency interest rate swaps and foreign exchange swap contracts entered into by the Group. The table reflects gross positions before the offsetting of any counterparty positions (and payments) and covers the contracts with settlement dates after the respective end of the reporting period.

Cross currency interest rate swap contracts are long-term while foreign exchange swap contracts are short-term in nature. The respective part of fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months.

The Group did not have any other derivative financial instruments besides cross currency interest rate swaps and foreign exchange swaps.

The disclosure below provides aggregated overview of the fair value of receivable and payable legs of individual contracts per currency mix.

	31 December 2017			
	Current		Non-Current	
In millions of Czech crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(477)	–	(11,302)
– EUR receivable on settlement (+)	–	271	–	10,530
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,565)
– EUR receivable on settlement (+)	–	36	–	1,502
Net fair value of cross currency interest rate swaps	**–**	**(209)**	**–**	**(835)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

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	31 December 2016			
	Current		Non-Current	
In millions of Czech crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(578)	–	(13,884)
– EUR receivable on settlement (+)	–	287	–	11,527
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,764)
– EUR receivable on settlement (+)	–	38	–	1,643
Net fair value of cross currency interest rate swaps	**–**	**(292)**	**–**	**(2,478)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

The Group had one outstanding obligation from foreign exchange swaps as at 31 December 2016.

	31 December 2017		31 December 2016	
In thousands of Czech crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Foreign exchange swaps: fair values, as at the reporting period, of				
– CZK receivable on settlement (+)	–	–	(108)	–
– EUR payable on settlement (-)	–	–	108	–
Net fair value of foreign exchange swaps – current	**–**	**–**	**–**	**–**

Cross currency interest rate swaps and foreign exchange swaps entered into by the Group are generally traded in an over-the--counter market with professional market counterparties on standardized contractual terms and conditions. Aforementioned financial instruments have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in foreign exchange rates, market interest rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly during the life time of derivatives.

Cross currency interest rate swaps

The nominal principal amounts of the outstanding cross currency interest rate swap contracts at 31 December 2017 were EUR 410 million / USD 484 million / CZK 1,397 million (2016: EUR 410 million / USD 484 million / CZK 1,397 million). All cross currency interest rate swaps have fixed interest rates on both legs. At 31 December 2017, the fixed interest rates vary from 2.50% to 5.23% p.a. (as at 31 December 2016: 2.50% to 5.23% p.a.).

The Group designates certain cross currency interest rate swaps, in combination with bonds denominated in EUR, as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from natural gas transmission revenues (cash flow hedge) – Note 29, Note 3d).

The Group designates certain cross currency interest rate swaps as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from bond issued (cash flow hedge) – Note 29, Note 3d).

29. Financial Risk Management

The risk management function within the Group is carried out in respect of financial risks, operational risks, market risks and environment risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. Management sets a strategy for each of the risk, including a limit on open position that may be accepted. The primary objectives of the financial risk management function are then ensure that exposure to risks stays within these limits. Monitoring is performed continuously but minimum on a monthly basis.

Credit risk. Exposure to credit risk arises as a result of cash and cash equivalents held with banks, loans provided to related parties, the Group's sales of services on credit terms and other transactions with counterparties giving rise to financial assets.

The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties. Limits on the level of credit risk are approved by management. The risks are monitored on a revolving basis and are subject to a monthly review. The Group is exposed to credit concentration risk considering the receivables from financial institutions.

The credit risk is mitigated by advance payments and a system of creditworthiness conditions which are applied to the Group's customers, suppliers of services with potential significant credit position and financial counterparties such as banks or insurance companies. The conditions are incorporated in the Network Code, relevant tender documentations and internal guidelines.

The Group's management reviews ageing analysis of outstanding trade and other receivables and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Note 13 and in Note 15.

Market risks. The Group takes on exposure to market risks. Market risks arise from open positions in (a) foreign currencies and (b) interest bearing assets and liabilities, all of which are exposed to general and specific market movements.

Sensitivities to market risks included below are based on a change in a factor while holding all other factors constant. In practice this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in interest rate and changes in foreign currency rates.

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Currency risk. The Group treasury's risk management policy is to hedge the long-term contracted cash flows (mainly revenues from the gas transmission) in each major foreign currency up until 2034. Management approves the strategy of the currency risk management. The positions are monitored continuously but at minimum on a monthly basis. The amount of risk is evaluated in terms of open positions.

The offsetting of currency positions is applied where possible. When needed the outstanding positions are managed by means of buying or selling the relevant currency in the short term derivative forward or swap contract. The Group reports no outstanding obligation from foreign exchange swaps as at 31 December 2017. In 2016 there was one outstanding obligation from foreign exchange swaps.

The table below summarises the Group's exposure to foreign currency exchange rate risk at the end of the reporting period:

	At 31 December 2017					At 31 December 2016				
In millions of Czech crowns	Monetary financial assets	Monetary financial liabilities	Derivatives (assets)	Derivatives (liabilities)	Net position	Monetary financial assets	Monetary financial (liabilities)	Derivatives (assets)	Derivatives (liabilities)	Net position
US Dollars	160	4	–	10,300	(10,144)	2	1,383	–	12,404	(13,785)
Euros	815	13,149	–	(10,471)	(1,863)	691	13,868	108	(11,078)	(1,991)
Total exposed to currency risk	**975**	**13,153**	**–**	**(171)**	**(12,007)**	**693**	**15,251**	**108**	**1,326**	**(15,776)**
Czech crowns	670	14,649	–	1,397	(15,376)	413	13,054	(108)	1,397	(14,146)
Total	**1,645**	**27,802**	**–**	**1,226**	**(27,383)**	**1,106**	**28,305**	**–**	**2,723**	**(29,922)**

As at 31 December 2017 and 2016 the outstanding derivatives, cross currency interest rate swaps and foreign exchange swaps, were disclosed in their notional amounts being translated to Czech crowns using foreign exchange rate as at 31 December 2017 and 2016. The fair values are disclosed in Note 31.

The above analysis includes only monetary assets and liabilities. Investments in non-monetary assets are not considered to give rise to any currency risk.

Hedging of currency risk. In 2014, the Group decided to introduce two cash-flow hedges to manage the foreign exchange currency risk in revenues in line with the Group treasury's policy. The financial instruments designated as hedging instruments are represented by a) 33 % of bonds maturing in 2021 denominated in EUR and (b) joint hedging instrument of 66 % of bonds maturing in 2021 denominated in EUR and bonds maturing in 2026 denominated in EUR and cross currency interest rate swaps EUR/USD (Note 17, Note 28). The hedged item is represented by contracted or highly probable forecasted natural gas transmission revenues denominated in foreign currencies (in USD and in EUR) that are expected to occur on a monthly basis up until 2034. The dynamic hedging strategy is applied to hedged item. This strategy allows identification of hedged item in any period of the hedge accounting and is based on the continuous designation and re-designation of hedged item on a monthly basis from 28 July 2014 to 31 December 2034. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034 which is beyond the repayment date of the hedging instruments (Note 17, Note 28). Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034, which is beyond the repayment date of the hedging instruments (Note 17, Note 28). There was no ineffectiveness to be recorded from cash flow hedges in 2017 and 2016. In May 2017 bank borrowing denominated in USD was fully repaid and hedge accounting for this instrument ceased to exist.

In 2015, the Group introduced additional, third, cash-flow hedge. The financial instruments designated as hedging instruments are represented by cross currency interest rate swap EUR/CZK (Note 17, Note 28). The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until 2026 (Note 17, Note 28). In 2017, there were no additional hedges. The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other reserves in equity will be continuously released to profit or loss within finance costs up until 2026 (Note 17, Note 28). There was no ineffectiveness to be recorded from cash flow hedges in 2017 and 2016.

The table below analyses the volume of hedged cash flows that were designated as hedged item:

In millions of Czech crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2017						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,069	1,405	1,642	4,883	1,031	10,030
Future cash flows from ceased hedging – future receivables USD	215	167	173	463	223	1,241
Hedging of future cash flows – future receivables EUR	566	1,404	417	–	–	2,387
Hedging of future cash flows – future payables EUR	(36)	(72)	(72)	(1,419)	–	(1,599)
TOTAL	**1,814**	**2,904**	**2,160**	**3,927**	**1,254**	**12,059**

In millions of Czech crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2016						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,711	2,497	1,958	5,441	1,345	12,952
Hedging of future cash flows – future receivables EUR	–	1,337	1,189	–	–	2,526
Hedging of future cash flows – future payables EUR	(38)	(76)	(76)	(1,540)	–	(1,730)
TOTAL	**1,673**	**3,758**	**3,071**	**3,901**	**1,345**	**13,748**

The amount of reclassified other comprehensive income to revenues during 2017 decreased revenues by CZK 222 million (2016: decreased revenues by CZK 275 million). The amount of reclassified other comprehensive income to financial costs during 2017 increased financial costs by CZK 63 million (2016: increased financial costs by CZK 1 million).

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The following table presents sensitivities of profit or loss or equity (cash flow hedge) to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency, with all other variables held constant:

	At 31 December 2017		At 31 December 2016	
In millions of Czech crowns	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
US Dollar strengthening by 10%	16	(955)	10	(1,284)
US Dollar weakening by 10%	(16)	955	(10)	1,284
Euro strengthening by 10%	76	(62)	77	(31)
Euro weakening by 10%	(76)	62	(77)	31

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Group and for currency sensitive derivatives.

The Group's exposure to currency risk with impact to profit or loss as at 31 December 2017 is influenced by (i) cash balances held in foreign currency,(ii) by existing loans to related parties provided in EUR (Note 12, Note 24 and Note 25) and (iii) outstanding payables and receivables.

Interest rate risk. The Group's bank borrowings are contracted at floating interest rates. Some instruments, like bonds and fix-to-fix cross currency interest rate swaps, are priced at fixed rates and are exposed to re-pricing risk at maturity. The fair value is among other factors also sensitive to interest rates through the discounted cash flow model which is used for the valuation (see Note 31a).

The table below summarises the Group's exposure to interest rate risks (e.g. term deposits; bonds and borrowings from related parties on fixed rate, both with re-pricing risk). The table presents the aggregated amounts of the Group's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

In millions of Czech crowns	On demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
31 December 2017					
Financial assets – floating rate	636	–	–	–	636
Financial assets – fixed rate with re-pricing risk	300	383	–	–	683
Financial liabilities – floating rate	(7,095)	–	–	–	(7,095)
Financial liabilities – fixed rate with re-pricing risk	–	–	(14,790)	(5,403)	(20,193)
Net interest sensitivity gap at 31 December 2017	**(6,159)**	**383**	**(14,790)**	**(5,403)**	**(25,969)**
31 December 2016					
Financial assets – floating rate	417	–	–	–	417
Financial assets – fixed rate with re-pricing risk	650	–	–	–	650
Financial liabilities– floating rate	(7,142)	–	–	–	(7,142)
Financial liabilities– fixed rate with re-pricing risk	–	–	(15,194)	(5,711)	(20,905)
Net interest sensitivity gap at 31 December 2016	**(6,075)**	**–**	**(15,194)**	**(5,711)**	**(26,980)**

As the Group's bank assets and liabilities (borrowings) are directly exposed to the floating interest rate, the change in interest rates has an impact on the Group's profit or loss for the current year.

The following table presents sensitivities of profit or loss to reasonably possible changes in short term interest rates applied at the end of the reporting period, with all other variables held constant:

In millions of Czech crowns	At 31 December 2017 Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(18)
1M CZK PRIBOR decrease by 25 bps	18
Overnight PRIBOR/EURIBOR increase by 25 bps	–
Overnight PRIBOR/EURIBOR decrease by 25 bps	–

NET4GAS Group
Notes to the Consolidated Financial Statements
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In millions of Czech crowns	At 31 December 2016 Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR increase by 25 bps	(1)
Overnight PRIBOR decrease by 25 bps	1

The Group interest rate risk management policy requires that at least 70% of the interest rate exposure arising from bonds and term loans is at fixed rate. The existing financing structure achieves this requirement.

The Group's exposure to interest rate risk at the end of the reporting period is representative of the typical exposure during the year, starting from July 2014.

The Group monitors interest rates for its financial instruments. The table below summarises effective interest rates at the respective end of the reporting period based on reports reviewed by key management personnel. Decrease of USD and CZK interest rates in 2017 was caused by refinancing – Note 17.

	31 December 2017			31 December 2016		
In % p.a.	CZK	USD	EUR	CZK	USD	EUR
Assets						
Cash and cash equivalents	0.08	0.00	0.00	0.10	0.01	0.01
Loans to related parties	n/a	n/a	0.32	0.96	n/a	0.39
Liabilities						
Borrowings	1.89	n/a	3.00	2.18	2.28	3.00

Liquidity risk. Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Group is exposed to daily calls on its available cash resources. Liquidity risk is managed by Treasury department of the Group and monitored in terms of monthly (one month forward), short-term (one year forward) and mid-term (five years forward) forecasts. Management monitors short-term forecasts of the Group's cash flows provided on the monthly basis.

The Group has strong liquidity position and is able to secure its operating funding needs through the cash collected from the business operations continuously throughout the year. The Group's liquidity portfolio comprises cash and cash equivalents (Note 15) and bank term deposits and deposit bills. Management estimates that the liquidity portfolio can be realised in cash within few days in order to meet unforeseen liquidity requirements.

The tables below show liabilities as at 31 December 2017 and 2016 by their remaining contractual maturity. The amounts disclosed in the table below are the contractual undiscounted cash flows and gross loan commitments. Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows Financial derivatives are included at the contractual amounts to be paid or received, unless the Group expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of financial liabilities at 31 December 2017 is as follows:

In millions of Czech crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 17)	179	461	23,824	6,079	30,543
Trade and other payables (Note 21)	517	–	13	–	530
Gross settled cross currency interest rate swaps (Note 28)					
– inflows	–	(306)	(6,206)	(6,079)	(12,591)
– outflows	–	522	7,571	7,103	15,196
Total future payments, including future principal and interest payments	**696**	**677**	**25,202**	**7,103**	**33,678**

The maturity analysis of financial liabilities at 31 December 2016 is as follows:

In millions of Czech crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 17)	212	485	24,503	6,620	31,820
Trade and other payables (Note 21)	524	–	8	–	532
Gross settled cross currency interest rate swaps (Note 28)					
– inflows	–	(324)	(6,701)	(6,620)	(13,645)
– outflows	–	620	9,374	8,567	18,561
Total future payments, including future principal and interest payments	**736**	**781**	**27,184**	**8,567**	**37,268**

NET4GAS Group
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The net current liquidity position calculated as difference between current assets and current liabilities at 31 December 2017 is net current asset of CZK 484 million (31 December 2016: net current liability of CZK 768 million). The decrease in net liquidity position in 2017 does not result in liquidity issue of the Group.

Payments in respect of cross currency interest rate swaps will be accompanied by related cash inflows which are disclosed at their present values in Note 28.

30. Management of Capital

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. The Group is managing its capital ratios to ensure a strong credit rating (e.g. the Company may adjust the amount of dividends paid to shareholders in order to maintain or adjust the capital structure).

According to the Group's policy, capital structure consists mainly of equity, subordinated borrowings from related parties, non-subordinated borrowings from banks and bonds.

In millions of Czech crowns	At 31 December 2017	At 31 December 2016
Equity	9,230	7,606
Non-subordinated borrowings from banks and bonds	27,265	28,022
Non-subordinated short-term borrowings from related parties	22	25
Total	**36,517**	**35,653**

The Group has complied with all covenants arising from the borrowings as at 31 December 2017 and 2016.

31. Fair Value of Financial Instruments

Fair value measurements are analysed by level in the fair value hierarchy. Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

(a) Recurring fair value measurements

Recurring fair value measurements are those that the accounting standards require or permit in the balance sheet at the end of each reporting period:

(b) Financial instruments carried at fair value

Only derivatives are measured at fair value.

All recurring fair value measurements are categorised in the fair value hierarchy into level 2 as at 31 December 2017 and 2016.

There were no changes in valuation technique for level 2 recurring fair value measurements since 31 December 2016.

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2017:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(1,044)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(1,044)**	**–**	**–**

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2016:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,770)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,770)**	**–**	**–**

NET4GAS Group
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The following table presents movements in fair values of derivative financial instruments:

In millions of Czech crowns	2017	2016
Opening balance	**(2,770)**	**(2,810)**
Change in fair value of contracts concluded and realised during the period	(37)	31
Settlement of contracts concluded and realised during the period	37	(31)
Change in unrealised gains or losses for the period included in other comprehensive income for contracts held at the end of the reporting period	1,726	40
Closing balance	**(1,044)**	**(2,770)**

(c) Non-recurring fair value measurements

There are no assets held for sale or other items with non-recurring fair value measurements as of 31 December 2017 and 31 December 2016.

(d) Financial assets and liabilities not measured at fair value but for which fair value is disclosed

Fair values analysed by level in the fair value hierarchy and carrying value of assets and liabilities not measured at fair value are as follows:

	31 December 2017				31 December 2016			
In millions of Czech crowns	Level 1	Level 2	Level 3	Carrying value	Level 1	Level 2	Level 3	Carrying value
ASSETS								
Other financial assets								
– Loans to related parties	–	–	5	5	–	–	653	652
Total ASSETS	**–**	**–**	**5**	**5**	**–**	**–**	**653**	**652**
LIABILITIES								
Borrowings								
– Borrowings from related parties	–	–	22	22	–	–	25	25
– Bank borrowings	–	–	7,122	7,073	–	–	7,127	7,117
– Bonds	20,357	–	1,388	20,192	20,941	–	1,394	20,905
TOTAL LIABILITIES	**20,357**	**–**	**8,532**	**27,287**	**20,941**	**–**	**8,546**	**28,047**

Trade and other receivables' carrying values approximate to their fair values.

The fair values in level 1 of fair value hierarchy reflects the price of fixed interest rate bonds listed in active markets in public stock exchanges.

The fair values in level 3 of fair value hierarchy were estimated using the discounted cash flows valuation technique. Inputs used for loans to related parties are market observable (PRIBOR, LIBOR, EURIBOR) adjusted by unobservable estimated credit spreads. Inputs used for bank borrowings, borrowings from related parties and financial leasing are market observable (PRIBOR, LIBOR, EURIBOR and IRS) adjusted by unobservable estimated credit spreads.

The fair value of unquoted bonds was determined based on estimated future cash flows expected to be received discounted by market observable yield curve adjusted by unobservable estimated credit spread.

Financial assets carried at amortised cost. The estimated fair value of asset instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Financial liabilities carried at amortised cost. The estimated fair value of liability instruments is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

NET4GAS Group
Notes to the Consolidated Financial Statements
for the year ended 31 December 2017

32. Events After the Reporting Period

No events have occurred subsequent to year-end that would have a material impact on the consolidated financial statements for the year ended 31 December 2017.

Signature of the members of the statutory body of the Company:

14 March 2018

Andreas Rau	**Radek Benčík**	**Václav Hrach**
Statutory Director	Statutory Director	Statutory Director

The General Meeting approved the consolidated financial statements for publication on 27 March 2018.

Annex no. 2: Separate Financial Statements

NET4GAS, s.r.o.
Separate Financial Statements

prepared in accordance with International Financial Reporting Standards
as adopted by the European Union, 31 December 2017

Contents

NET4GAS, s.r.o.
Balance Sheet as at 31 December 2017

In millions of Czech crowns	Note	31 December 2017	31 December 2016
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	8	43,177	44,041
Intangible assets	9	78	89
Investment in subsidiary	10	6,732	7,476
Other non-current assets	11	25	9
Total non-current assets		**50,012**	**51,615**
CURRENT ASSETS			
Inventories	12	61	63
Trade and other receivables	14	324	303
Current income tax prepayments	29	247	–
Loans to related parties	13	5	652
Other non-financial assets	15	32	27
Other financial assets	15	683	–
Cash and cash equivalents	16	625	410
Total current assets		**1,977**	**1,455**
TOTAL ASSETS		**51,989**	**53,070**

EQUITY AND LIABILITIES			
EQUITY			
Registered capital	17	2,750	2,750
Capital contributions outside registered capital	17	3,364	6,631
Cash flow hedge reserve	17	465	(1,813)
Retained earnings		2,643	21
Total equity		**9,222**	**7,589**
NON-CURRENT LIABILITIES			
Other payables	23	13	8
Borrowings	18	26,988	27,761
Finance lease liability	19	7,023	6,778
Derivative financial instruments	31	835	2,478
Deferred income tax liability	29	6,321	5,951
Provisions	22	–	167
Accrued employee benefits	24	101	100
Other non-financial liabilities	24	7	15
Total non-current liabilities		**41,288**	**43,258**

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

In millions of Czech crowns	Note	31 December 2017	31 December 2016
CURRENT LIABILITIES			
Borrowings	18	299	810
Finance lease liability	19	198	196
Trade and other payables	23	528	540
Derivative financial instruments	31	209	292
Current income tax payable	29	–	176
Other taxes payable	21	18	20
Provisions	22	2	–
Accrued employee benefits	24	43	15
Other non-financial liabilities	24	182	174
Total current liabilities		**1,479**	**2,223**
Total liabilities		**42,767**	**45,481**
EQUITY AND LIABILITIES		**51,989**	**53,070**

14 March 2018

Andreas Rau
Statutory Director

Radek Benčík
Statutory Director

Václav Hrach
Statutory Director

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

NET4GAS, s.r.o.
Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31 December 2017

In millions of Czech crowns	Note	2017	2016
Revenue	6	7,401	9,286
Raw materials consumed	25	(302)	(450)
Services purchased and lease charges	25	(308)	(545)
Employee benefits	25	(439)	(509)
Depreciation and amortisation	8, 9, 25	(2,007)	(2,068)
Gains less losses on disposal of property, plant and equipment		–	3
Changes in fair value of derivatives, net		(37)	31
Foreign exchange differences, net	25	(100)	1
Other operating income	26	437	458
Other operating expenses	25	(40)	(37)
Operating profit		**4,605**	**6,170**
Finance income	27	4	8
Finance costs	28	(1,439)	(1,852)
Finance result (net)		**(1,435)**	**(1,844)**
Profit before income tax		**3,170**	**4,326**
Income tax expense	29	(527)	(2,904)
PROFIT FOR THE YEAR		**2,643**	**1,422**

Other comprehensive income / (loss)			
Items that may be subsequently reclassified to profit or loss			
Cash flow hedge	17	2,813	274
Income tax recognised directly in other comprehensive income – cash flow hedge	29	(535)	(52)
TOTAL OTHER COMPREHENSIVE INCOME FOR THE YEAR		**2,278**	**222**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**4,921**	**1,644**

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

NET4GAS, s.r.o.
Statement of Changes in Equity
for the year ended 31 December 2017

In millions of Czech crowns	Registered capital	Capital contributions outside registered capital	Cash flow hedge reserve	Retained earnings	Total
Balance as at 1 January 2016	**2,750**	**29**	**(2,035)**	**1,789**	**2,533**
Total comprehensive income					
Profit for the year 2016	–	–	–	1,422	1,422
Cash flow hedge – net of related tax effect	–	–	222	–	222
Total comprehensive income for the year	–	–	222	1,422	1,644
Transactions with owners					
Non-cash contribution outside registered capital (Note 17)	–	6,602	–	–	6,602
Dividends paid				(1,540)	(1,540)
Advance dividends paid	–	–	–	(1,650)	(1,650)
Balance as at 31 December 2016	**2,750**	**6,631**	**(1,813)**	**21**	**7,589**
Total comprehensive income					
Profit for the year 2017	–	–	–	2,643	2,643
Cash flow hedge – net of related tax effect	–	–	2,278	–	2,278
Total comprehensive income for the year	–	–	2,278	2,643	4,921
Transactions with owners					
Decrease of contribution outside registered capital (Note 17)	–	(3,622)	–	–	(3,622)
Contribution outside registered capital (Note 17)	–	355	–	–	355
Dividends paid	–	–	–	(21)	(21)
Balance as at 31 December 2017	**2,750**	**3,364**	**465**	**2,643**	**9,222**

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

NET4GAS, s.r.o.
Statement of Cash Flows for the year ended 31 December 2017

In millions of Czech crowns	Note	2017	2016
Cash flows from operating activities			
Profit before tax		**3,170**	**4,326**
Adjustments for:			
Depreciation and amortisation	8, 9	2,007	2,068
Finance income	27	(4)	(8)
Finance costs	28	1,439	1,852
Impairment		–	–
Gains less losses on disposals of property, plant and equipment		–	(3)
Dividend income from subsidiary		(400)	(432)
Other non-cash operating expenses / (gains)		(107)	(2)
thereof: – provision for penalty for additional CIT return		–	*(39)*
– employee benefit provisions		*29*	*47*
– release of provisions		*(167)*	–
– other		*31*	*(9)*
Operating cash flows before working capital changes		**6,105**	**7,801**
Decrease / (Increase) in trade and other receivables	14, 15	(27)	(146)
Increase / (Decrease) in trade and other payables	23, 24	(90)	(244)
Decrease in inventories	12	2	2
Operating cash flows after changes in working capital		**5,990**	**7,413**
Interest paid	28	(1,097)	(1,534)
Interest received	27	1	11
Income tax paid	29	(1,115)	(701)
Net cash flows from operating activities		**3,779**	**5,189**

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

In millions of Czech crowns	Note	2017	2016
Cash flows from investing activities			
Purchase of property, plant and equipment	8	(713)	(694)
Purchase of intangible assets	9	(30)	(33)
Proceeds from sale of property, plant and equipment		–	4
Proceeds from decreased other capital funds of the subsidiary	10	744	–
Repayments of loans provided to related parties*	13	–	4
Loans provided to related parties	13	5	(650)
Purchase of other financial assets	15	(683)	–
Dividends received from subsidiary	26	400	432
Net cash flows used in investing activities		**(277)**	**(937)**
Cash flows from financing activities			
Payments of decreased contributions outside registered capital to the Company's shareholder	17	(3,000)	–
Payments of increased contributions outside registered capital from Company's shareholder	17	355	–
Dividends paid to the Company's shareholder	17	–	(1,540)
Advance dividends paid to the Company's shareholder	17	–	(1,650)
Repayment of borrowings*	18	(8,570)	(4,203)
Proceeds from borrowings	18	7,928	2,140
Net cash flows from financing activities		**(3,287)**	**(5,253)**
Net (decrease) in cash and cash equivalents		**215**	**(1,001)**
Cash and cash equivalents at the beginning of the period	16	410	1,411
Cash and cash equivalents at the end of the period	**16**	**625**	**410**

* In 2016 a part of loans from related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. in total amount of CZK 11,000 million was settled in cash (CZK 2,500 million). Remaining amount of CZK 8,500 million was cessed to NET4GAS Holdings, s.r.o. It was subsequently netted against receivable from capital contribution outside registered capital of CZK 6,602 million and also netted against loan provided to NET4GAS Holdings, s.r.o. of CZK 1,898 million (Note 17).

The accompanying notes on pages 104 to 158 are an integral part of these financial statements.

NET4GAS, s.r.o. Notes to the Separate Financial Statements

for the year ended 31 December 2017

1. NET4GAS, s.r.o. and Its Operations – General Information

These separate financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union for the year ended 31 December 2017 for NET4GAS, s.r.o. (the "Company" or the "NET4GAS").

The Company was incorporated and is domiciled in the Czech Republic where is also the Company's principal place of business. The Company is a limited liability company. It was incorporated on 29 June 2005 and has its registered office at Na Hřebenech II 1718/8, Prague 4 – Nusle, the Czech Republic. Identification number of the Company is 272 60 364.

The Company's main business activity is natural gas transmission in accordance with the Act No. 458/2000 Coll. (the "Energy Act").

Since 2 August 2013 the Company is fully owned by NET4GAS Holdings, s.r.o. (the "NET4GAS Holdings"), incorporated in the Czech Republic, which is the Company's ultimate parent company. NET4GAS Holdings is a joint venture of two venturers: Allianz Infrastructure Czech HoldCo II S.à r.l. (50%) with its registered office in Luxembourg and Borealis Novus Parent B.V. (50%) with its registered office in the Netherlands.

The Statutory Directors of the Company:

As at 31 December 2017	As at 31 December 2016
Andreas Rau	Andreas Rau
Radek Benčík	Radek Benčík
Václav Hrach	Václav Hrach

The members of the Supervisory Board of the Company were as follows:

As at 31 December 2017	Function	As at 31 December 2016	Function
Jaroslava Korpancová	Member	Melchior Stahl	Member
Lenka Kovačovská	Member	Jaroslava Korpancová	Member
Kenton Edward Bradbury	Chairman	Lenka Kovačovská	Member
Mikhail Nahorny	Member	Kenton Edward Bradbury (from 24 June 2016)	Chairman
Andrew Cox (from 11 May 2017)	Member	Mikhail Nahorny (from 1 July 2016)	Member

Andrew Cox became member of the Supervisory Board on 11 May 2017 and the change was registered in the Commercial Register on 19 July 2017.

Melchior Stahl was terminated from Supervisory Board on 10 May 2017 and the change was registered in the Commercial Register on 19 July 2017.

About the Company. The Company is the exclusive gas transmission system operator in the Czech Republic, operating more than 3,800 km of gas pipelines. NET4GAS is currently operating four compressor stations. The flow rate of the gas transmitted is measured at five border transfer stations (the Lanžhot, Brandov and Hora Svaté Kateřiny stations in the Czech Republic, and the Waidhaus and Olbernhau stations in the Federal Republic of Germany) and at almost a hundred national transfer stations. NET4GAS transmission system has been specifically targeted in last few years for a number of new projects delivering additional transmission capacity and the greater diversification of transmission routes. These projects have included the construction of the GAZELLE high-pressure gas pipeline (DN 1400, put in operation in 2013), connecting the transmission systems of the Czech Republic and the Federal Republic of Germany at the border points Brandov and Rozvadov, and a project of a connection between the Czech and Polish transmission systems in Český Těšín. The entire NET4GAS transmission system can also be used for reverse flow, which means that it now has the capacity and technology to cope with natural gas transmission in any direction. The newest and largest project of the company is Capacity4Gas Project. This project will contribute to enhancing the security and gas supplies in the Czech Republic and in the entire CEE region. The objective of the Capacity4Gas project is to build new gas infrastructure, most of which is to be located in the Ústí and Pilsen regions. The aim of the project is to connect the gas infrastructure operated by NET4GAS to the planned EUGAL pipeline in Germany and to increase its capacity for the needs of gas supplies in the Czech Republic and further transit via Slovakia. The project shall be implemented in two stages, with completion scheduled for 2019 and 2021, respectively.

The Company is the successor to Tranzitní plynovod, n. p., Transgas, a.s. and RWE Transgas Net, s.r.o.

The Company founded BRAWA, a.s. ("BRAWA") as its subsidiary on 10 October 2010. Till 1 January 2013 BRAWA, a.s. was a dormant company. On 1 January 2013, under the legal reorganisation of NET4GAS's business, the GAZELLE pipeline was transferred to BRAWA and BRAWA became the sole owner of the GAZELLE pipeline. The GAZELLE pipeline is operated by NET4GAS.

Note

The separate financial statements have been prepared in Czech and in English. In all matters of interpretation of information, views or opinions, the Czech version of these financial statements takes precedence over the English version.

2. Operating Environment of the Company

The regulatory environment in the Czech Republic:

(a) Legal framework pertaining to the transmission system operator

The transmission system operator holds an exclusive gas transmission licence under the Energy Act, and its operations are regulated by the Energy Regulatory Authority (the "ERO").

The transmission system operator's rights and obligations are primarily derived from Section 58 of the Energy Act and are clarified in more detail in the related implementing legislation. The transmission system operator is also required to comply with obligations under the European legislation, in particular Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks and the related implementing legislation.

(b) Regulatory framework pertaining to the transmission system operator

Gas transmission prices are set annually by the ERO based on regulation methodology applicable in the regulatory period. Gas transmission prices for the next calendar year are usually published in an ERO's Pricing Decision by 30 November of the current year.

The 2017 gas transmission prices were established by ERO's Price Decision No 6/2016 from 25 November 2016 on Regulated Prices related to the gas supply a by its amendment No 1/2017 from 2 March 2017.

(c) Current regulatory period

The transmission system operator is currently subject to the IV. regulatory period, which began on 1 January 2016 and ends on 31 December 2020 (the ERO prolonged the originally three years period by two years on 11 January 2018).

NET4GAS, s.r.o.
Notes to the Separate Financial Statements
for the year ended 31 December 2017

(d) Domestic transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for domestic gas transmission is based on a ceiling established for allowed revenues over a predetermined period (the revenue cap method). Domestic gas transmission prices are then derived from such defined allowed revenues. These prices consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(e) Transit transmission regulation methodology applicable in the fourth regulatory period
The transmission system operator regulation methodology for transit transmission relies on a price ceiling (of allowed prices) for a predetermined period (the price cap method). Allowed prices are set annually by the ERO based on a comparison of gas transmission prices in other relevant Member States of the European Union (benchmarking). These prices also consist of a fixed component for booked transmission capacity and a variable component depending on the amount of gas transmitted.

(f) Unregulated part
Further to a decision of the ERO of 28 July 2011, the GAZELLE interconnecting pipeline was exempted from the obligation to grant third-party access at a regulated price under the conditions set out in the Energy Act.

3. Summary of Significant Accounting Policies

a) Basis of preparation
These separate financial statements of the Company have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS") under the historical cost convention, as modified by the revaluation of relevant financial assets and financial liabilities (including derivative instruments) carried at fair value. The principal accounting policies applied in the preparation of these separate financial statements are set out below. These policies have been consistently applied to all the periods presented.

Preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the separate financial statements are disclosed in Note 4.

These separate financial statements relate to the consolidated financial statements prepared for the Company and its subsidiary BRAWA. They should be read together.

Presentation currency. These separate financial statements ("financial statements") are presented in Czech crowns ("CZK") which is also the functional currency of the Company.

b) Financial instruments – key measurement terms
Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is price in an active market. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date on which the Company commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Fair value of financial instruments traded in an active market is measured as the product of the quoted price for the individual asset or liability and the quantity held by the entity. This is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

A portfolio of financial derivatives that are not traded in an active market is measured at the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or paid to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date. This is applicable for assets carried at fair value on a recurring basis if the Company:

(a) manages the Company of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy; (b) it provides information on that basis about the Company of assets and liabilities to the entity's key management personnel; and (c) the market risks, including duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities is substantially the same.

Fair value measurements are analysed in the fair value hierarchy level as follows (Note 34):

(i) level one are measurements at quoted prices (unadjusted) in active markets for identical assets or liabilities, (ii) level two measurements are valuations techniques with all material inputs observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices), and (iii) level three measurements are valuations not based solely on observable market data (that is, the measurement requires significant unobservable inputs). Transfers between levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the balance sheet.

The effective interest method is a method of allocating interest income or interest expense over the relevant period, so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date, except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

c) Classification of financial assets
Financial assets are classified in the following categories: (a) loans and receivables; and (b) financial assets at fair value through profit or loss.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments and are carried at amortized costs.

Financial assets at fair value through profit or loss, including financial derivatives are carried at their fair value. All derivative instruments are carried as assets when fair value is positive and as liabilities when fair value is negative. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Company designates certain derivatives as hedges of a particular risk associated with a fixed commitment or highly probable forecast transaction (cash flow hedge).

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 31. Movements on the hedging reserve in other comprehensive income are shown in Note 17. The full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining hedged item is more than 12 months, and as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

Cash flow hedge: The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the profit or loss within 'Finance costs' (in case of hedging of cash flows from revenues denominated in foreign currencies) or 'Changes in fair value of derivatives, net' (in case of hedging of cash flows from bonds issued denominated in foreign currency). Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the forecast sale that is hedged takes place). The gain or loss relating to the effective portion of cross currency interest rate swaps hedging foreign exchange risk is recognised in the profit or loss within 'Revenue' (in case of hedging of revenues denominated in foreign currencies) or 'Finance costs' (in case of hedging of cash flows from bonds issued denominated in foreign currency).

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in profit or loss when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recorded in other comprehensive income is immediately transferred to profit or loss within 'Foreign exchange differences, net'.

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d) Classification of financial liabilities
Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in profit or loss for the year (as finance income or finance costs) in the period in which they arise. Other financial liabilities are carried at amortised cost.

The Company designates certain financial liabilities as hedges of a particular risk associated with highly probable forecast transactions (cash flow hedge – Note 3c).

e) Initial recognition of financial instruments
Financial instruments not carried at fair value through profit or loss are initially recognized at fair value plus transaction costs. Financial instruments carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in profit or loss. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

The Company uses discounted cash flow valuation techniques to determine the fair value of cross-currency interest rate swaps and loans to related parties that are not traded in an active market. Differences may arise between the fair value at initial recognition, which is considered to be the transaction price, and the amount determined at initial recognition using the valuation technique. Any such differences are amortised on a straight line basis over the term of the cross-currency interest rate swaps and loans to related parties.

f) Derecognition of financial assets and financial liabilities
The Company derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Company has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

The Company derecognises financial liabilities only when the contractual liabilities of the Company are discharged, cancelled or expire. The difference between the carrying amount of a derecognised financial liability and the consideration paid is recognised in profit or loss.

g) Property, plant and equipment
Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required.

Significant spare parts are recognised and treated as property, plant and equipment.

Repairs and maintenance expenditures of tangible fixed assets are expensed as incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

At the end of each reporting period management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its

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value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognised for an asset in prior years is reversed where appropriate if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised in profit or loss for the year.

When the Company recognises the cost of a replacement for part of the carrying amount of property, plant and equipment, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it was not practicable to determine the carrying amount of the replaced part, the Company used the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

h) Depreciation
Land is not depreciated. Construction in progress is not depreciated. Depreciation on other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives:

	Useful lives
Buildings and constructions	30 – 70 years
Plant, machinery and equipment	4 – 40 years
Furniture and fittings	4 – 8 years
Motor vehicles	5 – 8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

i) Capitalisation of borrowing costs
General and specific borrowing costs directly attributable to the acquisition, construction or production of assets that are not carried at fair value and that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets.

The commencement date for capitalisation is when (a) the Company incurs expenditures for the qualifying asset; (b) it incurs borrowing costs; and (c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Company capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Company's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred on the specific borrowings less any investment income on the temporary investment of these borrowings are capitalised.

j) Leasing
Operating leases. Where the Company is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Company, the total lease payments are charged to profit or loss for the year on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Finance lease liabilities. Where the Company is a lessee in a lease which transfers substantially all the risks and rewards incidental to ownership to the Company, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of future finance charges, are included in borrowings. The interest cost is charged to profit or loss over the lease period using the effective interest method. The assets acquired under finance leases are depreciated over their useful life or the shorter lease term, if the Company is not reasonably certain that it will obtain ownership by the end of the lease term.

k) Intangible assets
The Company's intangible assets have definite useful lives and primarily include capitalised computer software, patents, trademarks and licences.

Acquired computer software licences, patents and trademarks and other intangibles are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Company are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

l) Amortisation
Intangible assets are amortised using the straight-line method over their useful lives (unless the agreement or licence conditions state shorter or longer period):

	Useful lives
Software	3 years
Patents, and other licences	1.5 – 6 years
Development costs	6 years
Other intangible assets	6 years

m) Investment in subsidiary
Investment in subsidiary is measured at cost less any impairment loss. The transaction costs are capitalised as part of the cost of the investment. The transaction costs are the costs directly attributable to the acquisition of the investment such a profession fees for legal services, transfer taxes and other acquisition related costs.

The investment is tested for impairment whenever there are indicators that the carrying amount of an investment may not be recoverable. If the recoverable amount of an investment (the higher of its fair value less cost to sell and its value in use) is less than its carrying amount, the carrying amount is reduced to its recoverable amount.

The carrying amount of an investment is derecognised on disposal. The difference between the fair value of the sale proceeds and the disposed share of the carrying amount of the investment is recognised in profit or loss as gain or loss on disposal. The same applies if the disposal results in a step down from subsidiary to joint venture or an associate measured at cost.

n) Emission Rights
The Company receives free emission rights as a result of the European Emission Trading Schemes. The rights are received on an annual basis and in return the Company is required to return rights equal to its actual emissions. Therefore, a provision is only recognised when actual emissions exceed the emission rights received free of charge. The emission rights which were granted free of charge are carried at cost, i.e. at zero. When emission rights are purchased from third parties, they are measured at cost and treated as a reimbursement right. When emission rights are acquired by exchange and such an exchange is deemed to have the economic substance, they are measured at fair value as at the date when they become available for use and the difference between the fair value of rights received and cost of assets given up is recognised through profit or loss. The Company did not recognise any provision resulting from the gas emissions as at 31 December 2017 and 31 December 2016.

The amounts of emission rights held in zero value by the Company were as follows:

In tons	31 December 2017	31 December 2016
Emission rights	391,912	403,619

o) Impairment of non-financial assets
Intangible assets not ready to use are not subject to amortisation and are tested annually for impairment. Assets that are subject to depreciation and amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash inflows (cash-generating units). Prior impairments of non-financial assets are reviewed for possible reversal at each reporting date.

p) Assets held for sale
Assets (or disposal groups) are classified as assets held for sale and stated at the lower of their residual amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Assets held for sale are not depreciated.

q) Taxes
Income tax
Income taxes have been provided for in the financial statements in accordance with legislation enacted or substantively enacted by the end of the reporting period. The income tax charge/credit comprises current tax and deferred tax and is recognised in profit or loss for the year, except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity (for example the effective portion of changes in the fair value of financial derivatives that are designated and qualify as cash flow hedges).

Current tax is the amount expected to be paid to, or recovered from, the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxable profits or losses are based on estimates if financial statements are authorised prior to filing relevant tax returns. Taxes other than on income are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period, which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised.

The Company controls the reversal of temporary differences relating to taxes chargeable on dividends from subsidiaries or on gains upon their disposal. The Company does not recognise deferred tax liabilities on such temporary differences except to the extent that management expects the temporary differences to reverse in the foreseeable future.

Value added tax
Output value added tax (VAT) related to sales is payable to tax authorities on the earlier of (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a net basis. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

r) Uncertain tax positions
The Company's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period, and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognized based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

s) Inventories
Raw materials are mainly spare parts for the gas pipeline system. Purchased inventories are stated at the lower of cost and net realizable amount. Cost includes all costs related with its acquisition (mainly transport costs, customs duty, etc.). The weighted average cost method is applied for all disposals. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses. Significant spare parts are recognised and treated as property, plant and equipment.

t) Trade receivables
Trade receivables are carried at amortised cost using the effective interest method less relevant impairment.

u) Impairment of financial assets carried at amortised cost
Impairment losses are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Company determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment. The primary factors that the Company considers in determining whether a financial asset is impaired are its overdue status and realizability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- Any portion or instalment is overdue and the ate ayment cannot be attributed to a delay caused by the settlement systems;
- The counterparty experiences a significant financial difficulty as evidenced by its financial information that the Company obtains;
- The counterparty considers bankruptcy or a financial reorganisation;
- There is adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account within the profit or loss for the year.

v) Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Company has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Company. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

w) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

x) Dividends

Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved. Any dividends declared after the reporting period and before the financial statements are authorised for issue are disclosed in the subsequent events note.

y) Advance dividends paid

The Company's decision to pay an advance dividend is reflected in the financial statements as a decrease in equity as of the date of the payment and is deducted from the balance sheet line – Retained earnings.

z) Borrowings

Borrowings are carried at amortised cost using the effective interest method.

At their initial recognition, all bank credits, loans and issued bonds are recorded at their purchase price corresponding to the fair value of the received cash funds, less the costs of obtaining the credit or loan or issue of bonds.

Amortised cost is determined by taking into account the costs of obtaining the credit or loan, as well as the discounts or bonuses received at the settlement of the liability.

The Company designates certain borrowings as hedges of a particular risk associated with a highly probable forecast transaction (cash flow hedge – Note 3c).

aa) Government and other grants

Grants from the government and European Commission are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions. Grants relating to the purchase of property, plant and equipment decrease directly the costs of the relevant asset.

bb) Trade and other payables

Trade payables are accrued when the counterparty performs its obligations under the contract and are carried at amortised cost using the effective interest method.

cc) Provisions for liabilities and charges

Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Where there are a number of similar obligations, the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

dd) Financial guarantees

Financial guarantees are irrevocable contracts that require the Company to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. When the Company expects to receive recurring future premiums from an issued financial guarantee contract, the guarantee is recorded at the premium receivable at the inception of the contract and no receivable is recognised in respect of the future premium payments receivable. The premium receivable in one instalment is amortised on a straight line basis over the period covered by that instalment. At the end of each reporting period, the premium receivable in respect of the respective period is measured at its present value and the financial liability is measured at the higher of the remaining unamortised balance and the best estimate of expenditure required to settle the obligation at the end of the reporting period.

ee) Asset retirement obligations

The Company's transmission system is mainly constructed on the land owned by third parties. The current legislation requires the Company to incur the costs related to transmission system's operation and maintenance. The current Czech environmental and energy legislation does not set the obligation to liquidate the assets at the end of their useful life. Given the currently valid legislation management believes that there is no asset retirement obligation (dismantling and removing an item of property, plant and equipment) to be recognised in the financial statements.

ff) Foreign currency translation

The functional currency of the Company is the currency of the primary economic environment in which the entity operates. The functional currency of the Company is Czech crown ("CZK") and the Company's presentation currency is also CZK.

Monetary assets and liabilities are translated into each entity's functional currency at the official exchange rate of the Czech National Bank ("CNB") at the respective end of the reporting period. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into each entity's functional currency at year-end official exchange rates of the CNB are recognised in profit or loss within finance or operating income or expenses. Translation at year-end rates does not apply to non-monetary items that are measured at historical cost. Non-monetary items measured at fair value in a foreign currency, including equity investments, are translated using the exchange rates at the date when the fair value was determined. Effects of exchange rate changes on non-monetary items measured at fair value in a foreign currency are recorded as part of the fair value gain or loss.

gg) Revenue recognition

The Company recognises as revenue mainly income from fees collected for the gas transmission within and across the Czech Republic.

Revenue from gas transmission services is recognised on time proportional basis based on the reserved capacity, at the maximum on a monthly basis. Revenues are invoiced on a monthly basis (or shorter where applicable) and sales are shown net of VAT and discounts. Revenues are measured at the fair value of the consideration received or receivable.

Interest income is recognised on a time-proportion basis using the effective interest method.

hh) Employee benefits

Wages, salaries, contributions to the Czech state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits (such as health services and other services) are accrued in the year in which the associated services are rendered by the employees of the Company.

a) Pension obligations

A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan.

For defined contribution plans, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

b) Termination benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits at the earlier of the following dates: (a) when the Company can no longer withdraw the offer of those benefits; and (b) when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their present value.

c) Other long term benefits

Long-term employee benefits, such as long-term bonuses, and long service awards are accounted for measured using the projected unit credit method in the same way as defined benefit pension plan, with the exception that re-measurements (actuarial gains/losses) and related charges are recognised immediately through in profit or loss.

ii) Offsetting of financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously. Such a right of set off (a) must not be contingent on a future event and (b) must be legally enforceable in all of the following circumstances: (i) in the normal course of business, (ii) in the event of default and (iii) in the event of insolvency or bankruptcy.

jj) Segment reporting

Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance for the Company. Segments are reported in a manner consistent with the internal reporting provided to the Company's chief operating decision maker. Segments whose revenue, result or assets are ten percent or more of all the segments are reported separately.

4. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Company makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Functional currency

Management assessed the relevant primary and secondary factors during the consideration about the Company's functional currency. The functional currency is the currency of the primary economic environment, in which the entity operates. The regulated sales prices of the Company are determined by ERO – the Czech regulatory authority and are defined in CZK. Majority of the entity's revenue stems from regulated sales. Majority of the operating expenses of the Company are influenced by CZK. Capital expenditures are twofold: regular capital expenditure safeguarding the existing system and its safeness; and large one off projects. The regular capital expenditure is almost entirely influenced by CZK, while the pricing of large one off projects is influenced by a mix of currencies (including CZK, EUR and other). The funds from financing activities are generated by a mix of currencies (including CZK, EUR and US Dollars). Although the entity's operations are influenced by a mix of currencies, management concluded that majority of the indicators support CZK as the functional currency of the Company.

Finance lease contract with BRAWA

The Company entered into a long-term finance lease contract in January 2013 whereby it leases the GAZELLE pipeline from its subsidiary BRAWA. The contract is expiring on 1 January 2035.

In January 2013 the Company recognised finance lease as the leased asset and finance lease liability at the amount of CZK 7,312 million which is equal to the fair value of the leased GAZELLE pipeline as the fair value of leased GAZELLE pipeline was lower than the present value of the minimum lease payments (each determined at the inception of the lease) using discount rate equal to the market rate.

Minimum lease payments used in the calculation represent the payments over the lease term that the Company is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to BRAWA, together with any amounts guaranteed by the Company or by a party related to the Company.

Fair value of the leased GAZELLE pipeline used in the calculation represents the carrying value of leased GAZELLE pipeline recognised in BRAWA's financial statements and it reflects the amount for which the leased GAZELLE pipeline was exchanged during its construction between knowledgeable, willing parties in an arm's length transactions (representing mostly tendered price for the construction of the leased GAZELLE pipeline with unrelated parties).

Management of the Company estimated the total useful life of the leased GAZELLE pipeline being 70 years and represents the estimated period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits embodied in the leased GAZELLE pipeline are expected to be consumed by the Company.

In 2017 the carrying value of leased GAZELLE pipeline and finance lease liability were updated due to the change in the calculation of monthly lease payment (WACC rate used in monthly lease payment calculation was decreased with the

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effect from January 2017). The value of leased GAZELLE pipeline and liability increased by CZK 366 million.

Classification of pipeline capacity contracts
The Company entered into long-term contracts expiring on 1 January 2021 and 1 January 2035 whereby it provided majority of its GAZELLE pipeline capacity under 'ship or pay' basis. Management considered whether the contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Company's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract. The Company treats the pipeline as its property, plant and equipment and recognises revenue from the contract with the major customer in accordance with IAS 18.

New cross-border capacity was offered and successfully marketed at the annual capacity auction on March 6, 2017. The Company launched the implementation phase of a new project entitled Capacity4Gas. The objective of the project is to build new gas infrastructure within the NET4GAS transmission system. The Capacity4Gas project is executed in two stages, the completion of which is planned for 2019 and 2021. Management considered whether the new contract for the provision of pipeline capacity to its major customer is, in substance, a finance lease. Management's conclusion that the contract is not a lease of the pipeline DN 1400 is based on the fact that there is significant (although minority) capacity of the pipeline, which is available to other customers and this capacity can be used by the other customers. The pipeline is under the Company's full control and the major customer has no ability or right to control physical access to the pipeline. Therefore the arrangement is not, in substance, a lease contract.

Transmission System Operator licence and gas pipelines
Considering the applicability of IFRIC 12 for the Company, management believes that the control requirements have not been met as the title will never be transferred to the government nor can the government control the operator's practical ability to sell or pledge the infrastructure and government is not controlling the construction process. Therefore the Company's system is classified as property, plant and equipment and is not treated as infrastructure used in public-to-private service concession arrangements.

Risk related to tax position – year 2016
NET4GAS was established by way of legal reorganisation of part of the business of RWE Transgas, a.s. ("RWE Transgas") due to the unbundling requirement under the so called Second Energy Package of the European Union, while part of the business of RWE Transgas was contributed to registered capital of NET4GAS. As a result of the unbundling process and related revaluation, the accounting carrying amounts of the gas transmission system under the Czech accounting legislation ("local GAAP") were significantly increased (based on an appointed appraiser's valuation) compared to their tax values (i.e. the historical cost based measurement rolled over from the tax books of RWE Transgas, which was the basis for tax depreciation). Due to the temporary differences between the new carrying amounts and the tax values of the transmission system, the deferred tax liability was recorded in 2006 against equity of NET4GAS under local GAAP. ERO has approved the inclusion of accounting depreciation (based on the revalued amounts) of the gas pipeline system in the final price for the inland gas transmission services. It means that the regulated prices (taxable income) charged by NET4GAS to its customers have been increased by the effect of local GAAP accounting depreciation, while the original tax base has been based on the historical costs of the gas pipeline system only.

In 2015 NET4GAS applied the amended Income Tax Act, in which the provision of Section 23(4) (e) governs direct relation between tax non-deductible expenses and revenues. As a result of the change, part of the taxable income generated by the gas pipeline network was, in management's view, not taxable. Although the amended favourable rule was new, management was of the view that it was more likely than not, that the Company was able to sustain its position based on the amended law. The calculation of income tax charge for 2015 and deferred tax liability as at 31 December 2015 were based on this view.

Views of the expert audience and professional advisors developed during 2016. As a result of the development, management no longer keeps the view that it is more likely than not, that the Company sustains its position in connection with deferred tax liability position. Management decided to recognise deferred tax liability related to the temporary differences of pipeline network in full amount without taking into account the (potential) benefit of the provision of Section 23(4) (e). As a result of this change in management estimate the deferred tax liability was increased by CZK 2,125 million and the change was recognised as an expense (loss) in the previous period. This adjustment as a change in management view was a change in estimate in respect of deferred tax liability that was according to IAS 8 guidance recognised prospectively. It was neither a change in an accounting policy nor a correction of prior period error. Submitted income tax return for 2015 (filed on 24 October 2016, in extended deadline) reflected the revised management view.

In 2017 there was no impact of (potential) benefit of the provision of Section 23(4)(e) of the Income Tax Act on the Company.

Segments
Operating segments are components that engage in business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker (CODM) and for which discrete financial information is available. The CODM is the person or group of persons who allocates resources and assesses the performance of the Company. Recurring revenues are from the contracts with foreign and domestic customers. Information for CODM (the Company's Statutory Directors) who are responsible for allocating resources and assessing performance of the Company is prepared for the whole Company without any particular structuring. Management regularly obtain information with assessment of the split of revenue between the transit revenue and domestic transmission revenue. There is no profit measure, which would be based on similar basis. All profit measures used by the CODM are based on the results of the Company considered as one business unit. As a result, management consider the whole Company as one segment for the purpose of segment reporting.

Unpaid receivable – Arbitration court
Since October 2016, no monthly fees under one contract have been paid by a customer. An arbitration claim was filed on 26 April 2017 and the arbitration procedure is pending. It is assumed that at least until middle of 2018 no payments from this contract would be received. The Company believes it has a solid case and its chance of success is very good. The total unpaid receivable as of 31 December 2017 is CZK 129 million and is not impaired as the management believes that the receivable will be fully paid.

5. Adoption of New or Revised Standards and Interpretations and New Accounting Pronouncements

a) Adoption of new or revised standards and interpretations that are effective on or after 1 January 2017
Disclosure Initiative – Amendments to IAS 7 (issued on 29 January 2016 and effective for annual periods beginning on or after 1 January 2017). The amended IAS 7 requires disclosure of a reconciliation of movements in liabilities arising from financing activities.

No other new or revised standards and interpretations have material impact on the Company.

b) New standards and interpretations that have been issued and are mandatory for the annual periods beginning on or after 1 January 2018 or later

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2018 or later, and which the Company has not early adopted.

IFRS 9 "Financial Instruments: Classification and Measurement" (amended in July 2014 and effective for annual periods beginning on or after 1 January 2018). Key features of the new standard are:

– Financial assets are required to be classified into three measurement categories: those to be measured subsequently at amortised cost, those to be measured subsequently at fair value through other comprehensive income (FVOCI) and those to be measured subsequently at fair value through profit or loss (FVPL).

– Classification for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest (SPPI). If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

– Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

– Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

– IFRS 9 introduces a new model for the recognition of impairment losses – the expected credit losses (ECL) model. There is a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. In practice, the new rules mean that entities will have to record an immediate loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

– IFRS 9 provides an accounting policy choice: entities can either continue to apply the hedge accounting requirements of IAS 39 (see chapter 6.8A), pending the macro hedging project being finalised, or they can apply IFRS 9. For the reporting period beginning on January 1, 2018, the Company has decided to continue with hedge requirements of IAS 39. The Company is considering the transition to IFRS 9 in the future.

– Due to the nature of the entity's operations and the types of financial instruments it holds, IFRS 9 is not expected to change the classification and measurement of the Company financial instruments.

– The Company performed analysis of IFRS 9 impact of the new model for the recognition of impairment losses for the financial statements as at 31 December 2017. The ratio of impaired assets to total revenues from the company's business generating all profits is 0%. Of the value of short-term assets CZK 1,970 million, only CZK 137 million is included in overdue category (Note 140. Regarding the above mentioned, the Company does not expect IFRS 9 to have a significant impact on the financial statements.

IFRS 15, Revenue from Contracts with Customers (issued on 28 May 2014 and effective for the periods beginning on or after 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed.

The management of the Company has completed an initial assessment of the potential impact of IFRS 15 on the Company's financial statements and does not expect that this new standard would have a material impact on the financial statements during its initial application. Due to the nature of the Company's operations and the types of revenue, IFRS 15 is not expected to change the timing and revaluation of the Company's revenues.

Amendments to IFRS 15, Revenue from Contracts with Customers (issued on 12 April 2016 and effective for annual periods beginning on or after 1 January 2018). The amendments do not change the underlying principles of the Standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard.

IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Management is currently assessing the impact of the standard on the financial statements of the Company.

IFRIC 22 – Foreign Currency Transactions and Advance Consideration (issued on 8 December 2016 and effective for annual periods beginning on or after 1 January 2018). The interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) on the derecognition of a non-monetary asset or non-monetary liability arising from an advance consideration in a foreign currency. Under IAS 21, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part thereof) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine the date of the transaction for each payment or receipt of advance consideration. IFRIC 22 only applies in circumstances in which an entity recognises a non-monetary asset or non-monetary liability arising from an advance consideration. IFRIC 22 does not provide application guidance on the definition of monetary and non-monetary items. An advance payment or receipt of consideration generally gives rise

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to the recognition of a non-monetary asset or non-monetary liability, however, it may also give rise to a monetary asset or liability. An entity may need to apply judgment in determining whether an item is monetary or non-monetary. Management is currently assessing the impact of the amendments on its financial statements.

No other new or revised standards and interpretations have material impact on the Company.

6. Segment Information

(a) Description of products and services from which each reportable segment derives its revenue

The Company is organised on the basis of one main business segment – Natural gas transmission (representing natural gas transmission services).

(b) Factors that management used to identify the reportable segments

Refer to the information in Note 4.

(c) Information about reportable segment profit or loss, assets and liabilities

The Company is considered as one reportable segment. Segment information for the reportable segment for the years ended 31 December 2017 and 31 December 2016 is set out below:

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	2017	**2016**
Revenues from core activities	7,401	9,286
Other operating income	437	458
Finance income	4	8
Total segment income	**7,842**	**9,752**
Raw materials consumed	302	450
Employee benefits	439	509
Depreciation and amortization	2,007	2,068
Services purchased and lease charges	308	545
Gains less losses on disposals of property, plant and equipment	–	(3)
Changes in fair value of derivatives, net	37	(31)
Foreign exchange differences, net	100	(1)
Other operating expenses	40	37
Income tax expense	527	2,904
Finance costs	1,439	1,852
Segment profit for the year	**2,643**	**1,422**
Segment other comprehensive income for the year	**2,278**	**222**
Segment total comprehensive income for the year	**4,921**	**1,644**
Capital expenditures	**771**	**678**

In millions of Czech crowns	Natural gas transmission	Natural gas transmission
	31 December 2017	**31 December 2016**
Total reportable segment Assets	**51,989**	**53,070**
Total reportable segment Liabilities	**42,767**	**45,481**

Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(d) Geographical information

Total revenues for geographical areas for which the revenues are material are reported separately and disclosed below.

The analysis is based on domicile of shippers (users of transmission system that is operated by the Company in the Czech Republic).

In millions of Czech crowns	2017	2016
Czech Republic	1,570	1,856
Other EU countries	1,297	2,129
Non-EU countries	4,534	5,301
Total revenues from core activities	**7,401**	**9,286**

Capital expenditure for each individual country is reported separately as follows:

In millions of Czech crowns	2017	2016
Czech Republic	771	678
Total capital expenditure	**771**	**678**

The analysis is based on location of assets. Capital expenditure represents additions to non-current assets other than financial instruments and deferred tax assets.

(e) Major customers

Revenues from customers that represent 10% or more of the total revenues are as follows:

In millions of Czech crowns	2017	2016
Customer 1	4,885	5,659
Customer 2	1,117	1,390
Customer 3	406	1,274
Total revenues from major customers	**6,408**	**8,323**

Revenues comprise only revenues from core activities.

Entities known to the Company as being under common control are considered as a single customer.

7. Balances and Transactions with Related Parties

Parties are generally considered to be related if the parties are under common control or if one party has the ability to control the other party or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Company is fully owned by NET4GAS Holdings and NET4GAS Holdings is the ultimate parent company of the Company.

The Company's balances and transactions with subsidiaries of ultimate parent of Allianz Infrastructure Czech HoldCo II S.à r.l. and subsidiaries of ultimate parent of Borealis Novus Parent B.V. are disclosed below within the category Subsidiaries of joint ventures' ultimate parents.

At 31 December 2017, the outstanding balances with related parties are as follows:

In millions of Czech crowns	Subsidiary	Immediate parent
Loans to related parties (Note 13)		
NET4GAS Holdings, s.r.o.	–	5
Finance lease liability (Note 19)		
BRAWA, a.s – non-current	7,023	–
– current	198	–
Borrowings (Note 18)		
NET4GAS Holdings, s.r.o.	–	22

The income and expense items with related parties for the year ended 31 December 2017 are as follows:

In millions of Czech crowns	Subsidiary	Immediate parent
Purchases / expenses		
BRAWA, a.s. – interest expense from finance lease	491	–
BRAWA, a.s. – interest expense from cash-pooling	1	–
BRAWA, a.s. – services	2	–
Other revenues / gains / received payments		
NET4GAS Holdings, s.r.o. – interest income	–	2
NET4GAS Holdings, s.r.o. – services	–	1
BRAWA, a.s. – dividends	400	–
BRAWA, a.s. – payment received from decreased capital contributions outside share capital	744	–

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The transactions within Company's equity are disclosed in Note 17.

At 31 December 2016, the outstanding balances with related parties were as follows:

In millions of Czech crowns	Subsidiary	Immediate parent
Gross amount of trade and other receivables		
BRAWA, a.s.	1	–
Trade and other payables		
BRAWA, a.s.	17	–
Loans to related parties (Note 13)		
NET4GAS Holdings, s.r.o.	–	652
Finance lease liability (Note 19)		
BRAWA, a.s. – non-current	6,778	–
– current	196	–
Borrowings (Note 18)		
NET4GAS Holdings, s.r.o.	–	25
BRAWA, a.s. – cash-pooling	524	–

The income and expense items with related parties for the year ended 31 December 2016 were as follows:

In millions of Czech crowns	Subsidiary	Subsidiaries of joint venturers' ultimate parents	Immediate parent
Purchases / expenses			
BRAWA, a.s. – interest expense from finance lease	513	–	–
BRAWA, a.s. – interest expense from cash-pooling	1	–	–
BRAWA, a.s. – services	36	–	–
Borealis Novus Holdings B.V. – interest expense	–	182	–
Allianz Infrastructure Luxembourg I S.à r.l. – interest expense	–	182	–
NET4GAS Holdings, s.r.o. – interest expense	–	–	1
Other revenues			
NET4GAS Holdings, s.r.o. – interest income	–	–	6
NET4GAS Holdings, s.r.o. – services	–	–	1
BRAWA, a.s. – dividends	432	–	–

At 31 December 2017 and 2016 the Company did not have any other rights and obligations connected to related parties.

Key management compensation is presented below:

	2017		2016	
In millions of Czech crowns	Expense	Accrued liability	Expense	Accrued liability
Short-term benefits:				
– Salaries	57	4	47	4
– Short-term bonuses	15	14	14	14
– Current portion of long-term bonuses	–	–	–	8
Other long-term employee benefits:				
– Long-term bonus scheme	16	36	13	32
– Defined contribution benefits	5	3	5	3
Total	**93**	**57**	**79**	**61**

Short-term bonuses fall due wholly within twelve months after the end of the period in which management rendered the related services.

Key management represents Statutory Directors and managers directly reporting to them.

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8. Property, Plant and Equipment

Movements in the carrying amount of property, plant and equipment were as follows:

In millions of Czech crowns	Freehold Land	Buildings and constructions	Buildings and constructions under finance lease	Plant and equipment	Construction in progress	Total
Cost at 1 January 2016	179	53,680	7,312	5,624	326	67,121
Accumulated depreciation	–	(16,910)	(312)	(4,489)	–	(21,711)
Carrying amount at 1 January 2016	**179**	**36,770**	**7,000**	**1,135**	**326**	**45,410**
Additions	–	–	–	–	632	632
Capitalised borrowing costs	–	–	–	–	13	13
Transfers	4	308	–	183	(495)	–
Disposals	–	(20)	–	–	–	(20)
Depreciation charge	–	(1,666)	(106)	(222)	–	(1,994)
Carrying amount at 31 December 2016	**183**	**35,392**	**6,894**	**1,096**	**476**	**44,041**
Cost at 31 December 2016	183	53,917	7,312	5,774	476	67,662
Accumulated depreciation	–	(18,525)	(418)	(4,678)	–	(23,621)
Carrying amount at 1 January 2017	**183**	**35,392**	**6,894**	**1,096**	**476**	**44,041**
Impact of change of WACC in lease contract (Note 4)	–	–	366	–	–	366
Additions	–	–	–	–	732	732
Capitalised borrowing costs	–	–	–	–	9	9
Transfers	1	279	–	246	(526)	–
Disposals	–	(2)	–	(3)	–	(5)
Depreciation charge	–	(1,628)	(110)	(228)	–	(1,966)
Carrying amount at 31 December 2017	**184**	**34,041**	**7,150**	**1,111**	**691**	**43,177**
Cost at 31 December 2017	184	54,198	7,678	5,951	691	68,702
Accumulated depreciation	–	(20,157)	(528)	(4,840)	–	(25,525)
Carrying amount at 31 December 2017	**184**	**34,041**	**7,150**	**1,111**	**691**	**43,177**

The Company invested in 2017 a total of CZK 741 million in tangible assets. The most significant investment was within the Capacity4Gas project, a total of CZK 189 million. In 2017, the Company made resolution about continuance of operation of compressor stations and reassess their useful lives (Note 22). The impact on depreciation 2017 is a decrease of CZK 4 million.

As at 31 December 2017, construction in progress consists mainly of construction of Czech-Polish interconnector gas pipeline of CZK 308 million (31 December 2016: CZK 252 million). Upon completion, assets are expected to be transferred to buildings and constructions. Other items represent smaller projects.

The Company leases GAZELLE pipeline under non-cancellable finance lease agreement. The lease period is 22 years and ownership of the assets lies within the lessor.

9. Intangible Assets

In millions of Czech crowns	Acquired software licences	Development costs	Other	Assets under construction	Total
Cost at 1 January 2016	416	57	23	33	529
Accumulated amortisation	(356)	(52)	(11)	–	(419)
Carrying amount at 1 January 2016	**60**	**5**	**12**	**33**	**110**
Additions	–	–	–	33	33
Transfers	43	–	2	(45)	–
Amortisation charge	(48)	(3)	(3)	–	(54)
Carrying amount at 31 December 2016	**55**	**2**	**11**	**21**	**89**
Cost at 31 December 2016	458	54	25	21	558
Accumulated amortisation	(403)	(52)	(14)	–	(469)
Carrying amount at 1 January 2017	**55**	**2**	**11**	**21**	**89**
Additions	–	–	–	30	30
Transfers	38	–	2	(40)	–
Amortisation charge	(36)	(2)	(3)	–	(41)
Carrying amount at 31 December 2017	**57**	**–**	**10**	**11**	**78**
Cost at 31 December 2017	496	54	27	11	588
Accumulated amortisation	(439)	(54)	(17)	–	(510)
Carrying amount at 31 December 2017	**57**	**–**	**10**	**11**	**78**

10. Investment in Subsidiary

The Company's interest in its subsidiary as at 31 December 2017 was as follows:

Name	Activity	Carrying amount of the investment (CZK million)	% ownership interest held (% of voting rights if different)	Principal place of business	% ownership interest held	% of voting rights (if different than % ownership interest held)
Subsidiary:						
BRAWA, a.s.	Owner of the GAZELLE natural gas pipeline which is rented to the Company	6,732	100 %	Czech Republic	100 %	100 %
Total		**6,732**				

In December 2017, the Company as the sole shareholder of BRAWA, a.s., decided that a part of other capital contributions out of share capital of CZK 744 million was paid out to the Company. The transaction was recorded as a decrease of carrying amount of the investment in BRAWA, a.s.

The Company's interest in its subsidiary as at 31 December 2016 was as follows:

Name	Activity	Carrying amount of the investment (CZK million)	% ownership interest held (% of voting rights if different)	Principal place of business	% ownership interest held	% of voting rights (if different than % ownership interest held)
Subsidiary:						
BRAWA, a.s.	Owner of the GAZELLE natural gas pipeline which is rented to the Company	7,476	100 %	Czech Republic	100 %	100 %
Total		**7,476**				

BRAWA, a.s. with its registered office at Na Hřebenech II 1718/18, Prague – Nusle was incorporated on 27 October 2010. The company was registered in the Commercial Register maintained by the Municipal Court in Prague, section B, insert 16622, on 10 November 2010.

11. Other Non-Current Assets

In millions of Czech crowns	31 December 2017	31 December 2016
Advances for acquisition of fixed assets	25	9
Total other non-current assets	**25**	**9**

12. Inventories

In millions of Czech crowns	31 December 2017	31 December 2016
Raw materials	61	63
Total inventories	**61**	**63**

Raw materials are mainly spare parts for the gas transmission system.

There are no inventories valued at net realisable value as at 31 December 2017 and 2016.

13. Loans to Related Parties

In millions of Czech crowns	31 December 2017	31 December 2016
Corporate loans		
– denominated in Czech crowns	–	164
– denominated in Euros	5	488
Total loans provided	**5**	**652**

Loans to related parties as at 31 December 2016 are provided on the basis of the Loan agreement dated 11 November 2013 and are of short-term nature.

In June 2017, based on the resolution of sole shareholder of Company the loan provided to sole shareholder was sett-off against the liability of Company from profit distribution and the return of the contribution to other capital fund (Note 17).

Interest rates related to loan to related parties are disclosed in Note 32, section interest rate risk.

Analysis by credit quality of loans outstanding is as follows:

In millions of Czech crowns	31 December 2017 Corporate loans	31 December 2016 Corporate loans
Neither past due nor impaired		
– NET4GAS Holdings, s.r.o. – parent company (without external rating)	5	652
Total neither past due nor impaired	**5**	**652**
Total loans provided	**5**	**652**

There are no collaterals related to the above mentioned loans.

Refer to Note 34 for the estimated fair value of each class of loans. Interest rate analysis of loans is disclosed in Note 32. Information on related party transactions is disclosed in Note 7.

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14. Trade and Other Receivables

In millions of Czech crowns	31 December 2017	31 December 2016
Trade and estimated receivables	325	304
Less impairment loss provision	(1)	(1)
Total current trade and other receivables	**324**	**303**

Analysis by credit quality of trade and other receivables is as follows:

In millions of Czech crowns	31 December 2017 Trade and estimated receivables	31 December 2016 Trade and estimated receivables
Neither past due nor impaired – exposure to		
– Between A- and BBB-*	160	238
– Not rated	32	47
Total neither past due nor impaired	192	285
Past due but not impaired		
– less than 30 days overdue	12	9
– between 30 – 60 days overdue	9	9
– 60 days or more overdue	111	–
Total past due but not impaired	132	18
Individually determined to be impaired (gross)		
– 360 days or more overdue	1	1
Total individually impaired	1	1
Less impairment provision	(1)	(1)
Total trade and other receivables	**324**	**303**

* Rating disclosed is equivalent credit rating from the third party rating agencies defined in the Network Code approved by ERO which is applicable for the Company.

15. Other Non-Financial Assets and Other Financial Assets

Other Non-Financial Assets are following:

In millions of Czech crowns	31 December 2017	31 December 2016
Value-added tax prepaid	–	3
Prepayments for services	32	24
Total current non-financial assets	**32**	**27**

Other Financial Assets including credit quality are following:

In millions of Czech crowns	31 December 2017	31 December 2016
Deposit bills of exchange with original maturity of less than three months (A+ to A- rated)	300	–
Deposit bills of exchange with original maturity of less than six months (A+ to A- rated)	383	–
Total other financial assets	**683**	**–**

16. Cash and Cash Equivalents

In millions of Czech crowns	31 December 2017	31 December 2016
Bank balances available on demand	625	410
Total cash and cash equivalents	**625**	**410**

The credit quality of cash and cash equivalents balances may be summarised as follows:

In millions of Czech crowns	31 December 2017	31 December 2016
Neither past due nor impaired		
– A+ to A- rated	360	371
– BBB+ to BBB- rated	265	39
Total	**625**	**410**

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17. Equity

The Company is a limited liability company. It has no issued share securities. The rights attributed to share in the equity correspond to the proportion in the ownership interest.

Dividends declared and paid during the year were as follows:

In millions of Czech crowns	2017	2016
Dividends payable at 1 January	–	–
Dividends declared and paid during the year	21	1,540
Dividends payable at 31 December	–	–

Advance dividends paid during the year were as follows:

In millions of Czech crowns	2017	2016
Advance dividends paid	–	1,650
Total advance dividends paid	**–**	**1,650**

All dividends were declared in Czech crowns and paid in a different currency mix (CZK, EUR and USD).

On 15 December 2016 the Statutory Directors of the Company decided about the advance dividend payment of CZK 1,650 million. The payment of the advance dividend is subsequently subject to approval of the general meeting of the sole shareholder of the Company dated 16 June 2017. The advance dividend payments are recognised as a decrease in equity as at the date of the payment.

A description of the nature and purpose of each reserve is provided below the table.

In millions of Czech crowns	Capital contributions outside registered capital	Cash flow hedges	Total other reserves
Balance as at 1 January 2016	**29**	**(2,035)**	**(2,006)**
Revaluation – gross	–	(2)	(2)
Reclassification to profit or loss (Revenues) – gross	–	275	275
Reclassification to profit or loss (Finance costs) – gross	–	1	1
Deferred tax effect	–	(52)	(52)
Non-cash contribution outside registered capital	6,602	–	6,602
Balance as at 31 December 2016	**6,631**	**(1,813)**	**4,818**
Revaluation – gross	–	2,580	2,580
Reclassification to profit or loss (Revenues) – gross	–	228	228
Reclassification to profit or loss (Finance costs) – gross	–	4	4
Deferred tax effect	–	(534)	(534)
Contribution outside registered capital	(3,267)	–	(3,267)
Balance as at 31 December 2017	**3,364**	**465**	**3,829**

Capital contributions outside registered capital
Capital contributions outside registered capital comprises of cash and non-cash capital contributions that does not give rise to the registered capital.

Increase / decrease in Capital contributions outside registered capital

Month/Year	In millions of Czech crowns	Comment to the settlement of the increase/decrease
July 2016	6,602	Netted against cessed receivable from loan to related parties Borealis Novus Holdings B.V. and Allianz Infrastructure Luxembourg I S.à r.l. to NET4GAS Holdings
Total increase in 2016	**6,602**	
June 2017	(622)	Netted against receivable from loans incl. interest to NET4GAS Holdings (cash-pooling)
June 2017	(3,000)	Cash payment
November 2017	355	Cash received*
Total decrease in 2017	**(3,267)**	

* For purpose of Capacity4Gas project funding there was concluded Funding agreement based on which the sole shareholder provided capital contribution outside registered capital.

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Cash flow hedges
Cash flow hedges are used to recognize gains or losses on hedging instruments that are designated and qualify as cash flow hedges in other comprehensive income, as described in Note 3(c). Amounts are reclassified to profit or loss when the associated hedged transaction affects profit or loss.

18. Borrowings

In millions of Czech crowns	31 December 2017	31 December 2016
Short-term borrowings from related parties (cash pooling BRAWA)	–	524
Short-term borrowings from related parties (cash pooling NET4GAS Holdings)	22	25
Current portion of bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 30 May 2022)	12	–
– CZK denominated bond (repayable on 28 January 2021)	129	117
– EUR denominated bond (repayable on 28 July 2021)	66	70
– EUR denominated bond (repayable on 28 July 2026) – issued in 2014	56	59
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	14	15
Non-current bonds and bank borrowings		
– CZK denominated bank borrowings (repayable on 30 May 2022)	7,061	5,736
– USD denominated bank borrowings (repayable on 28 July 2018)	–	1,381
– CZK denominated bond (repayable on 28 January 2021)	6,968	6,952
– EUR denominated bond (repayable on 28 July 2021)	7,627	8,055
– EUR denominated bond (repayable on 28 July 2026) – issued in 2014	4,060	4,291
– EUR denominated bond (repayable on 28 July 2026) – issued in 2015	1,272	1,346
Total borrowings – current	**299**	**810**
Total borrowings – non-current	**26,988**	**27,761**
Total borrowings	**27,287**	**28,571**

Bank borrowings and bonds
The Group borrowings as at 31 December 2016 have been constituted by bank borrowings acquired in 2014 and bonds issued in 2014 and 2015. In May 2017 CZK and USD bank borrowings due in 2018 were replaced by new CZK bank borrowing with the maturity until 30 May 2022. The total value of the Group's debt has remained stable, the currency mix has changed.

The Company acquired the committed revolving facility agreement in equivalent of EUR 80 million (CZK 2,043 million per Czech National Bank foreign exchange rate as at 31 December 2017). Further, the Company acquired the Overdraft facility in the equivalent of EUR 20 million (CZK 511 million per Czech National Bank foreign exchange rate as at 31 December 2017). Both facility agreements might be utilized in CZK or EUR. During 2017 the Revolving facility agreement and Overdraft facility were drawn and repaid, as at 31 December 2017 were undrawn (as at 31 December 2016 Revolving facility and Overdraft facility was undrawn).

Six banks with different share participated on the total bank borrowings as at 31 December 2017 (nine banks as at 31 December 2016).

There is no collateral related to the above mentioned bank borrowings or bonds.

The Company's senior debts are all issued at pari-passu. The bank borrowings and bonds have no quantitative financial covenants. There are several qualitative covenants applied, i.e. negative pledge, change of control put and loss of finance put. Violation of these covenants can lead to immediate maturity of the debt.

The Company's right to lien its property in favour of another creditor is restricted due to conditions stated in bank and bond financing contracts.

Bank borrowings and bonds denominated in foreign currency represent a constituent of hedge accounting, which represents the hedging instrument for securing of foreign exchange risk associated with a highly probable forecasted future cash flows resulting from natural gas transmission revenues (cash flow hedge) – Note 32, Note 3c).

In May 2017 USD bank borrowing was repaid (was replaced by new CZK bank borrowing). The cumulative loss in equity (hedge accounting) remained in equity and will be recognised gradually in costs (based on effectivity test made at the date of redemption, till March 2030).

Bonds issued:

In millions of Czech crowns	Issue nominal value	Due date	Annual coupon repayment due date	31 December 2017	31 December 2016
Bond EUR, serial no. 1, ISIN XS1090450047	300,000,000 EUR	28 Jul 2021	Each 28.7. in arrears	7,693	8,125
Bond EUR, serial no. 2, ISIN XS 1090449627	160,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	4,116	4,350
Bond CZK, serial no. 3, ISIN XS1090620730	7,000,000,000 CZK	28 Jan 2021	Each 28.1. in arrears	7,097	7,069
Bond EUR, serial no. 4, ISIN XS 1172113638	50,000,000 EUR	28 Jul 2026	Each 28.7. in arrears	1,286	1,361
Total bonds				**20,192**	**20,905**

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Coupon rates to the above mentioned bonds are in range of 2.25% – 3.5% p.a. On 28 July 2014 bonds, serial no. 1 – 3, were accepted for trading on a regulated market of the Irish Stock Exchange PLC. The terms of issue of all above stated bonds have been approved by the decision of the Central Bank of Ireland. The 2015 bond, serial no. 4, was issued via private placement.

The fair value of borrowings is disclosed in Note 34.

19. Finance Lease Liability

Minimum lease payments under finance leases and their present values are as follows:

In millions of Czech crowns	Due in 1 year	Due between 1 and 5 years	Due after 5 years	Total
Minimum lease payments at 31 December 2017	601	2,324	19,836	22,761
Less future finance charges	403	1,859	13,278	15,540
Present value of minimum lease payments at 31 December 2017	**198**	**465**	**6,558**	**7,221**
Minimum lease payments at 31 December 2016	617	2,385	20,427	23,429
Less future finance charges	421	1,943	14,091	16,455
Present value of minimum lease payments at 31 December 2016	**196**	**442**	**6,336**	**6,974**

Leased assets with a carrying amount disclosed in Note 8 are effectively pledged for finance lease liabilities as the rights to the leased asset revert to the lessor in the event of default.

20. Government and Other Grants

The Company obtained grants from European Commission for construction projects and deducted the grant value from the carrying amount of the related property, plant and equipment when all conditions attached to the grant were fulfilled.

In millions of Czech crowns	31 December 2017	31 December 2016
Grants	7	15
Total grants	**7**	**15**

In 2017 the Company received a grant of CZK 2 million. The Company complied with all attached condition and therefore the amount of CZK 10 million was deducted from the carrying amount of property, plant and equipment in 2017 (2016: CZK 1 million).

21. Other Taxes Payable

In millions of Czech crowns	31 December 2017	31 December 2016
Other taxes payable within one year comprise:		
Property and other taxes	6	8
Social and health insurance	12	12
Other taxes payable – current	**18**	**20**

22. Provisions for Liabilities and Charges

Movements in provisions are as follows:

	2017		2016	
In millions of Czech crowns	Current	Non-current	Current	Non-current
Carrying amount at January 1	**–**	**167**	**40**	**177**
Additions charged to profit or loss	2	–	–	2
Unused amounts reversed	–	(167)	–	(12)
Amounts used during the year	–	–	(40)	–
Carrying amount at December 31	**2**	**–**	**–**	**167**

The non-current provisions as at 31 December 2016 were primarily set aside for restructuring on selected compressor stations (expected to be utilised in year 2021).

New cross-border capacity was offered and successfully marketed at the annual capacity auction on 6 March 2017 – a result of the joint efforts between the transmission operators in the Federal Republic of Germany, the Czech Republic and the Slovak Republic. Based on the results of this auction, The Company is ready to invest into relevant new gas infrastructure in the Czech Republic in the upcoming years. In connection with this construction, the Company made resolution about continue of operation of these compressor stations, reassessed their useful lives and released the provision for liquidation and the provision for restructuring – termination payments to employees.

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23. Trade and Other Payables

In millions of Czech crowns	31 December 2017	31 December 2016
Trade payables for purchased property, plant and equipment	150	145
Trade payables – other	58	68
Accrued liabilities for purchased property, plant and equipment	53	20
Accrued liabilities – other	118	165
Received deposits from customers	148	139
Other financial liabilities	1	3
Total financial payables within trade and other payables – current	**528**	**540**
Other payables	13	8
Total financial payables within other payables – non-current	**13**	**8**

24. Accrued Employees Benefits and Other Non-Financial Liabilities

In millions of Czech crowns	31 December 2017	31 December 2016
Accrued employee benefits		
– Salaries and bonuses	25	31
– Defined contribution costs	43	15
– Untaken holiday costs	12	7
Prepayments received	132	130
Other non-financial liabilities	13	6
Total accrued employee benefits and other non-financial liabilities – current	**225**	**189**

In millions of Czech crowns	31 December 2017	31 December 2016
Accrued employee benefits – other long-term benefits	101	100
Grant prepayments received (Note 20)	7	15
Total accrued employee benefits and other non-financial liabilities – non-current	**108**	**115**

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25. Expenses

In millions of Czech crowns	2017	2016
Raw materials consumed*	302	450
Salaries	296	337
Statutory and private pension contribution	143	172
Employee benefits	439	509
Depreciation and amortisation	2,007	2,068
Repairs and maintenance services	*141*	*137*
Flexibility costs	*–*	*25*
IT & Telecommunications expenses	*95*	*98*
Consultancy and advisory services	*60*	*74*
Lease charges	*66*	*88*
Marketing	*20*	*20*
Other services	*(74)*	*103*
Services purchased and lease charges	308	545
Losses (gains) on disposal of fixed assets	–	(3)
Losses / (gains) on derivative financial instruments	37	(31)
Foreign exchange differences, net	100	(1)
Other operating expenses	40	37
Total operating expenses	**3,233**	**3,574**

* Represents mainly consumption of natural gas.

26. Other Operating Income

In millions of Czech crowns	2017	2016
Dividend from subsidiary	400	432
Other operating income	37	26
Total other operating income	**437**	**458**

27. Finance Income

In millions of Czech crowns	2017	2016
Interest income on other financial assets	3	7
Other finance income	1	1
Total finance income recognised in profit or loss	**4**	**8**

28. Finance Costs

In millions of Czech crowns	2017	2016
Net foreign exchange differences on financing activities	258	262
Interest expense – finance lease	491	513
Interest expense – other	621	1,016
Other finance costs	69	61
Total finance costs recognised in profit or loss	**1,439**	**1,852**

29. Income Taxes

For details about the risks related to tax position refer to Note 4.

(a) Components of income tax expense

Income tax expense / (credit) recorded in profit or loss comprises the following:

In millions of Czech crowns	2017	2016
Adjustment in respect of current income tax from prior year	–	48
Current income tax expense for the year	692	923
Deferred income tax expense / (credit)	(165)	1,933
Income tax expense for the year in statement of profit and loss	**527**	**2,904**

(b) Reconciliation between the tax expense and profit or loss multiplied by applicable tax rate

The income tax rate applicable to the majority of the Company's 2017 and 2016 income is 19%. The reconciliation between the expected and the actual tax charge is provided below.

In millions of Czech crowns	2017	2016
Profit before tax	**3,170**	**4,326**
Theoretical tax charge at statutory rate of 19%:	602	822
Tax effect of items which are not deductible or assessable for income tax purposes:		
– Non-taxable items – Dividend income from subsidiary	(76)	(82)
– Non-deductible expenses	1	6
Difference between current income tax provision and final current income tax return	–	48
Other effects	–	(15)
Increase of deferred tax liability – change in estimate (Note 4)	–	2,125
Income tax expense for the year	**527**	**2,904**

(c) Deferred taxes analysed by type of temporary difference

Differences between IFRS and tax regulation in the Czech Republic give rise to temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below.

In millions of Czech crowns	1 January 2017	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2017
Tax effect of deductible / (taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(6,431)	190	–	(6,241)
Other liabilities; tax deductible in different period	24	6	–	30
Provisions for liabilities and charges	31	(31)	–	–
Cash flow hedges	425	–	(535)	(110)
Net deferred tax asset / (liability)	**(5,951)**	**165**	**(535)**	**(6,321)**

Management estimates that net deferred tax liabilities of CZK 6,321 million (2016: CZK 5,951 million) are recoverable after more than twelve months after the end of the reporting period.

The tax effect of the movements in the temporary differences for the year ended 31 December 2016 were:

In millions of Czech crowns	1 January 2016	(Charged) / credited to profit or loss	(Charged) / credited to other comprehensive income	31 December 2016
Tax effect of deductible/(taxable) temporary differences				
Difference between tax and accounting carrying amounts of property, plant and equipment (different tax depreciation)	(4,500)	(1,931)	–	(6,431)
Other liabilities; tax deductible in different period	24	–	–	24
Provisions for liabilities and charges	33	(2)	–	31
Cash flow hedges	477	–	(52)	425
Net deferred tax asset/(liability)	**(3,966)**	**(1,933)**	**(52)**	**(5,951)**

(d) Tax effects in the other comprehensive income

Disclosure of tax effects relating to cash flow hedge reserve (see also Note 17):

	31 December 2017			31 December 2016		
In millions of Czech crowns	Before tax	Tax effects	After tax	Before tax	Tax effects	After tax
Cash flow hedge	575	(110)	465	(2,238)	425	(1,813)
Other comprehensive income for the period	**575**	**(110)**	**465**	**(2,238)**	**425**	**(1,813)**

30. Contingencies and Commitments

Operating lease commitments in respect of lease agreements for offices Kavčí hory Office Park and car fleet are as follows:

In millions of Czech crowns	2017	2016
Not later than 1 year	73	44
Total operating lease commitments	**73**	**44**

Capital expenditure commitments. As at 31 December 2017 the Company has contractual capital expenditure commitments in respect of property, plant and equipment totalling CZK 477 million (31 December 2016: CZK 274 million) mainly related to project Capacity4Gas of CZK 289 million and Czech-Polish Interconnector gas pipeline of CZK 80 million (31 December 2016: CZK 125 million).

Guarantees. The Company did not recognise any obligations from financial guarantees as at 31 December 2017 and 2016.

Assets pledged and restricted. In connection with the Company's bank borrowings, the Company's right to lien its property in favour of another creditor is restricted.

Compliance with covenants. The Company is subject to certain qualitative covenants related to its borrowings. Non-compliance with such covenants may result in immediate maturity of the debt. The Company was in compliance with covenants at 31 December 2017 and 31 December 2016.

Leased assets with a carrying amount disclosed in Note 8 are effectively pledged for finance lease liabilities as the rights to the leased asset revert to the lessor in the event of default.

Other contingent liabilities. The Company did not recognise any significant contingent liabilities as at 31 December 2017 and 2016.

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31. Derivative Financial Instruments

The table below sets out fair values, at the end of the reporting period, of currencies receivable or payable under cross–currency interest rate swaps and foreign exchange swap contracts entered into by the Company. The table reflects gross positions before the offsetting of any counterparty positions (and payments) and covers the contracts with settlement dates after the respective end of the reporting period.

Cross currency interest rate swap contracts are long-term while foreign exchange swap contracts are short-term in nature. The respective part of fair value of a hedging derivative is classified as a non-current asset or liability if the remaining maturity of the hedged item is more than 12 months.

The Company did not have any other derivative financial instruments besides cross currency interest rate swaps and foreign exchange swaps.

The disclosure below provides aggregated overview of the fair value of receivable and payable legs of individual contracts per currency mix.

	31 December 2017			
	Current		Non-Current	
In millions of Czech crowns	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(478)	–	(11,301)
– EUR receivable on settlement (+)	–	271	–	10,530
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,565)
– EUR receivable on settlement (+)	–	36	–	1,502
Net fair value of cross currency interest rate swaps	**–**	**(210)**	**–**	**(834)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

In millions of Czech crowns	31 December 2016			
	Current		Non-Current	
	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Cross currency interest rate swaps: fair values, as at the reporting period, of				
EUR/USD currency mix				
EUR/USD currency mix				
– USD payable on settlement (-)	–	(578)	–	(13,884)
– EUR receivable on settlement (+)	–	287	–	11,527
EUR/CZK currency mix				
– CZK payable on settlement (-)	–	(39)	–	(1,764)
– EUR receivable on settlement (+)	–	38	–	1,643
Net fair value of cross currency interest rate swaps	**–**	**(292)**	**–**	**(2,478)**

Inputs used: Market data provided by commercial bank holding the related instruments, Czech National Bank foreign exchange rates.

The Company had one outstanding obligation from foreign exchange swaps as at 31 December 2016.

In millions of Czech crowns	31 December 2017		31 December 2016	
	Contracts with positive fair value	Contracts with negative fair value	Contracts with positive fair value	Contracts with negative fair value
Foreign exchange swaps: fair values, as at the reporting period, of				
– CZK receivable on settlement (+)	–	–	(108)	–
– EUR payable on settlement (-)	–	–	108	–
Net fair value of foreign exchange swaps – current	**–**	**–**	**–**	**–**

Cross currency interest rate swaps and foreign exchange swaps entered into by the Company are generally traded in an over-the-counter market with professional market counterparties on standardized contractual terms and conditions. Aforementioned financial instruments have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in foreign exchange rates, market interest rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly during the life time of derivatives.

Cross currency interest rate swaps
The nominal principal amounts of the outstanding cross currency interest rate swap contracts at 31 December 2017 were EUR 410 million / USD 484 million / CZK 1,397 million (2016: EUR 410 million / USD 484 million / CZK 1,397 million). All cross currency interest rate swaps have fixed interest rates on both legs. At 31 December 2017, the fixed interest rates vary from 2.50 % to 5.23 % p.a. (as at 31 December 2016: 2.50% to 5.23% p.a.).

The Company designates certain cross currency interest rate swaps, in combination with bonds denominated in EUR, as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from natural gas transmission revenues (cash flow hedge) – Note 32, Note 3c).

The Company designates certain cross currency interest rates swaps as hedging instrument of a foreign exchange risk associated with a highly probable forecasted cash flows from bond issued (cash flow hedge) – Note 32, Note 3c).

32. Financial Risk Management

The risk management function within the Company is carried out in respect of financial risks, operational risks, market risks and environment risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. Management sets a strategy for each of the risk, including a limit on open position that may be accepted. The primary objectives of the financial risk management function are then ensure that exposure to risks stays within these limits. Monitoring is performed continuously but minimum on a monthly basis.

Credit risk. Exposure to credit risk arises as a result of cash and cash equivalents held with banks, loans provided to related parties, the Company's sales of services on credit terms and other transactions with counterparties giving rise to financial assets.

The Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to counterparties. Limits on the level of credit risk are approved by management. The risks are monitored on a revolving basis and are subject to a monthly review. The Company is exposed to credit concentration risk considering the receivables from financial institutions.

The credit risk is mitigated by advance payments and a system of creditworthiness conditions which are applied to the Company's customers, suppliers of services with potential significant credit position and financial counterparties such as banks or insurance companies. The conditions are incorporated in the Network Code, relevant tender documentations and internal guidelines.

The Company's management reviews ageing analysis of outstanding trade and other receivables and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Note 14 and in Note 16.

Market risks. The Company takes on exposure to market risks. Market risks arise from open positions in (a) foreign currencies and (b) interest bearing assets and liabilities, all of which are exposed to general and specific market movements.

Sensitivities to market risks included below are based on a change in a factor while holding all other factors constant. In practice this is unlikely to occur and changes in some of the factors may be correlated – for example, changes in interest rate and changes in foreign currency rates.

Currency risk. The Company treasury's risk management policy is to hedge the long-term contracted cash flows (mainly revenues from the gas transmission) in each major foreign currency up until 2034.

Management approves the strategy of the currency risk management. The positions are monitored continuously but at minimum on a monthly basis. The amount of risk is evaluated in terms of open positions.

The offsetting of currency positions is applied where possible. When needed the outstanding positions are managed by means of buying or selling the relevant currency in the short term derivative forward or swap contract. The Company reports no outstanding obligation from foreign exchange swaps as at 31 December 2017. As at 31 December 2016 there was one outstanding obligation from foreign exchange swaps.

The table below summarises the Company's exposure to foreign currency exchange rate risk at the end of the reporting period:

	At 31 December 2017					At 31 December 2016				
In millions of Czech crowns	Monetary financial assets	Monetary financial liabilities	Derivatives (assets)	Derivatives (liabilities)	Net position	Monetary financial assets	Monetary financial (liabilities)	Derivatives (assets)	Derivatives (liabilities)	Net position
US Dollars	160	4	–	10,300	(10,144)	2	1,383	–	12,404	(13,785)
Euros	809	13,149	–	(10,471)	(1,869)	691	13,868	108	(11,078)	(1,991)
Total exposed to currency risk	**969**	**13,153**	**–**	**(171)**	**(12,013)**	**693**	**15,251**	**108**	**1,326**	**(15,776)**
Czech crowns	670	21,880	–	1,397	(22,607)	413	20,618	(108)	1,397	(21,710)
Total	**1,639**	**35,033**	**–**	**1,226**	**(34,620)**	**1,106**	**35,869**	**–**	**2,723**	**(37,486)**

As at 31 December 2017 and 2016 the outstanding derivatives, cross currency interest rate swaps and foreign exchange swaps, were disclosed in their notional amounts being translated to Czech crowns using foreign exchange rate as at 31 December 2017 and 2016. The fair values are disclosed in Note 34.

The above analysis includes only monetary assets and liabilities. Investments in non-monetary assets are not considered to give rise to any currency risk.

Hedging of currency risk. In 2014, the Company decided to introduce two cash-flow hedges to manage the foreign exchange currency risk in revenues in line with the Company treasury's policy. The financial instruments designated as hedging instruments are represented by a) 33 % of bonds maturing in 2021 denominated in EUR and (b) joint hedging instrument of 66 % of bonds maturing in 2021 denominated in EUR and bonds maturing in 2026 denominated in EUR and cross currency interest rate swaps EUR/USD (Note 18, Note 31). The hedged item is represented by contracted or highly probable forecasted natural gas transmission revenues denominated in foreign currencies (in USD and in EUR) that are expected to occur on a monthly basis up until 2034. The dynamic hedging strategy is applied to hedged item. This strategy allows identification of hedged item in any period of the hedge accounting and is based on the continuous designation and re-designation of hedged item on a monthly basis from 28 July 2014 to 31 December 2034. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the repayment of the hedging instruments and within revenue up until 2034 which is beyond the repayment date of the hedging instruments (Note 18, Note 31). Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until the

repayment of the hedging instruments and within revenue up until 2034, which is beyond the repayment date of the hedging instruments (Note 18, Note 31). There was no ineffectiveness to be recorded from cash flow hedges in 2017 and 2016. In May 2017 bank borrowing denominated in USD was fully repaid and hedge accounting for this instrument ceased to exist.

In 2015, the Company introduced additional, third, cash-flow hedge. The financial instruments designated as hedging instruments are represented by cross currency interest rate swap EUR/CZK (Note 18, Note 31). The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other comprehensive income will be continuously released to profit or loss within finance costs up until 2026 (Note 18, Note 31). In 2017, there were no additional hedges. The hedged item is represented by cash flow related to private placement EUR bond maturing in 2026. Gains and losses recognised in other reserves in equity will be continuously released to profit or loss within finance costs up until 2026 (Note 18, Note 31). There was no ineffectiveness to be recorded from cash flow hedges in 2017 and 2016.

The table below analyses the volume of hedged cash flows that were designated as hedged item:

In millions of Czech crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2017						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,069	1,405	1,642	4,883	1,031	10,030
Future cash flows from ceased hedging – future receivables USD	215	167	173	463	223	1 241
Hedging of future cash flows – future receivables EUR	566	1,404	417	–	–	2,387
Hedging of future cash flows – future payables EUR	(36)	(72)	(72)	(1,419)	–	(1,599)
TOTAL	**1,814**	**2,904**	**2,160**	**3,927**	**1,254**	**12,059**

In millions of Czech crowns	Within 1 year	1–3 years	3–5 years	5–10 years	Over 10 years	Total
31 December 2016						
Currency risk exposure:						
Hedging of future cash flows – future receivables USD	1,711	2,497	1,958	5,441	1,345	12,952
Hedging of future cash flows – future receivables EUR	–	1,337	1,189	–	–	2,526
Hedging of future cash flows – future payables EUR	(38)	(76)	(76)	(1,540)	–	(1,730)
TOTAL	**1,673**	**3,758**	**3,071**	**3,901**	**1,345**	**13,748**

The amount of reclassified other comprehensive income to revenues during 2017 decreased revenues by CZK 222 million (2016: decreased revenues by CZK 275 million). The amount of reclassified other comprehensive income to financial costs during 2017 increased financial costs by CZK 63 million (2016: increased financial costs by CZK 1 million).

The following table presents sensitivities of profit or loss or equity (cash flow hedge) to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency, with all other variables held constant:

	At 31 December 2017		At 31 December 2016	
In millions of Czech crowns	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
US Dollar strengthening by 10%	16	(995)	10	(1,284)
US Dollar weakening by 10%	(16)	995	(10)	1,284
Euro strengthening by 10%	76	(62)	77	(31)
Euro weakening by 10%	(76)	62	(77)	31

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the respective entity of the Company and for currency sensitive derivatives.

The Company's exposure to currency risk with impact to profit or loss as at 31 December 2017 is influenced by (i) cash balances held in foreign currency, (ii) by existing loans to related parties provided in EUR (Note 13, Note 27 and Note 28) and (iii) outstanding payables and receivables.

Interest rate risk. The Company's bank borrowings are contracted at floating interest rates. Some instruments, like bonds and fix-to-fix cross currency interest rate swaps, are priced at fixed rates and are exposed to re-pricing risk at maturity. The fair value is among other factors also sensitive to interest rates through the discounted cash flow model which is used for the valuation (see Note 34a).

The table below summarises the Company's exposure to interest rate risks (e.g. term deposits; bonds and borrowings from related parties on fixed rate, both with re-pricing risk). The table presents the aggregated amounts of the Company's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest re-pricing or maturity dates.

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In millions of Czech crowns	On demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
31 December 2017					
Financial assets – floating rate	631	–	–	–	631
Financial assets – fixed rate with re-pricing risk	300	383	–	–	683
Financial liabilities – floating rate	(7,095)	–	–	–	(7,095)
Financial liabilities – fixed rate with re-pricing risk	–	–	(14,790)	(5,403)	(20,193)
Financial liabilities – fixed rate with re-pricing risk – finance lease	(50)	(148)	(465)	(6,558)	(7,221)
Net interest sensitivity gap at 31 December 2017	**(6,214)**	**235**	**(15,255)**	**(11,961)**	**(33,195)**
31 December 2016					
Financial assets – floating rate	412	–	–	–	412
Financial assets – fixed rate with re-pricing risk	650	–	–	–	650
Financial liabilities– floating rate	(7,666)	–	–	–	(7,666)
Financial liabilities – fixed rate with re-pricing risk	–	–	(15,194)	(5,711)	(20,905)
Financial liabilities – fixed rate with re-pricing risk – finance lease	(113)	(83)	(442)	(6,336)	(6,974)
Net interest sensitivity gap at 31 December 2016	**(6,717)**	**(83)**	**(15,636)**	**(12,047)**	**(34,483)**

As the Company's bank assets and liabilities (borrowings) are directly exposed to the floating interest rate, the change in interest rates has an impact on the Company's profit or loss for the current year.

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The following table presents sensitivities of profit or loss to reasonably possible changes in short term interest rates applied at the end of the reporting period, with all other variables held constant:

	At 31 December 2017
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(18)
1M CZK PRIBOR decrease by 25 bps	18
Overnight PRIBOR increase by 25 bps	–
Overnight PRIBOR decrease by 25 bps	–

	At 31 December 2016
In millions of Czech crowns	Impact on profit or loss
1M CZK PRIBOR increase by 25 bps	(14)
1M CZK PRIBOR decrease by 25 bps	14
1M USD LIBOR increase by 25 bps	(3)
1M USD LIBOR decrease by 25 bps	3
Overnight PRIBOR/EURIBOR increase by 25 bps	(1)
Overnight PRIBOR/EURIBOR decrease by 25 bps	1

The Company interest rate risk management policy requires that at least 70% of the interest rate exposure arising from bonds and term loans is at fixed rate. The existing financing structure achieves this requirement.

The Company's exposure to interest rate risk at the end of the reporting period is representative of the typical exposure during the year, starting from July 2014.

The Company monitors interest rates for its financial instruments. The table below summarises effective interest rates at the respective end of the reporting period based on reports reviewed by key management personnel. Decrease of USD and CZK interest rates in 2017 caused by refinancing – Note 18.

	31 December 2017			31 December 2016		
In % p.a.	CZK	USD	EUR	CZK	USD	EUR
Assets						
Cash and cash equivalents	0.08	0.00	0.00	0.10	0.01	0.01
Loans to related parties	n/a	n/a	0.32	0.96	n/a	0.39
Liabilities						
Borrowings	1.89	n/a	3.00	2.10	2.28	3.00
Finance lease liability	5.29	n/a	n/a	7.35	n/a	n/a

Liquidity risk. Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company is exposed to daily calls on its available cash resources. Liquidity risk is managed by Treasury department of the Company and monitored in terms of monthly (one month forward), short-term (one year forward) and mid-term (five years forward) forecasts. Management monitors short-term forecasts of the Company's cash flows provided on the monthly basis.

The Company has strong liquidity position and is able to secure its operating funding needs through the cash collected from the business operations continuously throughout the year. The Company's liquidity portfolio comprises cash and cash equivalents (Note 16) and bank term deposits and deposit bills. Management estimates that the liquidity portfolio can be realised in cash within few days in order to meet unforeseen liquidity requirements.

The tables below show liabilities at 31 December 2017 and 2016 by their remaining contractual maturity. The amounts disclosed in the table below are the contractual undiscounted cash flows and gross loan commitments. Such undiscounted cash flows differ from the amount included in the balance sheet because the balance sheet amount is based on discounted cash flows. Financial derivatives are included at the contractual amounts to be paid or received, unless the Company expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of financial liabilities at 31 December 2017 is as follows:

In millions of Czech crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 18)	180	461	23,824	6,079	30,544
Finance lease liability (Note 19)	151	450	2,885	19,275	22,761
Trade and other payables (Note 23)	528	–	13	–	541
Gross settled cross currency interest rate swaps (Note 31)					
– inflows	–	(306)	(6,206)	(6,079)	(12,591)
– outflows	–	522	7,571	7,103	15,196
Total future payments, including future principal and interest payments	**859**	**1,127**	**28,087**	**26,378**	**56,451**

The maturity analysis of financial liabilities at 31 December 2016 is as follows:

In millions of Czech crowns	Demand and to 3 months	From 3 months to 12 months	From 12 months to 5 years	Over 5 years	Total
Liabilities					
Bank borrowings, bonds and borrowings from related parties (Note 18)	735	485	24,503	6,620	32,343
Finance lease liability (Note 19)	155	462	2,385	20,427	23,429
Trade and other payables (Note 23)	540	–	8	–	548
Gross settled cross currency interest rate swaps (Note 31)					
– inflows	–	(324)	(6,701)	(6,620)	(13,645)
– outflows	–	620	9,374	8,567	18,561
Total future payments, including future principal and interest payments	**1,430**	**1,243**	**29,569**	**28,994**	**61,236**

The net current liquidity position calculated as difference between current assets and current liabilities at 31 December 2017 is net current asset of CZK 484 million (31 December 2016 net current liability: CZK 768 million). The decrease in net liquidity position in 2017 does not result in liquidity issue of the Company.

Payments in respect of cross-currency interest rate swaps will be accompanied by related cash inflows which are disclosed at their present values in Note 31.

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33. Management of Capital

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. The Company is managing its capital ratios to ensure a strong credit rating (e.g. the Company may adjust the amount of dividends paid to shareholders in order to maintain or adjust the capital structure).

According to the Company's policy, capital structure consists mainly of equity, subordinated borrowings from related parties, non-subordinated borrowings from banks and bonds.

In millions of Czech crowns	At 31 December 2017	At 31 December 2016
Equity	9,222	7,589
Non-subordinated borrowings from banks and bonds	27,265	28,022
Non-subordinated short-term borrowings from related parties	22	549
Total	**36,509**	**36,160**

The Company has complied with all covenants arising from the borrowings as at 31 December 2017 and 2016.

34. Fair Value of Financial Instruments

Fair value measurements are analysed by level in the fair value hierarchy. Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. The significance of a valuation input is assessed against the fair value measurement in its entirety.

(a) Recurring fair value measurements
Recurring fair value measurements are those that the accounting standards require or permit in the balance sheet at the end of each reporting period.

(b) Financial instruments carried at fair value
Only derivatives are measured at fair value.

All recurring fair value measurements are categorised in the fair value hierarchy into level 2 as at 31 December 2017 and 2016.

There were no changes in valuation technique for level 2 recurring fair value measurements since 31 December 2016.

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2017:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(1,044)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(1,044)**	**–**	**–**

The description of valuation technique and description of inputs used in the fair value measurement for level 2 measurements at 31 December 2016:

In millions of Czech crowns	Fair value	Valuation technique	Inputs used
Derivative financial instruments			
Cross currency interest rate swap contracts	(2,770)	Discounted cash flow method	Czech National Bank foreign exchange rates, inter-bank swap rates
TOTAL RECURRING FAIR VALUE MEASUREMENTS AT LEVEL 2	**(2,770)**	**–**	**–**

The following table presents movements in fair values of derivative financial instruments:

In millions of Czech crowns	2017	2016
Opening balance	**(2,770)**	**(2,810)**
Change in fair value of contracts concluded and realised during the period	(37)	31
Settlement of contracts concluded and realised during the period	37	(31)
Change in unrealised gains or losses for the period included in other comprehensive income for contracts held at the end of the reporting period	1,726	40
Closing balance	**(1,044)**	**(2,770)**

(c) Non-recurring fair value measurements

There are no assets held for sale or other items with non-recurring fair value measurements as of 31 December 2017 and 31 December 2016.

(d) Financial assets and liabilities not measured at fair value but for which fair value is disclosed

Fair values analysed by level in the fair value hierarchy and carrying value of assets and liabilities not measured at fair value are as follows:

	31 December 2017				31 December 2016			
In millions of Czech crowns	Level 1	Level 2	Level 3	Carrying value	Level 1	Level 2	Level 3	Carrying value
ASSETS								
Other financial assets								
– Loans to related parties	–	–	5	5	–	–	653	652
Total ASSETS	**–**	**–**	**5**	**5**	**–**	**–**	**653**	**652**
LIABILITIES								
Borrowings								
– Borrowings from related parties – current – BRAWA	–	–	–	–	–	–	524	524
– Borrowings from related parties – current – NET4GAS Holdings	–	–	22	22	–	–	25	25
– Bank borrowings	–	–	7,122	7,073	–	–	7,127	7,117
– Bonds	20,357	–	1,388	20,192	20,941	–	1,394	20,905
Finance lease liability								
– Finance lease from BRAWA	–	–	8,545	7,221	–	–	9,976	6,974
Total LIABILITIES	**20,357**	**–**	**17,077**	**34,496**	**20,941**	**–**	**19,046**	**35,545**

Trade and other receivables' carrying values approximate to their fair values.

The fair values in level 1 of fair value hierarchy reflects the price of fixed interest rate bonds listed in active markets in public stock exchanges.

The fair values in level 3 of fair value hierarchy were estimated using the discounted cash flows valuation technique. Inputs used for loans to related parties are market observable (PRIBOR, LIBOR, EURIBOR) adjusted by unobservable estimated credit spreads. Inputs used for bank borrowings, borrowings from related parties and financial leasing are market observable (PRIBOR, LIBOR, EURIBOR and IRS) adjusted by unobservable estimated credit spreads.

The fair value of unquoted bonds was determined based on estimated future cash flows expected to be received discounted by market observable yield curve adjusted by unobservable estimated credit spread.

Financial assets carried at amortised cost. The estimated fair value of asset instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

Financial liabilities carried at amortised cost. The estimated fair value of liability instruments is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity.

35. Events After the Reporting Period

No events have occurred subsequent to year-end that would have a material impact on the separate financial statements for the year ended 31 December 2017.

Signature of the members of the statutory body of the Company:

14 March 2018

Andreas Rau	**Radek Benčík**	**Václav Hrach**
Statutory Director	Statutory Director	Statutory Director

The General Meeting approved the separate financial statements for publication on 27 March 2018.

Annex no. 3:

Independent auditor's report

to the shareholder of NET4GAS, s.r.o.

Report on the Audit of the Consolidated and Separate Financial Statements

Our Opinion

In our opinion:

- The accompanying consolidated financial statements give a true and fair view of the consolidated financial position of NET4GAS, s.r.o., with its registered office at Na Hřebenech II 1718/8, Praha 4 - Nusle ("the Company") and its subsidiary (together "the Group") as at 31 December 2017, of their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.
- The accompanying separate financial statements give a true and fair view of the financial position of the Company standing alone as at 31 December 2017, of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

We confirm that the audit opinion expressed herein is consistent with the additional report to the Audit Committee of the Company, which we issued today in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and of the Council ("the EU Regulation").

What we have audited

The Group's consolidated financial statements comprise:

- The consolidated balance sheet as at 31 December 2017;
- The consolidated statement of profit or loss and other comprehensive income for the year then ended;
- The consolidated statement of changes in equity for the year then ended;
- The consolidated statement of cash flows for the year then ended; and
- The notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

The Company's separate financial statements comprise:

- The balance sheet as at 31 December 2017;
- The statement of profit or loss and other comprehensive income for the year then ended;
- The statement of changes in equity for the year then ended;
- The statement of cash flows for the year then ended; and
- The notes to the separate financial statements, which include significant accounting policies and other explanatory information.

Basis for Opinion

We conducted our audit in accordance with the Act on Auditors, EU Regulation and Standards on Auditing of the Chamber of Auditors of the Czech Republic. These standards consist of International Standards on Auditing (ISAs) which may be supplemented and modified by related application guidance. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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Independence

We are independent of the Group and Company in accordance with the Act on Auditors, EU Regulation and Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) and accepted by the Chamber of Auditors of the Czech Republic, and we have not provided any non-audit services that are prohibited under Article 5 of the EU Regulation and fulfilled our other ethical responsibilities in accordance with these regulations.

Our audit approach

Overview

Group materiality is determined as 5 % from Group's consolidated profit before tax for the year ended 31 December 2017 and is CZK 162 million.

Materiality for separate financial statements is determined as 5 % from Company's profit before tax for the year ended 31 December 2017 decreased by dividend received and is CZK 139 million.

The Company and its subsidiary were subject to a full scope audit performed by PwC Prague office, Czech Republic.

Key audit matter: Capacity4Gas project, its impact on the Company´s restructuring plan and assessment of the classification of new transmission capacity contract

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated and separate financial statements (together "financial statements"). In particular, we considered where directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for each set of the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on each set of the financial statements as a whole.

Overall Group materiality	CZK 162 million
How we determined it	5 % of Group's profit before tax for the year ended 31 December 2017
Rationale for the materiality benchmark applied	Materiality is a matter of professional judgement. In drawing conclusions about materiality, we considered both quantitative and qualitative factors, and we chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most measured by users, and is a generally accepted benchmark. The 5 % threshold is within the range of acceptable quantitative materiality thresholds and best reflects the risk profit of the Group audit.

Note

Our report has been prepared in the Czech language and in English. In all matters of interpretation of information, views or opinions, the Czech version of our report takes precedence over the English version.

Overall materiality for the separate financial statements	CZK 139 million
How we determined it	5 % of the Company's profit before tax for the year ended 31 December 2017 decreased by dividend received.
Rationale for the materiality benchmark applied	Materiality is a matter of professional judgement. In drawing conclusions about materiality, we considered both quantitative and qualitative factors, and we chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Company is most measured by users, and is a generally accepted benchmark. The 5 % threshold is within the range of acceptable quantitative materiality thresholds and best reflects the risk profit of the Company's audit.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the key audit matter
Capacity4Gas project, its impact on the Company´s restructuring plan and assessment of the classification of new transmission capacity contract The Company/Group offered a new cross-border capacity and successfully marketed it at the annual capacity auction on 6 March 2017. The new transmission capacity contract was signed with the Company´s major customer. Consequently, the Company launched the implementation phase of a new project titled Capacity4Gas. Based on the results of the auction, the Company is ready to invest into relevant new gas infrastructure in the Czech Republic in two stages, the completion of which is planned for 2019 and 2021 respectively. In connection with the construction, the Company resolved that residual useful lives of selected compressor stations originally determined to be closed within a restructuring plan will be extended. During 2017 the Company reassessed their useful lives and decrease annual depreciation expense by CZK 4 million. The whole amount of the related restructuring provision of CZK 167 million was released to the statement of profit or loss and other comprehensive income. The Company also assessed the classification of new transmission capacity contract. Management evaluated whether the contract for the provision of the pipeline capacity to the Company´s major customer is, in substance, a lease. The conclusion that the contract is not a lease of the pipeline was based on the fact that there is significant (although minority) capacity of the new pipeline, which is available to other customers. See Note 4, 8 and 22 and Note 4, 8 and 20 of the Company's separate financial statements and the Group's consolidated financial statements respectively.	We held meetings with management, including project manager of the Capacity4Gas project, we read the minutes from Directors' meetings and we went through the publicly available information related to the capacity auction. We obtained understanding of the new transmission capacity contract. We also obtained minutes from Directors' meetings related to the reassessment of useful lives of compressor stations impacted by the Capacity4Gas project and recalculated the impact of the change. Further we read the minutes related to release of unused restructuring provisions and assessed reasonableness of management´s judgment in that respect. We also obtained the analysis of the capacity of the new pipeline available for other customers, assessed its reasonableness and compared this capacity with the capacity booked by the major customer. We concluded that management´s reassessment of useful lives in relation to the Capacity4Gas project, reversal of unused provisions and the management's conclusion that the new contract with the major customer is not a lease are adequate, including relevant disclosures in both sets of the financial statements.

How we tailored our audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide opinion on each set of the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which the Group operates.

The Group comprises of the Company and its subsidiary (consolidated entity). Both entities are considered as significant components therefore we performed audit of both entities.

Other Information

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than both of the financial statements and auditor's report thereon. The Statutory Directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge about the Group and the Company obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law and regulation, in particular, whether the other information complies with law and regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law and regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Group and the Company obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

Responsibilities of the Statutory Directors and Supervisory Board for the Financial Statements

The Statutory Directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as the Statutory Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Statutory Directors are responsible for assessing the Group and the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Statutory Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

The Supervisory Board is responsible for overseeing the financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the above stated requirements will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the above stated requirements, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group and the Company's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Statutory Directors.
- Conclude on the appropriateness of the Statutory Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group and the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the notes, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Statutory Directors, Supervisory Board and Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Supervisory Board and the Audit Committee, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

In compliance with Article 10(2) of the EU Regulation, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

Appointment of Auditor and Period of Engagement

We were appointed as the auditors of the Company for the year ended 31 December 2017 by the Sole Shareholder Decision on 13 November 2017 and our uninterrupted engagement has lasted for 5 years.

Provided Non-audit Services

The non-audit services are disclosed in the Chapter Consolidated Group Data of the Annual Report.

Shareholder of NET4GAS, s.r.o.
Independent auditor's report

Non-financial information

In accordance with § 32i of the Act on Accounting, we hereby report that the Company has prepared the non-financial information for the year ended 31 December 2017 and disclosed it in this Annual Report.

14 March 2018

represented by partner

Tomáš Bašta
Statutory Auditor, Evidence No. 1966

ID No.: 27260364
A PDF version of the NET4GAS Group Consolidated Annual Report 2017 is available on the NET4GAS website in Czech and in English. In all matters of interpretation, the Czech version of the annual report takes precedence over the English version.

Design, DTP and production: Heyduk, Musil & Strnad, s.r.o.
Photography: NET4GAS archive

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