



**HRVATSKA ELEKTROPRIVREDA d.d. Zagreb**

Consolidated annual financial statements and

Independent Auditor's Report

for the year 2018

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## Responsibility for the consolidated annual financial statements

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The Management Board of the company Hrvatska Elektroprivreda d.d., Zagreb, Ulica grada Vukovara 37, (hereinafter: "the Company") is responsible for ensuring that the consolidated annual financial statements for the year 2018, are prepared in accordance with the Accounting Act (Official Gazette No 78/15, 120/16, 116/18) and International Financial Reporting Standards as determined by the European Commission and published in the Official Journal of the EU, to give a true and fair view of the consolidated financial position, the consolidated results of operations, consolidated changes in equity and consolidated cash flows of the Company for that period.

After making enquiries, the Board has a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Board has adopted the going concern basis in preparing the consolidated annual financial statements of the Company.

In preparing the consolidated annual financial statements, the Management is responsible for:

- selection and consistent application of suitable accounting policies in accordance with the applicable financial reporting framework;
- giving reasonable and prudent judgments and estimates; and
- using the going concern basis of accounting in preparation of consolidated annual financial statements, unless it is inappropriate to presume so.

The Management is responsible for keeping the proper accounting records, which at any time with reasonable certainty present the consolidated financial position, the consolidated results of operations, consolidated changes in equity and consolidated cash flows of the Company, and also their compliance with the Accounting Act and the International Financial Reporting Standards. The Management is also responsible for safe keeping the assets of the Company and also for taking reasonable steps for prevention and detection of fraud and other irregularities.

Signed for and on behalf of the Management Board:




Marko Čosić  
Member



Nikola Rukavina  
Member



Petar Sprčić  
Member




Tomislav Šambić  
Member



Saša Dujmić  
Member



Frano Barbarić  
President



Hrvatska elektroprivreda d.d.  
Ulica grada Vukovara 37  
10000 Zagreb  
Republic of Croatia  
30 April 2019

HRVATSKA ELEKTROPRIVREDA d.d.  
Z A G R E B 3.2  
Ulica grada Vukovara 37

## INDEPENDENT AUDITOR'S REPORT

To the Shareholder of the company Hrvatska elektroprivreda d.d.

### Report on the audit of the consolidated annual financial statements

#### Opinion

We have audited the consolidated annual financial statements of the company Hrvatska elektroprivreda d.d., Zagreb, Ulica grada Vukovara 37 (the "Company" or "the Group"), which comprise the Consolidated statement of financial position (Consolidated Balance Sheet) as at 31 December 2018, Consolidated statement of profit or loss, Consolidated statement of other comprehensive income, Consolidated statement of changes in equity and Consolidated statement of cash flows for the year then ended, and Notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated annual financial statements give a true and fair view of the consolidated financial position of the Company as at 31 December 2018, and of its consolidated financial performance and consolidated cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS"), determined by the European Commission and published in the Official Journal of the EU.

#### Basis for Opinion

We conducted our audit in accordance with the Accounting Act, the Audit Act and the International Auditing Standards (ISAs). Our responsibilities under those standards are further described in our Independent Auditor's report under section *Auditor's responsibilities for the audit of the consolidated annual financial statements*. We are independent of the Company in accordance with the Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Emphasis of matter

As described in the Note 29 to the consolidated financial statements, at 31 December 2018, the Company stated clearing debt liability in the amount of HRK 779,214 thousand (31 December 2017: HRK 775,189 thousand) regarding a payment under a letter of credit based on the Consent of the Ministry of Finance for the use of funds pursuant to an interbank agreement. As there is no other document that would regulate the relationship between the Company and the Ministry of Finance regarding the clearing debt, until the issuance of our Independent Auditor's Report it has not been clearly defined whether it relates to a loan or some other legal transaction. Our opinion has not been modified in this respect.

**Emphasis of matter (continued)**

As described in the Note 35 to the consolidated financial statements, provisions of the Water Management Act that came into force on 1 January 2010, raised a question of ownership and legal status of the Company's property - reservoirs and ancillary facilities used for generation of electricity from hydropower plants, as they are defined as Public water resources in general use in ownership of the Republic of Croatia. The Republic of Croatia initiated several proceedings for registration of title to those properties, part of which were ruled in favour of the Republic of Croatia, part of them were rejected by the relevant courts, and part of them are in still in progress. In May 2018, the Law on Amendments to the Water Act (OG 46/18) entered into force, by which the Republic of Croatia establishes the construction rights on public water resources - land on which water structures were built through Company's or its predecessors' investments; except for the land on which the accumulation was constructed and the supply and drainage channels and tunnels built. These rights are granted in favour of the Company, without compensation for a period of 99 years. As long as this right is resumed, the Company is granted the right to manage, on behalf of the Republic of Croatia, public good / land on which constructions of electricity generation with accumulation and supply and drainage channels and tunnels are built. In view of the above, it is necessary to initiate relevant procedures for entering these rights into land registers. Our opinion has not been modified in this respect.

**Other matters**

Attention is drawn to the Note 35 to the consolidated financial statements, where is, in accordance with point (b) of paragraph 8 Article 21a of the Labour Act, listed a web page where the separate non-financial report of the Company will be published no later than 6 months from the date of the Consolidated statement of financial position (Consolidated Balance Sheet). Our opinion has not been modified in this respect.

**Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, are of most significance in our audit of the consolidated annual financial statements for the current period, and include the most significant recognized risks of significant misstatement due to error or fraud with the greatest impact on our audit strategy, the allocation of our available resources, and the time spent by the engaged audit team. These matters were addressed in the context of our audit of the consolidated annual financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our Independent Auditor's report:

## Key Audit Matters (continued)

| Key audit matter   | How we addressed the key audit matter   |
|--|---|
| <p><b>Revenue recognition from electricity sales to customers of universal service (Households) and application of IFRS 15</b></p> <p>Revenues from the sale of electricity are recognized on the basis of the best estimate of the delivered energy quantity. As the actual calculation of delivered energy quantities to customers of the household category is performed twice a year, the Group bases its electricity sales revenue on the total generated and purchased quantities of energy distributed in the distribution network. By doing so, the total produced and purchased amount of energy is corrected for losses on the distribution network based on logarithmic regression. After analysing several different approximation methods (five-year average, linear approximation and similar), the Management Board selected logarithmic regression as the most suitable one. Correction of revenue from households as at 31 December 2018 was obtained by calculating a logarithmic curve using 7.75% network losses, while for the year ended 31 December 2017, the percentage of losses used in the calculation was 7.71%. The result was a decrease in revenues of HRK 37,349 thousand in 2018 compared to the previous year, and the liability for accrued income amounted to HRK 6,250 thousand.</p> <p>Furthermore, the application of the new International Financial Reporting Standard 15 - Revenue from Contracts with Customers has a significant impact on the 2018 annual financial statements that will continue in the future. The Group has chosen, in accordance with the transitional provisions, not to modify comparable periods and to apply this standard retroactively with the cumulative effect of initial application on 1 January 2018. The cumulative effect of the initial application of IFRS 15 is recognized as a decrease in the initial balance of retained earnings (in the amount of HRK 2,685,047 thousand), increase in initial amount of deferred income and increase in initial amount of deferred tax assets for the remaining amount of recognised higher income from the connection fee, which required accounting treatment in accordance with previous standards and interpretations.</p> <p>We focused on this area because it involves significant estimates of revenue recognition from electricity sales on the reporting date and the material impact and complexity of the application of the new standard.</p> <p><b>Related disclosures in the accompanying annual consolidated financial statements</b></p> <p>See Notes 2, 3, 22 and 33 in the accompanying consolidated annual financial statements.</p> | <p><b>Our audit procedures related to this area, among other things, included:</b></p> <ul style="list-style-type: none"> <li>- Acquiring understanding of key management controls related to estimating revenue from electricity sales;</li> <li>- Evaluation of the reasonableness of the key assumptions used in the estimation model including the quantities of electricity sold and the price;</li> <li>- Mathematical accuracy test of the model of estimation of revenues from electricity sales;</li> <li>- Involvement of an IT expert to evaluate the reliability of the system and we internally made an independent estimate of the unrecorded revenues using data on quantities and prices received by the Group, and we have compared the results so obtained with the Group's revenue estimates;</li> <li>- Detailed analysis of accounting treatment of revenue from the connection fee in accordance with IFRS 15 - Step 5 model.</li> </ul> <p>We also assessed the adequacy of the Company's disclosure regarding the revenue recognition from the sale of electricity to universal service customers (household customers) and the application of IFRS 15.</p> |

## Key Audit Matters (continued)

| Key audit matter   | How we addressed the key audit matter   |
|--|---|
| <p><b>Contingent liabilities and court disputes</b></p> <p>Since the Group is exposed to significant legal claims, we have focused our attention on this area. Any contingent liability disclosed, or their non-disclosures in the financial statements, are inherently uncertain and depend on a number of significant assumptions and judgments. These are potentially significant amounts of which the determination of the amount for disclosure and disclosure in the consolidated financial statements, if applicable, is subject to a subjective assessment. According to that, the Management Board estimates future outcomes and amounts of contingent liabilities that may arise as a result of these claims.</p> <p><b>Related disclosures in the consolidated annual financial statements</b></p> <p>See Notes 2, 3 and 28 in the accompanying consolidated annual financial statements.</p> | <p><b>Our auditing procedures, related to this area included, among others:</b></p> <ul style="list-style-type: none"> <li>- Receiving and analysing the attorneys' responses to our written inquiries and considering certain issues with them;</li> <li>- Critical review of the used assumptions and estimates pertaining to the claims. This includes assessing the likelihood of unfavourable outcome of court proceedings and the reliability of the assessment of the related amount of obligation;</li> <li>- Assessment of the adequacy of disclosure in the consolidated financial statements, taking into account sensitivity and possible prejudice in the disclosure of detailed information.</li> </ul> <p>Furthermore, we assessed the adequacy of the Company's disclosure regarding Contingent liabilities and court disputes.</p> |

## Other Information in the Annual Report and separate nonfinancial report

The Management is responsible for other information. Other information include information contained in the Annual report, but do not include the consolidated annual financial statements and our Independent auditor's report on them which we received before the date of this Independent Auditor's Report and a separate non-financial report that we expect to be made available after that date.

Our opinion on the consolidated annual financial statements does not include other information, except to the extent explicitly stated in the part of our Independent auditor's report, entitled *Report on compliance with other legal or regulatory requirements*, and we do not express any form of assurance conclusion thereon.

In relation with our audit of the consolidated annual financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated annual financial statements or with our knowledge obtained in the audit or otherwise, appears to be materially misstated; as well as whether the separate nonfinancial report presents the non-financial information required by the provisions of paragraph 1 or paragraph 2 of Article 21a of the Accounting Act. If, based on the work we have performed, we conclude that there is a material misstatement of this other information; we are required to report that fact. In this sense, we do not have anything to report.

When we read a separate nonfinancial report, if we find that there is a significant misstatement in it, we are required to inform the Management and those charged with governance of the Company.

## **Responsibilities of the Management and Those Charged with Governance for the consolidated annual financial statements**

The Management is responsible for the preparation of consolidated annual financial statements that give a true and fair view in accordance with IFRS, determined by the European Commission and published in the Official Journal of the EU; and for such internal controls as management determines are necessary to enable the preparation of consolidated annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated annual financial statements, the Management is responsible for assessing 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 Management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## **Auditor's responsibilities for the audit of the consolidated annual financial statements**

Our objectives are to obtain reasonable assurance about whether the consolidated annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Independent 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 ISAs 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 consolidated annual financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated annual 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 control.
- 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 Company's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.



**Responsibilities of the Management and Those Charged with Governance for the consolidated annual financial statements (continued)**

- Conclude on the appropriateness of the Management's 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 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 consolidated annual 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 Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated annual financial statements, including disclosures, and whether the consolidated annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain enough audit evidence related to financial information from individuals or business activities within the Group to express our opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We are solely responsible for expressing our auditor's opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and that we will communicate with them all relationships and other matters that may reasonably be considered to influence our independence, and where applicable, related safeguards.

Among the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our Independent 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 Independent Auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## **Report on Compliance with Other Legal or Regulatory Requirements**

### **Report based on the requirements of Regulation (EU) No. 537/2014**

On 5 June 2018, we were appointed by the General Assembly of the Company, based on the suggestion of the Supervisory Board, to audit the consolidated annual financial statements for 2018.

At the date of this Report, we have been continuously engaged in carrying out the Company's statutory audits since audit of the Company's consolidated annual financial statements from 2012, up to the audit of the Company's annual financial statements for 2018, total of 7 years.

In addition to the matters we have mentioned in our Independent Auditor's Report as Key Audit Matters, we do not have anything to report in relation with point (c) of Article 10 of Regulation (EU) No. 537/2014.

Through our statutory audit of the Company's consolidated annual financial statements for the year 2018, we are able to detect irregularities, including fraud in accordance with Section 225, Responding to Non-Compliance with Laws and Regulations of the IESBA Code of Conduct, which requires us to, during our audit engagements, see if the Company has complied with laws and regulations which are generally recognized to have a direct impact on the determination of significant amounts and disclosures in consolidated annual financial statements, as well as other laws and regulations that do not have a direct effect on the determination of significant amounts and disclosures in the consolidated annual financial statements, but compliance with which may be crucial for operational aspects of the Company's business, its ability to continue as a going concern, or to avoid significant penalties.

Except where we encounter or gain knowledge about the non-compliance of any of the aforementioned laws or regulations that is apparently insignificant, in our judgment of its content and its influence, financially or otherwise, for the Company, its stakeholders and the general public, we are obliged to inform the Company and ask it to investigate this case and take appropriate measures to resolve the irregularities and to prevent the reappearance of these irregularities in the future. If the Company, at the audited consolidated balance sheet date, does not correct any irregularities that result in misstatements in the audited consolidated annual financial statements that are cumulatively equal to or greater than the amount of significance for the consolidated financial statements as a whole, we are required to modify our opinion in an Independent Auditor's Report.

During the audit of the consolidated annual financial statements of the Company for the year 2018, we have determined the significance for the annual financial statements, as a whole, in the amount of HRK 213,500 thousand, which represents about 1.5% of the total sales revenues of the Company for 2018, considering significant fluctuations of profit before taxation in previous and current period.

Our audit opinion is consistent with the additional report for the Company's auditing board, prepared in accordance with the provisions of Article 11 of Regulation (EU) No. 537/2014.

During the period between the initial date of the audited consolidated annual financial statements of the Company for the year 2018 and the date of this report, we did not provide the Company or its subsidiaries, with prohibited non-scheduled services, and in the business year prior to the aforementioned period, did not provide services for the design and implementation of internal control procedures or risk management related to preparation and/or control of financial information or the design and implementation of technological systems for financial information, and we have maintained independence in relation to the Company and subsidiaries.

## Report pursuant to the requirements of the Accounting Act

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company and we are obliged to express an opinion on the compliance of the Management report as part of the Annual report of the Company with the consolidated annual financial statements of the Company. In our opinion, based on the work that we performed during the audit, information in the Management report for 2018, as part of the Annual report of the Company for the year 2018, are in accordance with the financial information stated in the consolidated annual financial statements of the Company set out on pages 10 to 100 on which we expressed our opinion as stated in the Opinion section above.

In our opinion, based on the work we performed during the audit, the Company's Management report for 2018, which is an integral part of the Company's Annual report for 2018, is prepared in accordance with the Accounting act.

Based on the knowledge and understanding of the Company and its environment obtained while performing the audit, we have not found that there are material misstatements in the Company's Management report for 2018 which is an integral part of the Company's Annual report for 2018.

In our opinion, based on the work that we performed during the audit, the Corporate governance statement, included in the Annual report for 2018, is prepared in accordance with the requirements of article 22, paragraph 1, points 3 and 4 of the Accounting Act.

The Corporate governance statement, included in the Annual report for 2018, includes information from the article 22, paragraph 1, and points 2, 5, 6 and 7 of the Accounting Act.

The Management is responsible for the preparation of consolidated annual financial statements for the year ended 31 December 2018 in prescribed form based on the Statute of structure and content of annual financial statements (Official Gazette 95/16) and in accordance with other regulations governing the operations of the Company ("Standard consolidated annual financial statements"). Financial information presented in the Company's standard consolidated annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 10 to 100 on which we expressed our opinion as stated in the section Opinion above.


Engagement partner in the audit of the consolidated annual financial statements of the Company for 2018, which has resulted in this Independent Auditor's Report, is Zdenko Balen, certified auditor.

Zagreb, 30 April 2019

BDO Croatia d.o.o.  
Trg J. F. Kennedy 6b  
10000 Zagreb



Vedrana Stipić, Member of the  
Management Board

 CROATIA  
BDO Croatia d.o.o.  
za pružanje revizorskih, konzalting  
i računovodstvenih usluga  
Zagreb, J. F. Kennedy 6/b



Zdenko Balen, Certified Auditor

# Consolidated Statement of profit or loss

For the year ended 31 December 2018

|  | Notes | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|--|-------|---------------------|---------------------|
| Revenue from electricity sales                     | 4     | 11,650,333          | 11,493,664          |
| Revenue from thermal power sales                   | 4     | 664,442             | 683,264             |
| Revenue from sale of gas on wholesale market       | 4     | 932,243             | 963,887             |
| Revenue from sale of gas to customers              | 4     | 990,516             | 316,576             |
| <b>Sales revenue</b>                               |       | <b>14,237,534</b>   | <b>13,457,391</b>   |
| Other operating income                             | 5     | 960,766             | 1,511,894           |
| <b>Total operating income</b>                      |       | <b>15,198,300</b>   | <b>14,969,285</b>   |
| Electricity purchase expenses                      | 6     | (2,831,169)         | (2,786,423)         |
| Fuel expenses                                      | 6     | (1,695,300)         | (1,903,145)         |
| Costs of gas sold                                  | 6     | (1,823,664)         | (1,130,144)         |
| Employee benefit expenses                          | 7     | (1,841,220)         | (1,946,892)         |
| Depreciation and amortization costs                | 11,12 | (2,001,355)         | (1,935,963)         |
| Other operating expenses                           | 8     | (3,347,135)         | (2,971,895)         |
| <b>Total operating expenses</b>                    |       | <b>(13,539,843)</b> | <b>(12,674,462)</b> |
| <b>Profit from operations</b>                      |       | <b>1,658,457</b>    | <b>2,294,823</b>    |
| <b>Finance income</b>                              | 9     | 290,077             | 235,826             |
| <b>Finance expenses</b>                            | 9     | (265,345)           | (939,913)           |
| <b>Net profit / (loss) from finance activities</b> |       | <b>24,732</b>       | <b>(704,087)</b>    |
| <b>Profit before tax</b>                           |       | <b>1,683,189</b>    | <b>1,590,736</b>    |
| Tax expense  | 10    | (318,437)           | (290,437)           |
| <b>Profit for the year</b>                         |       | <b>1,364,752</b>    | <b>1,300,299</b>    |
| <b>Attributable to:</b>                            |       |                     |                     |
| Owners of the parent                               |       | 1,364,752           | 1,300,299           |


The accompanying notes form an integral part of these consolidated financial statements.

Signed for and on behalf of the Management Board on 30 April 2019:

  
Marko Ćosić  
Member

  
Nikola Rukavina  
Member

  
Petar Sprčić  
Member

  
Tomislav Šambić  
Member

  
Saša Dujmić  
Member

  
Franjo Barbarić  
President

HRVATSKA ELEKTROPRIVREDA d.d.  
Z A G R E B 3.2  
Ulica grada Vukovara 37

Consolidated Statement of other comprehensive income  
For the year ended 31 December 2018

|  | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|--|---------------------|---------------------|
| <b>Profit for the year</b>   | <b>1,364,752</b>    | <b>1,300,299</b>    |
| <b>Other comprehensive income</b>  |                     |                     |
| Exchange differences from foreign currency translations                                    | (18,645)            | (15,609)            |
| Changes in fair value of available-for-sale financial assets                               | (74,143)            | (3,565)             |
| Changes in fair value of financial assets at fair value through other comprehensive income |                     |                     |
| Reserves   | -                   | 25,514              |
| <i>Items that may be reclassified to comprehensive income</i>                              | (92,788)            | 6,340               |
| <b>Other comprehensive income / (loss), net</b>  | <b>(92,788)</b>     | <b>6,340</b>        |
| <b>Total comprehensive income, net</b>   | <b>1,271,964</b>    | <b>1,306,639</b>    |
| <b>Attributable to:</b>  |                     |                     |
| Owners of the parent   | 1,271,964           | 1,306,639           |


The accompanying notes form an integral part of these consolidated financial statements.

Signed for and on behalf of the Management Board on 30 April 2019:

  
Marko Čosić  
Member

  
Nikola Rukavina  
Member

  
Petar Sprčić  
Member

  
Tomislav Šambić  
Member

  
Saša Dujmić  
Member

  
Frane Barbarić  
President

HRVATSKA ELEKTROPRIVREDA d.d.  
ZAGREB 3.2  
Ulica grada Vukovara 37

# Consolidated Statement of financial position / Consolidated Balance Sheet

As at 31 December 2018

| ASSETS  | Note | 31 Dec 2018       | 31 Dec 2017       |
|---|------|-------------------|-------------------|
|   |      | in '000 HRK       | in '000 HRK       |
| <b>Non-current assets</b>   |      |                   |                   |
| Property, plant and equipment                                     | 11   | 31,222,257        | 31,033,112        |
| Advances for property, plant and equipment                        | 14   | 87,170            | 15,252            |
| Investment property   | 13   | 303,726           | 305,630           |
| Intangible assets   | 12   | 178,578           | 210,502           |
| Investments calculated using the equity method                    | 16   | 23,512            | 865               |
| Loans   | 17   | 35,790            | 36,107            |
| Financial assets available-for-sale                               | 18   | -                 | 283,578           |
| Financial assets at fair value through other comprehensive income | 18   | 197,307           | -                 |
| Other financial assets  | 19   | 30,764            | 42,918            |
| Deferred tax assets   | 10   | 962,466           | 610,389           |
| <b>Total non-current assets</b>                                   |      | <b>33,041,570</b> | <b>32,538,353</b> |
| <b>Current assets</b>   |      |                   |                   |
| Inventories   | 20   | 1,547,172         | 1,257,292         |
| Trade receivables   | 21   | 2,200,632         | 2,081,000         |
| Other current assets  | 22   | 604,930           | 957,817           |
| Cash and cash equivalents   | 23   | 2,955,325         | 2,017,095         |
| <b>Total current assets</b>                                       |      | <b>7,308,059</b>  | <b>6,313,204</b>  |
| <b>TOTAL ASSETS</b>   |      | <b>40,349,629</b> | <b>38,851,557</b> |

# Consolidated Statement of financial position / Consolidated Balance Sheet (continued)

As at 31 December 2018

| <b>EQUITY</b>                        | <b>Note</b> | <b>31 Dec 2018</b><br>in '000 HRK | <b>31 Dec 2017</b><br>in '000 HRK |
|--------------------------------------|-------------|-----------------------------------|-----------------------------------|
| Share capital                        | 24          | 19,792,159                        | 19,792,159                        |
| Reserves                             | 24          | 65,921                            | 162,242                           |
| Retained earnings                    | 24          | 4,511,318                         | 6,041,625                         |
| <b>Total capital</b>                 |             | <b>24,369,398</b>                 | <b>25,996,026</b>                 |
| Liabilities under issued bonds       | 25          | 3,560,375                         | 3,595,828                         |
| Loans                                | 26          | 220,450                           | 265,895                           |
| Liabilities to the State             | 27          | 10,281                            | 13,065                            |
| Provisions                           | 28          | 1,067,491                         | 1,018,467                         |
| Other liabilities                    | 29          | 7,315,415                         | 4,356,607                         |
| Deferred tax liabilities             |             | 5,441                             | 24,305                            |
| <b>Total non-current liabilities</b> |             | <b>12,179,453</b>                 | <b>9,274,167</b>                  |
| Trade payables                       | 30          | 2,051,676                         | 1,643,033                         |
| Current maturity of loans            | 26          | 115,479                           | 408,481                           |
| Taxes and contributions              | 31          | 223,310                           | 80,202                            |
| Interests                            |             | 39,308                            | 35,593                            |
| Employee benefit liabilities         | 32          | 141,557                           | 274,173                           |
| Other current liabilities            | 33          | 1,229,448                         | 1,139,882                         |
| <b>Total current liabilities</b>     |             | <b>3,800,778</b>                  | <b>3,581,364</b>                  |
| <b>TOTAL EQUITY</b>                  |             | <b>40,349,629</b>                 | <b>38,851,557</b>                 |

The accompanying notes form an integral part of these consolidated financial statements.

Signed for and on behalf of the Management Board on 30 April 2019:

  
 Marko Ćosić  
 Member

  
 Nikola Rukavina  
 Member

  
 Petar Sprčić  
 Member

  
 Tomislav Šambić  
 Member

  
 Saša Dujmić  
 Member

  
 Frane Barbarić  
 President

HRVATSKA ELEKTROPRIVREDA d.d.  
 Z A G R E B 3.2  
 Ulica grada Vukovara 37



Consolidated Statement of changes in equity  
For the year ended 31 December 2018

|   | Share capital     | Reserves        | Retained earnings /<br>(carried loss) | Total equity       |
|---|-------------------|-----------------|---------------------------------------|--------------------|
|   | in '000 HRK       | in '000 HRK     | in '000 HRK                           | in '000 HRK        |
| <b>Balance at 1 Jan 2017</b>                | <b>19,792,159</b> | <b>140,293</b>  | <b>5,551,226</b>                      | <b>25,483,678</b>  |
| Profit for the year                         | -                 | -               | 1,300,299                             | 1,300,299          |
| Other comprehensive income                  | -                 | 21,949          | (15,609)                              | 6,340              |
| <i>Total comprehensive income</i>           | -                 | 21,949          | 1,284,690                             | 1,306,639          |
| Dividends                                   | -                 | -               | (794,291)                             | (794,291)          |
| <b>Balance at 31 Dec 2017</b>               | <b>19,792,159</b> | <b>162,242</b>  | <b>6,041,625</b>                      | <b>25,996,026</b>  |
| Prior year adjustment – IFRS 9 –<br>Note 2  | -                 | (22,178)        | 27,046                                | 4,868              |
| Prior year adjustment – IFRS 15<br>– Note 2 | -                 | -               | (2,685,047)                           | (2,685,047)        |
| <b>Total prior year adjustment</b>          | <b>-</b>          | <b>(22,178)</b> | <b>(2,658,001)</b>                    | <b>(2,680,179)</b> |
| <b>Balance at 1 Jan 2018</b>                | <b>19,792,159</b> | <b>140,064</b>  | <b>3,383,624</b>                      | <b>23,315,847</b>  |
| Profit for the year                         | -                 | -               | 1,364,752                             | 1,364,752          |
| Other comprehensive income                  | -                 | (74,143)        | (18,645)                              | (92,788)           |
| <i>Total comprehensive income</i>           | -                 | (74,143)        | 1,346,107                             | 1,271,964          |
| Dividends                                   | -                 | -               | (218,413)                             | (218,413)          |
| <b>Balance at 31 Dec 2018</b>               | <b>19,792,159</b> | <b>65,921</b>   | <b>4,511,318</b>                      | <b>24,369,398</b>  |


The accompanying notes form an integral part of these consolidated financial statements.

Signed for and on behalf of the Management Board on 30 April 2019:

  
Marko Ćosić  
Member

  
Nikola Rukavina  
Member

  
Petar Sprčić  
Member

  
Tomislav Šambić  
Member

  
Saša Dujmić  
Member

  
Frane Barbarić  
President

HRVATSKA ELEKTROPRIVREDA d.d.  
Z A G R E B 3.2  
Ulica grada Vukovara 37



Consolidated Statement of cash flow  
For the year ended 31 December 2018

|   | 2018               | 2017               |
|---|--------------------|--------------------|
|   | in '000 HRK        | in '000 HRK        |
| <b>OPERATING ACTIVITIES</b>   |                    |                    |
| Profit before tax   | 1,683,189          | 1,590,736          |
| Net loss from financing activities  | 181,395            | 213,512            |
| Fair value of investment property   | 1,904              | (7,654)            |
| Depreciation of property, plant and equipment;<br>amortisation of intangible assets | 2,001,355          | 1,935,733          |
| Non-depreciated value of disposed assets  | 32,950             | 9,334              |
| Impairment of fixed assets  | 112,626            | 307,830            |
| Income from reversal of impairment  | -                  | (199,207)          |
| Impairment of receivables   | 352,750            | (60,756)           |
| Inventory impairment  | 18,884             | 7,217              |
| Increase in provisions  | 49,024             | 87,767             |
| <i>Cash from operating activities before changes in working capital</i>             | <i>4,434,077</i>   | <i>3,884,512</i>   |
| (Increase) in trade receivables   | (472,382)          | (66,652)           |
| (Increase) in inventories   | (308,764)          | 140,859            |
| (Increase)/decrease in other non-current assets                                     | (8,042)            | 32,998             |
| Decrease/(increase) in other current assets   | 330,240            | (226,900)          |
| Increase/(decrease) in trade payables   | 408,643            | (144,305)          |
| Increase in other current liabilities   | 156,996            | 141,712            |
| (Decrease)/ increase in other non-current liabilities                               | (99,526)           | 143,013            |
| <b>Cash generated from operations</b>   | <b>4,441,242</b>   | <b>3,905,237</b>   |
| Income taxes paid   | (441,054)          | (514,421)          |
| Interests paid  | (181,253)          | (230,788)          |
| <b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>                                     | <b>3,818,935</b>   | <b>3,160,028</b>   |
| <b>INVESTING ACTIVITIES</b>   |                    |                    |
| Interests received  | 41,791             | 44,902             |
| Purchases of property, plant and equipment  | (2,376,070)        | (2,431,933)        |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>  | <b>(2,334,279)</b> | <b>(2,387,031)</b> |

Consolidated Statement of cash flow (continued)  
For the year ended 31 December 2018

|   | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|---|---------------------|---------------------|
| <b>Financing activities</b>                                 |                     |                     |
| Loans and borrowings  | 76,207              | 12,149              |
| Repayment of loans and borrowings                           | (404,220)           | (408,099)           |
| Repayment of issued bonds                                   | -                   | (584,507)           |
| Dividends paid  | (218,413)           | (794,291)           |
| <b>NET CASH (USED IN)/FROM FINANCING ACTIVITIES</b>         | <b>(546,426)</b>    | <b>(1,774,748)</b>  |
| <b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b> | <b>938,230</b>      | <b>(1,001,751)</b>  |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>       | <b>2,017,095</b>    | <b>3,018,846</b>    |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>             | <b>2,955,325</b>    | <b>2,017,095</b>    |

The accompanying notes form an integral part of these consolidated financial statements.

Signed for and on behalf of the Management Board on 30 April 2019:

  
Marko Ćosić  
Member

  
Nikola Rukavina  
Member

  
Petar Sprčić  
Member

  
Tomislav Šambić  
Member

  
Saša Dujmić  
Member

  
Frane Barbarić  
President

HRVATSKA ELEKTROENERGETIKA d.d.  
ZAGREB 3.2  
Ulica grada Vukovara 37

## 1. GENERAL

Hrvatska elektroprivreda Group, Zagreb (hereinafter: the "Group") consists of the parent company Hrvatska elektroprivreda d.d., Zagreb (hereinafter: "HEP d.d." or the "Company") and the subsidiaries listed in the Note 36.

HEP d.d. is registered in Zagreb, Ulica grada Vukovara 37. The principal activities of the Group are generation, transmission and distribution of electricity, and the control of the electric power systems. In addition to main activities, HEP Group also produces and distributes thermal power through the district heating systems in Zagreb and Osijek, sale of gas on the wholesale market, and the distribution of gas in Osijek and Đakovo.

All the Group's activities are governed by applicable laws, regulations and decisions issued by the Croatian Government. As at 31 December 2018 the Group employed 11,011 employees (2017: 11,894), excluding Krško Nuclear Power Plant which employed 633 employees (2017: 608).

These consolidated financial statements are presented in Croatian Kuna as the Company's functional currency.

### ***Laws regulating the energy sector***

On 19 October 2012, the Croatian Parliament adopted the Energy Act and the Law on Regulation of Energy Activities and on 8 February 2013 the Electricity Market Act. The Gas Market Act was adopted on 22 February 2013, and the Heat Market Act on 21 June 2013. On 17 October 2014, the Croatian Parliament adopted the Energy Efficiency Act, on 10 September 2015, the Law on Renewable Energy Sources and Highly Effective Cogeneration, and on 18 September 2015, the Law on Amendments to the Electricity Market Act. On 17 February 2017, the Croatian Parliament adopted the Law on Amendments to the Gas Market Law. On 16 February 2018, the Croatian Parliament adopted the Gas Market Act and its entry into force annulled the validity of the Gas Market Act (OG 28/13, 14/14 and 16/17). On 23 August 2018, the Government of the Republic of Croatia adopted the Regulation on Amendments to the Heat Energy Market Act. On 13 July, the Croatian Parliament adopted the Law on Amendments to the Law on Regulation of Energy Activities. On 7 December 2018, the Croatian Parliament adopted the Law on Amendments to the Renewable Energy Sources Act and Highly Effective Cogeneration. On 14 December 2018, the Croatian Parliament adopted the Law on Amendments to the Energy Efficiency Act.

The new laws and accompanying by-laws, in line with EU directives and directives, further restructured and aligned the Group's operations. According to the provisions of the Electricity Market Act and the Act on Amendments to the Electricity Market Act, the Company and its subsidiaries continue to perform electricity activities carried out as public electricity services in the Republic of Croatia: electricity transmission, distribution of electricity and electricity supply which is performed as a universal service and as a guaranteed service. Electricity generation, electricity supply and electricity trade are performed as market activities as defined in the laws regulating energy activities and trading on the energy market.

Pursuant to the Electricity Market Act, every customer has the right to a free choice of suppliers, and household customers have the right to supply electricity as a universal service. Customers who have not exercised their right to choose a supplier or are left without supplier are using a guaranteed supply service.

### 1. GENERAL (continued)

Electricity supply is conducted at market rules and energy entities are free to contract the quantity and price of electricity delivered. Electricity supply that is performed as a guaranteed service is performed as a public service under regulated conditions customers other than households, who under certain conditions remain without the supplier.

Electricity supply that is performed as a universal service is performed as a public service to household customers who are entitled to such supply and are free to choose or use it automatically. Part of household customers have used the right to choose suppliers.

The Company and its subsidiaries align the Group's organization in accordance with the amended laws and deadlines prescribed by these laws.

In September 2015, the Croatian Energy Regulatory Agency (HERA) adopted the Methodology for determining the amount of tariff items for electricity distribution and Methodology for determining the amount of tariff items for electricity transmission, and in December 2015 the Decision on the amount of tariff items for electricity distribution and Decision on the amount of tariffs for electricity transfers to be applied from 1 January 2016. In December 2018 HERA adopted the Decision on the amount of tariff items for electricity distribution and Decision on the amount of tariffs for electricity transfers to be applied from 1 January 2019.

Since the Act on Amendments to the Electricity Market Act is in force, the decision on the amount of tariff items for the supply of electricity within the universal service is made by HEP Operator Distribucijskog Sustava d.o.o. or HEP Elektra d.o.o. from 2 November 2016. In accordance with the provisions of the Electricity Market Act, on 17 December 2013, HERA adopted a Methodology for determining the amount of tariff items for guaranteed electricity supply. Customers who are supplied with electricity in a guaranteed supply from 1 July 2014 pay the supply by the tariff items in accordance with the HERA decisions on the amount of tariff items for guaranteed electricity supply. In February 2019 HERA adopted a Methodology for determining the amount of tariff items for guaranteed electricity supply, which came into force on 1 March 2019.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

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### 1. GENERAL (continued)

#### General Assembly

The General assembly consists of the members representing the interests of the sole shareholder – the Republic of Croatia:

|                  |        |   |
|------------------|--------|---|
| Tomislav Panenić | Member | Member from 4 March 2016 to 25 January 2017     |
| Zdravko Marić    | Member | Member from 26 January 2017 to 14 February 2018 |
| Tomislav Ćorić   | Member | Member from 15 February 2018                    |

#### Supervisory Board

##### *Members of Supervisory Board in 2018*

|                       |           |  |
|-----------------------|-----------|--|
| Goran Granić          | President | President since 7 December 2017                |
| Marko Primorac        | Member    | Member from 7 December 2017 to 25 July 2018    |
| Jelena Zrinski Berger | Member    | Member since 7 December 2017                   |
| Lukša Lulić           | Member    | Member since 29 October 2018                   |
| Ivo Ivančić           | Member    | Member since 29 October 2018                   |
| Dubravka Kolundžić    | Member    | Member from 1 July 2015 to 10 January 2018     |
| Višnja Komnenić       | Member    | Member from 11 January 2018 to 22 October 2018 |
| Meri Uvodić           | Member    | Member since 4 December 2018                   |

##### *Members of Supervisory Board in 2017*

|                       |           |  |
|-----------------------|-----------|--|
| Nikola Bruketa        | President | President from 23 February 2012 to 6 December 2017 |
| Goran Granić          | President | President since 7 December 2017                    |
| Žarko Primorac        | Member    | Member from 23 February 2012 to 6 December 2017    |
| Ivo Uglešić           | Member    | Member from 23 February 2012 to 6 December 2017    |
| Igor Džajić           | Member    | Member from 19 September 2012 to 6 December 2017   |
| Mirko Žužić           | Member    | Member from 19 September 2012 to 6 December 2017   |
| Juraj Bukša           | Member    | Member from 5 June 2014 to 6 December 2017         |
| Marko Primorac        | Member    | Member from 7 December 2017                        |
| Jelena Zrinski Berger | Member    | Member from 7 December 2017                        |
| Dubravka Kolundžić    | Member    | Member from 1 July 2015 to 10 January 2018         |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

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### 1. GENERAL (continued)

#### Management Board

##### *Management Board in 2018*

|                 |           |                                |
|-----------------|-----------|--------------------------------|
| Frane Barbarić  | President | President since 1 January 2018 |
| Saša Dujmić     | Member    | Member since 4 December 2014   |
| Nikola Rukavina | Member    | Member since 1 January 2018    |
| Marko Čosić     | Member    | Member since 1 January 2018    |
| Petar Sprčić    | Member    | Member since 1 January 2018    |
| Tomislav Šambić | Member    | Member since 1 January 2018    |

##### *Management Board in 2017*

|                   |           |  |
|-------------------|-----------|--|
| Perica Jukić      | President | President from 12 September 2014 to 31 December 2017 |
| Zvonko Ercegovac  | Member    | Member from 23 February 2012 to 31 December 2017     |
| Saša Dujmić       | Member    | Member from 4 December 2014                          |
| Tomislav Rosandić | Member    | Member from 2 January 2015 to 31 December 2017       |

#### Basis of preparation

The consolidated financial statements for 2018 have been prepared in accordance with the Accounting Act (Official Gazette 75/15, 120/16, 116/18), the International Financial Reporting Standards ("IFRS"), determined by the European Commission and published in the Official Journal of the EU; as well as in accordance with the Ordinance on the structure and content of annual financial statements (Official Gazette 95/16).

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial instruments that are presented in revalued amounts. All amounts in the consolidated financial statements are presented in thousands of Croatian Kuna (HRK '000) as the Group's functional currency, unless otherwise stated. The Group keeps accounting records in Croatian language, in Croatian Kunas, and in accordance with Croatian legal requirements and accounting principles and practices applied by legal entities in Croatia.

The consolidated financial statements have been prepared with the application of the basic accounting assumption of the occurrence of a business event and the assumption of the going concern concept.

### • GENERAL (continued)

### ***Principles and methods of consolidation***

The Company's consolidated financial statements represent the aggregate of assets, liabilities, capital and reserves and the Group's business results for the year ended. Consolidated financial statements comprise the financial statements of the Company and the entities it controls - its subsidiaries. Subsidiaries within the Group are listed in Note 36. The Company has control over the entity if, based on its participation in it, it is exposed to variable yield, i.e. it has rights to them; and the ability to influence the yield by its predominance in that entity. As the Company has 100% equity in all subsidiaries and is the sole member of the company, which makes it possible to appoint management and decision making, all of these companies are included in the consolidated financial statements as subsidiaries. Inclusion of subsidiaries in consolidation begins on the date on which the Company as a parent acquires control over that company and ceases when the Company as a parent loses control over it.

Adjustments were made in the financial statements of subsidiaries as necessary to align their accounting policies with those used by the Group. All significant transactions and balances between Group companies were eliminated during consolidation. Non-controlling interests in the net assets of consolidated subsidiaries are presented in these consolidated financial statements separately from the shares of the Company in them. Non-controlling shares include the amount of the share on the business combination date and the share in changes in equity from the date of the business combination that belongs to the non-controlling interest. Gains or losses and any portion of other comprehensive income are attributed to parent's shareholders and non-controlling interests, even if this results in a negative amount of non-controlling interest.

A change in the equity of a subsidiary, without loss of control, is accounted for as a principal transaction.

If the Company loses control of a subsidiary, it discontinues recognising related assets (including goodwill) and liabilities, uncontrolled interest and other equity components, and any gain or loss is recognized in profit or loss. Any remaining investment is recognized at fair value.

## 2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

### a) *Changes in accounting policies*

#### ***Adoption of new and revised International Financial Reporting Standards***

##### *New standards, interpretations and amendments effective*

The following new standards, revised and amended existing standards and interpretations issued by the International Accounting Standards Board adopted by the European Union and are effective for the current period:

- **IFRS 9 Financial Instruments: Classification and Measurement**

The standard is effective for annual periods beginning on or after 1 January 2018, with early application permitted. The final version of IFRS 9 Financial Instruments reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, hedge accounting, and DE recognition. The Group adopted the standard on its effective date.

#### ***IFRS 9 Financial Instruments replaced IFRS 39 - Financial Instruments: Recognition and Measurement and had the following effect on the Group:***

Investments that were classified as financial assets available for sale in accordance with *IAS 39 - Financial Instruments: Recognition and Measurement*, in accordance with *IFRS 9 - Financial Instruments* are classified as financial assets at fair value through other comprehensive income. All gains arising from measurement at fair value of the asset in question are recognized in other comprehensive income and are not transferred to the consolidated statement of profit or loss. Previously, in accordance with *IAS 39 - Financial Instruments: Recognition and Measurement* impairment of the asset for which there was an objective evidence of impairment, was recognized in the statement of profit or loss as well as gains and losses accumulated in revaluation reserves at the time of derecognition of that asset.

Impairment of financial assets classified as available for sale previously recognized in the consolidated statement of profit or loss in the amount of HRK 27,046 thousand in accordance with *IAS 39 - Financial Instruments: Recognition and Measurement* (and subsequently accrued in retained earnings) were transferred to the revaluation reserve in the amount of HRK 22,178 thousand and in a deferred tax liability in the amount of HRK 4,869 thousand to ensure that such reserve and deferred tax liability reflect cumulative gains and losses on that asset from initial recognition.

The Group has chosen not to adjust comparable periods and to apply this Standard retroactively with the cumulative effect of initial application on 1 January 2018, and the changes are presented in the consolidated Statement of Changes in Equity for the year ended 31 December 2018.



**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)***a) Changes in accounting policies (continued)****Adoption of new and revised International Financial Reporting Standards (continued)****New standards, interpretations and amendments effective (continued)****IFRS 9 Financial Instruments replaced IFRS 39 - Financial Instruments: Recognition and Measurement and had the following effect on the Group (continued):***

If the Group continued to report in accordance with IAS 39 - Financial Instruments: Recognition and Measurement for the year ended 31 December 2018, the following amounts would be reported in these financial statements

|  | Reported in<br>accordance with<br>IFRS 9 | Effect      | Reported if IFRS 9<br>was not applied |
|--|--|-------------|---------------------------------------|
|  | in '000 HRK                              | in '000 HRK | in '000 HRK                           |
| <b>EQUITY</b>                              |  |             |                                       |
| Reserves                                   | 65,921                                   | 22,178      | 88,099                                |
| Retained earnings including current profit | 4,511,318                                | (27,046)    | 4,484,272                             |
| Deferred tax liabilities                   | 5,441                                    | 4,869       | 10,310                                |

- IFRS 15 Revenue from Contracts with Customers**

The standard is effective for annual periods beginning on or after 1 January 2018. IFRS 15 establishes a five-step model that will apply to revenue earned from a contract with a customer (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the entity's ordinary activities (e.g., sales of property, plant and equipment or intangibles). Extensive disclosures will be required, including disaggregation of total revenue; information about performance obligations; changes in contract asset and liability account balances between periods and key judgments and estimates.

- IFRS 15: Revenue from Contracts with Customers (Clarifications)**

The Clarifications apply for annual periods beginning on or after 1 January 2018 with earlier application permitted. The objective of the Clarifications is to clarify the IASB's intentions when developing the requirements in IFRS 15 Revenue from Contracts with Customers, particularly the accounting of identifying performance obligations amending the wording of the "separately identifiable" principle, of principal versus agent considerations including the assessment of whether an entity is a principal or an agent as well as applications of control principle and of licensing providing additional guidance for accounting of intellectual property and royalties. The Clarifications also provide additional practical expedients for entities that either applies IFRS 15 fully retrospectively or that elect to apply the modified retrospective approach.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*a) Changes in accounting policies (continued)*

***Adoption of new and revised International Financial Reporting Standards (continued)***

***New standards, interpretations and amendments effective (continued)***

***IFRS 15 - Revenue from Contracts with Customers have been replaced by IAS 18 - Revenues and IAS 11 - Construction Contracts and Related Interpretations, including IFRIC 18 - Transfer of Assets from Customers. Replacement of IFRIC 18 - Transfer of Assets from Customers to IFRSs 15 - Revenue from Contracts with Customers on the Group affected the following:***

Connection fees received from customers for contracts concluded until 30 June 2009 have been recognized as deferred income and recognized as income for the period, together with the amortization of the related assets (connections). After the entry into force of IFRIC 18, connection fees received from customers as from 1 July 2009 were recorded as revenue in the amount of money received from the buyer at the time the customer joined the network or was provided permanent access to service delivery. The Group applied IFRIC 18 prospectively, that is, to contracts that were concluded after July 1, 2009, while retaining prior accounting for contracts concluded prior to that date. In accordance with the provisions of IFRS 15, the scope of which are the network connection agreements, the network connection fee is associated with distribution, transmission and electricity supply services and cannot be considered as a separate execution obligation.

In accordance with IFRS 15, the network connection is considered to be a reimbursement for future network services and electricity, heat and gas supplies and will therefore be recognized as revenue after providing these future services. Furthermore, by providing network and electricity supply, heat and gas services, the customer simultaneously receives and uses the benefits arising from the Group's performance, which means that the IFRS 15 criterion for recognition of revenue during the execution of the service has been met. An acceptable approach to determining the service provision period is the lifetime of a terminal asset as the connections become part of the distribution network and relate to the Group's obligation to provide the customer with access to the network over the entire useful life of the connections. Therefore, revenue should be systematically allocated over the period of useful life of the constructed asset or transferred asset used for the provision of fixed services, and the fees received from the customers to be recorded as deferred income and recognized as the income of the period simultaneously with the amortization of the assets (connections).

The Group has elected not to restate comparative periods and apply this standard retroactively with the cumulative effect of the initial application on 1 January 2018. The cumulative effect of initial application of IFRS 15 is recognized as a reduction in the initial balance of retained earnings, an increase in the initial amount of deferred income and an increase in the initial amount of deferred tax asset for the remaining amount of recognized higher income than the related fee that required accounting treatment in accordance with IFRIC 18. The above impact on the Group's balance sheet position as at 1 January 2018 is as follows:

- Reduction of retained earnings in the amount of 2,685,047 ('000 HRK)
- Increase in deferred income in the amount of 3,009,663 ('000 HRK)
- Increase in deferred tax assets in the amount of 324,616 ('000 HRK)

## 2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

### a) Changes in accounting policies (continued)

#### **Adoption of new and revised International Financial Reporting Standards (continued)**

##### New standards, interpretations and amendments effective (continued)

**IFRS 15 - Revenue from Contracts with Customers have been replaced by IAS 18 - Revenues and IAS 11 - Construction Contracts and Related Interpretations, including IFRIC 18 - Transfer of Assets from Customers. Replacement of IFRIC 18 - Transfer of Assets from Customers to IFRSs 15 - Revenue from Contracts with Customers on the Group affected the following (continued):**

If the Group continued to report in accordance with IFRIC 18 - Transfer of Assets from Customers for the year ended 31 December 2018; the following amounts would be reported in these financial

|   | Reported in<br>accordance with<br>IFRS 15 | Effect         | Reported if IFRS<br>15 was not<br>applied |
|---|---|----------------|---|
| Statement of profit or loss                                 | in '000 HRK                               | in '000 HRK    | in '000 HRK                               |
| Revenue from sales of services and other operating revenues | 960,766                                   | 273,491        | 1,234,257                                 |
| <b>Profit before tax</b>                                    | <b>1,683,189</b>                          | <b>273,491</b> | <b>1,956,680</b>                          |
| Income tax  | (318,437)                                 | (48,461)       | (366,898)                                 |
| <b>Profit for the year</b>                                  | <b>1,364,752</b>                          | <b>225,030</b> | <b>1,589,782</b>                          |

|  | Reported in<br>accordance with<br>IFRS 15 | Effect      | Reported if IFRS<br>15 was not<br>applied |
|--|---|-------------|---|
| ASSETS   | in '000 HRK                               | in '000 HRK | in '000 HRK                               |
| Deferred tax assets                                      | 962,466                                   | (310,149)   | 652,317                                   |
| Tax receivables  | 9,593                                     | (48,461)    | (38,868)                                  |
| <b>EQUITY</b>  |   |             |   |
| Retained earnings including current tax                  | 4,511,318                                 | 2,965,555   | 7,476,873                                 |
| Deferred income for assets financed from connection fees | 6,209,712                                 | (3,324,645) | 2,885,067                                 |

## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *a) Changes in accounting policies (continued)*

#### ***Adoption of new and revised International Financial Reporting Standards (continued)***

##### *New standards, interpretations and amendments not yet effective*

- **IFRS 16: Leases**

The standard is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases on their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Group decided not to apply the new lease standard retroactively, but the exemption for the lessee will be used. When converting to the new standard, liabilities based on existing operating leases will be discounted using the appropriate incremental borrowing rate and will be recognized as a lease liability. Assets with the right to use property will be recognised in the amount of lease liability adjusted to the amount of prepaid or calculated lease payments.

The Company estimates that the application of the new standard will have approximately the following effects:

- Increase of assets with right to use for approximately HRK 65,966 thousand
- Increase in liabilities by approximately HRK 65,966 thousand

- **Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)**

The Amendments are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. It clarifies that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. These Amendments have not yet been endorsed by the European Union.

The Group will adopt amendments with their effective date and does not expect them to have a significant influence on the Group's financial statements.

## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *b) Summary of principal accounting policies*

#### **Joint arrangements**

Joint arrangements are classified in accordance with IFRS 11 in:

- Joint operation - a common affair in which parties that have joint control have rights to assets and liabilities based on the financial obligations of the venture in question
- Joint venture - a joint venture in which parties who have joint control have the right to net assets from the venture in question.

When classifying investments in joint arrangements the Group considers:

- The structure of a joint arrangement
- The legal form of joint arrangement structured through separate legal entities
- Contractual terms of joint arrangement
- All other facts and circumstances (including any other contractual arrangements).

Shares in joint arrangements are reported using the equity method.

The Group calculates its investment in joint operation by recognizing its share of assets, liabilities, revenues and expenses in accordance with its contractual rights and obligations.

The Group identified an investment in the Krško Nuclear Power Plant as joint operation (Note 15).

The Group identified an investment in LNG Hrvatska d.o.o. as joint venture (Note 16).

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)***b) Summary of principal accounting policies (continued)***Defined benefit schemes and other employee benefits**

The Group does not manage the defined benefit plans after retirement for its employees and executives. Accordingly, there is no provision for these costs. The Group has the obligation to pay contributions to pension and health insurance funds in Croatia in accordance with legal regulations. This obligation applies to all persons who are in employment under the employment contract. The aforementioned contributions are paid at a certain percentage determined on the basis of gross salary.

|                                  | <b>2018 and 2017</b> |
|----------------------------------|----------------------|
| Pension contributions            | 20%                  |
| Health contributions             | 15%                  |
| Employment contributions         | 1.7%                 |
| Professional injury contribution | 0.5%                 |

The Group member companies are required to suspend contributions from employees' gross salaries. Contributions on behalf of the worker and on behalf of the employer are calculated as the expense of the period in which they were incurred (see note 7).

**Pension benefits and jubilee awards**

The Group pays jubilee awards and one-off retirement severance payments to its employees. The liability and the cost of these benefits are determined by applying the projected unit credit method. With the projected unit credit method, each period of working life is viewed as the basis for the additional unit of earnings rights and each unit is measured separately until the final commitment is made. The liability is determined on the basis of the present value of estimated future cash outflows using a discount rate similar to the interest rate on government bonds in the Republic of Croatia with currencies and maturities in accordance with the currencies and estimated liability duration. Liabilities and expenses of these fees are calculated by an authorized actuary.

*Jubilee awards*

The Group pays to its employees some benefits for long-term work (jubilee awards) and pension benefits when retiring. The reward for long-term work ranges from HRK 1,500 to HRK 5,500 net for working continuously in the Group for 10 to 45 years.

*Severance payments*

From 1 January 2018, the Collective Agreement (which applies to all members of the HEP Group) is effective, on the basis of which every employee, when retiring, is entitled to severance pay in the amount of 1/8 gross average monthly salary paid to the employee for the previous three months before the termination of the employment contract and for each year of continuous employment. This Collective Agreement is valid until 31 December 2019.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)***b) Summary of principal accounting policies (continued)***Property, plant and equipment**

Property, plant and equipment are measured at cost less accumulated depreciation and any impairment losses, except for land, which is carried at cost. The estimated useful lives, residual values and depreciation methods are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis. Property, plant and equipment in use are depreciated using the straight-line method on the following bases:

| <b>Buildings</b>  | <b>2018 and 2017</b> |
|---|----------------------|
| Hydroelectric power plants (dams, embankments, buildings and other structures and facilities)   | 20 – 50 years        |
| Thermal power plants (buildings and other building facilities)  | 33 – 50 years        |
| Facilities and plants for the transmission and distribution of electricity (substations, overhead and cable lines, dispatch centres etc.)                                   | 20 – 40 years        |
| Power plants, pipelines and other structures for the production and transmission of heat energy   | 33 years             |
| Gas pipelines by 2014   | 20 – 25 years        |
| Gas pipelines from 2014   | 40 years             |
| Administrative buildings  | 50 years             |
| <b>Plant and equipment</b>  |                      |
| Hydropower plants   | 10 – 33 years        |
| Thermal power plants  | 6 – 25 years         |
| Electricity transmission plants<br>(Electrical part of the substation transformers, power lines fraction)   | 15 – 40 years        |
| Electricity distribution plants<br>(Electrical part of substations and transformers, electrical part of the power lines, measuring instruments, meters and other equipment) | 8 – 40 years         |
| Thermal power stations, hot-water pipelines and other equipment   | 15 -30 years         |
| Gas meters and other gas network equipment  | 5 – 20 years         |
| <b>Other equipment and vehicles</b>   |                      |
| Information technology  | 5 – 20 years         |
| Licenses for computer software  | 5 years              |
| Telecommunication equipment   | 5 – 20 years         |
| Motor vehicles  | 5 – 8 years          |
| Office furniture  | 10 years             |

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

***Property, plant and equipment (continued)***

The cost of property, plant and equipment comprises its purchase price, including import duties and non-refundable taxes and any directly attributable costs of bringing an asset to its working condition and location necessary for it to be capable of operating. Expenditures incurred after property, plant and equipment have been put into operation are normally charged to profit or loss in the period in which the costs are incurred.

In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard performance, the expenditures are capitalized as an additional cost of property, plant and equipment. Costs eligible for capitalization include costs of periodic, planned significant inspections and overhauls necessary for further operation.

Any gains or losses arising from the disposal or retirement of any item of property, plant and equipment is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognized as an expense or income in the statement of profit or loss.

*Impairment of property, plant and equipment and intangible assets*

At each reporting date, the Group reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is higher of net sales price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to that asset.



## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *b) Summary of principal accounting policies (continued)*

#### ***Property, plant and equipment (continued)***

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately as expenditure, unless the relevant asset is land or building not used as investment property; i.e. investment property is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease. Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, in a way that the increased carrying amount does not exceed the carrying amount that would have been determined if no impairment loss would have been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is immediately recognized as income, unless the relevant asset is carried at estimated value, in which case the reversal of the impairment loss is treated as a revaluation increase.

#### ***Intangible assets***

Non-current intangible assets include patents and licenses and are carried at cost less accumulated amortization. Non-current intangible assets are amortized on a straight-line basis over their useful life of 5 years.

#### ***Investment property***

Investment properties are properties held for the purposes of earning rentals and/or capital appreciation, including property under construction for such purposes. Investment properties are measured initially at cost, including transaction costs. Subsequently, investment properties are measured at fair value. Gains and losses arising from changes in the fair value of investment properties are included in profit or loss for the period in which they arise. An investment property is derecognized upon sale or retirement and when no future economic benefits are expected from its disposal. Any gain or loss arising from derecognition of the property (calculated as the difference between the net sale proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

#### ***Finance and operating leases***

##### *The Company as lessee*

The Company has no significant finance lease arrangements and there were no new significant operating lease arrangements concluded during 2018 and 2017. Operating lease payments are recognized as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

***Inventories***

Inventories comprise material and small inventory and are carried at lower of cost and expected net sales value. The Management carries out inventories write-off based on review of the ageing structure of all inventories as well as a review of significant individual amounts of inventories.

From 2013, inventories include CO<sub>2</sub> emission rights. After Croatia joined the European system for greenhouse gas emissions trading (EU ETS), Hrvatska elektroprivreda (the Company) as an electricity and thermal energy generator, is obligated to purchase greenhouse gas emission units in the amount corresponding to verified emissions of CO<sub>2</sub> generated from the fossil fuel combustion in thermal power plants, as a result of which CO<sub>2</sub> is emitted.

Companies are obligated to have defined quantities of CO<sub>2</sub> emission rights at 30 April (yearly cycle). Due to withdrawal of IFRIC 3 and insufficient provisions of IFRS, the Group has analysed different accounting models for CO<sub>2</sub> emission rights, and among other EFRAG discussion papers. Occasionally, the Group trades with CO<sub>2</sub> emission rights. Due to that the Group recognizes these emission rights as inventory.

From April 2014 inventories also contain gas for wholesale trading and are stated at a lower of value acquisition cost determined on the basis of the average weighted price and net expected sales value (Note 20). For gas quantities that are directly delivered to customers a specific identification method of their individual costs is used to calculate inventory costs.

The cost of the purchase includes the invoiced amount and other costs incurred directly in relation to bringing the stock to a particular location and in usable condition.

## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *b) Summary of principal accounting policies (continued)*

#### **Cash and cash equivalents**

Cash and cash equivalents comprise petty cash, demand deposits and other short-term liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

#### **Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation. All other borrowing costs are recognized as an expense in the period in which they incurred. Interest expense is recognized in the period to which it relates to.

#### **Foreign currencies**

The individual financial statements of each entity are presented in the currency of the primary economic environment in which the entity operates their functional currency. The results and financial position of each Group entity are presented in the consolidated financial statements in Croatian Kuna (HRK), which is the functional currency of the Group and the presentation currency for the consolidated financial statements.

In the individual financial statements of each entity, transactions in foreign currencies are translated to the functional currency of the entity at the applicable exchange rate prevailing on the date of transaction. At each reporting date, monetary balances denominated in foreign currencies are retranslated to the functional currency of the entity at the applicable exchange rate prevailing at the end of the year. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the applicable exchange rate prevailing on the date when the fair value was determined. Non-monetary items that are carried at historical cost in foreign currency are not retranslated. Exchange differences arising from the settlement of monetary items, and their retranslation, are stated as profit or loss of the period. Exchange differences arising from retranslation of non-monetary assets carried at fair value are stated as financial expense in the consolidated statement of profit or loss, except for exchange differences arising from the retranslation of non-monetary assets available for sale, for which gains and losses are recognized directly in equity. For such non-monetary items, any exchange gains or losses arising from retranslations are also recognized directly in equity.

When presenting the consolidated financial statements, the Group's assets and liabilities are translated into HRK at the exchange rate prevailing on the consolidated balance sheet date. These parts of the business are linked to EUR. Since the core objective of the monetary policy of the CNB is the stability of the exchange rate, the same is done by maintaining a strong HRK-EUR ratio. Income and expenditure items (together with comparative data) are translated at the average exchange rate period. However, if the exchange rate oscillation exceeds 10%, the Group applies the exchange rate on the transaction date. Foreign exchange differences arising from the translation at the end of the year are recognized within the Group's reserves and recognized as a profit or loss for the period of the sale of foreign operations.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

**Taxation**

Corporate income tax expense represents the sum of the current tax liability and deferred taxes.

*Current tax*

Current tax liability is based on taxable profit for the year. Taxable profit differs from profit for the year as stated in the consolidated statement of profit or loss because of items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's current tax liability is calculated using tax rates that have been enacted or substantively enacted at the end of the reporting period.

*Deferred tax*

Deferred tax is the amount expected to be payable or recovered on the basis of the difference between the carrying amount of assets and liabilities in the consolidated financial statements and the related tax base used to calculate the taxable profit and is calculated using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probable that there will be available taxable profits against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary differences arise from goodwill or from the initial recognition (other than in a business merger) of other assets and liabilities in transactions that affect neither the taxable profit nor the accounting profit. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and adjusted to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the tax asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability will be settled or asset realized, based on tax laws that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

*Current and deferred tax for the period*

Deferred tax is recognized as an expense or income in the consolidated statement of profit or loss, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognized directly in equity, or when the tax is arising from initial recognition in business combinations. In case of a business combination, tax effect is taken into account for the measurement of goodwill or in determining the excess of the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities over cost.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)***b) Summary of principal accounting policies (continued)***Financial assets**

The Group recognizes financial assets in its financial statements when it becomes party to the contractual provisions of the instrument. Depending on the business model for asset management and contractual features cash flows for the said asset, the Group measures financial assets at amortized cost, fair value through other comprehensive income or fair value through statement of profit or loss.

Asset items are classified and measured as follows:

| DESCRIPTION   | Classification / measurement  |
|---|---|
| <b>Fixed assets</b>   |   |
| Long-term loans   | Held for collection / amortised cost  |
| Financial assets at fair value through other comprehensive income | Equity instruments / held for collection and sale / fair value through other comprehensive income |
| Other financial assets (non-current receivables)                  | Held for collection / amortised cost  |
| <b>Current assets</b>   |   |
| Trade receivables   | Held for collection / amortised cost  |
| Other receivables   | Held for collection / amortised cost  |
| Cash and cash equivalents   | Held for collection / amortised cost  |

The Group's business models reflect the way in which the Group manages assets in order to realize cash flows regardless of whether the Company's objective is solely to collect contractual cash flows from assets (held for collection) or to collect contractual cash flows and cash flows arising from the sale of assets (held for collection and sale), and if none of the above applies, financial assets are classified as part of another business model and are measured at fair value through profit or loss.

*i) Financial assets at fair value through other comprehensive income*

This group of assets consists of equity instruments held by the Group and traded in an active market. Expected credit losses are not accounted for or recognized, and fair value changes are recognized in other comprehensive income (FVOCI) without reclassification to the statement of profit and loss. In case the equity instrument is sold, the accumulated revaluation reserve is reclassified to retained earnings. Dividends from these financial assets are recognized in the statement of profit or loss provided that they do not result in impairment losses at the same time.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

**Financial assets (continued)**

*ii) Loans granted*

Group loans are held within a business model whose purpose is to hold a financial asset in order to charge contractual cash flows. Contractual terms at a particular date are cash flows that represent only payments of principal and interest. At that, the principal is the fair value of the asset at initial recognition.

Based on the above, the given loans were measured at amortized cost.

Measurement at amortized cost implies the following;

- Interest income is calculated using the effective interest rate method and applied to the gross book value of the asset at the calculation. The effective interest method is the method of calculating the cost of depreciation of financial assets and the allocation of interest income over the relevant period. Effective interest rate is the rate that discounts future cash receipts through the expected period of financial assets or a shorter period, if appropriate.

*iii) Trade and other receivables*

Trade and other receivables are held with the strategy of collecting contracted cash flows. Trade receivables that do not have a significant financial component at initial recognition have been measured in accordance with IFRS 15 at their transaction price.

*iv) Impairment*

Based on expected credit losses the Group recognizes impairment of financial assets. At each reporting date, the Company measures expected credit losses and recognizes the same in the financial statements. Expected credit losses from financial instruments are measured in a manner that reflects:

- Impartial and weighted sum of probability which is determined by assessing the range of possible outcomes,
- Time value of money,
- Reasonable and acceptable data on past events, current conditions and predictions of future economic conditions.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

**Financial assets (continued)**

*iv) Impairment (continued)*

For the purposes of calculating the expected loan loss, the financial asset portfolio is divided into three levels: level 1, level 2 and level 3. At the date of first recognition, financial assets are included in level 1, and the subsequent reclassification to levels 2 and 3 depends on the increase of the credit risk of financial instrument after the initial recognition, i.e. the credit quality of the financial instrument.

The Group applies a simplified approach to IFRS 9 to measure expected credit losses using expected credit loss provisions for credit losses in trade receivables. To measure expected credit losses on an aggregate basis, trade receivables are grouped based on similar credit risk and age structure. The rates of expected credit losses are based on historical credit losses that occurred over a period of three years before the end of the period. Historical loss rates are then adjusted for current and future information on macroeconomic factors affecting the Company's customers. The Company has identified domestic product (GDP), unemployment rate and inflation rate as key factors for the country in which the Company operates.

The Group applied a new standard as follows:

- Receivables from domestic and foreign customers are considered in full

Through the analysis of age structure, it has been determined that the Group has no significant due receivables, the most significant part of the receivables has is not yet due and the Group estimates that it will be fully paid. No significant credit losses were identified.

Notwithstanding the foregoing, the Group separately considers the customers in difficulties and, in accordance with the estimate, generates expected credit losses that are most often in full value of the receivables.

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

***Financial assets (continued)***

*v) Derecognition of financial assets*

The Group ceases to recognize financial assets when contractual rights to cash flows from financial assets expire or financial assets are transferred and the transfer fulfils conditions for termination of recognition.

The Group transfers financial assets if, and only, either transfers contractual rights to receive cash flows from financial assets, or retains contractual rights to receive cash flows from a financial asset but assumes a contractual obligation to pay cash flows to one or more recipients in the arrangement.

When the Group transfers financial assets, it is required to estimate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case, when all risks and rewards of ownership are transferred, the Group ceases to recognize financial assets and recognizes separately, as assets or liabilities, all rights and obligations that have arisen or are retained in the transfer. If almost all the risks and rewards of ownership of financial assets are retained, the Group continues to recognize financial assets. If the Group neither transfers nor retains almost all the risks and rewards of ownership of financial assets, the Group determines whether it has retained control of the financial asset. If no control over financial assets is retained, the Group derecognises financial assets and recognizes separately, as assets or liabilities, all rights and obligations that have arisen or are retained in the transfer. If control is retained, the Group continues to recognize financial assets to the extent that it continues to participate in that financial asset.

***Derivative financial instruments***

The Group uses derivative financial instruments to reduce foreign exchange exposure. Additionally, the Group has concluded a Cross Currency Swap Agreement by which the Dollar obligation on bonds has been converted into the Euro obligation for the entire duration of the bonds, i.e. up to their maturity on 23 October 2022. More detailed information on derivative financial instruments is disclosed in Note 37.

Derivative financial instruments are initially recognized at fair value at the date of the conclusion of the contract and subsequently redeemed at fair value at the end of each reporting period. The Cross Currency Swap Agreement is classified as hedge of fair value with respect to the nature of the hedged item. Profit or loss from re-measurement of the hedging instrument at fair value is immediately recognized in the statement of profit or loss. Any gain or loss on a hedged item attributable to a hedged risk is adjusted to the carrying amount of the hedged item and is recognized in the statement of profit or loss.

The Group made the decision to measure the fair value of the currency swap with the "Markt To Market" ("MTM") value, according to the calculation of commercial banks. The positive value of "MTM" is recorded as a receivable, i.e. it generates financial income for the period, and the negative value of "MTM" is recorded as a liability and forms the financial expense of the reporting period. Upon the final maturity of the derivative financial instrument, the relevant receivables or liabilities will be discontinued at expense or in favour of the Group's income.



## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *b) Summary of principal accounting policies (continued)*

#### **Commodity contracts**

In accordance with IFRS 9, certain commodity contracts are treated as financial instruments and fall within the scope of the standard. Purchase and sale contracts concluded by the Group provide for the physical delivery of quantities that are intended for consumption or sale as part of the normal business of the Group; such contracts are therefore excluded from the area of application of the standard.

It is especially considered that term purchases and sales for physical deliveries of energy that are concluded as part of the Group's regular business are excluded from the scope of IFRS 9. This is demonstrated by the fulfilment of the following conditions:

/i/ Physical delivery of contracted quantities;

/ii/ The quantities purchased or sold correspond to the Group's business requirements;

/iii/ The contract cannot be considered as a written option defined by IFRS 9.

The Group therefore considers the transactions agreed with the aim of balancing the volume between buying and selling energy as part of its regular business as an integrated energy company, therefore not falling within the scope of IFRS 9.

#### **Financial liabilities**

##### *Initial Recognition and Measurement*

Financial liabilities are classified as financial liabilities that are measured at amortized cost. All financial liabilities are initially recognized at fair value plus associated transaction costs. Financial liabilities include trade payables and other payables, overdrafts and loans and borrowings.

##### *Subsequent measurement*

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method.

##### *Derecognition*

The Group ceases to recognize the liability in the financial statements when, and only then, the obligation has been settled. When the existing financial liability is replaced by another by the same creditor under substantially different terms or the terms of existing liabilities have changed significantly, such change or modification is treated as termination of the original liability and recognition of the new liability, and the difference in the corresponding carrying amounts is recognized in the statement of profit or loss.

## **2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

### *b) Summary of principal accounting policies (continued)*

#### **Provisions**

Provision is recognized only if the Group has a present obligation (statutory or derivative) as a result of the past event, and if it is probable that settlement of the obligation will require the outflow of resources with economic benefits, and if a reliable estimate can determine the amount of the liability. Provisions are reviewed at each reporting date and adjusted according to the latest best estimates. If the effect of the time value of the money is significant, the amount of the provision is the present value of the costs that are expected to be needed to settle the obligation. In the case of discounting, the increase in the provisions reflecting the time elapses is recognized as an interest expense (Note 28).

#### **Revenue recognition**

Business revenues are primarily generated through the sale of electricity, heat energy and gas to households, industrial and other customers in the Republic of Croatia.

In accordance with the new IFRS 15, the Company applies a five-step model for recognizing a contract with customer:

- 1) Identification of the contract with the customer(s)
- 2) Identification of the separate performance obligations in the contract
- 3) Determination of the transaction price
- 4) Allocation of the transaction price to the separate performance obligations
- 5) Recognition of revenue as each performance obligation is satisfied

Revenue is recognized for each separate contractual obligation in the transaction price amount. The transaction price is the amount of contractual remuneration that the Group expects to be entitled to in return for the delivery of the promised goods or services.

Revenues from the sale of electricity are recognized on the basis of the best estimate of the delivered energy quantity. As the actual calculation of the delivered volume of energy to customers of the household category is performed twice a year, the Group's electricity sales revenue is based on the total generated and purchased quantities of electricity distributed distribution network corrected for losses on the distribution network based on logarithmic regression. From the entry into force of the Act on Amendments to the Electricity Market Act (OG 102/2015), price regulation for the public service of electricity supply of households within the universal service and the amounts of tariff items for electricity supply by the supplier who is obliged to provide the public service is terminated. The Group does not have a separate accounting model for recognizing any deferral that would result from regulated tariffs. Accordingly, the Group recognizes revenue based on the prices approved by the regulatory agency, or the company's obligation to provide the public service. Alternatively, the Group provides its customers with the option to choose a market model, and in this case, revenues are recognized in accordance with free market prices (HEPI tariff model).

**2. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES AND THE SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)**

*b) Summary of principal accounting policies (continued)*

**Revenue recognition (continued)**

Revenues from the sale of heat energy to households as well as to industrial and other customers in the Republic of Croatia are recognized at a time when the customer acquires control over the product, i.e. when the heat is delivered to the buyer and if the Group is likely to receive a fee.

Gas sales revenue is recognized at the time the buyer acquires control over the product, i.e. when the gas is shipped to buyers and if it is likely that the Company will receive a fee. Gas price is regulated by the Croatian Energy Regulatory Agency (HERA). The Group does not have a separate accounting model for recognizing any deferral that would result from regulated tariffs.

*Income from connection fees*

In accordance with IFRS 15 Revenue from contracts with customers, which is effective from 1 January 2018, revenue from connection to the network is recognised systematically over the period of useful life of the asset (the connection), and fees received from customers for connection to the network are recognized as a deferred income and is recognized as the revenue of the period at the same time as the related amortization.

**Segmental analysis**

The Group has fully adopted IFRS 8 "Operating Segments" and discloses segment business data, as the Group trades in debt instruments on publicly traded markets (Note 4).

### 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The compilation of consolidated financial statements in accordance with International Financial Reporting Standards requires the Board to provide estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent liabilities. Future events are possible that will cause changes in assumptions based on which estimates are given, and thus changes in the estimates themselves. The effect of any change in the estimate will be reflected in the consolidated financial statements when it is possible to determine it. The estimates are presented in detail in the accompanying notes and the most significant of them relate to the following:

#### ***Life span of property, plant and equipment***

As explained in Note 2, the Group reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period.

#### ***Provision for decommissioning of power plants***

The Management Board estimates the cost of provisions for the decommissioning of the Krško Nuclear Power Plant and Group's thermal power plants on the basis of the applicable laws and regulations and its own experience. The provision also includes activities related to environmental protection to be carried out during the decommissioning of production facilities.

Decommissioning funds for Krško Nuclear Power Plant are reserved in accordance with the Regulation on Amount, Deadline and Method of Payment of Funds for Financing Decommission and Disposal of Radioactive Waste and Used Nuclear Fuel of Krško Nuclear Power Plant (OG 155/08) (Note 15).

The amount of provisions for the decommissioning of thermal power plants represents the discounted value of the estimated cost of decommissioning of the Group's thermal power plants (Note 28).

#### ***Recognition of revenues from electricity sales to customers of universal service (household customers)***

As the billing is based on prepayments with an actual calculation twice a year, the Group estimates revenue from electricity sales. The estimate is based on the total amount of electricity produced in a way that is produced or purchased, reducing the amount for estimated losses on the distribution network. After analysing several different approximation methods (five-year average, linear approximation and similar), the Management has chosen logarithmic regression as the most suitable one.

The difference between previously estimated income and actual payments is recognized in the consolidated balance sheet as other short-term liabilities or other short-term receivables.

#### ***Impairment of fixed assets***

The impairment calculation requires the estimate of the use value of the cash generating units. This value is measured based on the projection of the discounted cash flow. The most significant variables for determining the cash flow are the discounted rate, the term value, the time for which the cash flow projections are made, as well as the assumptions and judgments used to determine cash receipts and expenditures.

**3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)**

***The availability of taxable profit for which deferred tax assets can be recognized***

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that a profit will be generated that will enable the use of related tax benefits. The determination of deferred tax assets that can be recognized requires the application of significant judgment, which is based on the probable time and level of future taxable profits, together with future tax planning strategy (see Note 10).

***Actuarial estimates used to calculate retirement benefits***

The defined benefit cost was determined using actuarial estimates. Actuarial estimates include determining assumptions on discount rates, future increases in income and mortality or fluctuation rates. Due to the long-term nature of these plans, these estimates are a matter of insecurity (see Note 28).

***Consequences of certain legal disputes***

The Group is a party to numerous court disputes arising from regular business. Provisions are recorded if there is a present obligation as a result of the past event (taking into account all available evidence including the opinion of legal experts) where it is likely that settlement of the obligation will require a resource outflow and if the amount of the liability can be estimated reliably (Note 28).

***Expected credit loss model***

With IFRS 9, the expected loss credit model (ECL) is introduced. The measurement of the expected impairment loss is based on reasonable and supporting information available without excessive expense and effort and which includes information on past events, current and foreseeable future conditions and circumstances. The Group recognizes a 12-month or lifetime ECL, depending on whether there has been a significant increase in credit risk from initial recognition (or when a liability or guarantee is assumed). For the purpose of calculating the ECL model, the portfolio of financial assets is divided into three stages: level 1, level 2 and level 3. At the date of first recognition, financial assets are included in step 1 and the subsequent reclassification to steps 2 and 3 depends on the increase of the credit risk instrument after initial recognition, i.e. the credit quality of a financial instrument. For trade receivables, a simplified approach is applied whereby expected credit losses are recognized for the entire term of the receivable.

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

## 4. SEGMENT INFORMATION

Most of the Group's operating income is realized in the Republic of Croatia.

The reporting segments of the Group are divided into the following: electricity (production, transmission, distribution and sale of electricity), heating (production, distribution and sale of heat energy) and gas (distribution and sales of gas).

The profit or loss of each segment is the result of all revenues and expenses that directly relate to a particular segment. Information on financial income or expense and income tax is not stated at the segment level, as the basis for representation is the segment's operating profit.

|                                      | Electricity      |                  | Heating          |                 | Gas              |                 | Group            |                  |
|--------------------------------------|------------------|------------------|------------------|-----------------|------------------|-----------------|------------------|------------------|
|                                      | 2018             | 2017             | 2018             | 2017            | 2018             | 2017            | 2018             | 2017             |
|                                      | in '000<br>HRK   | in '000<br>HRK   | in '000<br>HRK   | in '000<br>HRK  | in '000<br>HRK   | in '000<br>HRK  | in '000<br>HRK   | in '000<br>HRK   |
| Revenue from main operations         | 11,650,333       | 11,493,664       | 664,442          | 683,264         | 1,922,759        | 1,280,463       | 14,237,534       | 13,457,391       |
| Other segment revenue                | 878,706          | 1,409,955        | 57,591           | 70,016          | 24,469           | 31,923          | 960,766          | 1,511,894        |
| <b>Profit / loss from operations</b> | <b>2,266,124</b> | <b>2,383,133</b> | <b>(239,954)</b> | <b>(65,908)</b> | <b>(367,713)</b> | <b>(22,402)</b> | <b>1,658,457</b> | <b>2,294,823</b> |
| Net financial expense                |                  |                  |                  |                 |                  |                 | 24,732           | (704,087)        |
| Corporate income tax                 |                  |                  |                  |                 |                  |                 | (318,437)        | (290,437)        |
| <b>Net profit</b>                    |                  |                  |                  |                 |                  |                 | <b>1,364,752</b> | <b>1,300,299</b> |

Segment assets consist primarily of property, plant and equipment, receivables, cash and inventories. Segment liabilities comprise trade payables and other liabilities. Assets and liabilities not belonging to segments represent property and liabilities that cannot reasonably be allocated to business segments. Total unallocated assets include investment in NPP Krško, part of property, plant and equipment and unallocated financial assets. Total unallocated liabilities include long-term loans, short-term loans and other various liabilities.

|                    | Total segment assets |                   | Total segment liabilities |                   |
|--------------------|----------------------|-------------------|---------------------------|-------------------|
|                    | 2018                 | 2017              | 2018                      | 2017              |
|                    | in '000 HRK          | in '000 HRK       | in '000 HRK               | in '000 HRK       |
| Electricity        | 32,238,163           | 31,631,552        | 8,305,271                 | 6,034,166         |
| Heating            | 1,155,130            | 1,205,007         | 198,267                   | 167,969           |
| Gas                | 390,921              | 365,519           | 89,909                    | 93,308            |
| Unallocated        | 6,565,415            | 5,649,479         | 7,386,784                 | 6,560,088         |
| <b>Total Group</b> | <b>40,349,629</b>    | <b>38,851,557</b> | <b>15,980,231</b>         | <b>12,855,531</b> |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

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### 4. SEGMENT INFORMATION (continued)

#### Information on the largest customers

Revenues from electricity sales in 2018 amount to HRK 11,650,333 thousand (in 2017 HRK 11,493,664 thousand).

Revenues from the sale of thermal energy in 2018 amount to HRK 664,442 thousand (in 2017 HRK 683,264 thousand).

Gas sales revenue in 2018 refers to gas sales in the wholesale market in the amount of HRK 932,243 thousand and gas sales to customers of gas supply in the amount of HRK 990,516 thousand (2017 sales of gas in the wholesale market amounted to HRK 963,887 thousand and sales gas to gas supply customers 316,576 thousand).

#### Territorial business analysis

The Group operates in the area of Europe, with countries that are members of the European Union and other countries that are not members of the European Union.

The following is a territorial analysis of revenues generated by the Group from the active parts of the business from external customers of electricity:

|                      | <b>2018</b>       | <b>2017</b>       |
|----------------------|-------------------|-------------------|
|                      | in '000 HRK       | in '000 HRK       |
| Croatia              | 10,687,377        | 10,302,678        |
| EU member states     | 742,009           | 1,038,870         |
| Non EU member states | 220,947           | 152,116           |
|                      | <b>11,650,333</b> | <b>11,493,664</b> |

## 5. OTHER OPERATING REVENUE

|  | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|--|---------------------|---------------------|
| Network connection services  | 3,071               | 372,088             |
| Revenue from assets funded from connection fees  | 319,745             | 224,404             |
| Collected value adjusted receivable (Note 21)  | 54,822              | 79,971              |
| Revenue from external services   | 77,898              | 94,233              |
| Penalty charges  | 42,908              | 38,961              |
| Revenue from sale of materials   | 37,652              | 32,728              |
| Revenue from the sale of cross-border transmission capacity                                    | 120,067             | 130,169             |
| Revenues from the HOPS inter-compensation mechanism - overseas                                 | 37,140              | 5,513               |
| Revenue from reversal of provisions for impaired fixed assets                                  | -                   | 199,207             |
| Income from reversal of long-term provisions for unused annual vacations                       | 4,271               | 15,348              |
| Income from reversal of provisions payments under the collective agreement                     | 12,752              | -                   |
| Income from reversal of long-term provisions for severance payments and jubilee awards         | 5,119               | 187                 |
| Revenues from termination of long-term provisions for legal disputes                           | 34,612              | 66,928              |
| Revenue from reversal of other provisions  | 2,825               | -                   |
| Collected pre-settlement receivables   | 6,891               | 11,640              |
| Revenue from customer notices  | 216                 | 1,345               |
| Revenue from court costs   | 7,011               | 7,385               |
| Gains from sale of tangible assets   | 5,192               | 18,043              |
| Claims written off   | 5,325               | 1,829               |
| Income from subsidies, grants, reimbursements and compensation                                 | 3,170               | 2,803               |
| More accrued fees in the previous year on CO <sub>2</sub> emissions for electricity generation | 11,428              | 13,109              |
| Other operating income NE Krško  | 9,141               | 5,409               |
| Other  | 159,510             | 190,594             |
|  | <b>960,766</b>      | <b>1,511,894</b>    |



## 6. PURCHASE EXPENSES

|   | <b>2018</b>             | <b>2017</b>             |
|---|-------------------------|-------------------------|
|   | in '000 HRK             | in '000 HRK             |
| Electricity purchase                          | 2,831,169               | 2,786,423               |
| Fuel costs                                    | 1,695,300               | 1,903,145               |
| Gas purchase for sale on the wholesale market | 1,823,664               | 1,130,144               |
|   | <b><u>6,350,133</u></b> | <b><u>5,819,712</u></b> |

Procurement of electricity and gas refers to purchases outside the system for the sale on the wholesale market and to final customers.

Fuel supply (coal, liquid fuels and gas) refers to purchases outside the power generation system in thermoelectric power plants.

## 7. EMPLOYEE BENEFITS EXPENSES

|                                   | <b>2018</b>             | <b>2017</b>             |
|-----------------------------------|-------------------------|-------------------------|
|                                   | in '000 HRK             | in '000 HRK             |
| Net salaries                      | 1,044,604               | 1,112,785               |
| Net salaries NPP Krško            | 94,258                  | 93,171                  |
| Taxes and contributions           | 662,213                 | 703,795                 |
| Taxes and contributions NPP Krško | 40,145                  | 37,141                  |
|                                   | <b><u>1,841,220</u></b> | <b><u>1,946,892</u></b> |

### Total employee benefits:

|  | <b>2018</b>             | <b>2017</b>             |
|--|-------------------------|-------------------------|
|  | in '000 HRK             | in '000 HRK             |
| Gross salaries                               | 1,706,817               | 1,816,580               |
| Gross salaries NPP Krško                     | 134,403                 | 130,312                 |
| Reimbursement of costs to employees (Note 8) | 117,175                 | 120,018                 |
| Material rights of employees (Note 8)        | 97,958                  | 99,520                  |
| Unused vacations (Note 8)                    | 12,884                  | 5,077                   |
|  | <b><u>2,069,237</u></b> | <b><u>2,171,507</u></b> |

## 7. EMPLOYEE BENEFITS EXPENSES (continued)

### Key management personnel compensation

|                       | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|-----------------------|---------------------|---------------------|
| Gross salaries        | 30,215              | 28,881              |
| Pension contributions | 6,677               | 6,430               |
| Other fees            | 3,759               | 3,508               |
|                       | <b>40,651</b>       | <b>38,819</b>       |

### Supervisory Board members compensation

|                         | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|-------------------------|---------------------|---------------------|
| Compensation fees       | 278                 | 367                 |
| Taxes and contributions | 23                  | 30                  |
| Other expenses          | 6                   | 10                  |
|                         | <b>307</b>          | <b>407</b>          |

Employee benefits expense include commuting expenses in 2018 in the amount of HRK 70,168 thousand (2017: HRK 73,602 thousand), daily allowances and travel expenses in 2018 in the amount of HRK 24,550 thousand (2017: HRK 22,679 thousand), supplementary health insurance in the amount of HRK 7,372 thousand (2017: HRK 8,697 thousand) and other similar expenses in 2018 in the amount of HRK 15,085 thousand (2017: HRK 15,040 thousand).

Costs of material rights of employees include benefits under the Collective Agreement. The largest part relates to payments under the Collective Agreement in the amount of HRK 72,109 thousand, and to a lesser extent to solidarity assistance, disability allowance, child allowance and other.

Members of the Management Board were not paid other than regular salaries and receipts in the amount of HRK 3,759 thousand in 2018 (2017: HRK 3,508 thousand).

## 8. OTHER OPERATING EXPENSES

|   | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|---|---------------------|---------------------|
| Maintenance costs   | 665,890             | 566,004             |
| Impairment of trade receivables (Note 21)                               | 452,582             | 151,143             |
| Gas acquisition costs   | 137,996             | 116,673             |
| Cost of external services and materials                                 | 430,353             | 388,086             |
| Daily Services and Material   | 87,839              | 179,522             |
| Gas Supply Charges  | -                   | 6,690               |
| Cost of CO2 Emission Units  | 263,125             | 120,163             |
| Write-off of fixed assets   | 26,653              | 223,128             |
| Impairment of inventories   | 18,884              | 7,216               |
| Impairment of fixed assets  | 96,014              | 39,630              |
| Impairment of intangible assets   | 10,178              | 72,680              |
| Employee Benefits Fee (Note 7)  | 117,175             | 120,018             |
| Other material rights of employees (Note 7)                             | 97,958              | 99,520              |
| NE Krško - costs of decommissioning by Government decision              | 105,613             | 106,386             |
| Contributions, taxes and fees to the state                              | 102,129             | 96,027              |
| Litigation provisions   | 11,188              | 18,471              |
| Contributions and concessions for water                                 | 73,541              | 65,079              |
| Provisions for unused annual vacations (Note 7)                         | 12,884              | 5,077               |
| Fee for the use of power plant space                                    | 99,675              | 75,138              |
| Fee for purification and drainage water                                 | 14,040              | 12,447              |
| Cost of materials sold  | 25,740              | 19,806              |
| The cost of billing   | 27,866              | 24,807              |
| Provision for severance payments and jubilee awards                     | 65,765              | 101,164             |
| Provisions for severance payments on termination of employment contract | 33,403              | -                   |
| Insurance premiums  | 10,918              | 11,835              |
| Environmental protection fees   | 709                 | 835                 |
| Damage charges  | 28,438              | 21,311              |
| Written off unclaimed receivables                                       | 11,612              | 14,936              |
| Provision for decommissioning of thermal power plants                   | 22,255              | 8,711               |
| Other costs   | 296,712             | 299,392             |
|   | <b>3,347,135</b>    | <b>2,971,895</b>    |

## 9. FINANCE INCOME AND EXPENSES

|   | <b>2018</b>      | <b>2017</b>      |
|---|------------------|------------------|
| <b>Finance income</b>   | in '000 HRK      | in '000 HRK      |
| Net foreign exchange gain   | 80,627           | 215,803          |
| Interest income   | 9,417            | 9,275            |
| Fair value of the cross-currency swap                                 | 197,972          | -                |
| Dividend income   | 18               | 8,935            |
| Other finance income  | 935              | 701              |
| NE Krško - Interest   | 1,108            | 1,112            |
| <b>Total finance income</b>   | <b>290,077</b>   | <b>235,826</b>   |
| <b>Finance expenses</b>   |                  |                  |
| Interest expenses   | (190,986)        | (222,787)        |
| Negative foreign exchange loss  | (68,037)         | (95,090)         |
| Fair value of the cross-currency swap                                 | -                | (569,172)        |
| Fair value of shares  | -                | (548)            |
| NE Krško – interest   | (934)            | (556)            |
| Impairment of financial assets  | (1,409)          | (6,000)          |
| Other finance expenses  | (3,979)          | (46,777)         |
| <b>Total finance expenses</b>   | <b>(265,345)</b> | <b>(940,930)</b> |
| Capitalized borrowing costs   | -                | 1,017            |
| <b>Finance expenses recognised in the statement of profit or loss</b> | <b>(265,345)</b> | <b>(939,913)</b> |
| <b>Net profit from finance activities</b>                             | <b>24,732</b>    | <b>(704,087)</b> |

## 10. CORPORATE INCOME TAX

|  | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|--|---------------------|---------------------|
| Current tax  | (345,898)           | (345,365)           |
| Deferred tax expense / (income) related to origination and reversal of temporary differences | 27,461              | 54,928              |
| <b>Tax expense</b>   | <b>(318,437)</b>    | <b>(290,437)</b>    |

Adjustments of deferred tax assets are shown as follows:

|  | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|--|---------------------|---------------------|
| Balance at 1 January                             | 610,389             | 555,461             |
| Prior period adjustment – application of IFRS 15 | 324,616             | -                   |
| Balance at 1 January                             | 935,005             | 555,461             |
| Reversal of deferred tax assets                  | (100,436)           | (124,329)           |
| Recognition of deferred tax assets               | 127,897             | 179,257             |
| Balance at 31 December                           | <b>962,466</b>      | <b>610,389</b>      |

Deferred tax asset has arisen from tax non-deductible provisions for jubilee awards and severance payments for regular retirement benefits, allowances which are not tax deductible and other provisions.

Reconciliation between income tax and profit reported in the statement of profit or loss is set out below:

|   | 2018<br>in '000 HRK | 2017<br>in '000 HRK |
|---|---------------------|---------------------|
| Profit before tax   | 1,683,189           | 1,590,736           |
| <b>Tax at the effective rate (20%/18%)</b>                          | <b>(302,974)</b>    | <b>(286,332)</b>    |
| Non-deductible income   | (37,104)            | (57,369)            |
| Tax effect of temporary differences                                 | 27,461              | 54,928              |
| Non-deductible deferred tax assets of Companies operating with loss | (5,820)             | (1,664)             |
| <b>Tax expense for the current year</b>                             | <b>(318,437)</b>    | <b>(290,437)</b>    |
| Effective tax rate  | 19%                 | 18%                 |

Reducing income tax rates in Croatia from 20% to 18% entered into force on 1 January 2017. As the result of the change in the tax rate, the relevant positions of deferred taxes are re-calculated.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 10. CORPORATE INCOME TAX (continued)

The Group and each of its subsidiaries are liable to pay income tax in accordance with the tax laws and regulations of the Republic of Croatia. Subsidiaries within the Group reported tax losses of HRK 304,834 thousand (2017: HRK 479,834 thousand), while the Group calculated profit tax in the amount of HRK 345,898 thousand (2017: HRK 345,365 thousand) and deferred tax assets in amounting to HRK 27,461 thousand (2017: HRK 54,928 thousand).

Existing tax losses can be transferred and recognized as a deductible item in the tax calculation in the next tax periods up to their statutory expiry date, which is 5 years from the end of the year in which the tax losses were incurred.

The Group's tax losses and their expiry dates are shown in the following table:

| Year of tax loss | Total tax loss – Group | Year of transfer cessation |
|------------------|------------------------|----------------------------|
|                  | in '000 HRK            |                            |
| 2014             | 168,027                | 2019                       |
| 2015             | 69,009                 | 2020                       |
| 2016             | 26,221                 | 2021                       |
| 2017             | 9,243                  | 2022                       |
| 2018             | 32,334                 | 2023                       |
|                  | <b>304,834</b>         |                            |

Group companies that continuously operate with loss do not recognize deferred tax assets. The Company realizes profit and has no tax losses for the transfer. In accordance with Croatian regulations, tax losses cannot be utilized on a consolidated basis. Each individual company determines its tax liability.

As at 31 December 2018, deferred tax assets deriving from transferred tax losses in the amount of HRK 304,834 thousand were not recognized.

In accordance with the tax regulations, the Tax Administration may at any time review the books and records of the Company and its subsidiaries for a period of three years after the expiration of the year in which the tax liability is reported and may impose additional tax liabilities and penalties. The Management Board is not aware of any circumstances that could lead to potential significant obligations in this respect.

In 2018, the Tax Administration conducted tax supervision for 2016 in the subsidiary HEP Toplinarstvo d.o.o. and HEP Opskrba d.o.o. Tax Supervision in 2018 for 2016 is started in HEP subsidiary company Telekomunikacije d.o.o. and is still in progress.

### 10. CORPORATE INCOME TAX (continued)

The table below summarizes the changes in deferred tax assets over the year:

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

| in '000 HRK   | Inventory<br>impairment | Provision for<br>jubilee<br>awards and<br>severance<br>payment | Depreciation<br>above<br>prescribed<br>rates | Provision<br>for MTM<br>bonds | Impairment of<br>fixed assets | Carried tax<br>losses | Other          | Total          |
|---|-------------------------|--|--|-------------------------------|-------------------------------|-----------------------|----------------|----------------|
| <b>1 Jan 2017</b>   | <b>42,676</b>           | <b>75,312</b>  | <b>9,489</b>                                 | <b>5,805</b>                  | <b>394,578</b>                | <b>1,340</b>          | <b>26,261</b>  | <b>555,461</b> |
| Credited to<br>statement of<br>profit or loss<br>for the year | 1,087                   | 17,585   | 1,776  | 85,136                        | (56,753)                      | (1,341)               | 7,438          | 54,928         |
| <b>31 Dec 2017</b>  | <b>43,763</b>           | <b>92,897</b>  | <b>11,265</b>                                | <b>90,941</b>                 | <b>337,825</b>                | <b>(1)</b>            | <b>33,699</b>  | <b>610,389</b> |
| <b>Restatement</b>  | -                       | -  | -  | -                             | -                             | -                     | <b>324,616</b> | <b>324,616</b> |
| <b>1 Jan 2018</b>   | <b>43,763</b>           | <b>92,897</b>  | <b>11,265</b>                                | <b>90,941</b>                 | <b>337,825</b>                | <b>(1)</b>            | <b>358,315</b> | <b>935,005</b> |
| Credited to<br>statement of<br>profit or loss<br>for the year | 3,126                   | 8,799  | 2,007  | (35,635)                      | (10,703)                      | -                     | 59,867         | 27,461         |
| <b>31 Dec 2018</b>  | <b>46,889</b>           | <b>101,696</b>   | <b>13,272</b>                                | <b>55,306</b>                 | <b>327,122</b>                | <b>(1)</b>            | <b>418,182</b> | <b>962,466</b> |

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

## 11. PROPERTY, PLANT AND EQUIPMENT

| in '000 HRK                                 | Buildings and land | Inventory and equipment | Assets under construction | Total             |
|---|--------------------|-------------------------|---------------------------|-------------------|
| <b>COST</b>                                 |                    |                         |                           |                   |
| <b>1 Jan 2017</b>                           | <b>39,163,741</b>  | <b>48,087,337</b>       | <b>2,677,233</b>          | <b>89,928,311</b> |
| Transfers                                   | 97,261             | (45,316)                | (51,397)                  | 548               |
| Additions                                   | 14,173             | 238,886                 | 1,964,703                 | 2,217,762         |
| Additions NEK                               | -                  | -                       | 195,306                   | 195,306           |
| Activation of assets under construction     | 623,767            | 1,254,726               | (1,938,594)               | (60,101)          |
| Activation of assets under construction NEK | 12,878             | 114,280                 | (127,158)                 | -                 |
| Disposal                                    | (74,532)           | (386,870)               | (277,534)                 | (738,936)         |
| Transfer to investment property             | (97,431)           | -                       | -                         | (97,431)          |
| <b>31 Dec 2017</b>                          | <b>39,739,857</b>  | <b>49,263,043</b>       | <b>2,442,559</b>          | <b>91,445,459</b> |
| Transfers                                   | 21,592             | (21,338)                | (188)                     | 66                |
| Additions                                   | 3,573              | 174,577                 | 1,816,782                 | 1,994,932         |
| Additions NEK                               | -                  | -                       | 291,798                   | 291,798           |
| Activation of assets under construction     | 494,043            | 1,762,607               | (2,263,490)               | (6,840)           |
| Activation of assets under construction NEK | 17,651             | 268,759                 | (286,410)                 | -                 |
| Disposal                                    | (63,229)           | (409,656)               | (18,368)                  | (491,253)         |
| <b>31 Dec 2018</b>                          | <b>40,213,487</b>  | <b>51,037,992</b>       | <b>1,982,683</b>          | <b>93,234,162</b> |
| <b>ACUMULATED DEPRECIATION</b>              |                    |                         |                           |                   |
| <b>1 Jan 2017</b>                           | <b>27,034,457</b>  | <b>32,122,765</b>       | -                         | <b>59,157,222</b> |
| Depreciation for the year                   | 674,478            | 1,087,016               | -                         | 1,761,494         |
| Depreciation for the year NEK               | 26,072             | 100,763                 | -                         | 126,835           |
| Asset valuation IAS 36 /i/                  | (10,357)           | (188,850)               | -                         | (199,207)         |
| Investment write-off IAS 36                 | 14,070             | 25,560                  | -                         | 39,630            |
| Transfer                                    | 13,115             | (12,662)                | -                         | 453               |
| Disposal                                    | (80,851)           | (383,442)               | -                         | (464,293)         |
| Transfer to investment property             | (9,787)            | -                       | -                         | (9,787)           |
| <b>31 Dec 2017</b>                          | <b>27,661,197</b>  | <b>32,751,150</b>       | -                         | <b>60,412,347</b> |
| Depreciation for the year                   | 677,438            | 1,150,734               | -                         | 1,828,172         |
| Depreciation for the year NEK               | 26,500             | 90,515                  | -                         | 117,015           |
| Investment write-off IAS 36                 | 5,957              | 88,301                  | -                         | 94,258            |
| Transfer                                    | 2,105              | (2,048)                 | -                         | 57                |
| Disposal                                    | (56,284)           | (383,660)               | -                         | (439,944)         |
| <b>31 Dec 2018</b>                          | <b>28,316,913</b>  | <b>33,694,992</b>       | -                         | <b>62,011,905</b> |
| <b>NET BOOK VALUE</b>                       |                    |                         |                           |                   |
| <b>31 Dec 2018</b>                          | <b>11,896,574</b>  | <b>17,343,000</b>       | <b>1,982,683</b>          | <b>31,222,257</b> |
| <b>31 Dec 2017</b>                          | <b>12,078,660</b>  | <b>16,511,893</b>       | <b>2,442,559</b>          | <b>31,033,112</b> |



#### **11. PROPERTY, PLANT AND EQUIPMENT (continued)**

The Group owns a large number of real estate, but ownership of certain real estate is not fully resolved. The Group is in the process of registering ownership of the Group's real estate. Due to the large number of real estates, there is a possibility that not all business property owned by the Group is recorded in the business books. There is also the possibility that for the property recorded in business books the Group has no registered ownership.

On 27 June 2013, the Management Board of the Company issued a Decision on measures and activities related to resolving the ownership status of the Company and its subsidiaries.

In the Decision are given tasks and the deadlines for submitting proposals to the competent land registry courts for registration of ownership. Activities on land registration conditions are continuing and in 2018.

/i/ Based on the indicators for impairment of assets and the calculation of the required impairment losses in accordance with IAS 36, the carrying value of the thermal power plant was corrected during 2014. The key indicators of impairment were the significantly higher costs of electricity generation in thermal power plants compared to the market price of electricity.

In July 2016, Block L in TE TO Zagreb was granted a status of eligible producer on the basis of the Decision on Acquiring the Status of Preferred Electricity Producer issued by the Croatian Energy Regulatory Agency (HERA) according to which it entered the system of incentives and electricity sales at a preferential price a period of twenty-five years. Said circumstance, after establishing sustainability of the financing model on which it was based on in 2017, has been recognized as an indication of changes in the value of the assets. In accordance with it the revaluation, has been made by an independent consultant that has shown the need to abolish the impairment loss recognized on Block L in TE TO Zagreb in the amount of HRK 199,207 thousand, resulting in an increase of the present value of the property as well as an increase in the income from the reversal of asset impairment. Calculating the recoverable amount is based on five-year plans for electricity and heat production. The calculation of the recoverable amount implies a terminal growth rate after a five-year period of 0%. Cash flow projections are discounted using a discount rate reflecting the risk of the asset in question and tested at each balance sheet date if any impairment indicators are observed.

## 12. INTANGIBLE ASSETS

|  | in '000 HRK    |
|--|----------------|
| <b>COST</b>                                    | <b>Licence</b> |
| <b>31 Dec 2016</b>                             | <b>797,775</b> |
| Transfers                                      | (548)          |
| Additions                                      | 40,320         |
| Investment activation                          | 60,101         |
| Disposal                                       | (38,532)       |
| <b>31 Dec 2017</b>                             | <b>859,116</b> |
| Transfers                                      | (66)           |
| Additions                                      | 17,422         |
| Investment activation                          | 6,840          |
| Disposal                                       | (280)          |
| <b>31 Dec 2018</b>                             | <b>883,032</b> |
| <b>ACCUMULATED AMORTISATION AND IMPAIRMENT</b> |                |
| <b>31 Dec 2016</b>                             | <b>640,189</b> |
| Transfer                                       | (453)          |
| Amortisation of the year                       | 47,404         |
| Disposal                                       | (38,526)       |
| <b>31 Dec 2017</b>                             | <b>648,614</b> |
| Transfer                                       | (57)           |
| Depreciation for the year                      | 56,168         |
| Disposals                                      | (271)          |
| <b>31 Dec 2018</b>                             | <b>704,454</b> |
| <b>NET BOOK VALUE</b>                          |                |
| <b>31 Dec 2018</b>                             | <b>178,578</b> |
| <b>31 Dec 2017</b>                             | <b>210,502</b> |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

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### 13. INVESTMENT PROPERTY

As at 31 December 2018 and 2017, investment property includes real estate held for the purpose of earning income from the lease and / or capital appreciation, and are stated at fair value based on the best estimate of the Management Board. Fair value includes the estimated market price at the end of the reporting period. All investment property is owned by the Company.

Estimates of the fair value of real estate were performed by the official appraisers or internal services of the Group whose estimate is based on available market price information of real estate at appropriate positions. These prices were collected from a variety of sources, including available statistics from the Central Bureau of Statistics, the Real Estate Agency, HGK, and the like. These values of average prices are adjusted for the characteristics and specifics of certain real estates.

| <b>At fair value</b>                              | <b>31 Dec 2018<br/>in '000 HRK</b> | <b>31 Dec 2017<br/>in '000 HRK</b> |
|---|------------------------------------|------------------------------------|
| Fair value  | <b>305,630</b>                     | <b>231,491</b>                     |
| Net value change through adjustment of fair value | (1,904)                            | 7,654                              |
| Transfer from property                            | -                                  | 66,485                             |
| Balance at year end – at fair value               | <b><u>303,726</u></b>              | <b><u>305,630</u></b>              |

**14. ADVANCES FOR PROPERTY, PLANT AND EQUIPMENT**

|                            | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|----------------------------|--------------------|--------------------|
|                            | in '000 HRK        | in '000 HRK        |
| Bio energana Bjelovar      | 417                | -                  |
| Dalekovod d.d.             | 84                 | -                  |
| Đuro Đaković Holding d.d.  | -                  | 1,325              |
| FATA S.P.A.                | 74,695             | -                  |
| General Electrics Hrvatska | -                  | 3,764              |
| HELB d.o.o.                | 6,400              | -                  |
| Končar inženjering Zagreb  | 869                | 3,043              |
| Končar KET                 | 787                | 2,208              |
| Siemens d.d.               | 2,529              | 336                |
| TPK Orometal d.d.          | -                  | 1,445              |
| Other                      | 1,389              | 3,131              |
|                            | <b>87,170</b>      | <b>15,252</b>      |

Advances for property, plant and equipment are related to the construction of production facilities.

## 15. INVESTMENT IN KRŠKO NUCLEAR POWER PLANT

### Investment history

At the end of 2001, a treaty was signed between the Government of the Republic of Croatia and the Government of the Republic of Slovenia to regulate the status and other legal affairs related to the investment, exploitation and decommissioning of Krško Nuclear Power Plant (NEK) and the Contract between HEP d.d. and ELES GEN d.o.o. The Treaty was ratified by the Parliament of the Republic of Croatia in mid-2002 and entered into force on 11 March 2003, after it was ratified by the Parliament of the Republic of Slovenia on 25 February 2003.

This treaty recognizes previously revoked ownership rights of HEP d.d. in the newly-formed company NEK in the amount of 50% of the share in the power plant. Both sides agreed that the life span of the power plant is at least until 2023. The produced electricity is delivered in a ratio of 50:50 for both parties, and the price of the delivered energy is determined according to the actual production costs.

This treaty also clearly defined the obligation of the Republic of Croatia for the disposal of half of radioactive waste and used nuclear fuel from NEK. Each country has an obligation to provide half of the funding needed to finance the costs of developing decommission program and costs of program implementation. Each party shall allocate funds for these purposes into their own funds in the amounts foreseen for decommissioning programs. According to the current NEK program of decommissioning and disposal of radioactive waste and used nuclear fuel, HEP d.d. is obliged to pay funds to the Fund in the amount of EUR 14,250 thousand a year.

### Current status

#### ***Payments to the Fund for financing NEK decommission***

Pursuant to the Regulation on the amount, deadline and method of payment of funds for the NEK program of decommissioning and disposal of radioactive waste and used nuclear fuel issued by the Government of the Republic of Croatia on 24 December 2008; from 2006 until the end of 2018 HEP d.d. the amount of paid HRK 1,587,528 thousand in the Fund. The current annual liability in the amount of EUR 14,250 thousand is paid to the Fund quarterly.

#### ***Extension of life span***

After NEK received a license without time constraints from the Board for nuclear safety of the Republic of Slovenia in 2012; at the beginning of 2016 HEP d.d. and GEN energija d.o.o. have decided to extend the power plant life until 2043. The decision was made with the consent of the Intergovernmental Commission for NEK and was preceded by an economic study of the viability of investing in a long-term power plant.

**15. INVESTMENT IN KRŠKO NUCLEAR POWER PLANT (continued)****Accounting of Joint operation in NEK**

Joint operation in NEK is recognized in the Company's financial statements using the equity method. Application required by IFRS 11 has resulted in numerous issues and ambiguities, as well as misunderstandings with some users of financial statements.

With the aim of eliminating possible doubts of individual state bodies (FINA, Ministry of Finance, Central Bureau of Statistics, etc.) about information in separate financial statements of the Company, the Company's Management made a decision to change this policy in accordance with IAS 1, paragraph 19 item 20.

In the consolidated financial statements, the Company applies the joint asset and liabilities management method and discloses the Company's share of each asset and each liability, income and expense in accordance with IFRS 11.

The following table shows the extract from the financial statements of NE Krško d.o.o. in 100% amounts as at 31 December 2018 and 31 December 2017:

|                                      | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|--------------------------------------|--------------------|--------------------|
|                                      | in '000 HRK        | in '000 HRK        |
| Property, plant and equipment        | 2,839,470          | 2,522,384          |
| Capital and reserves                 | 3,268,569          | 3,308,725          |
| Gross sales revenue                  | 1,172,816          | 1,181,749          |
| Cash flows from operating activities | 333,732            | 317,624            |
| Profit for the year                  | -                  | -                  |

**16. INVESTMENTS CALCULATED USING THE EQUITY METHOD**

Hrvatska elektroprivreda d.d. (hereinafter: HEP d.d.) and Plinacro d.o.o. concluded on 1 June 2010 the Contract on the Establishment of LNG HRVATSKA d.o.o. for liquefied natural gas business. According to the contract, LNG HRVATSKA d.o.o. became the coordinator of the LNG terminal project on Krk. Based on the Contract HEP d.d. and Plinacro d.o.o. became members and co-owners of LNG HRVATSKA d.o.o. each with a 50% of equity, management and property rights.

Pursuant to the decision of the Government of the Republic of Croatia on the designation of the LNG terminal project (construction of a liquefied natural gas terminal on the island of Krk, Omišalj municipality) as the strategic investment project of the Republic of Croatia (OG 78/15) of 16 July 2015 the LNG terminal design project was proclaimed a strategic investment project of the Republic of Croatia.

In November 2015, the European Commission adopted a list of projects of common interest (PCI) containing a list of key energy infrastructure projects, including the LNG terminal on the island of Krk. LNG Croatia has concluded contracts with INEA (Innovation and Networks Executive Agency) to co-finance projects of project licensing documentation preparation and a contract for co-financing construction.

The LNG Terminal Gas Act (OG 57/18), adopted by the Parliament on 18 June 2018, established that the construction of LNG terminal was in the interest of the Republic of Croatia and the LNG Hrvatska d.o.o. is appointed as the entity to implement the project.

Changes in investments calculated using the equity method are shown as follows:

|   | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|---|--------------------|--------------------|
|   | in '000 HRK        | in '000 HRK        |
| <b>Investments calculated using the equity method</b> |                    |                    |
| Investment in LNG Hrvatska d.o.o.                     | 23,512             | 865                |
|   | <b>23,512</b>      | <b>865</b>         |

The following table shows the excerpt from the financial statements of LNG Hrvatska d.o.o. in 100% amounts as at 31 December 2018 and 31 December 2017.

|                                      | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|--------------------------------------|--------------------|--------------------|
|                                      | in '000 HRK        | in '000 HRK        |
| Property, plant and equipment        | 120,569            | 101,219            |
| Capital and reserves                 | 19,409             | 426                |
| Sales revenue                        | 47                 | 101                |
| Cash flows from operating activities | (13,227)           | (17,947)           |
| Loss for the year                    | (7,328)            | (7,856)            |

## 17. LONG-TERM LOANS

|                                   | 31 Dec 2018   | 31 Dec 2017   |
|-----------------------------------|---------------|---------------|
|                                   | in '000 HRK   | in '000 HRK   |
| Receivables for loans             | 35,790        | 61,879        |
| Current maturity of loans granted | -             | (25,772)      |
| <b>Long-term portion</b>          | <b>35,790</b> | <b>36,107</b> |

Loans to companies in business combinations:

|                           | Year of approval | Repayment period | Approved amount in '000 EUR | 31 Dec 2018   | 31 Dec 2017   |
|---------------------------|------------------|------------------|-----------------------------|---------------|---------------|
|                           |                  |                  |                             | in '000 HRK   | in '000 HRK   |
| LNG Hrvatska              | 2015             | 5 years          | 4,900                       | 35,645        | 61,879        |
| Current maturity          |                  |                  |                             | -             | (25,772)      |
| Other loans               |                  |                  |                             | 145           | -             |
| <b>Long-term portions</b> |                  |                  |                             | <b>35,790</b> | <b>36,107</b> |



**18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME**

|   | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|---|--------------------|--------------------|
|   | in '000 HRK        | in '000 HRK        |
| Financial assets available-for-sale   | -                  | 283,578            |
| Financial assets at fair value through other comprehensive income                                 | 197,307            | -                  |
|   | <b>197,307</b>     | <b>283,578</b>     |
|   |                    |                    |
|   | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|   | in '000 HRK        | in '000 HRK        |
| <b>Opening balance of financial assets at fair value through other comprehensive income</b>       | <b>283,578</b>     | <b>288,493</b>     |
| Prior period adjustment – application of IFRS 9   | (22,178)           | -                  |
| <b>Balance of financial assets at fair value through other comprehensive income at 1 Jan 2018</b> | <b>261,400</b>     | <b>288,493</b>     |
| Changes in fair value of assets   | (64,684)           | (5,495)            |
| <b>Closing balance of financial assets at fair value through other comprehensive income</b>       | <b>196,716</b>     | <b>282,998</b>     |

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

## 18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (continued)

Changes in financial assets at fair value through other comprehensive income presented in the table above are presented in gross amount. In the consolidated statement of comprehensive income, other comprehensive income includes changes in the fair value of assets through other comprehensive income less profit tax on net profit/loss through other comprehensive income.

|  | 31 Dec 2018<br>in '000 HRK        | 31 Dec 2017<br>in '000 HRK        |
|--|-----------------------------------|-----------------------------------|
| <b>Investments through other comprehensive income (securities)</b> |                                   |                                   |
| Jadranski Naftovod d.d.  | 195,411                           | 280,701                           |
| Viktor Lenac d.d.  | 128                               | 305                               |
| Đuro Đaković d.d.  | 5                                 | 5                                 |
| Kraš d.d.  | 3                                 | 3                                 |
| Pevec d.d.   | 6                                 | 547                               |
| Jadran d.d.  | 204                               | 364                               |
| Elektrometal d.d.  | 40                                | 41                                |
| Optima Telekom d.d.,   | 186                               | 298                               |
| Institut IGH d.d.,   | 136                               | 191                               |
| Međimurje beton d.d.   | 153                               | 153                               |
| HTP Korčula d.d.   | 66                                | 61                                |
| Lanište d.o.o.   | 110                               | 61                                |
| Pominvest d.d.   | 35                                | 35                                |
| Konstruktor Inženjering d.d. u stečaju                             | 233                               | 233                               |
| <b>Total investment through other comprehensive income</b>         | <b>196,716</b>                    | <b>282,998</b>                    |
|  | <b>31 Dec 2018</b><br>in '000 HRK | <b>31 Dec 2017</b><br>in '000 HRK |
| <b>Other investment</b>  |                                   |                                   |
| Cropex   | 591                               | -                                 |
| Geopodravina d.o.o.  | -                                 | 200                               |
| Novenerg d.o.o.  | -                                 | 380                               |
| <b>Total other investment</b>                                      | <b>591</b>                        | <b>580</b>                        |
| <b>Total investment through other comprehensive income</b>         | <b>197,307</b>                    | <b>283,578</b>                    |

**18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (continued)**

During December 2008, by the decision of the Government of the Republic of Croatia on the transfer of shares of Jadranski naftovod d.d., HEP d.d. acquired 53,981 shares with a nominal value of HRK 2,700, i.e. the total nominal value of up to HRK 145,748,700. The Management Board it was decided that the shares of Jadranski naftovod d.d. are classified as available-for-sale assets. The registration of shares in the Central Depository Agency was completed on 19 March 2009.

In 2018 and 2017, a fair valuation was made on the basis of a notification by the Central Depository Clearing Company on the balance sheet date at 31 December. Market share price of Jadranski naftovod d.d. was HRK 3,620 as at 31 December 2018, and HRK 5,200 as at 31 December 2017. Through fair valuation of investments in Jadranski naftovod d.d; as on 31 December 2018 the value of the share was reduced by HRK 85,290 thousand (2017: decreased by HRK 5,398 thousand). The fair valuation effect in 2018 and 2017 was carried out through equity reserves.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 19. OTHER FINANCIAL ASSETS

|   | 31 Dec 2018   | 31 Dec 2017   |
|---|---------------|---------------|
|   | in '000 HRK   | in '000 HRK   |
| Receivables for housing loans                                       | 9,415         | 13,685        |
| Trade receivables for energy efficiency project – long-term portion | 15,730        | 23,610        |
| Other fixed assets  | 5,619         | 5,623         |
|   | <b>30,764</b> | <b>42,918</b> |

Before 1996, the Company sold its own apartments to its employees in accordance with the laws of the Republic of Croatia. The sale of this property was mainly on loans and receivables, with interest rates lower than the market rates, are repayable monthly for a period of 20 to 35 years. Receivables for sold flats were transferred to new subsidiaries as of 1 July 2002. Said receivables are reported in the financial statements at discounted net present value using the interest rate of 7.0%. The liability towards the state, representing 65% of the value of sold housing, is recorded in other long-term liabilities (Note 27). Receivables are secured by mortgages on sold real-estate.

### 20. INVENTORIES

|   | 31 Dec 2018      | 31 Dec 2017      |
|---|------------------|------------------|
|   | in '000 HRK      | in '000 HRK      |
| Fuel and chemicals                              | 113,583          | 109,854          |
| Electric material                               | 447,957          | 367,226          |
| Spare parts                                     | 205,449          | 201,458          |
| Construction material                           | 12,289           | 15,100           |
| Gas for wholesale                               | 375,950          | 353,600          |
| CO2 emission units                              | 234,050          | 106,248          |
| Other inventories                               | 86,736           | 57,001           |
| Nuclear fuel – NE Krško                         | 223,543          | 172,044          |
| Other material – NE Krško                       | 106,791          | 115,053          |
|   | <b>1,806,348</b> | <b>1,497,584</b> |
| Impairment of outdated material and spare parts | (259,176)        | (240,292)        |
|   | <b>1,547,172</b> | <b>1,257,292</b> |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 21. TRADE RECEIVABLES

|  | 31 Dec 2018        | 31 Dec 2017      |
|--|--------------------|------------------|
|  | in '000 HRK        | in '000 HRK      |
| Electricity – corporate                | 1,515,436          | 1,449,741        |
| Electricity – households               | 579,469            | 521,542          |
| Electricity – foreign markets          | 148,111            | 155,966          |
| Heat, gas and services                 | 1,066,272          | 717,772          |
| Receivables from NE Krško customers    | 8,696              | 15,788           |
| Other                                  | 71,038             | 55,831           |
|  | <b>3,389,022</b>   | <b>2,916,640</b> |
| <b>Impairment of trade receivables</b> | <b>(1,188,390)</b> | <b>(835,640)</b> |
|  | <b>2,200,632</b>   | <b>2,081,000</b> |

The age structure of trade receivables not impaired in 2018 and 2017 is as follows:

|                      | 31 Dec 2018      | 31 Dec 2017      |
|----------------------|------------------|------------------|
|                      | in '000 HRK      | in '000 HRK      |
| Not due              | 1,550,159        | 1,441,335        |
| Up to 30 days        | 311,907          | 349,467          |
| From 31 to 60 days   | 122,541          | 109,038          |
| From 62 to 90 days   | 65,369           | 62,517           |
| From 91 to 180 days  | 76,237           | 51,319           |
| From 181 to 365 days | 49,591           | 57,504           |
| Over 365 days        | 24,828           | 9,820            |
|                      | <b>2,200,632</b> | <b>2,081,000</b> |

## 21. TRADE RECEIVABLES (continued)

Changes in impairment allowance were as follows:

|  | <b>2018</b><br>in '000 HRK | <b>2017</b><br>in '000 HRK |
|--|----------------------------|----------------------------|
| <b>1 Jan</b>                             | <b>835,640</b>             | <b>896,396</b>             |
| Impairment of trade receivables (Note 8) | 452,582                    | 151,143                    |
| Write-offs and other                     | (45,010)                   | (131,928)                  |
| Collected impaired receivables (Note 5)  | (54,822)                   | (79,971)                   |
| <b>31 Dec</b>                            | <b>1,188,390</b>           | <b>835,640</b>             |

Management provides for doubtful receivables based on the overall aging of all receivables and a specific review of significant individual amounts receivable.

## 22. OTHER CURRENT RECEIVABLES

|  | 31 Dec 2018    | 31 Dec 2017    |
|--|----------------|----------------|
|  | in '000 HRK    | in '000 HRK    |
| Receivables for income tax   | 72,053         | 98,093         |
| Receivables for VAT  | 166,522        | 10,084         |
| Advances for working capital   | 15,298         | 54,777         |
| Receivables from the state for employees                                       | 4,163          | 3,642          |
| Demand and time deposits for a period longer than 3 months                     | 99,573         | 129,845        |
| Demand and time deposits for a period longer than 3 months NE Krško            | 111,464        | 252,244        |
| Short-term loans in the country - reprogram                                    | 14,896         | 94,486         |
| Receivables from HEP-ESCO d.o.o. from the energy efficiency project users      | 9,989          | 8,145          |
| Receivables for loans granted to related companies with participating interest | -              | 28,772         |
| Receivables for apartments sold  | 5,919          | 6,116          |
| Receivables for invoiced fee OIE - HROTE                                       | 31,858         | 48,766         |
| Other receivables from HROTE   | -              | 128,752        |
| Receivables for accrued income from electricity - household                    | -              | 31,099         |
| Other receivables NE Krško   | 2,466          | 2,431          |
| Other short-term receivables   | 70,729         | 60,565         |
|  | <b>604,930</b> | <b>957,817</b> |

## 23. CASH AND CASH EQUIVALENTS

|  | 31 Dec 2018      | 31 Dec 2017      |
|--|------------------|------------------|
|  | in '000 HRK      | in '000 HRK      |
| Current accounts in HRK                          | 2,228,672        | 1,037,821        |
| Foreign currency accounts                        | 282,724          | 412,724          |
| Restricted cash                                  | 35,445           | 69,104           |
| Petty cash                                       | 198              | 186              |
| Deposits with maturity up to 90 days             | 60,704           | 160,730          |
| Daily deposits                                   | 172,361          | 261,150          |
| Cash funds                                       | 175,099          | 75,252           |
| Current and foreign currency accounts – NE Krško | 122              | 128              |
|  | <b>2,955,325</b> | <b>2,017,095</b> |

## 24. CAPITAL AND RESERVES

At the first registration of the Company on 12 December 1994, the Company's capital was entered in the German mark (DEM) in the amount of DEM 5,784,832 thousand. By the subsequent registration of the Company, on 19 July 1995, the capital was expressed in Croatian kuna in the amount of HRK 19,792,159 thousand. Share capital consists of 10,995,644 ordinary shares with a nominal value of HRK 1,800.

### Capital reserves

|   | 31 Dec 2018   | 31 Dec 2017    |
|---|---------------|----------------|
|   | in '000 HRK   | in '000 HRK    |
| Opening balance   | 162,242       | 140,293        |
| Prior period adjustment – application of IFRS 9<br>1 January 2018 | (22,178)      | -              |
|   | 140,064       | 140,293        |
| Other comprehensive income, net                                   | (74,143)      | 21,949         |
|   | <b>65,921</b> | <b>162,242</b> |



**24. CAPITAL AND RESERVES (continued)**

| <b>Retained earnings</b>  | <b>31 Dec 2018</b> | <b>31 Dec 2017</b> |
|---|--------------------|--------------------|
|   | <b>in '000 HRK</b> | <b>in '000 HRK</b> |
| Opening balance   | 6,041,625          | 5,551,226          |
| Prior period adjustment – application of IFRS 9                   | 27,046             | -                  |
| Prior period adjustment – application of IFRS 15                  | (2,685,047)        | -                  |
| 1 January 2018  | 3,383,624          | 5,551,226          |
| Foreign exchange differences on translation of foreign operations | (18,645)           | (15,609)           |
| Dividend paid   | (218,413)          | (794,291)          |
| Profit for the year   | 1,364,752          | 1,300,299          |
|   | <b>4,511,318</b>   | <b>6,041,625</b>   |

## 25. BOND LIABILITIES

|  | 31 Dec 2018      | 31 Dec 2017      |
|--|------------------|------------------|
|  | in '000 HRK      | in '000 HRK      |
| Nominal value of domestic bonds issued in 2007 | -                | 93,030           |
| Discounted value                               | -                | -                |
| Due repayment                                  | -                | (93,030)         |
| Current maturity of bonds                      | -                | -                |
|  | <u>-</u>         | <u>-</u>         |
| Value of bonds issued abroad in 2012           | -                | 493,571          |
| Due repayment                                  | -                | (491,477)        |
| Exchange rate difference                       | -                | (2,094)          |
| Current maturity of bonds                      | -                | -                |
|  | <u>-</u>         | <u>-</u>         |
| <b>Bonds issued in 2015</b>                    | <u>-</u>         | <u>-</u>         |
| Value of bonds issued abroad in 2012           | 3,612,610        | 3,626,428        |
| Exchange rate differences                      | (46,645)         | (21,431)         |
| Discount value                                 | 7,720            | 7,613            |
|  | <u>3,573,685</u> | <u>3,612,610</u> |
| Accrued cost of bonds                          | (13,310)         | (16,782)         |
|  | <u>-</u>         | <u>-</u>         |
| <b>Bonds issued in 2015</b>                    | <u>3,560,375</u> | <u>3,595,828</u> |
|  | <u>-</u>         | <u>-</u>         |
| <b>Total bonds payable</b>                     | <u>3,560,375</u> | <u>3,595,828</u> |

### Bonds issued abroad in 2015

In October 2015, the Group issued corporate bonds in the amount of USD 550,000 thousand, at a discount, the maturity of 7 years and a fixed interest rate of 5.875% per annum. Bonds issued in 2015, for the most part, were used to repurchase 83.37% of the bonds issued in 2012 (i.e. the repurchase of USD 416,852 thousand). The remaining amount was intended to finance the Company's business activities. The bond has been listed on the Luxembourg Stock Exchange and is actively traded on it.

## 25. BOND LIABILITIES (continued)

### *Derivative financial instruments*

#### **Cross currency swap**

In order to reduce exposure to currency risk, i.e. the exposure to US dollar exchange rate, the Group concluded a cross currency swap agreement, by which are the dollar liabilities on bonds converted into euro, for the entire period, that is, until the final maturity on 23 October 2022.

According to the cross currency swap agreement from 2015, the annual interest rate paid by the Group is fixed and amounts to 4.851% (weighted interest rate) and is payable semi-annually (the interest rate also includes swap cost).

The purpose of the cross currency swap is to reduce currency risk and recommendations of credit agencies on the importance of strategic currency risk management in order to reduce the impact on the Group's business. The Group's fair value of derivative financial instruments is linked to the Mark to market value "MTM", according to official calculations of banks, for the reporting period.

The positive value of "MTM" is recorded as a receivable, i.e. it generates financial income for the period, and the negative value of "MTM" is recorded as a liability and forms the financial expense of the reporting period. Upon the final maturity of the derivative financial instrument, the relevant receivable or liability will be discontinued and charged or credited to the Group's income.

As at 31 December 2018, using the said method, the fair value of liabilities in the amount of HRK 307,255 thousand (2017: HRK 505,228 thousand) was stated on the bonds issued in 2015 (Note 29).

## 26. LOAN LIABILITIES

|   | Interest rates | 31 Dec 2018    | 31 Dec 2017    |
|---|----------------|----------------|----------------|
|   |                | in '000 HRK    | in '000 HRK    |
| Loans from domestic banks                     | Floating       | 75,898         | 445,468        |
| Loans from foreign banks                      | Fixed          | 257,144        | 219,793        |
| Finance lease                                 | Fixed          | 6,413          | 10,038         |
| <b>Total loan liabilities</b>                 |                | <b>339,455</b> | <b>675,299</b> |
| Deferred loan fees                            |                | (3,526)        | (923)          |
| <b>Total loan liabilities</b>                 |                | <b>335,929</b> | <b>674,376</b> |
| Current maturity                              |                | (112,061)      | (405,219)      |
| Current maturity of financial lease (Note 33) |                | (3,418)        | (3,262)        |
| <b>Long-term portion</b>                      |                | <b>220,450</b> | <b>265,895</b> |

The Company has contracted loans with domestic and foreign banks with variable and fixed interest rates which ranged from 0.44% to 2.57% in 2018. The Group has contracted financial lease with a fixed interest rate of 5.6%.

Loans from domestic banks are secured by bills of exchange and promissory notes. On 31 December 2018, the Company has no debt covered by the guarantee of the Republic of Croatia.

### New sources of funding

To finance the investment plan and operating activities in 2018, the Company used its own funds and funds from the loan in use.

On 24 July 2018, a loan agreement was signed with the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) for the financing of the project of construction of KKE EL-TO Zagreb in the amount of EUR 130 million. The EBRD accounts for EUR 87 million and EIB for EUR 43. The EBRD loan consists of two tranches, namely Tranche A (EUR 43.5 million) provided by the EBRD alone and Tranche B (EUR 43.5 million) in cooperation with the commercial banks trade union.

### Loans in use

In December 2018, EBRD and EIB loans were used to finance the KKE EL-TO Zagreb construction project. As at 31 December 2018 the outstanding balances of long-term loans amounted to EUR 6,9 million from the EBRD and EUR 3,4 million from the EIB. The use of the loan was contracted until 20 July 2021.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 26. LOAN LIABILITIES (continued)

The principal repayment schedule for long-term loans maturing in the next five years:

|            | ( in '000 HRK ) |
|------------|-----------------|
| 2019       | 115,479         |
| 2020       | 38,863          |
| 2021       | 39,555          |
| 2022       | 43,242          |
| 2023       | 43,242          |
| After 2023 | 55,548          |
|            | <b>335,929</b>  |

In 2018, two loans contracted with domestic banks (HPB and Banking Club<sup>1</sup>) were fully repaid. On the loan from HPB, the Group had EUR 20 million and a loan of EUR 150 million from the Banking Club.

Domestic banks' loans are secured by bills of exchange and promissory notes, while loans from development banks, the EBRD and the EIB have contracted financial guarantees in the form of financial indicators according to which the Group is obliged to meet certain prescribed levels on the annual and semi-annual basis of the following indicators: net financial debt/EBITDA, EBITDA net financial expenses, net financial debt/total net value.

The Group's basic objective regarding the risks borne by the financial indicators is to protect the Group from possible breach of contractual obligations, or premature maturities of contracted credit debts.

Contracted financial indicators are monitored and calculated based on the projected balance sheet and statement of profit or loss.

The Group prepares preliminary financial statements in the upcoming mid-term period and monitors their trends.

If the projections of the balance sheet and the statement of comprehensive income at the end of the business year indicate the possibility of exceeding the individual financial ratios, the Company shall inform the bank of the existence of a breach of contract and promptly request waiver from the bank.

In the event that a bank does not approve a waiver, the potential scenario is a premature maturity of debt representing the liquidity risk for the Group. The Management believes that in case of exceeding an individual indicator, the Company may obtain a waiver from the creditor, since the payment of liabilities to financial institutions is a priority obligation of the Company and the Company has never been in default towards financial institutions.

Due to all of the above, the Board estimates that the possibility of early maturity of credit liabilities resulting from exceeding in financial indicators as well as the Group's exposure to credit risk, liquidity risk and market risk that may arise as a result of overcoming the financial indicators are minimal.

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<sup>1</sup> PBZ, ZABA, RBA

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

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### 26. LOAN LIABILITIES (continued)

As at 31 December 2018, the Group met all contractual financial indicators.

The total exposure of the Group on the basis of contracted credit lines related to financial indicators as at 31 December 2018 amounts to EUR 10,290 thousand.

Below is an overview of long-term loans denominated in foreign currencies (in '000):

| Currency | 31 Dec 2018 | 31 Dec 2017 |
|----------|-------------|-------------|
|          | in '000 HRK | in '000 HRK |
| EUR      | 45,288      | 89,876      |

For the purpose of securing liquidity reserves in the next medium term, the Company has concluded multilateral framework contracts with domestic banks, totalling HRK 1,015 million. Funds from these limits may be used by the Company for short-term loans and issuance of guarantees, letters of credit, and letters of intent according to the needs of the Group companies. During 2018, short-term lines were used solely for the purpose of issuing guarantees and opening letters of credit, using funds of all banks equally.

From the aforementioned mid-term multi-purpose frameworks, there was no need for short-term loans due to good liquidity during 2018.

As at 31 December 2018 the total amount of available short-term funds amounts to HRK 904,384 thousand.

### 27. LIABILITIES TO STATE

Long-term liabilities to the state in the amount of HRK 10,281 thousand (2017: 13,065 thousand) related to the sale of housing units to employees under the Government program, which was discontinued in 1996. According to the legislation, 65% of the proceeds from the sale of apartments to employees were payable to the state upon receipt of funds. By law, the Company and its subsidiaries have no obligation to transfer the funds before they are collected from employees.

## 28. PROVISIONS

|   | <b>31 Dec 2018</b>      | <b>31 Dec 2017</b>      |
|---|-------------------------|-------------------------|
|   | in '000 HRK             | in '000 HRK             |
| Provisions for legal disputes   | 275,079                 | 298,504                 |
| Provisions for severance payments                                       | 494,845                 | 429,489                 |
| Provisions for severance payments , jubilee awards and other - NE Krško | 40,159                  | 52,611                  |
| Provisions for jubilee awards   | 41,373                  | 46,083                  |
| Provisions for thermal power plant decommissioning                      | 194,404                 | 170,149                 |
| Provisions for delivered energy from wind farms                         | 21,631                  | 21,631                  |
|   | <b><u>1,067,491</u></b> | <b><u>1,018,467</u></b> |

Provision for decommissioning costs of thermal power plants in the amount of 194,404 thousand represents a discounted value of the estimated decommissioning costs of thermal power plants of the Group.

# Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

## 28. PROVISIONS (continued)

The table below summarizes the changes in provisions during the period presented:

|                                  | Provisions for<br>legal disputes | Provisions for<br>severance<br>payments | Provisions for<br>jubilee awards | Provisions for<br>thermal power<br>plant<br>decommissionin<br>g | Other         | Total            |
|----------------------------------|----------------------------------|---|----------------------------------|---|---------------|------------------|
|                                  | in '000 HRK                      | in '000 HRK                             | in '000 HRK                      | in '000 HRK   | in '000 HRK   | in '000 HRK      |
| <b>1 Jan 2017</b>                | <b>337,899</b>                   | <b>329,693</b>                          | <b>44,986</b>                    | <b>161,438</b>  | <b>56,684</b> | <b>930,700</b>   |
| Additional provisions            | 27,104                           | 156,516                                 | 2,614                            | 8,711   | -             | 194,945          |
| Decrease in provision – payment  | (13,215)                         | (4,036)                                 | (600)                            | -   | -             | (17,851)         |
| Decrease in provision - estimate | (53,284)                         | (73)                                    | (917)                            | -   | (35,053)      | (89,327)         |
| <b>31 Dec 2017</b>               | <b>298,504</b>                   | <b>482,100</b>                          | <b>46,083</b>                    | <b>170,149</b>  | <b>21,631</b> | <b>1,018,467</b> |
| Transfer                         | -                                | 394                                     | 16                               | -   | -             | 410              |
| Additional provisions            | 11,186                           | 61,446                                  | 273                              | 24,255  | -             | 97,160           |
| Decrease in provision – payment  | (30,776)                         | (8,902)                                 | (3,743)                          | -   | -             | (43,421)         |
| Decrease in provision - estimate | (3,835)                          | (34)                                    | (1,256)                          | -   | -             | (5,125)          |
| <b>31 Dec 2018</b>               | <b>275,079</b>                   | <b>535,004</b>                          | <b>41,373</b>                    | <b>194,404</b>  | <b>21,631</b> | <b>1,067,491</b> |



## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 28. PROVISIONS (continued)

#### Provisions for legal disputes

The Group reserves costs for legal disputes for which it is estimated that it is unlikely to be in the favour of the Company or its subsidiaries. The most significant provisions relate to a case related to HPP Peruća, initiated in 1995, for which a first-instance verdict was issued in 2012 in favour of the plaintiff. The value of the dispute amounted to about HRK 330,000 thousand, and reserved funds amounted to 50% of the value of the dispute; HRK 165,000 thousand. Other major disputes relate to Kartnersparkass in the amount of HRK 9,903 thousand. There are several legal procedures conducted against HEP Proizvodnja d.o.o. for which the Company has made a provision. The most significant of them is dispute Sanac, whose value as at 31 December 2018 amounts to HRK 9,710 thousand. Based on the legal decision HEP d.d. and HEP - Production d.o.o., as solidary debtors, have paid the costs to the plaintiff Sanac d.o.o. in the amount of HRK 10.5 million and interests of HRK 11.4 million on 4 March 2019; each company 50% of the total amount.

#### Provisions for severance payments and jubilee awards

Changes in the present value of defined liabilities based on employee benefits in the current period are shown below:

|                               | <b>Severance<br/>payments</b> | <b>Jubilee awards</b> | <b>Total</b>   |
|-------------------------------|-------------------------------|-----------------------|----------------|
|                               | in '000 HRK                   | in '000 HRK           | in '000 HRK    |
| <b>1 January 2017</b>         | <b>329,693</b>                | <b>44,986</b>         | <b>374,679</b> |
| Service expenses              | 17,239                        | 2,486                 | 19,725         |
| Interest expenses             | 9,897                         | 1,044                 | 10,941         |
| Benefits paid                 | (26,330)                      | (6,438)               | (32,768)       |
| Past service cost             | 25,322                        | 915                   | 26,237         |
| Actuarial gains/(losses)      | 73,668                        | 3,090                 | 76,758         |
| <b>31 December 2017</b>       | <b>429,489</b>                | <b>46,083</b>         | <b>475,572</b> |
| NE Krško                      | 52,611                        | -                     | 52,611         |
| <b>Total 31 December 2017</b> | <b>482,100</b>                | <b>46,083</b>         | <b>528,183</b> |
| Service expenses              | 20,362                        | 2,421                 | 22,783         |
| Interest expenses             | 8,806                         | 726                   | 9,532          |
| Benefits paid                 | (8,130)                       | (4,625)               | (12,755)       |
| Past service cost             | (4,519)                       | (369)                 | (4,888)        |
| Actuarial gains / (losses)    | 48,837                        | (2,863)               | 45,974         |
| <b>31 December 2018</b>       | <b>547,456</b>                | <b>41,373</b>         | <b>588,829</b> |
| NE Krško                      | (12,452)                      | -                     | (12,452)       |
| <b>Total 31 December 2018</b> | <b>535,004</b>                | <b>41,373</b>         | <b>576,377</b> |

## 28. PROVISIONS (continued)

The following assumptions were used in preparing the calculations:

- The termination rate is from 0% to 5.68% and is based on the statistical fluctuation rates for the Group in the period from 2006 to 2018.
- The probability of death by age and sex is based on 2010-2012 Croatian Mortality Tables published by the Croatian Bureau of Statistics. It is assumed that the population of employees of the Company represents average with respect to mortality and health status.
- It is assumed that the annual salary growth will be 2%.
- To calculate present value of the obligation the following discount rates were used: .
  - 2.9% (HEP ESCO d.o.o., HEP Trgovina d.o.o., Program Sava d.o.o., HEP Telekomunikacije d.o.o.)
  - 2.4% (HEP Opskrba d.o.o., HEP ELEKTRA d.o.o., HEP NOC)
  - 1.9% (HEP d.d., HEP Toplinarstvo d.o.o., HEP Plin d.o.o., HEP Upravljanje imovinom d.o.o., HEP ODS d.o.o.)
  - 1.8% (HEP Proizvodnja d.o.o.)
  - 1.1% (HEP Opskrba plinom d.o.o.)

## 29. OTHER NON-CURRENT LIABILITIES

|   | 31 Dec 2018      | 31 Dec 2017      |
|---|------------------|------------------|
|   | in '000 HRK      | in '000 HRK      |
| Deferred income for assets financed by others                   | 6,209,712        | 3,080,826        |
| Long-term liabilities for assets financed from clearing debt    | 779,214          | 755,189          |
| Derivative financial liabilities on swap-transactions (Note 25) | 307,255          | 505,228          |
| Other non-current liabilities                                   | 19,234           | 15,364           |
|   | <b>7,315,415</b> | <b>4,356,607</b> |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 29. OTHER NON-CURRENT LIABILITIES (continued)

Deferred income refers to income for the received property or property financed from the connection fee. Revenue from this property is recognized at the same time as the depreciation of the tangible asset to which it applies, as applicable for the contracts for connection to the network concluded with the customers by 30 June 2009. After 1 July 2009, the connection fee is recognized as revenue in the amount of money that is received from the customer at the time the customer connects to the network or when allowed permanent access to the delivery of services.

On 31 December 2018 the Company has an obligation to clearing debt in the amount of HRK 779,214 thousand (2017: HRK 755,189 thousand), relating to the payment of letters of credit, based on the approval of the Ministry of Finance on the use of funds based on interbank agreements. Given that there is no other document that would regulate the relationship between the Company and the Ministry of Finance in relation to the above clearing debt, is not defined whether it is a loan or other legal relationship.

### 30. TRADE PAYABLES

|                                     | 31 Dec 2018      | 31 Dec 2017      |
|-------------------------------------|------------------|------------------|
|                                     | in '000 HRK      | in '000 HRK      |
| Trade payables – domestic suppliers | 1,610,060        | 1,407,038        |
| Trade payables – foreign suppliers  | 114,071          | 70,504           |
| Trade payables – EU suppliers       | 174,911          | 93,241           |
| Trade payables – NE Krško           | 152,634          | 72,250           |
|                                     | <b>2,051,676</b> | <b>1,643,033</b> |

### 31. LIABILITIES FOR TAXES AND CONTRIBUTIONS

|   | 31 Dec 2018    | 31 Dec 2017   |
|---|----------------|---------------|
|   | in '000 HRK    | in '000 HRK   |
| Income tax liability                                | 62,461         | -             |
| VAT liability                                       | 116,193        | -             |
| Utilities and other fees                            | 17,241         | 33,636        |
| Contributions on salaries                           | 19,307         | 21,034        |
| Taxes and contributions on employee material rights | 4,668          | 21,772        |
| Other   | 3,440          | 3,760         |
|   | <b>223,310</b> | <b>80,202</b> |

### 32. EMPLOYEE BENEFIT LIABILITIES

|  | 31 Dec2018<br>in '000 HRK | 31 Dec 2017<br>in '000 HRK |
|--|---------------------------|----------------------------|
| Net salaries                           | 76,308                    | 80,331                     |
| Contributions from salaries            | 33,999                    | 36,099                     |
| Severance payment – retirement benefit | 3,982                     | 123,487                    |
| Net salaries NE Krško                  | 9,899                     | 15,290                     |
| Other                                  | 17,369                    | 18,966                     |
|  | <b>141,557</b>            | <b>274,173</b>             |

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 33. OTHER CURRENT LIABILITIES

|   | 31 Dec 2018      | 31 Dec 2017      |
|---|------------------|------------------|
|   | in '000 HRK      | in '000 HRK      |
| Liabilities for advances received for connections   | 478,849          | 432,357          |
| Liabilities for other advance payments received     | 145,422          | 144,013          |
| Accrued costs of unused annual vacations            | 69,608           | 60,995           |
| Accrued income from electricity sales to households | 6,250            | -                |
| Liability for accrued solidarity fee                | 14,765           | 15,064           |
| Liability for renewable sources fees                | 135,053          | 128,859          |
| Accrued severance pay to workers                    | 33,403           | 179,820          |
| Accrued interest expenses                           | -                | -                |
| Accrued costs for CO <sub>2</sub> emissions         | 263,125          | 120,148          |
| Other accrued expenses                              | 6,271            | 9,008            |
| Current portion of financial lease (Note 26)        | 3,418            | 3,262            |
| Liabilities NE Krško                                | 35,292           | 23,822           |
| Other liabilities                                   | 37,992           | 22,534           |
|   | <b>1,229,448</b> | <b>1,139,882</b> |

Accrued income from the sale of electricity to households in the amount of HRK 6,250 thousand in 2018 (Note 33) and 31,099 thousand in 2017 (Note 22) is based on the calculation of correction income of households obtained by calculating the logarithmic curve. Correction of household income as at 31 December 2018 was obtained by calculating a logarithmic curve using 7.75% loss in network; while for the year ended 31 December 2017, the percentage of losses used in the calculation was 7.71%. In 2018, the result of the reduction of revenues was HRK 37,349 thousand compared to 2017, and a liability of HRK 6,250 thousand was reported. In 2017, the result was an increase in revenues of HRK 53,177 thousand compared to 2016, and a receivable amounting to HRK 31,099 thousand was reported.

According to the Air Protection Act (OG 130/2011, 47/2014, 61/2017, 118/2018) and the related by-laws in the field of greenhouse gas emissions; the Company has been classified as EU ETS payer and nine HEP plants are in the EU-ETS system since 1 January 2013.

The Group has obtained greenhouse gas emissions permits for all nine HEP plants in the EU-ETS and monitors plant emissions in accordance with approved monitoring plans and submits data on the amount of CO<sub>2</sub> emissions to all 9 accounts opened in the European Union Register no later than 31 March each year for the previous calendar year.

On the basis of verification of the amount of CO<sub>2</sub> emissions carried out by an independent accredited body, the Group is obliged to, no later than 30 April of the current year, submit the quantity of emission allowances to the EU Register in the amount corresponding to the total greenhouse gas emissions from the installation in the previous calendar year, in accordance with the verified report.

### 33. OTHER CURRENT LIABILITIES (continued)

HEP's EU-ETS plants have submitted to the EU Registry the quantities of verified emissions for 2013, 2014, 2015 and 2016, 2017 and 2018.

In accordance with the stated, costs of purchasing greenhouse gas emissions consist of the amount of CO<sub>2</sub> emitted (eq) and the unit price of the emission allowances that the Group calculates on the passive accruals (expense) and the expense of the period in the year in which the emissions of greenhouse gases emerged.

### 34. RELATED PARTY TRANSACTIONS

The Company has a 50% stake in the capital of NE Krsko. Although the investment in NE Krško is reported in the financial statements as common assets (joint operations) due to the fact that NE Krško is a separate legal entity here we present Transactions between NE Krško and the Company.

Electricity produced in NE Krško is delivered to HEP in the amount of 50% of the total quantity produced at a price determined by total production costs.

Receivables and liabilities and income and expenses with related parties are presented in the following table:

|                                       | 31 Dec 2018 | 31 Dec 2017 |
|---------------------------------------|-------------|-------------|
|                                       | in '000 HRK | in '000 HRK |
| <b>NE Krško</b>                       |             |             |
| Liabilities for purchased electricity | 49,580      | 49,603      |
| Costs of purchased electricity        | 577,283     | 585,443     |

Management remuneration is described in Note 7.

### 34. RELATED PARTY TRANSACTIONS (continued)

| in '000 HRK                                   | Sales revenue    |                | Purchase expense |                  |
|---|------------------|----------------|------------------|------------------|
|   | 2018             | 2017           | 2018             | 2017             |
| <b>State majority-owned companies</b>         |                  |                |                  |                  |
| Companies of Croatian Railways Group          | 111,473          | 97,956         | 54               | 439              |
| INA-Industrija nafte d.d.                     | 165,828          | 153,580        | 1,411,177        | 1,007,305        |
| Prirodni Plin d.o.o.                          | -                | -              | -                | -                |
| Plinacro d.o.o.                               | 593              | 2,104          | 146,150          | 156,944          |
| Croatia osiguranje d.d.                       | 6,265            | 2,591          | 7,078            | 8,754            |
| Hrvatska pošta d.d.                           | 22,751           | 6,728          | 38,564           | 34,537           |
| Hrvatske šume d.o.o.                          | 5,481            | 4,475          | 3,108            | 2,852            |
| Jadrolinija d.o.o.                            | 1,245            | 585            | 852              | 554              |
| Narodne novine d.d.                           | 2,234            | 2,450          | 4,174            | 3,748            |
| Hrvatska radio televizija                     | 12,839           | 11,650         | 1,566            | 1,594            |
| Plovput d.d.                                  | 696              | 564            | 149              | 155              |
| Croatia Airlines d.d.                         | 776              | 781            | -                | 4                |
| Petrokemija Kutina d.d.                       | 677,669          | 16,616         | 1,206            | 374              |
| Ministry of Foreign Affairs                   | 702              | 5              | -                | -                |
| Ministry of Defence                           | 20,280           | 21,284         | -                | -                |
| Ministry of Interior                          | 26,333           | 23,788         | -                | -                |
| Primary and secondary schools                 | 46,346           | 50,702         | 41               | 14               |
| Judicial institutions                         | 7,578            | 7,155          | 86               | 163              |
| Universities and colleges                     | 27,133           | 25,091         | 2,215            | 1,611            |
| Legislative, executive and other State bodies | 22,512           | 20,071         | 4,965            | 68,824           |
| Health institutions and organisations         | 151,654          | 96,089         | 550              | 639              |
| HROTE d.o.o.                                  | 272,747          | 389,600        | 971,638          | 763,968          |
| Other users                                   | 9,470            | 6,089          | 5,634            | 7,053            |
| <b>TOTAL</b>                                  | <b>1,592,605</b> | <b>939,954</b> | <b>2,599,207</b> | <b>2,059,532</b> |

### 34. RELATED PARTY TRANSACTIONS (continued)

| in '000 HRK                                   | Amount of receivables |                | Amount of liabilities |                |
|---|-----------------------|----------------|-----------------------|----------------|
|   | 31 Dec<br>2018        | 31 Dec<br>2017 | 31 Dec<br>2018        | 31 Dec<br>2017 |
| <b>State majority-owned companies</b>         |                       |                |                       |                |
| Companies of Croatian Railways Group          | 28,242                | 25,911         | 37                    | 245            |
| INA-industrija nafte d.d.                     | 15,185                | 16,053         | 170,712               | 45,264         |
| Plinacro d.o.o.                               | 669                   | 861            | 19,580                | 20,078         |
| Croatia osiguranje d.d.                       | 538                   | 213            | 1,693                 | 1,944          |
| Hrvatska pošta d.d.                           | 3,794                 | 3,446          | 8,568                 | 6,930          |
| Hrvatske šume d.o.o.                          | 1,112                 | 1,038          | 263                   | 2              |
| Jadrolinija d.o.o.                            | 239                   | 76             | 45                    | 22             |
| Narodne novine d.d.                           | 406                   | 529            | 797                   | 897            |
| Hrvatska radio televizija                     | 2,109                 | 2,514          | 12                    | 50             |
| Plovput d.d.                                  | 84                    | 67             | 44                    | 48             |
| Croatia Airlines d.d.                         | 111                   | 98             | -                     | -              |
| Petrokemija Kutina d.d.                       | 9,460                 | 3,095          | 347                   | 419            |
| Ministry of Defence                           | 3,602                 | 3,522          | -                     | -              |
| Ministry of Interior                          | 6,909                 | 6,030          | -                     | -              |
| Primary and secondary schools                 | 8,155                 | 12,037         | -                     | -              |
| Judicial institutions                         | 847                   | 1,144          | -                     | -              |
| Universities and colleges                     | 3,916                 | 4,664          | -                     | -              |
| Legislative, executive and other State bodies | 3,907                 | 3,712          | -                     | -              |
| Health institutions and organisations         | 32,283                | 20,218         | -                     | -              |
| HROTE d.o.o.                                  | 14,026                | 281,259        | 77,541                | 116,278        |
| Other users                                   | 3,854                 | 17,998         | 4,139                 | 6,587          |
| <b>TOTAL</b>                                  | <b>139,448</b>        | <b>404,485</b> | <b>283,778</b>        | <b>198,764</b> |



### **35. CONTINGENT LIABILITIES AND COMMITMENTS**

#### ***Disputes***

In 2018, the Group recorded provisions for legal disputes for which it was estimated were unlikely to be solved in favour of HEP d.d. and subsidiaries.

The Group has long-term investments in the territory of Bosnia and Herzegovina and Serbia in the amount of HRK 1,243,970 thousand. During the conversion of the Company to a stock company in 1994, this amount was excluded from the net asset value.

The Group has long-term investments in immovable assets in the territory of Bosnia and Herzegovina and Montenegro in the amount of HRK 722 thousand, which is excluded from the net asset value.

#### ***Liabilities from operations***

As a part of regular investment activities, the Group, on 31 December 2018, had concluded contracts according to which investments in various facilities and equipment were started, but not yet finished. The value of contracted unfinished works for the most significant projects was HRK 1,932,701 thousand (2017: HRK 944,834 thousand).

#### ***Environmental Protection***

The Group continuously monitors and analyses the impact of its business processes on the environment. The most important indicators of such impacts are emissions of air pollutants and the amount of generated waste. The Group reports on the state of these indicators, timely and objectively, to relevant institutions, units of local self-government and the interested public. The Group reports on its environmental, economic and societal impact within the framework of the non-financial report on sustainability, prepared under the GRI-Global Reporting Initiative guidelines and, since 2017, under GRI Standard Guidelines and publishes them on its website <http://www.hep.hr/o-hep-group/publications/report-on-sustainability/1,401>. Employees in charge of environmental protection are additionally trained at seminars and workshops, where they are informed about the obligations and activities arising from the provisions of legal regulations in the field of nature protection and the environment.

The Group has a system for monitoring environmental expenditures (RETZOK), monitoring expenditures in nature and environment since 2004.

All HEP's thermal power plants with rated thermal inputs greater than 50 MW have obtained Environmental permits from the Ministry of Environmental Protection and Energy. By the decision of the Management Board of the Group, a greenhouse gas emission trading system was established in 2012, and the Republic of Croatia and HEP joined the European GHG Emission Trading Scheme (EU-ETS) on 1 January 2013. The Croatian Environment and Nature Agency (since 1 January 2019 merged to the Ministry of Environmental Protection and Energy), at the Group's request, opened nine accounts of plant operators in the EU register. The Group successfully fulfilled its obligation to hand over emission units to the EU Greenhouse Gas Register for 2017, and for 2018 data on verified CO<sub>2</sub> emissions were verified by verifiers, and emission units were submitted to all nine plant operator accounts in amounts that corresponded with verified CO<sub>2</sub> emissions.

### **35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)**

#### ***Environmental Protection (continued)***

In 2018, a non-financial sustainability report for 2017 was completed for the HEP Group under the Global Reporting Initiative Standard (GRI Standard) guidelines. The Sustainability Report is published on the Company's website and in a printed version in Croatian and English.

#### **Report on the Status of the Nonfinancial Sustainability Report for the Group for 2018**

The preparation of a separate non-financial statement on the Group's sustainability for 2018 is underway. The nonfinancial report will be published on HEP's web pages in accordance with the provisions of the Accounting Act (OG 78/15 and 120/16) within 6 months from the balance sheet date, i.e. until 30 June 2019. The report will be published, as well as the previous four non-financial sustainability reports, on the following link <http://www.hep.hr/o-hep-grupi/publikacije/izvjesca-o-odrzivosti/1401>

In the preparation of these reports HEP Group uses the guidelines of the Global Reporting Initiative Standard (GRI Standard) and indicators in the above standard - general and standard indicators and sector supplement for the energy sector.

Course content of the sustainability report for 2018:

- Introduction by the president of the Management Board
- HEP approach to sustainability, includes goals, integrity and sustainability and how they are integrated in business policies, description of sustainability risk
- Materiality (description and impact assessment), sustainability framework according to UN development goals
- Stakeholders: analysis, inclusion, limitations
- Transparency of operations, including management approach, the principles of corporate governance, business ethics, professionalism and accountability in the work, transparency of communication and information (all according to the required GRI indicators). Responsibility in the working environment, data relating to employees (and prescribed by the GRI indicators), security and safety at work. The chapter also includes representative stories and case studies describing accountability and sustainability.
- Market access. HEP Group on the market. General approach. Business and responsibility, for each HEP Group company. Describes the most important trends related to market operations, supply chain, according to the requirements of the GRI indicator. The chapter also includes representative stories and case studies describing accountability and sustainability.
- Caring about the environment. Data on environmental protection, investments, projects and initiatives. Data are given by environmental protection areas (segments of activity). Data is indicated by GRI indicators. The chapter also includes representative stories and case studies describing accountability and sustainability.
- HEP in the community. It describes the various forms of community investment, cooperation with stakeholders, dialogue, information and education campaigns, initiatives aimed at cooperation and similar. The chapter also includes representative stories and case studies describing accountability and sustainability.
- Indicators

**35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)**

- HEP Proizvodnja d.o.o. has introduced and certified an integrated environmental, quality and energy management system in accordance with international standards ISO 14001:2015, ISO 9001:2015 and ISO 50001:2011 and, with its 35 components, it is among the largest environmental, quality and energy management systems in the Republic of Croatia. Efficient quality, environment and energy management is part of HEP-Proizvodnja d.o.o.'s business strategy in the production of electrical and thermal energy and in providing auxiliary services to the electro-energy system. Certification according to the new standards ISO 14001:2015 and ISO 9001:2015 and certification according to ISO 50001:2011 was carried out and confirmed by the certification company TÜV Croatia d.o.o. As one of the largest manufacturing companies in Croatia, and with regard to the activities covered by the number of employees, HEP-Proizvodnja d.o.o., aware of its environmental impacts, introduced the Environmental, Quality and Energy Management Policy that it has set for achieving maximum drive readiness and reliability of production capacities by implementing environmental protection measures and increasing the share of electricity generation and thermal energy in a regional market based on the principles of environmentally sound production, energy efficiency and sustainable business.
- By establishing and certifying quality management and environmental protection according to ISO 9001:2015 and ISO 14001:2015 HEP-Toplinarstvo d.o.o. has created the precondition for successful management of its processes, thus seeking to increase its competitiveness, position and reputation in the market.
- HEP ODS has established a certified health and safety management system in 2017, in accordance with the requirements of OHSAS 18001:2007, which continually achieves the defined health and safety management policy and set goals of the Company. Indicators of supervisory-transitional external auditors in 2018 confirmed that the applied environmental management system, certified for the first time in 2013, is in compliance with the requirements of ISO 14001:2015 and is continuously implementing the defined environmental management policy and the Company's set objectives. The fundamental commitment of the Energy Management Company is to achieve a lasting improvement of energy performance on all business facilities, equipment and devices, including the reduction of losses in the distribution network through the implemented energy management system according to ISO 50001:2011, which was also certified by an independent certification company TÜV Croatia Ltd.
- Customer Service of HEP-Supply d.o.o., through exceptional commitment and high level of service provided, was, as the first in Croatia, awarded the ISO 9001:2015 certificate for quality of service. In the second part of 2017, preparations for certification of the ISO 9001:2015 Customer Service were actively started. The process was successfully completed at the end of the planned period, and the Customer Service received ISO certification for a period of three years with mandatory recertification audits each year.
- In March 2017, implementation of an integrated management system in accordance with ISO / IEC 27001:2013, ISO 9001:2015, ISO 50001:2011, ISO 14001:2015 and BS OHSAS 18001:2007 started in HEP d.d. and HEP-Upravljanje imovinom d.o.o. In June 2017, there was a first series of lectures and workshops for team members participating in the implementation of these systems, which lasted until July 2018.

### **35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)**

#### ***Water Act***

Provisions of the Water Management Act that came into force on 1 January 2010, raised a question of ownership and legal status of the Company's property - reservoirs and ancillary facilities used for generation of electricity from hydropower plants, as they are defined as Public water resources in general use in ownership of the Republic of Croatia". The Group acquired the said property from their previous owners, merging an exceptionally large number of particles, which by the construction of the dam were flooded, resulting in accumulation. The Republic of Croatia initiated several proceedings for registration of title to those properties, part of which were ruled in favour of the Republic of Croatia, part of them were rejected by the relevant courts, and part of them are in still in progress.

In May 2018, the Law on Amendments to the Water Act (OG 46/18) entered into force, by which the Republic of Croatia establishes the construction rights on public water resources - land on which water structures were built through Company's or its predecessors' investments; except for the land on which the accumulation was constructed and the supply and drainage channels and tunnels built. These rights are granted in favour of the Company, without compensation for a period of 99 years. As long as this right is resumed, the Company is granted the right to manage, on behalf of the Republic of Croatia, public good / land on which constructions of electricity generation with accumulation and supply and drainage channels and tunnels are built.

### **35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)**

#### **Supply to the wholesale gas market**

The Act on Amendments to the Gas Market Act (OG 16/17) appointed Hrvatska elektroprivreda d.d. as the wholesale supplier on the wholesale gas market from 1 April 2017 until the tender for the selection of suppliers on the wholesale gas market is published. Supplier on the wholesale gas sales market sells gas to gas supply providers in the public gas supply service for household customers at a regulated sales price and is obliged to provide reliable and secure gas supply.

In accordance with the Act on Amendments to the Gas Market Act, at its session held on 28 February 2017, the Government of the Republic of Croatia adopted a Decision on the price of gas at which the gas wholesale supplier is obliged to sell gas to gas supply providers in the public gas supply service for household customers; which determines the price at HRK 0.1809 / kWh. On 1 March 2018 HERA issued a Decision on the amount of tariff items for the public gas supply service for the period from 1 April to 31 July 2018 (OG, 23/18), according to which the gas price did not change in relation to the price valid until 31 March 2018. In accordance with the methodology for determining tariff items for the public service of gas supply and a guaranteed supply (OG 34/18), the selling price of gas for the period from 1 August 2018 to 31 March 2019 amounted to HRK 0.1809 / kWh.

The Gas Market Act (OG 18/18) stipulates the selection of suppliers in the wholesale market for the period from 1 August 2018 to 31 March 2021, after which the role of the supplier in the wholesale market will be abolished. HERA carried out tenders for the selection of suppliers on the wholesale market for the period from 1 August 2018 to 31 March 2021 (on 15 May and 13 June 2018). As no proposals were received for these calls, in accordance with the provisions of the Act, on 27 June 2018 HERA, in consultation with the Ministry of Environmental Protection and Energy, appointed HEP d.d. as a wholesale supplier for a period of time shorter than the Act envisaged, i.e. from 1 August 2018 to 31 March 2019.

As of 1 April 2017, the natural gas producer has no longer the obligation to deliver gas and the regulated price at which it was obliged to sell gas to the supplier on the wholesale gas market for the needs of customers using the public service supply is no longer valid.

Pursuant to the Act on Amendments to the Gas Market Act HEP d.d. as a wholesale market supplier, was awarded 60%, or 61 storage capacity packages in the underground gas storage facility.

In the period from 1 April 2014 to 31 March 2015 HEP d.d. as a wholesale market supplier, has leased a capacity of 3,600 million kWh; in the period from 1 April 2015 to 31 March 2016 3,550 million kWh; from 1 April 2016 to 31 March 2017 3,500 million kWh; while in the period from 1 April 2017 to 31 March 2022, contracted capacity is 3,050 million kWh.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 36. SUBSIDIARIES

At 31 December 2018 the Group owned the following subsidiaries:

| <b>Subsidiary</b>                            | <b>Country</b> | <b>Share (%)</b> | <b>Main activity</b>  |
|--|----------------|------------------|---|
| HEP-Proizvodnja d.o.o.                       | Croatia        | 100              | Production of electricity and heating                           |
| Hrvatski operator prijenosnog sustava d.o.o. | Croatia        | 100              | Transfer of electricity   |
| HEP-Operator distribucijskog sustava d.o.o.  | Croatia        | 100              | Distribution of electricity                                     |
| HEP ELEKTRA d.o.o.                           | Croatia        | 100              | Supply of electricity   |
| HEP-Opskrba d.o.o.                           | Croatia        | 100              | Supply of electricity   |
| HEP-Toplinarstvo d.o.o.                      | Croatia        | 100              | Production and distribution of heating                          |
| HEP-Plin d.o.o.                              | Croatia        | 100              | Gas distribution  |
| HEP ESCO d.o.o.                              | Croatia        | 100              | Financing energy efficiency projects                            |
| Plomin Holding d.o.o.                        | Croatia        | 100              | Development of Ploming and surrounding infrastructure           |
| CS Buško Blato d.o.o.                        | BiH            | 100              | Hydro power plant equipment maintenance                         |
| HEP-Upravljanje imovinom d.o.o.              | Croatia        | 100              | Hospitality services  |
| HEP NOC Velika                               | Croatia        | 100              | Accommodation and education services                            |
| HEP-Trgovina d.o.o.                          | Croatia        | 100              | Trading in electricity and optimising plant operations          |
| HEP Energija d.o.o. Ljubljana                | Slovenia       | 100              | Trading in electricity  |
| HEP Energija d.o.o.                          | BIH            | 100              | Trading in electricity  |
| HEP Energija sh.p.k.                         | Kosovo         | 100              | Trading in electricity  |
| HEP Energija d.o.o.                          | Serbia         | 100              | Trading in electricity  |
| HEP-Telekomunikacije d.o.o.                  | Croatia        | 100              | Telecommunications  |
| HEP-VHS Zaprešić d.o.o.                      | Croatia        | 100              | Design and construction of multi-purpose hydro technical system |
| Nuklearna elektrana Krško d.o.o.             | Slovenia       | 50               | Production of electricity                                       |
| LNG Hrvatska d.o.o.                          | Croatia        | 50               | Liquefied gas operations  |

Most of these subsidiaries were established under the reorganization and restructuring of core business under the new energy laws that entered into force on 1 January 2002 (Note 1).

Company HEP-Telekomunikacije d.o.o. was founded in 2013. HEP-RVNP d.o.o. in 2014 changed its name to Sava d.o.o. program, and on 31 December 2018 was merged to the Company. In 2014 HEP Opskrba plinom d.o.o. was founded and on 31 December 2018 merged to HEP-Trgovina d.o.o.

Liquidation process of the company Hrvatski centar za čistiju proizvodnju (The Croatian Cleaner Production Centre) started on 9 November 2017 and it was liquidated on 7 March 2019.

HEP-Magyarország Energia Kft. was removed from the court registry on 22 March 2018.

In 2018 Program Sava d.o.o. founded HEP-VHS Zaprešić d.o.o., and on 31 December 2018 HEP-VHS Zaprešić d.o.o. was sold to HEP-Proizvodnja d.o.o.

**37. FINANCIAL RISK MANAGEMENT*****Capital risk management***

The Group manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.

The capital structure of the Group consists of debt, which includes loans and issued bonds disclosed in the Notes 25 and 26, cash and cash equivalents and equity attributable to owners of the parent, comprising of share capital, legal and other reserves and retained earnings.

***Gearing ratio***

The Management monitors and reviews the equity structure on a semi-annual basis. As part of this review, the Management considers the cost of equity and the risks associated with each class of equity. The gearing ratio at the year-end can be presented as follows:

|                           | <b>31 Dec 2018</b><br>in '000 HRK | <b>31 Dec 2017</b><br>in '000 HRK |
|---------------------------|-----------------------------------|-----------------------------------|
| Debt                      | 3,896,304                         | 4,270,205                         |
| Cash and cash equivalents | (2,955,325)                       | (2,017,095)                       |
| Net debt                  | 940,979                           | 2,253,110                         |
| Equity                    | 24,369,398                        | 25,996,026                        |
| Net debt to equity ratio  | <b>4%</b>                         | <b>9%</b>                         |

***Significant accounting policies***

Details on significant accounting policies and methods adopted, including criteria for recognition and basis for measurement of each class of financial assets, financial liabilities and equity instruments are disclosed in the Note 2 to the consolidated financial statements.

## Notes to the consolidated financial statements (continued)

For the year ended 31 December 2018

### 37. FINANCIAL RISK MANAGEMENT (continued)

#### Categories of financial instruments

|   | 31 Dec 2018<br>in '000 HRK | 31 Dec 2017<br>in '000 HRK |
|---|----------------------------|----------------------------|
| <b>Financial assets</b>   |                            |                            |
| Financial assets available-for-sale                                     | -                          | 283,578                    |
| Financial assets at fair value through other comprehensive income       | 197,307                    | -                          |
| Loans and borrowings (including cash and cash equivalents)              | 5,429,653                  | 4,525,801                  |
| Other non-current assets  | 60,935                     | 73,402                     |
| <b>Financial liabilities</b>  |                            |                            |
| Financial liabilities at fair value through statement of profit or loss | 307,255                    | 505,228                    |
| Non-current liabilities   | 4,581,178                  | 4,641,233                  |
| Other current liabilities   | 2,179,059                  | 2,078,873                  |

#### Financial risk management objectives

The HEP Group's Treasury function provides services to the business, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Group through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

#### Market risk

Market risk exposure is monitored and managed through sensitivity analysis. There have been no changes in the Group's exposure to market risks or in the manner in which the Group manages and measures the risk.

#### Foreign currency risk management

The Group undertakes certain transactions denominated in foreign currencies and thus the Group is exposed to foreign currency risk. Foreign currency risk exposure is managed within approved policy parameters utilizing cross currency swap contracts. The carrying amounts of the Group's foreign currency denominated monetary assets and liabilities at the reporting date are as follows:

|                      | Assets                   |                          | Liabilities              |                          |
|----------------------|--------------------------|--------------------------|--------------------------|--------------------------|
|                      | 31 Dec 2018<br>(in '000) | 31 Dec 2017<br>(in '000) | 31 Dec 2018<br>(in '000) | 31 Dec 2017<br>(in '000) |
| European Union (EUR) | 167,563                  | 252,468                  | 542,978                  | 678,756                  |
| USD                  | 1,181                    | 9,590                    | 122,084                  | 122,572                  |



**37. FINANCIAL RISK MANAGEMENT (continued)*****Foreign currency sensitivity analysis***

The Group is mainly exposed to the changes of EUR and USD currency. The following table details the Group's sensitivity to a 10% increase and decrease in the Croatian Kuna against the EUR and USD. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents Management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes foreign currency denominated receivables and liabilities and adjustments of their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans where the denomination of the loan is in a currency other than the currency of the lender or the borrower. A positive / negative number below indicates an increase in profit and other equity components where HRK strengthens 10% against the relevant currency. For a 10% weakening of the HRK against the relevant currency, there would be an equal effect, but the balance would be negative.

|                          | <b>2018</b><br><b>in '000</b><br><b>HRK</b> | <b>2017</b><br><b>in '000</b><br><b>HRK</b> |
|--------------------------|---|---|
| <b>EUR change effect</b> |   |   |
| Gain or loss             | 278,463                                     | 320,298                                     |
| <b>USD change effect</b> |   |   |
| Gain or loss             | 78,214                                      | 70,836                                      |

***Interest rate risk management***

The Group is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The Group's exposure to interest rates on financial assets and financial liabilities is explained in the *Liquidity risk management* section. The Group manages this risk by maintaining an appropriate mix between fixed and floating interest rate in its loan portfolio.

***Interest rate sensitivity analysis***

An analysis of the effect of interest rate changes has been made for the financial instruments for which the Group is exposed to interest rate risk on the consolidated balance sheet date. For variable interest rates, the analysis was made on the assumption that the outstanding amount of the liability at the date of the consolidated balance sheet was unavailable for the entire year. The 50-base rate change is used for internal reporting to the Management and represents the Management's estimate of reasonably possible interest rate changes.

### **37. FINANCIAL RISK MANAGEMENT (continued)**

#### ***Interest rate sensitivity analysis (continued)***

If interest rates had been 50 basis points higher/lower and all other variables were held constant:

- The Group's profit for the year ended 31 December 2018 would decrease by HRK 441 thousand (2017: HRK 1,918 thousand) based on exposure to interest rate risk. This is mainly attributable to the Group's exposure to interest rates on its floating interest rate loans representing 3.18% of all interest-bearing loans (2017: 10.30%); and
- the Group's sensitivity to interest rates decreased during the current period due to the reduced share of borrowings contracted at variable interest rates in total debt and due to low reference interest rates on the market.

#### ***Credit risk management***

Credit risk refers to the risk that counterparty will fail to meet its contractual obligations resulting in financial loss to the Group. The Group is the largest provider of electric energy in the Republic of Croatia. As such, it has public responsibility to provide services to all customers, and at all locations within the country, irrespective of credit risk associated with particular customer. Net trade receivables; consist of a large number of customers, spread across diverse industries and geographical areas.

The Group does not have any significant credit risk exposure to any single customer or any group of customers having similar characteristics. The Group defines customers as having similar characteristics if they are related entities. Credit risk with respect to trade receivables is primarily related to corporate receivables, specifically those companies that are in difficult financial position. Overdue receivables from households are limited due to Group's ability to disconnect such customers from the power supply network.

Carrying amount of financial assets presented in the unconsolidated financial statements, less losses arising from impairment, represents the Group's maximum exposure to credit risk without taking into account the value.

#### ***Liquidity risk management***

Ultimate responsibility for liquidity risk management rests with the Management Board, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate reserves, loans from banks, and other sources of financing, and by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

#### ***Liquidity and interest rate risk tables***

The following table details the remaining period to contractual maturity for the Group's non-derivative financial assets. The tables below have been drawn up based on the undiscounted cash flows of the financial assets, including interest to be earned on those assets except where the Group anticipates that the cash flow will occur in a different period.

### 37. FINANCIAL RISK MANAGEMENT (continued)

#### *Maturity of non-derivative financial assets*

|                    | Weighted<br>average<br>effective<br>interest rate | Less than<br>1 month | 1 - 3<br>months | 3 -12<br>months | 1 - 5<br>years | Over 5<br>years | Total            |
|--------------------|---|----------------------|-----------------|-----------------|----------------|-----------------|------------------|
|                    |   | in '000<br>HRK       | in '000<br>HRK  | in '000<br>HRK  | in '000<br>HRK | in '000<br>HRK  | in '000<br>HRK   |
| <b>31 Dec 2018</b> |   |                      |                 |                 |                |                 |                  |
| Interest free      |   | 4,853,005            | 584,078         | 140,371         | 97,547         | 616             | 5,675,617        |
| Floating interest  |   |                      |                 |                 |                |                 |                  |
| Fixed interest     | 0.77%   | -                    | -               | -               | 41,887         | -               | 41,887           |
| <b>Total</b>       |   | <b>4,853,005</b>     | <b>584,078</b>  | <b>140,371</b>  | <b>139,434</b> | <b>616</b>      | <b>5,717,504</b> |
| <b>31 Dec 2017</b> |   |                      |                 |                 |                |                 |                  |
| Interest free      |   | 4,069,586            | 514,463         | 123,992         | 111,298        | -               | 4,819,339        |
| Floating interest  | 0.72%   | 25,772               | -               | -               | 44,685         | -               | 70,457           |
| Fixed interest     |   | -                    | -               | -               | -              | -               | -                |
| <b>Total</b>       |   | <b>4,095,358</b>     | <b>514,463</b>  | <b>123,992</b>  | <b>155,983</b> | <b>-</b>        | <b>4,889,796</b> |

**37. FINANCIAL RISK MANAGEMENT (continued)****Liquidity risk management****Maturity of non-derivative financial liabilities**

The following table details the remaining contractual maturity of the Group for non-derivative financial liabilities. The table is made on the basis of undiscounted cash flows on the basis of the earliest date that the Group may be required to pay.

|                    | Weighted<br>average<br>effective<br>interest<br>rate | Less than 1<br>month | 1 - 3<br>months | 3 -12<br>months | 1 - 5<br>years   | Over 5<br>years | Total            |
|--------------------|--|----------------------|-----------------|-----------------|------------------|-----------------|------------------|
|                    | %  | in '000<br>HRK       | in '000<br>HRK  | in '000<br>HRK  | in '000<br>HRK   | in '000<br>HRK  | in '000<br>HRK   |
| <b>31 Dec 2018</b> |  |                      |                 |                 |                  |                 |                  |
| Interest free      |  | 1,338,102            | 657,107         | 112,528         | 1,099,341        | -               | 3,207,078        |
| Floating interest  | 1.02%  | 51                   | 19,127          | 57,462          | 16,931           | 35,414          | 128,985          |
| Fixed interest     | 4.63%  | 369                  | 614             | 214,754         | 4,240,200        | 24,089          | 4,480,026        |
| <b>Total</b>       |  | <b>1,338,522</b>     | <b>676,848</b>  | <b>384,744</b>  | <b>5,356,472</b> | <b>59,503</b>   | <b>7,816,089</b> |
| <b>31 Dec 2017</b> |  |                      |                 |                 |                  |                 |                  |
| Interest free      |  | 1,077,182            | 531,957         | 109,911         | 1,271,673        | -               | 2,990,723        |
| Floating interest  | 1.95%  | 68,432               | 28,762          | 278,727         | 77,506           | -               | 453,427          |
| Fixed interest     | 4.60%  | 311                  | 622             | 217,356         | 4,511,748        | 36,756          | 4,766,793        |
| <b>Total</b>       |  | <b>1,145,925</b>     | <b>561,341</b>  | <b>605,994</b>  | <b>5,860,927</b> | <b>36,756</b>   | <b>8,210,943</b> |

The Group has access to sources of financing. The total unused amount at the end of the reporting period was HRK 1,792,344 thousand. The Group expects to meet its other obligations from operating cash flows and proceeds from matured financial assets.

**Fair value of financial instruments**

The fair values of financial assets and financial liabilities are determined as follows:

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices.
- The fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

### 37. FINANCIAL RISK MANAGEMENT (continued)

#### *Fair value of financial instruments (continued)*

- Fair value of derivative instruments is calculated using the listed price. Where such prices are not available, the analysis uses discounted cash flows by applying the current yield curve for the period of non-derivative instruments.

#### *Fair value measurements recognized in the statement of financial position*

The table below analyses the financial instruments subsequently measured at fair value, classified within 3 groups according to IFRS 13:

1. Level 1 inputs – inputs are quoted prices in active market for identical assets or liabilities that the entity can access at the measurement date
2. Level 2 inputs – are inputs other than quoted market prices included within Level 1, that are observable for the asset or liability either directly (i.e. their prices) or indirectly (i.e. derived from prices), and
3. Level 3 inputs – Indicators derived using valuation methods in which asset data or liabilities that are not based on available market data (unavailable input data) are used as input data.

The measurement of fair value of cross currency swap is tied to the Mark-to-market value ("MTM") according to the calculation from the banks and the change in fair value in subsequent period is recognized through profit or loss.

The fair value levels recognized in the consolidated statement of financial position:

|   | Level 1<br>in '000 HRK | Level 2<br>in '000<br>HRK | Level 3<br>in '000<br>HRK | Total<br>in '000 HRK |
|---|------------------------|---------------------------|---------------------------|----------------------|
| <b>31 December 2018</b>   |                        |                           |                           |                      |
| Financial assets at fair value through other comprehensive income | 197,307                | -                         | -                         | <b>197,307</b>       |
| Derivative financial liabilities                                  | -                      | -                         | 307,255                   | <b>307,255</b>       |
| Investment property   | -                      | 303,726                   | -                         | <b>303,726</b>       |
| <b>31 December 2017</b>   |                        |                           |                           |                      |
| Financial assets available for sale                               | 283,678                | -                         | -                         | <b>283,678</b>       |
| Derivative financial liabilities                                  | -                      | -                         | 505,228                   | <b>505,228</b>       |
| Investment property   | -                      | 305,630                   | -                         | <b>305,630</b>       |

### 38. OTHER DISCLOSURES

The auditors of the Group's financial statements provided services in the amount of HRK 644 thousand in 2018 (in 2017: HRK 730 thousand). Services in 2018 and 2017 mainly relate to audit costs, review of condensed interim financial information and audits of financial reports prepared for regulatory purposes.

Fees for tax consultancy amounted to HRK 142 thousand in 2018 (2017: HRK 134 thousand).

### 39. APPROVAL OF THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS

These consolidated financial statements were approved by the Management Board and authorized for publication on 30 April 2019.

Signed for and on behalf of the Management Board on 30 April 2019:



Marko Čosić  
Member



Nikola Rukavina  
Member



Petar Sprčić  
Member



Tomislav Šambić  
Member



Saša Dujmić  
Member



Frane Barbarić  
President

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