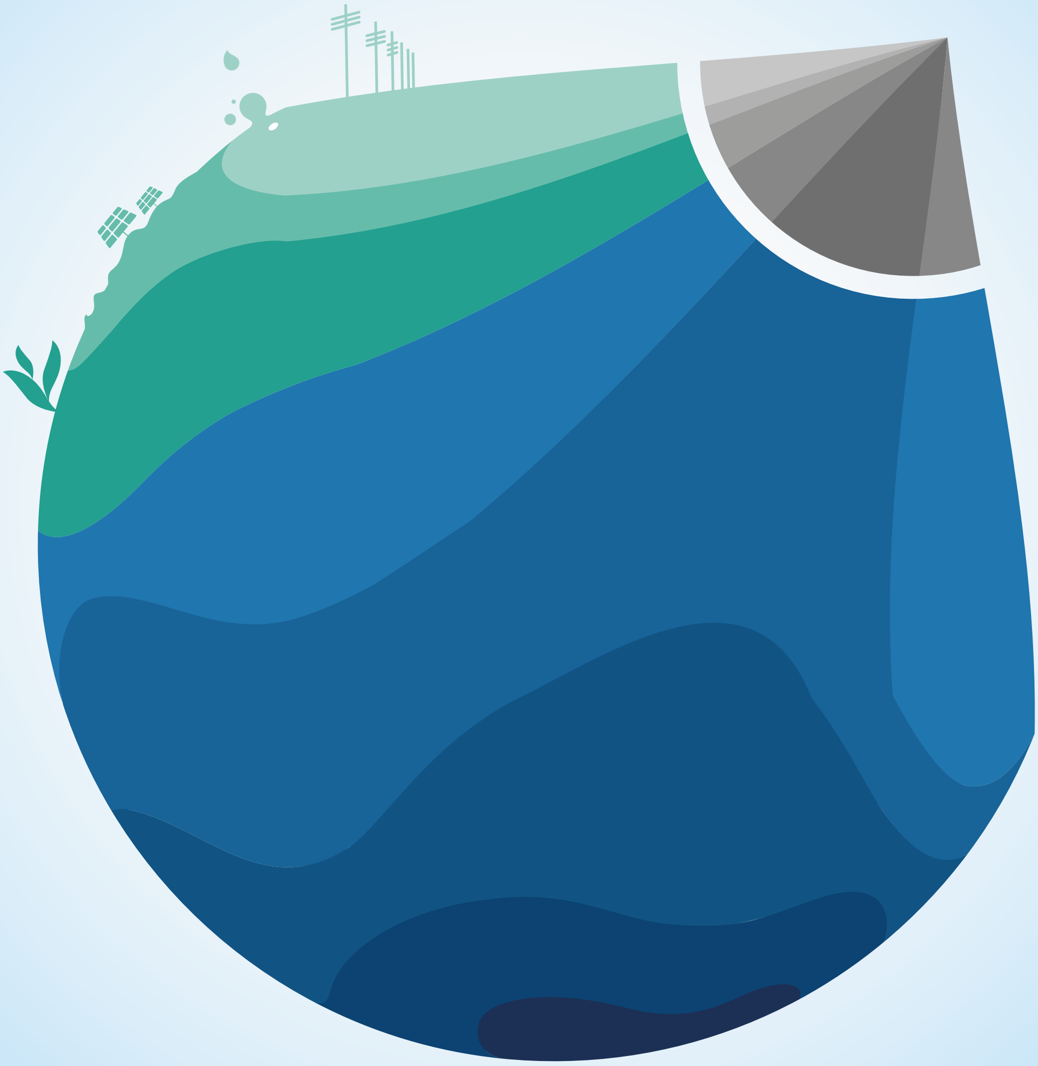
Annual Report

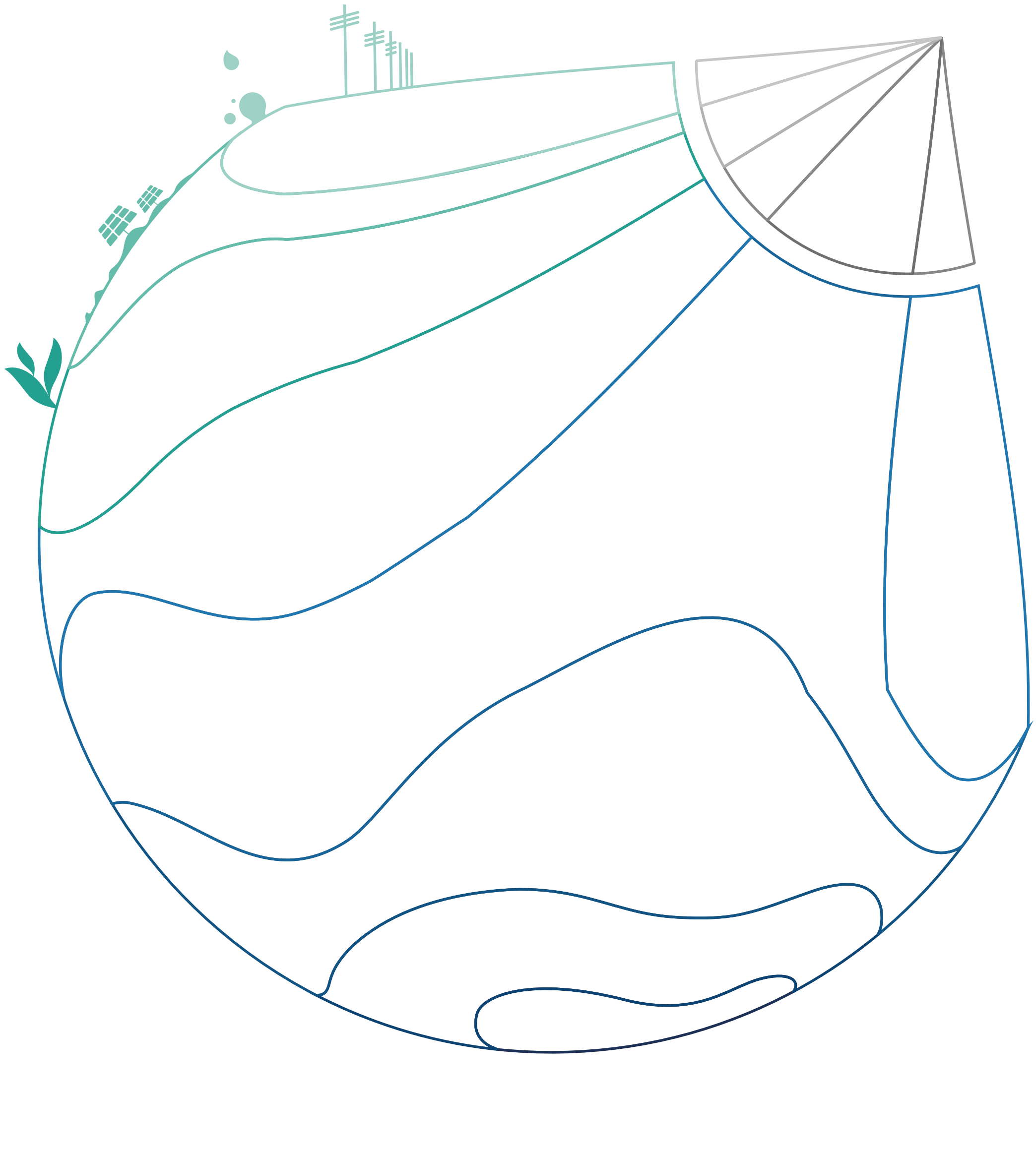
2016



HEP

Annual Report

2016



HEP GROUP 2016

KEY DATA

GENERATION FACILITIES, TRANSMISSION AND DISTRIBUTION NETWORK

26 HPPs

installed capacity
2,094 MW

excluding HPP Dubrovnik Unit B which generates electricity for Bosnia and Herzegovina

8 TPPs and 50% NPP Krško

installed capacity
2,270 MW

171

high voltage substations (400-200-110 kV)

25,614

medium and low voltage substations (35-20-10 kV)

7,759 km

of high voltage lines (overhead and cables)

including 110 kV overhead lines, which are currently operating on medium voltage (104 km in total)

136,732 km

of medium and low voltage lines (overhead and cables)

HEP GROUP 2016

KEY DATA

BASIC INDICATORS

Electricity production

2016

12.5 TWh

2015	11.5 TWh
2014	14.3 TWh

2016/2015 (%)

+ 8.5%

Sale of electricity

2016

16.8 TWh

2015	14.9 TWh
2014	15.2 TWh

2016/2015 (%)

+ 13.0%

* in Croatia and abroad

Heat sales

2016

1.9 TWh

2015	1.9 TWh
2014	1.9 TWh

2016/2015 (%)

+ 0.6%

Gas wholesale

2016

6.3 TWh

2015	6.1 TWh
2014	3.0 TWh

2016/2015 (%)

+ 4.2%

* gas wholesale launched in April 2014

Gas retail

2016

1.3 TWh

2015	1.2 TWh
2014	1.1 TWh

2016/2015 (%)

+ 9.5%

Operating income

2016/2015 (%) − 1.2%

2016

14,400.4 HRK m

2015 14,569.5 HRK m

2014 13,599.2 HRK m

HEP Group's net profit

2016

2,045.0 HRK m

2015 1,940.1 HRK m

2014 2,465.4 HRK m

2016/2015 (%) + 5.4%

EBITDA

2016

4,617.5 HRK m

2015 4,508.1 HRK m

2014 5,378.9 HRK m

2016/2015 (%) + 2.4%

Total assets

2016

39,232.9 HRK m

2015 38,211.4 HRK m

2014 35,856.7 HRK m

2016/2015 (%) + 2.7%

Investments

2016

2,589.1 HRK m

2015 2,528.1 HRK m

2014 2,063.7 HRK m

2016/2015 (%) + 2.4%

No. of employees

2016

11,832

2015 11,935

2014 12,061

2016/2015 (%) − 0.9%

CONTENTS

4

5

6

CHAIRMAN'S REPORT

Nikola Bruketa
Chairman of the Supervisory Board

During fiscal year 2016, the Supervisory Board held 10 meetings, of which two electronic, in the period between two Annual General Meetings of Shareholders.

The Supervisory Board adopted the proposal submitted by the Management Board of HEP d.d. on appointing BDP Croatia d.o.o. the auditor of Hrvatska elektroprivreda d.d. and its dependant companies in the fiscal year 2016.

During two meetings of the Audit Committee of Hrvatska elektroprivreda d.d., which also participated in the supervision of Company operations, numerous issues, in particular those regarding Company's financial statements, audit findings and the activities of external auditor were discussed as well as the report on the work conducted by the Department of Internal Audit and Risk Management of HEP d.d. in 2016.

The Supervisory Board supervised the conduct of Company affairs and carried out other work-related activities pursuant to the Companies Act, the Articles of Association of the Company and the Rules of Procedure of the Supervisory Board. It discussed and accepted information provided by the Management Board concerning the overall conditions in the Company, its business policy and relations with related companies, decisions significantly affecting the position of the Company, as well as general matters of the Company's future management. It also accepted the reports on the Company's business operations submitted during the business year and gave all necessary consents to decisions adopted by the Management Board pursuant to Article 27 of the Articles of Association of Hrvatska elektroprivreda d.d.

The Supervisory Board analysed the achievement of planned results and the implementation of core objectives set under the Company's business policy for 2016. It also took active participation in the supervision of the delivery of strategically important issues for HEP Group.

At the proposal of the Company's Management Board, the Supervisory Board gave its consent to the Consolidated Economic Plan and the Investment Plan of HEP Group for 2017. It also provided adequate prior consents to a number of decisions proposed by the Management Board of HEP d.d.

The active role undertaken by the Supervisory Board in 2016 in the execution of the restructuring process of HEP-Operator distribucijskog sustava d.o.o. (distribution system operator) must be pointed out. The SB received regular reports from the Management Board of HEP d.d., expressed its opinions and provided recommendations to the Management Board focusing on the improvement of operating efficiency and future strategic determinants of HEP Group in view of new circumstances emerging on the electricity market and taking an equal part in market competition.

By receiving regular reports and information from the Management Board of the Company, the Supervisory Board was continuously participating and monitoring the activities regarding HEP Group's capital investment projects, annual investment plans and documents under which the strategic framework for investments was set.

Apart from the regular reports submitted by the Management Board of HEP d.d. on operating performance and the business environment, the Supervisory Board also carried out in-depth discussions regarding other topics of current interest for HEP Group, especially the status of HEP Group's IT security; development and content of the HEP 2030 strategic document; delivery of the 2016 Investment Plan; notification process for TPP Plomin C; status of LNG Croatia, operation of the Internal Audit Department of HEP d.d; long term strategy of HEP Group's HR development for the period 2017-2026; revitalization of HPP Zakučac; development of windfarm projects in the Republic of Croatia of HEP Group's business interest; Business Cooperation Agreement with JP Elektroprivreda HZ HB d.d. Mostar; cabel procurement process for HEP-ODS d.o.o.; operating launch of HEP Elektra d.o.o.; status of the overall business relations and HEP's receivables in the neighbouring countries; securing additional funds for financing electricity purchase from RES; plan for reducing electricity losses in distribution; review and assessment of the organization of HEP Group's corporate relations and business operations pursuant to contracts and norms; continuing construction of the combined-cycle power plant at the site of EL-TO Zagreb CCPP; and ensuring finances for the implementation of energy efficiency projects under the ESCO model.

The review of business and financial reports found that Hrvatska elektroprivreda as a joint stock company and the Group of its subsidiaries had been conducting their affairs pursuant to the provisions of the Companies Act, Articles of Association, decisions of the Shareholders Assembly and the internal rules and regulations of the Company.

The annual financial reports were drafted in line with the balance existing in the Company books, showing accurate property-related and operating state of affairs of the Company.

The Supervisory Board expressed no objections to the auditor's report on examining Company's annual financial statements and HEP Group's consolidated financial statements for 2016.

Chairman of the Supervisory Board
Nikola Bruketa

PRESIDENT'S REPORT

Perica Jukić, M.Sc.
President of the Management Board

HEP Group fully completed its mission of safe, quality and reliable energy supply in 2016 achieving for the third consecutive year an exceptionally good business result of HRK 2 billion.

Our own generation facilities produced 12.5 TWh of electricity. A good availability of power plants, transmission and distribution network was achieved with no significant disturbances in electricity, heat energy and gas supply.

In the exceptionally demanding and volatile environment, the Management Board focused on achieving a flexible energy portfolio, business optimization and development, sustainable market flexibility and active stakeholder cooperation.

With the aim of retaining a dominant share on the Croatian electricity market, HEP carried out intensive measures for further improvement of its services in 2016 as well as for developing and offering innovative products adapted to customer requirements. It also continued with a number of other activities in line with the sustainable development and corporate responsibility norms. The share acquired on the Croatian market levelled off at 85 percent, while a further step in the supply of large customers was made on the Slovenian market having obtained a 12.5% share in the sale to commercial customers in early 2017. Business expansion activities continued throughout the region including the supply to its first customers in Serbia and Bosnia and Herzegovina.

A further opening of the domestic electricity market and a number of legal and regulatory changes affecting HEP Group's operations significantly conditioned and additionally accelerated the harmonization of our business system and the redefinition of business objectives. The Croatian Transmission System Operator successfully completed the procedure for obtaining the independent electricity transmission operator certificate in late February. The restructuring programme of HEP Distribution System Operator (HEP ODS) was developed with the aim of improving the business strategy, organization and the business model as well as its business processes. Its implementation is planned for 2017. Supply was unbundled from other HEP DSO activities in early November, thus complying to the legal obligation of separating network and supply.

Its active and thoughtful liquidity management was confirmed by Standard & Poor's, which upgraded HEP's stand-alone corporate rating from b+ to bb, as well as its overall rating from BB- to BB thus reaching Croatia's sovereign rating. According to the agency, at this point of time HEP's rating cannot be higher than the sovereign one. The positive assessment is a direct result of active corporate management of the company's financial position and the overall business operations of HEP Group. Thanks to the upgrade, HEP has been recognized as a stable company with the strategic investment plan as well as the possibilities of business growth and expansion in times which proved challenging for the energy sector across Europe. Furthermore, as the outlook on the sovereign rating was upgraded in December 2016, the agency affirmed the long-term credit rating on HEP (BB) and revised the outlook from negative to stable. HEP Group has been trying to meet the requirements of the energy sector development in the Republic of Croatia through its long-term investment cycle by accepting new circumstances such as the increasing presence of other open market participants, especially in electricity supply and electricity production from renewable energy sources. HEP has placed a major focus on the development of its RES portfolio. Several projects of hydropower plant reconstruction and revitalization continued in 2016. The construction of two wood biomass-fired cogeneration facilities in Sisak and Osijek is soon to be completed. The combined cycle cogeneration gas-fired unit in TE-TO Sisak was put into trial operation, and the construction of the highly-efficient gas-fired EL-TO Zagreb CCPP is being prepared. All thermal power facilities in the HEP's portfolio were issued environmental permits until end 2016.

The eMobility project really took off in 2016 including the installation of a total of 28 charging stations in several towns and cities across Croatia until the year end. Parallelly, due to the cross-border cooperation with the EU countries and the EU co-funding, the construction of the charging station network along Croatia's busiest roads and motorways is planned. Apart from electromobility, HEP was also successful in applying for co-funding grants in cooperation with domestic and foreign partners for several EU projects (SUNSHINE, A2PBEER, 3Smart, TEESCHOOLS), primarily in energy efficiency measure implementation.

In 2016, HEP first issued the 2013-2014 pilot sustainability report, which was followed by the 2015 report. It is therefore one of the first state-owned Croatian companies which has prepared for the implementation of the non-financial reporting directive.

Successful and proactive business operations as well as its respectable results achieved in 2016 represent a solid basis for HEP's development as a modern and efficient company comparable to its European counterparts and ready to respond to future challenges.

Our tradition of performing energy activities is more than a century old. As a strong and integral energy company, competitively present on the regional market, we will continue to ensure a sufficient and reliable energy supply to Croatian citizens and its economy adhering to the principles of environmentally friendly generation and energy efficiency.

President of the Management Board
Perica Jukić, M.Sc.

85%

The implementation of a number of activites focused on improving the customer relation, continuous adjustment to market requirements and marketing campaigns aimed at strengthening the HEP brand resulted in levelling the market share in electricity supply of domestic customers at about 85%.

1

Company Profile

Mission and vision, core values and strategic goals

Mission

To provide secure and quality energy supply to customers, with a high degree of social responsibility.

Vision

HEP Group as a strong regional, modern and socially responsible company, recognized as an example of efficient energy generation and supply to customers.

Core values

Competence and creativity

Our employees are the most valuable resource and support in achieving the company's mission and vision and in creating values for the company. With openness to new ideas and creativity, we develop skills and competencies.

Quality and business excellence

Following requirements and expectations of all stakeholders, we improve the quality of our products and services. Our goal is the company's business excellence.

Integrity

We act professionally and conscientiously in our relations towards customers, business partners, employees and assets. We affirm zero-tolerance for corruption. Our Code of Ethics defines the principles of business behavior.

Environmental responsibility

We produce, transmit and distribute energy in an environmentally friendly manner. We promote the efficient use of energy among our customers as well as the development and use of renewable energy sources.

Strategic goals

Sustainable and flexible energy portfolio

by investing into hydropower plants and other renewable energy sources, focusing on the construction of highly-efficient cogeneration projects; ownership of diverse electricity sources which become operational depending on the market availability and the prices of energy fuels thus providing sustainability and flexibility.

Optimization and improvement of business processes

by continuously upgrading employee competencies and innovativeness, efficiently managing knowledge at corporate level and optimizing business processes.

Market flexibility

by defining and creating new products and services across wholesale and retail market segments focusing on retaining the current share of the Croatian market and increasing the share in the regional market as well as implementing smart networks with an emphasis on network development, automation, smart network control and operation.

Cooperation with stakeholders

by timely and active participation in the development and the adoption of EU and national legal instruments, and in the process of creating the new energy market.

Company Profile

HEP GROUP COMPANIES

HEP Group consists of Hrvatska elektroprivreda d.d. as the parent company and its subsidiaries.

Dependent companies	Country	Ownership share (%)	Core activity
HEP-Proizvodnja d.o.o.	Croatia	100	Production of electricity and heat
Hrvatski operator prijenosnog sustava d.o.o.[1]	Croatia	100	Electricity transmission
HEP - Operator distribucijskog sustava d.o.o.	Croatia	100	Electricity distribution
HEP ELEKTRA d.o.o.[2]	Croatia	100	Electricity supply of customers as public service
HEP-Opskrba d.o.o.	Croatia	100	Electricity supply
HEP-TOPLINARSTVO d.o.o.	Croatia	100	Heat production and distribution
HEP-Trgovina d.o.o.	Croatia	100	Electricity trade and optimization of power plants' operations
HEP-PLIN d.o.o.	Croatia	100	Gas distribution and supply
TE Plomin d.o.o.	Croatia	100	Electricity generation
HEP-ESCO d.o.o.	Croatia	100	Implementation and funding of energy efficiency projects
Plomin Holding d.o.o.	Croatia	100	Development of local infrastructure in the vicinity of Plomin TPP
CS Buško Blato d.o.o.	Bosnia and Herzegovina	100	Hydro equipment maintenance
HEP - Upravljanje imovinom d.o.o.	Croatia	100	Management of non-operating assets and tourism
HEP NOC	Croatia	100	Training, professional improvement and accommodation
Program Sava d.o.o.	Croatia	100	Preparation of multipurpose real estate projects
HEP Trade d.o.o., Beograd	Serbia	100	Electricity trading
HEP Energija d.o.o., Ljubljana	Slovenia	100	Electricity trading
HEP Trade d.o.o., Mostar	Bosnia and Herzegovina	100	Electricity trading
HEP Magyarorszag Energia kft	Hungary	100	Electricity trading
HEP KS sh.p.k., Priština	Kosovo	100	Electricity trading
HEP Telekomunikacije d.o.o.	Croatia	100	Telecommunication services
HEP Opskrba plinom d.o.o.	Croatia	100	Wholesale gas market supply
The Croatian Cleaner Production Center	Croatia	100	Institution for the promotion of cleaner production
Nuklearna elektrana Krško d.o.o.[3]	Slovenia	50	Electricity generation
LNG Hrvatska d.o.o.[4]	Croatia	50	Gas pipeline construction and operation
Novenerg d.o.o.[5]	Croatia	50	Analysis of investing into capacities for producing electricity from RES and consulting services

[1] As of 1 July 2013, it operates under the Independent Transmission Operator model (ITO)

[2] Pursuant to the provisions of the Electricity Market Act on unbundling the network and supply, HEP Elektra was founded on 2 November 2016 by unbundling supply from HEP-Operator distribucijskog sustava d.o.o.

[3] In consolidated financial statements, the share in NE Krško d.o.o. is shown by a the method of joint asset and liabilities management, the HEP Group's share is shown for each asset and liability across income and expenditure.

[4] The joint venture with Plinacro d.o.o. (50%:50%) on the construction and the operation of gas pipelines for evacuating liquified natural gas from the island of Krk to mainland and on towards its final destinations.

[5] Joint venture with RWE Hrvatska d.o.o. (50%:50%)

HEP d.d.

Subsidiary companies wholly owned by HEP d.d.

HEP-Proizvodnja d.o.o. → CS Buško blato d.o.o. BiH

HEP-Operator distribucijskog sustava d.o.o. → Ustanova HEP Nastavno-obrazovni centar

HEP-Opskrba d.o.o.

HEP-Trgovina d.o.o. → HEP-TRADE d.o.o., Beograd; HEP-Energija d.o.o., Ljubljana; HEP-Trade d.o.o., Mostar; HEP-Magyarország Energia kft; HEP-KS sh.p.k., Priština

HEP-Toplinarstvo d.o.o.

HEP-Plin d.o.o.

HEP-Opskrba plinom d.o.o.

HEP ESCO d.o.o.

TE Plomin d.o.o.

HEP-Upravljanje imovinom d.o.o.

HEP-Telekomunikacije d.o.o.

Plomin Holding d.o.o.

Program Sava d.o.o.

The Croatian Cleaner Production Center

Companies in mixed ownership

LNG Hrvatska d.o.o.
co-owned by HEP d.d. and Plinacro d.o.o. (50%-50%)

NE Krško d.o.o.
co-owned by HEP d.d. and GEN Energija (50%-50%)

Novenerg d.o.o.
co-owned by HEP d.d. and RWE Hrvatska (50%-50%)

Independent Transmission Operator

Hrvatski operator prijenosnog sustava d.o.o. (HOPS)

LEGAL FRAMEWORK

EUROPEAN LEGAL FRAMEWORK

The energy-related national legislative framework as well as its secondary legislation are based on the European legal framework. As a full EU member, Croatia accepted the obligation of fully transposing the so-called 2009 'Third Energy Package' into its national legislature as well as a number of other regulations significantly affecting business operations of energy companies. As this is an ongoing process, the EU adopted the following regulations in 2016:

- Commission Regulation (EU) 2016/631 of 14 April 2016 establishing a network code on requirements for grid connection of generators
- Commission Regulation (EU) 2016/1719 of 26 September 2016 establishing a guideline on forward capacity allocation
- Commission Regulation (EU) 2016/1388 of 17 August 2016 establishing a Network Code on Demand Connection
- Commission Regulation (EU) 2016/1447 of 26 August 2016 establishing a network code on requirements for grid connection of high voltage direct current systems and direct current-connected power park modules

Following the European Commission Strategy and the EU public consultation conducted in 2015, during which HEP Group companies provided their opinion and proposals for the purpose of achieving a single European energy market with advanced climate policy, the European Commission introduced its package proposal titled 'Clean Energy for All Europeans' on 30 November 2016.

NATIONAL LEGAL FRAMEWORK

The legislative and regulatory framework of the energy sector in the Republic of Croatia is defined by the Energy Strategy of the Republic of Croatia (2009) and the core acts regulating the energy sector, in particular those resulting from the Third Energy Package.
The fundamental framework regulating the operation of HEP and its daughter companies by their energy performing business activities is based on the following acts:

- Energy Act
- Electricity Market Act
- Gas Market Act
- Heat Energy Market Act
- Regulation of Energy Activities Act
- Energy Efficiency Act
- RES and High Efficiency CHP Act
- Deployment of Alternative Fuels Infrastructure Act.

The Energy Act (OG 120/12, 14/14, 102/15) regulates the measures for safe energy supply and efficient energy generation and use. It also defines legal acts under which the energy policy and energy system planning is regulated as well as the performance of energy activities either as market-based or as public services while adhering to environmentally friendly and energy efficient measures.
RES and High Efficiency CHP Act (OG 100/2015, 123/16) regulates the planning and the promotion of the production and the consumption of electricity produced in generation facilities which use renewable energy sources and high efficiency cogeneration (RES CHP), sets measures for the promotion of electricity generation by using RES CHP, regulates the implementation of the system for the promotion of electricity generation from RES CHP, regulates issues regarding the construction of facilities for the generation of electricity from RES CHP on the state-owned land, regulates the management of the RES CHP registry for projects, lead partners and eligible producers of electricity from renewable energy sources and high efficiency cogeneration.
The use of RES CHP meets Croatia's energy interests, in particular in terms of fulfilling the national objective of using the energy produced from RES with regard to the RES share in the final energy consumption

in Croatia in 2020, a wider use of own natural energy resources, a long-term decrease of dependence on energy fuel import, efficient use of energy and reduced environmental impact of fossil fuels, opening new jobs and the development of entrepreneurship in energy and other business activities stimulated by energy project development and its results in the local community, fostering the development of new and innovative technologies and contributions to local community, diversification of energy production and the increase of the security of supply.
In late 2016, the Croatian Government adopted the Regulation on Amending the RES CHP Act under which the time frame set for launching the implementation of some provisions of the Act was postponed by one year. The supplier's obligation regarding the purchase of electricity from the electricity market operator which was supplied by eligible electricity producers at the regulated price of 0.42 HRK/kWh, proportional to the supplier's share on the Croatian electricity market, has been prolonged until 31 December 2017. The obligation set for launching the operation of the ECO Balance Group has also been postponed until 1 January 2018, as well as the implementation of the obligation on part of HROTE to sell electricity supplied by eligible producers on the electricity market in a transparent and unbiased manner pursuant to the Sale of Electricity Rules.
The Energy Efficiency Act (OG 127/2014) aims at achieving set energy savings objectives in the final energy demand, thus complying with the EU objective of a 20 percent lower consumption of primary energy until 2020. Under said Act, the efficient use of energy is regulated as well as the adoption of local, regional and national plans for improving energy efficiency and its implementation. Energy efficiency measures are set as well as energy efficiency obligations, responsibilities of the energy regulator, the transmission and distribution operator and of the energy market regarding energy transmission, transport and distribution, energy and/or water supply and in particular the activity of energy service, energy savings and user rights in energy efficiency implementation.
This Act aims at achieving objectives of sustainable energy development: reduced energy-caused adverse environmental effects, increased security of energy supply, meeting energy user needs as well as international obligations undertaken by Croatia for reducing greenhouse gas emissions by stimulating energy efficiency measures in all energy consumption areas.
The third national energy efficiency action plan contains the proposed energy efficiency sector measures, which implementation will result in meeting the objective of reduced final energy demand, as well as energy generation (transformation), transmission and distribution measures which aim at achieving primary energy savings and the revised energy consumption projection. The biggest savings are expected under the implementation of the programme for the renovation of buildings in the public, commercial and residential sectors launched by the Ministry of Construction and Physical Planning.

ELECTRICITY

The Electricity Market Act (OG 22/13, 102/15) regulates the rules and the measures for secure and reliable electricity generation, transmission, distribution and supply, electricity trade and the organization of the electricity market as part of the EU electric power market. Furthermore, it regulates the rules for end-customer protection, electric power system organization and operation, open market access, sets universal and guaranteed service obligations and electricity customer rights, network access rules, the principle of reciprocity and cross-border electricity transmission.
Under the Amendments to the Rules on Switching the Electricity Supplier, which come into effect in early 2017, the supplier to end-customer relation in terms of contracting has been simplified. The obligation of introducing the single bill for electricity supplied and the use of network for each metering point was set as of 1 January 2017. The universal service ceased to be regulated in 2016. Only guaranteed supplied continued to be performed under regulated terms and conditions.
Pursuant to the Regulation No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency and the implementation Regulation No 1348/2014 (so-called REMIT Regulation) of the European Commission, HEP Group companies are obligated to submit technical and commercial data to the Croatian Energy Regulatory Agency (HERA) and to the Croatian Competition Agency regarding all sale and purchase transactions carried out on the wholesale electricity market including derivatives. In line with the above, remit.hep.hr web page was set up in 2016, and the registration of HEP Group companies into the CEREMP application carried out.

Pursuant to the provisions of the Amendments to the Act, HEP Elektra d.o.o. was founded on 2 November 2016 under the status change of HEP Operator distribucijskog sustava d.o.o. (HEP ODS) aimed at unbundling electricity supply. HEP Elektra is the only energy entity authorized for the provision of the public service of electricity supply in Croatia i.e. it has the obligation to provide the public service of supply as the universal service for household customers and to provide the public service of supply carried out as guaranteed for other customers.

HEP Group companies were actively involved in public consultations during 2016 discussing secondary legislation proposals organized by the Ministry of Economy, HERA, the Croatian Energy Market Operator (HROTE), the Croatian Transmission System Operator (HOPS) and HEP ODS. As a result of the above-mentioned public consultations, the following documents have been adopted or amended:

- Deployment of Alternative Fuels Infrastructure Act (competent ministry)
- RES & CHP Act (to be adopted by competent ministry)
- Rules on Electricity Market Organization (HROTE)
- Rules on Balancing the Electric Power System (HOPS)
- Methodology for setting the ancillary service provision tariff (HOPS)
- Methodology for setting the tariff item amount for electricity transmission (HOPS)
- The pricelist of non-standard services provided by the distribution system operator (HEP ODS)
- Rules on the use of the electricity guarantees of origin register (HROTE)
- Decision on the tariff item amount for guaranteed supply of electricity (HERA)
- Rules for the implementation of standard load profile curves (HEP ODS)
- Methodology for setting the price of billing the balancing electricity (HERA)
- Estimated potential for increasing energy efficiency of electricity infrastructure (HERA)
- Decision on the method and the procedure of keeping unbundled accounting of energy entities (HERA)

Although public consultations were conducted in relation to several secondary legislation proposals, the following binding acts were not adopted until end 2016: RES and CHP Rules (to be adopted by competent ministry); Rules for ECO Balance Group Management (HROTE); Transmission System Grid Code (HOPS); Electricity Sale Rules (HROTE); Methodology for setting the electric power network connection fee and for increasing the connecting capacity (HERA); Rules on Electricity Supplier Switching (HERA); 2017-2026 Ten-Year Transmission Network Development Plan including a detailed elaboration for the initial three- and one-year periods (HOPS).

HEAT ENERGY

HEP-Toplinarstvo carries out heat energy production, distribution and supply and is the heat energy buyer pursuant to the following primary and secondary legislation:

- Heat Energy Market Act (OG 80/13, OG 14/14),
- General Terms and Conditions of Heat Energy Supply (OG 35/14),
- Heat Distribution Grid Code (OG 35/14),
- Methodology for setting the tariff item amounts for heat energy production (OG 56/14),
- Methodology for setting the tariff item amounts for heat energy distribution (OG 56/14),
- Rules on the method of cost distribution and billing for supplied heat energy (OG 99/14, OG 27/15, OG 124/15),
- Decision on the tariff item amounts for heat energy production for district heating systems in Zagreb, Osijek and Sisak, for HEP Proizvodnja d.o.o.;
- Decision on the tariff item amounts for heat energy distribution for district heating systems in Zagreb, Osijek and Sisak for HEP-Toplinarstvo d.o.o.;
- Decision on the tariff item amounts for heat energy production for district heating systems in Dubrava, Velika Gorica and Samobor for HEP-Toplinarstvo d.o.o.;
- Decision on the tariff item amounts for heat energy distribution for district heating systems in Dubrava, Velika Gorica and Samobor for HEP-Toplinarstvo d.o.o., (all decisions OG 105/14),

During last year, the following piece of secondary legislation was adopted – the Methodology for setting the heat distribution network connection fee and for increasing the connection capacity (OG 42/16), under which the structure of cost for setting the distribution network connection fee and for increasing the connection capacity is set consisting of the connection construction costs, preliminary and final works, and special creation of technical conditions in the distribution network.

GAS

The underlying acts regulating this business activity are the Energy Act (OG 120/12, 14/14, 95/15, 102/15) and the Energy Activity Regulation Act (OG 120/12). The establishment and the regulation of the gas market relations has been regulated under the Gas Market Act (OG 28/13, 14/14), the Gas Market Organization Rules (HROTE, 12/14), Gas Distribution System Rules (PLINACRO d.o.o., 1/15, 11/16), Rules of Use of the Gas Storage System (Podzemno skladište plina d.o.o, 12/14, 12/16), and General Terms and Conditions of Gas Supply (OG 158/13). The above has created assumptions for the full opening of the gas market in Croatia.

Apart from the aforementioned, the gas market relations in the Republic of Croatia have also been regulated under the following general acts and decisions:

- Gas Distribution System Code (Plinacro 11/2015, 11/2016),
- Methodology for setting tariff item amounts for the public service of gas supply and guaranteed supply (OG 38/14, 28/15, 25/16),
- Decision on the tariff item amount for the public service of gas supply for 2016 (OG 155/14 and 28/15, 137/15, 28/16),
- Methodology for setting tariff item amounts for gas transport (OG 85/13, 158/13 and 118/15),
- Methodology for setting tariff item amounts for gas storage (OG 22/14),
- Decision on the tariff item amount for gas storage (OG 28/14, 122/16),
- Methodology for setting the connection fee for gas distribution or transport system and for the increase of connection capacity (OG broj 76/14),
- Decision on the connection fee for gas distribution or transport system and for the increase of connecting capacity for the regulation period 2014-2016 (OG 86/14),
- Methodology for setting the price of non-standard gas transport, gas distribution, gas storage and the public service of gas supply (OG 158/13, 91/16, 116/16),
- Methodology for setting the price of gas system balancing energy (OG 155/14, 49/16),
- Decision on setting the obligation of the natural gas producer for the sale of natural gas to the wholesale gas market supplier (OG 29/14),
- Decision on the price of gas at which the natural gas producer must sell natural gas produced in Croatia to the wholesale gas supplier (OG 27/16),
- Decision on setting the gas wholesale supplier (OG 29/14),
- Decision on the price of gas at which the gas wholesale supplier must sell gas to the suppliers in the public service obligation of gas supply for household customers (OG 27/16),
- Decision on setting the priority in the process of allocating the gas storage capacity to the gas wholesale supplier (OG 29/14),
- Decision on the gas market organization fee (OG 38/12, 23/16),
- Decision on the adoption of the intervention plan of measures for the protection of the security of gas supply in the Republic of Croatia (OG 78/14).

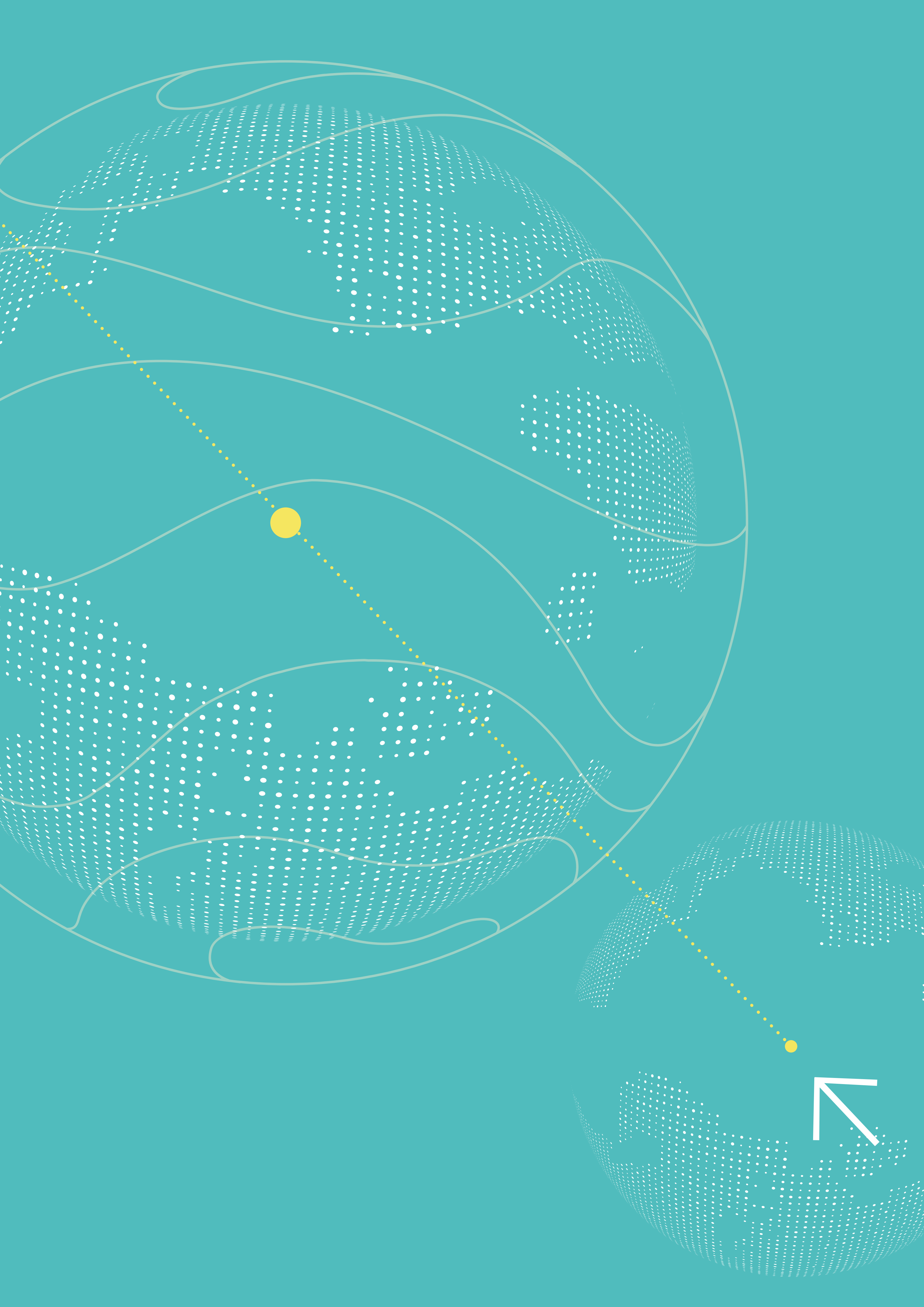
As of 1 April 2016 and pursuant to decisions adopted by the Croatian Government, the new price of gas came into effect under which the supplier in the public service obligation must sell gas to suppliers performing the public service. The price of 0.1734 HRK/kWh has been reduced by 24 percent compared to the previous period. The price of gas of 0.1369 HRK/kWh under which INA d.d. as the gas producer must sell gas to suppliers on the wholesale gas market has also been decreased by 20 percent. The selling price of gas includes the fee for the use of the transport system and the fee for exceeding the contracted capacity pursuant to provisions of the Transport System Grid Code, the fee for the use of the gas storage system and the use of other services pursuant to provisions of the Rules for the Use of the

Gas Storage System, the gas market organization fee as well as all other costs set under the provisions of the Gas Market Organization Rules.
In March 2016, HERA adopted the Decision on the gas market organization fee under which the fee was increased by 52 percent, and the amount of 0.0877 HRK/MWh of gas was measured on the exit points from the Croatian transport system for each balance group. The 2016 transport costs increased compared to 2015 due to a significant increase of tariff items resulting from the Extraordinary Audit of Tariff Item Amounts by Plinacro d.o.o. as the transport system operator. The exit and entry charge in Croatia increased by 71 and 26 percent, respectively, while the tariff item for the gas volume rose by 29 percent.
As of 1 October 2016, a partial implementation of the Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission Networks began setting the balancing rules including the nomination procedures, deviation charges, settlement processes associated with the daily imbalance charge and operational balancing between transmission system operators' networks. The implementation of this Regulation should ensure the intra-day wholesale gas market with the purpose of establishing the transport system balance although the Croatian legislative framework for the implementation of said Regulation was not fully defined until end 2016. The Regulation aims at introducing the daily balancing mechanism, the change of nomination cycles on interconnections and the underground gas storage, the obligation on the part of the distribution system operator in relation to metering point readings and the submission of system users' metering data as well as the obligation on the part of the transport system operator in relation to reporting to a transport system user.
Pursuant to the provisions of the Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems, interconnection auctions were made possible for the first time in Croatia on the operators' booking platforms (PRISMA and RBP). The Regulation aims at introducing the mechanism for the improvement and the organization of a single European gas market. The transport system operator must offer the use of the permanent and interrupting transport system connecting capacity at interconnections as standard products. The Regulation also defines the balancing market rules which provide a financial stimulus to transport system users for balancing the capacity of balance groups.

SHORT HISTORICAL OVERVIEW

1895	**First alternating current electricity system in Croatia, Krka HPP - Šibenik**
1912	Kraljevac HPP, among the largest hydro power plants at the time, built
1925	“Ante Šupuk i sin” (Ante Šupuk & Son), Šibenik, among UNIPEDE founders
1937	Vice Roy’s Electrica Company founded (BEP)
1941	State electrical company founded (DEP)
1945	Electrical company of Croatia founded (ELPOH)
1954	Union of electricity companies of Croatia founded (ZEPH)
	Beginning of district heating: hot water pipeline for Končar factory from EL-TO Zagreb plant
1961	Business association of electricity distribution companies of Croatia founded (ELDIH)
1965	United electricity industry of Croatia founded
1974	Union of electricity organizations of Croatia founded (ZEOH)
	Gas distribution and supply commenced within Elektroslavonija Osijek
1981	Krško nuclear power plant put into operation
1990	**Public enterprise Hrvatska elektroprivreda (HEP) founded**
1991	Heavy war destruction to power plants and facilities
1993	About 120 MW emergency diesel and gas power plants installed in Dalmatia
1995	Reconstruction and refurbishment of the Peruća dam completed (blasted in 1993)
1997	Eastern Slavonia reintegrated into the Croatian electricity system
1998	Gas -fired power plant (2x26 MW) put into operation at the EL-TO Zagreb site
2000	Plomin 2 TPP (210 MW) began commercial operation
2002	**Hrvatska elektroprivreda d.d. restructured into HEP Group**
2003	Combined cycle cogeneration unit K (200 MWe/150 MWt) at TE-TO Zagreb put into operation
2009	Combined cycle cogeneration unit L (100 MWe, 80 MWt) at TE-TO Zagreb put into operation
2010	HE Lešće put into operation (42 MW)
2012	HEP d.d. issued bonds in the amount of USD 500 m
2013	Croatian Transmission System Operator unbundled from HEP Group according to ITO model
2014	HEP d.d. became a wholesale gas market supplier
2015	HEP d.d. issued bonds in the amount of USD 550 m
	Trial run of combined-cycle Unit C of TE-TO Sisak (230 MWe, 50 MWt)
2016	Combined-cycle power plants fired by wood biomass constructed in Osijek and Sisak

HEP Elektra d.o.o. was founded on 2 November 2016 under the status change of HEP Operator distribucijskog sustava d.o.o. (HEP ODS) aimed at unbundling electricity supply.



2

Corporate Governance

Corporate Governance

In accordance with the HEP Group corporate governance model, HEP d.d. manages and performs some corporate tasks as well as directs, coordinates and monitors activities in dependent companies. Each member of the Management Board is an executive in charge of a corporate function. The main internal organization of HEP d.d. is based on a corporate governance approach and on the authority the Company has over individual business activities.
The Company implements the Corporate Governance Code for the companies in which the Republic of Croatia has shares (OG 112/2010). The Company adheres to the provision of the Code except for those which implementation at a given moment is not possible or applicable and practical.

GOVERNING BODIES OF HEP D.D. (FROM ARTICLES OF ASSOCIATION OF HEP D.D.)

MANAGEMENT BOARD

The Management Board of the Company consists of 6 members, one of whom is appointed the President of the Management Board. The president and members of the Management Board are appointed and revoked by the Supervisory Board. The term of office of the president and members of the Management Board is 4 years.
For the execution of its managerial tasks and powers, the Management Board carries out the following activities:

1. manages the business affairs of the Company,
2. establishes and implements the business policy, medium-term and long-term plans,
3. carries out decisions made by the Supervisory Board and the Shareholders Assembly, and takes measures and issues instructions for their implementation,
4. passes internal rules and regulations of the Company and organizational rules,
5. represents and acts for the Company, and signs contracts within the framework of the law and these Articles of Association,
6. proposes decisions on matters falling in the scope of work of the Supervisory Board and Shareholders Assembly of the Company,
7. submits reports to the Supervisory Board on business policy and other principle issues regarding the future operations as well as on deviations from earlier predictions providing the reason; reports on the operational profitability and the profitability of using own capital; reports on business underway, especially income and state-of-affairs; activities which might be of a large significance for operational profitability and company's liquidity;
8. submits annual financial reports to the Company's Supervisory Board;
9. submits the report on the Company's state-of-affairs to the General Assembly once a year;
10. submits the written consolidated annual company report to the General Assembly;
11. appoints members of the Assembly and Supervisory Boards of the companies in which HEP d.d. has controlling interest or significant influence;
12. appoints and revokes Company's employees with special authorities and responsibilities;
13. passes staff and employment plans;
14. proposes and takes necessary measures and issues direct orders to ensure operations of the Company, especially the safety and operation of the power system;
15. performs other work tasks in line with the law and Company rules.

The Management Board of the Company may, subject to approval by the Supervisory Board, decide on:

1. establishing companies in this country and abroad ,
2. sale and purchase of shares and stakes held by the Company in other companies, and the sale of real property in such companies,
3. sale and purchase of and lien on real property exceeding HRK 20,000,000.00
4. borrowing and issuance of securities exceeding HRK 100,000,000.00
5. giving the power of attorney and waiving rights without compensation above HRK 5,000,000.00

SUPERVISORY BOARD

The Supervisory Board consists of 7 (seven) members. Six members are appointed and revoked by the Shareholders Assembly of the Company and one member is elected and revoked by workers pursuant to provisions of the Labour Act. The Decision adopted by the General Assembly on appointing and revoking members of the Supervisory Board enters into force on the day of its adoption. The term of office of the members of the Supervisory Board is four years. After the expiry of their term the members of the Supervisory Board may be reelected. The members of the Supervisory Board elect the chairperson and a deputy chairperson among themselves.

The Supervisory Board supervises the management of the Company's business affairs. It:

1. appoints and revokes the Management Board of the Company;
2. examines and reviews business records, documentation, cash records, securities and other documents related to the operations of the Company;
3. gives consent to annual financial reports made by the Management Board of the Company;
4. gives prior consent to the decisions of the Management Board where this is required by these Articles of Association;
5. submits reports to the Shareholders Assembly of the Company on the supervision carried out, especially with respect to financial operations and their consistency with business records
6. performs other activities set by the law and Company rules.

GENERAL SHAREHOLDERS ASSEMBLY

The Shareholders Assembly is composed of shareholders and/or their proxies. The Shareholders Assembly decides on matters determined by law and these Articles of Association, in particular:

1. passes the Articles of Association and its amendments;
2. appoints and revokes the members of the Supervisory Board;
3. makes decisions on the use of profit;
4. revokes members of the Management and Supervisory Boards of the Company;
5. appoints the auditor of the Company;
6. decides on increase or decrease in the capital stock of the Company;
7. decides on status changes and dissolution of the Company;
8. carries out other work in accordance with the law and these Articles of Association.

Members of governing bodies of Hrvatska elektroprivreda d.d. (HEP d.d.)

SHAREHOLDERS ASSEMBLY

- **Zdravko Marić,**
member (as of 27 January 2017)*
(Minister of Finances of the Republic of Croatia)

*in the reporting period, the members of the Assembly were Ivan Vrdoljak (until 4 March 2016) and Tomislav Panenić (from 4 March 2016)

SUPERVISORY BOARD

- **Nikola Bruketa,** Chairman
- **Juraj Bukša**, member
- **Igor Džajić**, member
- **Dubravka Kolundžić,** member, workers' representative
- **Žarko Primorac**, member
- **Ivo Uglešić**, member
- **Mirko Žužić**, member

SB'S AUDIT COMMITTEE

- **Žarko Primorac**, president
- **Mirko Žužić,** member
- **Boris Tušek** (full professor at the Faculty of Economics in Zagreb), external member

MANAGEMENT BOARD

Perica Jukić,
President of the Board

Born in 1969. Graduated from the Faculty of Mechanical Engineering and Naval Architecture in Zagreb in 1996, obtained his Master's degree in 2005 in cogeneration facilities and distribution of heat energy. He was employed by HEP Generation in 1996 first as an independent engineer in TE-TO Zagreb, and then as the Head of Generation and the facilities' director in 2008. Within this period, he worked as a generation engineer on commissioning of the new CCGT unit (Unit K in 2004) and as a process engineer involved in the Unit L project (2006-2009). In the period from 2009 until May 2013 he was the director of the Thermal Power Plants Department in HEP-Generation d.o.o. when he was appointed a member of the Management Board of HEP d.d. He was the Head of the joint HEP/RWE Operation and Maintenance Committee in TE Plomin d.o.o.

Saša Dujmić,
Member

Born in 1970. Graduated first in 1995 from the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture in Split acquiring the associate degree in electrical enginnering and then in 2007 a bachelor's degree. He attends the postgraduate specialist studies in energy sector economy at the Faculty of Economics in Split. He had been employed by HEP, Elektrodalmacija Split, since 1996 first as an engineer in the Facility Maintenance Department and then in the Preparation and Implementation Department. From 2012 until 2014, he was director of Elektrodalmacija Split of HEP Distribution System Operator. He has been a visiting fellow at the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture since 2007 in the course of Electrical Equipment Maintenance and Testing. He passed the state exam for performing particular tasks in facility construction (2000) at the Ministry of Environment and Physical Planning.

Zvonko Ercegovac,
Member

Born in 1965. University specialist in economics (2008) and graduate electrical engineer (electrical energy programme) (2005). In 1992, a graduate degree in electromechanical engineering. State exam in the area of electrical engineering passed at the Ministry of Construction and Environmental Protection in 1993. Before being appointed a member of the Management Board, director of Supply Department, HEP Gas from 1989, preceded by the position of a protection engineer and the head of Sales and Customer Relations. From 2006 to 2010, a member of the HERA Council.

Tomislav Rosandić,
Member

Born in 1975. Graduated in 1997 from the Faculty of Economics, University of Zagreb in the field of managing company's finances. He was employed by Cibalae banka first as a securities analyst, and then as the director of the Retail Department. From 2000 until 2002, he was a branch manager of Zagrebačka banka, and a member of the Management Board of Dilj d.d. for a year. From 2003 until 2005, he presided over the Management Board of Dilj d.d., a member of Nexe Group. In 2005, he became the CFO of the Group, and then a member of the Management Board and its CFO. Before having been appointed a member of the Management Board of HEP d.d., he was a member of the Management Board and the CFO of Eurocable Group d,d, from 2012 until 2014. He has been a deputy chairman of the Supervisory Board of Slatinska banka since 2010 as well as a certfified investment advisor since 2003, and a certified member of supervisory boards since 2007. He won the 2016 Best Finance Director Award in Croatia at the 2017 CFO Conference.

GENERAL SHAREHOLDERS ASSEMBLY

GENERAL SHAREHOLDERS ASSEMBLY 2016

The annual meeting of the General Shareholders Assembly was held on 27 June 2016. The Assembly reviewed consolidated and unconsolidated annual financial statements of HEP d.d. and HEP Group for 2015 including the Independent Auditor's Report and the Annual Report on the state of affairs and operations of HEP d.d. and HEP Group in 2015 and the Report of the Supervisory Board on the supervision conducted over HEP d.d. operations in 2015. Acts of the members of the Management and the Supervisory Boards, respectively, were ratified for 2015.

GENERAL SHAREHOLDERS ASSEMBLY 2017

The annual meeting of the General Shareholders Assembly was held on 8 June 2017. The Assembly reviewed consolidated and unconsolidated annual financial statements of HEP d.d. and HEP Group for 2016 including the Independent Auditor's Report and the Annual Report on the state of affairs and operations of HEP d.d. and HEP Group in 2016 and the Report of the Supervisory Board on the supervision conducted over HEP d.d. operations in 2016. Acts of the members of the Management and the Supervisory Boards, respectively, were ratified for 2016.

INDEPENDENT AUDITOR

At the meeting held on 27 June 2016, the General Assembly appointed BDO Croatia d.o.o. Zagreb the auditor of HEP d.d. and its related companies' 2016 financial statements.

INTERNAL AUDIT

The Internal Audit and Risk Management Department is responsible for the corporate function of internal audit and as such represents a part of the internal supervision of HEP Group.
Business operations of Internal Audit are defined under the Act on the Internal Control System in the Public Sector (OG 78/15) and the Internal Audit Rules, which have been harmonized with the IPPF (International Professional Practices Framework). The Rules are based on the fundamental internal audit principles (integrity, objectivity, confidentiality, expertise) and guarantee a quality normative framework necessary for the professional conduct of the internal audit department tasks. The International Professional Practices Framework is a layout of professional rules and guidelines defining the work of the internal audit, which have been structured and integrated in a document published by the IIA Global.
The Internal Audit Department carries out internal audits in line with the Strategic Plan and the Department Annual Plan adopted by the Management Board of HEP d.d. with the consent of the Audit Committee. The purpose of internal audits is to provide the Supervisory Board, the Audit Committee and the Management Board of HEP d.d. a reasonable guarantee of security, efficiency and effectiveness of the business system and processes, reliability and accuracy of information, compliance of business operations with laws, regulations and HEP Group's internal rules, plans, programmes and business policies.
The Department also provides recommendations for enhancing business processes, assists the Management Board of HEP d.d. and the responsible management of HEP Group in improving internal controls and the mitigation of operating risks.
Pursuant to the Audit Act and the Act on the Internal Control System in the Public Sector, the Internal Audit Department falls under the jurisdiction of the Audit Committee.

3

Business Operations in 2016

Business Operations in 2016

BUSINESS ENVIRONMENT

According to the first estimated figures of the Croatian Bureau of Statistics for 2016, the Croatian economy grew and the gross domestic product increased by 2.9 percent compared to 2015. Thus, the positive growth rate of GDP was achieved for the second year in a row after 2008.

Favourable trends were facilitated by the exceptionally successful tourist season, foreign demand growth, tax reform, recovery of personal consumption, increase of net salaries, and continued lower interest rates. As per data published by the Croatian Bureau of Statistics, the average registered unemployment rate was decreased from 17.6 percent in 2015 to 14.8 percent in 2016.

In the first quarter 2016, the price of electricity on the neighbouring reference power exchanges fell under 34 EUR/MWh, and then grew in the second quarter. In late 2016, the price of electricity in Europe increased as a direct result of French nuclear power plants unavailability as well as cold winter and bad hydrology. The price of one-year ahead futures in late 2016 was 39.8 EUR/MWh.

In 2016, HEP Group completely fulfilled its mission of a secure and quality supply of energy to customers while retaining a high level of social responsibility. Very good business result was achieved strengthening the Group's financial position.

Despite increased sale, income from electricity in Croatia decreased compared to the 2015 results. Reduced income was affected by the introduction of a solidarity charge paid by household customers pursuant to the Ordinance of the Ministry of Economy on the criteria for the acquisition of the status of vulnerable energy customers from network systems and the Decision adopted by the General Shareholders Assembly of HEP d.d. under which HEP retained the level of the overall electricity price for households. Reduced income was also the result of lower tariff items for universal service customers as of 1 July 2015, lower tariff items for guranteed service customers as of 1 January and 1 July 2016, as well as the lower average price for HEP Supply customers for the purpose of keeping up with the competition.

Income from the sale of electricity abroad was significantly increased compared to 2015 due to a higher export of electricity surpluses generated in HEP power plants and the increased volume of regional customer supply. HEP sold 13.2 TWh and 3.7 TWh to domestic and foreign customers, respectively.

The implementation of a number of activites focused on improving the customer relation, continuous adjustment to market requirements and marketing campaigns aimed at strengthening the HEP brand resulted in levelling the market share in electricity supply of domestic customers at about 85%. HEP Group additionally strengthened its market leader position in electricity supply by entering regional markets (Slovenia, Bosnia and Herzegovina, Serbia).

Year 2016 was characterized by favourable hydrology. More frequent production by thermal power plants and increased sale abroad led to a more intensified procurement of electricity on market terms and consequently to the rise of operating cost.

In 2016, HEP ensured 19.2 TWh of electricity for customer supply, sale abroad, losses in the transmission and distribution network and for its own consumption, 12.5 TWh of which was produced in power plants owned or partially owned by HEP Group, while the remaining volume was procured on the market.

Due to lower average temperatures in the last quarter 2016, the sale of heat and gas was increased. However, a significant decrease of the gas price at which the gas wholesale supplier had to sell gas to suppliers in public service of gas supply for household customers under the decision of the Croatian Government as well as reduced tariff items for the public service of gas supply and guaranteed supply led to reduced income from the sale of retail and wholesale gas.

The Group recorded net profit of HRK 2.05 billion, which was by HRK 104.9 million more than HRK 1,94 billion in 2015. Electricity accounts for the highest share of the profit.

All liabilities were settled within due period throughout 2016, while the investments were financed by own funds without the need for any new long-term debt due to good liquidity as a result of yet another good business year.

With HRK 2.59 billion invested, HEP Group continued to be one of the biggest investors in Croatia in 2016. Equipment was being replaced on an ongoing bases as well as the reconstructions and refurbishments of the existing generation facilities and the transmission and distribution network carried out primarily engaging domestic producers and contractors.

FINANCAL PERFORMANCE

According to financial indicators, HEP Group is one of the biggest business groups in the Republic of Croatia.

In 2016, the Group achieved profit from operations of HRK 2,723.2 m, which was by HRK 272.6 m (or 9.1%) less compared to 2015 due to decreased operating income and increased operating expenses. Financial activities also recorded the loss of HRK 132.8 m compared to HRK 600 m in 2015, which resulted in increased net profit of HEP Group in the amount of HRK 2,045 m i.e. by HRK 104.9 m more than the net profit in 2015.

Operating income amounted to HRK 14,400.4 m, which was a decrease by HRK 169.1 m compared to 2015. Despite the increase of income from sale by HRK 71 m (0.6%) in light of increased income from the sale of electricity (2.8%) and increased income from the sale of heat (2.5%), a decrease of other operating income by HRK 240.1 m (14.4%) resulted in lower operating income for the Group.

Operating expenses amounted to HRK 11,677.2 m, which represented an increase by HRK 103.5 m compared to 2015. Said increase was the result of the cost of provisions for severance pays to workers in line with the upcoming reorganisation of HEP - Operator distribucijskog sustava d.o.o. and the increased cost of electricity procurement (10.6%) caused by a higher volume of procurement of electricity for the supply of regional customers and increased wholesale. The cost of energy fuel decreased (13.9%) due to lower gas and coal prices and a discontinuation of fuel oil use, as well as the lower procurement cost of gas intended to be sold on the wholesale market (7.8%) as a result of lower gas procurement prices.

Consolidated profit and loss account (abridged) HRK m	**2015**	**2016**	**Δ 2015**	**%2015**
Operating income	14,569.5	**14,400.4**	-169.1	-1.2%
Operating expenses	11,573.7	**11,677.2**	+103.5	+0.9%
Profit from operations	2,995.8	**2,723.2**	-272.6	-9.1%
Net profit of the Group	1,940.1	**2,045.0**	+104.9	+5.4%
Net profit attributable to equity holders of the parent	1,939.1	**2,045.0**	+105.9	+5.5%

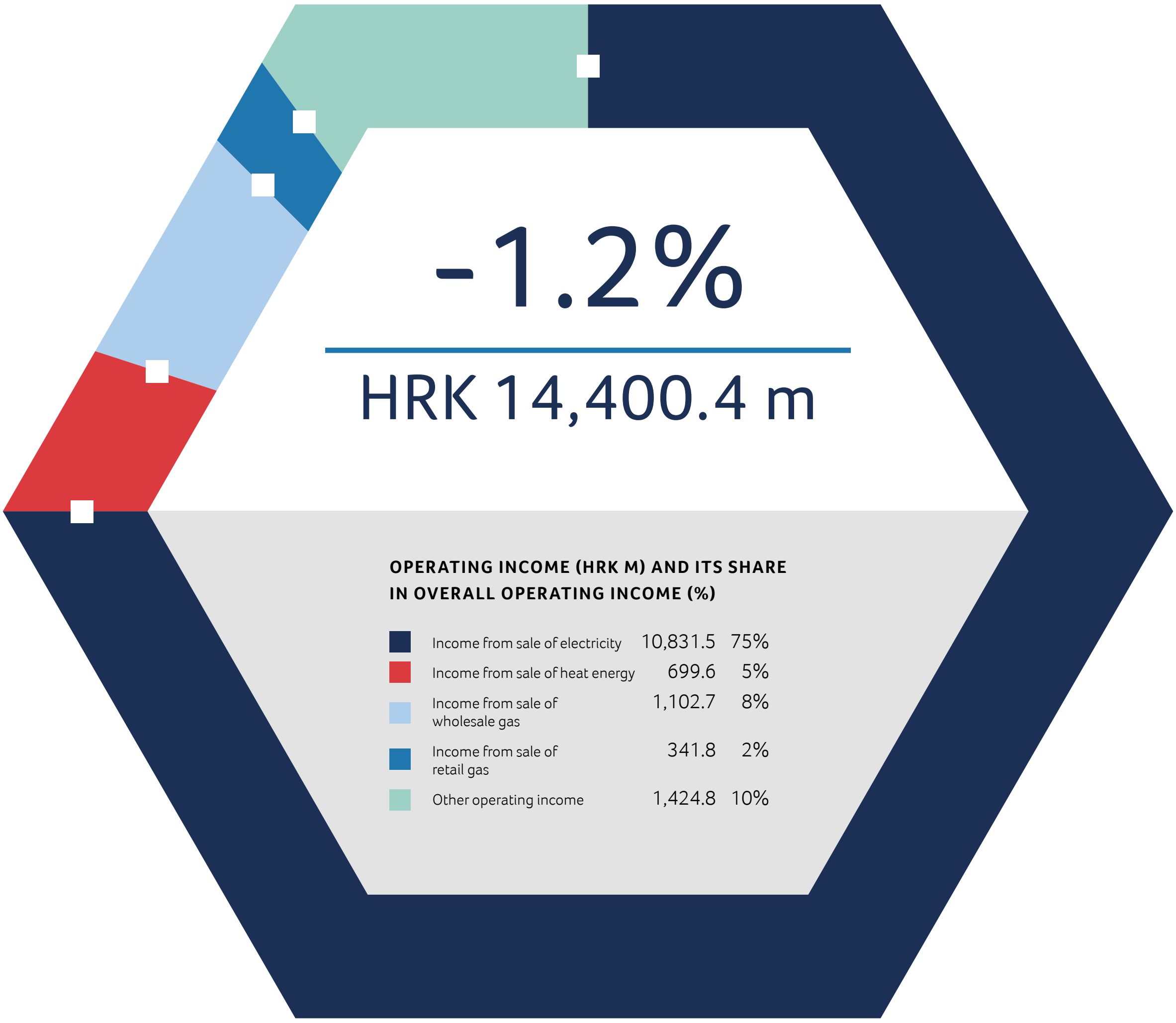
The Group recorded net profit of HRK 2.05 billion, which was by HRK 104.9 million more than HRK 1.94 billion in 2015.

HRK

2.05

billion

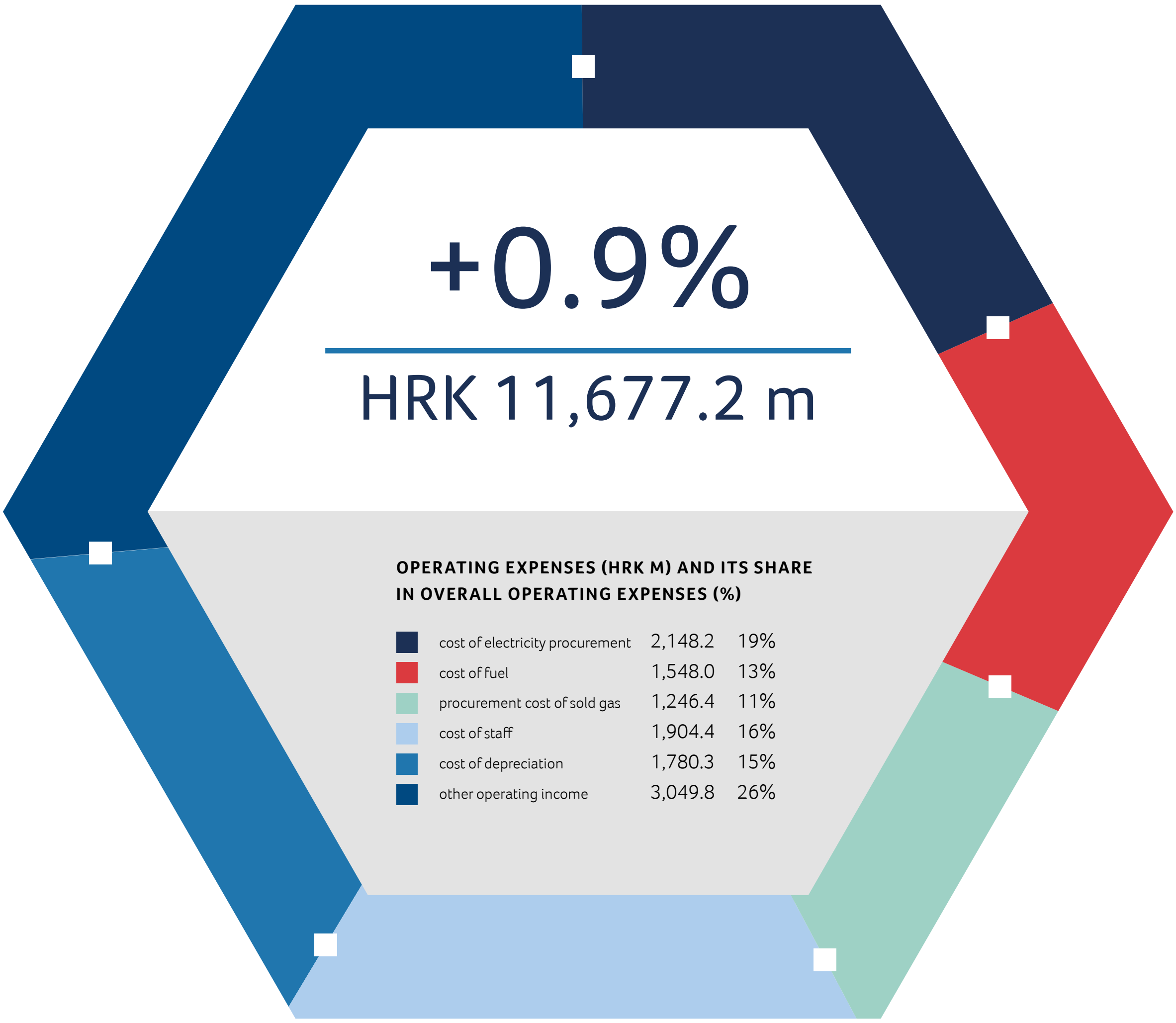
OPERATING INCOME



In 2016, the Group earned operating income in the amount of HRK 14,400.4 m, a decrease by HRK 169.1 m (1.2%) compared to 2015. Said drop was primarily the result of lower income from the sale of gas on the wholesale market as well as the decrease of other operating income.
The Group earned 75% of its operating income from the sale of electricity. A 2.8% increase (HRK 294.0m) compared to the year before was the result of a significantly higher sale of electricity abroad as well as increased sale of HEP's eligible producers.
Income from the sale of electricity to Croatian customers was reduced by 0.7 percent despite a 0.9 percent increase of sale by HEP Group (114 GWh). The drop in income was a result of decreased income from households by HRK 164.1 m paid as the solidarity charge (0.03 HRK/kWh) towards the State Budget, reduced tariff items for customers under the universal service as of 1 July 2015, and reduced tariff items for customers under guaranteed supply as of 1 January 2016 and 1 July 2016. The average price of electricity for household customers under the universal service, excluding the charge for the use of transmission and distribution network, decreased by 6 percent, as did the average price for commercial customers under guaranteed supply by 3.2 percent compared to 2015. The average price for HEP Supply customers was also reduced, excluding the charge for the use of the transmission and distribution network, by 5.3 and 7.4 percent for commercial and household customers, respectively.
Under the decision of the Croatian Government, Hrvatska elektroprivreda d.d. became the wholesale market supplier for the period 1 April 2014 until 31 March 2017. It sells gas to suppliers obligated to

adhere to the public service of household gas supply under regulated terms and provides a reliable and safe gas supply. The Group recorded income from this activity of HRK 1,102.7 million accounting for 8% of its operating income. Said income was by HRK 195.6 million lower than in 2015 as a result of a decreased selling price as per the decision od the Croatian Government. Under the Amendments of the Gas Market Act from February 2017, Hrvatska elektroprivreda d.d. is planning to continue the conduct of the gas wholesale business until the completion of the tender for defining the gas wholesale market supplier.
Income from the sale of heat energy amounted to HRK 699.6 m, which accounted for 5 percent of operating income. This increase by HRK 17.2 m was the result of increased consumption by 0.6 percent as well as the 2 percent higher average selling price.
Income from the sale of retail gas amounted to HRK 341.8 m, accounting for 2 percent of operating income. It represents a decrease by HRK 44.6 m (11.5%) compared to 2015 despite a 9.5% increase in gas sale resulting from a 20 percent lower average selling price pursuant to the Decision adopted by HERA on tariff item amount for the public service of gas supply for HEP Plin d.o.o.
Other operating income in the amount of HRK 1,424.8 m decreased overall by HRK 240.1 m (14.4%) compared to the year before in view of the 2015 income from damages paid by the Republic of Slovenia for unsupplied electricity from Krško NPP in the period from 1 July 2002 until 19 April 2003 of HRK 328.9 m. Income from network connections and the cancellation of long-term provisions increased.

OPERATING EXPENSES



The Group's operating expenses in 2016 increased by HRK 103.5 m to HRK 11,677,2 m.
Energy fuel for electricity and heat production and electricity procurement accounted for 32 percent of overall costs amounting to HRK 3,696.3 million.
Electricity procurement cost increased by HRK 205.2 m (10.6%). In light of increased supply volume in Croatia and its region as well as increased sale on the wholesale market, electricity import rose by 630 GWh, while the procurement price decreased by 12.6 percent. The off-system electricity procurement including traders within Croatia increased by 63 GWh at a 17 percent lower price. 538 GWh more electricity at 20.8 percent lower price was repurchased from eligible producers within the system of incentives.
The cost of energy fuel decreased by HRK 251 m (13.9%) compared to 2015 despite 21.4 percent more natural gas and 12.3 percent more coal utilized by thermal and cogeneration plants due to increased electricity and heat energy production. The lower cost of energy fuel was a result of 25.5 percent lower gas and 8.1 percent lower coal prices as well as the discontinuation of fuel oil utilization in production, which 2015 costs amounted to HRK 159.5 million.
The procurement value of sold gas on the wholesale market was HRK 1,246.4 million, which was lower compared to 2015 by HRK 105.6 million (7.8%) due to a lower average procurement price.
The cost of staff was HRK 1,904.4 m, a decrease of HRK 19.4 million or by 1% as a result of reducing the number of employees.
The 11.7 percent increase of other operating expenses, compared to 2015, was primarily the result of the provisions for severances paid pursuant to terminations of work contracts in the amount of HRK 343 million allocated for the planned restructuring of HEP - Operator distribucijskog sustava d.o.o. in 2017. The cost of value adjustment of thermal power plant fixed assets as well as maintenance costs increased, while the cost of value adjustment for trade receivables, long-term severance provisions and jubilee awards as per the Collective Agreement decreased. The cost of gas procurement for customer supply was lower by 18. percent as a result of lower procurement prices.

RESULT BY ACTIVITIES

The major portion of the Group's operating income (75.2%) and operating profit was earned from electricity. Compared to 2015, operating profit was lower due to increased cost of electricity procurement and severance provisions in line with the planned reorganization of HEP - Operator distribucijskog sustava in 2017. District heating accounted for 4.9% of operating income and recorded operating loss of HRK 162.6 million. Compared to the year before, the loss was lower due to a reduced cost of heat energy production resulting from lower energy fuel prices. The share of gas wholesale and retail in operating income accounted for 10 percent recording HRK 18 million of operating profit. Compared to the year before, profit was reduced as a result of a higher decrease of selling than of procurement price of gas intended for sale to suppliers in the public service of gas supply to household customers.

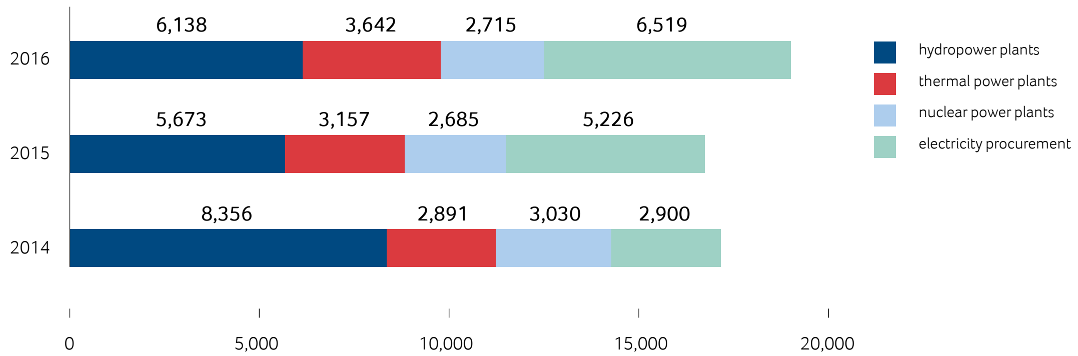
Operating performance in HRK m

	electricity			heat energy			gas		
	2015	**2016**	%2015	2015	**2016**	%2015	2015	**2016**	%2015
Operating income	12,125.8	**12,181.5**	+0.5%	737.8	**751.5**	+1.9%	1,705.9	**1,467.4**	-14.0%
Operating expenses	8,976.8	**9,313.8**	+3.8%	1,028.5	**914.1**	-11.1%	1,568.5	**1,449.3**	-7.6%
Profit (loss) from operations	3,149.0	**2,867.7**	-8.9%	-290.7	**-162.6**	-44.1%	137.4	**18.0**	-86.9%

ELECTRICITY

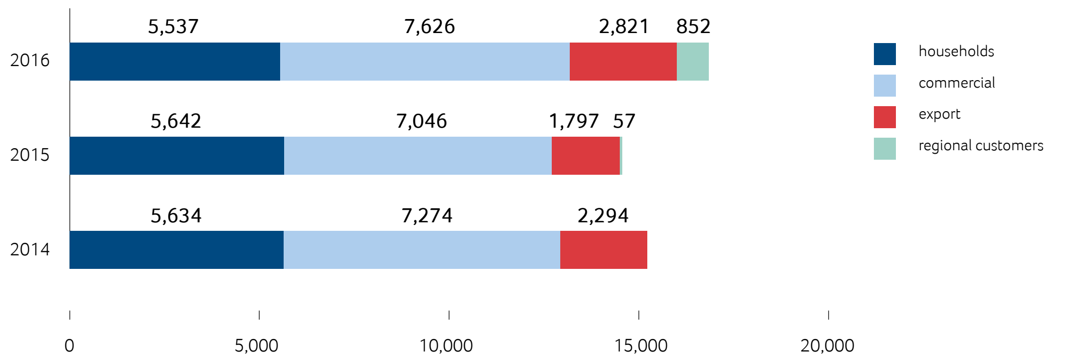
Electricity generation, transmission, distribution and supply are carried out by HEP Group across the entire territory of Croatia. The Group is the biggest supplier of electricity in the Republic of Croatia with 13.2 TWh of sold electricity. 852 GWh more was sold to customers in Slovenia, Serbia and Bosnia and Herzegovina. In 2016, the operating profit of HRK 2,867.7 m was achieved.
Income from the sale of electricity totalled at HRK 10,831.5 m, 91.7% (HRK 9,937 m) of which from the supply of domestic customers, and 8.3 % (HRK 894.4 m) from the sale abroad.

Electricity production and procurement (GWh)



Power plants wholly or partially owned by the Group generated 12.5 TWh of electricity, which was 981 GWh more than in 2015 accounting for 65% of the overall electricity turnover recorded by the Group in 2016. Under favourable hydrology in 2016, 6,138 GWh of electricity was generated, which was by 465 GWh more compared to the 2015 generation accounting for 32 percent of the overall electricity demand. Generation by thermal and cogeneration power plants also increased by 485 GWh to 3,642 GWh accounting for 19% of the overall energy demand in 2016. Generation was increased in Plomin 2 TPP and the highly efficient Unit L of CCGT Zagreb granted the eligible producer status and the contract with the Croatian Electricity Market Operator (HROTE) for the sale of electricity at incentivized price as of July 2016. Krško NPP produced 2,715 GWh, which was by 0.9% more than in 2015.
6,519 GWh od electricity (34.0% of electricity demand) was purchased from market suppliers and re-purchased from HROTE, which was by 1,293 GWh (24.8%) more than in 2015. Out of the overall amount, 4,918 GWh was allocated to electricity import for customer supply and reselling. Furthermore, 1,464 GWh was dedicated to the mandatory repurchase of electricity produced by eligible producers in the system of incentives (RES and highly-efficient cogeneration) from HROTE, while 137 GWh was dedicated to the off-system procurement including traders in Croatia.

Sale of electricity (GWh)



13.2 TWh of electricity was sold to domestic customers: 5.5 TWh (42%) to households and 7.6 TWh (58%) to commercial customers. Thus, HEP acquired the 84.9% share in the overall electricity sale to end customers in Croatia in 2016. The sale abroad amounted to 3.7 TWh, twice as much than in 2015 which was the result of 1 TWh higher export of electricity surpluses produced in HEP's power plants and 795 GWh higher supply volume of regional customers.
Compared to 2015, income from the sale of electricity increased by HRK 294 million (2.8%) to HRK 10.83 billion, which was the result of increased sale of electricity abroad (by HRK 363.9 m) as well as the increased sale of HEP producers in the system of incentivized production from RES and highly efficient cogeneration (by HRK 125.1 million).
Income from the sale of electricity to end customers in the Republic of Croatia decreased by HRK 231 million (2.3%) despite increased sale by HEP Group (by 114 GWh). Due to the implementation of the Ordinance adopted by the Ministry of Economy on the criteria for the acquisition of the status of an energy vulnerable customer from network systems (OG 95/2015) and the Decision passed by the General Shareholders Assembly of HEP d.d. under which the price of electricity for household customers had not changed, the solidarity charge led to decreasing the income from the sale of electricity to customers by HRK 164.2 million. Reduced income was also the result of decreased tariff items for customers under universal service as of 1 July 2015, decreased tariff items for customers within guarantee supply as of 1 January and 1 July 2016 as well as reduced average price for HEP Supply customers for the purpose of adjusting to the competition.

DISTRICT HEATING

Heat energy production, distribution and supply are conducted on the areas of Zagreb, Osijek, Velika Gorica, Zaprešić, Samobor and Sisak.
A total of 2,306 GWh of heat energy was produced in 2016, which was by 14 GWh or 0.6 percent less than in 2015.
The sale of heat energy in 2016 amounted to 1,939 GWh, a 0.6% increase by 11 GWh compared to 2015, of which 57.9% is allocated to households and 42.1% to commercial customers. Due to above-average warm winter in the first quarter 2016, consumption lowered compared to the same period the year before, while the last quarter 2016 was characterized by lower temperatures resulting in increased consumption. The sale to households in 2016 decreased by 1 percent overall, while the sale to commercial customers increased by 2.9 percent.
District Heating recorded operating loss in 2016 of HRK 162.6 million.
Compared to 2015, the loss was lower by HRK 128.1 million, primarily due to a reduced cost of energy fuel resulting from lower gas prices and a smaller volume of produced heat energy.

GAS

HEP Group conducts the activity of retail distribution and customer supply. As of 1 April 2014, it has become the wholesale market supplier. These business activities recorded profit from operations of HRK 18 million compared to HRK 137.4 million achieved in 2015.
Retail gas distribution and supply is conducted in the following counties: Osječko-baranjska, Virovitičko-podravska and Požeško-slavonska. With the opening of the gas market, HEP Plin d.o.o. started supplying customers on other distribution areas (Zagreb, Varaždin, Bjelovar, Zadar, Križevci, Kutina, Ivanić Grad, Sisak, Slavonski Brod, Samobor, Koprivnica, Pitomača, Virovitica, Rijeka, Vinkovci, Đurđevac, Čakovec, Zabok, Karlovac, Jastrebarsko, Vrbovec, Dugo Selo, Pakrac, Orahovica, Umag, Pitomača, Nova Gradiška, Vukovar, Daruvar, Krapina, etc.).
Income from retail gas distribution and supply rose in 2016 by 9.5 percent. The sale of gas to households and entrepreneurs increased by 4.3% and 15.2%, respectively. The sale to customers on distribution areas of HEP Plin d.o.o. and the sale to new customers on other distribution areas in Croatia increased by 5.7 and 79.4 percent, respectively.
Income from gas distribution and supply amounted to HRK 337.7 million. Despite increased sale, it decreased by 12.6 percent compared to 2015 resulting from a significantly lower selling price stemming from the Decision adopted by HERA on tariff item amount for the public service of gas supply for the period from 1 April until 31 December 2016 under which the average gas price for the supply of custom-

ers, excluding the fixed monthly fee, was reduced on average by 20 percent compared to tariff items in effect from 1 January until 31 March 2016.
In gas wholesale, conducted by HEP Group as of 1 April 2014 pursuant to the decision of the Croatian Government, income of HRK 1,102.7 m was achieved, which was by 15.1 percent less than in 2015 as a result of the decision passed by the Croatian Government on reducing the price of gas under which the supplier on the gas wholesale market must sell gas to suppliers in the public service of gas supply for household customers in the period from 1 April 2016 until 31 March 2017 by 24.2 percent compared to the one in effect until 31 March 2016. At the same time, although at a lower rate of 20.2 percent, the price at which HEP procured gas from INA was reduced which affected the operating profit of gas wholesale.

FINANCIAL POSITION

Consolidated balance (abridged)

	31 Dec 2015		**31 Dec 2016**		change
	HRK m	share	HRK m	share	%2015
Long-term assets	31,546.1	83%	32,124.2	82%	+1.8%
Short-term assets	6,665.3	17%	7,108.7	18%	+6.7%
Total assets	**38,211.4**	**100%**	**39,232.9**	**100%**	**+2.7%**
Capital and reserves	24,025.2	63%	25,483.7	65%	+6.1%
Long-term provisions	969.5	3%	930.7	2%	-4.0%
Long-term liabilities	9,645.7	25%	8,503.2	22%	-11.8%
Short-term liabilities	3,571.0	9%	4,315.3	11%	+20.8%
Total liabilities and equity	**38,211.4**	**100%**	**39,232.9**	**100%**	**+2.7%**

ASSETS

The value of HEP Group's total assets at the end of 2016 was HRK 39.2 bn and it increased by HRK 1,021.5 m. Long-term assets accounted for 82% of the Group's asset value, which marked an increase of HRK 578.1 m resulting from the increased value of real estates, plants and equipment, while the ongoing investments were reduced which affected the commissioning of the new combined-cycle Unit C in CCGT Sisak.
The value of short-term assets was HRK 7.1 bn and it increased by HRK 443.5 m due to the increase of cash and cash equivalents by HRK 525.7 m, trade receivables by HRK 106.5 m, while the other short-term receivables reduced by HRK 104.2 m. Inventories stood at HRK 1.4 billion, a decrease by HRK 83.9 m due to reduced CO_2 emission unit and wholesale gas reserves, while nuclear fuel and other in Krško NPP d.o.o. increased.

EQUITY AND LIABILITIES

Capital and reserves at the end of 2016 amounted to HRK 25.5 bn with an increase of HRK 1,458.5 m in comparison with 2015 due to achieved profit in 2016. The dividend in favour of the State Budget of HRK 607 million was paid in 2016 consisting of HRK 151.4 m and HRK 455.6 m from retained profit for 2014 and 2015, respectively. The share of capital and reserves in total assets of the Group increased from 63 to 65 percent.
Long-term provisions were reduced by HRK 38.8 m, primarily due to reduced provisions for severance pays and litigation, while the provisions for thermal power plant decommissioning increased.
Long-term liabilities amounted to HRK 8,503.2 m accounting for 22% of the Group's total liabilities and equity. They decreased by HRK 1,142.5 m primarily due to decreased liabilities for the bonds issued in 2012 which mature in 2017 and were shown in short-term liabilities as well as due to decreased liabilities under long-term loans.

Short-term liabilities amounted to HRK 4,315.3 m. They increased by HRK 744.3 m compared to early 2016. Trade liabilities, due maturity of issued bonds and loans as well as other short-term liabilities increased as a result of severance provisions under the termination of work contracts in the amount of HRK 343 million for the planned restructuring of HEP Operator distribucijskog sustava d.o.o. in 2017. Staff and interest liabilities as well as tax contributions decreased. The debt/equity ratio was reduced to 20.8% compared to 23.7% in late 2015.

CREDIT RATING

HEP is rated by both Standard&Poor's and Moody's.
In late October 2016, Standard & Poor's (S&P) upgraded the stand-alone assessment of Hrvatska elektroprivreda from b+ to bb, as well as the overall assessment of HEP's credit rating from BB- to BB. It was stated in the report that the underlying reasons for upgrading the company's rating was strengthened liquity as well as very strong credit parameters of the company due to which the liquidity assessment was upgraded from less than adequate to adequate, as per terms used by S&P. In December 2016, S&P affirmed the long-term credit rating of Hrvatska elektroprivreda (BB) as well as upgraded the outlook from negative to stable following the sovereign rating upgrade for the Republic of Croatia.
In March 2016, Moody's changed the outlook of then current rating of Hrvatska elektroprivreda from stable to negative as a result of the sovereign downgraded outlook. In mid March 2017, Moody's affirmed the long-standing credit rating on HEP (Ba2) as well as upgraded the outlook on HEP from negative to stable as a result of improved sovereign rating.

Credit agency	**baseline credit assessment**	**standalone credit quality**
Standard & Poor's	BB (stable)	bb
Moody's	Ba2 (stable)	ba3

INVESTMENTS

In 2016, the Group made investment in the amount of HRK 2.589.1 m. Main investments focused on the reconstruction and the modernization of generation facilities and electric power system plants, the construction of new generation facilities and the reconstruction of the existing and the construction of new transmission and distribution network infrastructure.
Apart from the above, investments were made in district heating and gas distribution systems as well as the upgrade of IT and telecommunication infrastructure and the extension and development of the EV charging station network in the cities and along the motorways in Croatia.

Investments in HRK m	2014	2015	2016	16/15
Investments in property, plants and equipment	2,063.7	2,528.1	**2,589.1**	+2.4%

Through continuous investments into the maintenance and modernization of the existing facilities and the construction of new generation capacities and network systems, HEP meets the following objectives: security of energy supply, competitiveness of HEP's power system, the development of HEP Group's business system, contribution to sustainability and the continuity of the Croatian energy sector by taking into consideration an ever bigger presence of other participants on the open market, especially in electricity supply and electricity generation from renewable energy sources.
Through investments, HEP Group meets preconditions for Croatia's future reach of an adequate level of energy independence in electricity sector, by taking into consideration today's electricity consumption and the projection of its growth as well as the essential decommissioning of thermal facilities, which are not able to meet the prescribed conditions of environment protection because of their technological old age.

IMPORTANT INVESTMENTS

- The construction of the gas-fired CCCGT Unit C in TPP Sisak was completed and put into trial run. Following the issuance of the operating permit, the facility will become commercially operational.
- The construction of wood biomass cogeneration facilities BE-TO Osijek and BE-TO Sisak is completed. The trial run is planned for the first quarter 2017.
- The fourth phase of the installation of the replacement units with increased capacity as part of the revitalisation of HPP Zakučac is underway. Units A and B of HPP Dubrovnik were refurbished and put into operation.
- The continuation of the TPP Plomin C project depends on the notification process of the business model towards the European Commission and the adoption of the investment decision.
- The development of the EIAS for HES Kosinj and HPP Senj 2 is in its final phase and will be submitted to the relevant ministry in early 2017; biospeleological research was conducted on Lipovo polje and on the area of the planned accumulation of Kosinj as well as the concept designs for HPP Kosinj and HPP Senj 2 developed.
- In case of the replacement of Unit A of EL-TO Zagreb CCPP, the prequalification tender for the construction and long-term maintenance was conducted under the EBRD procurement rules.
- In terms of distribution, the construction, reconstruction, transformation upgrade or the construction of additional MV plants in several 110/10(20)kv, 35/10(20)kv electric power facilities and the MV network was completed. The recovery of voltage conditions and the increase of the security of supply in distribution network continued as well as investments into the replacement and the regulation of metering points and connections.
- In terms of district heating, the works on connecting Zagreb districts of Dubrava onto the central heating system, the revitalisation of the hot water and steam pipeline network of the city of Zagreb, the revitalisation of a section of the warm-water network in Velika Gorica, the revitalisation of hot water and steam pipeline network of the city of Osijek, the introduction of the remote operation system in Osijek continued as well as the revitalisation of the warm-, hot-, and steam pipeline network in Sisak suburb of Caprag.
- In terms of gas distribution, the construction of the gas network in Osijek-Baranja County (Potnjani, Gorjani, Branjina, Topolje and Duboševica) continued.
- Continuous investments are made in the development of the telecommunication infrastructure and the construction of the telecommunication network which ensures the connection of important facilities and business infrastructure with HEP's telecommunication system as well as the creation of preconditions for the implementation of the smart grid concept.
- The most important project in developing the IT infrastructure is the upgrade of SAP IS-U-based EDM/ECM system, which completion is planned until end 2017.
- Within the project of e-mobility, development and construction of the public EV charging infrastructure continued across Croatia ensuring the existence of a future platform for the acquisition of new customers and the facilitation of the smart grid concept as a support to the electric power system.

Through investments, HEP Group meets preconditions for Croatia's future reach of an adequate level of energy independence in electricity sector.

4

Financial Statements

HRVATSKA ELEKTROPRIVREDA D.D. ZAGREB

Consolidated annual financial statements

together with Independent Auditor's Report
for the year 2016

RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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 2016, are prepared in accordance with the Accounting Act (Official Gazette No 78/15, 120/16) and International Financial Reporting Standards, 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, 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:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Member	Member	Member	President

Hrvatska elektroprivreda d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia
28 April 2017

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") for the year ended 31 December 2016, which comprise the consolidated Statement of financial position (consolidated Balance Sheet) as at 31 December 2016, consolidated Income Statement, consolidated Statement of other comprehensive income, consolidated Statement of changes in equity and consolidated Statement of cash flows of the Company for the year then ended, and Notes to the consolidated financial statements, including a summary of significant accounting policies and other explanations.

In our opinion, the accompanying consolidated annual financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, 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").

Basis for Opinion

We conducted our audit in accordance with Accounting Act, Audit Act and 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 2016, the Company stated clearing debt liability in the amount of HRK 863,450 thousand (31 December 2015: HRK 842,162 thousand) regarding a payment under a letter of credit on the basis of 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 a some other legal transaction. Our opinion has not been modified in this respect.

As described in the Note 28 to the consolidated financial statements, provisions of the Water Management Act that came into force on 1 January 2010, raised a question on the ownership and legal status of the Company's property - reservoirs and ancillary facilities, used for generation of electricity from hydropower plants. Pursuant to the Water Act those property is defined as "Public water resources in general use as the property 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. The Company has filed a motion to the Constitutional Court for review of the constitutionality of Article 23 Paragraph 4 of the Water Act and for the cancelation of the same. During 2015, the Ministry of Agriculture has initiated the procedure for amendment and change of the Water Act, and the Ministry of Economy has also submitted its consent to the initiative of the Company for change and amendment of the Water Act. During 2016 and 2017, the Company continued activities with relevant Ministries and Institutions on the above-mentioned issue. Our opinion has not been modified in this respect.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated annual financial statements for the current period. 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:

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

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 are performed twice a year, the Group's electricity sales revenue is based on the total generated and purchased quantities of energy on the distribution network. By doing so, the total generated and purchased amount of energy is corrected for losses on the distribution network based on logarithmic regression. After analyzing several different approximation methods (five-year average, linear approximation and similar), the Management Board of the Company selected logarithmic regression as the most suitable one.

The correction of household income as at 31 December 2016 was obtained by calculating the logarithmic curve using losses in the network of 7.87%, while for the year ended on 31 December 2015, the percentage of losses used in the calculation was 8.39% . The result is an increase in revenues for 2016 in the amount of HRK 11,462 thousand compared to the previous year, and stated liability for accrued income in the amount of HRK 22,077 thousand. We focused on this area because it involves significant estimates of the recognition of electricity sales revenue at the reporting date.

Related disclosures in the consolidated annual financial statements

See Notes 2, 3 and 33 in the accompanying consolidated annual financial statements.

Audit procedures

We have:

- Obtain an understanding of key management controls related to estimating electricity sales revenue
- Assessed the reasonableness of the key assumptions used in the estimation model including the quantities of electricity sold and the price
- Test the mathematical accuracy of the model of estimation of electricity sales revenue
- engage an IT expert to assess system reliability and internally make an independent estimate of unrecorded revenue using data on quantities and prices received by the Group, and we have compared such results with the Group's revenue estimate.

We also evaluated the adequacy of the Company's disclosure regarding the recognition of revenues from the sale of electricity to customers of universal service (household customers).

The results of our tests were satisfactory.

Contingent liabilities and court disputes

Since the Group is exposed to significant legal claims, we have focused our attention on this area. According to that, the Management Board estimates future outcomes and amounts of contingent liabilities that may arise as a result of these claims.

Related disclosures in the consolidated annual financial statements

See Notes 2, 3 and 28 in the accompanying consolidated annual financial statements.

Key Audit Matters (continued)

Contingent liabilities and court disputes (continued)

Audit procedures

We have:

- obtain the understanding of the status of any significant claim and the historical outcomes of previous similar cases
- obtain the statements of all external legal representatives for all material proceedings
- analyse the assessment of the nature of disputes and claims by discussing the most significant cases with the Company's management and the internal legal department

Based on the collected evidence, taking into account inherent uncertainty in legal issues, we agree with the Company's management's assessment of the likelihood of future significant outflows related to these issues. We have found that issues that are likely to become future outflows are stated as provisions. Furthermore, we assessed the adequacy of the Company's disclosure regarding Contingent liabilities and court disputes. The results of our tests were satisfactory.

Other Information in the Annual Report

The Management is responsible for other information. Other information includes information included in the Annual report, but do not include the consolidated annual financial statements and our Independent auditor's report on them.

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 connection 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 our knowledge obtained in the audit or otherwise appears to be materially misstated. 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.

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, and for such internal control as management determines is 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 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.

Auditor's Responsibilities for the audit of the consolidated annual financial statements (continued)

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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- 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 the disclosures, and whether the consolidated annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with 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 control 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.

From 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

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 our audit of the consolidated annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the consolidated annual financial statements of the Company set out on pages 8 to 90 on which we expressed our opinion as stated in the section Opinion above.

In our opinion, based on the work that we performed during the audit, the Company's Management report for 2016, which is an integral part of the Annual report for 2016 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 2016, which is an integral part of the Company's Annual report for 2016.

In our opinion, based on the work that we performed during the audit, the Statement that code of corporate governance is applied, included in the Annual report for 2016, is in accordance with the requirements of article 22, paragraph 1, points 3 and 4 of the Accounting Act.

The Statement that code of corporate governance is applied, included in the Annual report for 2016, includes information from article 22, paragraph 1, points 2, 5 and 6 of the Accounting Act.

The Management is responsible for the preparation of consolidated annual financial statements for the year ended 31 December 2016 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 Company's standard consolidated annual financial statements are in accordance with the information presented in the Company's consolidated annual financial statements given on pages 8 to 90 on which we expressed our opinion as stated in the section Opinion above.

The engagement partner on the audit of consolidated annual financial statements of the Company for 2016, resulting in this Independent auditor's report is Irena Jadrešić, certified auditor.

In Zagreb, 28 April 2017

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

Zdenko Balen,
Management Board member

Irena Jadrešić,
Certified auditor

Consolidated Income statement

FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	2016	2015
		In HRK'000	In HRK'000
Revenue from electricity sales	4	10,831,456	10,537,427
Revenue from thermal power sales	4	699,596	682,388
Revenue from sale of gas on wholesale market	4	1,102,728	1,298,352
Revenue from sale of gas to customers	4	341,812	386,388
Sales revenue		***12,975,592***	***12,904,555***
Other operating income	5	1,424,766	1,664,910
Total operating income		**14,400,358**	**14,569,465**
Electricity purchase cost	6	(2,148,249)	(1,943,077)
Fuel cost	6	(1,548,033)	(1,798,986)
Costs of gas sold	6	(1,246,442)	(1,352,038)
Staff cost	7	(1,904,443)	(1,923,831)
Depreciation and amortization costs	11, 12	(1,780,269)	(1,825,097)
Other operating expenses	8	(3,049,765)	(2,730,671)
Total operating expenses		**(11,677,201)**	**(11,573,700)**
Operating profit		**2,723,157**	**2,995,765**
Financial income	9	232,873	70,479
Financial expenses	9	(365,669)	(670,520)
Net loss from financial activities		**(132,796)**	**(600,041)**
Profit before taxation		**2,590,361**	**2,395,724**
Corporate income tax expense	10	(545,359)	(455,667)
Profit for the year		**2,045,002**	**1,940,057**
Attributable to:			
Owners of the Parent		2,045,002	1,939,095
Non-controlling interest		-	962
		2,045,002	**1,940,057**

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

Consolidated Statement of other comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	In HRK'000	In HRK'000
Profit for the year	**2,045,002**	**1,940,057**
Other comprehensive income		
Exchange (losses) arising on translation of foreign operations	(18,984)	(4,453)
Net gain on AFS financial assets	39,457	45,889
Net other comprehensive income to be reclassified to income/ (loss) in subsequent periods	20,473	41,436
Other comprehensive income, net	**20,473**	**41,436**
Total comprehensive income for the year, net	**2,065,475**	**1,981,493**
Total comprehensive income attributable to:		
Owners of the Parent	2,065,475	1,980,788
Non-controlling interest	-	705
	2,065,475	**1,981,493**

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

Consolidated Statement of financial position / Cosolidated Balance sheet

AS AT 31 DECEMBER 2016

ASSETS	Notes	31 Dec 2016	31 Dec 2015
		In HRK'000	In HRK'000
Non-current assets			
Property, plant and equipment	11	28,093,856	25,722,455
Assets under construction	11	2,677,233	4,386,574
Intangible assets	12	157,586	121,437
Investment property	13	231,491	236,778
Prepayments for property, plant and equipment	14	36,707	37,880
Long-term loans and deposits	17	28,973	28,605
Available-for-sale and other investments	18	295,938	245,910
Other non-current assets	19	46,941	115,795
Deferred tax assets	10	555,461	650,681
Total non-current assets		**32,124,186**	**31,546,115**
Current assets			
Inventories	20	1,405,368	1,489,289
Trade receivables	21	1,953,592	1,847,063
Other short-term receivables	22	730,917	835,753
Cash and cash equivalents	23	3,018,846	2,493,166
Total current assets		**7,108,723**	**6,665,271**
TOTAL ASSETS		**39,232,909**	**38,211,386**

Consolidated Statement of financial position / Cosolidated Balance sheet (continued) As at 31 December 2016

EQUITY AND LIABILITIES	Notes	31 Dec 2016	31 Dec 2015
		In HRK'000	In HRK'000
Share capital	24	19,792,159	19,792,159
Revaluation reserves	24	140,293	100,836
Retained earnings	24	5,551,226	4,132,208
Equity Attributable to Owners of the Parent		**25,483,678**	**24,025,203**
Non-controlling interest		-	-
Total equity		**25,483,678**	**24,025,203**
Liabilities under issued bonds	25	3,606,173	4,223,883
Long-term loan liabilities	26	664,764	936,243
Long-term liabilities to the State	27	15,901	18,774
Long-term provisions	28	930,700	969,501
Other long-term liabilities	29	4,190,347	4,444,970
Deferred tax liabilities		26,007	21,816
Total non-current liabilities		**9,433,892**	**10,615,187**
Trade payables	30	1,787,338	1,740,910
Current portion of long-term bonds issued	25	586,601	93,380
Current portion of long-term loans	26	411,832	386,509
Taxes and contributions	31	157,750	199,288
Interests payable		42,569	45,693
Liabilities to employees	32	155,269	226,510
Other current liabilities	33	1,173,980	878,706
Total current liabilities		**4,315,339**	**3,570,996**
TOTAL EQUITY AND LIABILITIES		**39,232,909**	**38,211,386**

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

Consolidated Statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2016

	Share capital	Revaluation reserves	Retained earnings / Loss carried forward	Equity attributable to Owners of the Parent	Non-controlling interests	Total equity
	In HRK'000	In HRK'000	In HRK'000	In HRK'000	In HRK'000	In HRK'000
Balance at 1 January 2015	**19,792,159**	**54,947**	**2,201,265**	**22,048,371**	**29,202**	**22,077,573**
Profit for the year	-	-	1,939,095	1,939,095	962	1,940,057
Other comprehensive income	-	45,889	(4,196)	41,693	(257)	41,436
Total comprehensive income	-	*45,889*	*1,934,899*	*1,980,788*	*705*	*1,981,493*
Land surpluses	-	-	1,401	1,401	-	1,401
Other changes	-	-	(5,357)	(5,357)	-	(5,357)
Distribution of dividends to RWE	-	-	-	-	(29,907)	(29,907)
Balance at 31 December 2015	**19,792,159**	**100,836**	**4,132,208**	**24,025,203**	**-**	**24,025,203**
Profit for the year	-	-	2,045,002	2,045,002	-	2,045,002
Other comprehensive income	-	39,457	(18,984)	20,473	-	20,473
Total comprehensive income	-	*39,457*	*2,026,018*	*2,065,475*	-	*2,065,475*
Distribution of dividend to the Owner	-	-	(607,000)	(607,000)	-	(607,000)
Balance at 31 December 2016	**19,792,159**	**140,293**	**5,551,226**	**25,483,678**	**-**	**25,483,678**

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić
Management Board member

Zvonko Ercegovac
Management Board member

Saša Dujmić
Management Board member

Perica Jukić
President of the Management Board

Consolidated Statement of cash flows

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	In HRK'000	In HRK'000
OPERATING ACTIVITIES		
Profit for the year	2,045,002	1,940,057
Corporate income tax expense recognized in profit	545,359	455,667
Net loss from financial activities	132,796	600,041
Fair value of property investment	5,287	(625)
Value adjustment of non-current assets	108,256	47,507
Depreciation and amortization	1,780,269	1,825,097
Receivables value adjustment	(149,202)	71,419
Inventories value adjustment	13,353	14,257
Increase /(decrease) in provisions	(38,801)	66,722
Operating cash flows before movements in working capital	*4,442,319*	*5,020,142*
(Increase) in trade receivables	42,673	(53,802)
Decrease /(increase) in inventories	70,568	109,751
(Increase) in other current assets	163,636	(317,544)
Increase/(decrease) in trade payables	46,428	150,165
Increase in other current liabilities	286,318	63,034
(Decrease) in other non-current liabilities	(224,969)	(247,223)
Cash generated from operations	**4,826,973**	**4,724,523**
Corporate income tax paid	(553,691)	(843,656)
Interests paid	(244,612)	(389,097)
NET CASH FROM OPERATING ACTIVITIES	**4,028,670**	**3,491,770**
INVESTING ACTIVITIES		
Interest receipts	49,335	49,420
Increase in property, plant and equipment	(2,589,126)	(2,528,144)
Disposal of property, plant and equipment	2,392	25,674
Increase in other non-current assets	(30,796)	(23,966)
NET CASH (USED IN) INVESTING ACTIVITIES	**(2,568,195)**	**(2,477,016)**

Consolidated Statement of cash flows (continued) For the year ended 31 December 2016

	2016	2015
	In HRK'000	In HRK'000
FINANCING ACTIVITIES		
Receipts from bonds issued	-	3,703,533
Long-term loans received	147,623	66,722
Repayment of long-term loans	(382,038)	(417,915)
Repayment of issued bonds	(93,380)	(2,900,335)
Repayment of short-term loans	-	(8,981)
Dividends paid to the owner	(607,000)	-
Dividends paid to RWE	-	(44,512)
NET CASH (USED IN) / FROM FINANCING ACTIVITIES	**(934,795)**	**398,512**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**525,680**	**1,413,266**
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	**2,493,166**	**1,079,900**
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	**3,018,846**	**2,493,166**

The accompanying notes form an integral part of these consolidated financial statements.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

Notes to the consolidated financial statements

FOR THE YEAR ENDED 31 DECEMBER 2016

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, 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 2016 the Group employed 11,832 employees (2015: 11,935), excluding Krško Nuclear Power Plant which employed 617 employees (2015: 648).

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

LAWS REGULATING THE ENERGY SECTOR

The Croatian Parliament adopted following Acts and Regulations that are regulating the Group's activities:

- the Energy Act and the Regulation of Energy Activities Act (adopted on 19 October 2012),
- the Electricity Market Act (adopted on 8 February 2013),
- the Gas Market Act (adopted on 22 February 2013),
- the Heat Energy Market Act (adopted on 21 June 2013),
- Law on Amendments of the Electricity Market Act (adopted on 18 September 2015).

New Acts and Regulations, harmonized with EU Guidelines and Directives, determined further restructuring and adjustments of operations of HEP Group. According to provisions of the Electricity Market Act and amendments of the Electricity Market Act, HEP d.d. and its subsidiaries continue to provide public energy services in the Republic of Croatia, namely: transmission, distribution and universal and guaranteed supply of electricity. Generation, supply (on open market) and trading of electricity are performed as market activities as defined by legislation regulating the energy activities and trading on energy markets. Supply of electricity on open market is performed in accordance with rules governing market relations, where the energy subjects freely negotiate quantities and prices on a free market basis. Supply of electricity as a universal and guaranteed service, is performed according to regulated conditions to the protected customers who have a right to such model of supply and choose it freely or automatically. Household customers are supplied with electricity as guaranteed public service, as well as part of protected customers that have not exercised their right to select the electricity supplier or are left without a supplier. Part of household customers exercised their right to choose their supplier. HEP d.d. and its subsidiaries are reorganizing the Group in accordance with changed Acts and Regulations and prescribed deadlines.

1. GENERAL (continued)

LAWS REGULATING THE ENERGY SECTOR (CONTINUED)

In April 2012, the Government of the Republic of Croatia issued following Decisions: Tariff Model for Electricity Generation, with the exemption of protected customers, with no tariff items; Electricity Transmission Tariff Model, with no tariff items; Electricity Distribution Tariff Model, with no tariff items; and Electricity Supply Tariff Model, with the exemption of protected customers, with no tariff items. The Group has been applying above mentioned Tariff Models since 1 May 2012. On 30 September 2013 Decisions on Tariff Model for Electricity Generation, with the exemption of protected customers, with no tariff items and Electricity Supply Tariff Model, with the exemption of protected customers, with no tariff items ceased to have effect.

Electricity Market Act adopted in February 2013, determines that each customer has a right to freely choose a supplier, and household customers have a right to electricity supply as a universal service. Customers that have not exercised their right to select the electricity supplier or are left without a supplier, are using public guaranteed supply service. Pursuant to the provisions of the Electricity Market Act on 13 September 2013 the Croatian Energy Regulatory Agency (HERA) issued Methodology for determining tariff items for electricity supplies within the universal service and on 17 December 2013 HERA adopted the Methodology for determining the amount of tariff items for guaranteed electricity supplies. From 1 October 2013, households supplied with electricity within the universal service, are charged in accordance with Methodology for setting tariff items for electricity supply within the universal service and the Decision of HEP Operator distribucijskog sustava d.o.o. on the amount of tariff items for electricity supply within universal service dated 1 October 2013, and from 1 January 2015 by Decision of HERA on the amount of tariff items for electricity supply in the context of universal service.
From the entry into force of the Act on Amendments to the Electricity Market Act, the decision on the amount of tariff items for electricity supply within the universal service is made by the HEP Operator distribucijskog sustava d.o.o. or HEP Elektra d.o.o. from 2 November 2016.
Customers using public guaranteed supply service were charged in accordance with the Methodology for setting prices for balancing electricity price charged to customers responsible for deviations and from 1 July 2014, in accordance with the Methodology for setting the tariff items for guaranteed electricity supply and the Decision of Croatian Energy Regulatory Agency on the amount of tariff items for guaranteed electricity supply.

1. GENERAL (continued)

GENERAL ASSEMBLY

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

Ivan Vrdoljak	Member	Member since 21 November 2012 until 3 March 2016
Tomislav Panenić	Member	Member since 4 March 2016 until 25 January 2017
Zdravko Marić	Member	Member since 26 January 2017

SUPERVISORY BOARD

Members of the Supervisory Board in 2016

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Mirko Žužić	Member	Member since 19 September 2012
Juraj Bukša	Member	Member since 5 June 2014
Dubravka Kolundžić	Member	Member since 1 June 2015

Members of the Supervisory Board in 2015

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Mirko Žužić	Member	Member since 19 September 2012
Juraj Bukša	Member	Member since 5 June 2014
Jadranko Berlengi	Member	Member since 3 June 2008 to 31 May 2015
Dubravka Kolundžić	Member	Member since 1 June 2015

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

1. GENERAL (continued)

MANAGEMENT BOARD

Management Board in 2016

Perica Jukić	President	Member since 12 September 2014
Zvonko Ercegovac	Member	Member since 23 February 2012
Tomislav Rosandić	Member	Member since 2 January 2015
Saša Dujmić	Member	Member since 4 December 2014

Management Board in 2015

Perica Jukić	President	Member since 10 May 2013, President since 12 September 2014
Zvonko Ercegovac	Member	Member since 23 February 2012
Željko Štromar	Member	Member since 16 December 2013 to 31 March 2015
Tomislav Rosandić	Member	Member since 2 January 2015
Saša Dujmić	Member	Member since 4 December 2014

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Group's significant accounting policies which have been applied consistently in the current and previous years is set out below.

PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements for 2016 have been prepared in accordance with the Accounting Act (Official Gazette 75/15, 120/16), the International Financial Reporting Standards ("IFRS"), 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 non-current assets and certain financial instruments that are presented in revalued amounts. The consolidated financial statements are presented in thousands of Croatian Kuna (HRK '000) as the Group's functional currency.

BASIS OF ACCOUNTING

The Group maintains its accounting records in the Croatian language, in Croatian Kuna and in accordance with Croatian legislation and the accounting principles and practices observed by enterprises in Croatia.

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

Standards and Interpretations effective in the current period

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions – IAS 19 requires subjects to consider employee or third party contributions in accounting defined earning.
- Annual Improvements to IFRSs 2012–2014 Cycle
    - IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
    - IFRS 7 Financial Instruments: Disclosures (with consequential amendments to IFRS 1)
    - IAS 19 Employee Benefits
    - IAS 34 Interim Financial Reporting

  The effective date of the amendments is 1 January 2016. Earlier application is allowed.
- Annual Improvements 2010-2012 Cycle, these amendments are effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted. They include:
    - IFRS 2 Share-based Payment,
    - IFRS 3 Business Combinations,
    - IFRS 8 Operating Segments,
    - IFRS 13 Fair Value Measurement,
    - IAS 16 Property, Plant and Equipment and IAS 38 Intangible assets,
    - IAS 24 Related Party Disclosures;
- Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception (issued in December 2014)
- Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations (issued in May 2014)
- Amendments to IAS 1 Disclosure Initiative (issued in December 2014)

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

- Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation (issued in May 2014)
- Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants (issued in June 2014)
- Amendments to IAS 27 Equity Method in Separate Financial Statements (issued in August 2014)

The application of the above-mentioned standards had no influence on the consolidated financial statements of the Company for 2016.

NEW AND REVISED IFRSS ISSUED BY THE IASB BUT NOT EFFECTIVE

- IFRS 9 Financial Instruments – in July 2014, IASB issued a final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments replacing IAS 39 Financial Instruments: Recognition and measurement and all other preceding versions IFRS 9. IFRS 9 is effective for the annual period beginning on or after 1 January 2018, earlier applications are permitted. The application of this standard will have negligible affect the classification and measurement of financial instruments.
- IFRS 15 Revenue from Contracts with Customers - IFRS 15 was issued in May 2014 and represents a new model in five steps that relate to revenue that results from contracts with customers. The Standard replaces IAS 11 and IAS 18. Standard is effective for the annual period beginning on or after 1 January 2018, earlier applications are permitted. The Standard allows a modified transfer model which does not require retroactive modifications. The Management performs detailed analysis on its possible effects on the Company`s consolidated financial statements.

NEW AND REVISED IFRSS ISSUED BY THE IASB BUT NOT YET ADOPTED BY THE EU

The following standards and amendments to the existing standards have not been adopted by the EU yet:

- IFRS 14 Regulatory Deferral Accounts – this standard relates to subjects that operate on regulated markets and are applying IFRS for the first time. IFRS 14 is effective for the annual period beginning on or after 1 January 2016. The European Commission has decided not to implement this standard due to the fact that only small number of companies was within the scope of the standard.
- IFRS 16 Leases – the standard brings a new comprehensive model of identification of arrangements which have leases and their accounting treatment on the side of lessor and lessee. The standard will replace IAS 17 and interpretations of IFRIC 4, SIC 15 and SIC 27. IFRS 16 is effective for the annual period beginning on or after 1 January 2019. Earlier applications are permitted, but this is conditioned with the application of IFRS 15 unless already adopted. This standard brings significant changes to the accounting model of the lessee. Consequently, assets and liabilities will be recognised in the financial statements of the lessee in most contract that were formerly recognised as operating lease. This will result in an increase of assets and liabilities. The Management Board plans detailed analysis in the coming periods to determine effects on the consolidtated financial statements of the Company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

NEW AND REVISED IFRSS ISSUED BY THE IASB BUT NOT YET ADOPTED BY THE EU (CONTINUED)

- Amendments to IFRS 2 – classification and measurement of share based payment transactions (issued in June 2016).
- Amendments to IFRS 4 – Application of IFRS 9 Financial instruments with IFRS 4 Insurance agreements (issued in June 2016).
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued in September 2014).
- Clarifications to IFRS 15 Revenue from Contracts with Customers (issued in April 2016).
- Amendments to IAS 7 – part of its disclosure initiative (issued in January 2016)
- Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses (issued in January 2016).
- Amendments to IAS 40 – Transfer of real estate investments (issued December 2016.)
- Annual Improvements 2014-2016 Cycle (issued December 2016). They include:
  - IFRS 1 First application of IFRS,
  - IFRS 12 Disclosure of interests in other entities,
  - IFRS 28 Investments in associates and joint ventures

  Amendments which relate to IFRS 12 are effective for periods starting on 1 January 2017, while amendments to IFRS 1 and IAS 28 are effective for the annual period beginning on or after 1 January 2018.
- IFRIC 22 Foreign currency transactions and advance considerations (issued December 2016).

The Company's management anticipates that the application of the above standards, amendments and interpretations, except for IFRS 16 as stated above, will have no material impact on the consolidated financial statements in the period of initial application.

THE BASIS FOR PREPARATION OF THE COMPANY'S CONSOLIDATED FINANCIAL STATEMENTS

The Company's consolidated financial statements represent aggregate amounts of assets, liabilities and equity, and the results of the Group's operations for the year ended.

PRINCIPLES AND METHODS OF CONSOLIDATION

The consolidated financial statements incorporate the financial statements of HEP d.d. (the Parent company) and entities controlled by HEP d.d. (it's subsidiaries). List of Group's subsidiaries is provided in the Note 36. HEP d.d. has control over the entity if based on its participation is exposed to variable yield, i.e. has a right to it and ability to influence the yield with its prevalence in the entity. Considering that HEP has a 100% share in the capital of its subsidiaries and represents the only member resulting in the ability to manage and appoint Members of the Board, all mentioned companies are included in the consolidated financial statements as subsidiaries.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PRINCIPLES AND METHODS OF CONSOLIDATION (CONTINUED)

Subsidiaries are included in the consolidated financial statements from the date the Company gains control until the date when the Company ceases to control the subsidiary.
Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with those used by other members of the Group.
All significant intergroup transactions, balances, income and expenses are eliminated in consolidation.
Non-controlling interest in the net assets of consolidated subsidiaries in these consolidated financial statements are identified separately from the Group's equity therein. Non-controlling interest consist of the amount of those interests at the date of the original business combination and the non-controlling share of changes in equity since the date of the combination. Profit or loss and every part of other comprehensive income are attributable to Owners of the parent and non-controlling interest, even if it results in a negative amount of non-controlling interest.
Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are accounted as equity transactions. If the parent loses control over the subsidiary, it derecognises related assets (including goodwill) and liabilities, non-controlling interest and other components of equity in former subsidiary, and recognises the gain or loss associated with the loss of control attributable to the former controlling interest. Any remaining interest is recognized at fair value.

REPORTING CURRENCY

The consolidated financial statements of the Company are presented in Croatian Kuna (HRK '000).

INVESTMENTS IN JOINT ARRANGEMENTS

In accordance with IFRS 11, Joint arrangements are classified as:

- joint operations - whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement
- joint venture - whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement.

In classification of investments in joint operations, the Group considers:

- The structure of joint operation,
- Legal form of the joint operation structured through separate legal entities,
- Contracting conditions of joint operations,
- All other facts and circumstances (including any other contractual arrangements).

Interest in joint ventures are measured using equity method.
The Group recognizes its interest in joint operation through its share of assets, liabilities, income and expenses in accordance with its contractual rights and obligations.
The Group identified its investment in Krško Nuclear Power Plant as joint operation (Note 15).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

EMPLOYEE BENEFITS

The Company has no defined post-retirement benefits for its employees or Management. Accordingly, no provision for these costs has been included. Legal pension and health insurance contributions are paid on behalf of the Company's employees. This obligation applies to all employees hired on the basis of employment contract. The contributions are paid at a certain percentage determined on the basis of gross salary.

	2016 and 2015
Pension insurance contributions	20%
Health insurance contributions	15%
Employment Fund contribution	1.7%
Occupational injury	0.5%

The Company has the obligation to withhold the contributions from the employees' gross salaries. Contributions on behalf of the employer and the employees are recognized as cost in the period in which they incurred (Note 7).

The Group pays employees jubilee awards and one-time severance payments upon retirement. The liabilities and expenses for these payments are determined with the application of the projected unit credit method. By using projected unit credit method, each period of seniority is observed as the basis for additional units of eligibility to allowances and each unit is measured separately until the realization of final liabilities. This liability is determined at the present value of projected future cash outflow with the application of the discount rate which is similar to the interest rate of State bonds in Croatia released on the market where the currency and maturity is in accordance with the currency and estimated duration of liabilities for the payment of these allowances. Liabilities and the costs of these allowances were calculated by a certified actuary.

Jubilee awards
The Group provides long-service benefits (jubilee awards) and retirement benefits to its employees. The long-service benefits range from HRK 1,500 to HRK 5,500, net, and are provided for tenure from 10 to 45 years of continuous employment with the employer.

Severance payments
A new Collective Agreement was adopted as of 1 July 2016 (which covers all of the HEP Group companies), under which the employees are entitled to a severance payment in the extent of 1/8 of the average gross monthly salary earned in the period of three months prior to termination of the employment contract, for each completed year of continuous employment at the employer. The effective date of the Collective contract is until 31 December 2017.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT (HEREINAFTER: PPE)

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 method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.
PPE in use are depreciated using the straight-line method on the following bases:

Buildings	**2016 and 2015**
Hydroelectric power plants (flood gates and dams, buildings and other buildings as well as accompanying objects)	20 – 50 years
Thermal power plants (buildings and other structures)	33 – 50 years
Electricity transmission and distribution plants and facilities (transmission lines and buildings of transformer stations, switch-yard, dispatch centres and others)	20 – 40 years
Water and steam pipelines and other thermal power generation and transmission objects	33 years
Gas pipelines until 2014	20 – 25 years
Gas pipelines from 2014	40 years
Administrative buildings	50 years
Plant and equipment	
Hydroelectric power plants	10 – 33 years
Thermal power plants	6 – 25 years
Electricity transmission plants and facilities (electric parts of transformer stations and transformers; and electric parts of transmission lines)	15 – 40 years
Electricity distribution plants and facilities (electric parts of transformer stations and transformers, electric parts of distribution 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
Other equipment and vehicles	
IT equipment	5 – 20 years
Software licenses	5 years
Telecommunications equipment	5 – 20 years
Motor vehicles	5 – 8 years
Office furniture	10 years

The cost of PPE 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 as intended by Management. Expenditures incurred after PPE have been put into operation are normally charged to profit or loss in the period in which the costs are incurred.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

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 PPE beyond its originally assessed standard performance, the expenditures are capitalized as an additional cost of PPE. 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 PPE is determined as the difference between the sale proceeds and the carrying amount of the asset and are recognized and is recognized as an expense or income in the consolidated income statement.

Impairment of PPE and intangible assets

At each reporting date, the Group reviews the carrying amounts of its PPE 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 fair value less costs to sell 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 for which the estimates of future cash flows have not been adjusted.

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 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 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 on 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 Group as lessee
The Group has no significant finance lease arrangements and there were no new significant operating lease arrangements concluded during 2016 and 2015. Operating lease payments are recognized as an expense in on a straight-line basis over the lease term.

TRADE RECEIVABLES AND PREPAYMENTS

Trade receivables are carried at cost less any impairment for bad and doubtful receivables.
The Management carries out impairment of bad and doubtful receivables based on review of the ageing structure of all receivables as well as a review of significant individual amounts included in the receivables.
Given the uncertainty that some of receivables will be collected over longer period, the Group carries out impairment of unrecoverable amounts, based on a reasonable estimate and past experience as follows:

	2016 and 2015
Receivables ageing structure	Impairment percentage
31 - 60 days	1.5%
61 - 90 days	3%
91 - 180 days	9%
181 - 365 days	30%
Over one year	90%

Receivables for which legal proceedings have been initiated and receivables from entities in bankruptcy and pre-bankruptcy settlement proceedings (principal and interests) are impaired in their full amount by debiting expenses, regardless of the overdue period.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

INVENTORIES

Inventories comprise material and small inventory and are carried at lower of cost and net realisable 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_2 emission rights. After Croatia joined to the European system for greenhouse gas emissions trading (EU ETS), Hrvatska elektroprivreda as an electricity and thermal energy generator, is obligated to purchase greenhouse gas emission units in the amount corresponding to verified emissions of CO_2 generated from the fossil fuel combustion in thermal power plants, as a result of which CO_2 is emitted.

Companies are obligated to have defined quantities of CO_2 emission rights at 30 April (yearly cycle). Due to withdrawal of IFRIC 3 *Emission Rights* and insufficient provisions of IFRS, the Group has analysed different accounting models for CO_2 emission rights, and among other EFRAG discussion papers. Occasionally, the Group trades with CO_2 emission rights. Due to that the Group recognize these emission rights as inventory.

From April 2014, inventories include gas stock held for trading on the wholesale market and are stated at lower of cost and net realizable value. The Company measures inventories based on the weighted average price (Note 20).

Inventory costs for quantities of gas for direct delivery to customers are calculated using method of specific identification.

Cost comprise invoiced amount as well as all other costs directly attributable to bringing inventories to their present location and condition.

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 on an accrual basis.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FOREIGN CURRENCIES

Separate financial statements of each Group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group entity are presented in Croatian Kuna (HRK), as the Group's functional and presentation currency.
In the financial statements of individual Group entities, transactions in foreign currencies are translated to the functional currency of the entity at the applicable exchange rates prevailing on the dates of transactions. At each reporting date, monetary balances, denominated in foreign currencies are retranslated to the functional currency of the entity at the applicable exchange rates 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 rates 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 on the settlement of monetary items, and on their retranslation, are stated in the consolidated income statement in the period in which they incurred. Exchange differences arising on retranslation of non-monetary assets carried at fair value are stated in the consolidated income statement as financial cost, except for exchange differences arising on 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.
For the purpose of presenting consolidated financial statements, assets and liabilities of the Group's foreign entities are presented in Croatian Kuna at the applicable exchange rate on the date of the consolidated statement of financial position. Those assets and liabilities are originally denominated in EUR. As the main goal of the CNB monetary policy is stability of the currency which is secured through maintenance of the stable HRK rate against EUR, income and expense items (together with comparatives) are translated at the annual average exchange rate. However, if exchange rate fluctuates significantly (over 10%), the Group use the exchange rates at the dates of transactions. Exchange differences arising from year-end translation, are classified as reserves and recognized as profit or loss for the period in the period when the foreign entity is sold.

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 statement of comprehensive income 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 by the end of the reporting period.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

TAXATION (CONTINUED)

Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and are accounted for using the statement of financial position liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available 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 combination) 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 income statement, except when relate 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 of accounting for a business combination.

In case of a business combination, tax effect is taken into account in the measurement of goodwill or in determining the excess of the acquirer’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities over cost.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL ASSETS

Investments are recognized and derecognized on the date of transaction. Financial assets are initially measured at fair value, increased by transaction costs, except for those financial assets classified at fair value through profit or loss.
Financial assets are classified as Available-for-sale, at fair value through profit or loss and Loans and receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method
The effective interest method is a method of calculating the amortized cost of financial asset and of allocation interest income over the relevant period. The effective interest rate is the rate that discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period. Income is recognised on an effective interest basis for debt instruments.

Available-for-sale financial assets (AFS)
Shares held by the Group that are traded in an active market are classified as Available-for-sale financial assets and are measured at fair value. Gains and losses arising from changes in fair value are recognised in revaluation reserve through other comprehensive income, except for impairment losses, interests calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss for the period. Where the investment is disposed or impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is recognized in profit for the period.
Dividends, i.e. profit shares on equity instruments are recognized as profit or loss when the Group's right to receive the dividends has been established.
The fair value of available-for-sale financial assets denominated in a foreign currency is determined in that foreign currency and translated at the exchange rate prevailing at the end of the reporting period.

Loans and receivables
Trade receivables, loans, and other receivables with fixed or determinable payments and that are not quoted in an active market, are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL ASSETS (CONTINUED)

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected. For financial assets carried at amortized cost, the amount of the impairment is the difference between the assets carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced for the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the impairment account. When a trade receivable is considered uncollectible, it is written off through the impairment account. Subsequent recoveries of amounts previously written-off are credited to impairment account. Changes in the carrying amount of the impairment account are recognized in profit or loss.

With the exception of AFS equity instruments, if in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognized, previously recognized impairment losses are reversed through the profit or loss to the extent that the carrying amount of the investment, at the date when the impairment is reversed, does not exceed what the amortized cost would have been if the impairment has not been recognized.

In respect of AFS equity instruments, any increase in fair value subsequent to an impairment loss is recognized directly in revaluation reserve.

Investments

Investments in immaterial non-consolidated companies are generally recorded at cost less any impairment.

FINANCIAL LIABILITIES

Financial liabilities, including loans and borrowings, are subsequently measured at amortized cost by applying the effective interest method.

The effective interest method is a method of calculating the amortized cost of financial liability and of allocating interest expense over the relevant period. Effective interest rate is the rate that discounts estimated future cash payments (including all fees and points paid and received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Group derecognizes financial liabilities only when the Group's liabilities are settled, cancelled or they expire. The difference between the carrying amount of derecognized financial liability and consideration paid and payable is recognized in profit or loss.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

DERIVATIVE FINANCIAL INSTRUMENTS

The Company entered into a cross currency swap agreement in order to manage its exposure to exchange rate risk. Further details on derivative financial instruments are disclosed in the Note 25.
Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently re-measured to their fair value at the end of each reporting period. Profit or loss arising from fair value measurement is recognized in profit and loss.
The Company brought Decision on measurement of the fair value of the cross-currency swap according to the calculation of Mark-to-market ("MTM") value prepared by business banks. Profit or loss arising from fair value measurement is recognized in profit and loss.

PROVISIONS

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of obligation. Provisions are reviewed at the end of each reporting period and adjusted to reflect the present best estimate. Where the effect of discounting is materially significant, the amount of the provision is the present value of the expenses expected to be required to settle the obligation. When discounting is used, increase in provisions that reflects the passage of time is recognized as interest expense.

USE OF ESTIMATES IN PREPARATION OF THE CONSOLIDATED FINANCIAL STATEMENTS

Preparation of the consolidated financial statements in conformity with International Financial Reporting Standards, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent liabilities. Estimates used in preparation of these consolidated financial statements relate to employee benefits, impairment of assets, determination of fair values of assets and liabilities and estimated decommissioning costs. Future events may occur which could cause changes in the assumptions used for making these estimates. The effect of any changes in estimates will be recorded in the consolidated financial statements, when determinable.

REVENUE RECOGNITION

Revenue is realized primarily from the sale of electricity to households, industrial and other customers within the Republic of Croatia. These activities constitute the main source of the Group's operating income.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

REVENUE RECOGNITION (CONTINUED)

Revenue from the sale of electricity is recognized based on best estimate on the quantities of energy delivered. As the actual calculation of the quantities of energy delivered to customers is performed twice a year, the Group recognized revenue from sales of electricity based on the total generated and purchased energy quantities on the distribution network corrected for losses on the distribution network based on logarithmic regression. The price of electricity is regulated by the Croatian Energy Regulatory Agency until entry into force of the Law on Amendments to the Electricity Market Act (Official Gazette 102/2015.), when price regulation for public service electricity supply of households in the context of universal service and amounts of tariff items for electricity supply provided by the supplier who has the obligation to provide public service, ceases to exist. 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 determined by tariffs approved by the regulatory agency, or by decision of the company that has obligation to provide the public service. Alternatively, the Group provides option for their customers to choose market price model, in which case revenue is recognized in accordance with free market prices (HEPI tariff model).

Revenue from sale of heating energy to households, industrial and other customers in the Republic of Croatia is recognized when the heating energy is delivered to the customers and is probable that future economic benefits related to transaction will inflow into the Group.

Revenues from gas sale are recognized in the period when the gas is delivered to the customers and is probable that future economic benefits related to transaction will inflow into the Group. The price of gas is regulated by the Croatian Energy Regulatory Agency. The Group does not have a separate accounting model for recognizing any deferral that would result from regulated tariffs.

REVENUE FROM CONNECTION FEES

As of 1 July 2009, the Group adopted IFRIC 18 “Transfers of Assets from Customers”.

IFRIC 18 clarifies the IFRS requirements regarding accounting of contracts in which an entity receives an asset (item or property, plant and equipment or cash) from the customer for their construction, which the entity, in return, must use either to connect the customer to a network or to provide the customer with the ongoing access to a supply of goods or services. When the item of property, plant and equipment transferred from a customer meets the definition of an asset, the Group must recognize the asset in its consolidated financial statements.

Since 1 July 2009, connection fees received from customers have been recognized as income in the amount of cash received from the customer, in the moment customer is connected to the network/grid or in a moment the customer is enabled continuous access to services.

SEGMENT ANALYSIS

The Group has adopted IFRS 8 “Operating Segments” and disclosed information about their operating segments, given that the Group has debt instruments, which are traded in public market.

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

CRITICAL JUDGMENTS WHEN APPLYING ACCOUNTING POLICIES

When applying accounting policies described in the Note 2, the Management made certain judgments that had a significant impact on the amounts stated in the consolidated financial statements. These judgments are provided in detail in the accompanying notes and the most significant relate to the following:

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

Fair value of financial assets
As described in the Note 21, Management uses judgment to estimate whether trade and other receivables have suffered an impairment loss.

Provisions for environment protection
The exact scope of activities or technologies to be applied has not been specified by the applicable laws or regulations. In determining the level of provisions for environmental protection and decommissioning, Management relies on the prior experience and its own interpretation of the current laws and regulations. Pursuant to Article 4.1 of the Law on Acknowledging the Contract between the Government of the Republic of Croatia and the Government of the Republic of Slovenia on Regulating the Status and other Legal Relations in Respect of Investments in, Exploitation and Decommissioning of, the Nuclear Power Plant Krško (Official Gazette No. 9/2002), the Croatian Government on 28 April 2006 issued a decree on the payment of funds for the decommissioning and disposal of radioactive waste and consumed nuclear fuel of the NPPK. Pursuant to Article 10, Par. 3 of the Law on the fund to finance the decommissioning and disposal of radioactive waste and consumed nuclear fuel from the Krško Nuclear Power Plant (Official Gazette 107/2007), on 24 December 2008 the Croatian government adopted an Ordinance on the amount, timeframe and method of payment of funds to finance the decommissioning and disposal of radioactive waste and consumed nuclear fuel from the Krško Nuclear Power Plant (Official Gazette 155/08) (Note 15).
Provision for decommissioning of thermal power plants represent present value of the estimated decommissioning costs of the Group's thermal power plants.

Recognition of revenues from sale of electricity - households
As the collection is conducted through prepayments with actual calculation twice a year, the Group is estimating revenues from the sale of electricity. The estimate is based on the total generated and purchased energy quantities, which are corrected for losses in the distribution network based on logarithmic regression. After analysing a number of different methods of approximation (five-year average, a linear approximation, etc.), the Management chosen method of logarithmic regression as the most appropriate. The difference between initially estimated revenues and actual prepayments is recognized in the consolidated statement of financial position as other short-term liabilities or other short-term receivables.

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

Impairment of non-current assets

The impairment calculation requires the estimate of value in use of the cash generating units. That value is measured using the discounted cash flow projections. The most significant variables in determining cash flows are discount rates, time values, the period of cash flow projections, as well as assumptions and judgments used in determining cash inflows and outflows.

Availability of taxable profits for which deferred tax assets could be recognized

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that the related tax benefit will be realised against future taxable profits. Measurement of the amount of deferred taxes that can be recognised, requires a significant level of judgement which is based on the probable quantification of the time and level of future taxable profits, together with the future tax planning strategy. Carrying amount of deferred tax assets as at 31 December 2016 amounted to HRK 555,461 thousand, as at 31 December 2015 to HRK 650,681 thousand (Note 10).

Actuarial estimates used in determining severance payments and jubilee awards

The cost of defined benefits is determined using actuarial estimates. Actuarial estimates involve assumptions about discount rates, future salary increases and the mortality or fluctuation rates. Because of the long-term nature of those plans, there is uncertainty regarding those estimates. Provisions for jubilee awards and severance payments amounted to HRK 374,679 thousand as at 31 December 2016, and to HRK 420,425 thousand as at 31 December 2015 (Note 28).

Consequences of certain court disputes

The Group is a subject to number of court disputes arising from operating activities. Provisions are made if there is a present obligation as a result of a past event (taking into account all available evidence, including the opinion of law experts) for which is probable that outflow of resources will be required to settle the obligation and if a reliable estimate can be made of the amount of the obligation. (Note 28).

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

4. SEGMENT INFORMATION

The Group generates most income from its operations in a single geographical area – the Republic of Croatia. The Group's reportable segments are defined as follows: electricity (generation, transmission, distribution and sale of electricity), heating (generation, distribution and sale of heating power), and gas (distribution and sale of gas). Each segment's operating profit or loss includes all revenue and expenses directly attributable to the reportable segment. Information about financial income, expense and income tax is not provided on a segment level, as the segments are disclosed based on the operating profit.

	Electricity		Heating		Gas		Group	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Operating revenue	10.831.456	10.537.427	699.596	682.388	1.444.540	1.684.740	12.975.592	12.904.555
Other segment income	1.350.081	1.588.378	51.868	55.407	22.817	21.125	1.424.766	1.664.910
Operating profit / loss	**2.867.744**	**3.149.041**	**(162.625)**	**(290.676)**	**18.038**	**137.400**	**2.723.157**	**2.995.765**
Net financial expense							(132.796)	(600.041)
Corporate income tax							(545.359)	(455.667)
Net profit							**2.045.002**	**1.940.057**

Segment assets consist primarily of property, plant and equipment, receivables, cash and inventories. Segment liabilities consist of trade and other payables. Non-segment assets and liabilities consist of assets and liabilities that cannot be reasonably attributed to the reportable business segments. Total unallocated assets include investments in NEK, a part of property, plant and equipment, and unallocated financial assets. Total unallocated liabilities include long-term loans, short-term loans and various other liabilities.

	Total segment assets		Total segment liabilities	
	2016	**2015**	**2016**	**2015**
	HRK'000	HRK'000	HRK'000	HRK'000
Electricity	30,179,137	29,030,695	6,227,856	6,125,754
Heating	1,226,459	1,204,678	170,255	187,850
Gas	370,917	383,816	99,960	101,933
Unallocated	7,456,396	7,592,197	7,251,160	7,770,646
Total Group	**39,232,909**	**38,211,386**	**13,749,231**	**14,186,183**

4. SEGMENT INFORMATION (continued)

CUSTOMER INFORMATION

In 2016 electricity sales amounts to HRK 10,831,456 thousand (2015: HRK 10,537,427 thousand). Heating energy sales for the year 2016 amounts to HRK 699,596 thousand (2014: HRK 682,388 thousand). In 2016 gas sales in wholesale market amounts to HRK 1,102,728 thousand and gas sales to customers in the amount of HRK 341,812 thousand (2015 wholesale market: HRK 1,298,352 thousand; gas sales to customers HRK 386,388 thousand).

GEOGRAPHICAL INFORMATION

The Group operates in Europe, with countries that are members of the European Union and other countries that are not members of the European Union. Presented below is the territorial analysis of the revenue that the Group realized from continuing operations with external buyers of electricity:

	2016	**2015**
	In HRK'000	In HRK'000
Croatia	9,937,036	10,006,893
EU member states	789,423	365,132
Non - EU member states	104,997	165,402
	10,831,456	**10,537,427**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

5. OTHER OPERATING INCOME

	2016	2015
	In HRK'000	In HRK'000
Network/grid connection services	449,450	367,263
Revenues from court verdict for undelivered electricity NEK	-	328,925
Income from assets financed by network/grid connection fee	231,909	230,636
Reversal of impaired receivables (Note 21)	84,807	73,123
Services rendered	97,441	135,658
Capitalized assets	99,916	95,437
Penalty interests	40,592	74,243
Income from sale of materials	28,735	37,592
Income from sale of cross – border transmission capacity	60,616	58,508
Revenues from inter-compensation (HOPS) - cross-border	22,570	18,341
Reversal of severance payments based on termination of employment contract	-	21,915
Reversal of long-term provisions – vacation accrual	-	5,843
Reversal of long-term provisions for retirement benefits and jubilee awards	72,847	21,695
Reversal of long-term provisions – court costs	55,117	20,593
Reversal of other provisions	5,039	6,170
Recovery of receivables from pre-bankruptcy proceedings	5,433	17,363
Income in respect of the electricity payments reminders	3,538	5,082
Income in respect of court costs on claims	9,382	8,177
Income from sale of tangible assets	30,778	51,281
Recovery of written-off receivables	2,190	2,352
Income from subsidies, grants, reimbursements and compensation	11,930	-
Overcharged fee in previous year on CO_2 emissions for electricity generation	9,486	255
Other income - NEK d.o.o.	5,813	4,977
Other	97,177	79,481
	1,424,766	**1,664,910**

In 2016 the Group realized income from network/grid connection services in the amount of HRK 449,450 thousand (2015: HRK 367,263 thousand) pursuant to IFRIC 18 (Transfers of assets from Customers).

6. PURCHASE COSTS

	2016	2015
	In HRK'000	In HRK'000
Cost of electricity	2,148,249	1,943,077
Gas cost	1,548,033	1,798,986
Fuel cost for sale on the wholesale market	1,246,442	1,352,038
	4,942,724	**5,094,101**

Cost of electricity and gas refers to purchases outside the wholesale sales system and to final customers. Fuel supply (coal, liquid fuels and gas) refers to purchases outside the power generation system in thermal power plants.

7. STAFF COSTS

	2016	2015
	In HRK'000	In HRK'000
Net salaries	1,069,123	1,078,947
Net salaries NEK d.o.o.	92,807	95,097
Taxes and contributions	704,001	711,389
Taxes and contributions NEK d.o.o.	38,512	38,398
	1,904,443	**1,923,831**

TOTAL STAFF COSTS:

	2016	2015
	In HRK'000	In HRK'000
Gross salaries	1,773,123	1,790,336
Gross salaries NEK d.o.o.	131,319	133,495
Reimbursement of costs to employees (Note 8)	119,205	117,937
Employee benefits (Note 8)	65,498	59,359
Unused vacation (Note 8)	9,800	-
	2,098,945	**2,101,127**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

7. STAFF COSTS (continued)

REMUNERATION FOR MEMBERS OF THE MANAGEMENT BOARD AND EXECUTIVE DIRECTORS OF THE GROUP:

	2016	2015
	In HRK'000	In HRK'000
Gross salaries	28,523	27,198
Pension contributions	6,370	6,107
Other benefits	3,329	3,360
	38,222	**36,665**

REMUNERATION FOR MEMBERS OF THE SUPERVISORY BOARD:

	2016	2015
	In HRK'000	In HRK'000
Fees	192	192
Taxes and contributions	194	203
Other costs	18	17
	404	**412**

Reimbursement of costs to employees for 2016 includes commuting costs in the amount of HRK 72,711 thousand (2015: HRK 74,398 thousand), daily allowances and travelling expenses for 2016 in the amount of HRK 21,150 thousand (2015: HRK 19,581 thousand), additional health insurance for 2016 amounting to HRK 8,548 thousand (2015: HRK 7,507 thousand) and other similar expenses for 2016 in the amount of HRK 16,790 thousand (2015: HRK 16,451 thousand).

Employee benefit costs mostly include benefits under the Collective Agreement which amounts to HRK 46,890 thousand, and to a minor extent to solidarity support, family separation allowances, child benefits and other.
In 2016 there were no other payments to the Management Board members in addition to regular salaries and benefits in kind in the amount of HRK 2,721 thousand (2015: HRK 2,694 thousand).

8. OTHER OPERATING EXPENSES

	2016	2015
	In HRK'000	In HRK'000
Maintenance costs	636,610	605,513
Impairment of trade receivables (Note 21)	107,276	170,915
Gas costs	126,178	154,122
Cost of services	296,732	295,829
Chargeable services and supplies	142,643	154,948
Cost of material	86,236	87,149
Compensation for lower quantities of gas than contracted	12,745	5,073
CO2 emission allowances cost	137,315	133,768
Value adjustment of inventory	13,209	15,898
Value adjustment of non-current tangible assets	108,256	47,507
Employee benefits (Note 7)	119,205	117,937
Other employees benefits (Note 7)	65,498	59,359
NE Krško – decommissioning expense	107,197	108,681
Taxes and contributions	90,980	87,339
Litigation provisions	25,244	25,313
Contributions and concession for water fees	64,785	71,517
Provision for unused vacation (Note 7)	9,800	-
Fee for the usage of power plant facilities	73,223	74,825
Compensation for water-purification and drainage	10,528	11,898
Property, plant and equipment write off	18,369	25,674
Cost of materials sold	15,049	30,012
Calculation and collection costs	29,111	30,004
Provisions for retirement benefits and jubilee awards	27,101	78,226
Provisions for severance payments based on the termination of employment contract	342,964	-
Insurance premiums	12,612	16,186
Environmental protection fees	732	2,864
Compensation for damages	16,141	20,406
Bed debts write off	20,528	7,943
Provisions for decommissioning of fossil fuelled power plants	8,141	7,608
Other operating expenses NEK d.o.o.	245,275	216,761
Other	80,082	67,396
	3,049,765	**2,730,671**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

9. FINANCIAL INCOME AND EXPENSES

	2016	2015
Financial income	In HRK'000	In HRK'000
Foreign exchange gains	138,034	56,081
Interests	11,939	8,237
Fair value of cross currency swap (Note 25)	74,921	-
Dividend income	7,176	3,094
Other financial income	5	-
NEK d.o.o. – other financial income	798	3,067
Total financial income	**232,873**	**70,479**
Financial expenses		
Interests	(246,857)	(287,316)
Foreign exchange losses	(110,727)	(189,244)
Fair value of cross currency swap	-	(12,449)
Bond repurchase	-	(178,943)
Fair value of shares	-	(969)
NEK - Other financial expenses	(1,781)	(1,461)
Other financial expenses	(6,304)	(138)
Total financial expenses	**(365,669)**	**(670,520)**
Net loss from financial activities	**(132,796)**	**(600,041)**

10. CORPORATE INCOME TAX EXPENSE

	2016	2015
	In HRK'000	In HRK'000
Current tax	450,226	452,441
Deferred tax expense / (income) relating to the origination and reversal of temporary differences	95,133	3,226
Corporate income tax expense	**545,359**	**455,667**

Adjustments of deferred tax assets are shown as follows:

	2016	2015
	In HRK'000	In HRK'000
Balance at 1 January	650,681	653,907
Reversal of deferred tax assets	(112,497)	(47,609)
Recognition of deferred tax assets	17,277	44,383
Balance at 31 December	**555,461**	**650,681**

Deferred tax assets have arisen from tax unrecognized provisions for jubilee awards and regular severance payments, value adjustments and other provisions.
The reconciliation between income tax and profit reported in the income statement is set out below:

	2016	2015
	In HRK'000	In HRK'000
Profit before taxation	2,590,361	2,395,724
Income tax at the applicable rate in the Republic of Croatia of (20%)	**518,072**	**479,145**
Tax unrecognized income	(73,090)	(40,506)
Tax effect on permanent differences	95,133	3,226
Unrecognized deferred tax assets from companies operating with loss	5,244	13,802
Tax expense for the year	**545,359**	**455,667**
Effective tax rate	21%	19%

Reduction of the profit tax rate in Croatia from 20% to 18% comes into effect from 1 January 2017. As a result of the change in the tax rate, the relevant positions of deferred taxes have been re-calculated.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

10. CORPORATE INCOME TAX EXPENSE (continued)

The Group and its subsidiaries are subject to corporate income tax, according to the tax laws and regulations of the Republic of Croatia. Subsidiaries in the Group stated total tax losses in the amount of HRK 1,035,951 thousand (2015: HRK 1,444,665 thousand), while the Group stated total corporate income tax expense in the amount of HRK 450,226 thousand (2015: HRK 452,441 thousand) and deferred tax assets in the amount of HRK 95,133 thousand (2015: HRK 3,226 thousand).

Tax losses are available for carrying forward and offsetting against the tax base in future tax periods until their expiration as prescribed by the law, which is 5 years following the year in which the tax losses were incurred.
Tax losses stated by the Group and their expirations are presented below:

Year of tax loss origination	Total tax loss stated by the Groupe	Year of expiry
	HRK'000	
2012	565,360	2017
2013	207,334	2018
2014	168,027	2019
2015	69,009	2020
2016	26,221	2021
	1,035,951	

Group companies which are continuously stating losses in their financial statements, are not recognizing deferred tax assets. HEP d.d. is realizing profit and has no tax losses carried forward to be utilized. According to the Croatian legislation, it is not possible to utilize tax losses at the Group level. Each individual company determines its tax liability.
As of 31 December 2016, the Group could not recognize deferred tax assets arising from tax losses carried forward in the amount of HRK 1,035,951 thousand.

10. CORPORATE INCOME TAX EXPENSE (continued)

In recent years Croatian Tax Authorities have not performed a review of the corporate income tax returns of HEP d.d. and its subsidiaries, except the short monitoring in 2013. In accordance with local regulations, Tax Authority may at any time inspect the books and records of any Group company within 3 years following the year in which the tax liability is reported and may impose additional tax liabilities and penalties. The Company's Management is not aware of any circumstances that could lead to a potential material liability in this respect.
The following table summarizes movements in deferred tax assets during the year:

In HRK'000	Inventories write-off	Provisions for jubilee awards and retirement benefits	Depreciation over prescribed rates	Provisions for MTM bonds	PPE impairment	Tax losses carried forward	Other	Total
As at 1 January 2015	**42,243**	**82,414**	**6,908**	**-**	**477,881**	**-**	**44,461**	**653,907**
Credited to profit and loss for the year	2,832	10,791	2,105	16,375	(26,682)	3,242	(11,889)	(3,226)
As at 31 December 2015	**45,075**	**93,205**	**9,013**	**16,375**	**451,199**	**3,242**	**32,572**	**650,681**
Transfers to another account	-	(105)	-	-	-	-	18	(87)
Credited to profit and loss for the year	(2,399)	(17,788)	476	(10,570)	(56,621)	(1,902)	(6,329)	(95,133)
As at 31 December 2016	**42,676**	**75,312**	**9,489**	**5,805**	**394,578**	**1,340**	**26,261**	**555,461**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

11. PROPERTY, PLANT AND EQUIPMENT

In HRK'000	Land and buildings	Fixtures and equipment	Assets under construction	Total
COST				
As at 1 January 2015	**37,910,992**	**43,912,045**	**4,188,741**	**86,011,778**
Transfers to another account	(156,753)	156,294	219	(240)
Additions	16,009	324,141	1,997,895	2,338,045
Additions NEK	-	100,899	519	101,418
Transfer from assets under construction	415,538	1,327,783	(1,788,095)	(44,774)
Inventory surpluses	13,523	16,334	-	29,857
Disposals	(117,081)	(373,617)	(12,705)	(503,403)
As at 31 December 2015	**38,082,228**	**45,463,879**	**4,386,574**	**87,932,681**
Transfers to another account	298,204	(303,614)	-	(5,410)
Additions	5,602	261,579	2,091,299	2,358,480
Additions NEK	-	-	208,761	208,761
Transfer from assets under construction	749,456	2,966,971	(3,767,586)	(51,159)
Transfer from assets under construction - NEK	112,456	127,405	(239,861)	-
Inventory surpluses	8,155	8,666	-	16,821
Disposals	(92,360)	(437,549)	(1,954)	(531,863)
As at 31 December 2016	**39,163,741**	**48,087,337**	**2,677,233**	**89,928,311**
ACCUMULATED DEPRECIATION				
As at 1 January 2015	**25,855,401**	**30,632,822**	-	**56,488,223**
Depreciation for the year	671,785	959,834	-	1,631,619
Depreciation for the year - NEK	-	213,765	-	213,765
Transfers to another account	(75,614)	75,580	-	(34)
Disposals	(113,300)	(364,966)	-	(478,266)
Inventory surpluses	6,349	(38,004)	-	(31,655)
As at 31 December 2015	**26,344,621**	**31,479,031**	-	**57,823,652**
Depreciation for the year	672,049	1,043,998	-	1,716,047
Depreciation for the year - NEK	25,179	104,703	-	129,882
Transfers to another account	49,912	(49,881)	-	31
Disposals	(62,047)	(437,798)	-	(499,845)
Inventory surpluses	4,743	(17,288)	-	(12,545)
As at 31 December 2016	**27,034,457**	**32,122,765**	**-**	**59,157,222**
CARRYING AMOUNT				
At 31 December 2016	**12,129,284**	**15,964,572**	**2,677,233**	**30,771,089**
At 31 December 2015	**11,737,607**	**13,984,848**	**4,386,574**	**30,109,029**

11. PROPERTY, PLANT AND EQUIPMENT (continued)

The Group owns a large number of properties, however titles to individual properties has not been fully resolved. The Group is in process of registering ownership over properties. Due to a large number of properties, there is a possibility that all properties of the Group are not registered in the Group's business ledgers. Also, there is a possibility that the Group's business ledgers include records of properties to which the Group has no title. The Management Board of the parent company adopted the Decision on measures and activities related to resolving the ownership status of properties of HEP d.d. and subsidiaries dated 27 June 2013. The Decision contains tasks and deadlines for the purpose of submitting proposals to the Land Registry Courts in order to register ownership rights. Activities on land-registry will be continued in 2017.

The Water Act that came into force on 1 January 2010, raised a question on the ownership and legal status of the Group's property - reservoirs and ancillary facilities used for generation of electricity from hydropower plants, which are, according to the Water Act defined as "Public water resources in general use as the property in ownership of the Republic of Croatia". The Group acquired above mentioned property through payment to previous owners, uniting an extremely large number of cadastral plots (land plots), which were submerged by the construction of the dam and therefore created reservoirs. 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.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

12. INTANGIBLE ASSETS

	In HRK'000
COST	**Licences**
Balance at 31 December 2014	**656,402**
Transfers to another account	240
Additions	26,308
Transfer from assets under construction	44,774
Disposals	(1,108)
Balance at 31 December 2015	**726,616**
Transfers to another account	5,410
Additions	21,885
Transfer from assets under construction	51,159
Disposals	(7,295)
Balance at 31 December 2016	**797,775**
ACCUMULATED AMORTIZATION	
Balance at 31 December 2014	**579,356**
Transfers to another account	34
Amortization for the year	26,897
Disposals	(1,108)
Balance at 31 December 2015	**605,179**
Transfers to another account	(31)
Amortization for the year	42,337
Disposals	(7,296)
Balance at 31 December 2016	**640,189**
CARRYING AMOUNT	
At 31 December 2016	**157,586**
At 31 December 2015	**121,437**

13. INVESTMENT PROPERTY

As of 31 December 2016 and 2015 investment property comprise properties held for the purposes of earning rentals and/or capital appreciation, and are carried at fair value by reference to the best management estimate. The fair value comprise estimated market price at the end of the reporting period. All investment properties are owned by HEP d.d.

Fair valuation was conducted by internal departments of the Group. The estimate is based on data available on the real estate market price in the appropriate locations. These prices are collected from different sources, including available data from Central Bureau of Statistics, Agency for Transactions and Mediation in Immovable Properties, CCE and others. These average values are adjusted to the characteristics and peculiarities of individual properties.

At fair value	**31 Dec 2016**	**31 Dec 2015**
	In HRK'000	In HRK'000
Fair value	**236,778**	**236,153**
Net fair value adjustment	(5,914)	(795)
Closing balance at fair value	**230,864**	**235,358**
Investment property NEK	627	1,420
	231,491	**236,778**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

14. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Alstom Hrvatska d.o.o.	8,066	-
Arvos Ljungstroem GMBH	1,600	-
Končar KET	6,482	4,269
JSC Tehnopromexport –TE Sisak	58	58
Končar GIM	1,527	2,707
Litostroj Slovenia	85	160
VOITH Siemens Austrija	16	16
Končar inženjering Zagreb	350	2,605
Spegra Inženjering	1,046	2,224
Đuro Đaković Holding d.d.	2,754	19,810
Siemens	4,282	461
TPK Orometal d.d.	3,101	736
Other	7,340	4,834
	36,707	**37,880**

Prepayments for PPE relate to construction of production facilities.

15. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

INVESTMENT BACKGROUND

Legal status of the Nuclear Power Plant Krško ("NE Krško") was regulated by inter-republic (between Slovenia and Croatia) agreement dating back to 1970 and various agreements between the founders from 1974 and 1982. Pursuant to the stated agreements, the Company had a 50% interest in the NE Krško in Slovenia, the other 50% was held by ELES d.o.o., Ljubljana, the legal successor of the Slovenian power utility. In 1998, the Slovene government passed a decree transforming the NE Krško into a public company, NE KRŠKO d.o.o. ("NEK"), and nationalizing the nuclear power plant. Additionally, due to operational disputes, which include disagreements on energy prices to be charged and approval of annual budgets, the supply of power to HEP d.d. from NEK was cut off on 30 July 1998 and was not restored until 19 April 2003. In late 2001, the Governments of the Republic of Croatia the Republic of Slovenia signed an Agreement governing the status and other legal relations in connection with their respective investment in NEK, usage and decommissioning, as well as a partnership agreement between HEP d.d. and ELES GEN d.o.o. This agreement was ratified by the Croatian parliament during 2002, and it came into force at 11 March 2003, following the ratification by the Slovenian parliament on 25 February 2003.
The Agreement acknowledges the ownership rights of HEP d.d. in the newly formed company, Nuklearna elektrana Krško d.o.o. ('NEK') in respect to its 50% holding in NEK, which were previously denied. Both parties have agreed to extend the useful life of the power plant at least to the year 2023. The Agreement also regulates that the produced electricity is supplied 50:50 to both contracting parties, and that the price of the electricity supplied is determined based on real production cost.
The Agreement was also clearly defined obligation towards the Croatian half of disposal of radioactive waste and used nuclear fuel from NEK. Each country/government has an obligation to provide half of the funds necessary to prepare the decommissioning plan and cost of the program. Each side will allocate fund for this purpose into a separate fund in the amounts estimated by the decommissioning program. According to the current program of decommissioning and disposal of radioactive waste and spent nuclear fuel, HEP d.d. is a contributor to the Fund in the amount of EUR 14,250 thousand per year. HEP d.d. started to receive electricity from NEK on 19 April 2003, and expects to receive 2,700-2,950 GWh annually up to year 2023, representing 15% of electricity consumption in Croatia.
By the end of 2003, the provisions of the Agreement have been implemented according to which HEP d.d. and NEK waive mutual receivables for damages and withdraw all claims arising there from up to 30 June 2002, including the disputed liabilities for electricity purchase and amounts due with respect to the previously calculated contribution for financing the decommissioning of the power plant and funds to cover the losses from previous years. After implementing the changes, the capital of NEK as at 31 December 2003 amounted to SIT 84.7 billion (approximately: HRK 2.8 billion).

CURRENT STATUS

Payments to the Fund for Decommissioning of NEK

Based on the Regulation on the amount, time and manner of payment of funds for the decommissioning and disposal of radioactive waste and used nuclear fuel of NEK, adopted by the Croatian Government on 24 December 2008, in the period from 2006 to 2016 HEP d.d. made payments to the Fund for Decommissioning of NEK in the amount of HRK 1,375,530 thousand. The amount of payment is determined by the Program of decommissioning from 2004. Actual annual liability in the amount of EUR 14,250 thousand is payable quarterly.

15. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)

CURRENT STATUS (CONTINUED)

Extension of useful life of NEK

After NEK has obtained from the Slovenian nuclear safety administration a safety license to operate without any limitations in 2012, at the end of 2014 HEP and GEN Energija d.o.o. adopted a decision to extend the operational life of the plant until 2043. The decision to extend the operating life of NEK for 20 years was preceded with an investment feasibility study of long-term investments in the power plant.

Resolution of an international arbitration dispute

The Company has acquired the right to compensation for damages claimed from the Republic of Slovenia for undelivered electricity from NEK in the period from 1 July 2002 to 18 April 2003 in the amount of HRK 328,926 thousand (Note 5).
Compensation was paid in December 2015 and January 2016.

Accounting of NEK joint operation

Joint operation in NEK is recognized in the financial statements by using the equity method (in 2014 the Group recognizes its share in assets, liabilities, revenues and expenses of NEK in its financial statements). In order to eliminate possible concerns of individual government agencies (FINA, the Ministry of Finance, Central Bureau of Statistics, etc.) on the information in the separate financial statements of the Company, and in accordance with the provisions of IAS 1, point 19 and point 20, the Management Board adopted a decision to change that policy.
In its consolidated financial statements, the Company applies the method of joint management of assets and liabilities and reports share of the Company in each asset and each liability, income and expense in accordance with IFRS 11.

EXTRACT FROM FINANCIAL STATEMENTS

In table below is shown an extract from financial statements of NEK in full (100%) amounts at 31 December 2016 and 2015:

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Property, plant and equipment	2,400,731	2,270,953
Capital and reserves	3,339,824	3,374,393
Gross sales	1,229,413	1,372,011
Cash flow from operating activities	137,363	662,485
Profit for the year	3,396	-

16. INVESTMENT IN THE TE PLOMIN

In November 1996, HEP d.d. entered into a Joint Venture Agreement with RWE Energie Aktiengesellschaft, Germany ('RWE') regarding the completion and operation of TE Plomin II. Consequently, a joint venture, TE Plomin d.o.o. ('TE Plomin') was formed in December 1996, with each partner holding 50% of the equity of the new entity. Agreement between HEP d.d. and RWE expired in May 2015 in accordance with its provisions since HEP decided to exercise its right related to the possibility that 15 years after start of production, HEP can takeover RWE's shares in TE Plomin d.o.o..
Joint Venture Agreement from 1996 with RWE expired in May 2015. The Company signed with RWE termination of Joint Venture Agreement for TE Plomin II and the Agreement on the transfer of shares in TE Plomin II., and it became sole owner of the company TE Plomin d.o.o.
The Company paid all liabilities to RWE.

EXTRACT FROM FINANCIAL STATEMENTS

In these consolidated financial statements, the Group has stated its interest in TE Plomin using full consolidation method.

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Property, plant and equipment	257,646	205,779
Capital and reserves	182,089	181,584
Gross sales	626,734	645,363
Operating profit	9,902	15,910
Net profit	2,901	3,357
Cash flows from operating activities	76,278	115,347

	2016	2015
	In HRK'000	In HRK'000
Opening balance	**-**	**29,202**
Equity payoff	-	(25,853)
Liabilities for dividend / Dividend payment	-	(4,054)
Increase for current year's profit	-	962
Exchange differences	-	(257)
Closing balance	**-**	**-**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

17. LONG TERM LOANS AND DEPOSITS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Loans given	57,373	28,947
Impairments	-	(12)
Current portion of long-term loans given	(28,400)	(330)
Long-term portion	**28,973**	**28,605**

Loans given to non-related parties:

	Year of loan approval	Repayment period	Loan amount	31 Dec 2016	31 Dec 2015
				In HRK'000	In HRK'000
City of Dubrovnik	2013	5 years	5,707	2,512	2,707
City of Pregrada	2006	10 years	1,358	136	271
Did d.o.o.	2007	4 years	1,010	129	129
LNG Hrvatska	2015	5 years	63,600	54,596	25,840
Total				**57,373**	**28,947**
Impairment				-	(12)
Current portion				(28,400)	(330)
Long-term portion				**28,973**	**28,605**

18. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Available-for-sale investments	288,493	244,845
Other investments	7,445	1,065
	295,938	**245,910**

Movements on available-for-sale investments are presented below:

	2016	2015
	In HRK'000	In HRK'000
Opening balance	**244,845**	**191,611**
Changes in fair value of available-for-sale investments	43,648	53,127
Investment in shares	-	107
Closing balance	**288,493**	**244,845**

Changes in fair value of available-for-sale investments shown in the table above are presented in the gross amount. In the consolidated income statement within other comprehensive income is presented amount of changes in fair value of available-for-sale investments net of corporate income tax under Net gain/(loss) on AFS financial assets.

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Available-for-sale investments:		
Jadranski Naftovod d.d.	286,099	242,915
Viktor Lenac d.d.	177	115
Đuro Đaković d.d.	5	5
Kraš d.d.	4	3
Pevec d.d.	555	312
Jadran d.d.	364	364
Industrogradnja grupa d.d.	490	490
Optima Telekom d.d.,	296	223
Institut IGH d.d.,	172	98
Međimurje beton d.d.	153	154
HTP Korčula d.d.	71	59
Lanište d.o.o.	72	72
Other	35	35
	288,493	**244,845**

18. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS (continued)

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Other investments		
Geopodravina d.o.o.	200	200
LNG Hrvatska d.o.o.	865	865
Novenerg d.o.o.	380	-
Cropex	6,000	-
	7,445	**1,065**
	295,938	**245,910**

In December 2008, HEP d.d. acquired 53,981 shares of Jadranski Naftovod d.d. under a Decision of the Croatian Government, with a nominal value of HRK 2,700 per share i.e. the total nominal value of HRK 145,748,700. By Decision of the Management Board, shares of Jadranski Naftovod were classified as available for sale. Transfer of shares was registered at Central Depository Agency on 19 March 2009.
In 2016 and 2015 fair value was determined by a market value from Zagreb Stock Exchange as of 31 December. The market price of one share of Jadranski Naftovod as of 31 December 2016 was HRK 5,300 and as of 31 December 2015 was HRK 4,500. By fair valuation of the investment in Jadranski Naftovod as of 31 December 2016 total amount of investment was increased by HRK 43,184 thousand (2015: increased by HRK 54,037 thousand). The fair valuation in 2016 and 2015 was recognised through equity (revaluation reserves). For 18% (2015: 20%) of the increase in the value of investments, reserves were decreased and the deferred tax liability increased.
On 1 June 2010, HEP d.d. and Plinacro d.o.o. had concluded the Articles of Incorporation of LNG Hrvatska d.o.o., *a liquefied natural gas company*. Recapitalization was conducted in 2011 and subscribed capital was increased from HRK 20 thousand to HRK 220 thousand and in 2012 to HRK 1,730 thousand. HEP d.d. has a 50% stake in the company, and Plinacro d.o.o. has other 50%. As registered at Commercial court, on 4 February 2013 LNG Hrvatska d.o.o. was recapitalized by Plinacro d.o.o. in the amount of HRK 22,600 thousand. Subscribed capital of LNG Hrvatska d.o.o. is stated in the amount of HRK 24,330 thousand.
Based on the pre-bankruptcy settlement agreements with debtors for electricity, heating and gas sold, the Group has become a stakeholder in those companies in the total amount of HRK 2,145 thousand.

19. OTHER NON-CURRENT ASSETS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Housing loan receivables	17,590	21,818
Energy efficiency receivables – long-term portion	23,836	15,460
Derivative financial instruments	-	70,900
Other non-current assets	5,515	7,617
	46,941	**115,795**

Prior to 1996, the Group had sold apartments/flats in its ownership to its employees, the sale of which was regulated by the laws of Republic of Croatia. These flats were usually sold on credit, and the related receivables, which are secured and bear interest at rates below market, are repayable on a monthly basis over periods of 20- 35 years. Receivables for sold apartments/flats were transferred to new subsidiaries as of 1 July 2002. The housing loan receivables are stated in the consolidated financial statements at their discounted net present values, determined using an interest rate of 7.0%. The liability to the State, which represents 65% of the value of sold apartments, is included in non-current liabilities to the State (Note 27). The receivables are secured by mortgages over the sold apartments.

20. INVENTORIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Inventories of fuels and chemicals	150,627	129,118
Electric materials	330,917	320,381
Spare parts	194,400	197,320
Construction material	24,974	32,699
Gas inventory for wholsesale	379,488	439,951
CO_2 emission units	222,957	297,128
Other inventories	74,967	62,473
Nuclear fuel and other material - NEK d.o.o.	260,113	229,941
	1,638,443	**1,709,011**
Value adjustment of obsolete materials and spare parts	(233,075)	(219,722)
	1,405,368	**1,489,289**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

21. TRADE RECEIVABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Electricity – Corporate customers	1,422,648	1,473,439
Electricity – Households	489,270	478,274
Export of electricity	67,886	32,770
Heating, gas and services	791,301	805,186
Connection to transmission network	-	27,292
Receivables from NEK d.o.o.	15,057	8,951
Other	63,826	66,749
	2,849,988	**2,892,661**
Impairment of bad and doubtful receivables	(896,396)	(1,045,598)
	1,953,592	**1,847,063**

Aging structure of unimpaired trade receivables:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Undue	1,336,879	1,206,160
Up to 30 days	333,439	349,305
31-60 days	118,850	125,892
61-90 days	55,159	51,797
91-180 days	56,141	62,379
181-365 days	43,773	41,659
More than 365 days	9,351	9,871
	1,953,592	**1,847,063**

Movements in impairments were as follows:

	2016	2015
	In HRK'000	In HRK'000
Balance at 1 January	**1,045,598**	**974,179**
Impairment of trade receivables (Note 8)	107,276	170,915
Derecognition of previously impaired trade receivables	(171,671)	(26,373)
Reversal of impairments (Note 5)	(84,807)	(73,123)
Balance at 31 December	**896,396**	**1,045,598**

The Management performs review of receivables and recognizes impairment of bad and doubtful receivables based on a review of the overall ageing structure of all receivables and of significant individual receivables amounts.

22. OTHER SHORT-TERM RECEIVABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Receivables for corporate income tax	60,522	210,936
Prepayments	5,863	5,359
Receivables from the State for employees	9,714	6,435
Claims for overcharged water management fee	5,914	-
Demand and term deposits with maturity over 3 months	111,191	99,166
Demand and term deposits with maturity over 3 months NEK	275,980	417,904
Receivables from HEP-ESCO d.o.o. for Energy efficiency project	9,813	13,063
Loan receivables from companies with participating interest	25,752	-
Receivables for sold flats	6,464	6,499
Receivables from OIE - HROTE	34,774	30,548
Received bills of exchange	27,456	-
Derivative financial instruments (Note 25)	96,196	-
Other receivables NEK	2,369	2,031
Other short-term receivables	58,909	43,812
	730,917	**835,753**

23. CASH AND CASH EQUIVALENTS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Current accounts – Foreign currency	938,761	497,566
Current accounts - HRK	216,798	427,145
Current accounts for special purposes	31,686	30,706
Petty cash - HRK	260	271
Short term deposits - up to 90 days	1,314,216	1,419,032
Daily deposits	441,633	118,393
Cash Funds	75,322	-
Current account – HRK and foreing currency - NEK	170	53
	3,018,846	**2,493,166**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

24. EQUITY AND RESERVES

The share capital was first registered on 12 December 1994 in German marks (DEM) and amounted to DEM 5,784,832 thousand. On 19 July 1995, the share capital was reregistered in Croatian Kuna in the amount of HRK 19,792,159 thousand. The share capital consists of 10,995,644 ordinary shares, with a nominal value of HRK 1,800 each.

RESERVES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Opening balance	100,836	54,947
Other comprehensive income/(loss)	39,457	45,889
	140,293	**100,836**

Retained earnings	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Opening balance	4,132,208	2,201,265
Other changes	-	(5,357)
Exchange losses arising on translation of foreign operations	(18,984)	(4,196)
Land surpluses	-	1,401
Dividends paid	(607,000)	-
Profit / (loss) for the year	2,045,002	1,939,095
	5,551,226	**4,132,208**

25. LIABILITIES FOR ISSUED BONDS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Nominal value of bonds in the country issued in 2007	92,946	186,410
Discounted value	84	(84)
Current maturity on bonds	(93,030)	(93,380)
	-	**92,946**
Value of bonds issued abroad in 2012	498,617	3,008,746
Bond repurchase (83.37%)	-	(2,806,955)
Exchange differences	(5,046)	296,826
Current portion of bonds	(493,571)	-
Bonds issued in 2012	**-**	**498,617**
Nominal value of bonds from 2015 issued abroad	3,656,047	3,703,533
Exchange differences	(37,511)	3,455
Discounted value	7,892	(50,941)
	3,626,428	**3,656,047**
Accrued bond expenses	(20,255)	(23,727)
Bonds issued in 2015	**3,606,173**	**3,632,320**
Total liabilities for issued bonds	**3,606,173**	**4,223,883**

BONDS ISSUED IN THE REPUBLIC OF CROATIA

Bonds issued at the end of 2007 amounting to HRK 700,000 thousand are repayable in 15 semi-annual instalments, commencing three years from the date of issue, and are bearing fixed interest of 6.50 percent. The bonds are listed on the Zagreb Stock Exchange.

BONDS ISSUED ABROAD

In November 2012, the Company has issued bonds in the amount of USD 500,000 thousand. Bonds have maturity of 5 years and are bearing fixed annual interest of 6%. Bonds are listed at Luxembourg stock - exchange and they are actively traded.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

25. LIABILITIES FOR ISSUED BONDS (continued)

Cross currency swap
In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is converted in EUR for all period of bond duration, respectively until its outermost maturity date at 9 November 2017.
According to the cross-currency swap agreement from 2012, annual interest rate paid by the Company semi-annually is fixed and amounts to 6.53% (include swap cost).

Refinancing
In October 2015, bonds issued in 2012 were refinanced from the new bond issue and repaid 83.37% of the principal respectively USD 416,852 thousand. The amount of outstanding principal on bonds issued in 2012, on 31 December 2016 amounted to USD 83,148 thousand.
Cross currency swap agreement from 2012 is applicable for outstanding principal until its outermost maturity date at 9 November 2017.

The new bond issue
In October 2015, the Company issued new corporate bonds in the amount of USD 550,000 thousand with maturity of 7 years, fixed interest rate of 5.875% per annum and the issue price of 98.594%.
Bonds issued in 2015, are mainly used for the repurchase of 83.37% of the bonds issued in 2012 (i.e. the repurchase of USD 416,852 thousand). The remaining issue is intended to finance the Company's business.
Bonds are listed at Luxembourg stock - exchange and they are actively traded.

Cross currency swap
In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is converted in EUR for all period of bond duration, respectively until its outermost maturity date at 23 October 2022.
According to the agreement from 2015, annual interest rate paid by the Company semi-annually is fixed and amounts to 4.851% (weighted interest rate include swap cost).

DERIVATIVE FINANCIAL INSTRUMENTS

Cross currency swap
In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreements, by which liabilities upon issued bonds abroad in 2012 and 2015 in USD are converted in EUR for all period of bond duration, respectively until its outermost maturity date.

25. LIABILITIES FOR ISSUED BONDS (continued)

The purpose of the cross-currency swap agreement is to reduce currency risk and recommendations of the credit agencies about the importance of strategic management of currency risks to reduce their impact on the business performance of the Company.

According to the agreement from 2012., annual interest rate paid by the Company semi-annually is fixed and amounts to 6.53%, and according to the agreement from 2015 amounts to 4,851% (weighted interest rate).

The Company measures the fair value of the cross-currency swap according to the calculation of Mark-to-market ("MTM") value, according to official banks calculation for the reporting period.

A positive "MTM" value is recorded as a receivable respectively it is formed financial income for the period, and negative "MTM" value is recorded as a liability and it is formed financial expense of the reporting period.

After a final maturity of derivative financial instruments, subject receivables or liabilities will be debited to the expense or credited to the income of the Company.

On 31 December 2016, using this measuring method, the Company stated fair value of assets by bonds issued in 2012 in the amount of HRK 96,196 thousand (Note 22) (31 December 2015: HRK 70,900 thousand), (Note 19).

On 31 December 2016, using this measuring method, the Company stated fair value of liabilities by bonds issued in 2015 in the amount of HRK 32,251 thousand (31 December 2015: HRK 81,876 thousand), (Note 29).

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

26. LONG-TERM LOAN LIABILITIES

	Interest rates	31 Dec 2016	31 Dec 2015
		In HRK'000	In HRK'000
Domestic bank loans	Floating	827,728	1,219,772
Foreign bank loans	Fixed	237,817	90,296
Finance leases	Fixed	13,202	16,066
Total		**1,078,747**	**1,326,134**
Deferred loan originated fees		(2,152)	(3,382)
Total long-term loans		**1,076,595**	**1,322,752**
Current portion of long-term loans		(408,711)	(383,525)
Current portion of finance lease (Note 33)		(3,120)	(2,984)
Long-term portion		**664,764**	**936,243**

In 2016, the Company contracted loans with domestic and foreign banks with floating and fixed interest rates ranging from 0.47% to 5.6%
Loans from domestic banks are secured by bills of exchange and promissory notes. At 31 December 2016, the Group doesn't have any liabilities covered by *sovereign loan guarantees*.

NEW FINANCING SOURCES

For the financing of the investment plan and the regular operations in 2016 the Group used own funds and funds from loans in use.

LOANS IN USE

During 2016, the Group still had available funds from long-term loan approved in 2008 by KfW Entwicklungsbank in the amount of EUR 50,000 thousand for the financing of energy efficiency and renewable energy projects. As of 31 December 2016, KfW loan balance was EUR 31,5 million, and the amount of EUR 18,5 million were unutilised.

Annual principal repayment schedule of long-term loans in next five years is stated as follows:

	(In HRK'000)
2017	411,831
2018	432,452
2019	138,952
2020	61,174
2021	34,338
	1,078,747

26. LONG-TERM LOAN LIABILITIES (continued)

Loans from domestic banks are secured by bills of exchange and promissory notes, except for one club loan for which the Group is obliged to meet the required level of financial indicators (covenants) on annual and semi-annual basis: tangible net worth, EBITDA to net finance charges, total net borrowings to tangible net worth.
The primary goal related to risks resulting from covenants is to protect the Group from possible defaults, respectively early maturity of loan liabilities.
The agreed covenants are monitored and calculated based on the projected Balance sheet and the Income statement. The Group prepares preliminary calculations of the covenants in the upcoming mid-term period, and is following their trends.
If the projections accounted at the end of the financial year shows that the Company could be in breach of covenants, the Company is obligated to inform the bank regarding the possibility of a breach (event of default) and timely request a waiver from the bank.
In the event that the bank does not approve the "waiver", the possible scenario is an early maturity of the debt, which represents liquidity risk for the Group.
The Management believes that in the case of breach of covenants, the Company can obtain a "waiver" from the creditors, given that timely payment of liabilities to financial institutions represent priority obligation of the Company and the Company has never been late in payment of liabilities to financial institutions.
Therefore, the Management estimates that possibility of early maturity of loan liabilities due to breach of covenant, as well as Group's exposure to credit risk, liquidity risk and market risk, which would result from a possible non-compliance with covenants is minimal.
As of 31 December 2016 covenants were not breached and the Group has met all contractual financial indicators.
The Group's total exposure to loan liabilities subject to covenant conditions as of 31 December 2016 amounts to EUR 70,588 thousand.

An analysis of long-term loans in foreign currencies is provided below (in '000):

Currency	31 Dec 2016	31 Dec 2015
EUR	142,733	173,690

For the purpose of providing solvency reserves for the following mid-term period, the Company has concluded with domestic banks multi-purpose overdraft agreements in the total amount of HRK 1,0 billion. Funds from agreed overdrafts the Company may use as short-term loans, as well as for issuance of guarantees, letters of credit and letters of intention in accordance with the Group needs.
During 2016, due to good liquidity, the Group did not conclude short-term loans from preapproved mid-term multipurpose overdraft agreements. Also, the Group has signed reverse factoring agreement in the amount of EUR 50 million with maturity until 31 December 2017.
As of 31 December 2016, the Group has available the amount of up to HRK 699,3 million from short-term financing sources.
After the balance sheet date, the Government of the Republic of Croatia issued a consent on the basis of which the overdrafts of banks were prolonged for 3 years and the total amount of available short-term funds amounts to HRK 1,392 million.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

27. LONG-TERM LIABILITIES TO THE STATE

Long-term liabilities to the State amounted to HRK 15,901 thousand in 2016 (2015: HRK 18,774 thousand) and relate to the sale of apartments to employees in accordance with the State program that was discontinued in 1996. According to the law regulating housing sales, 65% of the proceeds from the sale of apartments to employees were payable to the State at such time as the proceeds were collected. According to the law, HEP d.d. has no liability to allocate the funds until they are collected from the employee.

28. LONG-TERM PROVISIONS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Provisions for court disputes	337,899	367,772
Provisions for severance payments	329,693	374,550
Provisions for jubilee awards	44,986	45,875
Provisions for decommissioning of fossil fuelled power plants	161,438	128,297
Provision for electricity purchased from wind power plants	21,631	21,631
Provisions for severance payments, jubilee awards and other - NEK	35,053	31,376
	930,700	**969,501**

Provisions for decommissioning of fossil fuelled power plants in the amount of HRK 161,438 thousand represent discounted value of the estimated decommissioning costs of the Group's fossil fuel power plants.

Movements in provisions during the presented period were as follows:

	Legal disputes	**Provisions for severance payments**	**Jubilee awards**	**Decommissioning of FFPPs**	**Other**	**Total**
	In HRK'000	In HRK'000	In HRK'000	In HRK'000	In HRK'000	In HRK'000
At 1 January 2015	**363,052**	**319,691**	**44,806**	**120,689**	**54,541**	**902,779**
Additional provisions	25,260	77,566	8,538	7,608	-	118,972
Decrease in provisions (amounts paid)	(16,922)	(2,977)	(4,901)	-	(1,534)	(26,334)
Decrease in provisions based on estimates	(3,618)	(19,730)	(2,568)	-	-	(25,916)
At 31 December 2015	**367,772**	**374,550**	**45,875**	**128,297**	**53,007**	**969,501**
Additional provisions	25,870	29,789	2,031	33,141	3,677	94,508
Decrease in provisions (amounts paid)	(10,650)	(3,856)	(857)	-	-	(15,363)
Decrease in provisions based on estimates	(45,093)	(70,790)	(2,063)	-	-	(117,946)
At 31 December 2016	**337,899**	**329,693**	**44,986**	**161,438**	**56,684**	**930,700**

28. LONG-TERM PROVISIONS (continued)

Provisions for court disputes
Provisions for court disputes relate to cases where possible outcome has been determined as uncertain or negative. Most significant court disputes are initiated against HEP Proizvodnja d.o.o. and HEP d.d. HEP Proizvodnja d.o.o. is in litigation with Zagrebački Holding d.o.o., with provisions amounting to HRK 38,045 thousand in 2016 and relate to dispute for fee for wastewater treatment plant.
At HEP d.d. most significant provision relate to the litigation related to HE Peruča (hydropower plant Peruča) which started in 1995, for which a first Instance ruling was issued in 2012 and was ruled in favour of the plaintiff. Litigation case value amounts to HRK 330,000 thousand, and provisions are recorded at 50% of case value, i.e. HRK 165,000 thousand. Other significant provisions relate to Kartner sparkass amounting to HRK 9,903 thousand.

WATER MANAGEMENT ACT

According to an interpretation by the State Attorney's Office, *Water Management Act* that came into force on 4 January 1996 and the new *Water Management Act* that came into force on 1 January 2010, bring into question the property-legal status of the asset for electricity production from the hydro-power plant because the land on which the hydro-power plants was constructed is classified as 'Public Water Resources' which by its legal nature is considered to be real estate for common use owned by the Republic of Croatia and cannot be the subject of ownership of a physical or legal entity. There are currently several out of court settlement procedures between HEP d.d. and Republic of Croatia relating the right of registering ownership of hydro power plants in favour of Republic of Croatia. There is no uniform case law regarding this issue.
The Company has disputed the interpretation of the Water Management Act as aforementioned property was included in balance sheet of the Group during ownership transformation and therefore cannot be subject to laws that came into force after transition was conducted. This interpretation by the Company is in accordance with the Decision by the Croatian Constitutional Court, Ref. No. U-III-3049/2007. Also, it is necessary to take into account the overall electro-energy security in the Republic of Croatia, and the fact that the Company has constructed and invested significant funds in these facilities, that the Company maintains the mentioned facilities and is the owner of all equipment necessary for the management and functionality of the said hydroelectric power plants.
The Company has filed a motion to the Constitutional Court to institute proceedings to review the constitutionality of Article 23 Paragraph 4 of the Water Management Act with the Constitution and upon conclusion of the procedure to annul the said provision.
In addition, during 2015 the Ministry of Agriculture initiated a procedure for amending and change of the Water Act. As part of this process, and bearing in mind all the above, the Company has submitted suggestion for amendment and change of the provisions of the Water Act with the aim of clarifying the property-ownership rights and ownership of the Republic of Croatia on electricity production facilities built by legal entities in majority ownership of the Republic of Croatia. The Ministry of Economy has also sent its consent to the initiative of the Company for amending and change of the Water Act.
In 2016 and 2017, the Company continued its activities in order to address the issue of ownership of hydroelectric power plants and reported to the Ministry of Environmental Protection and Energy on the mentioned issue.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

28. LONG-TERM PROVISIONS (continued)

Provisions for severance payments and jubilee awards

Movements in the present value of the defined employees benefits during the current period were as follows:

	Retirement benefits	Jubilee awards	Total
	In HRK'000	In HRK'000	In HRK'000
At 1 January 2015	**319,691**	**44,806**	**364,497**
Cost of services	13,309	2,308	15,617
Interest expense	14,140	1,706	15,846
Benefits paid	(8,993)	(6,829)	(15,822)
Past service cost	29,823	1,394	31,217
Actuarial (losses)	6,580	2,490	9,070
At 31 December 2015	**374,550**	**45,875**	**420,425**
Cost of services	12,636	2,393	15,029
Interest expense	8,636	1,161	9,797
Benefits paid	(11,639)	(5,830)	(17,469)
Past service cost	3,267	474	3,741
Actuarial (losses)	(57,757)	913	(56,844)
At 31 December 2016	**329,693**	**44,986**	**374,679**

The following assumptions were used in preparing the calculations:

- The termination rates ranges from 0% to 5,66% and is based on the statistical fluctuation rates for the Group in the period from 2006 to 2016.
- 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 Group represents average with respect to mortality and health status.
- It is assumed that there will be no annual salary growth.
- Present value of the obligation was determined using a 2.8% discount rate for all Group members.

29. OTHER LONG-TERM LIABILITIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Deferred income – assets financed by third parties	3,280,668	3,505,750
Long-term liabilities for assets financed from clearing debt	863,450	842,162
Cross currency swap (Note 25)	32,251	81,876
Other long-term liabilities	13,978	15,182
	4,190,347	**4,444,970**

Deferred income relate to income from assets ceded by customers and others without charge or assets financed from connection fee. The income from these assets is recognized over the same period as the related assets are depreciated, which applies to contracts for connection to the network concluded with customers by 30 June 2009. After 1 July 2009 the connection fee is recognized as income in the amount of cash received from the customer in the period when the customer is connected to the grid/network or when the customer is permitted permanent access to the delivery of the service.

At 31 December 2016, the Company stated clearing debt liability in the amount of HRK 863,450 thousand (2015: HRK 842,162 thousand) regarding a payment under a letter of credit on the basis of 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, it has not been clearly defined whether it relates to a loan or a government grant.

30. TRADE PAYABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Domestic trade payables	1,490,580	1,510,348
Foreign trade payables	169,824	73,293
Foreign trade payables - EU	97,937	136,569
Trade payables - NEK d.o.o.	28,997	20,700
	1,787,338	**1,740,910**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

31. TAXES AND CONTRIBUTIONS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
VAT liability	106,110	105,430
Utility and other fees	17,190	37,326
Contributions on salaries	21,527	22,738
Contributions and taxes for employees material right	8,878	29,530
Other	4,045	4,264
	157,750	**199,288**

32. LIABILITIES TO EMPLOYEES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Net salaries	79,092	79,744
Contributions	36,379	40,435
Severance payments for retirements	4,303	60,718
Severance payments for termination of employment contracts	-	12,406
Net salaries NEK d.o.o.	15,176	11,601
Other	20,319	21,606
	155,269	**226,510**

33. OTHER NON-CURRENT LIABILITIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Prepayments received for connection fees	380,208	357,756
Other prepayments	128,914	116,202
Accrued expenses for unused vacations	71,304	61,504
Accrued income from electricity sale to households	22,077	33,539
Liabilities for calculated solidarity fee	14,612	13,980
Liabilities for fees for renewable energy sources	46,457	46,704
Accrued severance payments to employees	342,964	31,851
Accrued interest expenses	2,122	-
Accrued expenses for CO_2 emissions	137,289	133,740
Other accrued expenses	3,682	12,844
Current portion of liabilities for finance lease (Note 26)	3,120	2,984
NEK d.o.o. liabilities	5,045	44,420
Other	16,186	23,182
	1,173,980	**878,706**

Correction of household income as at 31 December 2016 was obtained by calculating the logarithmic curve using network losses of 7,87%, while for the year ended 31 December 2015, stated percentage of loss used in the calculation was 8,39%. The result is an increase in revenue for 2016 in the amount HRK 11,462 thousand in comparison to the previous year, and stated liability for accrued income in the amount of HRK 22,077 thousand (2015: HRK 33,539 thousand).

Pursuant to The Act on Air Protection (Official Gazette No. 130/2011, 47/14) and the accompanying ordinances in the area of greenhouse gas emissions, HEP d.d. has been classified as the obligator of the EU ETS system. The Group obtained permits for greenhouse gas emissions fo all nine plants and monitor emissions from facilities in accordance with the approved monitoring plan and is submitting verified reports the Environmental Protection Agency by 31 March each year, on the total CO_2 emissions for the previous calendar year. Based on the submitted report, and not later than 30 April of the current year, the Group is obligated to submit quantities of emission units to the EU Registry in the amount equal to the verified total greenhouse gas emissions from the facilities in the previous calendar year, according to verified report.
HEP's EU-ETS plants submitted to the EU Registry emission units in the quantities of verified emissions for 2013, 2014, 2015 and 2016.

Pursuant to the above, the cost of greenhouse gas emissions fee consists of the amount of CO_2 emitted (equivalent) and the price of emission units which the Group calculates on accruals (accrued expenses) and expenses of the period during the year in which the greenhouse gases emissions.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

34. RELATED PARTY TRANSACTIONS

The Company holds 50% of shares in Krško Nuclear Power Plant d.o.o. (NEK). Although investment in NEK is recognized in the financial statements as joint operation, due to the fact that NEK is a separate legal entity, transactions between NEK and HEP d.d. are also presented within related party transactions. The electricity generated by NEK is delivered to HEP d.d. at 50% of total generated quantities and at prices determined in accordance with the total generation costs.

Receivables and liabilities, and income and expenses arisen from related party transactions are presented in the table below:

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
NEK		
Liabilities for purchased electricity	52,444	41,802
Costs of purchased electricity	609,026	664,425

Management remunerations are explained in the Note 7.

34. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchase cost	
In HRK'000	**2016**	**2015**	**2016**	**2015**
Companies partially owned by the State				
Hrvatske Željeznice	101,658	107,502	1,307	2,185
INA-Industrija nafte d.d.	158,780	152,362	1,049,732	1,278,937
Prirodni Plin d.o.o.	-	-	-	-
Plinacro d.o.o.	1,377	1,456	149,952	103,603
Croatia osiguranje d.d.	2,839	4,449	1,775	2,074
Hrvatska pošta d.d.	12,147	14,069	39,331	21,785
Hrvatske šume d.o.o.	3,751	3,481	3,042	3,469
Jadrolinija d.o.o.	609	514	580	851
Narodne novine d.d.	2,346	3,663	3,639	3,682
Hrvatska radio televizija	11,713	16,394	1,514	1,422
Plovput d.d.	327	270	164	164
Croatia Airlines d.d.	974	1,096	6	2
Petrokemija Kutina d.d.	17,631	20,924	257	197
Ministry of Foreign Affairs	481	969	-	-
Ministry of Defence	21,192	21,726	-	-
Ministry of the Interior	23,236	19,090	-	-
Elementary and high schools	76,890	83,648	18	18
Judicial institutions	9,126	8,660	126	75
Colleges and universities	31,294	37,652	1,201	1,820
Legislative, executive and other bodies of Republic of Croatia	27,836	27,014	4,031	4,335
Health institutions and organizations	100,785	109,853	193	718
HROTE d.o.o.	157,687	38,055	655,880	573,697
Others	9,635	13,518	7,353	18,249
TOTAL	**772,314**	**686,365**	**1,920,101**	**2,017,283**

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

34. RELATED PARTY TRANSACTIONS (continued)

	Receivables		Liabilities	
In HRK'000	**31 Dec 2016**	**31 Dec 2015**	**31 Dec 2016**	**31 Dec 2015**
Companies partially owned by the State				
Hrvatske Željeznice	27,589	28,735	177	400
INA-industrija nafte d.d.	19,923	16,269	119,264	138,417
Plinacro d.o.o.	152	119	31,228	22,950
Croatia osiguranje d.d.	242	302	427	656
Hrvatska pošta d.d.	1,448	1,249	8,120	2,381
Hrvatske šume d.o.o.	1,029	361	13	2
Jadrolinija d.o.o.	123	91	25	487
Narodne novine d.d.	411	459	645	778
Hrvatska radio televizija	2,525	2,850	23	35
Plovput d.d.	58	8	51	51
Croatia Airlines d.d.	109	109	-	-
Petrokemija Kutina d.d.	3,176	3,773	82	152
Ministry of Defence	4,356	4,366	-	-
Ministry of the Interior	4,648	3,587	-	-
Elementary and high schools	15,531	14,658	-	-
Judicial institutions	1,495	1,254	-	-
Colleges and universities	5,519	9,979	-	-
Legislative, executive and other bodies of Republic of Croatia	5,404	4,442	-	-
Health institutions and organizations	19,881	17,261	-	-
HROTE d.o.o.	80,128	33,354	127,841	100,680
Others	18,567	21,731	18,892	19,212
TOTAL	**212,314**	**164,957**	**306,788**	**286,201**

35. CONTINGENT LIABILITIES AND COMMITMENTS

COURT DISPUTES

In 2016 the Group has recorded provisions for court disputes for which it considers it is unlikely that they will be ruled in favour of HEP d.d. and subsidiary companies.

The Group has long-term investments in Bosnia and Herzegovina and Serbia in the amount of HRK 1,243,970 thousand. During the Company's transition in 1994 into a shareholding company, this amount was excluded from the net assets value.
The Company 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.

OPERATING COMMITMENTS

As part of regular investment activities, at 31 December 2016 the Group had concluded agreements for investments in various facilities and equipment that has commenced but has not been completed. In 2016, the value of the most significant contracted investments in progress amounted to HRK 1,380,746 thousand (2015: HRK 1,474,040 thousand).

ENVIRONMENTAL AND NATURE PROTECTION

HEP d.d. and subsidiaries continuously monitors and analyses impact of its business operations to the environment. The most important indicators of that impact are emissions of air pollutants and the quantity of industrial waste and ensures timely and objective reporting to the relevant institutions, local government and the public. HEP d.d. reports on its impact on the environment, economy and society within the framework of non-financial sustainability reports prepared under the GRI-Global Reporting Initiative guidelines and publishes them on its website http://www.hep.hr/o-hep-grupi/publikacije/izvjesca-o-odrzivosti/1401. Employees involved in environmental and nature protection are going through additional trainings, seminars and workshops where they are informed of the obligations and activities resulting from legal regulations in the areas of environmental and nature protection.
HEP d.d. environmental expenditure monitoring system (RETZOK) introduced in 2004, monitors all investments for the environmental and nature protection.
A request has been submitted to the Ministry of Environmental and Nature Protection (today: the Ministry of Environment and Energy) to unify environmental protection conditions (environmental permits). All nine of the HEP's plants with power inputs >50 MWt have come up with solutions on the unified environmental and energy protection (environmental permit solutions) - TE Plomin 1, TE Plomin 2, TE Rijeka, TE-TO Zagreb, EL-TO Zagreb, TE-TO Sisak, KTE Jertovec, TE-TO Osijek and Pogon Osijek HEP-Toplinarstvo.
The CO_2 emissions trading system was officially set up pursuant to the Decision of the Management Board of HEP d.d. under which, obligations, responsibilities and deadlines for meeting obligations for individual departments and companies within HEP's emission trading system are set. Croatian Environment Agency has opened nine "Accounts" of plant operators in the EU Greenhouse Gas Inventory. HEP successfully fulfilled its legal obligations for submission of emission units to the EU Greenhouse Gas Inventory for 2015 and for 2016 HEP entered information verifying CO_2 emission, which were after confirmation by Croatian officials submitted onto all nine Accounts of plant operators with the relevant quantities that corresponded the verified CO_2 emissions.

35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

In 2016, non-financial sustainability report for 2015 for the HEP Group in accordance with Global Reporting Initiative (GRI 4) guidelines is finished. Sustainability Report was published on the website of HEP in Croatian and English language. Implementation of Environment management system in accordance with ISO 14001 in HEP's generation facilities is finished in 2015 and during 2016 internal audits were carried out at HEP-Proizvodnja d.o.o. and HEP-ODS d.o.o., as well as recertification procedures in facilities where it was necessary to extend the certificates.
In 2016, it is continued establishment of environmental information system (INFOZOK) with a goal of unifying data relating to environmental and nature protection. INFOZOK is upgraded with modules for data collection about usage and monitoring of water quality, managing data on environmental permits and analyzes of legal regulations in the field of environmental protection

GAS SUPPLY AT WHOLESALE MARKET

By a Decision of the Government of the Republic of Croatia in April 2014, HEP d.d. was defined as a gas supplier on the wholesale market in a period until April 2017. Pursuant to the above Decision from the Croatian Government, the Company has rented 70% of warehouse capacities in underground gas storage facilities. In the period from 1 April 2014 to 31 March 2015 the Company agreed rent of capacities of 3.600 million kWh, in the period of 1 April 2015 to 31 March 2016, the Company agreed rent of capacities of rent of 3.550 million kWh, and in the period from 1 April 2016 to 31 March 2017 the Company agreed rent of capacities of 3.500 million kWh. By the Act on Amendments to the Gas Market Act the Company is determind as suppliers on the wholesale gas Market from April 1, 2017 to March 31, 2018. Pursuant to the provisions of the Act on Amendments to the Gas Market Act, the gas storage system operator allocated to the Company 3,050 kWh or 60% of storage capacity in the underground gas storage facility. The Wholesale Market Provider (HEP d.d.) sells gas to public service providers for the needs of household customers under regulated conditions and is obliged to provide reliable and secure gas supply.

36. SUBSIDIARIES

As at 31 December 2016 the Company had the following subsidiaries in its ownership:

Subsidiary	Country	Ownership interest in %	Principal activity
HEP-Proizvodnja d.o.o.	Croatia	100	Electricity generation and heating
Hrvatski operator prijenosnog sustava d.o.o.	Croatia	100	Electricity transmission
HEP-Operator distribucijskog sustava d.o.o.	Croatia	100	Electricity distribution
HEP ELEKTRA d.o.o.	Croatia	100	Electricity supply
HEP Opskrba d.o.o.	Croatia	100	Electricity supply
HEP–Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP–Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	100	Electricity generation
HEP ESCO d.o.o.	Croatia	100	Financing of energy efficiency projects
Plomin Holding d.o.o.	Croatia	100	Development of infrastructure in area around Plomin
CS Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
HEP–Upravljanje imovinom d.o.o.	Croatia	100	Accommodation and recreation services
HEPNOC Velika	Croatia	100	Accommodation and training
HEP –Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP Energija d.o.o. Ljubljana	Slovenia	100	Electricity trading
HEP -MagyarorszagEnergiaKft	Hungary	100	Electricity trading
HEP- Trade d.o.o. Mostar	BIH	100	Electricity trading
HEP KS sh.p.k, Priština	Kosovo	100	Electricity trading
HEP- Trade d.o.o. Beograd	Serbia	100	Electricity trading
Program Sava d.o.o.	Croatia	100	Spatial planning, design, construction and supervision
HEP Opskrba plinom d.o.o.	Croatia	100	Gas distribution
HEP-Telekomunikacije d.o.o.	Croatia	100	Telecommunication services
Hrvatski centar za čistiju proizvodnju	Croatia	100	Teaching and counseling in the field of cleaner production and environmental management systems

The majority of these subsidiaries were founded for the purpose of reorganization and restructuring of the core business activities driven by the new energy legislation, which came into force as of 1 January 2002 (Note 1). The company HEP-Telekomunikacije d.o.o. was founded in 2013 and HEP-Opskrba plinom d.o.o. in 2014. In 2014 the company HEP- RVNP d.o.o. changed its name to Program Sava d.o.o. za usluge. In 2015, the company APO d.o.o., for environmental protection was merged with the Company and the company HEP OIE d.o.o. was merged to the company HEP Proizvodnja d.o.o. The ownership of the company HEP NOC Velika in 2015 was transferred to HEP Operator distribucijskog sustava d.o.o. In November 2016 was founded HEP-ELEKTRA d.o.o., which was created by the status change of division from the HEP-Operator distribucijskog sustava d.o.o.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

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:

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Debt	5,269,370	5,640,015
Cash and cash equivalents	(3,018,846)	(2,493,166)
Net debt	2,250,524	3,146,849
Equity	25,483,678	24,025,203
Net debt to equity ratio	**9%**	**13%**

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.

CATEGORIES OF FINANCIAL INSTRUMENTS

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Financial assets		
Available-for-sale	295,938	245,910
At fair value through profit or loss	96,196	70,900
Loans and receivables (including cash and cash equivalents)	5,454,059	4,956,580
Other non-current assets	70,399	73,500
Financial liabilities		
At fair value through profit or loss	32,251	81,876
Non-current liabilities	5,161,943	6,036,244
Other current liabilities	2,844,932	2,315,955

37. FINANCIAL RISK MANAGEMENT (continued)

FINANCIAL RISK MANAGEMENT OBJECTIVES

The Treasury function within the Group provides to the companies support 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 companies 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 MANAGEMENT

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 2016	**31 Dec 2015**	**31 Dec 2016**	**31 Dec 2015**
	In HRK'000	In HRK'000	In HRK'000	In HRK'000
European Union EUR	236,444	239,017	733,424	751,030
USD	10,496	10,738	12,814	3,775

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

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.

	2016	2015
	In HRK'000	In HRK'000
EUR change effect		
Gain or loss	375,606	390,924
USD change effect		
Gain or loss	1,662	(4,869)

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

The sensitivity analysis has been determined only for financial instruments with floating interest rate, based on the Group's exposure at the end of the reporting period. For floating interest rates, the analysis is prepared assuming that the amount of outstanding liability at the date of the consolidated statement of financial position, was outstanding for the whole year. A 50 basis-point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents Management's assessment of the reasonably possible change in interest rates.

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

- Profit for the year ended 31 December 2016 would decrease by HRK 3,866 thousand (2015: HRK 5,963 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 15,52% of all interest-bearing loans (2015: 21,33%); and
- the Group's sensitivity to interest rates would decrease during current period mainly due to decrease in floating interest rate.

37. FINANCIAL RISK MANAGEMENT (continued)

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 counterparty or any group of counterparties having similar characteristics. The Group defines counterparties 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 consolidated financial statements, less losses arising from impairment, represents the Group's maximum exposure to credit risk without taking into account the value of any collateral obtained.

Notes to the consolidated financial statements (continued)
For the year ended 31 December 2016

37. FINANCIAL RISK MANAGEMENT (continued)

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.

Maturity of non-derivative financial assets

	Weighted average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
		HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
31 Dec 2016							
Interest free		4,943,768	589,005	250,529	81,441	-	5,864,743
Floating interest	0.45%	25,923	-	-	36,230	-	62,153
Fixed interest		-	-	-	-	-	-
Total		**4,969,691**	**589,005**	**250,529**	**117,671**	**-**	**5,926,896**
31 Dec 2015							
Interest free		4,343,494	803,872	55,069	46,927	68,923	5,318,285
Floating interest	3.00%	-	-	775	26,254	-	27,029
Fixed interest		-	-	-	-	-	-
Total		**4,343,494**	**803,872**	**55,844**	**73,181**	**68,923**	**5,345,314**

37. FINANCIAL RISK MANAGEMENT (continued)

LIQUIDITY RISK MANAGEMENT (CONTINUED)

Maturity of non-derivative financial liabilities

The following table details the Group's remaining contractual maturity for its non-derivative financial liabilities. The table has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

	Weighted average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
		HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
31 Dec 2016							
Interest free		1,144,789	611,756	86,834	875,105	32,251	2,750,735
Floating interest	2.09%	70,981	29,634	297,689	693,488	-	1,091,792
Fixed interest	4.84%	313	626	837,098	963,718	3,850,940	5,652,695
Total		**1,216,083**	**642,016**	**1,221,621**	**2,532,311**	**3,883,191**	**9,495,222**
31 Dec 2015							
Interest free		1,077,052	744,376	23,429	949,204	-	2,794,061
Floating interest	2.31%	73,876	30,315	308,418	863,662	-	1,276,271
Fixed interest	5.03%	0	632	319,220	1,453,234	4,066,660	5,839,746
Total		**1,150,928**	**775,323**	**651,067**	**3,266,100**	**4,066,660**	**9,910,078**

The Group has access to sources of financing. The total unused amount at the end of the reporting period was HRK 839,370 thousand. The Group expects to meet its other obligations from operating cash flows and proceeds from matured financial assets.

37. FINANCIAL RISK MANAGEMENT (continued)

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.
- 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 or indirectly, and
3. Level 3 inputs – inputs are unobservable inputs for the asset or liability

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.

37. FINANCIAL RISK MANAGEMENT (continued)

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

	1st level	2nd level	3rd level	Total
	HRK '000	HRK '000	HRK '000	**HRK '000**
2016				
Available-for-sale assets	295,938	-	-	**295,938**
Derivative financial assets	-	-	96,196	**96,196**
Derivative financial liabilities	-	-	32,251	**32,251**
Investment property	-	231,491	-	**231,491**
2015				
Available-for-sale assets	245,910	-	-	**245,910**
Derivative financial assets	-	-	70,900	**70,900**
Derivative financial liabilities	-	-	81,876	**81,876**
Investment property	-	236,778	-	**236,778**

38. OTHER DISCLOSURES

The auditors of HEP Group's financial statements provided services in the amount of HRK 730 thousand (in 2015: HRK 730 thousand). Services in 2016 and 2015 mainly relate to audit costs, review of condensed interim financial information and audits of regulatory reports prepared for regulatory needs.

39. EVENTS AFTER THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION DATE / (CONSOLIDATED BALANCE SHEET DATE)

After the consolidated statement of financial position date / (consolidated balance sheet) date, there were no events relevant to be published in the consolidated financial statements of the Company for 2016.

40. APPROVAL OF THE FINANCIAL STATEMENTS

These consolidated financial statements were approved by the Management Board and authorized for issue on 28 April 2017.
Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

HEP d.d. – financial reports

INDEPENDENT AUDITOR'S REPORT

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

REPORT ON THE AUDIT OF THE UNCONSOLIDATED ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the unconsolidated annual financial statements of the company Hrvatska elektroprivreda d.d., Zagreb, Ulica grada Vukovara 37 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended, and Notes to the unconsolidated financial statements, including a summary of significant accounting policies and other explanations.
In our opinion, the accompanying unconsolidated annual financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with Accounting Act, Audit Act and 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 unconsolidated 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 28 to the unconsolidated financial statements, at 31 December 2016, the Company stated clearing debt liability in the amount of HRK 863,450 thousand (31 December 2015: HRK 842,162 thousand) regarding a payment under a letter of credit on the basis of 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 a some other legal transaction. Our opinion has not been modified in this respect.

As described in the Note 29 to the unconsolidated financial statements, provisions of the Water Management Act that came into force on 1 January 2010, raised a question on the ownership and legal status of the Company's property - reservoirs and ancillary facilities, used for generation of electricity from hydropower plants. Pursuant to the Water Act those property is defined as "Public water resources in general use as the property 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. The Company has filed a motion to the Constitutional Court for review of the constitutionality of Article 23 Paragraph 4 of the Water Act and for the cancelation of the same. During 2015, the Ministry of Agriculture has initiated the procedure for amendment and change of the Water Act, and the Ministry of Economy has also submitted its consent to the initiative of the Company for change and amendment of the Water Act. During 2016 and 2017, the Company continued activities with relevant Ministries and Institutions on the above-mentioned issue. Our opinion has not been modified in this respect.

The Company's accompanying unconsolidated financial statements are prepared in accordance with International Financial Reporting Standards and the requirements of Croatian laws and regulations, and the Company's investments in subsidiaries and associates are stated at cost. The Company has also prepared consolidated financial statements for the Company and its subsidiaries compiled on 28 April 2017. For a better understanding of the Company and the Group as a whole, users should read the annual consolidated financial statements together with these unconsolidated annual financial statements.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the unconsolidated annual financial statements for the current period. These matters were addressed in the context of our audit of the unconsolidated 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:

Valuation of investments in subsidiaries and joint ventures

As at 31 December 2016 investments in subsidiaries were determined in the amount of HRK 9,132,618 thousand. As there are some impairment indicators for individual companies, the Company's Management Board was required to assess the value of investments in subsidiaries for which there are impairment indicators. Determining the value of individual investments in subsidiaries requires the Company's Management to make significant estimates of future cash flows and associated discount rates and growth rates based on estimates of future business of the companies.

Related disclosures in the unconsolidated annual financial statements

See Notes 2, 15, 16 and 35 in the accompanying unconsolidated annual financial statements.

Audit procedures

We have:

- assess the reasonableness of the key assumptions used in the valuation model for valuation of investments in subsidiaries and joint ventures, and in particular the projections of operating cash flows, discount rates and long-term growth rates estimates.
- compare the key assumptions with external information and the estimates, made by ourselves.
- test the mathematical accuracy of the valuation model for valuation of investments in subsidiaries and joint ventures.
- test the sensitivity of the valuation model for valuation of investments in subsidiaries and joint ventures regarding the change of key assumptions.

We have also assessed the adequacy of the Company's disclosure of investments in subsidiaries and joint ventures.
The results of our tests were satisfactory. We agree that the assumptions used in the valuation model, including the discount rate and the fact that there was no impairment of the value of subsidiaries, are appropriate.

Contingent liabilities and court disputes

Since the Company is exposed to significant legal claims, we have focused our attention on this area. According to that, the Management Board estimates future outcomes and amounts of contingent liabilities that may arise as a result of these claims.

Related disclosures in the unconsolidated annual financial statements

See Notes 2, 3 and 29 in the accompanying unconsolidated annual financial statements.

Audit procedures

We have:

- obtain the understanding of the status of any significant claim and the historical outcomes of previous similar cases
- obtain the statements of all external legal representatives for all material proceedings
- analyse the assessment of the nature of disputes and claims by discussing the most significant cases with the Company's management and the internal legal department

Based on the collected evidence, taking into account inherent uncertainty in legal issues, we agree with the Company's management's assessment of the likelihood of future significant outflows related to these issues. We have found that issues that are likely to become future outflows are stated as provisions.
Furthermore, we assessed the adequacy of the Company's disclosure regarding Contingent liabilities and court disputes. The results of our tests were satisfactory.

Other Information in the Annual Report

The Management is responsible for other information. Other information includes information included in the Annual report, but do not include the unconsolidated annual financial statements and our Independent auditor's report on them.
Our opinion on the unconsolidated 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 connection with our audit of the unconsolidated 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 unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. 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.

Responsibilities of the Management and Those Charged with Governance for the unconsolidated annual financial statements

The Management is responsible for the preparation of unconsolidated annual financial statements that give a true and fair view in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of unconsolidated annual financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the unconsolidated 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.

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

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

Auditor's Responsibilities for the audit of the unconsolidated annual financial statements

Our objectives are to obtain reasonable assurance about whether the unconsolidated annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with 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 unconsolidated annual financial statements.

Auditor's Responsibilities for the audit of the unconsolidated annual financial statements (continued)

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 unconsolidated 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- 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 unconsolidated 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 unconsolidated annual financial statements, including the disclosures, and whether the unconsolidated annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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 control 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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the unconsolidated 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

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 unconsolidated annual financial statements of the Company. In our opinion, based on our audit of the unconsolidated annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the unconsolidated annual financial statements of the Company set out on pages 8 to 95 on which we expressed our opinion as stated in the section Opinion above.

In our opinion, based on the work that we performed during the audit, the Company's Management report for 2016, which is an integral part of the Annual report for 2016 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 2016, which is an integral part of the Company's Annual report for 2016.

In our opinion, based on the work that we performed during the audit, the Statement that code of corporate governance is applied, included in the Annual report for 2016, is in accordance with the requirements of article 22, paragraph 1, points 3 and 4 of the Accounting Act.

The Statement that code of corporate governance is applied, included in the Annual report for 2016, includes information from article 22, paragraph 1, points 2, 5 and 6 of the Accounting Act.

The Management is responsible for the preparation of unconsolidated annual financial statements for the year ended 31 December 2016 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 unconsolidated annual financial statements"). Financial information presented in Company's standard unconsolidated annual financial statements are in accordance with the information presented in the Company's unconsolidated annual financial statements given on pages 8 to 95 on which we expressed our opinion as stated in the section Opinion above.

The engagement partner on the audit of unconsolidated annual financial statements of the Company for 2016, resulting in this Independent auditor's report is Irena Jadrešić, certified auditor.

In Zagreb, 28 April 2017

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

Zdenko Balen,	**Irena Jadrešić,**
Management Board member	Certified auditor

Income statement – HEP d.d.

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	In HRK'000	In HRK'000
Revenue from electricity sales	6,012,610	6,073,195
Revenue from electricity sales-related companies	126,965	67,812
Revenue from sale of gas	1,106,876	1,298,352
Revenue from sale of gas to HEP- Plin – related company	128,938	167,124
Operating income – related companies	319,829	286,576
Income from sale	***7,695,218***	***7,893,059***
Other operating income	172,705	499,648
Total operating income	**7,867,923**	**8,392,707**
Electricity purchase cost	(1,957,758)	(2,108,770)
Electricity supplies – related companies	(584,920)	(464,428)
Costs of gas sold	(1,244,014)	(1,352,038)
Staff cost	(86,110)	(89,101)
Depreciation and amortization costs	(63,125)	(96,558)
Costs of fees and services - related companies	(2,598,170)	(2,526,392)
Other operating expenses	(468,529)	(477,429)
Total operating expenses	**(7,002,626)**	**(7,114,716)**
Operating profit	**865,297**	**1,277,991**
Financial income	988,646	1,124,158
Financial expenses	(348,460)	(601,129)
Net profit from financial activities	**640,186**	**523,029**
Profit before taxation	**1,505,483**	**1,801,020**
Corporate income tax expense	(181,664)	(176,681)
Profit for the year	**1,323,819**	**1,624,339**

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić
Management
Board member

Zvonko Ercegovac
Management
Board member

Saša Dujmić
Management
Board member

Perica Jukić
President of the
Management Board

Statement of other comprehensive income – HEP d.d.

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	In HRK'000	In HRK'000
Profit for the year	**1,323,819**	**1,624,339**
Other comprehensive income		
Net gain from AFS financial assets	39,456	45,889
Net other comprehensive income to be reclassified to profit/ (loss) in subsequent periods	39,456	45,889
Other comprehensive income, net	**39,456**	**45,889**
Total comprehensive income for the year, net	**1,363,275**	**1,670,228**

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić	Zvonko Ercegovac	Saša Dujmić	Perica Jukić
Management Board member	Management Board member	Management Board member	President of the Management Board

Statement of financial position / Balance sheet – HEP d.d.

AS AT 31 DECEMBER 2016

ASSETS	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Non-current assets		
Property, plant and equipment	623,875	1,410,174
Assets under construction	717,961	447,646
Intangible assets	57,745	22,244
Investment property	15,433	14,487
Prepayments for property, plant and equipment	7,206	21,454
Investment in NE Krško	1,754,419	1,754,419
Investment and receivables from TE Plomin	249,975	252,201
Investment in subsidiaries	7,199,111	6,032,580
Available-for-sale and other investments	289,558	245,838
Long-term loans and deposits	28,830	28,476
Receivables on long-term leases from related parties	16,279,407	13,239,929
Receivables on long-term loans from related parties	63,329	79,129
Receivables on sub-leases from related parties	672,733	897,024
Other receivables	666	776
Derivative financial instruments	-	70,900
Deferred tax assets	19,727	31,431
Total non-current assets	**27,979,975**	**24,548,708**
Current assets		
Inventories	605,412	753,624
Trade receivables	320,061	309,963
Derivative financial assets	96,196	-
Current portion of long-term receivables from related companies for rental	1,083,937	1,057,217
Current portion of long-term loans from related parties	260,881	148,223
Other short-term receivables	105,538	131,966
Receivables from related companies	2,692,696	6,180,063
Cash and cash equivalents	2,366,100	1,951,873
Total current assets	**7,530,821**	**10,532,929**
TOTAL ASSETS	**35,510,796**	**35,081,637**

Statement of financial position / Balance sheet – HEP d.d. (continued) as at 31 December 2016

EQUITY AND LIABILITIES	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Share capital	19,792,159	19,792,159
Revaluation reserves	140,292	100,836
Retained earnings	5,649,310	4,932,491
Total equity	**25,581,761**	**24,825,486**
Liabilities under issued bonds	3,606,173	4,223,883
Long-term loan liabilities	654,682	923,161
Other long-term liabilities	909,524	939,287
Long-term provisions	212,605	211,589
Deferred tax liabilities	26,007	21,816
Total non-current liabilities	**5,408,991**	**6,319,736**
Trade payables	630,250	681,827
Current portion of long-term bonds issued	586,601	93,380
Current portion of long-term loans	408,711	383,525
Short-term loans	-	-
Taxes and contributions	76,595	114,512
Interests payable	42,568	45,692
Liabilities toward related companies	2,758,202	2,578,573
Liabilities to employees	6,104	21,061
Other short-term liabilities	11,013	17,845
Total current liabilities	**4,520,044**	**3,936,415**
TOTAL EQUITY AND LIABILITIES	**35,510,796**	**35,081,637**

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić
Management Board member

Zvonko Ercegovac
Management Board member

Saša Dujmić
Management Board member

Perica Jukić
President of the Management Board

5

Reports by HEP Group companies

with the financial statements and independent auditor's reports

HEP-Proizvodnja d.o.o.

HEP-Proizvodnja (generation) continued to improve core generation activities within HEP Group in 2016 in line with the Company's registration for electricity and heat energy generation meeting the needs and the cost of supplying HEP's customers with electricity, heat energy and process steam.
The upgrading of company's generation activities encompasses a wide scope of technical and technological, economic and legal activities from the following area of business priority: the preparation and execution of the construction of new and the revitalization of the existing hydropower, thermal power and cogeneration plants; prevention and corrective maintenance according to plants condition and the needs of the Croatian electric power system; operational planning and management of generation as well as fuel procurement, storage and consumption optimization; provision of ancillary services to HOPS, provision and activation of power and energy regulation reserves; certification of the guarantee of green energy origin as well as electricity generation within the incentive system; implementation of environmental and work safety measures and activities; contribution to improvements of the Croatian energy regulations and active cooperation with the Croatian bodies and institutions.
By appropriately maintaining its generation facilities, HEP Proizvodnja retained a high availability level of almost all its generation units.
MHE Prančevići (small hydropower plant), MHE ABM HE Varaždin (small HPP), and combined-cycle Unit L of TE-TO Zagreb (CCGT) obtained the status of an eligible producer. The production of HPP Varaždin was entered in the Registry of Guarantees of Electricity Origin kept by HROTE. The remaining environmental permits for TPP Plomin 1 and 2, TE-TO Zagreb CCGT, and EL-TO Zagreb CCPP were issued. The ten-year period of obtaining the green energy certificate issued by the international certification company for all hydropower plants continued, which facilitated the sale of electricity on domestic and foreign markets.
The Methodology for setting the price and conditions for the provision of ancillary services was adopted as well as six individual contracts on the provision of ancillary services with HOPS signed.
The seven-day operational regime in the Production Department continued for the purpose of enhancing the planning process of daily gas needs, the implementation of additional daily reserves, and the operating harmonization of billing elements for invoicing ancillary services.
A further decrease of natural gas consumption resulted in cost optimization and electricity production competitiveness, while retaining regulated income i.e. insufficient tariff items for covering the cost of heat energy and process steam production. Contracts were signed with HEP District Heating on the sale of produced heat energy and process steam for district heating systems in Zagreb, Osijek and Sisak in 2017 under which HEP DH is responsible for the regulation of the metering points at the interface of the heat energy producer and distributer.
Pursuant to the Connection Agreement signed between HOPS and HEP Generation, 64 metering points at the interface of the transmission network with generation facilities were regulated as well as 103 metering points at the interface of the distribution network operated by HEP DSO and HEP Generation facilities.

Director
Željko Starman*
*In the reporting period, director was Nikola Rukavina

GENERATING CAPACITIES

HYDROPOWER PLANTS	AVAILABLE CAPACITY (MW) / (-MW pumping regime)	HYDROPOWER PLANTS	AVAILABLE CAPACITY (MW)
Storage		**Run-of-river**	
GHE Zakučac	539.15*	HE Varaždin	92.65
RHE Velebit	270 (-240)	HE Dubrava	79.78
HE Orlovac	237.0	HE Čakovec	77.44
HE Senj	216.0	HE Gojak	55.5
HE Dubrovnik	126/115	HE Lešće	41.2
HE Vinodol	90.0	HE Rijeka	36.8
HE Peruća	60.0	HE Miljacka	20
HE Kraljevac	46.4	HE Jaruga	7.2
HE Đale	40.8	HE Golubić	6.54
HE Sklope	22.5	HE Ozalj	5.5
CS Buško blato	7.5/4.2/(-10.2/-4.8)	HE Lešće ABM	1.09
CHE Fužine	4.6/(-5,7)	HE Krčić	0.34
HE Zavrelje	2		
RHE Lepenica	0.8 (-1.2)		
HE Zeleni vir	1.7		

CS: pumping station/CHE: pumped storage HE/RHE: reversible pump HPP
* MHE Prančevići net available capacity of 1.15 MWh in operation

THERMAL POWER PLANTS	NET AVAILABLE CAPACITY (MW,MWt,t/h)	FUEL
TE-TO Sisak	623 / 0 / 161	oil/natural gas
TE-TO Zagreb	422 / 743 / 360	oil/natural gas
TE Rijeka	303	oil
TE Plomin (A)	105	coal
EL-TO Zagreb	88,8 / 384 / 416	oil/natural gas
TE-TO Osijek	89 / 184 / 150	oil/natural gas/extra light oil
KTE Jertovec	74	natural gas/ extra light oil
TE PLOMIN (B)*	192	coal

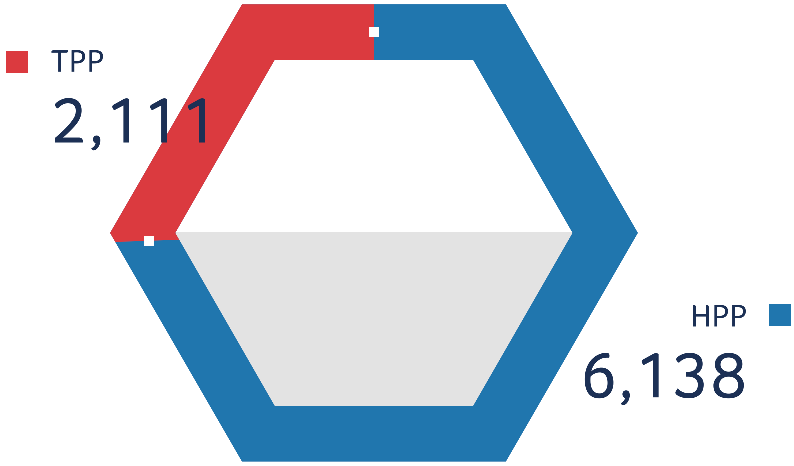
* HEP-Proizvodnja d.o.o. has the O&M agreement

ELECTRICITY AND HEAT PRODUCTION

Electricity production

During 2016, HEP Proizvodnja's power plants produced a total of 8.249 TWh of electricity, not including the generation by Unit B of TPP Plomin of 1.531 TWh. Out of the said total, hydro and thermal (including cogeneration) production accounted for 6.138 TWh or 74.4 percent and 2.111 TWh or 25.6 percent, respectively.

Electricity production in HEP Proizvodnja power plants in 2016 (GWh)



Heat production

In 2016, HEP Proizvodnja's combined cycle facilities produced a total of 2,124,716 MWh of heat energy. Compared to 2,115,109 MWh produced the year before, this year's figure represents a 0.5% increase. Process steam production amounted to 709,700 tonnes (2015: 734,568 t).
Heat production in 2016 was 1,569,139 MWh (2015: 1,541,177 MWh).

Power plant availability

The availability of all generating plants operated by HEP Proizvodnja in 2016, including TE Plomin d.o.o. (HEP's power plant) measured as the ratio of availability hours (availability hours = operation + reserve in relation to total number of hours minus planned overhauls) was 89.2%, which was by 5.4% less than the 2015 availability.

FINANCIAL REPORTS

INDEPENDENT AUDITOR'S REPORT
To the owner of HEP Proizvodnja d.o.o.:

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP Proizvodnja d.o.o., Zagreb, Ulica grada Vukovara 37 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.

In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Significant Uncertainty Related to Going Concern Assumption

We draw attention to the fact that as at 31 December 2016 the Company made a loss exceeding capital in the amount of HRK 322,539 thousand. Pursuant to the Financial Operations and Pre-bankruptcy Settlement Proceedings Act, the Company does not meet the required criteria of capital adequacy.

The Company's continued operations under the going concern basis depend on the Company's ability to secure sufficient resources to settle obligations in a timely manner, to secure adequate sources of financing and to commence operating at a profit. In order to achieve this as described in Note 1 to the Financial Statements, a member of the Company has obliged to offer financial support to the Company and the Company's Management is making efforts to improve current operations and the Company's financial position. Our opinion is not modified in respect of this matter.

Emphasis of Matter

As described in the Note 25 to the financial statements, provisions of the Water Act which came into force on 1 January 2010 raised a question on the ownership and legal status of the Company's property - reservoirs and ancillary facilities used for generating electricity from hydropower plants. Pursuant to the Water Act those properties 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 still in progress. Owner of the Company, Hrvatska elektroprivreda d.d. has filed a motion to the Constitutional Court for review of the constitutionality of Article 23 Paragraph 4 of the Water Act and the proposal for cancelation of the said provision.

During 2016 and 2017 activities regarding this issue continued with the competent ministries and institutions. Our opinion is not modified in respect of this matter.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.

Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material misstatement of these other information, we are required to report this fact. In this sense, we do not have anything to report.

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

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS, and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Management Board 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 annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.
- 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 control that we identify during our audit.

Report on Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company.
In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 6 to 56 on which we expressed our opinion as stated in the Opinion section above.
In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016
The Management Board is responsible for the preparation of annual financial statements for the year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 6 to 56 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 20 April 2017

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

Zdenko Balen,	Irena Jadrešić,
Member of the Management Board	Certified Auditor

HEP-Proizvodnja d.o.o., Zagreb
Income statement

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Income from fee electricity generation and other income from related companies	3,070,204	3,210,602
Revenue from electricity sale in the incentives system	132,527	7,500
Other operating income	69,291	85,919
	3,272,022	**3,304,021**
Energy for manufacturing, materials and spare parts	(1,194,985)	(1,424,701)
Service expenses	(306,761)	(322,951)
Staff expenses	(305,957)	(344,049)
Depreciation	(244,403)	(233,306)
Administrative expenses – related companies	(120,594)	(122,067)
Other operating expenses	(438,346)	(369,513)
	(2,611,046)	**(2,816,587)**
Profit from operating activities	**660,976**	**487,434**
Financial income	1,117	720
Financial expenses	(61,315)	(64,577)
Net loss from financial activities	**(60,198)**	**(63,857)**
Profit from operating activities before taxation	**660,778**	**423,577**
Corporate income tax expense	(172,490)	(86,467)
Profit for the year	**428,288**	**337,110**

Signed for and on behalf of the Management Board, on 20 April 2017:
Nikola Rukavina,
Director

HEP-Proizvodnja d.o.o., Zagreb
Statement of other comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Profit for the year	**428,288**	**337,110**
Other comprehensive income or loss for the current year	-	-
Total comprehensive profit for the current year	**428,288**	**337,110**

Signed for and on behalf of the Management Board, on 20 April 2017:
Nikola Rukavina,
Director

HEP-Proizvodnja d.o.o., Zagreb
Statement of financial position / Balance Sheet

AS AT 31 DECEMBER 2016

ASSETS	**31 December 2016**	**31 December 2015**
	HRK`000	HRK`000
Intangible assets	45,767	42,011
Property, plant and equipment	5,945,816	4,034,362
Investments in progress	441,576	2,439,758
Investment properties	31,260	38,617
Prepayments for property, plant and equipment	61,738	31,796
Investments in subsidiaries	8	8
Receivables from the sale of apartments	5,014	6,524
Deferred tax assets	455,018	513,915
Total non-current assets	**6,986,197**	**7,106,991**
Inventories	128,509	148,016
Other current assets	18,771	123,698
Receivables from related companies	2,075,034	1,913,324
Trade receivables	44,764	2,382
Current portion of non-current receivables	2,275	2,420
Cash and cash equivalents	94,990	53,600
Total current assets	**2,364,343**	**2,243,440**
TOTAL ASSETS	**9,350,540**	**9,350,431**

HEP-Proizvodnja d.o.o., Zagreb
Statement of financial position / Balance Sheet (continued)
As at 31 December 2016

EQUITY AND LIABILITIES	**31 December 2016**	**31 December 2015**
	HRK`000	HRK`000
Share capital	20	20
Retained earnings	(322,539)	(750,827)
Total equity	**(322,519)**	**(750,807)**
Non-current liabilities to related companies	7,979,237	6,142,445
Non-current provisions	302,179	289,195
Other non-current liabilities	4,519	5,568
Total non-current liabilities	**8,285,935**	**6,437,208**
Trade payables	247,538	293,124
Liabilities to related companies	717,857	2,903,451
Current portion of non-current liabilities to related companies	244,403	233,306
Other current liabilities	177,326	234,149
Total current liabilities	**1,387,124**	**3,664,030**
TOTAL EQUITY AND LIABILITIES	**9,350,540**	**9,350,431**

Signed for and on behalf of the Management Board, on 20 April 2017:
Nikola Rukavina,
Director

HEP-Operator distribucijskog sustava d.o.o.

HEP-Operator distribucijskog sustava d.o.o. (HEP DSO-distribution system operator) is the largest company within the vertical structure of HEP Group. Its core activity during 2016 was electricity distribution and supply. These activities are carried out as a public service i.e. they are regulated. Under the provision of the Electricity Market Act and with the purpose of unbundling electricity supply carried out as a public service, the new company within HEP Group, HEP Elektra d.o.o., was founded on 2 November 2016 by a status change of company separation.

As the company operates within the constantly changing legal and regulatory framework, its operations are carried out along with the ongoing harmonization of business processes. The underlying legal framework is set by the Energy Act and the Electricity Market Act, as well as resulting secondary legislation and other general regulations defining company operations. The most significant piece of secondary legislation are the General Terms of Network Use and Electricity Supply.

During 2016, a number of measures and activities based on set business objectives and the method of their fulfilment as well as other operating determinants from the Work Programme of the Management Board of HEP d.d. and the Work Programme of HEP DSO for the period 2012-2016 was conducted. Key business objectives of the company are: increasing the quality of electricity supply, increasing general operating efficiency in meeting maintenance and investment plans, raising the level of services provided to network users and electricity market participants, enhancing energy efficiency in electricity distribution and use by implementing measures for decreasing electricity losses, the development of the distribution network into the distribution system with advanced solutions considering the inevitable establishment of distributed generation and its consolidation with the network, and the ongoing development of electricity market operation-related processes.

Year 2016 was characterized by intensive preparations of underlying documents for the implementation of the strategic and operational restructuring of HEP DSO. Apart from this project, the introduction of a new IT support software (SAP) for key business processes must also be mentioned as important.

Business operations of HEP DSO underwent the process of harmonization with the new legislative framework in 2016 as well as the adjustment to new electricity market relations. Contracts with all the suppliers in relation to the issuance of a single bill were concluded. As of 1 January 2017, all suppliers are obligated to issue a single bill, combining electricity consumption and the network use charge, to all residential and commercial customers on low voltage.

HEP DSO has been adjusting to social goals of creating new values, the support to investments into power facility construction, work efficiency increase and cost justification. It is also focused on meeting high environmental and work and fire safety objectives. Investment and development programmes are planned and carried out for the purpose of achieving a balanced and efficient development and the construction of distribution network. In view of the constantly changing business environment and work technologies, we keep investing into the development of new knowledge and skills of our employees through professional education, specialisation and training.

Director
Nikola Šulentić

LINE LENGTH BY VOLTAGE LEVEL AND LINE TYPE (km)

OHL 35 kV, 20 kV, 10 kV	CB 35 kV, 20 kV, 10 kV	OHLLV - 0.4 kV	CBLV - 0.4 kV
23,692	17,571	69,305	30,787

As of 31 December 2016 (according to data in the report for HERA)

NUMBER OF TRANSFORMER STATIONS BY VOLTAGE LEVEL

110/x kV	**35(30)/10(20) kV**	**10(20)/0.4 kV**
139	307	25,556

As of 31 December 2016 (according to data in the report for HERA)

FINANCIAL REPORTS

INDEPENDENT AUDITOR'S REPORT
To the owner of HEP - Operator distribucijskog sustava d.o.o.

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP Operator distribucijskog sustava d.o.o., Zagreb, Ulica grada Vukovara 37 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.
In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.
Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material misstatement of these other information we are required to report this fact. In this sense, we do not have anything to report.

Responsibilities of the Management and Those Charged with Governance for the Annual Financial Statements

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the annual financial statements, the Management Board 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 annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.

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 control that we identify during our audit.

Report on the Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company.
In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 6 to 58 on which we expressed our opinion as stated in the Opinion section above.

In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016.

The Management Board is responsible for the preparation of annual financial statements for the year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 6 to 58 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 21 April 2017

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

Zdenko Balen,	Irena Jadrešić,
Member of the Management Board	Certified Auditor

HEP – Operator distribucijskog sustava d.o.o., Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK'000	HRK'000
OPERATING INCOME		
Revenues from sale of electricity as universal and guaranteed supply	2,209,286	2,871,623
Revenues from sale of electricity – distribution fee	3,339,246	3,327,735
Revenues from distribution and supply of electricity – related companies	121,593	38,251
Revenues from sale of services	386,401	357,403
Other revenues – related companies	76,953	18,932
Other operating income	483,941	402,374
Total operating income	**6,617,420**	**7,016,318**
OPERATING EXPENSES		
Electricity purchase cost - HEP d.d.	(1,790,010)	(2,476,573)
Losses on distribution network and electricity balancing costs	(516,203)	(492,042)
Electricity purchase cost - HROTE	(221,738)	(235,525)
Services costs	(229,625)	(239,045)
Staff costs	(1,075,964)	(1,057,481)
Depreciation and amortization	(919,221)	(853,746)
Administrative costs – related companies	(166,795)	(154,658)
Provisions for severance payments resulting from restructuring	(342,964)	-
Other operating expenses	(457,594)	(533,464)
Total operating expenses	**(5,720,114)**	**(6,042,534)**
Operating profit	**897,306**	**973,784**
Financial income	1,581	2,072
Financial expenses	(56,190)	(67,605)
Net loss from financial activities	**(54,609)**	**(65,533)**
Profit before taxation	**842,697**	**908,251**
Corporate income tax expense	(175,610)	(183,052)
Profit for the year	**667,087**	**725,199**

Signed on behalf of the Management Board on 20 April 2017:
Nikola Šulentić,
Director

HEP – Operator distribucijskog sustava d.o.o., Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK'000	HRK'000
Profit for the year	667,087	725,199
Other comprehensive income for the year	-	-
Total comprehensive income for the year	667,087	725,199

Signed on behalf of the Management Board on 20 April 2017:
Nikola Šulentić,
Director

HEP – Operator distribucijskog sustava d.o.o., Balance Sheet / Statement of financial position

AS AT 31 DECEMBER 2016

ASSETS	31 December 2016	31 December 2015
	HRK'000	HRK'000
Property, plant and equipment	13,675,022	12,937,655
Assets under construction	848,293	843,099
Intangible assets	24,513	30,692
Investment property	59,186	59,085
Receivables for sold flats	10,392	12,922
Prepayments for property, plant and equipment	2,826	1,947
Deferred tax assets	60,599	82,703
Financial assets	15,960	16,033
Total non-current assets	**14,696,791**	**13,984,136**
Inventories	269,764	260,846
Trade receivables	335,914	755,407
Receivables from related companies	1,016,172	912,644
Current portion of long-term receivables	3,350	3,140
Other current assets	35,596	18,262
Cash and cash equivalents	379,742	308,821
Total current assets	**2,040,538**	**2,259,120**
TOTAL ASSETS	**16,737,329**	**16,243,256**

HEP – Operator distribucijskog sustava d.o.o.,
Balance Sheet / Statement of financial position (continued)
As at 31 December 2016

EQUITY AND LIABILITIES	31 December 2016	31 December 2015
	HRK'000	HRK'000
Share capital	699,436	699,456
Capital reserves	1,065,524	460,244
Retained earnings	899,817	726,601
Total equity	**2,664,777**	**1,886,301**
Non-current liabilities to related companies	7,485,248	6,312,510
Other non-current liabilities and deferred income	3,045,687	3,259,796
Non-current provisions	286,749	359,754
Total non-current liabilities	**10,817,684**	**9,932,060**
Trade payables	384,820	407,991
Liabilities to related companies	1,287,955	2,695,027
Current portion of non-current liability to related company	607,403	584,782
Other current liabilities	974,690	737,095
Total current liabilities	**3,254,868**	**4,424,895**
TOTAL EQUITY AND LIABILITIES	**16,737,329**	**16,243,256**

Signed on behalf of the Management Board on 20 April 2017:
Nikola Šulentić,
Director

HEP Elektra d.o.o.

Under the provisions of the Act on the Amendments of the Electricity Market Act aimed at unbundling electricity supply carried out as a public service, the new company within HEP Group – HEP Elektra d.o.o. was founded on 2 November 2016 by a status change of company separation.

HEP Elektra carries out electricity supply for universal and guaranteed customers. The universal service is a uniform method of electricity sale which ensures the right of a residential customer to the public service of electricity supply of prescribed quality across the entire territory of Croatia at real, clearly comparable and transparent prices. Guaranteed supply is the regulated supply of electricity to end customers who are left without a supplier under defined term.

The process of unbundling supply from HEP Distribution System Operator started under the 2015 Decision of the Management Board of HEP d.d. and will continue until the new company, HEP Elektra becomes fully autonomous. Pursuant to the separation plan, 77 employees of HEP Elektra have undertaken the supply of 2,078,044 customers. As the activity could not have been conducted independently, HEP Elektra signed the Service Provision Agreement with HEP Distribution System Operator regarding the provision of supply services in the period of transition. The Agreement has been concluded for a fixed period of time, no later than 31 December 2017. During the period, HEP DSO will provide HEP Elektra the services of electricity settlement and billing: keeping customer records, drafting contracts, billing consumed electricity, making and sending invoices, charging, customer relation, receiving and processing complaints, analysis of sales ledger.

The company is organized in four regional centers and the head office. Regional centers encompass an equal number of customers (about 500,000 except the Zagreb Regional Center with 700,000 customers). Regional centers will conduct the billing and the collection of trade receivables for individual regional center. The new IT application system is being introduced, which will enable customers the selection of their regional center.

The unbundling of HEP Elektra has not introduced any significant changes for customers. HEP Elektra became the new supplier of all the customers priorly supplied by HEP DSO. They have continued to use the service of supply under unchanged conditions. The result of the unbundling process is the increase of service quality as the customers may contact either HEP DSO or HEP Elektra, which acts as a mediator between customers and HEP DSO for network related issues, resolution of network-related queries (consumption, breakdowns, voltage quality,...).

In order to raise the quality level of service provision to customers, HEP Elektra set up a single contact center immediately after its establishment in which its employees reply to about 300 phone calls a day and to about 400 queries submitted by e-mail. All customers with regular electricity settlement in November or December 2016 received a brochure informing them of the changes regarding the unbundling of supply. The Company has also taken over the tasks specified under the Distribution Plan from HEP DSO and prepared the basis for entering into other legal transactions required for the performance of its registered activity.

The number of employees must be increased in 2017 in order to fully take over all supply-related business tasks. The priority is the contact center so as to be able to manage the increasing number of customer queries. It is also necessary to introduce a new application support as well as the SAP Software System as soon as possible.

Director
Zvonko Stadnik

HEP ELEKTRA IN 2016

Number of customers/metering points (as of 31 December 2016)

Customer category	
High voltage	**0**
Medium voltage	**258**
Low voltage - commercial	74,251
Low voltage - public lighting	1,559
Low voltage - households	2,005,637
Low voltage total	**2,081,447**
Total	**2,081,705**

Sales (GWh)

Voltage level	
High voltage	**2**
Medium voltage	**52**
Low voltage – commercial	567
Low voltage – public lighting	19
Low voltage - households	5,460
Low voltage total	**6,046**
SALES TOTAL	**6,100**

FINANCIAL REPORTS

INDEPENDENT AUDITOR'S REPORT
To the owner of HEP ELEKTRA d.o.o.

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP ELEKTRA d.o.o., Zagreb, Ulica grada Vukovara 37 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.

In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.

Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material misstatement of these other information, we are required to report this fact. In this sense, we do not have anything to report.

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

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS, and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Management Board 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.

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

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

Auditor's Responsibilities for the audit of the annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.

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 control that we identify during our audit.

Report on Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company. In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 6 to 42 on which we expressed our opinion as stated in the Opinion section above.

In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016.
The Management Board is responsible for the preparation of annual financial statements forthe year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 6 to 42 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 25 April 2017

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

Zdenko Balen,	Irena Jadrešić,
Member of the Management Board	Certified Auditor

HEP ELEKTRA d.o.o., Income Statement

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016
	HRK`000
OPERATING INCOME	
Income from the sale of electricity as a universal and guaranteed service	449,379
Income from related companies	435
Other operating income	5,500
Total operating income	**455,314**
OPEARTING EXPENSES	
Purchase of electricity – related companies	(339,788)
Purchase of electricity outside of the system	(62,717)
Service expenses	(5,532)
Staff expenses	(2,373)
Depreciation and amortization costs	(84)
Administrative expenses – related companies	(9,076)
Other operating expenses	(17,873)
Total operating expenses	**(437,443)**
Profit from operating activities	**17,871**
Financial income	5
Net profit from financial activities	**5**
Profit before taxation	**17,876**
Corporate income tax expense	(5,125)
Profit for the year	**12,751**

Signed for and on behalf of the Management Board, on 24 April 2017:
Zvonko Stadnik,
Director

HEP ELEKTRA d.o.o., Statement of Comprehensive Income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016
	HRK`000
Profit for the year	**12,751**
Other comprehensive profit for the year	-
Total comprehensive profit for the year	**12,751**

Signed for and on behalf of the Management Board, on 24 April 2017:
Zvonko Stadnik,
Director

HEP ELEKTRA d.o.o., Statement of Financial Position/Balance Sheet

AS AT 31 DECEMBER 2016

ASSETS	31 December 2016	2 November 2016
	HRK`000	HRK`000
Property, plant and equipment	1,211	286
Deferred tax assets	544	-
Total non-current assets	**1,755**	**286**
Trade receivables	457,448	407,248
Receivables from related companies	485,643	162,892
Other short-term asset	31,976	13,153
Cash and cash equivalents	310	-
Total current assets	**975,377**	**583,293**
TOTAL ASSETS	**977,132**	**583,579**

EQUITY AND LIABILITIES	31 December 2016	2 November 2016
	HRK`000	HRK`000
Share capital	20	20
Retained earnings	97,423	84,672
Total equity	**97,443**	**84,692**
Long-term liabilities to related companies	707	202
Other long-term liabilities	3,024	1,817
Total non-current liabilities	**3,731**	**2,019**
Trade payables	171	40,139
Liabilities to related companies	745,167	312,056
Current portion of long-term liabilities to related companies	504	84
Other short-term liabilities	130,116	144,589
Total current liabilities	**875,958**	**496,868**
TOTAL EQUITY AND LIABILITIES	**977,132**	**583,579**

Signed for and on behalf of the Management Board, on 24 April 2017:
Zvonko Stadnik,
Director

HEP-Opskrba d.o.o.

HEP Opskrba (supply) successfully faced all market-imposed challenges in 2016. Retaining the market share, the company remained the leading supplier holding 85 percent of the overall electricity market in Croatia. The result achieved in Slovenia working in synergy with HEP Trgovina (trade), i.e. contracting 12.5 % of commercial consumption, additionally strengthened our position as a growing regional supplier. Commercial customers remained the core of our sales accounting for 60 percent of the overall sale to end customers domestically i.e. 74 percent of 9.4 TWh consumption which was covered by HEP Opskrba. We successfully adapted to market trends i.e sudden price changes on power exchanges. The year started with high 39.6 EUR/MWh, and then reached a record low 30 EUR/MWh in the first quarter of the year. This was the result of various global trends from nuclear power plant decommissioning to raising the share of RES and decreasing the coal and CO_2 emission prices.

Despite a continued slowdown of purchasing power and industrial consumer consumption, we achieved our planned contracted consumption domestically of 7,119.7 GWh, exceeding the planned by 7 percent and matching the 2009 sale level (before the recession and market liberalisation).

The ambitious plan regarding the 99 percent collection of receivables based on invoiced electricity consumption in 2016 was met with 101.4 percent. The objective was accomplished as a result of collection activities aimed at inactive customers which earned the company 5 million kuna, a continuous monitoring of small and medium-sized customers' collection, campaigns aimed at monitoring the collection from corporate, key and large customers as well as activating instruments of payment. Our successful collection of receivables contributed to the upgrade of HEP's credit assessment.

In conducting its business operations, HEP Opskrba complies with all legal norms and meets all conditions set for a supplier, which created preconditions for the extension of its work permit for the next seven year period.

Our innovativeness and entrepreneurial spirit achieved positive effects in the sale of energy from renewable sources with exceptional results and exceeding the ZelEn sales plan by more than 200 percent. This was yet another proof of HEP Opskrba's ability to recognize the market moment and keep up with market trends.

We successfully responded to very complex needs of large industrial customers by ensuring them competitive terms of supply, products adjusted to their needs as well as energy service provision in cooperation with HEP ESCO. All our key customers stayed loyal, and we managed to bring some of our old customers back: Hrvatske šume, Hrvatske vode, Plamen, City of Sisak, Impol Ulaganja, FINA, Punta Skala, Kutjevo, etc.

Our competitiveness was proven in 2016 in public procurement procedures by winning 69 percent of tenders and entering into HRK 237 million worth business contracts. We also took care of small and medium-sized entrepreneurs and secured them increased savings and market competitiveness through a number of activities and in cooperation with chambers of trade. The number of residential customers increased by almost 25 percent. In 98 percent of cases, we managed to find the solution to phone queries during the first call, which had a vast positive effect on the satisfaction of our customers and raised the efficiency of work in our Contact Centre.

Working in synergy with HEP Trade daughter companies in the region, we acquired more than 170 new industrial customers on the Slovenian market with annual consumption exceeding 2.1 TWh as well as our first customers in Bosnia and Herzegovina and Serbia.

Steps forward made by HEP Opskrba on the domestic and regional markets in 2016 came as a result of in-house improvements and the effort invested by the entire team. The Rulebook on Work Efficiency Management and Rewards of HEP Opskrba Employees was adopted. This comprehensive process was the result of multi-year efforts invested in attempts to monitor the work of HEP Opskrba's employees as well as to adequately reward them according to performance results and additionally motivate our workers to be even more dedicated and efficient. The work efficiency management system in HEP Opskrba is the first of its kind in HEP Group, and as such represents a significant step forward in the management and customer relations.

HEP Opskrba rounded up its part of involvement in the ELEN development project by opening a unique ELEN LEAF EV charging station in Zagreb.

For the fifth consecutive time, the business year was ended with the meetings of HEP Opskrba customers. More than 800 biggest customers joined us in Osijek, Split, Rijeka, Zagreb and Ljubljana. December marked the completion of the renovation of I.B.Mažuranić Home for Children in Lovran, the HRK 400,000 worth ZelEn donation, and the announcement of a new tender for awarding the HRK 1 million worth ZelEn donation.

Director
Tina Jakaša

HEP OPSKRBA IN 2016 – BASIC DATA

Number of metering points

Voltage level	**2015**	**2016**	**%16/15**
High voltage	**55**	**131**	**138.18**
Medium voltage	**1,225**	**1,264**	**3.18**
Low voltage - commercial	86,844	**86,020**	-0.95
Low voltage – public lighting	12,758	**11,066**	-13.26
Low voltage - households	25,313	**30,798**	21.67
Low voltage total	**124,915**	**127,884**	**2.38**
Total	**126,195**	**129,279**	**2.44**

Number of customers

Customer category	**2015**	**2016**	**%16/15**
No. of customers	66,724	**69,217**	3.74
No. of metering points per customer	1.90	**1.87**	-1.70
Electricity sale (MWh) per customer	102	**103**	0.84

Electricity sale (in GWh) per consumption categories (voltage levels)

Customer category	**2015**	**2016**	**%16/15**
High voltage	789	642	-18.6
Medium voltage	2,910	3,206	10.2
Low voltage - commercial	2,813	2,906	3.3
Low voltage – public lighting	220	251	14.
Sales to commercial customers	6,732	7,005	4.1
Sales to household customers	97	115	18.6
TOTAL SALES	**6,829**	**7,120**	**4.3**

FINANCIAL REPORTS

Independent auditor's report
To the owner of HEP Opskrba d.o.o., Zagreb

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP Opskrba d.o.o., Zagreb, Ulica grada Vukovara 37 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.
In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.
Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material misstatement of these other information, we are required to report this fact. In this sense, we do not have anything to report.

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

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS, and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the annual financial statements, the Management Board 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.

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

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

Auditor's Responsibilities for the audit of the annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.

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 control that we identify during our audit.

Report on Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company. In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 5 to 44 on which we expressed our opinion as stated in the Opinion section above.

In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016.

The Management Board is responsible for the preparation of annual financial statements for the year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 5 to 44 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 19 April 2017

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

Zdenko Balen,
Member of the Management Board

Irena Jadrešić,
Certified Auditor

HEP Opskrba d.o.o., Income statement

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Income from related companies	396,270	352,092
Other operating income	671	1,209
	396,941	**353,301**
Purchase of el. energy out of renewable sources' system	(330,319)	(255,209)
Material and spare parts expenses	(952)	(720)
Service expenses	(3,032)	(2,797)
Staff expenses	(12,826)	(12,694)
Depreciation and amortization costs	(1,085)	(908)
Costs based on energy balance	(24,055)	(53,776)
Administrative expenses – related companies	(9,934)	(11,740)
Other operating expenses	(14,130)	(14,274)
	(396,333)	**(352,118)**
Profit from operating activities	**608**	**1,183**
Financial income	245	350
Financial expenses	(6)	(18)
Net profit from financial activities	**239**	**332**
Profit before taxation	**847**	**1,515**
Corporate income tax expense	(230)	(342)
Profit for the year	**617**	**1,173**

Signed for and on behalf of the Management Board, on 13 April 2017:
Tina Jakaša
Director

HEP Opskrba d.o.o., Statement of other comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Profit for the year	**617**	**1,173**
Other comprehensive income for the year	**-**	**-**
Total comprehensive income for the year	**617**	**1,173**

Signed for and on behalf of the Management Board, on 13 April 2017:
Tina Jakaša
Director

HEP Opskrba d.o.o., Statement of financial position / Balance Sheet

AS AT 31 DECEMBER 2016

ASSETS	**31 December 2016**	**31 December 2015**
	HRK`000	HRK`000
Intangible assets	391	538
Property, plant and equipment	2,858	3,694
Long-term loan receivables	129	129
Deferred tax assets	241	174
Total non-current assets	**3,619**	**4,535**
Trade receivables	447,950	428,880
Receivables from related companies	75,952	41,219
Inventory of materials	71	119
Other short-term asset	48,590	44,430
Received bills of exchange	27,456	-
Cash and cash equivalents	6,468	16,363
Total current assets	**606,487**	**531,011**
TOTAL ASSETS	**610,106**	**535,546**

EQUITY AND LIABILITIES		
Share capital	20	20
Retained earnings	617	1,173
Total equity	**637**	**1,193**
Long-term liabilities to related companies	2,292	3,453
Other long-term liabilities	1,340	870
Total non-current liabilities	**3,632**	**4,323**
Trade payables	44,447	26,689
Liabilities to related companies	521,165	463,335
Current portion of long-term liabilities to related companies	1,085	908
Other short-term liabilities	39,140	39,098
Total current liabilities	**605,837**	**530,030**
TOTAL EQUITY AND LIABILITIES	**610,106**	**535,546**

Signed for and on behalf of the Management Board, on 13 April 2017:
Tina Jakaša
Director

HEP-Toplinarstvo d.o.o.

In 2016, HEP-Toplinarstvo d.o.o. (district heating) supplied 1.9 TWh of heat energy and process steam to about 126,000 end customers with subscribed demand of 1.5 GW, thus reaffirming its status of the largest distibutor, supplier and heat energy buyer in the Republic of Croatia.

HEP-Toplinarstvo successfully conducted all its planned activities in 2016. It ensured a continuous and secure supply of heat energy to all end customers in Zagreb, Osijek, Sisak, Velika Gorica, Samobor and Zaprešić throughout the year in line with its core business objective.

During the non-heating period, the revitalisation of the hot- and warm water- as well as steam pipeline routes was carried out to maintain the reliability of heat energy supply. Apart from the works on heating system revitalisation, the activities on the project of connecting the Zagreb district of Dubrava onto the central heating system continued. The project was launched in mid 2011. In light of the scope and size of required works, it was divided into six stages. During 2016, planned works on most sections were completed, and the taking-over procedure of the construction site carried out. The project shall continue in the following period.

The project of Technical and Economic Optimization of the Remote Heating System (i.e. the remote operation system) in the city of Osijek, completed in 2016, must also be mentioned. The project ensured the optimal operation of the remote heating system, heat loss reduction and the hot water system operation optimization. The modernization of the remote heating system increases system understanding, facilitates the identification of past, current and future operating conditions, simulates system behaviour in real time for various project scenarios, and optimizes heat energy production and distribution in real time.

The project of introducing the remote metering system in HEP Toplinarstvo continued in 2016. The procurement of the equipment and the application for equipping the representative sample of heat substations in Zagreb, Velika Gorica and Osijek was carried as a testing of the remote metering system's technical solution.

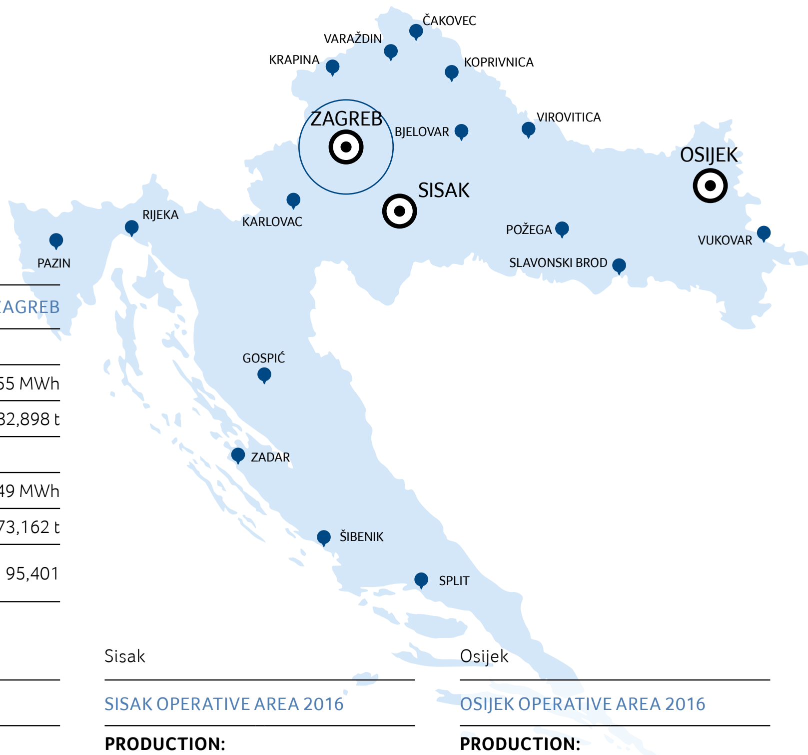
HEP-Toplinarstvo focused on increasing the satisfaction of heat energy end customers by conducting the modernization and the reconstruction of the Customer Relation Centre in its head office as well as by introducing the new Customer Support Phone Number application and the on-duty number. The redesigned web site of the company was also launched in 2016, which will enable faster search and easier access to all relevant information. Apart from the above stated, HEP Toplinarstvo technical services systematically received, processed and responded to all queries, complaints and demands submitted by end customers by post, customer service contact number, on-duty contact number, e-mail and fax.

Let me conclude that HEP Toplinarstvo responded to all business challenges of 2016 thanks to active involvement and dedicated work of its own technical services and professional staff. The company will continue to focus its business operations on upgrading the service quality provided to its end customers by recognizing their wishes and needs and by achieving a safe and reliable supply of heat energy.

Direktor
Zdravko Zajec

HEP TOPLINARSTVO D.O.O. IN 2016

During 2016, the number of end heat energy customers rose by 1.1 percent to a total number of 126,200 until end 2016, of which 119,880 (95.0%) were households and 6,320 (5%) corporate entities.
In heat consumption (district heat and process steam), households accounted for 57.9 percent (46.2% in income) leaving the remaining 42.1 percent (53.8% in income) to corporate entities. The ratio of supplied heat energy (hot water) to process steam (in MWh) was 79.9%:20.1%.
In total consumption of district heat, the share of Zagreb (including Samobor, Velika Gorica and Zaprešić) was 85.3 percent, Osijek 11.1 percent, and Sisak 3.6 percent. The consumption of process steam was 467,382 tonnes (Zagreb 79.8%, Osijek 14.3, Sisak 5.6%).
In 2016, heat energy sales increased by 0.6 percent compared to the year before. Taking each of the two main products of HEP District Heating separately, the sale of heat energy increased by 1.1%, while the sale of process steam decreased by 1.4 percent.



Zagreb

DISTRICT HEATING SYSTEM ZAGREB

PRODUCTION:	
heat	1,387,555 MWh
steam	482,898 t
SALES:	
heat	1,192,349 MWh
steam	373,162 t
NUMBER OF CUSTOMERS:	95,401

Zagreb

LOCAL BOILER PLANTS 2016

PRODUCTION:	
heat	139,497 MWh
SALES:	
heat	128,884 MWh
NUMBER OF CUSTOMERS:	14,942

Sisak

SISAK OPERATIVE AREA 2016

PRODUCTION:	
heat	93,289 MWh
steam	27,352 t
SALES:	
heat	55,387 MWh
steam	27,352 t
NUMBER OF CUSTOMERS:	4,145

Osijek

OSIJEK OPERATIVE AREA 2016

PRODUCTION:	
heat	186,388 MWh
steam	89,608 t
SALES:	
heat	172,909 MWh
steam	66,868 t
NUMBER OF CUSTOMERS:	11,712

FINANCIAL REPORTS

INDEPENDENT AUDITOR'S REPORT
To the owner of HEP Toplinarstvo d.o.o., Zagreb

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP Toplinarstvo d.o.o., Zagreb, Miševečka 15a (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.
In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Significant Uncertainty Related to Going Concern Assumption

The Company made a net loss of HRK 158,689 thousand during the year ended 31 December 2016 when its current liabilities exceeded its total assets by HRK 256,304 thousand. Pursuant to the Financial Operations and Pre-bankruptcy Settlement Proceedings Act, the Company does not meet the required criteria of capital adequacy.
The Company's continued operations under the going concern basis depend on the Company's ability to secure sufficient resources to settle obligations in a timely manner, to secure adequate sources of financing and to commence operating at a profit. In order to achieve this as described in Note 1 to the Financial Statements, a member of the Company has obliged to offer financial support to the Company and the Company's Management is making efforts to improve current operations and the Company's financial position. Our opinion is not modified in respect of this matter.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.
Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material

misstatement of these other information we are required to report this fact. In this sense, we do not have anything to report.

Responsibilities of the Management and Those Charged with Governance for the Annual Financial Statements

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Management Board 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 annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.

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 control that we identify during our audit.

Report on the Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company.
In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 6 to 50 on which we expressed our opinion as stated in the Opinion section above.
In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016.
The Management Board is responsible for the preparation of annual financial statements for the year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 6 to 50 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 19 April 2017

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

Zdenko Balen,	Irena Jadrešić,
Member of the Management Board	Certified Auditor

HEP Toplinarstvo d.o.o., Zagreb
Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Income from thermal energy sale to the buyers outside the HEP Group	699,596	682,388
Income from sale of electric energy to preferential customers	10,922	11,838
Income from thermal energy and other income – related companies	4,816	4,769
Restaurant income	418	456
Other operating income	51,450	54,951
	767,202	**754,402**
Energy, materials and spare parts expenses	(556,090)	(585,113)
Service expenses	(22,865)	(21,918)
Staff cost	(49,313)	(52,736)
Depreciation	(57,254)	(56,643)
Administrative expenses – related companies	(21,812)	(21,563)
Other operating expenses	(64,280)	(58,426)
	(771,614)	**(796,399)**
Loss from operating activities	**(4,412)**	**(41,997)**
Financial income	46	46
Financial expenses	(12,541)	(14,864)
Net loss from financial activities	**(12,495)**	**(14,818)**
Loss before taxation	**(16,907)**	**(56,815)**
Corporate income tax	-	-
Loss for the year	**(16,907)**	**(56,815)**

HEP Toplinarstvo d.o.o., Zagreb
Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Loss for the year	**(16,907)**	**(56,815)**
Other comprehensive income for the year	-	-
Total comprehensive loss for the year	**(16,907)**	**(56,815)**

Signed on behalf of the Management Board on 18 April 2017:

Zdravko Zajec

Director

HEP Toplinarstvo d.o.o., Zagreb
Statement of financial position/ Balance sheet

AS AT 31 DECEMBER 2016

ASSETS	31 December 2016	31 December 2015
	HRK`000	HRK`000
Property, plant and equipment	856,787	855,150
Investments in progress	126,653	122,732
Intangible assets	940	990
Receivables for sold flats	298	383
Prepayments for property, plant and equipment	491	273
Investment property	220	260
Total non-current assets	**985,389**	**979,788**
Inventories	29,360	26,921
Trade receivables	184,524	169,214
Receivables from related companies	1,601	1,069
Other receivables	2,180	3,613
Current portion of long-term receivables	116	119
Cash and cash equivalents	24,890	25,023
Total current assets	**242,671**	**225,959**
TOTAL ASSETS	**1,228,060**	**1,205,747**

HEP Toplinarstvo d.o.o., Zagreb
Statement of financial position Balance sheet (continued)
As at 31 December 2016

	Note	31 December 2016	31 December 2015
		HRK`000	HRK`000
Share capital		20	20
Capital reserves		54,955	20
Retained earnings		(213,664)	(196,757)
Total equity	18	**(158,689)**	**(196,717)**
Non-current liabilities to related companies	19	769,376	779,647
Other non-current liabilities	14	267	295
Non-current provisions	24	14,453	9,021
Deferred income	20	103,678	111,833
Total non-current liabilities		**887,774**	**900,796**
Trade payables	21	44,175	40,613
Liabilities to related companies	23	398,024	386,587
Current portion of non-current liability to related company	19	49,094	48,380
Other current liabilities	22	7,682	26,088
Total current liabilities		**498,975**	**501,668**
TOTAL EQUITY AND LIABILITIES		**1,228,060**	**1,205,747**

Signed on behalf of the Management Board on 18 April 2017:

Zdravko Zajec

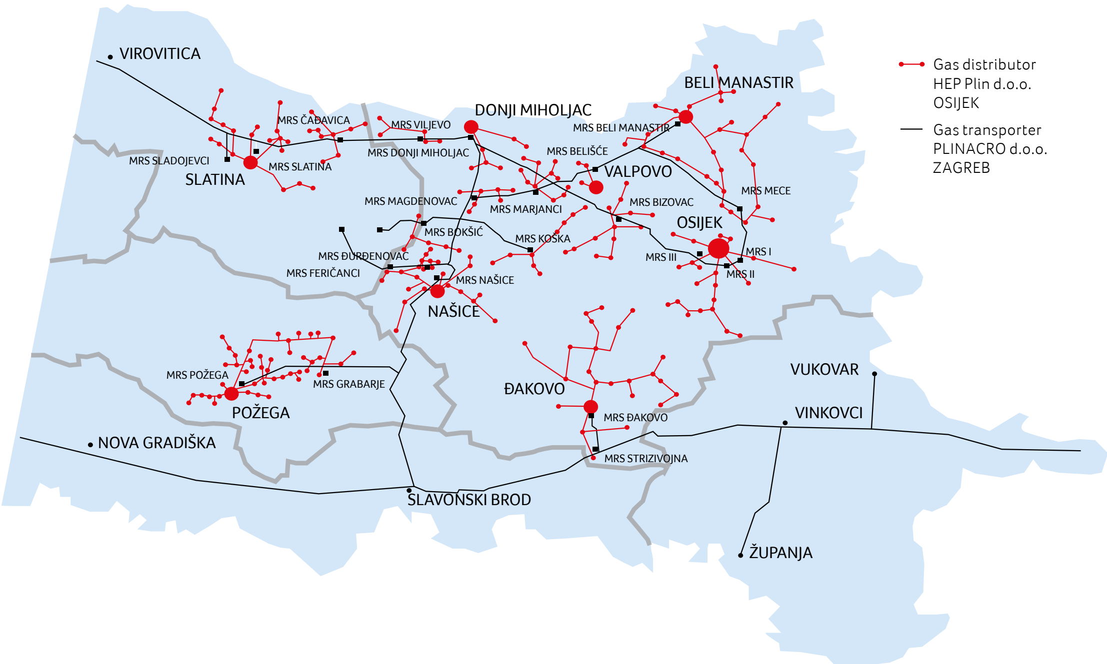
Director

HEP-Plin d.o.o.

HEP-Plin d.o.o. (HEP Gas) carries out two energy-related activities: gas distribution and supply. Gas distribution is carried out under regulated principles of public service provision. Gas supply to commercial customers is conducted under market conditions while residential customers are supplied as per regulated terms and conditions of public service provision.
The continuity of customer gas supply was ensured in 2016 by securing sufficient gas volumes from our gas wholesalers. Commercial customers' gas needs in the gas year 2015/2016 were met by procuring wholesale gas from the most favourable bidders.
In view of a partial waking up of stagnant business activities in the country, gas sale to commercial customers increased. The consumption of household customers who primarily use gas for heating increased due to a somewhat colder winter than the year before.
Everyday activities of gas distribution successfully continued in 2016 to our pleasure and the satisfaction of a large majority of customers and our concesionaires - regional and local self-governments. The distribution network was maintained in a working and functional order. Technical services conducted repairs on gas acceptance points in the shortest time possible. There were no major delays in gas supply caused by gas network breakdowns. Special attention was continuously paid to environmental protection by preventing gas leakages into the atmosphere.
The construction of the gas network in line with the concession agreements continued in 2016. The portion of works will be conducted in 2017. Unfortunately, the connection of new customers onto the built network was not carried out according to expectations due to the economic and social crisis resulting in a lower rate of return on investments into the construction of the gas network. All necessary modifications and reconstructions were carried out on the existing network.
In terms of distribution activities, there is no competition as long as the existing concession agreements are valid and the activity is performed according to contracted terms. If HEP Gas loses the right to distribute gas in some areas, the distribution network owned by HEP Gas will be leased or sold to the new concessionaire, thus compensating for current investments.
In terms of harmonizing its business operations with the new gas regulations in line with the EU Directives, HERA adopted several important implementing regulations in late 2013, which affected the changes and the harmonization of operations in end customer relations in 2016. Until the full gas market opening for household customers, a transitional period has been set until 31 March 2017. HEP Gas carries out the supply of households under the public service of supply as an incumbent supplier. Although the market opened to all participants even earlier, the real market competition took off in 2016. HEP Plin faced much stronger competition than the year before.
Upon full gas market opening and the end of price regulation for all eligible customers, we are expecting a permanent and uncertain market competition. On the other hand, the opening of the gas market represents an opportunity for HEP Gas to expand its operations to some other areas either by obtaining concession rights or taking over some smaller neighbouring or even farther energy entities without a solid perspective of independent survival.

Director
Damir Pećušak

HEP PLIN IN 2016



Gas network

	2015	2016	2016/2015 (%)
Gas lines – owned by HEP (km)	2,161	2,203	1.9
Gas lines – owned by other parties (km)	492	492	0
Gas lines - total	**2,653**	**2,695**	**1.9**
Reducing stations – DRS (units)	**52**	**52**	**0**
Odorizors (units)	**25**	**25**	**0**

Number of customers (metering points)

Customer categories	**2015**	**2016**	**2016/2015(%)**
TM1-TM4 residential	70,135	**70,045**	0
TM1-TM8 commercial (under 1 m m^3)	5,745	**5,388**	-6.2
TM9-TM12 commercial (over 1 m m^3)	8	**8**	
Total	**75,888**	**75,441**	**-0.6**

Energy balance (10 m^3)

	2015	2016	2016/2015
Procurement (10^3 m^3)	129,343	**142,630**	10.3
Sales (10^3 m^3)	124,536	**137,003**	10.0

Gas sale structure

Customer categories	**2015**	**2016**	**2016/2015**
TM1-TM4 residential	65,407	68,461	4.7
TM1-TM8 commercial (under 1 m m^3)	40,175	45,758	13.9
TM9-TM12 commercial (over 1 m m^3)	18,954	22,784	20.2
Total	**124,536**	**137,003**	**10.0**

FINANCIAL REPORTS

INDEPENDENT AUDITOR'S REPORT
To the owner of HEP Plin d.o.o.

REPORT ON THE AUDIT OF ANNUAL FINANCIAL STATEMENTS

Opinion

We have audited the enclosed annual financial statements of HEP Plin d.o.o., Osijek, Cara Hadrijana 7 (the "Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended and the accompanying Notes to the financial statements, including a summary of significant accounting policies and other explanations.

In our opinion, the accompanying annual financial statements, give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the "IFRS").

Basis for Opinion

We conducted our audit in accordance with the Accounting Act, Auditing Act and International Standards on Auditing (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 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.

Other Information in the Annual Report

The Management is responsible for other information. Other information include information included in the Annual report, but do not include the annual financial statements and our Independent auditor's report on them.

Our opinion on the 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 connection with our audit of the annual financial statements, our responsibility is to read the other information and consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is material misstatement of these other information, we are required to report this fact. In this sense, we do not have anything to report.

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

The Management is responsible for the preparation of annual financial statements that give a true and fair view in accordance with the IFRS, and for such internal control as the Management Board determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Management Board 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 annual financial statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 control 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 control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management's Board 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 Independent Auditor's report to the related disclosures in the 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 Independent 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 annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manger that achieves fair presentation.

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 control that we identify during our audit.

Report on Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. 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 annual financial statements of the Company.
In our opinion, based on our audit of the annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the annual financial statements of the Company set out on pages 5 to 49 on which we expressed our opinion as stated in the Opinion section above.

In our opinion, based on the work that we performed during the audit, the Company's management report for 2016, which is an integral part of the Annual report for 2016, 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 2016, which is an integral part of the Company's Annual report for 2016.
The Management Board is responsible for the preparation of annual financial statements for the year ended 31 December 2016 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 annual financial statements"). Financial information presented in Company's standard annual financial statements are in accordance with the information presented in the Company's annual financial statements given on pages 5 to 49 on which we expressed our opinion as stated in the Opinion section above.

Zagreb, 19 April 2017

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

Zdenko Balen,	Irena Jadrešić,
Member of the Management Board	Certified Auditor

HEP Plin d.o.o., Osijek
Income statement

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Revenue from sale of gas	337,664	386,388
Revenue from services	4,484	3,138
Income from related companies	1,828	2,051
Other operating income	15,217	17,987
Total operating income	**359,193**	**409,564**
Cost of gas sold and material used	(269,793)	(329,012)
Cost of services	(8,790)	(5,293)
Staff cost	(20,853)	(21,225)
Depreciation and amortization costs	(10,723)	(10,213)
Expenses with related parties	(5,302)	(4,741)
Other operating expenses	(18,162)	(16,552)
Total operating expenses	**(333,623)**	**(387,036)**
Profit from operating activities	**25,570**	**22,528**
Financial income	589	1,089
Financial expenses	(700)	(839)
Net profit/(loss) from financial activities	**(111)**	**250**
Profit before taxation	**25,459**	**22,778**
Corporate income tax expense	(5,968)	(5,186)
Profit for the year	**19,491**	**17,592**

Signed for and on behalf of the Management Board, on 19 April 2017:
Damir Pećušak
Director

HEP Plin d.o.o., Osijek
Statement of other comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

	2016	2015
	HRK`000	HRK`000
Profit for the year	**19,491**	**17,592**
Other comprehensive income for the year, net	-	-
Total comprehensive profit for the year, net	**19,491**	**17,592**

Signed for and on behalf of the Management Board, on 19 April 2017:

Damir Pećušak

Director

HEP Plin d.o.o., Osijek
Statement of financial position / Balance Sheet

AS AT 31 DECEMBER 2016

ASSETS	31 December 2016	31 December 2015
	HRK`000	HRK`000
Property, plant and equipment	227,723	221,710
Assets under construction	8,718	5,105
Intangible assets	3,544	389
Prepayments for property, plant and equipment	69	25
Deferred tax assets	828	740
Total non-current assets	**240,882**	**227,969**
Inventories	3,190	2,138
Trade receivables	103,529	102,185
Receivables from related companies	8,165	1,027
Other current assets	603	420
Cash and cash equivalents	22,713	51,104
Total current assets	**138,200**	**156,874**
TOTAL ASSETS	**379,082**	**384,843**

EQUITY AND LIABILITIES	31 December 2016	31 December 2015
	HRK`000	HRK`000
Share capital	20	20
Accumulated loss	19,491	11,632
Total equity	**19,511**	**11,652**
Non-current liabilities to related companies	149,893	137,966
Non-current provisions	75,104	78,623
Other non-current liabilities	4,603	3,701
Total non-current liabilities	**229,600**	**220,290**
Trade payables	14,580	6,809
Liabilities to related companies	102,510	126,576
Current portion of non-current liabilities to related companies	7,208	6,715
Other current liabilities	5,673	12,801
Total current liabilities	**129,971**	**152,901**
TOTAL EQUITY AND LIABILITIES	**379,082**	**384,843**

Signed for and on behalf of the Management Board, on 19 April 2017:
Damir Pećušak
Director

6

Reports by Other HEP Group Companies

HEP-Trgovina d.o.o.

Having optimized the operation of HEP Group power plants with electricity purchase and sale on the electric power market, HEP Trgovina d.o.o. (Trade) fulfilled all its business tasks in 2016. Everyday business operations required adapting to changeable electricity market conditions, electricity consumption fluctuations, volatile hydrology, and occasional unavailability of generation capacities.

During 2016, HEP-Trgovina continued with the operation of its companies established in the neighbouring countries with the purpose of increasing the profit by achieving favourable prices of electricity purchase and sale. As HEP d.d. has a direct access to the liquid Western European electricity, gas, coal and emission unit market, it conducts all wholesale transactions of electricity purchase and sale in the EU countries. Having obtained the electricity trade license in Serbia, HEP d.d. established its own balance group with a direct access to the wholesale electricity market including the trade of electricity in Serbia and at its borders as well as at the borders of the neighbouring countries (Hungary, Bosnia and Herzegovina, Romania, Bulgaria, Montenegro). The market acces in the non-EU countries (Bosnia and Herzegovina, Kosovo) is maintained via HEP Trgovina's daughter companies abroad. As electricity supply of customers outside Croatia can only be carried out via local companies licenced for the performance of such activity, HEP Trgovina in cooperation with HEP Opskrba (supply) intensified the electricity supply of customers abroad via such companies. During 2016, a total of 211,788 MWh of electricity was sold to customers in Slovenia. Contracts for supplying electricity for loss coverage and guaranteed supply to the Slovenian distribution system operator (SODO) were concluded for the following period as well as the contracts for supplying electricity to Slovenian customers accounting for 12.5 % share of HEP Group on the Slovenian market. In January 2016, the electricity supply of customers in Serbia and Bosnia and Herzegovina started thus making HEP the first supplier on the market of Bosnia and Herzegovina which supplies customers connected to the distribution network.

HEP Trgovina purchases gas in the name and for the account of HEP d.d. for supplying thermal and cogeneration power plants of HEP Proizvodnja (generation) as well as HEP Plin (gas) business customers. HEP d.d. and HEP Trgovina entered into the register of balance responsible parties on the gas market in Croatia which secured the gas transport system capacity lease as well as gas trade on the virtual trading point in Croatia. HEP Trgovina set up HEP d.d.'s balance group on the Slovenian and Austrian gas markets which has ensured the possibility of transport system capacity lease from Austria to Croatia. As a member of CEGH (Central European Gas Hub), HEP d.d. has a direct access to the liquid Western European gas market and the possibility of gas purchase at a delivery point (a virtual trading point in Austria), which represents a significant diversification of supply routes and gas sellers. A total of 5,493 GWh of gas was purchased for 2016, which was by 29.1 percent more than planned.

Apart from the bilateral purchase of CO_2 emissions, HEP Trgovina participates in the name and for the account of HEP d.d. in primary auctions for the procurement of CO_2 emissions organized by the EEX exchange and on the EEX Forward Market. During 2016, a total of 1,475,000 of CO_2 emissions was purchased, covering all HEP Group needs for CO_2 emissions in electricity and heat energy production in 2016 as well as 75 percent of its planned needs in 2017.

The overall electricity consumption in Croatia in 2016 was 17,620 GWh, a 0.14 percent increase compared to 2015. Total customer consumption amounted to 15,549 GWh, of which 2,349 GWh was consumed by off-system customers. The market share of suppliers other than HEP Group in late 2016 accounted for 15.1 percent.

Hydro generation in 2016 was 6,128 GWh, satisfying 38 percent of HEP Group consumption needs. HEP Proizvodnja's thermal facilities produced 1,877 GWh. Electricity procurement of 5,166 GWh was by 25.6 percent more than planned, while the sale and supply of 3,685 GWh of electricity was by 82.1 more than planned primarily due to exceptionally favourable hydrology in the first quarter and October 2016 as well as due to intensified wholesale market activities. During 2016, the volume trade of 8,851 GWh was achieved. From the overall generation by eligible producers in Croatia (1,760 GWh), HEP Group was obliged to take 1,464 GWh of electricity as per its market share.

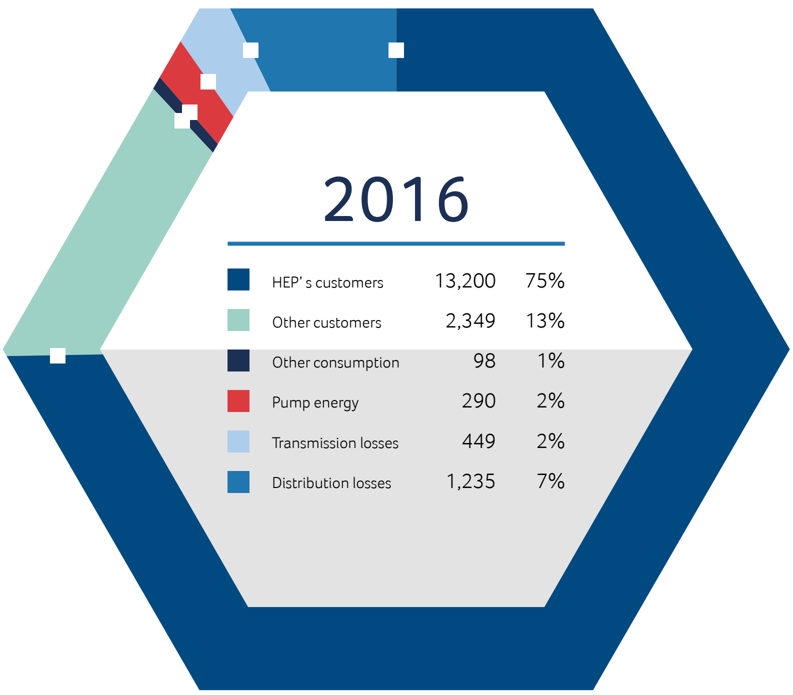
Director
Ante Ćurić

ACHIEVED IN 2016 - ENERGY DATA

Electricity balance

	2015	2016	2016/2015
Electricity consumption in Croatia	**17,596**	**17,620**	**0.1**
Electricity consumption by HEP	**15,212**	**15,217**	**0.0**
Hydro generation	5,673	**6,128**	8.0
Thermal generation	1,862	**1,877**	0.8
NE Krško d.o.o.	2,685	**2,715**	1.1
TE Plomin d.o.o.	1,295	**1,531**	18.2
Import	3,818	**5,166**	35.3
Export	-1,065	**-3,685**	246.1
Producers off-system	19	**20**	9.5
Eligible producers	926	**1,464**	58.1
Buyers off-system	2,384	**2,349**	-1.5
Procurement for covering HOPS losses	0	**53**	
Total available electricity HEP	**15,212**	**15,217**	**0.0**
Total available electricity Croatia	**17,596**	**17,620**	**0.1**

Structure of electricity consumption in 2016 (GWh; %)



HEP-Opskrba plinom d.o.o.

HEP-Opskrba plinom d.o.o. (gas supply) participates in business activities of trade mediation in domestic and foreign markets, contracting of energy fuel (gas) procurement, and sale for the needs of public service users, HEP Group companies as well as other end customers. The company optimizes the gas portfolio of the balance group organized and operated by HEP d.d. for the needs of the public service suppliers.

In the name and for the account of HEP d.d., HEP-Opskrba plinom conducts the activities of a wholesale gas market supplier. During 2016, the energy fuel (gas) procurement contracts were signed, the Contract Terms and Conditions for the Sale of Gas to the Supplier in the Public Services published, and contracts with the suppliers of the publis service concluded. The same as during the previous two storage years, HROTE appointed HEP d.d. a balancing energy tenderer for the storage year 2016/2017.

According to the transport system operator data, total gas volume supplied to customers in the Republic of Croatia in 2016 was 24,381 GWh, which was a 6 percent annual increase compared to 2015. The share of HEP d.d. as the gas wholesale market supplier was 25 percent i.e. 6,096 GWh.

During 2016, HEP-Opskrba plinom recorded total income of HRK 1,234,729 in the name and for the account of HEP d.d.; receivables of HRK 1,542,995,481 for gas supplied, overruns for more/less gas volume purchased, balancing energy and interest at the 100% collection.

In line with the above indicators and no recorded incidents in the balancing energy market nor in the operation of the Croatian transport system, it can be concluded that HEP-Opskrba plinom managed to successfully face all the challenges by keeping up with legislative changes in the name and for the account of HEP d.d., carried out all its obligations set under the law, general acts and decisions of the Croatian Government, as well as ensured the security and balance of the gas supply system in the Republic of Croatia.

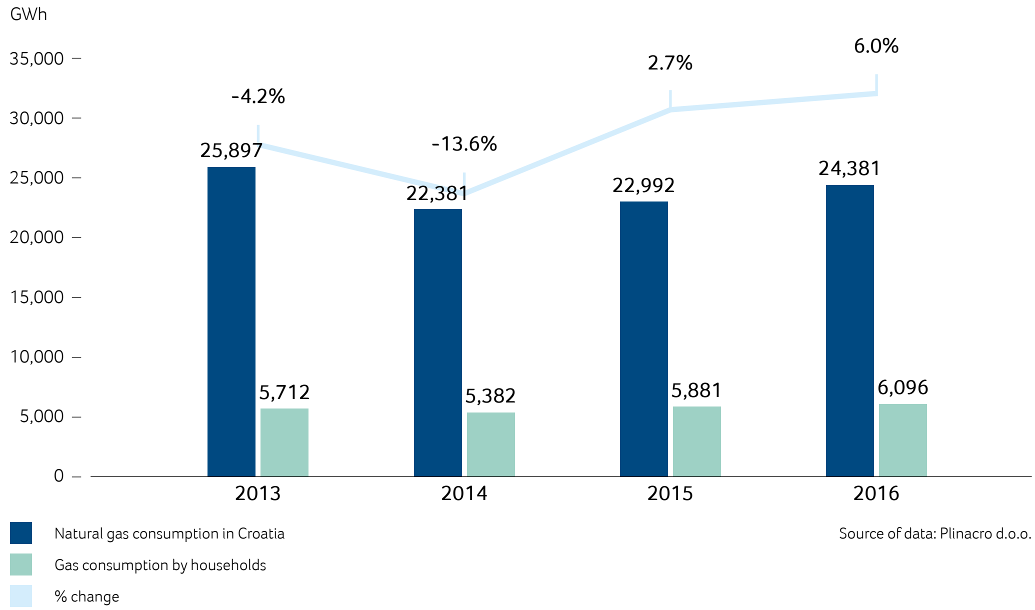
During 2016, the first six modules of ISOP (information system of gas supply) were implemented. Accurate and centralized historic database on gas consumption, procurement and storage makes an important system element thus simplifying the acquisition of invoicing data, annual and other reports, etc. Suppliers in the public service obligation as well as external system users can access it by their user name and password, while the user interface facilitates a simpler entry of prenominations and renominations, the overview of previously entered prenominations as well as the acquisition of allocated gas volumes. Ever since the IT system was introduced, the increase of gas consumption announcement accuracy has been noticed i.e. prenominations by suppliers in the public service obligation, which has contributed to a successful operation of the balance group portfolio.

The increasing openness of the energy market as well as the time-limited role of the gas wholesale market supplier in Croatia for public service suppliers requires the definition of strategic objectives of gas business development within HEP Group. Experiences from neighbouring markets have shown the need for a faster creation of new 'energy products' aimed at increasing the competitiveness of HEP Group companies and facilitating its strengthening and positioning on the energy market in Croatia and the neighbouring countries. The sale of energy packages (electricity and gas combined) represents one of the possibilities for additionally strengthening the market position of HEP Group. HEP-Opskrba plinom is prepared to become a part of the service definition process and to offer a new energy product to end customers in joint cooperation with other HEP Group companies.

Director
Marko Blažević

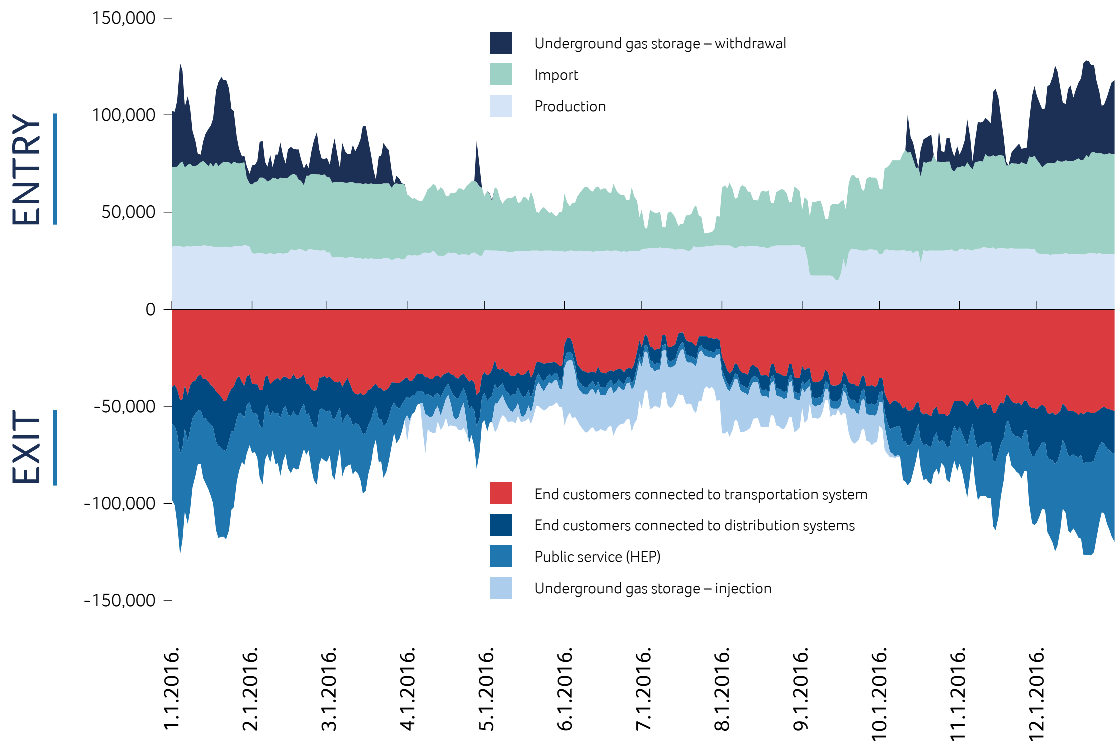
HEP OPSKRBA PLINOM IN 2016 – BASIC DATA

Gas consumption in Croatia (GWh)



Source of data: Plinacro d.o.o.

Gas volume distribution (MWh) at entry and exit points of the Croatia's transport system



Source of data: Plinacro d.o.o.

HEP ESCO d.o.o

HEP ESCO provides energy services by identifying, developing and managing energy efficiency and RES projects integrated in the buildings whereby the return of investments is achieved from the savings. Its abbreviation ESCO, which stands for the Energy Service Company, is a worldwide recognizable term for the companies which provide integral energy services aimed at reducing the cost of energy and maintenance, the installation of new and more efficient equipment, the optimization of energy systems, and project funding excluding client indebtedness. Industry was in the focus of ESCO project development in 2016.

Apart from project implementation as per the ESCO model, HEP ESCO offered other energy management-related services in 2016 including energy reviews, development of detailed investment studies, analysis of energy and water consumption, establishment of the remote reading system, use of ESCO Monitor® and ESCO Monitor® Panel systems, consulting services, savings measuring and certification, end-users education and consulting services in the implementation of the systematic energy management according to ISO 50001.

The cooperation with market-focused companies of HEP Group has been established, primarily with HEP Opskrba (supply) for the purpose of offering energy services and ESCO projects to HEP Group clients whose operations are already market based. As part of the energy service development for HEP Group customers, the pilot projects of installing the remote reading system for regional and domestic customers were carried out as well as consulting and education services for HEP Opskrba's customers. Until end 2016, the remote reading systems should be installed in forty locations, consulting services were agreed with four customers, the energy review of a large company with one i.e. the implementation of ISO 50001, while education services were arranged with three other buyers.

In order to ensure the integral user support, the upgrade of the ESCO Monitor® computer application version 2.0 started in 2016.

In line with the national goals of energy savings, Hrvatska elektroprivreda as a state-owned company started the implementation of the 'Programme of the Establishment and Implementation of the Energy Management System and the Implementation of the ESCO Monitor® System on the premises of Hrvatska elektroprivreda d.d.' in late 2015 (HEP SGE Programme). During the first year of its implementation, the focus was primarily on the establishment of the central registry of all the facilities owned by HEP Group. On the basis of data analysis and in cooperation with energy managers, one hundred priority facilities were selected in which other activities would continue to be carried out as part of the first implementation phase of the HEP SGE Programme.

As part of the ZelEn project, the donated energy efficiency project was carried out in 'Ivana Brlić Mažuranić' Children's Home in Rijeka.

Due to its experience and market position, HEP ESCO has become a desirable partner to international and EU institutions as well as the European partner in the implementation of EU funded projects. In 2016, HEP ESCO participated in the implementation of the EU SUNSHINE (Smart UrbaN Services for Higher eNergi Efficiency) and A2PBEER (Affordable and Adaptable Buildings throught Energy Efficient Retrofitting) projects, as well as cooperated with international partners on the preparation of three new Interred projects applied for EU funding. These were TEESCHOOLS, FEEDSCHOOLS and 3Smart.

In cooperation with the Faculty of Mechanical Engineering and Naval Architecture in Zagreb, and as part of the heating and air-conditioning optimization project in the new office building of HEP d.d., the KGH system's smart regulation project was conducted (air-conditioning, heating and cooling) in HEP's new office building. This experimental project is one of few conducted worldwide.

Director
Vlasta Zanki

Program Sava d.o.o.

The Programme of Development, Regulation and Use of the Sava River and its River Banks from the Border with Slovenia to the City of Sisak entered a new phase.
Led by the management of Program Sava d.o.o., the international consortium of *MottMacdonald-WYG-Atkins* optimized the programme technical option by achieving the savings of almost 25 percent of the overall foreseen implementation costs. The optimized option has retained all the benefits from the previously considered options such as the production of electricity from renewable sources, the relocation of waterways outside the city of Zagreb, raising the level of the protection against the flood, facilitating river navigability to the Slovenian border, and the stabilization of the underground water levels.
The biggest change under the new optimized solution is the changed concept of Zaprešić and Prečko hydropower plants, which shall become a chain of five small water-energy steps. The installed capacity of each step, located in the river bed, is between 11 and 15 MW. Four water energy steps are retained in the river bed through Zagreb, while the location of the water-energy step Sisak was changed to achieve the synergy with the construction of the new Sisak Port. Said change should result in a multi-million savings in the construction of the Sisak River Port, which represents a direct benefit for both projects.
Apart from the feasibility study, the international consortium also developed the strategic environmental impact assessment study, which will be revised in 2017 by the Council of Programme Professionals. The development and the revision of both documents will include all stakeholders foreseen under the Conclusion adopted by the Government as well as all interested NGOs. The public discussion and the final proposal of the Programme are planned for autumn 2017.

Director
Irena Ratković Malbaša*

*In the reporting period, director was Dubravko Ponoš.

HEP Upravljanje imovinom d.o.o.

HEP - Upravljanje imovinom (asset management) manages leisure facilities in its own name and for its own account. It operates and maintains non-operating assets of HEP d.d. as well as business premises on the location of HEP's head office, organizes restaurant operations, manages the fleet, waste and environmental protection in the name and for the account of HEP d.d.

Under the Lease Agreement in the name of its owner HEP d.d., the company manages leisure facilities on 32 locations (14 of which are being used, while 15 either do not meet minimum conditions or are devastated, one land plot and two facilities abroad), with 180 accommodation units (apartments, studio apartments, hostels) and a total of 573 beds. The company objective is to increase the number of accommodation capacities available to HEP Group employees as well as other interested parties by making investments. Therefore, it plans to continue with the development of real estate investment projects as well as to reconstruct and renovate the remaining facilities which do not require any big capital investments in order to increase its bottom line.

HEP Group employees could choose to spend their summer holidays in 2016 on 14 locations along the entire Adriatic coast. Vacation facilities can used by HEP Group employees under the tender for the use of said facilities as well as by external guests (the Hrid Hostel in Biograd and the Val Hostel in Karlobag). The company aims at extending the season to a minimum of 120 days, and all year round in some capacities. In 2016, the number of overnight stays reached 31,415 i.e. 123 overnight stays or by 0.4 percent more than in 2015. The task entrusted to the company in 2016 was to finish the reconstruction of the facilities and to continue raising the quality of facility equipment, which resulted in increasing the income from core activity.

Another task of HEP - Upravljanje imovinom is to monitor the condition and the maintenance of the facilities (construction, electrical and mechanical) on the premises of HEP Group HQ as well as to manage the non-operating assets in the name and on the account of HEP d.d. Apart from the above, the company also implements legal regulations regarding waste management on the premises of HEP Group HQ. HEP - Upravljanje imovinom makes investments in the improvement of system operations and ensures all necessary technical conditions for the work of employees in HEP Group HQ.

Some of the company's more important 2016 achievements in this respect included the adoption of the non-operating asset management strategy, the implementation of the Enterprise Asset Management software (early stage), drafting the Instruction on Waste Management on the HQ premises, the introduction of the new energy management systems and preparations for ISO standard implementation.

Director
Dinko Salopek*

*In the reporting period, director was Stanko Kežman.

HEP Telekomunikacije d.o.o.

HEP-Telekomunikacije d.o.o. (telecommunications) operates the telecommunication infrastructure and the telecommunication system of the subsidiary and HEP Group as a whole.
The telecommunication infrastructure includes all passive telecommunication equipment and systems (optic infrastructure, antenna poles, etc.), while the telecommunication system encompasses all active network gear and accompanying systems. HEP Telekomunikacije is solely responsible for defining general telecommunication rules, standards and procedures for the development and exploitation of telecommunication infrastructure and systems; planning, designing, developing, constructing, and maintaining of telecommunication infrastructure and the system.
In 2016, contracts under which the network upgrade projects (connecting new locations, structured cabling, the installation of the new and the upgrade of the existing LAN/WAN network equipment, wireless system upgrade, etc.) were concluded as well as the upgrade of the SDH transmission system carried out as per the requirements specified by HEP Group companies and HOPS.
The process of procuring the licenses, accompanying infrastructure and the implementation of the public cloud system was launched during the year, which resulted in the signing of the framework agreement in July. Public sector users are leading drivers of IT consumption growth. Although their business need for applications which will facilitate digitalisation and automation of business processes is inevitable, one of key obstacles in a further expansion of service applications is the lack of quality technological infrastructure and insufficiently skilled IT staff. These two issues represent an opportunity for HEP Telekomunikacije in the area of cloud computing services.
The procurement of the Study of Possibilities for the Expansion and the Upgrade of Transmission Telecommunication Infrastructure was also initiated in 2016 together with developing the project of optimum technical solutions which will serve as the basis of the 10-thread OPGW replacement project in the following period. The upgrade of the optic network infrastructure includes the installation of new optic connections (OPGW, underground, ADSS) as well as the introduction of new network functionalities aimed at providing new services and improving the quality, availability and safety of the old ones.
HEP-Telekomunikacije owns the optic networks consisting of OPGW, underground, submarine and ADSS optic cables. The network stretches throughout Croatia and makes the backbone of the telecommunication system. Some of the most important systems connected via said cables include the Remote Control System, the OHL Relay Protection System, the Metering System, and the Business IT System.
HEP-Telekomunikacije uses the existing system for network infrastructure monitoring and operation, which serves as a central point of infrastructure monitoring and facilitates the unobstructed operation of business services within HEP Group companies. The maintenance and upgrade of the existing network infrastructure monitoring and operation system is required as well as the expansion of the license rights to include a larger number of devices.
Service provision has been increasingly adapted to users' real needs. One of the preconditions for meeting such provision is the construction of the internal CRM system for keeping records of the entire interaction with the users as well as the overview of utilized services.

Director
Željko Racanović

NOTES:

Name of the Group and the Company

Unless required otherwise by the context, the term 'HEP Group', 'HEP', or 'Group' means Hrvatska elektroprivreda d.d. together with its dependent companies. The term 'Company' means Hrvatska elektroprivreda d.d.

Timeframe of the Report

This Annual Report gives an overview of the business year 2016 – from January 1 to December 31, 2016. Data on the events important for HEP Group operations occurring after 31 December 2016 is also provided, but no later than June 2017.

Financial reports of HEP Group companies

In Chapters HEP d.d. – financial statements with the independent auditor's report and Reports by HEP Group companies with the financial statements and independent auditor's reports, due to their large scope, the abridged financial statements without accompanying notes which are an integral part of financial statements are provided.

Presentation of HOPS data

The Croatian Transmission System Operator Ltd. (HOPS), unbundled from HEP Group in 2013 under the Electricity Market Act according to the ITO model (Independent Transmission Operator), has been presented in this Annual Report under the overview of the 2015 HEP Group basic data, in the chapter on 2016 Business Operations and in the Consolidated Financial Statements for HEP Group together with the Report by the Independent Auditor. In line with the independent status of HOPS, data regarding its business operations have not been presented in any other chapters hereof.

Presentation of non-financial data

This Annual Report for HEP Group makes an integral whole with the non-financial report i.e. the HEP Group's 2016 Sustainability Report. In line with the Global Reporting Initiative guidelines, said report will contain operating aspects not presented in the AR which regard the environment, the supply chain, human resources, customer and community relations, etc. Pursuant to the Amendments of the Accounting Act (OG 120/2016), the Sustainability Report will be published no later than 31 October 2017.

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