

Offering Circular dated 22 October 2015

**Hrvatska Elektroprivreda d.d.**  
(incorporated with limited liability in the Republic of Croatia)

**U.S.\$550,000,000 5.875% Notes due 2022**  
**Issue price: 98.594%**

The U.S.\$550,000,000 5.875% Notes due 2022 (the “**Notes**”) are issued by Hrvatska Elektroprivreda d.d. (the “**Issuer**”, the “**Company**”) or “**HEP**”, and together with its subsidiaries, the “**Group**”).

Interest on the Notes is payable semi-annually in arrear on 23 April and 23 October in each year and the first payment shall be made on 23 April 2016. All payments in respect of the Notes shall be made without withholding or deduction for, or on account of, taxes imposed or levied by or on behalf of the Republic of Croatia (“**Croatia**”) to the extent described under “*Conditions of the Notes—Taxation*”.

The Issuer may, at its option, redeem all, but not some only, of the Notes at any time at par plus accrued interest, in the event of certain tax changes as described under “*Conditions of the Notes—Redemption and Purchase*”. The Notes mature on 23 October 2022.

On the occurrence of a Change of Control (as defined in the Conditions), each Noteholder shall have the option to give notice requiring the Issuer to redeem or, at the Issuer’s option, purchase (or procure the purchase of) each Note held by the relevant Noteholder on the Change of Control Put Date (as defined in the Conditions), at 101% of the principal amount of the Note together with accrued interest (if any). See “*Conditions of the Notes—Redemption at the Option of the Noteholders upon a Change of Control*”. In addition, upon the occurrence of an Ownership Unbundling Event (as defined in the Conditions), each Noteholder shall have the option to give notice requiring the Issuer to redeem or, at the Issuer’s option, purchase (or procure the purchase of) each Note held by the relevant Noteholder on the Ownership Unbundling Event Put Date (as defined in the Conditions) at its principal amount together with accrued interest (if any). See “*Conditions of the Notes—Redemption at the Option of the Noteholders upon an Ownership Unbundling Event*”.

Application has been made to the *Commission de Surveillance du Secteur Financier* (the “**CSSF**”) in its capacity as competent authority under the Luxembourg Act dated 10 July 2005 on prospectuses for securities (the “**Prospectus Act 2005**”) to approve this document as a prospectus. By approving this Offering Circular, the CSSF assumes no responsibility as to the economic and financial soundness of the transaction or the quality or solvency of the Issuer in accordance with Article 7(7) of the Prospectus Act 2005. Application has also been made to the Luxembourg Stock Exchange for the Notes to be admitted to trading on the Luxembourg Stock Exchange’s regulated market and to be listed on the Official List of the Luxembourg Stock Exchange.

References in this Offering Circular to Notes being listed (and all related references) shall mean that such Notes have been admitted to trading on the Luxembourg Stock Exchange’s regulated market and have been admitted to the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange’s regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC), as amended.

The Notes are expected to be rated Ba2 by Moody’s Investors Service Ltd. (“**Moody’s**”) and BB– by Standard & Poor’s Credit Market Services Europe Limited (“**S&P**”). Each of Moody’s and S&P is established in the European Union (the “**EU**”), domiciled in the United Kingdom, and is included in the list of credit rating agencies registered in accordance with Regulation (EC) No. 1060/2009 on Credit Rating Agencies as amended by Regulation (EU) No. 513/2011 (the “**CRA Regulation**”). This list is available on the ESMA website (<http://www.esma.europa.eu/page/list-registered-and-certified-CRAs>) (last updated 12 December 2014). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating organisation.

The net proceeds of the offering of Notes will be used (i) to finance the purchase of U.S.\$416,852,000 of the outstanding U.S.\$500,000,000 6.00% notes due 2017 (the “**2017 Notes**”) issued by the Issuer on 9 November 2012 and validly tendered and accepted for purchase in accordance with the terms and conditions of the tender offer launched by the Issuer on 7 October 2015 pursuant to a tender offer memorandum of the same date, as supplemented (the “**Tender Offer**”) and (ii) for general corporate purposes, as set out in “*Use of Proceeds*”.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended, (the “**Securities Act**”) or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, any U.S. persons (as such terms are defined in Regulation S) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Notes are being offered, sold or delivered: (a) in the United States only to qualified institutional buyers (“**QIBs**”) (as defined in Rule 144A under the Securities Act (“**Rule 144A**”)) in reliance on, and in compliance with, Rule 144A; and (b) to persons (other than U.S. Persons) (each as defined in Regulation S) outside the United States in reliance on Regulation S under the Securities Act (“**Regulation S**”). Each purchaser of the Notes will be deemed to have made the representations described in “*Subscription and Sale*” and is hereby notified that the offer and sale of Notes to it is being made in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A. In addition, until 40 days after the commencement of the offering, an offer or sale of any of the Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if the offer or sale is made otherwise than in accordance with Rule 144A.

The Notes will be issued in registered form in minimum denominations of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof. The Notes will initially be represented by two global certificates in registered form (the “**Global Certificates**”), one of which will be issued in respect of the Notes (“**Rule 144A Notes**”) offered and sold in reliance on Rule 144A (the “**Restricted Global Certificate**”) and will be registered in the name of Cede & Co., as nominee for the Depository Trust Company (“**DTC**”) and the other of which will be issued in respect of the Notes (“**Regulation S Notes**”) offered and sold in reliance on Regulation S (the “**Unrestricted Global Certificate**”) and will be registered in the name of BT Globenet Nominees Limited, as nominee of a common depository for Euroclear Bank SA/NV (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”). Interests in the Restricted Global Certificate will be subject to certain restrictions on transfer. See “*Transfer Restrictions*”. Beneficial interests in the Global Certificates will be shown on, and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Clearstream, Luxembourg and their participants. It is expected that delivery of the Global Certificates will be made on 23 October 2015 or such later date as may be agreed (the “**Closing Date**”) by the Issuer and the Joint Lead Managers (as defined under “*Subscription and Sale*”). Except in limited circumstances, certificates for Notes will not be issued in exchange for beneficial interests in the Global Certificates.

An investment in Notes involves certain risks. Prospective investors should have regard to the factors described under the heading “*Risk Factors*” on page 1.

JOINT LEAD MANAGERS AND ARRANGERS

BANCA IMI/PRIVREDNA BANKA ZAGREB

MORGAN STANLEY

UNICREDIT/ZAGREBAČKA BANKA

The date of this Offering Circular is 22 October 2015.

## TABLE OF CONTENTS

	<b><u>Page</u></b>
IMPORTANT INFORMATION ABOUT THIS OFFERING CIRCULAR .....	ii
NOTICE TO PROSPECTIVE INVESTORS IN THE UNITED STATES .....	iii
NOTICE TO NEW HAMPSHIRE RESIDENTS .....	iv
FORWARD LOOKING STATEMENTS .....	iv
AVAILABLE INFORMATION .....	v
SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES .....	vi
PRESENTATION OF FINANCIAL AND OTHER INFORMATION .....	vi
EXCHANGE RATES .....	ix
RISK FACTORS .....	1
OVERVIEW .....	29
SELECTED FINANCIAL INFORMATION .....	39
USE OF PROCEEDS .....	42
CAPITALISATION .....	43
MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS .....	44
BUSINESS .....	76
MANAGEMENT .....	117
REGULATION .....	123
CONDITIONS OF THE NOTES .....	155
THE GLOBAL CERTIFICATES .....	173
TAXATION .....	175
CLEARING AND SETTLEMENT ARRANGEMENTS .....	181
SUBSCRIPTION AND SALE .....	184
TRANSFER RESTRICTIONS .....	187
GENERAL INFORMATION .....	190
GLOSSARY OF TERMS AND DEFINITIONS .....	192
INDEX TO THE FINANCIAL STATEMENTS .....	F-1

## IMPORTANT INFORMATION ABOUT THIS OFFERING CIRCULAR

This Offering Circular comprises a prospectus for the purposes of Article 5.3 of Directive 2003/71/EC, as amended (the “**Prospectus Directive**”) and for the purposes of the Luxembourg Act.

The Issuer accepts responsibility for the information contained in this Offering Circular. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains all material information with respect to the Issuer and the Notes (including all information which, according to the particular nature of the Issuer and of the Notes, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Issuer and of the rights attaching to the Notes), that the information contained in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any such information of the expression of any such opinions or intentions misleading.

Neither the Joint Lead Managers nor Deutsche Trustee Company Limited (the “**Trustee**”) has independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Joint Lead Managers or the Trustee as to the accuracy or completeness of the information contained in this Offering Circular or any other information provided by the Issuer in connection with the offering of the Notes. No Joint Lead Manager or the Trustee accepts any liability in relation to the information contained in this Offering Circular or any other information provided by the Issuer in connection with the offering of the Notes or their distribution. The contents of this Offering Circular are not, are not to be construed as, and should not be relied on as, legal, business or tax advice and each prospective investor should consult its own legal and other advisers for any such advice relevant to it.

No person is or has been authorised to give any information or to make any representation not contained in or not consistent with this Offering Circular or any other information supplied in connection with the offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, any of the Joint Lead Managers or the Trustee.

Neither this Offering Circular nor any other information supplied in connection with the offering of the Notes (a) is intended to provide the basis of any credit or other evaluation or (b) should be considered as a recommendation by the Issuer, any of the Joint Lead Managers or the Trustee that any recipient of this Offering Circular or any other information supplied in connection with the offering of the Notes should purchase the Notes. Each investor contemplating purchasing any Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Offering Circular nor any other information supplied in connection with the offering of the Notes constitutes an offer or invitation by or on behalf of the Issuer, any of the Joint Lead Managers or the Trustee to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of the Notes shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Notes is correct as of any time subsequent to the date indicated in the document containing the same. The Joint Lead Managers and the Trustee expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Notes or to advise any investor in the Notes of any information coming to their attention.

This Offering Circular does not constitute an offer to sell or the solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer, the Joint Lead Managers and the Trustee do not represent that this Offering Circular may be lawfully distributed, or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the Joint Lead Managers or the Trustee which is intended to permit a public offering of the Notes or the distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Offering Circular nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Offering Circular or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Circular and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Offering Circular and the offer or sale of Notes in the United States, the European Economic Area (including the United Kingdom), Japan and the Republic of Croatia, see “*Subscription and Sale*”.

**IN CONNECTION WITH THE ISSUE OF THE NOTES, UNICREDIT BANK AG AS STABILISING MANAGER (THE “STABILISING MANAGER”) (OR PERSON(S) ACTING ON BEHALF OF THE STABILISING MANAGER) MAY OVER-ALLOT NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE NOTES. ANY STABILISATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.**

The Notes have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities reviewed or passed upon the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offence.

This Offering Circular is being submitted in the United States to a limited number of QIBs for informational use solely in connection with the consideration of the purchase of the Notes. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Each purchaser or holder of interests in the Notes will be deemed, by its acceptance or purchase of any such Notes, to have made certain representations and agreements as set out in “*Subscription and Sale*”.

#### **NOTICE TO PROSPECTIVE INVESTORS IN THE UNITED STATES**

NEITHER THE U.S. SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS OFFERING CIRCULAR IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE.

THE NOTES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE U.S. SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. AS A PROSPECTIVE INVESTOR, YOU SHOULD BE AWARE THAT YOU MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME. PLEASE REFER TO THE SECTIONS IN THIS OFFERING CIRCULAR ENTITLED “*SUBSCRIPTION AND SALE*” AND “*TRANSFER RESTRICTIONS*.”

#### **NOTICE TO NEW HAMPSHIRE RESIDENTS**

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

#### **FORWARD LOOKING STATEMENTS**

Certain statements included herein may constitute “forward looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the United States Securities Exchange Act of 1934, as amended (the “**Exchange Act**”); however, this Offering Circular is not entitled to the benefit of the safe harbour created thereby. This Offering Circular contains certain forward-looking statements that reflect the Issuer’s current views with respect to future events and financial and operational performance, including but not limited to risks specific to the Issuer’s business and the implementation of strategic initiatives, as well as other statements relating to the Issuer’s future business development and economic performance. Forward-looking statements are statements in this Offering Circular that do not relate to historical facts and events. The words “will”, “believes”, “assumes”, “intends”, “estimates”, “expects”, “may”, “plans”, “seeks”, “approximately”, “aims”, “projects”, “anticipates” or similar expressions regarding indications or prognoses of future developments or trends, which are not statements based on historical facts, constitute forward-looking information. Forward-looking statements are set forth in a number of places in this Offering Circular, including in the sections “*Business*” and “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*”. While these forward-looking statements represent the Issuer’s judgments and future expectations concerning the development of its business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from the Issuer’s expectations. In light of these risks, uncertainties and assumptions, it is possible that the future events referred to in this Offering Circular may not occur. Because these forward-looking statements involve known and unknown risks and uncertainties, the outcome could differ materially from those set out in the forward-looking statements as a result of:

- absence of the ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which the Group currently operates in the Republic of Croatia;
- the Issuer’s ability to maintain and increase market share for its products and services and control expenses;
- changes in the competitive environment and competitive pressures;

- any declines in property values and asset quality;
- any decline in the availability of financing at acceptable prices;
- changes in general economic and business conditions;
- changes and fluctuations in interest rates, share prices and exchange rates;
- political, governmental, legislative and regulatory changes or changes in political or social conditions;
- changes in the Issuer's credit ratings;
- changes in economic conditions in the countries in which the Issuer operates;
- the extent and nature of future developments in the lending market and in other market segments that have been affected by the global financial crisis and the European sovereign debt crisis;
- other market and macro-economic developments, including movements in local and international securities markets, credit spreads, currency exchange rates and interest rates, whether or not arising directly or indirectly from the global financial crisis or the European sovereign debt crisis;
- changes in internal risk control;
- limitations in the effectiveness of the Issuer's internal risk management processes, of its risk measurement, control and modelling systems, and of financial models generally;
- developments relating to the Issuer's access to capital and funding, including the successful completion of this offering of the Notes;
- changes in the financial position or creditworthiness of the Issuer's customers, obligors and counterparties, and developments in the markets in which they operate;
- management changes and changes to the structure of the Issuer's business group;
- the occurrence of operational failures, such as fraud, unauthorised trading and systems failures;
- technological developments; and
- the impact of all such future developments on positions held by the Issuer.

Additional factors that could cause the Issuer's actual business, results of operations or financial condition to differ from the forward-looking statements include, but are not limited to, the other factors that the Issuer has indicated in other parts of this Offering Circular which could materially adversely affect its business and financial performance. For a more complete discussion of the factors that could potentially influence the future performance of the Issuer's business and the markets in which it operates, the Issuer advises investors to read, in particular, the sections entitled "*Risk Factors*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operations*". The forward-looking statements included in this Offering Circular speak only as of the date of this Offering Circular. The Issuer undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

#### **AVAILABLE INFORMATION**

The Issuer is not currently required to file periodic reports under Section 13 or 15 of the Exchange Act with the U.S. Securities and Exchange Commission. To permit compliance with Rule 144A in

connection with any resales or other transfers of Notes that are “restricted securities” within the meaning of the Securities Act, the Issuer has undertaken to furnish, upon the request of a holder of such Notes or any beneficial interest therein, to such holder or to a prospective purchaser designated by him, the information required to be delivered under Rule 144A(d)(4) under the Securities Act if, at the time of the request, the Issuer is neither a reporting Company under Section 13 or 15(d) of the Exchange Act nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder.

## **SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES**

The Issuer is a corporation organised under the laws of the Republic of Croatia. All of the officers and directors named herein reside in the Republic of Croatia and all or a substantial portion of the assets of the Issuer and of such officers and directors are located in the Republic of Croatia. As a result, it may not be possible for investors to effect service of process outside the Republic of Croatia upon the Issuer or such persons, or to enforce judgments against them obtained in courts outside the Republic of Croatia predicated upon civil liabilities of the Issuer or such directors and officers under laws other than Croatian law, including any judgment predicated upon United States federal or state securities laws.

There is doubt as to the enforceability in Croatia of original actions, or actions for the enforcement of judgments of U.S. courts, of civil liabilities predicated solely upon the federal laws of the United States. Croatia is not a party to any multilateral or bilateral treaty by which the judgments of U.S. courts would be recognised and enforced, and Croatian courts have not established “factual reciprocity” with the U.S. courts. Therefore, the relevant Croatian conflict statutory laws will directly apply. In general, judgments of non-Croatian and non-EU Member State’s courts will have the same status and legal effect as of Croatian court judgments if they are recognised by a Croatian court. Such a decision will be recognised unless (i) the issue involved falls within the exclusive jurisdiction of a Croatian court; (ii) a Croatian court or another tribunal has rendered a final binding decision on the same issue, or if another foreign judicial decision rendered on the same issue has been recognised in Croatia; (iii) it is contrary to the public policy of Croatia; (iv) there is no reciprocity (currently, there is a rebuttable presumption (*praesumptio juris tanto*) such reciprocity exists); or (v) it is found that there were procedural irregularities in the proceedings before the non-Croatian court which are objected to by the party against whom judgment was made. As a result, it may be difficult to recover against the Issuer in Croatian courts for actions that are solely predicated upon the federal laws of the United States or to enforce judgments of U.S. courts in Croatia.

The Republic of Croatia is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “**New York Convention**”). Consequently, a foreign arbitral award obtained in a state which is party to the New York Convention should be recognised and enforced by a Croatian court in accordance with the terms of the New York Convention. The conditions of the Notes and the Trust Deed contain a provision allowing for arbitration of disputes with London, England, designated as the seat of arbitration. Since the United Kingdom is a party to the New York Convention, arbitral awards in relation to those disputes may be enforced in the Republic of Croatia in accordance with the terms of the New York Convention.

## **PRESENTATION OF FINANCIAL AND OTHER INFORMATION**

### **Financial Statements**

The Issuer maintains its financial books and records and prepares its financial statements in HRK in accordance with International Financial Reporting Standards, as adopted by the European Union (“**IFRS**”). The audited consolidated financial statements included herein at and for the three years ended 31 December 2012, 2013 and 2014 (the “**Annual Financial Statements**”) were audited by BDO Croatia d.o.o. (“**BDO**”), independent auditors in accordance with International Standards on Auditing. The reviewed condensed consolidated interim financial statements for the six months ended 30 June 2015 (the “**Interim Financial Statements**” and together with the Annual Financial Statements, “**Financial Statements**”) included herein were prepared in accordance with IFRS and IAS 34 and have been reviewed by BDO.

BDO is a member of the Croatian Chamber of Auditors and has audited the Annual Financial Statements in accordance with International Standards on Auditing and reviewed the Interim Financial Statements in accordance with International Standards on Review Engagements, as stated in its reports appearing in this Offering Circular.

The financial information at and for the years ended 31 December 2012 and 31 December 2013 in the Annual Financial Statements have been restated for comparative purposes due to the transfer of electricity facilities from Hrvatske autoceste d.o.o. (“**HAC**”), the reclassification of the Issuer’s joint venture in the Krško nuclear power plant (“**NPPK**”) as a ‘joint arrangement’ in accordance with IFRS 11 “Joint Arrangements” and the revaluation of the net asset value of the thermal power plants. For more information, please see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Restatement of the Annual Financial Statements*” and Note 3 of the Annual Financial Statements.

Certain amounts which appear in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

### **Hydro power plants**

In this Offering Circular, any information in relation to hydro power plants should be always read and considered in conjunction with “*Risk Factors*” and “*Business*.” For more information, see “*Risk Factors—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group’s right to operate such plants in the future*”, “*Risk Factors—Merits of investing in the construction or development of hydro power plants are unclear*” and “*Business—Legal Proceedings—Proceedings related to hydro power plants*.”

### **Currencies**

All references in this document to “**Euro**”, “**EUR**” and “**€**” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended, “**U.S. dollars**,” “**dollars**,” “**U.S.\$**” and “**\$**” refer to United States dollars, and to “**HRK**” and “**Kuna**” refer to the lawful currency of the Republic of Croatia. In addition, references to “**SDR**” refer to Special Drawing Rights, a reserve currency created by the International Monetary Fund (the “**IMF**”).

### **Third-Party Information**

The third-party information that has been included in this Offering Circular, has been accurately reproduced by the Issuer and, as far as it is aware and is able to ascertain from information published by such third party, no facts have been omitted that would render the reproduced information inaccurate or misleading.

### **Non-IFRS Measures**

In this Offering Circular, certain financial data and measures are presented which are not calculated in accordance with IFRS. As presented herein:

- Adjusted EBITDA consists of profit for the period excluding financial expense, financial income, corporate income tax expense, depreciation and amortisation and impairment of long-lived assets;
- Adjusted EBITDA Margin consists of profit for the period excluding financial expense, financial income, corporate income tax expense, depreciation and amortisation and impairment of long-lived assets, divided by total operating income, expressed as a percentage.



Adjusted EBITDA and Adjusted EBITDA Margin are supplemental measures of performance and liquidity that are not required by or presented in accordance with IFRS and have limitations as analytical tools. Furthermore, Adjusted EBITDA and Adjusted EBITDA Margin should not be considered in isolation or as alternatives to profit/(loss) before tax, profit/(loss) for the year or any other performance measures derived in accordance with IFRS or as alternatives to cash flow from operating activities, as measures of liquidity or as measures of cash available to invest in the growth of a business. The Group's use of the term Adjusted EBITDA may vary from others' in the same industry.

Some of the limitations related to non-IFRS measures are:

- they do not reflect cash expenditures or future requirements for capital expenditures or contractual commitments;
- they do not reflect changes in, or cash requirements for, working capital needs;
- they do not reflect the interest expense or cash requirements necessary to service interest or principal payments on debt;
- they do not reflect gains or losses in hedging or foreign exchange contracts;
- they do not reflect any cash income taxes that may require payment;
- they are not adjusted for all non-cash income or expense items that are reflected in statements of cash flows;
- they do not reflect the impact of earnings or charges resulting from certain matters that are considered not to be indicative of ongoing operations;
- assets are depreciated or amortised over differing estimated useful lives and often have to be replaced in the future, and these measures do not reflect any cash requirements for such replacements; and
- other companies in the same industry may calculate these measures differently than here, limiting their usefulness as comparative measures.

Because of these limitations, non-IFRS measures should not be considered as measures of discretionary cash available to invest in the growth of a business or as measures of cash that will be available to meet any obligations. It is necessary to compensate for these limitations by relying primarily on IFRS results and using these non-IFRS measures only as supplemental means for evaluating performance. Please see “*Selected Financial Information*,” “*Management's Discussion and Analysis of Financial Condition and Results of Operations*,” and the Financial Statements and the notes thereto, which are contained in this Offering Circular.

## EXCHANGE RATES

The following table sets forth, for the periods indicated, information concerning the period average and period-end rates for U.S. dollars and Euros. The rates set forth below are provided solely for your convenience and were not used by the Issuer in the preparation of the Issuer's Financial Statements included elsewhere in this Offering Circular. No representation is made that Kuna could have been, or could be, converted into U.S. dollars or Euros, as applicable, at that rate or at any other rate.

	Exchange Rates			
	Period End	Average	Period End	Average
	(HRK per U.S.\$1.00)		(HRK per €1.00)	
<b>Year</b>				
2010.....	5.57	5.50	7.39	7.29
2011.....	5.82	5.34	7.53	7.43
2012.....	5.73	5.85	7.55	7.52
2013.....	5.55	5.71	7.64	7.57
2014.....	6.30	5.75	7.66	7.63
<b>Month</b>				
January 2015 .....	6.78	6.60	7.69	7.68
February 2015 .....	6.84	6.79	7.69	7.71
March 2015 .....	7.05	7.05	7.64	7.65
April 2015 .....	6.90	7.06	7.59	7.59
May 2015.....	6.90	6.76	7.58	7.55
June 2015.....	6.83	6.76	7.58	7.57
July 2015 .....	6.92	6.88	7.59	7.58
August 2015 .....	6.69	6.78	7.54	7.55
September 2015.....	6.79	6.75	7.63	7.57
October 2015 (through to October 6) .....	6.77	6.82	7.63	7.64

Source: Croatian National Bank—midpoint exchange rates

## RISK FACTORS

*The Issuer believes that the following factors may affect its ability to fulfil its obligations under the Notes. All of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.*

*In addition, factors which the Issuer believes are material for the purpose of assessing the market risks associated with the Notes are described below.*

*The Issuer believes that the factors described below represent the principal risks inherent in investing in the Notes, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with the Notes may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Offering Circular and reach their own views prior to making any investment decision.*

### **Risks Related to the Group's Business**

***The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group's right to operate such plants in the future.***

The Group operates a diversified mix of power plants, but primarily relies on low-cost hydro power plants for electricity generation, especially in periods when there are sufficient amounts of rainfall. For example, as at 30 June 2015, the Group operated 26 hydro power plants with total installed electricity generation capacity of 2,214 MW which collectively generated 58.5% and 58.3% of the electricity generated by the Group during the year ended 31 December 2014 and the six months ended 30 June 2015, respectively. In the years ended 31 December 2013 and 2012, approximately 55.0% and 39.5%, respectively, of the electricity generated by the Group was sourced from the hydro power plants.

According to the land registry of the Republic of Croatia (the “**Land Registry**”), the Company is registered as an owner of the real estate connected to nine hydro power plants operated by the Group, but ownership titles with respect to the real estate connected to the remaining 17 Croatian hydro power plants are registered in the name of either the Republic of Croatia, municipal authorities or other third parties, including natural persons. Moreover, the State Prosecutor's Office and the Ministry of Agriculture of the Republic of Croatia have initiated several proceedings contesting the ownership title over certain real estate, including dams, reservoirs and land plots currently registered in the Land Registry in the name of the Company, on which the hydro power plants operated by the Group had been built, claiming that the various legislative acts by which the Group was transformed from a so-called “social company” into a joint stock company in 1994 did not give the Group title to the real estate related to the hydro power plants. For more information, see “*Business—Legal Proceedings—Proceedings related to hydro power plants*”.

As a result, the Company, the State Prosecutor's Office, the Ministry of Agriculture and the Ministry of Economy have entered into discussions aimed at clarifying and potentially resolving the uncertainties related to the ownership of the real estate connected to the hydro power plants. The preferred solution put forward by the Group to all relevant stakeholders was for the working group to prepare draft legislation for consideration by the Croatian Government and, if approved by the Government, to eventually put such draft legislation to a vote in Parliament. If passed, the Group expects that such legislation would be a first step in helping to clarify who the registered owner of the hydro power plant-related real estate is or should be, who has the right to operate the plants and who has the right to occupy the related real estate for that purpose. Accordingly, the Company has officially proposed amendments to the relevant legislation, which have been supported by the Ministry of Economy and are now under consideration by the Ministry of Agriculture. The resolution of these issues, if any, would be expected to apply to all 26 of the hydro power plants currently

operated by the Group in Croatia as well as any future hydro power plants that the Group may construct.

It is unclear when a comprehensive legislative proposal will be put forward to the Croatian Government and, further, when such proposal will be passed on to Parliament, if at all. Given the recent dissolution of the Parliament and upcoming parliamentary elections, it is even more unclear when a resolution may be passed into law, if at all. Furthermore, it is currently unclear what solution will be provided by and what ownership and operator rights, if any, the Group will continue to have in the real estate and the attached hydro power plants if new legislation is passed. Such rights could range in form from clean title to an easement of some kind to a right and/or a need to enter a competitive tender to operate the assets. The legislation may result in a less definitive solution, which could require the Group to pursue additional legislative, contractual, licensing or other steps before any rights to the subject assets in favour of the Group would crystallise, if at all.

In the event that a comprehensive legislative solution is not adopted, and in the event that the Group is unable to defeat the various claims made by the State Prosecutor's Office and the Ministry of Agriculture or any future claims and/or support its claims in the municipal courts in the registration proceedings, the Group risks losing its current *de facto* ownership interest in the assets for which it holds registered title, and potentially the ability to operate some or all of its hydro power plants.

Should the Group lose its current right to operate some or all of the hydro power plants, it is unclear what the ramifications to the Group would be. In addition, the Republic of Croatia may consider holding public tender procedures for the right to operate these assets and, only if the Group provides the most favourable proposal in accordance with the terms of the public tender, it may be granted concession rights with respect to the assets, but could be required to make regular rental or similar payments and to comply with other terms of such concession agreements.

In addition, if the courts decide that the contested properties were unlawfully transferred to the Group as part of its transformation in 1994, the courts may order the Group to compensate the Republic of Croatia for unjust enrichment with respect to the revenues generated from operation of such properties, subject to statute of limitation provisions under applicable Croatian laws.

If any of these events occur or any of the above factors materialise or the relevant legislative amendments are not made in order to permit the Group to continue to operate and realise the revenues from all of the hydro power plants it currently operates, it could have a material adverse effect on the Group's business, results of operations and financial condition.

***The merits of investing in the construction or development of hydro power plants are unclear.***

The Water Act (OG 153/2009, 130/2011, 56/2013 and 14/2014) (the "**Water Act**"), in effect since 2010, establishes the ownership of the Republic of Croatia over electricity generation facilities constructed by entities controlled by the Republic of Croatia, including HEP and its subsidiaries. The Company has initiated proceedings in the Constitutional Court of the Republic of Croatia contesting the validity of the relevant provisions of the Water Act. For more information, see "*Business—Legal Proceedings—Proceedings related to hydro power plants—Constitutional Court proceedings*".

Pending the resolution of this issue in the Constitutional Court or by way of amendments to the Water Act, the merits of investing in the construction or development of the hydro power plants remain unclear. See also "*—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group's right to operate such plants in the future.*"

***The Group is subject to significant competition and to changing market conditions in the electricity, thermal energy and gas markets in Croatia.***

The Energy Act (2001) and the Electricity Market Act (2004) established the regulatory framework for the Croatian electricity market and Croatian electricity companies. These and other secondary

legislative acts have brought about the liberalisation of the Croatian electricity market, with the market becoming fully liberalised on 1 July 2008. Liberalisation of the Croatian electricity market continued with adoption of the new Energy Act and the new Electricity Market Act, which transported the EU's Third Energy Package into Croatian law.

While there is currently no competition for residential customers ("**Households**") and customers operating in either the industrial or commercial sectors ("**Commercial Customers**") that have not chosen a particular supplier offering non-tariff based rates (each, a "**Market Supplier**") and are supplied through the public supply system in the electricity market (the "**Tariff Customers**"), competition for Households and Commercial Customers that have selected a Market Supplier and are supplied on the basis of non-tariffed rates (the "**Non-Tariff Customers**") has significantly increased as a result of the entrance of the Republic of Croatia into the EU (the "**Accession**") and the grant of access to non-Croatian companies to enter the market under the prescribed preconditions. Customers who choose a Market Supplier pay market rates, which are typically lower than the tariffed rates under the public supply system set by HERA, but they may be more exposed to price fluctuations. See "*Business—Overview—Tariff System and Classification of Key Customers*". According to the Croatian Energy Regulatory Agency ("**HERA**"), 22 Market Suppliers are registered and operating in the Croatian electricity market. According to the Croatian Energy Market Operator ("**HROTE**"), the Group's share of the electricity sold to end-consumers in Croatia was 98.6%, 95.5%, 86.8% and 85.1% for the years ended 31 December 2012, 2013, 2014 and for the six months ended 30 June 2015, respectively. Market Suppliers compete for the Non-Tariff Customers by, among other things, expanding their product range and introducing various payment options and pricing plans.

Gas market activities are conducted under the Energy Act, the Gas Market Act and several implementing regulations. Gas distribution and supply to household end users are subject to principles of public service provision, which are regulated by HERA. HERA is responsible for determining the general terms of gas supply, as well as the methodology for setting tariffs of public service gas distribution and supply. However, gas supply to commercial end users is conducted under pure competition and the right of customers to select gas suppliers freely, which limits the Group's leadership in the commercial gas market.

In the thermal energy market, the Thermal Energy Act allows customers to choose a registered company for heat energy supply, billing, substation maintenance, and indoor heating installations. Currently, no registered companies present significant competition for the Group largely because customers of thermal energy are connected to joint thermal energy meters, such that, if any of these customers are unable to pay their debts to their supplier, such supplier will be unable to terminate or suspend such customer's connection to the joint meter. However, the liberalisation of the thermal energy market may increase competition as new participants are expected to enter, which may in turn reduce the Group's income.

The Group cannot be certain that it will be able to successfully maintain its leading positions in its operating markets, and its financial results may be negatively affected by increased competition. Any further significant increase in competition in any of the Group's operating markets could have a material adverse effect on its business, results of operations and financial condition.

***Changes in regulated tariffs could have a material adverse effect on the Group's results of operations and financial condition.***

Although the energy sector in Croatia has been fully liberalised since 2008, the Group is still subject to a substantial degree of regulation particularly with respect to the tariffs that it can charge. A significant portion of the Group's revenue from electricity sales is derived from the regulated electricity tariff rates it charges its customers (71.2% in 2014). HERA currently determines the tariff rates that may be charged for the transmission and distribution of electricity for all of the Group's customers and the public supply of electricity within the universal service (for households) and guaranteed supply (for commercial customers). Similar to electricity tariffs, HERA also determines gas tariff rates for gas distribution and public supply within the universal service (for Households) and

guaranteed supply (for Commercial Customers). Thermal energy tariff rates for thermal energy distribution and thermal energy generation exceeding 60% of thermal energy requirements from the centralised thermal energy system are regulated by the methodologies approved by HERA. See “*Regulation*” for further details on the tariff system. As a result, the Group is affected by the pricing decisions of HERA for electricity, gas and thermal energy prices.

Although certain increases in tariff rates have historically been approved by HERA at the Group’s request, tariff rates for electricity transmission and distribution have not changed since 2012. Even when approved, such increases have not always fully reflected the Group’s requests or have been granted following lengthy delays. Furthermore, tariff rates for public electricity supply within the universal service (for Households) and guaranteed supply (for Commercial Customers) were reduced by HERA effective 1 July 2015 due to the reduced purchase price of electricity and the reduced average market price of electricity. If the Group is unable to increase the electricity, thermal energy or gas tariff rates it charges customers in order to cover increases in operating costs or capital investment requirements, this could have a material adverse effect on its business, results of operations and financial condition.

***The Group may have material weaknesses in its accounting and reporting systems and the internal controls relating to the preparation of IFRS financial statements.***

In the course of the audit of the Issuer’s Financial Statements for the year ended 31 December 2014, certain material weaknesses in the Group’s internal controls were identified and the Group’s independent auditor communicated these weaknesses to the Supervisory Board. Under International Standards on Auditing, a material weakness is a weakness in the design or operation of one or more internal control components that does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the consolidated financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The following areas of material weakness were identified in the Group’s internal controls and financial reporting, some of which resulted in significant adjustments as part of the audit and review of the Group’s Financial Statements:

- failure to properly recognise on the Group’s balance sheet electricity facilities transferred from HAC to the Group, even though the facilities had been in use and operated by HEP since 2009, due to incomplete documentation and technical specifications; and
- failure to properly record impairment associated with the carrying amount of the Group’s thermal power plants in accordance with IAS 36 by neglecting to account for market prices of electricity significantly lower than the cost of electricity generation in thermal power plants as a key impairment indicator.

To address the deficiencies identified in the Group’s financial statements, the Group restated its balance sheet and income statement for each of the years ended 31 December 2012 and 2013 in order to reflect the respective accounting impacts of these adjustments. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Restatement of the Annual Financial Statements*”. The Group’s management continues to closely monitor impairment levels in order to timely indicate any impairment indicators. The Group also intends to continue implementation of an internal control system consistent with international best practices. Despite the steps the Group is taking to address these issues, it may not be successful in preventing future material weaknesses.

The inability to maintain adequate financial reporting functions and internal control systems could adversely affect the Group’s business, financial condition and results of operations. Notwithstanding these risks, the Group believes that its financial reporting functions and internal control systems are sufficient to ensure compliance with all applicable laws and regulations and the Group’s management believes that, in particular, despite the difficulties described above, the Group will be able to prepare and produce accurate financial information in a timely manner.

***The Republic of Croatia, which owns 100% of the share capital of HEP, controls the Group's policies by electing members of the Supervisory and Management Boards and may pursue decisions that reflect Croatian Government policy.***

As the Group's sole shareholder, the Republic of Croatia has the power to nominate and elect members of HEP's supervisory board (the "**Supervisory Board**") through proposals made to HEP's general assembly of shareholders (the "**General Assembly**"). Supervisory Board members are elected for a four-year term and six out of the seven members can be replaced by the General Assembly at any time. The seventh member is elected by the employees of HEP, in accordance with the rules set out in the Labour Act (Official Gazette 93/14), who can also replace such member. The Supervisory Board appoints members of HEP's management board (the "**Management Board**"). The Management Board is appointed for a four-year term and is replaced after its four-year term expires, however the Supervisory Board may terminate the powers of any of the members of the Management Board, if, in the opinion of the Supervisory Board, there exist significant grounds for such termination, such as material violations by the members of the Management Board of their obligations to the Group. Consequently, the Republic of Croatia, through the General Assembly and the Supervisory Board, has and will continue to have, directly and indirectly, the power to significantly influence the Group's operations and strategic planning. As a result, certain of the Group's decisions may reflect the policy of the Government of the Republic of Croatia ("**Croatian Government**"), including Croatian energy policy. Accordingly, the Group may make decisions that are different from those that it would have made without this influence. Complying with any such decisions could lead to significant expenditures by the Group, including additional debt, which could have a material adverse effect on the Group's ratings, business, results of operations and financial condition.

In September 2014, at the request of the Croatian Government through the Supervisory Board, the Group replaced the Chairman and two members of the Management Board, since, in the opinion of the Croatian Government, such members of the Management Board were unsuccessful in implementing sufficient measures to maintain the Group's market share in the electricity market. This was the third time since January 2012 that the Chairman of the Management Board was replaced at the request of the Croatian Government. Any future changes to the Supervisory Board or the Management Board could be disruptive to the Group's business and operations and could have a material adverse effect on its business, results of operations and financial condition.

***The Group's restructuring required under EU energy laws has not yet been completed.***

Due to the Accession and in order to comply with the Third Energy Package and corresponding Croatian legislation, the Group has made significant changes to its business structure and operations. The Third Energy Package was designed to complete the liberalisation of the electricity and gas markets within the EU. It aims to create a market with the basic elements of a high standard of public service, customer protection, a structural separation and independence of distribution and transmission activities from generation and supply activities ("**unbundling**") and the establishment of a supranational energy regulator (i.e. the European Agency for the Cooperation of Energy Regulators – ACER). Furthermore, unbundling of distribution activity from generation and supply activities must be carried out in case an electricity undertaking serves more than 100,000 connected customers.

HEP opted to unbundle its transmission system operator, Hrvatski operator prijenosnog sustava d.o.o. ("**HOPS**"), and the Group initiated activities for the separation of generation and supply activities from transmission activities on this basis, which is ongoing. Furthermore, the approval and certification procedure of the transmission system operator by HERA and the European Commission is still active. Applicable legislation does not prescribe precisely the final deadline for submitting the final and complete certification request, and therefore is subject to different interpretation of the competent authorities and involved parties. However, once HERA receives the complete certification request, it is obliged to prepare a draft certificate and submit it to the European Commission for approval within four months. Following approval of the European Commission, HERA is obliged to provide the final certificate within two months. HOPS submitted its certificate request to HERA for

review in July 2015, and currently expects HERA to prepare and submit the draft certificate to the European Commission in October 2015.

Although necessary certification and approval have not yet been granted to HOPS, both HOPS and HEP are required to undertake their operations and maintain their relationship in strict compliance with the restrictions imposed under the EU legislation and the Electricity Market Act. See “*Regulation—The Republic of Croatia—Electricity Sector—Transmission and distribution of electricity.*” Failure to comply with the legislative restrictions may result in imposition of fines on HOPS in the amount of up to 10% of total profit of the Group for the previous year.

Furthermore, applicable Croatian law prescribes that the distribution system operator must be independent in terms of its legal form, organisation and decision making, from other activities not relating to distribution and other electric activities. HEP regulates its mutual relations with HEP-ODS as the distribution system operator by a separate agreement, which is generally in line with applicable legislation. Failure to observe such legislation may result in the Croatian Government’s decision (based on a proposal of a competent Ministry and/or HERA) to order mandatory corporate unbundling of the distribution system operator from the vertically integrated undertaking if it is determined that their connections disable market development and/or ensure the preferential status of the vertically integrated undertaking. Any such enforcement actions could have a material adverse effect on the Group’s business, results of operations and financial condition.

***The Group’s generation capacity, revenues, costs and results of operations are significantly influenced by weather conditions, seasonal variations and climate change that are not within its control.***

Electricity, thermal energy and gas consumption are seasonal and are mainly affected by weather conditions. In Europe, electricity consumption is generally higher during the summer and winter months, and the Group generally experiences higher demand during the colder months of October through March and lower demand during the warmer months of April through September. As a result of these seasonal patterns, the Group’s sales and results of operations are higher in the first and fourth quarters and lower in the second and third quarters. Sales and results of operations for all of the Group’s energy operations can be negatively affected by periods of unseasonably warm weather during the summer and winter months. The Group expects seasonal and weather-related fluctuations in its sales and results of operations to continue in the future.

The Group’s hydro power electricity generation is largely determined by hydrological conditions which can dramatically vary on a year-to-year basis, and conditions such as droughts, heat waves, other weather patterns or climate change can significantly limit the Group’s generation capacity. For example, in 2013 and 2014, when hydrological conditions were high, the Group was able to generate approximately 55% and 59%, respectively, of its total electricity from the hydro power plants. However, hydro power plants generated only 36% of the Group’s total electricity in 2011 when hydrological conditions were weaker. Consequently, the Group may need to compensate for a reduction in the availability of electricity generated by the hydro power plants by using other means with a higher generation cost (such as increasing generation of electricity through its thermal power plants) and may also be required to access the wholesale markets to a greater extent and at higher prices, each of which could have a material adverse effect on its business, results of operations and financial condition.

***The Group may not successfully implement its key strategies due to operational, political, economic and strategic risks.***

One of the key goals of the Group is to improve profitability and increase generation capacity in Croatia in order to achieve self-sufficiency in energy generation. In line with this goal, the Group is actively investing in projects to further enhance supply in Croatia. During the period from 2015 until 2028 the Group expects to invest approximately HRK 18.3 billion in a number of generation, transmission, distribution and other projects, including the modernisation of existing hydro power plants, construction of two thermal power plants (KKE Osijek 500 and EL-TO Zagreb) and two hydro



power plants (HPP Dubrovnik II and HPP Kosinj/Senj) and other smaller generation projects. However, due to the mandatory provisions of the Water Act, any investment in either existing or new hydro power plants under current legislation has unclear legal status, but is expected to be defined through legislative amendments and/or concessions. See “—*The merits of investing in the construction or development of hydro power plants are unclear.*” In addition, the Group intends to enter into a joint venture with a strategic partner in order to finance the construction of a new thermal power plant, Plomin C, which would require approximately HRK 6.5 billion in aggregate investments and which is expected to increase the Group’s electricity generation capacity by 500 MW. These investments are specifically intended to reduce Croatia’s dependence on energy imports from the neighbouring countries (in 2014, Croatia imported 41.6% of its total power consumption through the Group’s transmission network, without the NPPK).

Potential risks may include availability and cost of funding, the willingness of international partners to invest in the Croatian energy market, changes in electricity, thermal energy and gas demand in Croatia and internationally, changes in emission allowance prices and the regulatory framework governing them, increases in generation and distribution costs, higher competition in the markets in which the Group operates, political and economic developments affecting Croatia and Europe, as well as other legal and regulatory changes. See “—*The Republic of Croatia, which owns 100% of the share capital of HEP, controls the Group’s policies by electing members of the Supervisory and Management Boards and may pursue decisions that reflect Croatian Government policy.*”

By the end of 2020, the Group plans to invest approximately HRK 8.8 billion out of the HRK 18.3 billion in developing its transmission and distribution networks. In particular, the Group will focus on reducing network losses and ensuring the reliable and safe operation of new and upgraded generation plants, meeting the country’s growing need for electricity and connecting new customers. The Group also intends to explore opportunities in new markets and expand its customer base both domestically and internationally. However, the Group may face operational, political, economic and strategic risks that could adversely affect its ability to implement these strategies. Failure to implement the Group’s key strategies successfully could have a material adverse effect on its business, results of operations and financial condition.

Furthermore, pursuant to the Electricity Market Act HOPS is required to adopt and approve with HERA a 10-year transmission network development investment plan in accordance with the Ten-Year Network Development Plan (ENTSO-E TYNDP) on the EU level. These transmission network development investment plans may be further updated by HOPS subject to the prior approval of HERA. For more information, see “*Business—Transmission of Electricity—The Transmission Network.*” If HERA establishes that the transmission system operator, for reasons other than the reasons beyond its control, would not be able to carry out investments required under the approved 10-year network development investment plan within the following three years, the Electricity Market Act allows HERA to take certain measures, such as, among others, to organise tender procedures open to all investors interested in investing in the development of the transmission system operator or to oblige the transmission system operator to allow independent investors to participate in its charter capital through a charter capital increase. Consequently, failure by the Group to make investments in accordance with the approved 10-year transmission network development investment plan of HOPS may result in the decrease of the Company’s shareholding in HOPS, which could have a material adverse effect on the Group’s business, results of operations and financial condition.

***Any deterioration in the credit rating of the Group could have a material adverse effect on the Group’s cost of, and access to, funding.***

The Group’s ability to access the capital markets and other forms of financing (or refinancing), and the costs connected with such activities, depend in part on its credit ratings. HEP has a credit rating of BB- with a negative outlook by S&P and Ba2 with a stable outlook by Moody’s. Information about S&P and Moody’s rating agencies as required by the CRA Regulation is provided in “*Overview—Credit Ratings*”. The credit ratings currently assigned to HEP by S&P and Moody’s are based in part on the opinion of S&P and Moody’s that Croatia may potentially provide support to it in the event of

financial distress. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. There is no assurance that the Group's credit ratings will not be subject to negative rating action at any time by the relevant assigning rating organisation. Such negative rating action could be caused by any of a number of factors, some of which may be beyond the Group's control.

The Group's ability to maintain its current ratings is dependent on a number of factors, some of which may be beyond the Group's control. Any deterioration of the Group's credit ratings could undermine confidence of foreign and local investors in the Group, limit its access to capital markets and/or increase the Group's cost of funding, which could require the Group to seek alternative and possibly more expensive sources of funding in order to implement the Group's investment programmes or grow its business. This could have a material adverse effect on its business, results of operations and financial condition.

***The Group may be prohibited from suspending or interrupting the supply of electricity, thermal energy or gas to certain of the Group's customers, even if such customers are in payment default.***

Under Croatian law and in accordance with the General Conditions of Electricity Supply, if customers are unable to pay their debts to their supplier, a supplier may require the transmission/distribution system operator to terminate electricity supply to such customers. The system operator may also terminate electricity supply in case of customers' non-payment of the regulated portion of the final price (i.e. of the network charge). The only exemption under Croatian law is for protected customers, who may not be disconnected (as defined in the Energy Act, protected customers include persons with vulnerable social status and eligible for social welfare, persons with certain degrees of disability, persons with special needs or persons of poor health whose life or health may be threatened in case of termination of electricity supply). Furthermore, most thermal energy customers are connected to one common heat meter located in the heating substation of the building. If those customers are unable to pay their debts to the Group, the Group is not able to terminate their particular thermal energy supply. The Group is able to take legal action against its defaulting customers to seek to recover amounts outstanding, although the timing and amount of such recovery is uncertain. Management conducts a value adjustment for bad or doubtful accounts based on a review of the total age structure of the receivables and based on a review of significant, individual amounts included in the receivables. The Group's impaired trade receivables amounted to HRK 974,179 thousand, HRK 917,490 thousand and HRK 891,679 thousand at 31 December 2014, 31 December 2013 and 31 December 2012, respectively. Any material increase in doubtful receivables, increased delays in payment times or write-offs could have a significant effect on the Group's business, results of operations and financial condition.

***Default or delay in debt servicing by any of the Group's counterparties (which include its partners, contractors, subcontractors and suppliers) may affect the Group's financial condition.***

The Group undertakes significant capital expenditures related to the modernisation, renewal and construction of energy power plants, transmission and distribution assets. The Group faces risks relating to the construction of its electricity and heating generation facilities and electricity, heating and gas transmission and distribution facilities. These risks include access to equipment from reliable suppliers, the steady supply of building materials and technical components, the availability of key personnel, including qualified engineering personnel, delays in construction, the unclear legal status of any investment in existing or new hydro power plants under current legislation, and budget constraints. The Group may also encounter various setbacks such as adverse weather conditions, difficulties in connecting to electricity transmission grids, construction defects, unexpected delays in obtaining zoning and other permits or legal actions brought by third parties. In addition, the Group faces the risk of potential default or delay by its counterparties (which include its partners, contractors, subcontractors and suppliers), especially in cases of financial hardship or bankruptcy. Such risks may increase in the future if the economic conditions in Croatia do not improve in the short-to-medium term.

Any default by the Group's counterparties may affect the cost and completion of its projects, the quality of its work and the supply of certain critical products or services to its customers. It may also expose it to reputational risk, business continuity risk and the loss of important contracts. In addition, the Group may be required to pay contractual penalties or find alternative counterparties. Any such setbacks may result in delays in the completion of the Group's projects and other unforeseen costs, which could have a material adverse effect on its business, financial condition, prospects or results of operations.

***The Group is subject to differing regulatory regimes in all of the jurisdictions in which it operates and these regimes are complex and subject to change.***

The Group is subject to the laws and regulations of the regulatory agencies of the various jurisdictions in which the Group operates, including, *inter alia*, the EU, Slovenia and Bosnia and Herzegovina. These laws and regulations affect many aspects of the Group's business and, in many respects, determine the manner in which the Group conducts its business. This includes the fees it charges or obtains for its products and services, such as in respect of electricity generation (from both traditional and renewable energy sources). In addition, as an operator of hydro and thermal power plants and electricity, thermal energy and gas distribution and transmission facilities and part owner of a nuclear plant, the Group is subject to extensive regulations, whether governmental or otherwise. Any new regulation or any changes in existing regulations may require significant changes in the Group's business in ways that it cannot predict. Additionally, if the Group were to expand to new jurisdictions, it would be subject to the laws and regulations of such jurisdictions, and may be required to make changes to its business or incur costs to comply with such laws and regulations. In addition, political developments or changes in economic policy in the EU, Croatia or other countries in which the Group has or plans to have a business presence, including changes in the composition of the EU and its institutions, such as the potential withdrawal of some member states from the EU, may have an adverse effect on the overall economic stability of the region in which the Group's assets and operations are located. This could have a material adverse effect on the Group's business, financial condition, prospects or results of operations.

***The Group has a clearing debt liability towards the Republic of Croatia, the status of which remains unclear pending the clarification of the European Commission.***

In July 2006, the Croatian Government and the Government of the Russian Federation entered into an agreement to regulate liabilities of the Russian Federation (as a successor of the Union of Soviet Socialist Republics) towards the Republic of Croatia (as one of the successors of the Socialist Federal Republic of Yugoslavia) in relation to the past commodity exchanges between the countries. Pursuant to this agreement, the Russian Federation agreed to settle its debt to the Republic of Croatia by delivery of goods, including a gas turbine with the value of U.S.\$120.45 million for TE Sisak operated by the Group. Although delivery of the gas turbine to TE Sisak was conducted in accordance with the agreement between the Croatian Government and the Government of the Russian Federation and was further authorised by the Ministry of Finance, such addition to HEP's assets has not been documented as a contribution to HEP's property, charter capital or otherwise. Therefore, the value of the gas turbine delivered to the Group is recorded as part of its non-current liabilities and at 30 June 2015 amounted to HRK 822,604 thousand. In order to resolve this uncertainty, the Ministry of Economy (on behalf of the Republic of Croatia) proposed to increase the Company's charter capital by way of a debt-to-equity swap of the outstanding liabilities of HEP to the Republic of Croatia. However, such debt-to-equity swap may be considered to constitute state aid, which is generally prohibited under the Treaty on the Functioning of European Union (TFEU), subject to limited exceptions. The Ministry of Finance has instructed the Ministry of Economy to file a clarification request with the European Commission with respect to this issue. If in response to the clarification request (which is yet to be filed) the European Commission decides that the proposed swapping of the liabilities to the Republic of Croatia into contribution to HEP's charter capital constitutes a form of state aid, the Company will be obliged to repay the respective amounts together with accrued interest, if applicable, to the Republic of Croatia.

***Changes in the EU's renewable energy policy and an accelerated market shift towards renewable energy sources could have a material adverse effect on the Group's results of operations and financial condition.***

As a result of the Accession, the Croatian electricity industry has become increasingly influenced by the EU Climate and Energy Package, which aims to increase the supply of renewable energy in the EU. The EU Climate and Energy Package requires a 20% decrease in greenhouse gas emissions and a 20% increase in energy efficiency by 2020. It also requires that renewable energy sources provide at least 20% of the total energy consumed in the EU by 2020. Costs for compliance with the applicable regulations, in particular, CO<sub>2</sub> emission allowances costs, may have a significant effect on the Group's operating expenses, particularly if the Group is unable to pass on all, or some, of the additional costs to its customers. A draft law on renewable energy sources and co-generation is currently under consideration in the Croatian Parliament, which, among other things, is expected to introduce premiums instead of tariffs for support. This draft law also includes certain elements from the State Aid Energy and Environment Guidelines 2014-2020 (EEAG). In addition, continued or increased support for renewable energy sources in the EU may adversely affect the profitability of the Group's nuclear, coal-fired and oil-fired power plants by imposing additional costs. As a result, further implementation of the EU Climate and Energy Package regulations and any future amendments to these targets could have a material adverse effect on the Group's business, results of operations and financial condition.

***The Group conducts its business in several different currencies and is exposed to foreign currency risks.***

The Group is exposed to transactional foreign currency risk in two main ways: (i) on expenses (particularly fuel and purchased electricity costs) and, to a much lesser extent, on revenues that are denominated in currencies other than Kuna; and (ii) because a significant portion of the Group's debt is denominated in currencies other than the Kuna. As a result, the Group is sensitive to domestic currency depreciation. The Group is mainly exposed to changes in the Euro exchange rate. At 30 June 2015, the Group's exposure to currency risk accounted for 95.02% of its total debt.

As a member state of the EU, Croatia will be eligible to adopt the Euro once it fulfils necessary conditions, and will seek to enter the Exchange Rate Mechanism ("ERM II"), although the timing for this process remains uncertain and is unlikely to be in the short-to-medium term. Any significant change or fluctuation in the Kuna's exchange rate against the Euro, as a result of regular exchange rate fluctuations or due to any other factor, could have a material adverse effect on the Group's business, results of operations and financial condition.

The Group also presents its consolidated results in Kuna. Accordingly, its reported financial results are subject to movements in exchange rates, particularly with regard to the areas of the Group's business where the functional currency is not the Kuna. The translation effect resulting from fluctuations in the exchange rate between the Kuna and the other currencies to which it is exposed, such as Euro or U.S. dollar, may have a material adverse effect on the Group's consolidated revenues, assets and liabilities that are initially denominated in such other currency and which are translated back to Kuna for reporting purposes.

***The Group may not successfully manage the risks associated with expanding its operations and integrating newly acquired subsidiaries and may face significant risks and liabilities as a result of such acquisitions.***

The Group regularly evaluates potential opportunities to expand its operations both internationally and domestically by acquiring new power businesses or establishing additional offices, through strategic partnerships or otherwise. This strategy depends on the Group's ability to successfully identify, acquire, and integrate companies or identify and set up joint ventures and/or strategic partnerships that enhance the Group's operations. In order to obtain the necessary approvals for acquisitions, the Group may be required to divest other parts of its operations or make concessions or undertakings that materially affect its business. The Group might not be able to manage all of the

risks associated with expanding its operations, including compliance with new regulatory requirements, default by any joint-venture partners, issues with integrating existing and newly acquired operations and unexpected costs and time delays. In addition, the Group may not be able to achieve the expected benefits and financial returns from its acquisitions or investments.

In particular, the Group faces many risks inherent in expanding its operations and doing business on an international level, including trade barriers, import and export controls, customs and duties, management experience and difficulties in staffing and managing foreign operations, political instability, political risks, such as expropriation, nationalisation and war, fluctuations in currency exchange rates and potentially adverse tax consequences. Any failure to manage the risks associated with expanding the Group's operations could have a material adverse effect on its business, results of operations and financial condition.

***The Group's activities require various administrative permits, authorisations and licences that may be difficult to obtain, maintain or renew or whose grant may be subject to conditions that may become significantly more stringent.***

The Group's activities of generation, transmission, distribution and supply of electricity and the distribution and supply of thermal energy and gas require various administrative permits, authorisations and licences, at local and national levels, in Croatia and in the other countries in which the Group operates. The procedures for obtaining and renewing these permits, authorisations and licences can be protracted and complex. Obtaining these permits, authorisations and licences is not routine and the conditions attached to obtaining them are subject to change and may not be predictable. As a result, the Group may incur significant expenses in order to comply with the requirements associated with obtaining or renewing these permits, authorisations and licences. Delays, extremely high costs or the suspension of the Group's operating activities due to its inability to obtain, maintain, or renew permits, authorisations and licences, may also have a negative impact on its business activities and profitability. In addition, the Group often invests resources prior to obtaining the necessary permits and authorisations and licences, particularly in connection with feasibility studies and environmental studies, but may have to cancel or withdraw from a project if it is unable to obtain such permits, authorisations or licences.

Licences for the generation and transmission of electricity in Croatia are granted for a maximum of 30 years and a licence for distribution is granted for a maximum of 20 years. Certain other material licences for the operation of the Group's power plants are also due to expire within the next two to six years and the Group's concession licences are due to expire within the next three to six years. For further information, see "*Business—Licences*" and "*Regulation—Concession Licences*". In particular, the hydro power plants operate under various concession licences, which might not be extended for the same period or at all by the Croatian Government. In addition, the current status of the respective concession licences is unclear, since they were approved to HEP and transferred to its subsidiaries without clear transfer approval from the concession provider. Any failure to obtain, maintain, renew or extend all the necessary administrative permits, authorisations and licences necessary for the operation of the Group's business and execution of its strategy, could have a material adverse effect on its business, results of operations and financial condition.

***The Group may become liable for increased decommissioning costs or be required to keep additional amounts as restricted funds for the decommissioning of its nuclear power plant.***

According to the agreement between the Croatian and Slovenian Governments on Regulating the Status and other Legal Relations in Respect of Investments in Exploitation and Decommissioning of, the NPPK (Official Gazette No. 9/2002) (the "**2001 Agreement**"), the Slovenian and Croatian Governments are responsible for the decommissioning and disposal of radioactive waste and spent nuclear fuel (article 10). Both Governments are also responsible for financing the preparation and implementation of the decommissioning and disposal. Pursuant to the ratification of the 2001 Agreement on 28 April 2006 (which was subsequently amended on 24 December 2008), the Croatian Government issued a decree relating to the payment of funds for the decommissioning and disposal of

radioactive waste and spent nuclear fuel of NPPK. According to the 2001 Agreement, the decommissioning costs of the NPPK and management costs of radioactive waste and spent nuclear fuel are apportioned equally between Gen Energija (“GenE”) and HEP, with each party depositing half of the expected costs into a decommissioning fund. HEP is required to pay an annual fee of €4,250 thousand per year into the Croatian decommissioning fund, but this amount may be adjusted in the future due to changes in decommissioning costs, revisions of national radioactive waste policies or other regulatory changes or further to the extension of useful life of the NPPK. At 30 June 2015, HEP had paid a total of approximately HRK 1,213,892 thousand (€163,880 thousand) into the fund. In order to accumulate an adequate amount of funds to cover the ultimate costs of decommissioning of the plant, expert organisations nominated by both the Croatian and Slovenian Governments periodically review the decommissioning cost estimates and update their decommissioning provisions. The second audit of the decommissioning programme is scheduled to commence in the end of 2015 with the results published in 2016. In addition, if such amounts are not sufficient to meet future decommissioning costs or if the NPPK is closed earlier than anticipated, the Group may be required to pay additional amounts and/or make payments sooner. This could have a material adverse effect on its business, results of operations and financial condition.

***Failures, breakdowns, planned or unplanned outages as well as natural disasters or sabotage at the Group’s power plants or damage to the distribution and transmission infrastructure may harm the Group’s business and reputation or could cause significant harm to the environment and local populations.***

Power plants operated by the Group (including its thermal, hydro and nuclear power plants), distribution and transmission infrastructure and the information systems controlling these facilities could be subject to failure, breakdowns, unplanned outages, capacity limitations, system loss, breaches of security or physical damage due to natural disasters (such as storms, floods or earthquakes), sabotage, terrorism, computer viruses, fuel interruptions and other causes. The occurrence of any such events could negatively impact generation levels and the Group’s ability to provide service to its customers, result in loss of life or injury to the Group’s employees or third parties or damage to the Group’s facilities, lead to disruption or stoppage to operations or otherwise disrupt the business. The condition of some of the Group’s equipment and the components of its power plants may also be affected by their continuous operation, as well as processes such as erosion and corrosion. The impact of such operation and processes tends to increase as the plant, equipment and components grow older. The Group may need to temporarily shut down some of the facilities and may incur expenses in connection with inspections, maintenance or repair activities in addition to the periodic planned inspections, maintenance and repair that the Group currently conducts, including such additional activities that governmental authorities may require it to conduct.

The Group’s business and its ability to generate revenue depend on the availability and operating performance of the equipment necessary to operate its power plants and distribution and transmission networks. Mechanical failures or other defects in equipment, or accidents that result in non-performance or underperformance of a power plant or distribution or transmission network may have a direct impact on the profitability of the Group’s operations. In addition, if the Group suffers a reduction in electricity generation, it may be required to purchase greater amounts of electricity in the open market, which may be at unfavourable prices. Moreover, any insurance coverage, warranties or guarantees provided by equipment suppliers in favour of the Group that purport to cover additional expenses incurred by the Group as a result of any failures, may not fully compensate the Group for any increased costs and any resulting decrease in revenues. This could mean that any significant expenses incurred as a result of failures, defects or accidents involving the Group’s operating equipment and infrastructure could have a material adverse effect on the Group’s business, financial condition, prospects or results of operations.

***Disruptions in the supply of coal, fuel, gas or other raw materials, or an unexpected increase in their cost, could materially and adversely affect the Group's results of operations and financial condition.***

In the ordinary course of the Group's business, it is exposed to the risk of disruptions in the supply of fuel oil, coal, nuclear fuel, gas or other raw materials and to increases in their cost. The Group's generation operations depend upon obtaining deliveries of an adequate supply of raw materials on a timely basis and at adequate prices. In addition, the Group has fixed contracts with a limited number of suppliers for its fuel (see "*Business—Commodities*"). As a result, the Group may be exposed to the risk of its suppliers not being able to provide the agreed amount of products on a timely basis, or at all, due to contractual defaults, bankruptcies or other reasons. Any significant shortage or an interruption in the supply of raw materials or any significant price increases could disrupt the Group's generation operations, which could have a material adverse effect on the Group's business, results of operations and financial condition. Such increased costs if passed through to the Group's customers, together with a worsening of the overall economic environment, may make it more difficult for the Group's customers to make their required payments, which may increase the Group's doubtful receivables and damage its financial condition and results of operations.

A significant portion of the Group's expenses are made up of commodity costs, which are heavily influenced by prices in the world market for gas, fuel oil and coal. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels. Gas and electricity prices in particular are highly volatile, and there may be a time gap between fluctuations in energy sources and prices to end users. Although the Group mitigates such fluctuations by entering into long-term contracts for its wholesale gas and electricity supply and hedging wholesale contracts with fixed prices, pricing volatility remains a significant risk to the Group's profitability and competitiveness. Electricity supply contracts are typically entered into on an annual basis, while gas contracts may be annual, quarterly or monthly. Since August 2014, the Group has traded on the derivatives market of the EEX Exchange (the European futures market for electricity, gas, coal, emission allowances and guarantees of origin) to manage commodity price risks. However, any significant increases in commodity prices could have an adverse effect on the Group's business, results of operations and financial condition.

In addition, the Group routinely imports electricity from other countries, primarily from Hungary, Slovenia, Germany/Austria and Bosnia and Herzegovina, and re-sells most of it to end-consumers in Croatia (12% of the Group's total consumption or 1.8 TWh in 2014). As a result, the Group is exposed to fluctuations in electricity market prices in those countries, as well as other local regulatory, economic and political conditions. If the Group is unable to generate a sufficient amount of electricity from the hydro power plants and is unable to import the remaining amount from neighbouring countries there may be a material adverse effect on the Group's business, results of operations and financial condition.

***The Group is unable to insure itself against all potential accidents and may become subject to higher insurance premiums.***

The Group's business is exposed to risks associated with the construction and operation of power plants, electricity, heating and gas distribution and transmission grids and other energy related facilities, such as mechanical breakdowns, manufacturing defects, natural disasters, terrorist attacks, sabotage, personal injury and other interruptions in service resulting from events outside of the Group's control. The Group is also exposed to environmental risks, in particular that certain environmental conditions that may destroy, damage or impair any of its facilities. These events may result in increased costs and other losses, which could have a material adverse effect on the Group's business, financial condition, prospects or results of operations.

In compliance with applicable Slovenian regulations and international conventions, the entity operating the NPPK, Nuklearna elektrarna Krško d.o.o. ("**NEK**"), maintains insurance coverage for NPPK, including for property, employees, terrorism and third party liability. The Group cannot be

certain that these insurance policies will fully insure it against all risks and losses that may arise in the future. The Group does not have any insurance coverage for the NPPK and must rely on insurance coverage obtained by NEK. The Group may incur substantial losses as a result of a nuclear accident or failure at the NPPK, including loss of generation capacity, repair and clean-up expenses, legal liabilities, reputational losses and legislative and regulatory reforms by Slovenia or the EU, which could substantially affect the Group's operations.

Malfunctions or interruptions of service at the Group's facilities could also expose it to legal challenges and sanctions. Therefore, the Group may be adversely affected by the costs of accidents or other unexpected occurrences at its facilities for which insurance coverage is not available, has not been obtained or is not sufficient, which could have a material adverse effect on the Group's business, results of operations and financial condition. In addition, the Group's insurance policies are subject to annual review by its insurers and may not be renewed or may not be renewed on similar terms, particularly should the Group have made any significant claims under previous such policies. If the Group were to incur a substantial uninsured loss or a loss that significantly exceeded the limits of its insurance policies, or if the Group's insurance policies are renewed on less favourable terms or premiums significantly increase, such factors could have a material adverse effect on the Group's business, financial condition, prospects or results of operations.

***The Group is subject to environmental, health and safety laws and regulations and must maintain environmental, health and safety regulatory approvals and may be exposed to significant liabilities if it fails to comply with such laws or maintain such approvals.***

The Group is subject to various environmental, health and safety laws and regulations governing, among other things: the generation, storage, handling, release, use, disposal and transportation of waste or hazardous and radioactive materials; the emission and discharge of hazardous materials into the ground, air or water; the decommissioning and decontamination of its facilities; and the health and safety of the Group's employees. The Group is also required to obtain environmental and safety permits from various governmental authorities for its operations. Certain permits require periodic renewal or review of their conditions as well as continuous monitoring and compliance reporting. The Group may not be able to renew such permits or there may be material changes to its permits requiring significant expenditure. Violations of these laws, regulations or permits could result in plant shutdowns, fines or legal proceedings being commenced against the Group or other sanctions, in addition to negative publicity and significant damage to the Group's reputation.

Although environmental laws and regulations have an increasing impact on the Group's activities in all of the countries in which it operates, it is impossible to predict accurately the effect of future developments in such laws and regulations on the Group's future earnings and operations. While the Group has budgeted for future capital and operating expenditures to comply with current environmental and health and safety laws, it is possible that any of these laws may change or become more stringent in the future or that new laws may be adopted. Some risk of environmental costs and liabilities is inherent in the Group's particular operations, as it is with other companies engaged in similar businesses, and there can be no assurance that material costs and liabilities will not be incurred. For more information on environmental matters, see "*Regulation—Environmental Matters.*"

***The Group's facilities could be the source of industrial accidents or environmental and public health impacts.***

The Group operates or has operated certain facilities which, as currently operated, could be the source of industrial accidents or environmental and public health impacts, such as inadequately controlled emissions, leakages in electricity supply lines insulated with oil under pressure, asbestos and polychlorinated biphenyls. In particular, large quantities of hazardous materials (mainly explosive or flammable, such as gas and fuel oil) are stored in certain facilities. These facilities may be located in industrial areas where other activities facing similar risks are carried out, such that the Group's facilities may be impacted by accidents occurring at neighbouring facilities that are not within its control. In addition, the labour intensive requirements of the Group's businesses and the wide



geographical disbursement of the Group's employees in the field (in particular, on public roads and at customer sites), as well as difficult working conditions, make the increase in the frequency and severity of work accidents and the increasing incidence of work-related illnesses a risk. All of these factors could expose the Group to litigation and significant costs, including costs incurred in connection with adopting more stringent safety and security measures for the operation or construction of its generation facilities and transmission or distribution networks, which could have a material adverse effect on the Group's business, results of operations and financial condition.

Questions with respect to the risks to human health as a result of exposure to electromagnetic fields ("EMFs"), in particular, from power lines operated by the Group, have been raised within Croatia, the EU and elsewhere internationally. Based on studies completed over the past 25 years, numerous international health organisations (including the World Health Organisation and the International Agency for Research on Cancer) consider, given currently available scientific information, that the existence of health risks, if any, are low. However, medical knowledge about health risks related to exposure to EMFs may evolve, public sensitivity about such risks could increase, or the principle of precaution could be applied very broadly. In the EU, new regulations aimed at understanding the risks associated with EMFs are being developed. As per other EU legislation, Croatia is under an obligation to implement all such changes domestically. In addition, Croatia has also implemented the Act on Protection from Non-Ionising Radiation (OG 91/2010) and the Rules on Protection from Electromagnetic Radiation (OG 146/2014), which aim to protect against potential risks associated with electromagnetic radiation. The risks associated with EMFs could expose the Group to litigation and significant costs, including costs incurred in connection with the adoption of more stringent security measures for the operation or construction of the Group's generation facilities and distribution networks, which could have a material adverse effect on its business, results of operations and financial condition.

***A strike or other labour disruption at the Group's facilities could adversely affect its business.***

At 1 October 2014, all of the Group's employees in Croatia (except for employees of HOPS) were covered by a collective bargaining agreement (the "**Collective Agreement**") in accordance with Croatian law, which is valid until 30 June 2016. The Collective Agreement determines the framework for the Group's dealings with its employees and provides certain rights above the statutory minimum. Management believes that partly as a result of the collective agreements that the Group has executed in the years, since its inception, it has not experienced any strikes or other resistance or work stoppages. However, any such action by the Group's employees could impair the Group's ability to implement further measures to reduce costs and improve production efficiencies, which could have a material adverse effect on its business, results of operations and financial condition.

***The Group may not be able to hire, train or retain a sufficient number of qualified staff.***

The Group transacts a variety of business requiring a wide range of continually evolving skills, so it can keep up with changes in its sector of the market, in particular its environment-related businesses. The need to constantly seek out new technical experts, train staff in new techniques and recruit and train managers creates a risk for the Group if it is not able to mobilise in a timely manner the skills required at all of its locations. Experienced and capable personnel in the energy industry are in high demand and the Group faces significant competition in its principal markets to recruit such personnel. Moreover, as a result of a high average age of the Group's employees (47.61 as of 31 December 2014), the Group expects a significant number of retirements in the next three to five years, and a reduction of up to 6% in the Group's total workforce is possible within the next two years by means of attrition and/or redundancies in connection with the Group's organisational restructuring (10-20% of the employees of Group companies will be affected by the restructuring). For further information on the organisation restructuring, see "*Business—Employees and Health and Safety—Employees.*" Consequently, when the Group's experienced employees leave, the Group may have difficulty, and incur additional costs, in replacing them. The Group has implemented various programmes to ensure a smooth transition between the retiring employees and their replacements and is improving employee training schemes, but any failure to transfer the relevant financial, technical or operating knowledge

between these two groups, could have a material adverse effect on the Group's business, results of operations and financial condition.

In addition, the loss of any member of the Group's senior management team may result in a loss of organisational focus, poor execution of its operations and corporate strategy and an inability to identify and execute potential strategic initiatives in the future, including strategies relating to the growth of its business. The Group's failure to hire, train or retain a sufficient number of experienced, capable and reliable personnel, especially senior and middle management with appropriate professional qualifications, or to recruit skilled professional and technical staff in pace with its growth, could have a material adverse effect on its business, results of operations and financial condition.

***The Group may not be able to keep pace with the technological changes in the energy sector or properly maintain its IT systems.***

The technologies used in the energy sector have changed and may change and evolve rapidly in the future. In order for the Group to maintain its competitiveness and to expand its business, it must effectively adjust to these changes. In particular, technologies related to power generation and electricity transmission are constantly improving and becoming more complex. If the Group is unable to modernise its technologies quickly and regularly and to take advantage of industry trends, it could face increased pressure from competitors and lose customers in the markets in which it operates. The Group could also lose valuable opportunities to expand its operations in existing and new markets due to insufficient integration of new technologies in its operations. As a result, the Group's failure to respond to current and future technological changes in the energy sector in an effective and timely manner could have a material adverse effect on the Group's business, financial condition, prospects or results of operations.

Information and communication technology plays an important role in the Group's operation, in particular, innovative and efficient IT systems are a key success factor for the Group. For example, the Group is routinely exposed to IT risks in connection with the development, implementation and application of its IT systems. In addition, there is a risk that there might be unauthorised access to the Group's sensitive data by third-parties and improper use of such data, which may lead to the loss of company secrets and may result in a breach of Croatian data protection regulations. As a result, any breach or unauthorised use of the Group's IT systems may have material adverse effects on the Group's business, financial condition, prospects or results of operations.

***The Group is subject to a variety of litigation and regulatory proceedings in the ordinary course of business.***

In the ordinary course of its business, the Group is subject to numerous civil, administrative and arbitration proceedings. The Annual Financial Statements contain provisions for contingent liabilities relating to particular proceedings, calculated based on the advice of the Group's internal and external legal counsel. However, the Group has not recorded provisions in respect of all legal, regulatory and administrative proceedings to which it is a party or in which it may become a party. In particular, the Group has not recorded provisions in cases in which the financial outcome is uncertain or which the Group currently expects to be ruled in its favour. The Group's failure to record sufficient provisions or to properly assess the likely outcome of any proceedings against it, could have a material adverse effect on its business, results of operations and financial condition. For more information, see "Business—Legal Proceedings".

***The Group could incur unforeseen taxes, tax penalties and sanctions which could adversely affect its results of operations and financial condition.***

Due to the recent economic crisis, a number of EU member states and other countries in the region have faced significant budget deficits and, as a result, have imposed additional taxes on the utilities sector, such as the nuclear tax in Germany and the power sales tax in Hungary. There is also ongoing discussion in Croatia on a new property tax which could affect the Group. It is not possible to

estimate the effects of any new taxes in the countries in which the Group operates, changing interpretations or application of existing tax regulations by the tax authorities, harmonisation of Croatian and EU tax legislation and regulation after the Accession and/or the possible imposition of retroactive penalties and other sanctions due to new tax liabilities. Any such tax consequences could have a material adverse effect on the Group's business, results of operations and financial condition.

### **Risks Related to Croatia**

***An investment in a developing country such as Croatia is subject to substantially greater risks than an investment in a more developed country.***

An investment in a country such as Croatia, which achieved independence in 1991 and whose economy is still in transition, is subject to substantially greater risks than an investment in a country with a more developed economy and more developed political and legal systems. Although progress has been made in reforming Croatia's economy and political and legal systems, the development of Croatia's legal infrastructure and regulatory framework is still continuing. As a consequence, an investment in Croatia carries risks that are not typically associated with investing in more mature markets. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, such an investment is appropriate.

In addition, international investors' reactions to the events occurring in one country sometimes appear to demonstrate a "contagion" effect, in which an entire region or class of investment is disfavoured by international investors. Croatia could be adversely affected by negative economic or financial developments in neighbouring countries, EU countries, such as Greece, or countries with similar credit ratings. While in recent years Croatia has reduced its external vulnerability and implemented sound macroeconomic policies, which have been reflected in the positive evolution of its ratings and spreads, Croatia has been adversely affected by such contagion effects on a number of occasions, including following the 1998 Russian financial crisis and the recent global economic crisis. Similar developments can be expected to affect the Croatian economy in the future. There can be no assurance that the factors such as those described above or similar events will not negatively affect investor confidence in markets such as Croatia. In addition, there can be no assurance that these events will not adversely affect Croatia's economy which may in turn impact the Group and have a material adverse effect on the Group's business, results of operations and financial condition.

***Having recently acceded to the EU on the back of a raft of legal, economic, financial and other reforms and policies, Croatia is undergoing a period of transition which may adversely affect the Croatian economy.***

On 1 July 2013, Croatia joined the EU and became its 28<sup>th</sup> member state. To facilitate this, it was necessary for the Croatian Government to introduce a number of structural measures in 2012 and 2013 with the aim of strengthening the quality of public finances and bringing political, economic and judicial structures in line with EU requirements. In light of these large-scale sweeping measures, Croatia is in a transitional period and may experience difficulty during this period as its structures integrate into the EU.

Croatia has also undergone and continues to undergo changes in legislation due to the Accession. As a result of these changes, there is a lack of an established practice under many securities, tax and other regulatory regimes in Croatia and new regulations may be subject to contradictory, ambiguous or changing interpretations by the Croatian regulatory authorities. Consequently, companies operating in this region may face tax, securities and other regulatory compliance-related risks that may be less predictable than in countries with more stable regulatory systems. As a result of EU membership, Croatia may be eligible to receive financial assistance from EU structural funds pursuant to the EU Cohesion Policy. However, there is no guarantee that Croatia will meet the criteria to receive disbursements under these funds or that such funds would be available or the timing of any such disbursements. Access to EU structural funds will require co-financing by Croatia, which may be challenging in light of Croatia's fiscal and budgetary situation, and the Excessive Deficit Procedure imposed (*see below*). Furthermore, as an EU Member State, Croatia incurs additional costs related to

its EU membership, including its contribution to the EU budget, which amounts to €462 million for the 2015 fiscal year, which may place further strains on Croatia's fiscal condition.

Further, the Government has encountered resistance in the implementation of these reforms from trade unions. Most recently, school workers went on strike in September and October 2015 regarding their demands for the annual wage adjustments. In addition, Croatia's implementation of the Excessive Deficit Procedure (*as defined below*) as a result of its budget deficit exceeding the reference value of 3 per cent. of gross domestic product ("GDP"), could result in additional resistance, labour disruptions or social unrest. There can be no assurance that implementation of these or additional reforms will not result in further prolonged labour unrest or disruptions, which could have an adverse effect on Croatia's economy which may in turn impact the Group and have a material adverse effect on the Group's business, results of operations and financial condition.

Following the Accession, Croatia's trade policy is now in accordance with the rules of the EU Treaty. The EU has a common trade policy in relation to non-EU countries which involves, among other things, a common external tariff and common trade agreements with non-EU Member States. As part of the EU internal market, Croatia's economy is exposed to increased competition with other Member States. In addition, as part of its EU accession, Croatia also exited from the Central European Free Trade Agreement ("CEFTA"), a trade agreement between the non-EU countries in Southeast Europe which includes Serbia, Macedonia, Montenegro, Bosnia and Herzegovina, Kosovo, Albania, and Moldova. Prior to Croatia's exit from CEFTA, CEFTA countries accounted for a significant portion of Croatia's exports, particularly in the agriculture and food industries. Croatia's trade with its non-EU trade partners will now rely solely on each country's respective Stabilisation and Association Agreement, which is each such country's bilateral trade agreement with the EU. Although the European Commission has conducted negotiations with the CEFTA countries on changing their Stabilisation and Association Agreements to account for Croatia's EU accession, many Croatian exports may still face new or higher import tariffs and quotas in the CEFTA countries, which could have adverse effects on sectors of the economy that are unable to compete. Further, following the Accession, Croatia's trade with CEFTA countries declined, specifically in agro-food exports. In addition, as a result of the Accession, Croatia is also required to significantly reduce the level of domestic subsidies to the agriculture sector.

As a member state of the EU, Croatia will be eligible to adopt the Euro once it fulfils the necessary conditions, and will seek to enter the ERM II, although the timing for this process remains uncertain and is unlikely to be in the short to medium-term. Under ERM II, the exchange rate of a non-euro area Member State is fixed against the Euro and is only allowed to fluctuate within set limits. Entry into ERM II is based on an agreement between the ministers and central bank governors of the non-euro area Member State and the euro-area Member States, and the European Central Bank. Entry into ERM II will be a step towards the full adoption of the Euro in Croatia, in line with Croatia's commitment pursuant to the treaty signed on 9 December 2011 in connection with the Accession (the "**Accession Treaty**"). Croatia's date of entry into ERM II and, subsequently, into the Eurozone, will primarily depend on Croatia's macroeconomic indicators, i.e. its ability to fulfil a set of membership criteria which are more stringent than those applied to previous candidates. The policy measures required to meet such criteria, Croatia's entry into ERM II and adoption of the Euro could each result in adverse macroeconomic effects on Croatia's economy and lead to lower rates of, or negative, economic growth.

***Croatia is subject to the Excessive Deficit Procedure and implementation of deficit reduction measures may adversely affect Croatia's economy.***

Under the Treaty on European Union of February 1992 (the "**Maastricht Treaty**"), implementing regulations and the Stability and Growth Pact among EU Member States (the "**Pact**"), Member States are required to pursue a medium-term objective of ensuring the long-term sustainability of public finances and minimising the risk of their budget deficit exceeding the reference value of 3 per cent. of GDP. A Member State whose general budget deficit exceeds the reference value of 3 per cent. of its GDP, or whose ratio of Government debt to GDP exceeds the reference value of 60 per cent.,

becomes subject to the excessive deficit procedure (the “**Excessive Deficit Procedure**”). The Excessive Deficit Procedure provides that the Economic and Finance Affairs Council, a Council composed of Economics and Finance Ministers of the Member States (the “**Ecofin Council**”), decides whether an excessive deficit has been incurred. If it concludes that there is an excessive deficit, the Ecofin Council, based on recommendations by the European Commission, suggests corrective measures aimed at a deficit reduction and then reviews the corrective measures taken by the Member State. If it determines that such corrective measures are not adequately implemented, the Maastricht Treaty and the Pact provide for a wide range of remedies, including the imposition of annual financial penalties. On 28 January 2014, the Council of the European Union opened an excessive deficit procedure for Croatia, adopting a decision on the existence of an excessive Government deficit as well as recommendations setting out measures to be taken to correct the deficit by 2016. Croatia’s budget deficit is currently above 3 per cent. of GDP and the Croatian Government believes that it may correct such deficit by 2017. The debt to GDP ratio was 85.1 per cent. in 2014 and is expected to increase and stabilise only in 2017, although there can be no assurance at what level it will peak at and by when. Efforts to reduce taxation in order to stimulate growth and encourage entrepreneurs may hinder efforts to reduce the deficit. Separately, privatisations and/or a reduction in public spending/wages may prove unpopular and be difficult to implement. As such, this may result in the budget deficit exceeding 3 per cent. of GDP for longer than expected and implementation of the agreed deficit reduction measures may have an adverse effect on Croatia’s economy which may in turn have a material adverse effect on the Group’s business, results of operations and financial condition.

***Croatia’s economy remains vulnerable to external shocks which could have an adverse effect on Croatia’s economic growth.***

Croatia’s economy remains vulnerable to external shocks, including those stemming from the global financial and economic crisis that started in 2008 and the recent political turmoil in certain emerging markets as well as the continuing uncertainty regarding the EU Member States, including renewed uncertainty regarding Greece. The global financial and economic crisis negatively affected the Croatian economy.

After the Accession, Croatia was obliged to leave CEFTA, but obtained access to concessions negotiated in the EU’s preferential trade agreements with third countries. Croatia’s economy remains vulnerable to any trade disruptions with its main EU trading partners, namely Austria, Germany and Italy.

In addition, the recent hostilities between Russia and Ukraine have been strongly opposed by the EU and the United States. The hostilities have prompted the EU and the United States to impose trade restrictions and sanctions on certain persons and entities affiliated with Russia as well as on certain key sectors of the Russian economy. The restrictions on EU exports of agricultural and food products to Russia have to date had a limited effect on Croatia. Nonetheless, the potential repercussions surrounding the situation are unknown. The emergence of new or escalated tensions in the region, or the imposition of further economic or other sanctions could negatively affect other economies in the region and the Eurozone in general. Although Ukraine is not a material trading partner for Croatia, any contingent and ongoing escalation of the current tension in Ukraine may in turn have serious economic and geopolitical consequences for Europe as a whole and indirectly impact Croatia through its trading partners Austria and Germany and impact the Croatian economy.

A significant decline in the economic growth of any of Croatia’s major trading partners, such as the EU countries, could, *inter alia*, have a material adverse impact on Croatia’s balance of trade and adversely affect Croatia’s economic growth, which may in turn impact the Group and have a material adverse effect on the Group’s business, results of operations and financial condition.

***Croatia's current account balance may deteriorate, and previous economic growth may not be sustainable.***

Croatia's current account deficit has declined gradually since 2008 and recorded small surpluses in each of 2013 and 2014. Croatia's current account balance is significantly affected by its trade balance and any future negative changes in the trade balance and the current account balance could have an adverse effect on the Croatian economy and thus on the Group's business, results of operations and financial condition.

Moreover, Croatia continues to face a number of economic challenges including low worker participation, deleveraging of the private sector, a decline in personal consumption and a lack of growth. There can be no assurance that Croatia will return to the growth pattern experienced in the period from 2001 to 2008 given that it relied heavily on substantial inflows of foreign capital during this period. Even if the global economy recovers in the future, the recovery may not be sustained and may reverse. This could have a material adverse effect on the Group's business, results of operations and financial condition.

***Deterioration in Croatia's relations with its major energy suppliers may adversely affect the supply of energy resources and therefore have a negative effect on the Croatian economy.***

Croatia's economy depends on trade flows with certain other countries, including Russia (directly and indirectly via third countries), largely because Croatia imports a large percentage of its energy requirements. If bilateral trade relations with Croatia's major energy suppliers were to deteriorate or if supplies of oil or natural gas to Croatia were to be restricted or if the price of oil were to significantly increase, Croatia's economy could be adversely affected. In addition, an increase in the price of oil or natural gas could adversely affect the pace of economic growth in Croatia. Furthermore, although higher gas prices have increased pressure for reforms in the energy sector, for modernisation of major energy-consuming industries of Croatia through the implementation of energy- efficient technologies and modernisation of production facilities, there can be no assurance that these reforms and modernisations will be implemented or will succeed. Any major changes in relations with major energy suppliers to Croatia, in particular any such changes adversely affecting supplies of energy resources to Croatia, may have adverse effects on the Group's business, results of operations and financial condition.

***If government revenue decreases, some or all of the Croatian Government's expenditure reduction plans prove insufficient, or state-owned enterprises' dependence on public finances is not reduced, Croatia may not be able to service its public debt and, as a result, may impact the Group's business, results of operations and financial condition.***

Without sufficient structural reforms aimed at reducing the dependence of state-owned enterprises on public finances and at fostering greater economic efficiency through broader private sector participation, revenue raising measures could prove inadequate to cover the continued increases in public debt and interest payments. As a result, the current account surplus could go into deficit and debt servicing could in turn become more demanding. Croatian Government payment capacity may become further affected by economic cyclical trends and the risk of a delayed recovery of key economic sectors. Actual economic growth in 2015 may be lower than projections and assumptions of the Croatian Government used for the 2015 budget. Lower than expected growth would have a negative impact on budget revenue and negative implications in adhering to the Excessive Deficit Procedure. Lower than expected growth would increase the Croatian Government deficit (with an unchanged level of expenditure) thereby making it more likely that the Croatian Government will fail to meet the targets set in the Excessive Deficit Procedure. In a lower growth environment, additional expenditure reduction measures may be required to adhere to the Excessive Deficit Procedure.

Taken as a whole, reduced revenues, coupled with high expenses related to public wages, social benefits, interest payments, healthcare system, pensions and subsidies, may adversely affect the Group's business, results of operations and financial condition.

***Private Croatian borrowers may not be able to repay or reschedule their debt which may have a material adverse effect on the Croatian banking system and the Croatian economy.***

Private debt in Croatia has grown rapidly since the mid-2000s as corporate and household sectors accumulated a heavy debt burden. Household debt in Croatia as a share of GDP is one of the highest among Central and Eastern European countries. Non-publicly guaranteed private sector external debt relates almost entirely to foreign borrowing by the corporate sector and banks. According to the Croatian National Bank (“CNB”), non-publicly guaranteed private sector external debt has remained relatively flat in recent years and amounted to €29.6 billion at 31 May 2015, €28.8 billion at 31 December 2014 and €29.3 billion at 31 December 2013. (These figures do not include the effects of round-tripping transactions, which involve Croatian equity investment abroad to companies which then lend back to the investing company in Croatia). According to the CNB, non-performing loans have been increasing continuously since the economic crisis, from 4.9% in 2008 to 17.3% at 30 June 2015, slowing significantly recently but which may continue to rise. Non-performing loans to enterprises have experienced the greatest increase, from 7.5% in 2008 to 30.9% at 30 June 2015.

Failure of private borrowers to repay or reschedule their debt may have a material adverse effect on the Croatian banking system and the Croatian economy. In turn, this may affect the Group’s business, results of operations and financial condition.

***The high level of foreign ownership in the Croatian banking system makes it vulnerable to disruption as a result of internal or external factors***

According to the CNB, at 31 March 2015, foreign banks owned approximately 90.3 per cent. of banks’ assets in Croatia. The Croatian banking system is exposed to the banking systems of other European countries, including, among others, Italy and Austria. Foreign banks may rebalance their global loan portfolio in a manner adversely affecting Croatia as a result of events related or unrelated to Croatia, including as a result of adverse economic developments in the Eurozone and negative factors impacting the sovereign debt markets. In addition, foreign banks may decrease funding to their subsidiaries operating in Croatia due to actual or perceived deterioration in asset quality, particularly in the event of a weaker than expected economic performance and further increases in non-performing loans. As a result of these or other factors, or other potential shocks, foreign banks may revise their business strategies in, or relating to, Croatia and in particular their decision to fund their subsidiaries in Croatia. This may lead to, among other things, a loss of confidence in the Kuna which, in turn, may result in significant depreciation of the Kuna. Resulting balance sheet mismatches may negatively affect the Croatian economy and, as a result, have an adverse effect on the Group’s business, results of operations and financial condition.

***Depreciation in the Kuna may adversely affect the Croatian economic and financial condition.***

A significant portion of Croatia’s public external debt and domestic debt is denominated in or linked to foreign currencies. Foreign-currency and foreign currency-linked debt accounts for 78.4% of Croatia’s general government debt at 31 December 2014, according to the CNB. In addition, according to the CNB, substantially all of the Croatian Government’s guarantees are denominated in or linked to foreign currency. In the event of foreign currency fluctuations, and a depreciation of the Kuna relative to the U.S. dollar or the Euro, the negative impact on the service obligations in respect of the debt denominated in foreign currencies will not be completely offset by the positive impact on the service obligations in respect of debt denominated in Kuna. Any significant depreciation of the Kuna may have an adverse effect on Croatia’s ability to repay its debt denominated in foreign currencies.

In addition, according to the CNB, at 31 December 2014, approximately 82.5% of Croatia’s corporate debt and 72.5% of household debt was denominated in, or linked to, foreign currency. Only a small fraction of this debt is hedged. From 2012 onwards, the share of the Kuna component in Croatia’s bank loan portfolio has been increasing. Despite the fact that foreign currency deposits now account for approximately 70.0% of all deposits and that large foreign currency deposits by households reduce currency mismatches at the aggregate level, this does not eliminate macro-level mismatches and there

are likely to be mismatches at the individual level between borrowers and depositors as well. Since 1 January 2013 the CNB has intervened in the foreign currency market only four times as part of its policy of pursuing a stable Euro/Kuna exchange rate. The depreciation of the Kuna against foreign currencies may negatively affect the capacity of corporate and household borrowers to repay their debt and as a result adversely affect the financial and economic condition of Croatia.

***The further proliferation of the Euro in the Croatian economy may adversely affect the CNB's ability to implement its monetary policies.***

In recent years, the role of the Euro in the Croatian economy and circulation of the Euro in Croatia substantially increased as a result of sizeable Euro capital inflows from abroad, including from persons working abroad who send money to their families in Croatia; the tourism industry, in particular the population's willingness to accept the Euro from tourists and the fact that a majority of corporate and household loans are Euro-denominated or Euro-indexed. As the CNB's monetary policy mostly impacts the Kuna and has limited impact on other currencies including the Euro, the further proliferation of the Euro in the Croatian economy and widespread use of the Euro by the Croatian population may undermine the ability of the CNB to implement its monetary policy. Similarly, the policies of the European Central Bank affecting the Euro may indirectly impact the Croatian economy. Any limitations on the ability of the CNB to implement its monetary policies may have an adverse effect on the Croatian economy and thus on the Group's business, results of operations and financial condition.

***Corruption and money laundering issues may hinder the growth of the Croatian economy and otherwise have a material adverse effect on Croatia.***

Independent analysts have identified corruption and money laundering as problems in Croatia. In the 2014 Transparency International Corruption Perceptions Index, Croatia ranked 61 out of 175 countries under review (indicating that there were at least 60 countries with lower perceived levels of corruption). In 2008, Croatia commenced a reform of the judicial system in order to combat corruption and restore confidence in the judicial system.

The Act on Prevention of Money Laundering and Financing of Terrorism (OG 87/08 and 25/12) came into force on 1 January 2009 and is aimed at harmonising Croatian law on the prevention of money laundering and financing of terrorism with the provisions of the Third EU Money Laundering Directive (Directive 2005/60/EC). However, there is no certainty as to the success of these measures. Any future allegations or evidence of corruption or money laundering in Croatia may have an adverse effect on the Croatian economy, in particular on Croatia's ability to attract foreign investment, and thus could negatively affect the Group's business, results of operations and financial condition.

***Croatia's legal system is not fully developed and presents greater risks and uncertainties than a more developed legal system.***

Since Croatia declared independence in 1991, the Croatian legal system has been evolving to support the country's transition to a market-based economy. In connection with the Accession, new laws have been introduced and revisions have been made with respect to, amongst others, company, property, competition, public procurement, securities, labour and taxation laws in order to harmonise them with EU laws. While the EU Directives have become an integral part of Croatia's legal system, and a significant number of the EU regulations have already been implemented in Croatian law, the Croatian legal system still remains in transition and is therefore subject to greater risks and uncertainties than a more mature legal system. In particular, risks associated with the Croatian legal system include: (i) potential inconsistencies between and among the Constitution and various laws, governmental, ministerial and local orders, decisions, resolutions and other acts; (ii) provisions in the laws and regulations that are ambiguously worded or lack specificity and thereby raise difficulties when implemented or interpreted; (iii) difficulty in predicting the outcome of judicial application of Croatian legislation; and (iv) the fact that not all Croatian resolutions, orders and decrees and other similar acts are readily available to the public or available in an understandable, organised form.



These and other factors that may impact Croatia's legal system lead to an investment in the Notes being subject to greater risks and uncertainties than an investment in a company located in a country with a more mature legal system.

***The uncertainties relating to the Croatian judicial system could have a negative effect on the economy and thus on the Group's business, results of operations and financial condition.***

The independence of the judicial system and its immunity from economic and political interference in Croatia remains questionable. The application and interpretation of Croatia's Constitution remains complicated and, accordingly, it is difficult to ensure smooth and effective resolution of discrepancies between Croatia's Constitution and applicable Croatian legislation on the one hand and among various laws of Croatia on the other hand.

The court system is underfunded compared to more mature jurisdictions. As Croatia is a civil law jurisdiction, judicial decisions under Croatian law generally have no precedential effect and the courts are generally not bound by earlier court decisions taken under the same or similar circumstances. This may result in an inconsistent application of Croatian legislation to resolve the same or similar disputes. Because legislation in a number of areas was adopted following independence and is still fairly recent, relevant judicial decisions may not be publicly available and, therefore, the role of judicial decisions as guidelines in interpreting applicable Croatian legislation to the public at large may be generally limited.

In 2008, the Republic commenced a reform of the judicial system. Despite these efforts, judicial decisions in Croatia remain difficult to predict. In addition, court orders are not always enforced or followed by law enforcement institutions. The uncertainties of the Croatian judicial system could have a negative effect on the economy and thus on the Group's business, results of operations and financial condition.

***Croatia's official economic data may not be accurate and could be revised.***

Although a range of government ministries including the Ministry of Finance, along with the CNB and the Croatian Bureau of Statistics (the "CBS"), produce statistics on Croatia and its economy, there can be no assurance that these statistics are as accurate or as reliable as those compiled by other bodies, or in other countries, which use different methodologies. Prospective investors should be aware that figures relating to Croatia's GDP and many other aggregate figures cited in this Offering Circular may differ from figures prepared by international bodies, such as the International Monetary Fund (the "IMF"), which may use different methodologies. The statistical information presented herein is based on the latest official information currently available from the stated source. The development of statistical information relating to Croatia is, however, an ongoing process and revised figures and estimates are produced on a regular basis. Figures presented may be subject to rounding and GDP figures are initially provisional. In addition, the existence of an unofficial and unobserved economy may affect the accuracy and reliability of statistical information. Prospective investors should be aware that none of the statistical information in this Offering Circular has been independently verified.

## **Risks Related to the Notes**

***The Notes may not be a suitable investment for all investors.***

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Offering Circular or any applicable supplement;

- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments is different from the potential investor's currency;
- (iv) understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant financial markets; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

The Notes are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in the Notes unless it has the expertise (either alone or with a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of the Notes and the impact this investment will have on the potential investor's overall investment portfolio.

***Redemption prior to maturity.***

The Issuer may redeem all outstanding Notes in accordance with the Conditions of the Notes in the event that the Issuer has been or would become obligated to pay additional amounts as a result of certain changes in tax laws or their interpretation and such obligation cannot be avoided by the Issuer taking reasonable measures available to it.

On any such redemption, Noteholders would receive the principal amount of the Notes that they hold, together with interest accrued on those Notes up to (but excluding) the date fixed for redemption. The redemption at the option of the Issuer may affect the market value of the Notes. During any period when the Issuer may elect to redeem the Notes, the market value of the Notes generally will not rise substantially above the price at which they can be redeemed. In addition, it may not be possible to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes. See *"Terms and Conditions of the Notes—Redemption and Purchase-Redemption for Taxation Reasons"*.

***The Issuer may not be able to finance certain mandatory redemptions required by the Conditions of the Notes.***

Upon the occurrence of a Change of Control (as defined in *"Terms and Conditions of the Notes—Redemption and Purchase—Redemption at the Option of the Noteholders upon a Change of Control"*) or an Ownership Unbundling Event (as defined in *"Terms and Conditions of the Notes—Redemption and Purchase—Redemption at the Option of the Noteholders upon an Ownership Unbundling Event"*), the Issuer will be required to offer to repurchase all outstanding Notes at a purchase price in cash equal to (i) 101% of the principal amount of the Notes plus any accrued and unpaid interest, if any, in the case of a Change of Control and (ii) the principal amount of the Notes plus any accrued and unpaid interest, if any, in the case of an Ownership Unbundling Event, plus, in both cases, additional amounts, if any, to the date of the repurchase. If any such Change of Control or Ownership Unbundling Event were to occur, there can be no assurance that the Issuer would have sufficient funds available at the time to pay the price of the outstanding Notes or that restrictions in agreements governing other indebtedness would not restrict or prohibit such repurchases. The Change of Control or Ownership Unbundling Event may cause the acceleration of other indebtedness that may be senior to the Notes or rank equally with the Notes. In any case, the Issuer expects that it would require third

party financing to make a change of control offer. There can be no assurance that the Issuer would be able to obtain this financing.

***The Trustee may request Noteholders to provide an indemnity and/or security and/or prefunding to its satisfaction.***

In certain circumstances (including without limitation pursuant to Condition 16, the Trustee may (at its sole discretion) request Noteholders to provide an indemnity and/or security and/or prefunding to its satisfaction before it takes action on behalf of Noteholders. The Trustee shall not be obliged to take any such action if not indemnified and/or secured and/or prefunded to its satisfaction. Negotiating and agreeing an indemnity and/or security and/or prefunding can be a lengthy process and may impact on when such action can be taken. The Trustee may not be able to take action, notwithstanding the provision of an indemnity or security or prefunding to it, in breach of the terms of the Trust Deed and in circumstances where there is uncertainty or dispute as to the applicable laws or regulations and, to the extent permitted by the agreements and applicable law, it will be for the Noteholders to take such action directly.

***The conditions of the Notes contain modification and waiver provisions.***

The conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

The conditions of the Notes also provide that the Trustee may, without the consent of Noteholders, agree to (i) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of Notes or (ii) determine without the consent of the Noteholders that any Event of Default or potential Event of Default shall not be treated as such, in the circumstances described in Condition 14 of the Conditions of the Notes.

***The Issuer is not required to pay additional amounts on account of withholding pursuant to the Savings Directive.***

If any person by or through whom a payment on the Notes is made or received is required to withhold any amount from such payment as a consequence of or pursuant to EC Directive 2003/48/EC on the taxation of savings income (the “**Savings Directive**”) or any law implementing or complying with, or introduced in order to conform to, the Savings Directive, there is no requirement for the Issuer to pay any additional amounts on account of that withholding. In this regard, prospective Noteholders should read the information about the Savings Directive in the section entitled “*Taxation*” and consult their advisers.

***Noteholders’ rights may be adversely affected by a change of law.***

The conditions of the Notes are based on English law in effect at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Offering Circular.

***Croatian insolvency laws to which the Issuer is subject may not be as favourable to the holders of the Notes as U.S. or other insolvency laws.***

The Issuer is incorporated and organised under the laws of the Republic of Croatia. Any insolvency proceedings relating to the Issuer, even if brought in the United States, might involve Croatian insolvency laws, the procedural and substantive provisions of which may differ from comparable provisions of U.S. federal bankruptcy law. If the Issuer becomes insolvent, there is a risk that holders of Notes may not be able to fully enforce their rights under the Notes and that any claims may be considerably delayed. The Croatian insolvency laws may not be as favourable as insolvency laws in the United States or in any other jurisdiction with which the investors may be familiar.

***Investors may experience difficulties in enforcing foreign judgments under laws other than Croatian law, including under U.S. federal securities laws.***

The Issuer is a corporation organised under the laws of the Republic of Croatia. All of the officers and directors of the Issuer are residents of the Republic of Croatia and all or a substantial portion of the assets of the Issuer and its officers and directors are located in the Republic of Croatia. As a result, it may not be possible for an investor to effect service of process outside the Republic of Croatia upon the Issuer or such persons, or to enforce any judgments against them obtained in courts outside the Republic of Croatia predicated upon civil liabilities of the Issuer or such directors and officers under laws other than Croatian law, including any judgments predicated upon United States federal or state securities laws.

There is doubt as to the enforceability in Croatia of original actions, or actions for the enforcement of judgments of U.S. courts, of civil liabilities predicated solely upon the federal laws of the United States. Croatia is not a party to any multilateral or bilateral treaty by which the judgments of U.S. courts would be recognised and enforced, and Croatian courts have not established “factual reciprocity” with the U.S. courts. See “*Service of Process and Enforcement of Civil Liabilities.*”

***An active trading market for the Notes may not develop.***

The Notes may not have an established trading market when issued and the Issuer cannot assure investors that an active trading market for the Notes will develop or be maintained. In addition, there may be a limited number of buyers when an investor decides to sell the Notes, which can affect the price an investor receives for such Notes or the ability to sell such Notes at all. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Illiquidity may have a severely adverse effect on the market value of the Notes.

Furthermore, the Notes have not been, and will not be, registered under the Securities Act or any other applicable securities laws and are being offered pursuant to an exemption from the registration requirements of the Securities Act. Accordingly, the Notes are subject to certain transfer restrictions and will bear a legend regarding those restrictions. See “*Subscription and Sale*” and “*Notice to Purchasers and Holders of Notes and Transfer Restrictions.*” These restrictions may limit the ability of investors to resell the Notes.

***Investors may be exposed to exchange rate risks and exchange controls.***

The Issuer will pay principal and interest on the Notes in U.S. dollars. This presents certain risks relating to currency conversions if an investor’s financial activities are denominated principally in a currency or currency unit (the “**Investor’s Currency**”) other than U.S. dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of the U.S. dollar or depreciation of the Investor’s Currency) and the risk that authorities with jurisdiction over the Investor’s Currency may impose or modify exchange controls. An appreciation in the value of the Investor’s Currency relative to the U.S. dollar, would decrease (i) the Investor’s Currency-equivalent yield on the Notes, (ii) the Investor’s Currency-equivalent value of the principal payable on the Notes and (iii) the Investor’s Currency-equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

***Investors may be exposed to interest rate risks.***

Investment in Notes bearing interest at a fixed rate involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

***Any credit ratings assigned to the Issuer or the Notes may not reflect all the risks of an investment in the Notes.***

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised, suspended or withdrawn by the assigning rating agency at any time.

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by the European Securities and Markets Authority (“ESMA”) on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings is set out on the cover of this Offering Circular.

***Legal investment considerations may restrict certain investments.***

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (i) the Notes are legal investments for it, (ii) the Notes can be used as collateral for various types of borrowing and (iii) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

***Reliance on DTC, Euroclear and Clearstream, Luxembourg procedures.***

The Rule 144A Notes will be represented by the Restricted Global Certificate, which will be deposited with a nominee for DTC. Except in the circumstances described in the Restricted Global Certificate, investors will not be entitled to receive Notes in definitive form. DTC and its direct and indirect participants will maintain records of beneficial interests in the Restricted Global Certificate. While the Notes are represented by the Restricted Global Certificate, investors will be able to trade their beneficial interest only through DTC and its participants, including Euroclear and Clearstream, Luxembourg.

The Regulation S Notes will be represented by the Unrestricted Global Certificate, which will be deposited with a common depository for Euroclear and Clearstream, Luxembourg. Except in the circumstances described in the Unrestricted Global Certificate, investors will not be entitled to receive Notes in definitive form. Euroclear and Clearstream, Luxembourg and their respective direct and indirect participants will maintain records of beneficial interests in the Unrestricted Global Certificate. While the Notes are represented by the Unrestricted Global Certificate, investors will be able to trade their beneficial interest only through Euroclear and Clearstream, Luxembourg and their respective participants.

While the Notes are represented by the relevant Global Certificate(s), the Issuer will discharge its payment obligations under the Notes by making payments through the relevant clearing systems(s). A holder of a beneficial interest in a Global Certificate must rely on the procedures of the relevant clearing system and its participants to receive payments under the Notes. The Issuer has no

responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in any Global Certificate.

Holders of beneficial interests in a Global Certificate will not have a direct right to vote in respect of the Notes. Instead, such holders will be permitted to act only to the extent that they are enabled by the relevant clearing system and its participants to appoint appropriate proxies.

***The Notes may be delisted in the future.***

Application has been made to the Luxembourg Stock Exchange for the Notes to be listed on the Official List and admitted to trading on the regulated market of the Luxembourg Stock Exchange. The Notes may subsequently be delisted despite the best efforts of the Issuer to maintain such listing and, although no assurance is made as to the liquidity of the Notes as a result of listing, any delisting of the Notes may have a material effect on a Noteholder's ability to resell the Notes on the secondary market.

## OVERVIEW

**This Overview must be read as an introduction to this Offering Circular and any decision to invest in the Notes should be based on a consideration of this Offering Circular as a whole. This overview is indicative only, does not purport to be complete and is qualified in its entirety by the more detailed information appearing elsewhere in this Offering Circular. See in particular “Conditions of the Notes”.**

Words and expressions defined in “Conditions of the Notes” and “Business” shall have the same meanings in this Overview.

**“Issuer”** ..... Hrvatska Elektroprivreda d.d. was established on 9 August 1990 as a public enterprise and was converted into a joint stock company in 1994 under the laws of Croatia as a joint stock company with unlimited duration. HEP is 100% owned by the Republic of Croatia, represented by the Ministry of Economy and is registered in the Court’s Register administered by the Commercial Court in Zagreb with identification numbers MBS: 080004306 and OIB: 28921978587. At 30 June 2015, HEP had a registered share capital of HRK 19,792,159,200. The registered office is Ulica grada Vukovara 37, Zagreb, Republic of Croatia with telephone number +385 1 6322 111.

**“Description of Notes”** ..... U.S.\$550,000,000 5.875% Notes due 2022 (the “Notes”), to be issued by the Issuer on or about 23 October 2015 (the “Issue Date”).

**“Currency”** ..... U.S. dollars.

**“Final Redemption and Maturity Date”** ..... Unless previously redeemed in accordance with Condition 7 of the Conditions of the Notes, the Notes will be redeemed at their principal amount on 23 October 2022, (the “Maturity Date”).

**“Yield”** ..... 6.125%

**“Risk Factors”** ..... An investment in the Notes involves risks. Such risks include, but are not limited to, the risk factors summarised below and certain other risk factors relating to the Notes are set out in full in “Risk Factors”. The Issuer is or may be exposed to some or all of the risks described in the section “Risk Factors” in its future operations. Any of these risk factors, as well as additional risks of which the Issuer is not aware, could also affect the business operations of the Issuer.

Investors should read carefully the risks described below and in more detail in “Risk Factors” and all of the information contained in this Offering Circular before deciding whether or not to purchase any Notes. The order in which these risks are presented is not intended to provide an indication of the likelihood of their occurrence or of their severity or significance. The risk factors summarised below and certain other risk factors relating to the Notes are described more fully in “Risk Factors”.

This Offering Circular also contains forward-looking

	statements that are subject to future events, risks and uncertainties. The actual outcome could differ materially from the outcome anticipated in these forward-looking statements as a result of many factors, including but not limited to the risks described below and elsewhere in this Offering Circular. See “ <i>Forward-looking statements</i> ”.
<b>“Joint Lead Managers”</b> .....	Banca IMI, S.p.A.  Morgan Stanley & Co. International plc  UniCredit Bank AG.
<b>“Trustee”</b> .....	Deutsche Trustee Company Limited.
<b>“Principal Paying Agent and Transfer Agent”</b> .....	Deutsche Bank AG, London Branch.
<b>“Registrars, Paying Agents and Transfer Agents”</b> .....	<i>In respect of the Rule 144A Notes:</i> Deutsche Bank Trust Company Americas.  <i>In respect of the Regulation S Notes:</i> Deutsche Bank Luxembourg S.A.
<b>“Interest”</b> .....	The Notes will bear interest from and including the Issue Date at the rate of 5.875% per annum, payable semi-annually in arrear on 23 April and 23 October in each year. The first payment (for the period from and including the Issue Date to but excluding 23 April 2016 and amounting to U.S.\$29.375 per U.S.\$1,000 principal amount of Notes) shall be made on 23 April 2016.
<b>“Redemption for Taxation Reasons”</b> ...	The Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time (subject to certain conditions), at their principal amount (together with interest accrued to the date fixed for redemption) if, as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 8), or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 23 October 2015, on the next Interest Payment Date the Issuer would be required to pay additional amounts as provided or referred to in Condition 8 and the requirement cannot be avoided by the Issuer taking reasonable measures available to it.
<b>“Redemption at the option of the Noteholders upon a Change of Control”</b> .....	If at any time a Change of Control occurs, each Noteholder shall have the option to give notice requiring the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Noteholder’s Note(s) at 101% of the principal amount of the Note(s) together with interest (if any) accrued to (but excluding) the Change of Control Put Date.
<b>“Redemption at the Option of the Noteholders upon an Ownership</b>	If at any time an Ownership Unbundling Event (as defined in Condition 7) occurs, each Noteholder shall have the



<b>Unbundling Event”</b> .....	option to give notice requiring the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Noteholder’s Note(s) at the principal amount of the Note(s) together with interest (if any) accrued to (but excluding) the Ownership Unbundling Event Put Date.
<b>“Events of Default”</b> .....	Events of Default under the Notes include non-payment of principal or premium for 7 days, non-payment of interest for 14 days, breach of other obligations under the Notes or the Trust Deed (which breach is not remedied within 30 days), cross default and certain events related to insolvency or winding up of the Issuer or any Material Subsidiary (as defined in Condition 4).
<b>“Covenants-Negative Pledge”</b> .....	See Condition 4 of the Conditions of the Notes.
<b>“Status of the Notes”</b> .....	The Notes will constitute direct, general, unsubordinated, unconditional and (subject to the provisions of Condition 4 of the Conditions of the Notes) unsecured obligations of the Issuer and will rank <i>pari passu</i> amongst themselves and at least <i>pari passu</i> in right of payment, without preference among themselves, with all other unsecured and unsubordinated obligations of the Issuer, present and future, but, in the event of insolvency, only to the extent permitted by applicable laws relating to creditors’ rights.
<b>“Meetings of Noteholders”</b> .....	The Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.
<b>“Modification and Waiver”</b> .....	The Trustee may agree, without the consent of Noteholders, to any modification of (subject to certain exceptions), or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of Notes in the circumstances and subject to the conditions described in Condition 14 of the Conditions of the Notes.
<b>“Withholding Tax and Additional Amounts”</b> .....	All payments of principal and interest in respect of the Notes made by or on behalf of the Issuer shall be made without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatsoever nature imposed or levied by or on behalf of the Relevant Jurisdiction (as defined in Condition 8), unless such withholding or deduction is required by law. In that event, the Issuer shall pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been received in the absence of the withholding or deduction, except that no such additional amounts shall be payable in the circumstances described under Condition 8 of the Conditions of the Notes.

<b>“Listing, approval and admission to trading”</b> .....	<p>Application has been made to the CSSF to approve this document as a prospectus and to the Luxembourg Stock Exchange for the listing of the Notes on the Official List of the Luxembourg Stock Exchange and admission to trading on the Luxembourg Stock Exchange’s regulated market. The Notes are expected to be listed on or around 23 October 2015.</p>
<b>“Governing Law”</b> .....	<p>The Notes, and any non-contractual obligations arising out of or in connection therewith, will be governed by, and construed in accordance with, English law. See Condition 18 of the Conditions of the Notes.</p>
<b>“Form, Transfer and Denominations”</b> .....	<p>The Notes will be issued in registered form in minimum denominations of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof. The Notes will initially be represented by two global certificates in registered form, one of which will be issued in respect of the Notes offered and sold in reliance on Rule 144A, the Restricted Global Certificate, and the other of which will be issued in respect of the Notes offered and sold in reliance on Regulation S, the Unrestricted Global Certificate. The Unrestricted Global Certificate will be in registered form, without interest coupons attached, will be delivered to a common depositary for, and registered in the name of BT Globenet Nominees Limited as common nominee of, Euroclear and Clearstream, Luxembourg. The Restricted Global Certificate will be in registered form, without interest coupons attached, will be deposited with a custodian for, and registered in the name of Cede &amp; Co. as nominee for, DTC. Except in limited circumstances, certificates for Notes will not be issued in exchange for beneficial interests in the Global Certificates. See Condition 2 of the Conditions of the Notes.</p> <p>Interests in the Rule 144A Notes will be subject to certain restrictions on transfer. See “<i>The Global Certificates</i>” and “<i>Transfer Restrictions</i>”. Interests in the Global Certificates will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg, in the case of the Regulation S Notes, and by DTC and its direct and indirect participants, in the case of Rule 144A Notes.</p>
<b>“Credit Ratings”</b> .....	<p>The Notes are expected to be assigned on issue a rating of Ba2 by Moody’s and BB– by S&amp;P. Each of Moody’s and S&amp;P is established in the EU and is registered under the CRA Regulation. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Neither the assigning rating agency nor the Issuer is obliged to provide the holders of the Notes with any notice of any suspension, change or withdrawal of any rating.</p> <p>S&amp;P is established in the EU, domiciled in the United</p>

	Kingdom and is included in the list of credit rating agencies registered in accordance with Regulation (EC) No. 1060/2009. Moody's is established in the EU, domiciled in the United Kingdom and is included in the list of credit rating agencies registered in accordance with Regulation (EC) No. 1060/2009. This list is available on the ESMA website ( <a href="http://www.esma.europa.eu/page/list-registered-and-certified-CRAs">http://www.esma.europa.eu/page/list-registered-and-certified-CRAs</a> ) (last updated 12 December 2014).
<b>“Selling Restrictions”</b> .....	The Notes have not been nor will be registered under the Securities Act or any state securities laws and may not be offered or sold within the United States or to, or for the account or benefit of, any U.S. person (as defined in Regulation S under the Securities Act), except to qualified institutional buyers in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A or otherwise pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. The Notes may be sold in other jurisdictions (including Croatia and Member States of the European Economic Area) only in compliance with applicable laws and regulations. See “ <i>Subscription and Sale</i> ” below.
<b>“Use of Proceeds”</b> .....	The net proceeds of the offering of Notes will be used to finance the Tender Offer. The remaining proceeds will be used for general corporate purposes, as set out in “ <i>Use of Proceeds</i> ”.
<b>“Regulation S Security Codes”</b> .....	<ul style="list-style-type: none"> <li>• ISIN: XS1309493630</li> <li>• Common Code: 130949363</li> </ul>
<b>“Rule 144A Security Codes”</b> .....	<ul style="list-style-type: none"> <li>• ISIN: US443293AB13</li> <li>• Common Code: 131093179</li> <li>• CUSIP: 443293AB1</li> </ul>
<b>Operating and Other Information</b>	
<b><i>Operating overview</i></b>	
<p>According to the most recent Annual Energy Report of the Ministry of Economy for 2013, the Group is the leading power generation, transmission, distribution and supply company in Croatia. The Group is a vertically integrated power utility company, operating across the entire electricity market spectrum from generation to end-consumer distribution organisation. As part of its operations, the Group is also engaged in, <i>inter alia</i>, thermal energy (heat) generation, distribution and supply, gas distribution and supply on the wholesale and retail markets in Croatia, as well as in electricity trading. The Group operates under the trading name “HEP”.</p> <p>According to Management's estimates, the Group accounted for approximately 84% of electricity generated, approximately 92% of installed electricity generation capacity, 100% of electricity distribution (in terms of the number of connection points) and approximately 85% of all electricity sold in Croatia in the year ended 31 December 2014.</p>	

In order to comply with EU regulation, the Group has implemented legal, financial, accounting, IT and managerial barriers between its subsidiaries engaging in regulated activities, such as transmission and distribution, and those engaging in other activities, such as generation and supply (“**unbundling**”). Each company within the Group is tasked with specific roles within the various energy segments of the market. The Group comprises 15 wholly owned subsidiaries and one jointly controlled power plant. The power plant is the Krško nuclear power plant (NPPK), located in the Republic of Slovenia and co-owned with Gen Energija (“**GenE**”). In addition, HEP jointly owns, together with Plinacro d.o.o., LNG Hrvatska d.o.o. (“**LNG Hrvatska**”), which joint venture was formed for the purpose of developing a liquefied natural gas regasification terminal in Omišalj on the island of Krk, Croatia.

Electricity, thermal energy and gas consumption is seasonal and is mainly affected by weather conditions. In Europe electricity consumption is generally higher during the summer and winter months, and the Group is generally affected by these trends in customer consumption.

### ***Financial Overview***

In the years ended 31 December 2012, 2013 and 2014 and the six months ended 30 June 2015 the Group had a total operating income of HRK 14,024,630 thousand, HRK 14,709,185 thousand, HRK 13,599,174 thousand and HRK 7,143,902 thousand, respectively, loss for the year ended 31 December 2012 of HRK 43,941, and profit for the years ended 31 December 2013 and 2014 of HRK 1,267,874 thousand, HRK 2,465,424 thousand and for the six months ended 30 June 2015 profit of HRK 1,345,146 thousand.

At 31 December 2014 and 30 June 2015, the Group had total assets of HRK 35,856,718 thousand and HRK 35,751,984 thousand, respectively. At 31 December 2014 and 30 June 2015, the Group had approximately 12,061 employees and 12,000 employees, respectively.

### ***Principal Activities***

The Group’s principal activities are the generation, transmission, distribution and supply of electricity.

#### ***Generation***

The Group operates a portfolio of power generation assets with an aggregate installed capacity of 4,232 MW at 31 December 2014. The Group’s electricity and thermal energy generation operations are carried out by HEP-Proizvodnja d.o.o. (“**HEP-Generation**”), a wholly owned subsidiary of HEP established on 17 June 2002, which is responsible for the generation of electricity and thermal (heat) energy.

The Group benefits from a diversified generation mix, which includes 26 hydro power plants with an aggregate total installed capacity of 2,214 MW and the NPPK which has 696 MW of installed capacity (of which 348 MW is allocated to the Group). The Group’s generation mix also includes eight thermal power plants (including TE Sisak and TE Rijeka which are currently not operating) with total installed capacity of 1,670 MW, of which 482 MW is natural gas, 892 MW is oil and 297 MW is coal. The Group uses its oil-fired thermal power plants primarily to meet high electricity demand or during adverse weather conditions, such as prolonged dry periods, during which the hydro power plants are not operating at full capacity.

The following chart shows the Group's electricity generation mix for the year ended 31 December 2014 and for the six months ended 30 June 2015:

	For the year ended 31 December 2014		For six months ended 30 June 2015	
	GWh	%	GWh	%
<i>Electricity Generation:</i>				
Hydro power plants .....	8,356	58.5	3,625	58.3
Nuclear power plant .....	3,030	21.2	1,192	19.2
Thermal power plants .....	2,891	20.3	1,395	22.5
<b>Total:</b> .....	<b>14,277</b>	<b>100</b>	<b>6,212</b>	<b>100</b>

#### *Transmission*

Further to the Accession and in order to comply with the Third Energy Package and the Electricity Market Act the Group was required to conduct the unbundling of the Group's transmission operations from the generation and supply operations. HEP opted for the independent transmission operator ("TTO") model of unbundling, which prescribes that the transmission system operator ("TSO") shall be equipped with all human, technical, physical, financial and IT resources necessary for fulfilling their obligations and carrying out the activity of electricity transmission. In particular, assets that are necessary for the activity of electricity transmission (including the transmission system) shall be owned by the TSO, and personnel necessary for the performance of electricity transmission (including all corporate tasks) shall be employed by the TSO. As of 2 July 2013 the Group's transmission operator, HEP-Operator prijenosnog sustava d.o.o., was renamed to Hrvatski operator prijenosnog sustava d.o.o. ("HOPS") and restructured to ensure legal, financial, accounting, IT and managerial independence from the Group's generation and supply operations. The unbundling process of HOPS has not been completed and the Group is awaiting the required approval and certification of HERA and the European Commission. For more information, see "*Regulation—Third Energy Package*" and "*Risk Factors—The Group's restructuring required under EU energy laws has not yet been completed*".

HOPS is the sole operator of the Croatian electricity transmission system and is responsible for its maintenance, development and further construction costs. HOPS transfers electricity produced by Croatian power plants or imported from other countries to its Croatian customers and transfers Croatian-produced electricity for export purposes and non-HEP generated electricity to the Non-Tariff Customers from other Market Suppliers. See "*Business—Overview—Tariff System and Classification of Customers*" below for further details. At 30 June 2015 HOPS operated 7,648 kilometres of 400/220/110 kV lines and 173 accompanying sub-stations across Croatia.

#### *Distribution*

The Group's distribution operations transfer electricity through its distribution network from sub-stations to electricity suppliers, including the Group's competitors. The Group's electricity distribution operations are run by HEP-Operator distribucijskog sustava d.o.o. ("HEP-ODS"), a wholly owned subsidiary of HEP established on 13 June 2002. HEP-ODS is also responsible for providing the Group's services to the Tariff Customers, and, moreover, pursuant to the Electricity Market Act HEP-ODS acts as the sole supplier of electricity to the Tariff Customers in Croatia. See "*Business—Overview—Tariff System and Classification of Customers*" below for further details.

In the year ended 31 December 2014 the Group distributed a total of approximately 14,183 GWh of electricity in Croatia and at 31 December 2014 the Group had a market share of 100% for the distribution of electricity and public supply services to the Tariff Customers in Croatia.

#### *Supply*

The Group supplies the Non-Tariff Customers with electricity through HEP Opskrba d.o.o. ("HEP-Supply"), a wholly owned subsidiary of HEP established on 20 January 2003.

While there is no competition for the Tariff Customers, competition for the Non-Tariff Customers has significantly increased as a result of the Accession and liberalisation of the electricity supply market in Croatia and further intensified as a result of a significant decrease of electricity prices in the Croatian wholesale market during the second quarter of 2013.

In the year ended 31 December 2014 the Group sold 12,908 GWh of electricity to end-consumers in Croatia. Due to the liberalisation of the Croatian energy market and subsequent entry of competitors into such market, the Group has seen an increase in competition in electricity supply to the Non-Tariff Customers in the recent years. According to Management's estimates, the Group's share of the electricity sold to end-consumers in Croatia was 98.6%, 95.5% and 86.8% for the years ended 31 December 2012, 2013 and 2014, respectively, and 85.1% for the six months ended 30 June 2015. In order to prevent any further loss of market share in electricity supply to the Non-Tariff Customers, the Group is currently focusing on a number of supply projects, such as offering new products and energy services to its customers, including renewable energy products, introducing electronic billing and online payment options, tailoring the pricing plans to the individual customer's needs and emphasising customer relations as being at the forefront of its operations.

#### ***Other Activities***

The Group also has a trading platform in electricity, thermal and gas operations and other ancillary businesses related to energy services.

#### ***Trading***

The Group's trading platform, HEP-Trgovina d.o.o. ("**HEP-Trade**"), a wholly owned subsidiary of HEP established on 30 October 2006, buys and sells electricity and is responsible for the optimisation of the Group's power plant operation and intermediation in the domestic and international markets. The Group operates in the wholesale electricity market in Croatia and abroad, through its local balance groups (Austria, Hungary, Slovenia, Germany) and HEP-Trade's subsidiaries located in Hungary, Bosnia and Herzegovina, Serbia, Slovenia and Kosovo. HEP-Trade also operates in the retail electricity market in Slovenia through its subsidiary, HEP Energija d.o.o. Ljubljana, as well as gas trading on wholesale market, trading green certificates and CO<sub>2</sub> emissions allowances.

### *Thermal Energy (heat)*

In addition to electricity, the Group is actively engaged in thermal energy generation, distribution and supply through HEP-Toplinarstvo d.o.o. (“**HEP-Top**”), a wholly owned subsidiary of HEP established on 18 May 2001. At 31 December 2014, the Group had a total installed capacity of 2,137 MW<sub>heat</sub>. Thermal energy is primarily generated as a by-product of electricity generation at the Group’s thermal power plants and is distributed to the cities of Zagreb, Osijek, Sisak, Zaprešić, Velika Gorica and Samobor. At 31 December 2014 the Group distributed thermal energy to more than 124,000 customers covering approximately 80% of the district heating market in Croatia, making the Group the largest of 19 distributors of thermal energy in the country (according to the most recent report of HERA, for 2014). In the year ended 31 December 2014 the Group distributed a total of approximately 1,859 GWh\* of thermal energy to end-consumers in Croatia.

	For the year ended 31 December 2014		For six months ended 30 June 2015	
	GWh	%	GWh	%
<i>Thermal Energy Generation:</i>				
Thermal Power Plants .....	2,058	92.8	1,237	92.2
District Boiler Stations <sup>(1)</sup> .....	159	7.2	105	7.8
<b>Total:</b> .....	<b>2,217</b>	<b>100</b>	<b>1,342</b>	<b>100</b>

(1) Stations for distributing thermal energy generated in a centralised location for residential and commercial heating requirements.

### *Gas-Wholesale*

Pursuant to the decision of the Croatian Government, HEP was chosen as the sole supplier to the Croatian wholesale gas market for the period from 1 April 2014 until 31 March 2017. HEP Opskrba plinom d.o.o. (“**HEP Gas Supply**”), a wholly owned subsidiary of HEP established on 5 May 2014, acts as an agent for HEP and performs HEP’s obligations (i) to distribute gas under regulated terms to suppliers in Croatia for further sale to household customers and (ii) to ensure a reliable and safe gas supply in Croatia. HEP entered into gas supply/sales agreements with 35 companies (public service suppliers), including its subsidiary HEP-Plin d.o.o. (“**HEP-Plin**”). HEP also entered into gas procurement contracts with two companies, a transmission system operator and a storage system operator. In the year ended 31 December 2014 the Group distributed a total of approximately 3,022 million GWh (or 315 million m<sup>3</sup>) of gas on wholesale market.

### *Gas-Retail*

The Group is also engaged in gas distribution and supply in the retail market through HEP-Plin, a wholly owned subsidiary of HEP established on 5 June 2001. In the year ended 31 December 2014 the Group distributed a total of approximately 1,114 GWh (or 115 million m<sup>3</sup>) of gas to end-consumers in Croatia and according to Management’s estimates, at 31 December 2014 the Group had a market share of approximately 10.5% for the distribution and supply of gas in retail market.

### *Other*

The Group’s other businesses involve the preparation, construction and use of renewable energy sources (including wind, biofuel, small hydro and geothermal water), energy efficiency projects, environmental protection, tourism and hospitality services, infrastructure and entrepreneurial projects and training and education services. The revenues of these other companies account for less than 0.5 % of the Group’s profit for the year ended 31 December 2014.

\* The quantity of thermal energy generated is different to the quantity distributed to end-consumer as a result of network losses. Losses totalled 358 GWh for the year ended 31 December 2014.

### ***Tariff System and Classification of Customers***

The energy sector has been fully liberalised since 2008. Nevertheless, certain activities, including transmission, distribution and public supply of electricity and the distribution of thermal energy and gas, are regulated activities. Such regulated activities are subject to fixed tariff rates which are set by HERA. The Group's customers in Croatia can be split between "**Commercial Customers**", which includes commercial and industrial entities, and "**Households**", which are residential customers. As part of its Accession process, the Croatian Government has adopted EU regulations for the energy market which allow, pursuant to the Electricity Market Act all electricity customers to choose a Market Supplier which offers non-tariff based rates, rather than remaining with the public supply system (see "*Regulation—Accession of the Republic of Croatia to the EU*" for further details). Customers who choose a Market Supplier typically pay lower rates than the tariffed rates under the public supply system, but they may be more exposed to price fluctuations in market rates. In the event that a customer fails to choose a Market Supplier or its contract with a Market Supplier is terminated, such customer will be supplied by the public supply system within the universal service (for Households) or within guaranteed supply (Commercial Customers). Customers who are supplied through the public supply system are referred to as Tariff Customers and customers who are supplied by Market Suppliers (including HEP-Supply (as defined below)) are referred to as Non-Tariff Customers".

### **Strengths and Strategy**

#### ***The Group's key strengths***

The Group has a number of key competitive strengths, which it believes benefit its current market position and provide an opportunity for future growth.

- *Vertically integrated power utility with economies of scale*
- *Leading position in Croatian electricity, gas and thermal energy markets*
- *Stable and predictable revenue stream*
- *Favourable and diversified power generation mix with access to low-cost generation facilities*
- *Strong commitment to social policies*

#### ***Strategy***

The Group's overarching goal is to improve profitability and increase generation capacity in Croatia in the medium term, primarily in order to achieve self-sufficiency without a need for power imports. The Group intends to achieve these goals through the following key strategies:

- *Improve operating efficiencies and cost structure*
- *Construct new generation facilities and expand generation capacity of its existing assets*
- *Improve customer service experience and introduce new services*
- *Expand business operations into regional markets*
- *Improve and expand its distribution and transmission network*
- *Expand use of renewable energy sources*



## SELECTED FINANCIAL INFORMATION

The following tables set forth, for the periods indicated, selected consolidated financial information of the Issuer and its subsidiaries derived from the Annual Financial Statements and the Interim Financial Statements included elsewhere in this Offering Circular.

Prospective investors should read the following information in conjunction with the Annual Financial Statements and the Interim Financial Statements.

The financial information at and for the years ended 31 December 2012 and 31 December 2013 in the Annual Financial Statements have been restated for comparative purposes due to the transfer of electricity facilities from HAC, the reclassification of the Issuer's joint venture in NPPK as a "joint operation" based on adoption of the new IFRS 11 "Joint Arrangements" and the revaluation of the net asset value of the thermal power plants. For more information, please see "*Risk Factors—Risks Related to the Group's Business— The Group may have material weaknesses in its accounting and reporting systems and the internal controls relating to the preparation of IFRS financial statements*", "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Restatement of the Annual Financial Statements*" and Note 3 "Restatements" to the Annual Financial Statements.

### Consolidated Statement of Comprehensive Income Data

	Year ended 31 December			Six months ended 30	
				June	
	2012	2013	2014	2014	2015
	(Restated)	(Restated)			
				(Unaudited)	
	(HRK thousands)				
Revenue from electricity sales.....	11,630,275	11,947,939	10,575,290	5,236,859	5,244,063
Revenue from thermal power sales.....	585,485	763,461	671,946	374,844	389,556
Revenue from gas sales on wholesale market ...	—	—	689,575	155,879	789,773
Revenue from gas sales to customers.....	395,956	406,167	371,490	181,557	220,291
Other operating income.....	1,412,914	1,591,618	1,290,873	544,190	500,219
<b>Total operating income.....</b>	<b>14,024,630</b>	<b>14,709,185</b>	<b>13,599,174</b>	<b>6,493,329</b>	<b>7,143,902</b>
Electricity purchase cost .....	(3,085,280)	(1,942,301)	(1,200,023)	(481,639)	(774,794)
Fuel cost .....	(3,434,478)	(2,734,741)	(1,777,077)	(986,482)	(976,073)
Costs of gas sold .....	—	—	(717,721)	(165,663)	(808,823)
Staff cost.....	(1,990,410)	(1,868,718)	(1,880,519)	(901,948)	(942,642)
Depreciation and amortisation costs.....	(1,855,158)	(1,883,970)	(1,897,190)	(933,853)	(922,212)
Other operating expenses.....	(3,396,984)	(3,943,827)	(2,926,195)	(1,241,176)	(1,207,581)
<b>Total operating expenses.....</b>	<b>(13,762,310)</b>	<b>(12,373,557)</b>	<b>(10,398,725)</b>	<b>(4,710,761)</b>	<b>(5,632,125)</b>
<b>Operating profit .....</b>	<b>262,320</b>	<b>2,335,628</b>	<b>3,200,449</b>	<b>1,782,568</b>	<b>1,511,777</b>
Financial income.....	69,398	64,434	433,671	76,294	423,584
Financial expenses .....	(355,317)	(875,370)	(556,577)	(162,861)	(239,547)
<b>Net profit/(loss) from financial activities .....</b>	<b>(285,919)</b>	<b>(810,936)</b>	<b>(122,906)</b>	<b>(86,567)</b>	<b>184,037</b>
<b>Profit/(loss) before taxation.....</b>	<b>(23,599)</b>	<b>1,524,692</b>	<b>3,077,543</b>	<b>1,696,001</b>	<b>1,695,814</b>
Corporate income tax expense.....	(20,342)	(256,818)	(612,119)	(373,039)	(350,668)
<b>Profit/(loss) for the period .....</b>	<b>(43,941)</b>	<b>1,267,874</b>	<b>2,465,424</b>	<b>1,322,962</b>	<b>1,345,146</b>

## Consolidated Statement of Financial Position Data

	At 31 December			At 30 June
	2012 (Restated)	2013 (Restated)	2014	2015 (Unaudited)
	(HRK thousands)			
Total non-current assets .....	30,485,794	30,701,947	30,779,159	31,121,725
Total current assets .....	4,039,872	3,869,493	5,077,559	4,630,259
Total assets .....	34,525,666	34,571,440	35,856,718	35,751,984
Total equity .....	18,579,891	19,845,562	22,077,573	23,418,163
Long-term loan liabilities .....	1,894,864	1,722,010	1,262,036	1,081,637
Long-term liabilities to the state .....	27,544	24,451	21,690	20,245
Long-term provisions .....	686,333	808,382	902,779	924,041
Liabilities under issued bonds .....	3,335,608	3,278,893	3,194,986	3,116,606
Other long-term liabilities .....	4,912,601	5,038,526	4,499,502	4,445,408
Deferred tax liabilities .....	1,511	654	13,573	13,573
Total non-current liabilities .....	10,858,461	10,872,916	9,894,566	9,601,510
Total current liabilities .....	5,087,314	3,852,962	3,884,579	2,732,311
Total equity and liabilities .....	34,525,666	34,571,440	35,856,718	35,751,984

## Consolidated Statement of Cash Flow Data

	Year ended 31 December			Six months ended 30 June	
	2012 (Restated)	2013 (Restated)	2014	2014	2015 (Unaudited)
	(HRK thousands)				
Net cash from operating activities .....	2,112,632	2,804,728	4,173,736	1,853,320	1,287,876
Net cash used in investing activities .....	(2,823,545)	(2,318,338)	(2,029,668)	(692,328)	(894,342)
Net cash from/(used) in financing activities .....	908,871	(830,627)	(1,325,012)	(708,658)	(296,848)

## Other Financial Data

Adjusted EBITDA and Adjusted EBITDA Margin are supplemental measures of performance and liquidity that are not required by or presented in accordance with IFRS. Furthermore, Adjusted EBITDA and Adjusted EBITDA Margin should not be considered as alternatives to profit/(loss) before tax, profit/ (loss) for the year or any other performance measures derived in accordance with IFRS or as alternatives to cash flow from operating activities, as measures of liquidity or as measures of cash available to invest in the growth of a business. The Group's use of the term Adjusted EBITDA may vary from others' in the same industry.

	Year ended 31 December			Six months ended 30 June	
	2012	2013	2014	2014	2015
	(Unaudited)				
	(HRK thousands)				
Profit/(loss) for the period .....	(43,941)	1,267,874	2,465,424	1,322,962	1,345,146
Financial expenses .....	355,317	875,370	556,577	162,861	239,547
Financial income .....	(69,398)	(64,434)	(433,671)	(76,294)	(423,584)
Corporate income tax expense .....	20,342	256,818	612,119	373,039	350,668
Depreciation and amortisation .....	1,855,158	1,883,970	1,897,190	933,853	922,212
Adjusted EBITDA <sup>(1)</sup> .....	2,117,478	4,219,598	5,097,639	2,716,421	2,433,989

	Year ended 31 December			Six months ended 30 June	
	2012	2013	2014	2014	2015
	%				
Adjusted EBITDA Margin <sup>(2)</sup> .....	15.1	28.7	37.5	41.8	34.1

(1) Adjusted EBITDA consists of profit for the period excluding financial expense, financial income, corporate income tax expense, depreciation and amortisation and impairment of long-lived assets.

- (2) Adjusted EBITDA Margin consists of profit for the period excluding financial expense, financial income, corporate income tax expense, depreciation and amortisation and impairment of long-lived assets, divided by total operating income, expressed as a percentage.

## USE OF PROCEEDS

The net proceeds of the offering of Notes will be used (i) to finance the purchase of U.S.\$ 416,852,000 of the outstanding U.S.\$500,000,000 6.00% notes due 2017 (the “**2017 Notes**”) issued by the Issuer on 9 November 2012 and validly tendered and accepted for purchase in accordance with the terms and conditions of the tender offer launched by the Issuer on 7 October 2015 pursuant to a tender offer memorandum of the same date, as supplemented (the “**Tender Offer**”) and (ii) for general corporate purposes.

## CAPITALISATION

The following table sets out the Group's capitalisation at 30 June 2015. Prospective investors should read this table together with the information under “*Management's Discussion and Analysis of Financial Condition and Results of Operations*” and the Group's Financial Statements.

	At 30 June 2015
	(Unaudited) (HRK thousands)
Long-term loan liabilities.....	1,081,637
Liabilities under issued bonds <sup>(1)</sup> .....	3,116,606
Current portion of long-term bonds.....	93,380
Current portion of long-term loans .....	385,004
<b>TOTAL DEBT</b> <sup>(2)</sup> .....	<b>4,676,627</b>
Share capital .....	19,792,159
Revaluation reserves .....	97,718
Retained earnings .....	3,528,286
<b>TOTAL EQUITY</b> .....	<b>23,418,163</b>
<b>TOTAL CAPITALISATION</b> .....	<b>28,094,790</b>

(1) Total liabilities under issued bonds in accordance with IFRS after the effect of the Tender Offer and the issue of the Notes is expected to be U.S.\$625,415 thousand, equivalent to HRK 4,197,998 thousand. Total liabilities under issued bonds in accordance with IFRS is expected to increase to U.S.\$625,415 thousand (equivalent to HRK 4,197,998 thousand) as compared to total liabilities under issued bonds of HRK 3,116,606 thousand at 30 June 2015, primarily as a result of (i) the repurchase of U.S.\$416,852 thousand of the outstanding 2017 Notes (equivalent of HRK 2,798,052 thousand), (ii) issuance of the Notes in the amount of U.S.\$550,000 thousand (equivalent of HRK 3,691,787 thousand), shown net of debt discount on issuance of 1.406%, equating to U.S.\$542,267 thousand (equivalent of HRK 3,639,880 thousand), which will be recorded in accordance with IFRS, and (iii) costs incurred by the Issuer in connection with the payment of the premium and accrued interest with respect to the tendered 2017 Notes in the aggregate amount of U.S.\$37,968 thousand (equivalent of HRK 254,856 thousand). The amounts in HRK are based on CNB midpoint exchange rate at 21 October 2015 (HRK 6.712340 per U.S.\$1).

In addition, the Issuer expects to receive EUR 30,939 thousand (equivalent to HRK 235,709 thousand) as a result of termination of the USD-EUR currency swap entered into by the Company in order to manage foreign currency exchange risk in connection with the 2017 Notes. The amount in HRK is based on CNB midpoint exchange rate at 21 October 2015 (HRK 7.618506 per EUR 1).

(2) Total debt does not include the Group's clearing debt liability towards the Republic of Croatia, which amounted to HRK 822,604 thousand at 30 June 2015. For more information, please see “*Risk Factors—Risks Related to the Group's Business—The Group has a clearing debt liability towards the Republic of Croatia, the status of which remains unclear pending the clarification of the European Commission.*”

Except as described above, there has been no material change in the consolidated capitalisation of the Group since 30 June 2015.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*This section includes certain information derived from the Issuer's Financial Statements. The following discussion should be read in conjunction with the Financial Statements and related notes which are annexed to this Offering Circular. The statements in this discussion regarding industry outlook, the Group's expectations regarding its future performance, liquidity and capital resources and other non-historical statements are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in the "Risk Factors" and "Forward-Looking Statements" sections of this Offering Circular. The Group's actual results may differ materially from those contained in, or implied by, any forward-looking statements.*

### Overview

According to the most recent Annual Energy Report of the Ministry of Economy for 2013, the Group is the leading power generation, transmission, distribution and supply company in Croatia. The Group is a vertically integrated power utility company, operating across the entire electricity market spectrum from generation to end-consumer distribution organisation. As part of its operations, the Group is also engaged in thermal energy (heat) generation, and gas distribution and supply on the wholesale and retail markets in Croatia, as well as in electricity trading. The Group operates under the trading name "HEP".

According to Management's estimates, the Group accounted for approximately 84% of electricity generated, approximately 92% of installed electricity generation capacity, 100% of electricity distribution (in terms of the number of connection points) and approximately 85% of all electricity sold in Croatia in the year ended 31 December 2014.

In order to comply with EU regulation, the Group has implemented legal, financial, accounting, IT and managerial barriers between its subsidiaries engaging in regulated activities, such as transmission and distribution, and those engaging in other activities, such as generation and supply (unbundling). Each company within the Group is tasked with specific roles within the various energy segments of the market. The Group comprises 15 wholly owned subsidiaries and one jointly controlled power plant. The power plant is the Krško nuclear power plant (NPPK), located in the Republic of Slovenia and co-owned with GenE. In addition, HEP jointly owns, together with Plinacro d.o.o., LNG Hrvatska, which joint venture was formed for the purpose of developing a liquefied natural gas regasification terminal in Omišalj on the island of Krk, Croatia.

Electricity, thermal energy and gas consumption is seasonal and is mainly affected by weather conditions. In Europe, electricity consumption is generally higher during the summer and winter months, and the Group is generally affected by these trends in customer consumption.

### Factors that Affect the Group's Results of Operations

#### *Tariffs*

A significant portion of the Group's revenue from electricity sales is derived from the regulated electricity tariff rates it charges its Tariff Customers (71.2% at 31 December 2014) with the remaining revenue derived from Non-Tariff Customers and other operations.

The Group's customers in Croatia can be split between "**Commercial Customers**", which include commercial and industrial entities, and "**Households**", which are residential customers. As part of its Accession process, the Croatian Government has adopted EU regulations for the energy market which allow, pursuant to the Electricity Market Act, all electricity customers to choose a Market Supplier which offers non-tariff based rates, rather than remaining with the public supply system (see "*Regulation—Accession of the Republic of Croatia to the EU*" for further details). Customers who choose a Market Supplier typically pay lower rates than the tariffed rates under the public supply system, but they may be more exposed to price fluctuations in market rates. In the event that a

customer fails to choose a Market Supplier or its contract with a Market Supplier is terminated, such customer will be supplied by the public supply system within the universal service (for Households) or within guaranteed supply (for Commercial Customers). Customers who are supplied through the public supply system are referred to as Tariff Customers” and customers who are supplied by Market Suppliers (including HEP-Supply (as defined below)) are referred to as Non-Tariff Customers.

Although certain increases in tariff rates have historically been approved by HERA at the Group’s request, tariff rates for electricity transmission and distribution have not changed since 2012. Even when approved, such increases have not always fully reflected the Group’s requests or have been granted following lengthy delays. Furthermore, tariff rates for public electricity supply within the universal service (for Households) and guaranteed supply (for Commercial Customers) were reduced by HERA effective 1 July 2015 due to the reduced purchase price of electricity and the reduced average market price.

The Group may also be unable to switch its operational focus between different products, such as electricity, thermal energy or gas, and must meet the existing demand of all Tariff Customers. At times, this means that the Group is required to supply its products with only a limited profit margin or at a significant loss, which could have an adverse impact on the Group’s financial performance and results of operations. The Group’s reserve margin (which is calculated as installed dependable generation capacity less peak load divided by peak load, shown as a percentage) has shown an increase over the period under review, from 33% in 2012, to 52% in 2013, 69% in 2014 and 70% in the first six months of 2015.

### ***Competition***

While there is currently no competition for Tariff Customers, competition for Non-Tariff Customers has significantly increased following the Accession and liberalisation of the electricity supply market in Croatia. According to the information published on HERA’s website, 22 Market Suppliers (three Market Suppliers are part of the Group) of electricity are registered and operating in Croatia. Currently, the Group competes primarily with RWE Energija, GEN-I and Proenergy, and the Group expects higher competition in the short to medium-term for Non-Tariff Customers. In the year ended 31 December 2014, the Group sold 12,908 GWh of electricity to end-consumers in Croatia of which 56.3% was sold to Commercial Customers (29.8% to high and medium voltage customers, predominantly industrial customers and 26.5% to low-voltage customers) and 43.7% to Households (low-voltage). According to Management’s estimates, the Group’s share of the electricity sold to end-consumers in Croatia was 98.6% in 2012, 95.5% in 2013, 86.8% in 2014 and 85.1% in the first six months of 2015.

In order to compete effectively, including retaining market share and profitability, the Group is offering new products and energy services to its customers, including renewable energy products, introducing electronic billing and online payment options, tailoring the pricing plans to the individual customer’s needs and emphasising customer relations as being at the forefront of its operations.

### ***Weather Conditions***

The Group’s electricity generation operations are materially impacted by weather conditions and commodity prices. Weather conditions, such as droughts or heat waves, can significantly reduce the hydro plants electricity generation, which typically represents between 31% and 59% of the Group’s total electricity generation based on historical trends over the last ten years. In 2011 and 2012, Croatia experienced long periods of drought and historically low water inflows, while in 2013 and 2014 the weather conditions were extremely favourable and the Group experienced high water inflows.

In addition, under EU regulations, generation of electricity through thermal power plants is subject to the increased costs associated with emissions allowances. Accordingly, during years in which weather conditions are sub-optimal for hydro-electric generation, the Group might be required to

switch its operations to less cost-effective production methods and could incur significant additional costs as a consequence of increased emissions.

In the year ended 31 December 2014, the Group generated 14,277 GWh of electricity, representing a decrease of 373 GWh, or 2.5%, from 14,650 GWh in the year ended 31 December 2013. In the year ended 31 December 2014, 8,356 GWh, or 58.5%, of the Group's total electricity was generated by hydro power plants, 3,030 GWh, or 21.2%, was generated by the NPPK and the remaining 2,891 GWh, or 20.2%, was generated by thermal power plants, compared with 8,054 GWh, or 55.0%, 2,518 GWh, or 17.2%, and 4,078 GWh, or 27.8%, respectively in the year ended 31 December 2013. Electricity generation in 2013 and 2014 remained relatively flat, with a slight decrease in electricity generation in 2014, primarily due to a decrease of 1,187 GWh, or 70.9%, in electricity generated by thermal power plants, as a result of the favourable hydrology, as well as an increase of 302 GWh, or 3.7%, in hydro electricity generation. This overall decrease was also offset by an increase of 512 GWh, or 20.3%, in electricity generated by the NPPK.

In the six months ended 30 June 2015, this trend continued. In the six months ended 30 June 2015, the Group generated 6,212 GWh of electricity, representing a decrease of 1,067 GWh, or 14.7%, from 7,279 GWh in the six months ended 30 June 2014. In the six months ended 30 June 2015, 3,625 GWh, or 58.3%, of the Group's total electricity generated was generated by hydro power plants, 1,192 GWh, or 19.2%, was generated by the NPPK and the remaining 1,395 GWh, or 22.5%, was generated by its thermal power plants, compared with 4,194 GWh, or 57.6%, 1,504 GWh, or 20.7%, and 1,581 GWh, or 21.7%, respectively, in the six months ended 30 June 2014. The decrease in electricity generation in the first half of 2015 was primarily due to lower water inflows and lower generation by hydro power plants.

The cost of electricity on an open market is affected by similar factors that affect the Group's operations and open market prices are likely to increase during the periods of drought or other unfavourable conditions. Consequently, if the Group is unable to obtain a sufficient amount of electricity from hydro power plants and is forced to purchase additional electricity on an open market, it is likely that it will be required to pay higher market prices. Accordingly, volatility in the prices of electricity purchased and in the volume purchased on the market may have a significant effect on the Group's financial performance and results of operations.

### ***Commodity Prices***

The Group operates a mix of electricity generation assets, with hydro and nuclear power plants being the most efficient and lower cost options. In particular, hydro power plants are a significantly less expensive source of energy than thermal power plants, which require fuel to operate (principally fuel-oil, oil, coal and natural gas). A significant portion of the Group's expenses are made up of commodity costs, which are heavily influenced by prices in the world market for gas, fuel oil and coal. The prices for such commodities have historically been volatile and there is no guarantee that prices will remain within projected levels.

The Group does not undertake any hedging transactions with regards to the commodity products it consumes and any significant increases in commodity prices could have an adverse effect on the Group's operating results and financial condition, especially if the Group is not able (or not permitted by regulatory authorities) to shift production from cogeneration units to lower-cost commodities (import) or to adjust its rates to offset such increases in prices. As the Group does not typically enter into long-term commodity supply agreements, its annual results are subject to substantial variation depending on its ability to generate electricity through hydro power plants and the need to purchase significant amounts of fuel-oil, oil, gas and other commodities in order to power its thermal and nuclear power plants.

### **Geographical and Operating Segments**

The Group generates the vast majority of its income from its operations in Croatia. The Group also has generating facilities in Slovenia (where it has a 50% holding in NEK, which operates the NPPK)



and Bosnia and Herzegovina where it has a pumping station. The Group's trading subsidiary, HEP Trade, carries out trading activities through subsidiaries located in Hungary, Slovenia, Serbia, Bosnia and Herzegovina and Kosovo.

The Group's principal activities are the generation, transmission, distribution and supply of electricity. In addition to these principal activities, the Group also deals with the generation, distribution and supply of thermal energy, i.e. heat, through the district heating systems in Zagreb, Osijek, Sisak, Samobor, Zaprešić and Velika Gorica and the distribution and supply of gas in Osijek-Baranja County, Požega-Slavonia County and Virovitica-Podravina County and on the wholesale market.

## **Joint Ventures**

The Group jointly owns (together with GenE) the NPPK through a 50% holding in NEK, which operates the NPPK. In addition, HEP jointly owns, together with Plinacro d.o.o., LNG Hrvatska, which joint venture was formed for the purpose of developing a liquefied natural gas regasification terminal in Omišalj on the island of Krk, Croatia.

## **Restatement of the Annual Financial Statements**

### *Transfer of electricity facilities from HAC d.o.o.*

During the period between 2007 and 2009, the Company and HAC signed a number of agreements of mutual relations and joint financing of the construction of electric power facilities to be located along the highways in Croatia. Further, on 25 March 2015, the Company and HAC entered into an agreement to finalise the transfer of the electric power facilities to the Company from HAC. Further to the execution of this agreement, the Company has recorded certain business events in its accounts for 2014 and, as required by International Accounting Standard (IAS) 8 "Accounting Policies, Changes in Accounting Estimates and Errors", made the below corrections by means of balance sheet restatements for the previous periods. Such restatements were necessary due to the fact that, as a result of incomplete documentation and technical specifications for this electricity complex, HEP was not able to recognise this facility in its accounts for the previous periods, even though the electricity complex has been in use and operated by HEP since 2009.

The balance sheet restatement made at 31 December 2012 resulted in an increase of fixed assets in the amount of HRK 957,950 thousand, an increase in retained earnings in the amount of HRK 711,799 thousand and an increase in current liabilities in the amount of HRK 246,151 thousand. The restatement in income statement made at 31 December 2012 resulted in an increase in depreciation cost in the amount of HRK 40,718 thousand and a decrease in income tax in the amount of HRK 8,144 thousand.

The balance sheet restatement made at 31 December 2013 resulted in an increase of fixed assets in the amount of HRK 919,654 thousand, an increase in retained earnings in the amount of HRK 673,503 thousand, and an increase in current liabilities in the amount of HRK 246,151 thousand. The restatement in income statement made at 31 December 2013 resulted in an increase in depreciation cost in the amount of HRK 47,169 thousand and a decrease in income tax in the amount of HRK 9,433 thousand.

### *IFRS 11 Joint Arrangements – NPPK*

Further to the adoption of International Financial Reporting Standards (IFRS) 11 "Joint Arrangements", which replaced the International Accounting Standard (IAS) 31 "Interests in Joint Venture", investment in NEK is now classified in accordance with IFRS 11 as a joint operation. The Company recognizes its share in assets and liabilities, income and expenses based on its share in the joint operation of NEK. Prior to adoption of IFRS 11, the Company measured investment in NEK using the equity method. Within the restatement, amount recognised based on the equity method has been replaced by individual items of assets and liabilities. The difference between the equity method and the method of accounting of assets and liabilities is stated within retained earnings. Although the investment in NEK was realised through a separate entity, the Group and its co-investor (GenE), in

accordance with NEK's articles of association, are decided by consensus. Taking into account these and certain other facts and circumstances set out in IFRS 11, the Group has concluded that the joint venture in NEK should be classified as a joint operation. The Group applied IFRS 11 retrospectively, in accordance with the transitional provisions and therefore the financial information at 31 December 2012 and 31 December 2013 with respect to NEK has been restated accordingly.

The balance sheet restatements made at 31 December 2012 resulted in a decrease in investment in NEK in the amount of HRK 1,754,419 thousand, an increase in property, plant and equipment in the amount of HRK 1,487,124 thousand, an increase in capital work in progress in the amount of HRK 16,955 thousand, an increase in investment property in the amount of HRK 1,924 thousand, an increase in other non-current assets in the amount of HRK 534 thousand, an increase in current assets in the amount of HRK 336,348 thousand, a decrease in retained earnings in the amount of HRK 96,211, an increase in non-current liabilities in the amount of HRK 81,124 thousand and an increase in the current liabilities in the amount of HRK 103,553 thousand.

The restatements in the income statement for the year ended 31 December 2012 resulted in an increase of other operating income in the amount of HRK 5,052 thousand and a decrease of electricity purchase cost in the amount of HRK 707,758 thousand, which were reassigned to fuel cost, staff cost, depreciation cost and other operating expenses in the amounts of HRK 114,966 thousand, HRK 127,175 thousand, HRK 234,060 thousand and HRK 231,557 thousand, respectively, and an increase in other operating expenses of HRK 4,112 thousand. Also, restatement of income statement resulted in an increase in financial income in the amount of HRK 1,469 thousand and an increase in financial expenses in the amount of HRK 2,409 thousand.

The balance sheet restatements made at 31 December 2013 resulted in a decrease in investment in NEK in the amount of HRK 1,754,419 thousand, an increase in property, plant and equipment in the amount of HRK 1,397,569 thousand, an increase in capital work in progress in the amount of HRK 14,072 thousand, an increase in investment property in the amount of HRK 1,772 thousand, an increase in other non-current assets in the amount of HRK 478 thousand, an increase in current assets in the amount of HRK 464,723 thousand, a decrease in retained earnings in the amount of HRK 75,080, an increase in non-current liabilities in the amount of HRK 63,110 thousand and an increase in the current liabilities in the amount of HRK 136,165 thousand.

The restatements in the income statement made for the year ended 31 December 2013 resulted in an increase of other operating income in the amount of HRK 6,302 thousand and a decrease of electricity purchase cost in the amount of HRK 727,854 thousand which were reassigned to fuel cost, staff cost, depreciation cost and other operating expenses in the amounts of HRK 124,938 thousand, HRK 128,754 thousand, HRK 229,191 thousand and HRK 244,971 thousand, respectively, and in an increase of other operating expenses in the amount of HRK 5,079 thousand. Also, restatement of income statement resulted in an increase in financial income in the amount of HRK 1,893 thousand and an increase in financial expenses in the amount of HRK 2,083 thousand. Said restatements resulted in an increase in profit before tax in the amount of HRK 1,033 thousand.

#### *Impairment of thermal power plants*

During 2014, the Group conducted an impairment testing of its assets in accordance with IAS 36 "Impairment of Assets". Taking into account the indicators of impairment set out in IAS 36 the Group concluded that it is required to restate the financial information at 31 December 2013 and 31 December 2012 in the Annual Financial Statements to reflect the value adjustments in property, plant and equipment of the Group's thermal power plants.

The balance sheet restatements made at 31 December 2012 resulted in a decrease in net asset value in the amount of HRK 2,500,125 thousand, an increase in deferred tax assets in the amount of HRK 500,025 thousand and a decrease in retained earnings in the amount of HRK 2,000,100 thousand. The restatements of income statement information for the year ended 31 December 2012 resulted in a decrease in the depreciation charge in the amount of HRK 198,020 thousand and an increase in value adjustment for long-term tangible assets in the amount of HRK 245,195 thousand.

The balance sheet restatements made at 31 December 2013 resulted in a decrease of asset net value in the amount of HRK 2,503,815 thousand, an increase in deferred tax assets in the amount of HRK 500,763 thousand and a decrease in retained earnings in the amount of HRK 2,003,052 thousand. The restatements of income statement information made for the year ended 31 December 2013 resulted in a decrease in the depreciation charge in the amount of HRK 191,607 thousand, an increase in value adjustment for long-term tangible assets in the amount of HRK 195,296 thousand and decrease in income tax in the amount of HRK 738 thousand.

### **Acquisitions and Divestitures**

In May 2015 the Group assumed a 50% share in TE Plomin d.o.o. (“**TE Plomin**”) from RWE in accordance with a joint venture agreement entered into in November 1996, and currently holds 100% of the shares in TE Plomin. Save for the above, the Group did not have any material acquisitions or divestitures during the period from 1 January 2012 through 30 June 2015 and no material acquisitions or divestitures are currently pending or planned.

### **Explanation of Key Income Statement Items**

#### ***Sales revenues***

The Group presents revenues divided into three main areas: (i) electricity—generation, transmission, distribution and sale of electricity; (ii) thermal power—distribution and sale of thermal power; and (iii) gas—distribution and sale of gas.

#### ***Revenue from electricity sales***

The Group derives a substantial portion of its annual revenue from the sale of electricity to Tariff and Non-Tariff Customers within Croatia. A small portion of revenue is derived from the sale of electricity to neighbouring markets in Hungary, Slovenia, Serbia, Bosnia and Herzegovina and Kosovo.

Revenue from the sale of electricity to Tariff Customers (Households and Commercial Customers) is estimated based on anticipated consumption which is derived from historical consumption, and on energy data available from the Group’s internal records, and applicable tariff rates or market prices, depending on the type of customer. Any variation between estimated consumption and actual consumption which is determined on a periodic basis is recognised in revenue in the following period (once meter and other relevant readings are available). For additional information on the Group’s tariffs, see “—*Factors that Affect the Group’s Results of Operations—Tariffs*”.

Electricity sales to Non-Tariff Customers are based on the prevailing market rates, with prices set by the Group. Sales and tariff rates for Tariff Customers are regulated by HERA. The current tariff rates for transmission and distribution have been in place since April 2012, the tariff rates for the supply of electricity within universal service (to Households) since October 2013, and the current tariff rates for guaranteed supply of electricity (for Commercial Customers) since January 2015.

#### ***Revenue from thermal power sales***

The Group derives a portion of its annual revenue from the sale of thermal power (generated from steam and hot water in the Group’s power plants) to customers located in Zagreb, Osijek, Sisak, Zaprrešić, Velika Gorica and Samobor. Revenue from the sale of thermal power is calculated based on energy consumption readings, and applicable tariff rates or market prices, depending on the type of customer.

The Group’s thermal power customers can be divided into tariff customers and non-tariff customers. Thermal power sales to non-tariff customers are based on the prevailing market rates, with prices set by the Group. Sales and tariff rates for tariff customers are regulated by HERA. The current tariff rates have been in effect since December 2012.

### ***Revenue from gas sales on wholesale market***

The Group derives a portion of its annual revenue from the sale of gas on the wholesale market. From 1 April 2014 the Company was appointed the sole supplier to the Croatian wholesale gas market for a three-year period ending 31 March 2017. Revenue from the sale of gas on wholesale market is calculated based on contracted quantities and applicable tariff rates.

### ***Revenue from gas sales to customers***

The Group derives a portion of its annual revenue from the sale of gas to customers located in Osijek- Baranja County, Požega-Slavonia County and Virovitica-Podravina County. Revenue from the sale of gas is calculated based on energy consumption readings, and applicable tariff rates or market prices, depending on the type of customer.

The Group's gas customers can be divided into regulated customers and non-regulated customers. Gas sales to non-regulated customers are based on the prevailing market rates, with prices set by the Group. Sales and tariff rates for regulated customers are set by HERA. Starting from 1 April 2015, HERA decreased tariff rates for Households by approximately 7% for supply and distribution. In regard to the business category, since 2013 exchange rate variations of the U.S. dollar have caused oscillations in purchase price of natural gas leading to changes in sale price every 15 days.

### ***Other operating income***

In addition to the three main income generating segments described above, the Group also derives operating income from various other ancillary sources, in particular network connection fees received from customers which are recognised as income on the date the fees are received.

Other ancillary sources of operating income include: services for connection to network, income from assets received free of charge, reversal of impaired receivables, services rendered (including services provided by the Group's power plants), capitalised assets (including capitalised costs of personnel working on the Group's investments), penalty interest (in relation to outstanding receivables for electricity, thermal energy and gas paid after maturity), income from the sale of materials, income from the sale of cross-border transmission capacity, revenues from cross-border inter-compensation (HOPS), reversal of severance payments based on termination of employment contract, reversal of long-term provisions—vacation accrual, reversal of long-term provisions for retirement benefits and jubilee awards, reversal of long-term provisions—court costs, reversal of other provisions, income in respect of the electricity payment reminders, income from balancing energy, income in respect of court costs on claims, surplus of non-current assets, income from sale of tangible assets, recovery of written-off receivables, other operating income of the NEK and certain other income sources.

### ***Operating expenses***

Operating expenses comprise the expenses the Group incurs in the course of operating its business, and include the following:

#### ***Electricity purchase cost***

Electricity purchase cost includes the cost of electricity purchased from third parties for resale to the Group's customers in Croatia. Electricity is purchased from wholesalers based on international tenders. In addition, these costs include the electricity generated from renewable energy sources. This is done in accordance with Croatian regulations on cross-border transmission of electricity to/from Croatia.

#### ***Fuel cost***

Fuel costs include gas, coal and fuel oil used as fuel at the Group's thermal power plants and district boilers for the generation of electrical and thermal energy, as well as 50 per cent. share of total fuel

costs of NEK. It also includes costs of additional materials and chemicals used in the production process and costs of transport and quality control.

#### ***Costs of gas sold***

Costs of gas sold include the costs of gas purchased from third parties for resale to the Group's customers on the wholesale market in Croatia, fees for storage capacities, fees for use of the transport system and certain other costs.

#### ***Staff costs***

Staff costs include employee salaries and wages, remuneration of the members of the Management Board and the Supervisory Board, taxes and other contributions, expense reimbursements, employee benefits and pension contributions, as well as 50 per cent. share of staff costs of NEK. Salaries and other employee benefits are governed by the Collective Agreement (see "*Business—Employees*" for further details).

#### ***Depreciation and amortisation costs***

The depreciation costs include the depreciation of tangible and intangible assets, except for land which is not depreciated. Intangible assets are depreciated over their useful lives using the straight-line method. At the end of each business year, the Group reviews the residual values, useful lives and methods of depreciation and adjusts these estimates as appropriate. The impact of each change in the estimation is disclosed in the income statement, however there were no such changes in the years ended 31 December 2012 and 2013. In 2014 useful lives of gas pipelines were extended from 20-25 years to 40 years due to the decision of the Group's management to switch to plastic pipelines, which have longer lifespan than previously used steel pipelines, in the construction of gas pipelines.

#### ***Other operating expenses***

The Group incurs various other ancillary expenses including maintenance costs (service and materials), impairment of trade receivables, gas costs (for the distribution and supply of gas), cost of services, chargeable services and material, cost of material, compensation for lower quantities of gas than contracted, CO<sub>2</sub> emission allowances cost, value adjustment of inventories, employee benefits, other employee benefits, decommissioning expense relating to the NEK, taxes and contributions, litigation provisions, contributions and concession for water fees, provision for unused vacation, fees for the usage of power plant facilities, compensation for water purification and drainage, property, plant and equipment write-off, cost of materials sold, calculation and collection costs, provisions for retirement bonuses and jubilee awards, provisions for severance payments based on termination of employment contract, provisions for other expenses—employees, insurance premiums, environmental protection fees, compensation for damages, bad debts write off, provisions for decommission of fossil fuelled power plants, impairment of property, plant and equipment, other operating expenses of the NEK and certain other expenses.

#### ***Financial income***

Financial income includes foreign currency exchange gains, interest income, fair value of cross currency swap, dividend income and income on deposits of the NEK. Foreign currency differences includes differences on foreign exchange accounts and deposits with banks, on accounts of foreign buyers and suppliers and on loans denominated in currencies other than Kuna. Interest income includes interest income on deposits with banks and interest income due to payment delays.

#### ***Financial expenses***

Financial expenses include interest expense (interest paid on capital assets and working capital loans, issued bonds and suppliers' accounts), foreign currency losses (losses from capital assets and working capital loans and exchange rate losses on accounts with foreign suppliers), fair value of cross currency

swap, fair value of shares and certain other financial expenses less capitalised borrowing costs allocated to property, plant and equipment.

### **Corporate income tax expense**

Corporate income tax expense includes the Group's current taxes and deferred income taxes relating to the origination and reversal of temporary differences. Temporary differences, which increase or decrease the tax base, include costs of provisioning for severance payments and jubilee awards, provisioning for receivables of customers against whom no legal action has been taken and other temporary differences.

Current tax liability is based on the taxable profit for the year. Taxable profit is not disclosed in the Income Statement, because it is not included in the income and expense items in other years. The same applies to items that are not taxable or deductible.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the taxable assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax rates (and laws) that have been enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

### **Results of Operations**

The following table contains the Group's consolidated income statement data for the periods indicated:

	<b>Year ended 31 December</b>			<b>Six months ended 30 June</b>	
	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2014</b>	<b>2015</b>
	<b>(Restated)</b>	<b>(Restated)</b>			
				<i>(Unaudited)</i>	
	<i>(HRK thousands)</i>				
Revenue from electricity sales .....	11,630,275	11,947,939	10,575,290	5,236,859	5,244,063
Revenue from thermal power sales.....	585,485	763,461	671,946	374,844	389,556
Revenue from sale of gas on wholesale market ..	—	—	689,575	155,879	789,773
Revenue from sale of gas to customers .....	395,956	406,167	371,490	181,557	220,291
Other operating income.....	1,412,914	1,591,618	1,290,873	544,190	500,219
<b>Total operating income.....</b>	<b>14,024,630</b>	<b>14,709,185</b>	<b>13,599,174</b>	<b>6,493,329</b>	<b>7,143,902</b>
Electricity purchase cost .....	(3,085,280)	(1,942,301)	(1,200,023)	(481,639)	(774,794)
Fuel cost .....	(3,434,478)	(2,734,741)	(1,777,077)	(986,482)	(976,073)
Costs of gas sold .....	—	—	(717,721)	(165,663)	(808,823)
Staff cost.....	(1,990,410)	(1,868,718)	(1,880,519)	(901,948)	(942,642)
Depreciation and amortisation costs .....	(1,855,158)	(1,883,970)	(1,897,190)	(933,853)	(922,212)
Other operating expenses.....	(3,396,984)	(3,943,827)	(2,926,195)	(1,241,176)	(1,207,581)
<b>Total operating expenses.....</b>	<b>(13,762,310)</b>	<b>(12,373,557)</b>	<b>(10,398,725)</b>	<b>(4,710,761)</b>	<b>(5,632,125)</b>
<b>Operating profit .....</b>	<b>262,320</b>	<b>2,335,628</b>	<b>3,200,449</b>	<b>1,782,568</b>	<b>1,511,777</b>
Financial income.....	69,398	64,434	433,671	76,294	423,584
Financial expenses .....	(355,317)	(875,370)	(556,577)	(162,861)	(239,547)
<b>Net profit/(loss) from financial activities .....</b>	<b>(285,919)</b>	<b>(810,936)</b>	<b>(122,906)</b>	<b>(86,567)</b>	<b>184,037</b>
<b>Profit/(loss) before taxation.....</b>	<b>(23,599)</b>	<b>1,524,692</b>	<b>3,077,543</b>	<b>1,696,001</b>	<b>1,695,814</b>
Corporate income tax expense.....	(20,342)	(256,818)	(612,119)	(373,039)	(350,668)
<b>Profit/(loss) for the period .....</b>	<b>(43,941)</b>	<b>1,267,874</b>	<b>2,465,424</b>	<b>1,322,962</b>	<b>1,345,146</b>

## Six Months Ended 30 June 2015 Compared with the Six Months Ended 30 June 2014

### Operating Income

	Six months ended 30 June	
	2014	2015
	<i>(Unaudited)</i>	
	<i>(HRK thousands)</i>	
Revenue from electricity sales .....	5,236,859	5,244,063
Revenue from thermal power sales .....	374,844	389,556
Revenue from gas sales on wholesale market .....	155,879	789,773
Revenue from gas sales to customers .....	181,557	220,291
Other operating income .....	544,190	500,219
<b>Total operating income .....</b>	<b>6,493,329</b>	<b>7,143,902</b>

#### *Revenue from electricity sales*

Revenue from electricity sales marginally increased by HRK 7,204 thousand, or 0.1%, from HRK 5,236,859 thousand for the six months ended 30 June 2014 to HRK 5,244,063 thousand for the six months ended 30 June 2015, as a result of the increased consumption of electricity due to weather conditions with lower temperatures in the first half of 2015 as compared to the first half of 2014 and due to the modest recovery of the Croatian economy. This increase was partially offset by a decrease in HEP's market share, as well as a slight decrease in market prices charged by HEP-Supply.

#### *Revenue from thermal power sales*

Revenue from thermal power sales increased by HRK 14,712 thousand, or 3.9%, from HRK 374,844 thousand for the six months ended 30 June 2014 to HRK 389,556 thousand for the six months ended 30 June 2015, as a result of increased consumption of heat energy due to weather conditions with lower temperatures in the first half of 2015 as compared to the first half of 2014.

#### *Revenue from gas sales on wholesale market*

From 1 April 2014, the Company was appointed the sole supplier to the Croatian wholesale gas market for the three-year period ending 31 March 2017. For the six months ended 30 June 2015 revenue from gas sales on the wholesale market was HRK 789,773 thousand. For the six months ended 30 June 2014 revenue from gas sales on wholesale market was HRK 155,879 thousand.

#### *Revenue from gas sales to customers*

Revenue from gas sales increased by HRK 38,734 thousand, or 21.3%, from HRK 181,557 thousand for the six months ended 30 June 2014 to HRK 220,291 thousand for the six months ended 30 June 2015, as a result of increased gas consumption due to weather conditions with lower temperatures in the first half of 2015 as compared to the first half of 2014, as well as an increase in the number of the Group's customers.

#### *Other operating income*

Other operating income decreased by HRK 43,971 thousand, or 8.1%, from HRK 544,190 thousand for the six months ended 30 June 2014 to HRK 500,219 thousand for the six months ended 30 June 2015. This decrease was primarily due to a decrease in income from sale of cross-border transmission capacity of HRK 13,851 thousand, or 36.5%, from HRK 37,899 thousand for the six months ended 30 June 2014 to HRK 24,048 thousand for the six months ended 30 June 2015 as a result of lower prices set in auctions of transmission capacities. There was also a decrease in revenues from cross-border inter-compensation (HOPS) by HRK 6,787 thousand, or 46.2%, from HRK 14,700 thousand for the six months ended 30 June 2014 to HRK 7,913 thousand for the six months ended 30 June 2015 as a result of decreased transmission of electricity through the HOPS control area by foreign transmission system operators. There was also a decrease in income from reversal of long-term provisions for retirement benefits and jubilee awards by HRK 23,459 thousand, or 97.7%, from HRK 24,023

thousand for the six months ended 30 June 2014 to HRK 564 thousand for the six months ended 30 June 2015, primarily due to the fact that retirement benefits and jubilee awards for employees subject to the ongoing organisational restructuring were provisioned as costs for severance payments based on termination of employment contracts.

### ***Total Operating Income***

Total operating income increased by HRK 650,573 thousand, or 10.0%, from HRK 6,493,329 thousand for the six months ended 30 June 2014 to HRK 7,143,902 thousand for the six months ended 30 June 2015.

	<b>Six months ended 30 June</b>	
	<b>2014</b>	<b>2015</b>
	<i>(Unaudited)</i>	
	<i>(HRK thousands)</i>	
Electricity purchase cost .....	(481,639)	(774,794)
Fuel costs .....	(986,482)	(976,073)
Cost of gas sales on wholesale market .....	(165,663)	(808,823)
Staff cost .....	(901,948)	(942,642)
Depreciation and amortisation costs .....	(933,853)	(922,212)
Other operating expenses .....	(1,241,176)	(1,207,581)
<b>Total operating expenses .....</b>	<b><u>(4,710,761)</u></b>	<b><u>(5,632,125)</u></b>

### ***Electricity purchase cost***

Electricity purchase cost increased by HRK 293,155 thousand, or 60.9%, from HRK 481,639 thousand for the six months ended 30 June 2014 to HRK 774,794 thousand for the six months ended 30 June 2015, as a result of increased purchase of electricity due to lower generation by hydro power plants as a result of lower water inflows and increased purchase of electricity generated from renewable energy sources.

### ***Fuel costs***

Fuel costs decreased by HRK 10,409 thousand, or 1.1%, from HRK 986,482 thousand for the six months ended 30 June 2014 to HRK 976,073 thousand for the six months ended 30 June 2015, as a result of decreased electricity generation by NPPK due to a scheduled overhaul during April and May 2015.

### ***Cost of gas sales on wholesale market***

From 1 April 2014, the Company was appointed the sole supplier to the Croatian wholesale gas market for the three-year period ending 31 March 2017. For the six months ended 30 June 2015 cost of gas sales on wholesale market was HRK 808,823 thousand. For the six months ended 30 June 2014 cost of gas sales on wholesale market was HRK 165,663 thousand.

### ***Staff cost***

Staff costs increased by HRK 40,694 thousand, or 4.5%, from HRK 901,948 thousand for the six months ended 30 June 2014 to HRK 942,642 thousand for the six months ended 30 June 2015, as a result of an increase in health insurance rates from April 2014 and higher salaries and wages in accordance with the provisions of the Collective Agreement in effect from October 2014.

### ***Depreciation and amortisation costs***

Depreciation and amortisation costs decreased by HRK 11,641 thousand, or 1.2%, from HRK 933,853 thousand for the six months ended 30 June 2014 to HRK 922,212 thousand for the six months ended 30 June 2015. This decrease was primarily due to the fact that the value of assets that fully depreciated within the six months ended 30 June 2015 more than offsets the value of assets acquired during the period.



### **Other Operating Expenses**

Other operating expenses decreased by HRK 33,595 thousand, or 2.7%, from HRK 1,241,176 thousand for the six months ended 30 June 2014 to HRK 1,207,581 thousand for the six months ended 30 June 2015, primarily as a result of decreased expenses for impairment of trade receivables in the amount of HRK 27,394 thousand, decreased gas costs, in the amount of HRK 61,732 thousand. This decrease was partially offset by an increase of administrative costs in the amount of HRK 25,436 thousand.

### **Total Operating Expenses**

For the reasons described above, total operating expenses increased by HRK 921,364 thousand, or 19.6%, from HRK 4,710,761 thousand for the six months ended 30 June 2014 to HRK 5,632,125 thousand for the six months ended 30 June 2015.

### **Operating profit**

The Group recorded an operating profit of HRK 1,511,777 thousand for the six months ended 30 June 2015 as compared with a profit of HRK 1,782,568 thousand for the six months ended 30 June 2014.

### **Financial Income**

Financial income increased significantly by HRK 347,290 thousand, or 455.2%, from HRK 76,294 for the six months ended 30 June 2014 to HRK 423,584 thousand for the six months ended 30 June 2015. The increase was primarily due to an increase in the fair value of cross currency swaps by HRK 333,702 thousand, or 2,398%, from HRK 13,914 thousand for the six months ended 30 June 2014 to HRK 347,616 thousand for the six months ended 30 June 2015, as a result of a strengthening of the U.S. dollar against the Euro, especially in the first quarter of 2015.

### **Financial Expenses**

Financial expenses increased by HRK 76,686 thousand, or 47.1%, from HRK 162,861 thousand for the six months ended 30 June 2014 to HRK 239,547 thousand for the six months ended 30 June 2015. The increase was primarily due to an increase of HRK 73,822 thousand, or 540.5%, in foreign exchange losses from HRK 13,658 thousand for the six months ended 30 June 2014 to HRK 87,480 thousand for the six months ended 30 June 2015, primarily as a result of foreign exchange losses incurred in relation to HEP's clearing debt liability.

### **Corporate income tax expense**

Corporate income tax expense decreased by HRK 22,371 thousand, or 6.0%, from HRK 373,039 thousand for the six months ended 30 June 2014 to HRK 350,668 thousand for the six months ended 30 June 2015. The decrease was due to decreased profit before tax in the six months ended 30 June 2015 as compared to the corresponding period in 2014.

### **Year Ended 31 December 2014 Compared with the Year Ended 31 December 2013 and Year Ended December 2013 Compared with Year Ended 31 December 2012**

	Year ended 31 December		
	2012	2013	2014
	(Restated)	(Restated)	
		(HRK thousands)	
Revenue from electricity sales .....	11,630,275	11,947,939	10,575,290
Revenue from thermal power sales .....	585,485	763,461	671,946
Revenue from gas sales on wholesale market .....	—	—	689,575
Revenue from gas sales to customers .....	395,956	406,167	371,490
Other operating income .....	1,412,914	1,591,618	1,290,873
<b>Total operating income .....</b>	<b>14,024,630</b>	<b>14,709,185</b>	<b>13,599,174</b>

### ***Revenue from electricity sales***

Revenue from electricity sales increased by HRK 317,664 thousand, or 2.7%, from HRK 11,630,275 thousand for the year ended 31 December 2012 to HRK 11,947,939 thousand for the year ended 31 December 2013 and decreased by HRK 1,372,649 thousand, or 11.5%, to HRK 10,575,290 thousand for the year ended 31 December 2014. The increase in 2013 was primarily due to an increase in electricity exports because of extremely favourable hydroelectric generation conditions. The decrease in 2014 is due to a decrease in electricity sales in Croatia as result of HEP's declining market share, lower market prices and reduced electricity consumption during the year as compared with the previous year following a milder winter in Croatia.

### ***Revenue from thermal power sales***

Revenue from thermal power sales increased by HRK 177,976 thousand, or 30.4%, from HRK 585,485 thousand for the year ended 31 December 2012 to HRK 763,461 thousand for the year ended 31 December 2013 and decreased by HRK 91,515 thousand, or 12.0%, to HRK 671,946 thousand for the year ended 31 December 2014. The increase in 2013 was primarily due to an increase in tariff rates for thermal power in December 2012. The decrease in 2014 was primarily due to a decrease in sales of thermal power as a result of a decrease in consumption following a milder winter in Croatia.

### ***Revenue from gas sales on wholesale market***

From 1 April 2014, the Company was appointed as the sole supplier to the Croatian wholesale gas market for a three-year period ending 31 March 2017. For the year ended 31 December 2014, the Group recorded revenue of HRK 689,575 thousand compared to zero in the years ended 31 December 2012 and 31 December 2013.

### ***Revenue from gas sales to customers***

Revenue from gas sales to customers increased by HRK 10,211 thousand, or 2.6%, from HRK 395,956 thousand for the year ended 31 December 2012 to HRK 406,167 thousand for the year ended 31 December 2013 and decreased by HRK 34,677 thousand, or 8.5%, to HRK 371,490 thousand for the year ended 31 December 2014. The increase in 2013 was due to an increase in gas tariffs for distribution and supply in May 2012, partially offset by a decrease in gas consumption. The decrease in 2014 was due to a decrease in consumption as compared to the previous year following a milder winter.

### ***Other operating income***

Other operating income increased by HRK 178,704 thousand, or 12.6%, from HRK 1,412,914 thousand for the year ended 31 December 2012 to HRK 1,591,618 thousand for the year ended 31 December 2013 and decreased by HRK 300,745 thousand, or 18.9%, to HRK 1,290,873 thousand for the year ended 31 December 2014.

### ***For the years ended 31 December 2012 and 2013***

The increase in other operating income in 2013 as compared with 2012 was primarily due to a HRK 204,712 thousand income from cancellation of costs that were provisioned for 2012 with respect to severance payments to former employees of HOPS and HEP-ODS who decided not to enter into new employment contracts after the termination of their employment contracts in connection with the ongoing restructuring of HOPS and HEP-ODS. There was also an increase in default interest of HRK 29,679 thousand, or 38.3%, from HRK 77,418 thousand for the year ended 31 December 2012 to HRK 107,097 thousand for the year ended 31 December 2013, due to one large customer declaring bankruptcy and default interest being calculated. The Group also had a HRK 17,994 thousand, or 41.8%, increase in income from sale of cross-border transmission capacity from HRK 43,047 thousand for the year ended 31 December 2012 to HRK 61,041 thousand for the year ended 31 December 2013 due to changes made to the auction procedures in relation to prices reached at the

auctions. There was also a significant increase of HRK 36,547 thousand, or 1,045.1%, in income from electricity in foreign transit from HRK 3,497 thousand for the year ended 31 December 2012 to HRK 40,044 thousand for the year ended 31 December 2013 due to increased electricity flows through the Group's network as a result of higher activity in Inter-Transmission System Operator Compensation (ITC) mechanism which provides compensation for the costs of losses incurred by national transmission systems as a result of hosting cross-border flows of electricity and the costs of making infrastructure available to host cross-border flows of electricity.

The increase in other operating income in 2013 as compared with 2012 was offset by a decrease of HRK 29,491 thousand, or 24.7%, in the recovery of receivables previously written off from HRK 119,555 thousand for the year ended 31 December 2012 to HRK 90,064 thousand for the year ended 31 December 2013. In addition, there was a decrease of HRK 6,802 thousand, or 4.4%, in services rendered from HRK 155,657 thousand for the year ended 31 December 2012 to HRK 148,855 thousand for the year ended 31 December 2013, which was due to a general decrease of market activities. There was also a decrease of HRK 21,156, or 34.1%, in income from sale of materials from HRK 61,968 thousand for the year ended 31 December 2012 to HRK 40,812 thousand for the year ended 31 December 2013 as a result of a decrease in construction activities.

#### *For the years ended 31 December 2013 and 2014*

The decrease in other operating income in 2014 compared with 2013 was primarily due to the Group recording income in the year ended 31 December 2013 in the amount of HRK 204,712 thousand in respect of the one-off cancellation of costs for severance payments to former employees of HOPS and HEP-ODS who decided not to enter into new employment contracts after the termination of their employment contracts in connection with the ongoing restructuring of HOPS and HEP-ODS. There was also a decrease of HRK 48,433 thousand, or 45.2%, in default interest from HRK 107,097 thousand for the year ended 31 December 2013 to HRK 58,664 thousand for the year ended 31 December 2014, due to shorter delays in payments by customers. The Group also had a significant decrease of HRK 57,970, or 92.5%, in income from reversal of long-term provisions for retirement benefits and jubilee awards from HRK 62,666 thousand in the year ended 31 December 2013 to HRK 4,696 thousand in the year ended 31 December 2014, which was due to employee retirement and changes in the discount rate in actuarial assessment.

#### ***Total Operating Income***

For the reasons described above total operating income increased by HRK 684,555 thousand, or 4.9%, from HRK 14,024,630 thousand for the year ended 31 December 2012 to HRK 14,709,185 thousand for the year ended 31 December 2013 and decreased by HRK 1,110,011 thousand, or 7.5%, to HRK 13,599,174 thousand for the year ended 31 December 2014.

#### ***Operating Expenses***

	Year ended 31 December		
	2012	2013	2014
	(Restated)	(Restated)	
	(HRK thousands)		
Electricity purchase cost .....	(3,085,280)	(1,942,301)	(1,200,023)
Fuel costs .....	(3,434,478)	(2,734,741)	(1,777,077)
Costs of gas sales on wholesale market .....	—	—	(717,721)
Staff costs .....	(1,990,410)	(1,868,718)	(1,880,519)
Depreciation and amortisation costs .....	(1,855,158)	(1,883,970)	(1,897,190)
Other operating expenses .....	(3,396,984)	(3,943,827)	(2,926,195)
<b>Total operating expenses .....</b>	<b>(13,762,310)</b>	<b>(12,373,557)</b>	<b>(10,398,725)</b>

#### ***Electricity purchase cost***

Electricity purchase cost decreased by HRK 1,142,979 thousand, or 37.0%, from HRK 3,085,280 thousand for the year ended 31 December 2012 to HRK 1,942,301 thousand for the year ended 31 December 2013 and decreased by HRK 742,278 thousand, or 38.2%, to HRK 1,200,023 thousand

for the year ended 31 December 2014. The decreases in 2013 and 2014 were primarily due to favourable hydrological conditions resulting in increased electricity generation by hydro power plants, which allowed the Group to use less fuel fired power plants and to purchase less electricity.

#### *Fuel costs*

Fuel costs decreased by HRK 699,737, or 20.4%, from HRK 3,434,478 thousand for the year ended 31 December 2012 to HRK 2,734,741 thousand for the year ended 31 December 2013 and decreased by HRK 957,664 thousand, or 35.0%, to HRK 1,777,077 thousand the year ended 31 December 2014. The decreases in 2013 and 2014 were attributable to lower fuel costs incurred by the Group due to increased electricity generation by hydro power plants as a result of favourable hydrological conditions and consequently lower generation by thermal power plants, as well as to lower fuel prices (natural gas and coal).

#### *Costs of gas sales on wholesale market*

From 1 April 2014, the Company was appointed as the sole supplier to the Croatian wholesale gas market for a three-year period ending 31 March 2017. Costs of gas sales on the wholesale market for the year ended 31 December 2014 were HRK 717,721 thousand compared to zero in the years ended 31 December 2012 and 2013.

#### *Staff costs*

Staff costs decreased slightly by HRK 121,692 thousand, or 6.1%, from HRK 1,990,410 thousand for the year ended 31 December 2012 to HRK 1,868,718 thousand for the year ended 31 December 2013 and increased by HRK 11,801 thousand, or 0.6%, to HRK 1,880,519 thousand for the year ended 31 December 2014. The increase in 2014 was primarily due to increased health insurance rates in effect from April 2014.

#### *Depreciation and amortisation costs*

Depreciation and amortisation costs increased by HRK 28,812 thousand, or 1.6%, from HRK 1,855,158 thousand for the year ended 31 December 2012 to HRK 1,883,970 thousand for the year ended 31 December 2013 and increased by HRK 13,220, or 0.7%, to HRK 1,897,190 thousand for the year ended 31 December 2014. The increase is primarily due to a larger asset pool as a result of the Group's continued investment in replacing and refurbishing its existing facilities and construction of new facilities.

#### *Other operating expenses*

Other operating expenses increased by HRK 546,843, or 16.1%, from HRK 3,396,984 thousand for the year ended 31 December 2012 to HRK 3,943,827 thousand for the year ended 31 December 2013 and decreased by HRK 1,017,632 thousand, or 25.8%, to HRK 2,926,195 thousand for the year ended 31 December 2014.

#### *For the years ended 31 December 2012 and 2013*

The increase in other operating expenses in 2013 was due to a significant increase in other material employee benefits from HRK 83,691 thousand in the year ended 31 December 2012 to HRK 518,370 thousand in the year ended 31 December 2013 due to severance payments to former employees of HOPS and HEP-ODS who decided not to enter into new employment contracts after the termination of their employment contracts in connection with the ongoing restructuring of HOPS and HEP-ODS. There was also a significant increase of HRK 124,563 thousand, or 613.7%, in compensation for failure to purchase minimum volumes under take-or-pay contracts, from HRK 20,296 thousand for the year ended 31 December 2012 to HRK 144,859 thousand for the year ended 31 December 2013 when, due to a significant increase in hydroelectric generation, it was more profitable to pay compensation under these contracts than to run production in thermal power plants. There were expenses for purchase of emission units of CO<sub>2</sub> of HRK 98,661 thousand in the year ended 31 December 2013, as

compared to zero in the year ended 31 December 2012, since trading of the emission units of CO<sub>2</sub> began in 2013. In addition, expenses for litigation provisions increased by HRK 156,758 thousand, or 391.1%, from HRK 40,079 thousand in the year ended 31 December 2012 to HRK 196,837 thousand in the year ended 31 December 2013 due to provisions for court proceedings related to reconstruction of the Peruća hydro power plant.

The increase in other operating expenses in 2013 was partially offset by a decrease of HRK 72,199 thousand, or 21.8%, in costs of services from HRK 331,541 thousand in the year ended 31 December 2012 to HRK 259,342 thousand in the year ended 31 December 2013, due to expenses recorded in 2012 in connection with preparation for the issuance of the 2017 Notes and decreased costs of postal services for delivering customer bills in 2013 as a result of agreed lower delivery rates for the Group. There was a significant decrease of HRK 116,082 thousand, or 46.6%, in provisions for severance payments to former employees of HOPS and HEP-ODS who decided not to enter into new employment contracts after the termination of their employment contracts in connection with the ongoing restructuring of HOPS and HEP-ODS from HRK 249,174 thousand in the year ended 31 December 2012 to HRK 133,092 thousand in the year ended 31 December 2013. There was a decrease of HRK 20,175 thousand, or 40.3%, in purchase value of sold materials from HRK 50,045 thousand in the year ended 31 December 2012 to HRK 29,870 thousand in the year ended 31 December 2013 due to a decrease in services rendered.

#### *For the years ended 31 December 2013 and 2014*

The decrease in operating expenses in 2014 was due to a significant decrease of HRK 445,126, or 85.9%, in other material employee benefits from HRK 518,370 thousand in the year ended 31 December 2013 to HRK 73,244 thousand in the year ended 31 December 2014 due to paid severance payments in connection with the Group's employee optimization process. In addition, there was a decrease of HRK 136,563 thousand, or 37.8%, in gas costs from HRK 361,296 thousand in the year ended 31 December 2013 to HRK 224,733 thousand in the year ended 31 December 2014. This decrease resulted from the start of the Group's operations on the wholesale market, with the costs incurred by HEP-Plin in relation to gas purchases from the Company now consolidated in the Financial Statements. There was a decrease of HRK 142,248 thousand, or 98.2%, in compensation for failure to purchase minimum volumes under take-or-pay contracts, from HRK 144,859 thousand in the year ended 31 December 2013 to HRK 2,611 thousand in the year ended 31 December 2014 as a result of changes in market relations and contracting conditions as compared to 2013, when, due to a significant increase in hydroelectric generation, it was more profitable to pay compensation under these contracts than to run production in thermal power plants. There was also a decrease of HRK 79,524, or 59.8%, in provisions for severance payments on the basis of employment contract cancellation from HRK 133,092 thousand in the year ended 31 December 2013 to HRK 53,568 thousand in the year ended 31 December 2014 due to a lower amount of provisions made with respect to retirements due in 2015.

The decrease in other operating expenses in 2014 was partially offset by an increase of HRK 94,601 thousand, or 3,086.5%, in provisions for retirement bonuses and jubilee awards from HRK 3,065 thousand in the year ended 31 December 2013 to HRK 97,666 thousand in the year ended 31 December 2014 due to changes in the accounting policy. There was also an increase of HRK 49,995 thousand, or 9.1%, in maintenance costs from HRK 550,142 thousand for the year ended 31 December 2013 to HRK 600,137 thousand for the year ended 31 December 2014 due to increased costs for maintenance of the distribution and transmission network as a result of storms and floods during the winter and spring seasons of 2014.

#### *Total Operating Expenses*

For the reasons described above, total operating expenses decreased by HRK 1,388,753 thousand, or 10.1%, from HRK 13,762,310 thousand for the year ended 31 December 2012 to HRK 12,373,557 thousand for the year ended 31 December 2013 and decreased by HRK 1,974,832 thousand, or 16.0%, to HRK 10,398,725 thousand for the year ended 31 December 2014.

### ***Operating profit***

For the reasons described above, operating profit significantly increased by HRK 2,073,308, or 790.4%, from HRK 262,320 thousand for the year ended 31 December 2012 to HRK 2,335,628 thousand for the year ended 31 December 2013 and increased by HRK 864,821, or 37.0%, to HRK 3,200,449 thousand for the year ended 31 December 2014.

### ***Financial income***

Financial income decreased by HRK 4,964, or 7.2%, from HRK 69,398 thousand for the year ended 31 December 2012 to HRK 64,434 thousand for the year ended 31 December 2013 and significantly increased by HRK 369,237, or 573.0%, to HRK 433,671 thousand for the year ended 31 December 2014.

The decrease in 2013, as compared with 2012, was largely due to a decrease of HRK 16,539 thousand, or 25.8%, in foreign exchange gains from HRK 64,147 thousand for the year ended 31 December 2012 to HRK 47,608 thousand for the year ended 31 December 2013 as a result of an increase in the average exchange rate of the Croatian National Bank EUR/HRK by approximately 0.74%. This was partially offset by an increase of HRK 10,475 thousand, or 200.1%, in interest income from HRK 5,265 thousand for the year ended 31 December 2012 to HRK 15,710 thousand for the year ended 31 December 2013, due to an increase of interest received in respect of term deposits and interest accrued on outgoing invoices, and by an increase of HRK 424 thousand, or 28.9%, in interest on NEK's deposits from HRK 1,469 thousand for the year ended 31 December 2012 to HRK 1,689 thousand for the year ended 31 December 2013. The increase in 2014 was primarily due to fair value of the currency swap of HRK 393,281 thousand entered into by the Company in order to manage foreign currency exchange risk in connection with the 2017 Notes.

### ***Financial Expenses***

Financial expenses increased by HRK 520,053, or 146.4%, from HRK 355,317 thousand for the year ended 31 December 2012 to HRK 875,370 thousand for the year ended 31 December 2013 and decreased by HRK 318,793, or 36.4%, to HRK 556,577 thousand for the year ended 31 December 2014.

The increase in financial expenses in 2013 was primarily due to expenses for fair value of interest rate swap of HRK 391,808 in the year ended 31 December 2013 executed by the Company in order to manage foreign currency exchange risk in connection with the 2017 Notes, which was zero in the year ended 31 December 2014.

The decrease in financial expenses in 2014 was primarily due to expenses for fair value of interest rate swap of HRK 391,808 in the year ended 2013 executed by the Company in order to manage foreign currency exchange risk in connection with the 2017 Notes, which were zero in the year ended 31 December 2014. This decrease was partially offset by a HRK 92,886 thousand, or 155.6%, increase in foreign currency losses as a result of an increase in the average exchange rate of the Croatian national bank EUR/HRK by approximately 0.75%.

### ***Corporate income tax expense***

Corporate income tax expense increased significantly by HRK 236,476, or 1,162.5%, from HRK 20,342 thousand for the year ended 31 December 2012 to HRK 256,818 thousand for the year ended 31 December 2013 and increased by HRK 355,301, or 138.3%, to HRK 612,119 thousand for the year ended 31 December 2014.

The increase in income tax expense in 2013 was primarily due to a HRK 197,449 thousand, or 222.5%, increase in current taxes from HRK 88,757 thousand for the year ended 31 December 2012 to HRK 286,206 thousand for the year ended 31 December 2013 as a result of higher total income. The increase in 2013 was partially offset by a decrease of HRK 39,027 thousand, or 57.0%, in deferred tax income relating to the origination and reversal of temporary differences from

HRK 68,415 thousand for the year ended 31 December 2012 to HRK 29,388 thousand for the year ended 31 December 2013, due to provisions made in relation to the currency swap for the 2017 Notes.

The increase in income tax expense in 2014 was largely due an increase of HRK 223,558 thousand, or 78.1%, in current taxes from HRK 286,206 thousand for the year ended 31 December 2013 to HRK 509,764 thousand for the year ended 31 December 2014, primarily due to an increase in profit before tax during the period. The Group also reported deferred tax expenses relating the origination and reversal of temporary differences in the amount of HRK 102,355 in the year ended 31 December 2014, as compared to deferred tax income of HRK 29,388 thousand for the year ended 31 December 2013, due to provisions made in relation to the currency swap for the 2017 Notes.

### ***Liquidity and Capital Resources***

The Group's financial condition and liquidity is and will continue to be influenced by a variety of factors, including:

- the ability to generate cash flows from its operations;
- the level of outstanding indebtedness, and the interest it is obligated to pay on such indebtedness, which affects its finance costs;
- prevailing interest rates, which affect its debt service requirements;
- ability to continue to borrow funds from banks and international debt capital markets;
- capital expenditure requirements and development projects; and
- ability to collect receivables from its customers.

The Group's cash requirements consist mainly of the following:

- funding capital expenditures;
- operating costs and working capital;
- servicing its indebtedness and the indebtedness of its subsidiaries; and
- paying taxes.

The Group's sources of liquidity consist mainly of the following:

- cash generated from its operating activities;
- existing cash and external borrowings; and
- potential future borrowings.

At 30 June 2015, the total current assets exceed the total current liabilities by HRK 1,897,948 thousand. The Group's principal sources of liquidity are cash flow from its current operations and proceeds of maturing financial assets together with borrowings from third parties. Operating expenses, capital expenditures, development projects and acquisition projects are financed from a combination of the Group's own liquidity and bank loans and borrowings under debt securities.

See "*Liabilities-Short-term borrowings*" for details as to the available commitment under the Group's facility agreements at 30 June 2015.

## Cash Flow Data

### Six Months Ended 30 June 2015 Compared with the Six Months Ended 30 June 2014

The following is a discussion and analysis of the Group's cash-flow data for the six months ended 30 June 2015 and 2014, which has been derived from the consolidated statement of cash flows contained in the Interim Financial Statements.

The following table summarises the Group's consolidated cash flow statement for the periods indicated.

	Six months ended 30 June	
	2014	2015
	<i>(Unaudited)</i>	
	<i>(HRK in thousands)</i>	
Net cash from operating activities .....	1,853,320	1,287,876
Net cash (used in) investing activities .....	(692,328)	(894,342)
Net cash (used in) provided by financing activities .....	(708,658)	(296,848)
<b>Net (decrease)/increase in cash and cash equivalents .....</b>	<b>452,334</b>	<b>96,686</b>
Cash and cash equivalents at the beginning of the year .....	260,844	1,079,900
Cash and cash equivalents at the end of the year .....	713,178	1,176,586

#### *Net cash from operating activities*

The Group's net cash from operating activities decreased by HRK 565,444 thousand, or 30.5%, to HRK 1,287,876 thousand in the six months ended 30 June 2015 from HRK 1,853,320 thousand in the six months ended 30 June 2014. This decrease was primarily due to a decrease in other current liabilities of HRK 332,065 thousand in the six months ended 30 June 2015 as compared to an increase of HRK 258,821 thousand in the six months ended 30 June 2014, as well as an increase in corporate income tax paid of HRK 79,307 thousand, or 18.5%, to HRK 506,715 thousand in the six months ended 30 June 2015 from HRK 427,408 thousand in the six months ended 30 June 2014.

#### *Net cash used in investing activities*

The Group's net cash used in investing activities increased by HRK 202,014 thousand, or 29.2%, to HRK 894,342 thousand in the six months ended 30 June 2015 from HRK 692,328 thousand in the six months ended 30 June 2014. This increase was primarily attributable to a 25.8% increase in expenditure for property, plant and equipment as part of the Group's investment plan for 2015.

#### *Net cash used in financing activities*

The Group's net cash used in financing activities decreased by HRK 411,810 thousand, or 58.1%, to HRK 296,848 thousand in the six months ended 30 June 2015 from HRK 708,658 thousand in the six months ended 30 June 2014. This decrease is a result of lower repayments of short-term borrowings in the six months ended 30 June 2015, as compared to the six months ended 30 June 2014. The overall decrease was partially offset by an increase in repayments of long-term loans in the six months ended 30 June 2015, as compared to the six months ended 30 June 2014.

### Year Ended 31 December 2014 Compared with the Year Ended 31 December 2013 and Year Ended 31 December 2013 Compared with Year Ended 31 December 2012

The following is a discussion and analysis of the Group's cash-flow data for the years ended 31 December 2014, 2013 and 2012, which has been derived from the consolidated statement of cash flows contained in the Annual Financial Statements.



The following table summarises the Group's consolidated cash flow statement for the periods indicated.

	Year ended 31 December		
	2012	2013	2014
	(Restated)	(Restated)	
	<i>(HRK in thousands)</i>		
Net cash from operating activities .....	2,112,632	2,804,728	4,173,736
Net cash used in investing activities .....	(2,823,545)	(2,318,338)	(2,029,668)
Net cash from/(used in) financing activities .....	908,871	(830,627)	(1,325,012)
<b>Net increase/(decrease) in cash and cash equivalents .....</b>	<b>197,958</b>	<b>(344,237)</b>	<b>819,056</b>
Cash and cash equivalents at the beginning of the year .....	407,123	605,081	260,844
Cash and cash equivalents at the end of the year .....	605,081	260,844	1,079,900

#### *Net cash from operating activities*

The Group's net cash from operating activities increased by HRK 1,369,008 thousand, or 48.8%, from HRK 2,804,728 thousand in the year ended 31 December 2013 to HRK 4,173,736 thousand in the year ended 31 December 2014. This was primarily the result of an increase in cash generated from operations of HRK 1,494,945 thousand, or 42.1%, from HRK 3,548,029 thousand for the year ended 31 December 2013 to HRK 5,042,974 thousand for the year ended 31 December 2014 due to an increase in profit. The increase in net cash generated in 2014 was partially offset by a HRK 100,072 thousand, or 27.4%, increase in income taxes paid from HRK 364,946 thousand in the year ended 31 December 2013 to HRK 465,018 thousand in the year ended 31 December 2014.

The Group's net cash from operating activities increased by HRK 692,096, or 32.8%, to HRK 2,804,728 thousand for the year ended 31 December 2013 from HRK 2,112,632 thousand for the year ended 31 December 2012. This increase was largely the result of an increase in cash generated from operations of HRK 1,162,863 thousand, or 48.8%, from HRK 2,385,166 thousand for the year ended 31 December 2012 to HRK 3,548,029 thousand for the year ended 31 December 2013 due to an increase in profit. The increase in net cash generated in 2013 was partially offset by HRK 364,946 thousand in income taxes paid during the course of 2013, as compared to HRK 33,983 thousand in income tax returns, which was primarily as a result of corresponding increase in profit during the 2013 year.

#### *Net cash used in investing activities*

The Group's net cash used in investing activities decreased by HRK 288,670 thousand, or 12.5%, to HRK 2,029,668 thousand in the year ended 31 December 2014 from HRK 2,318,338 thousand in the year ended 31 December 2013. This decrease was primarily attributable to a 12.8% decrease in expenditure for the acquisition of property, plant and equipment due to lower payments to suppliers as a result of decreased investment activities.

The Group's net cash used in investing activities decreased by HRK 505,207 thousand, or 17.9%, to HRK 2,318,338 thousand for the year ending 31 December 2013 from HRK 2,823,545 thousand for the year ended 31 December 2012. This was primarily due to a 16.8% decrease in expenditures for the acquisition of property, plant and equipment, as a result of decreased investment activities.

#### *Net cash from/(used) in financing activities*

Net cash used in financing activities increased by HRK 494,385 thousand, or 59.5%, to HRK 1,325,012 thousand in the year ended 31 December 2014 from HRK 830,627 thousand in the year ended 31 December 2013, as compared to net cash generated from financing activities of HRK 908,871 thousand in the year ended 31 December 2012.

The change in the balance between borrowings and payments during the year ended 31 December 2013, as compared to 2012, was primarily attributable to a HRK 2,955,595 thousand in receipts from issuance of bonds, recorded in the year ended 31 December 2012.

The change in the balance between borrowings and payments during the year ended 31 December 2014, as compared to 2013, was primarily due to HRK 478,000 thousand in gains from short-term loans for the year ended 31 December 2013, while during 2014 there were no new short-term borrowings and the balance of short-term borrowings for the year ended 31 December 2014 was zero. In addition, the Company declared a dividend in the amount of HRK 284,970 thousand in 2014, while no dividend was paid in 2013.

### **Liabilities**

The following table sets forth the Group's liabilities for the periods indicated.

	At 31 December			At 30 June
	2012	2013	2014	2015
	(Restated)	(Restated)		(Unaudited)
	(HRK in thousands)			
Long-term loan liabilities.....	1,894,864	1,722,010	1,262,036	1,081,637
Long-term liabilities to the state.....	27,544	24,451	21,690	20,245
Long-term provisions.....	686,333	808,382	902,779	924,041
Liabilities under issued bonds.....	3,335,608	3,278,893	3,194,986	3,116,606
Other long-term liabilities.....	4,912,601	5,038,526	4,499,502	4,445,408
Deferred tax liabilities.....	1,511	654	13,573	13,573
<b>Total non-current liabilities</b> .....	<b>10,858,461</b>	<b>10,872,916</b>	<b>9,894,566</b>	<b>9,601,510</b>
Trade payables.....	2,556,759	1,580,440	1,590,745	967,353
Current portion of long-term bonds.....	593,380	93,380	93,380	93,380
Current portion of long-term loans.....	132,084	208,838	416,349	385,004
Short-term loans.....	430,914	692,654	8,981	-
Taxes and contributions.....	347,817	165,670	361,095	145,993
Interest payable.....	45,574	41,132	38,263	37,384
Liabilities to employees.....	149,747	145,940	151,240	147,655
Other short-term liabilities.....	831,039	924,908	1,224,526	955,542
<b>Total current liabilities</b> .....	<b>5,087,314</b>	<b>3,852,962</b>	<b>3,884,579</b>	<b>2,732,311</b>

The following table illustrates the Group's long-term loan liabilities at 30 June 2015.

### **Long-term loan liabilities**

	At 30 June 2015
	(Unaudited)
	(HRK in thousands)
Domestic bank loans.....	1,405,634
Foreign bank loans.....	49,623
Financial leases.....	20,413
<b>Total</b> .....	<b>1,475,670</b>
Deferred loan origination fees.....	(3,996)
<b>Total long-term loans</b> .....	<b>1,471,674</b>
Current portion.....	(390,037)
<b>Long-term portion</b> .....	<b>1,081,637</b>

The following table illustrates the annual principal repayment schedule of long-term loans within the next five years.

	At 30 June 2015
	(Unaudited)
	(HRK in thousands)
2015.....	194,608
2016.....	383,502
2017.....	389,551
2018.....	382,855
2019.....	88,466
Thereafter.....	32,692
<b>Total</b> .....	<b>1,471,674</b>

The Group's long-term loan liabilities decreased during the 2012 to 2014 period from HRK 1,894,864 thousand at 31 December 2012 to HRK 1,722,010 thousand at 31 December 2013 and HRK 1,262,036 thousand at 31 December 2014. This decrease was primarily due to a combination of good business results, reduced expenditure on investments as a result of the implementation of cost cutting measures which allowed the Group to make increased repayments in respect of its long-term borrowings and a decreased need for long-term borrowings. At 30 June 2015, the Group's total outstanding balance on long-term borrowings was HRK 1,081,637 thousand.

At 31 December 2012, 2013 and 2014 and 30 June 2015, 83.8%, 93.0%, 94.4% and 95.0%, respectively, of the Group's total long-term loan liabilities, including bonds, were denominated in Euro.

Long-term loan liabilities from domestic banks, including domestic bonds, made up 49.04%, 42.3%, 39.0% and 35.4% of the Group's total long-term loan liabilities, at 31 December 2012, 2013 and 2014 and 30 June 2015, respectively, and were secured by bills of exchange and promissory notes. Long-term loans from foreign banks, including the 2017 Notes, made up 51.0%, 57.7%, 61.0% and 64.6% of the Group's long-term loan liabilities, at 31 December 2012, 2013 and 2014 and 30 June 2015, respectively.

At 30 June 2015, 29.9% and 70.1% of the Group's total long-term borrowings bore interest at fixed and floating interest rates, respectively.

At 30 June 2015, the aggregate amount available under the Group's long-term existing bank facilities (domestic and foreign) was HRK 329,410 thousand. This represents the balance of the KfW loan facility (of which HRK 49,622 thousand was drawn at 30 June 2015). For a description of the KfW loan facility, please refer to "*—Long-Term Loan Agreements*".

#### ***Long-term liabilities to the Republic of Croatia***

The Group's long-term liabilities to the Republic of Croatia decreased during the 2012 to 2014 period from HRK 27,544 thousand at 31 December 2012 to HRK 24,451 thousand at 31 December 2013 to HRK 21,690 thousand at 31 December 2014. At 30 June 2015, the Group's long-term liabilities to the Republic of Croatia decreased to HRK 20,245 thousand. This outstanding indebtedness primarily relates to mortgage receivables on apartments originally owned by the Group and that were sold under a Croatian Government programme to the Group's employees. This programme was discontinued in 1996. The mortgages were typically for a period of 20-35 years and are payable monthly. In accordance with applicable laws regulating such housing sales, 65.0% of the proceeds from the apartment sales were payable to the state on the date the proceeds were collected. According to the law, the Group has no liability to remit the funds unless and until they are collected from the employee.

#### ***Bonds Issued***

In December 2007, the Group issued HRK 700,000 thousand 6.5% bonds maturing on 7 December 2017, listed on the Zagreb stock exchange. The bonds are repayable in 15 semi-annual instalments, the first of which was due in December 2010. At 30 June 2015, the principal amount outstanding in respect of such bonds was HRK 233,100 thousand.

In November 2012, the Group issued U.S. \$500,000,000 notes maturing on 9 November 2017, listed on the Luxembourg stock exchange. The 2017 Notes bear interest at the rate of 6.00% per annum, payable semi-annually in arrears on 9 May and 9 November in each year. Events of default under the 2017 Notes include non-payment of principal or premium for 7 days, non-payment of interest for 14 days, breach of other obligations under the 2017 Notes or the trust deed (which breach is not remedied within 30 days), cross default and certain events related to insolvency or winding up of the Issuer or any material subsidiary.

### **Short-term loans**

The Group's short-term loans decreased during the 2012 to 2014 period from HRK 430,914 thousand at 31 December 2012 to HRK 692,654 thousand at 31 December 2013 and HRK 8,981 thousand at 31 December 2014. This was primarily the result of the Group's approach to use its own funds for working capital purposes and for the settlement of trade payables. Additionally, due to favourable hydrology conditions during 2013 and 2014, the need for market procured electricity decreased which resulted in lower costs of electricity purchase and decreased production from thermal power plants which use expensive energy fuel for production. These factors resulted, among other things, in the improved liquidity position of the Group with less need for short-term loans.

At 30 June 2015, the Group did not have any amounts outstanding under its short-term financing facilities and HRK 1,323,561 thousand was available for drawing.

### **Capital Expenditures and Acquisitions**

The following table sets forth the Group's capital expenditures by operating segment for the periods indicated.

	Year ended 31 December			Year ended 31 December	
	2012	2013	Change	2014	Change
	<i>(HRK in thousands)</i>			<i>(HRK in thousands)</i>	
			%		%
HEP Proizvodnja (generation).....	788,092	580,515	(26.3)	426,845	(26.5)
HOPS (transmission).....	489,622	416,710	(14.9)	423,721	1.7
HEP-ODS (distribution).....	1,065,840	894,593	(16.1)	997,606	11.5
Other .....	499,895	473,844	(5.2)	215,551	(54.5)
<b>Total (Group).....</b>	<b>2,843,449</b>	<b>2,365,662</b>	<b>(16.8)</b>	<b>2,063,723</b>	<b>(12.8)</b>

The Group has invested and is expected to invest significant additional amounts in the next five years to maintain and develop its generation capacity, to meet regulatory standards with respect to its transmission and distribution networks, to improve efficiency and to increase capacity. Construction and maintenance costs have increased throughout the power industry over the past several years and future costs will be highly dependent on the cost of building materials and availability of contractors. Since 1 January 2012, the Group has invested HRK 1,795 million towards increasing the generation capacity and improving the operational efficiency and environmental performance of the existing generation facilities, HRK 1,330 million to improve its electricity transmission network, HRK 2,958 million to improve its electricity distribution networks and HRK 1,189 million towards other items, including improving its thermal energy and gas distribution network and information and telecommunication infrastructure and a safety upgrade program for NPPK as the main precondition for the extension of its plant lifetime.

The table below sets out the Group's investment program and planned capital expenditure from 2015 until 2028.

	<b>Expected Increase in Installed Capacity</b>	<b>Expected Amount of Investment (HRK billions)</b>	<b>Planned Construction</b>
Revitalisation of 12 HPPs and one TPP	144 MW	2.1	Until 2022
<b>Thermal Power Plants (TPPs)</b>			
Construction of EL-TO Zagreb (CCCGT)	130 MWe	0.8	Completed by the end of 2020
Construction of KKE Osijek (CCCGT)	500 MWe	2.4	Completed by the end of 2020
<b>Biomass Power Plants</b>			
BE TO Sisak	3 MWe, 11 MWt	0.144	Completed by the end of 2017
BE TO Osijek	3 MWe, 11 MWt	0.123	Completed by the end of 2017
<b>Hydro Power Plants (HPPs)</b>			
HPP Dubrovnik II <sup>(1)</sup>	152 MW	0.7	Commence in 2018
HPP Kosinj/Senj	410 MW	3.2	Commence in 2022
	—	4.9	Completed by the end of 2020
<b>Modernisation of distribution network</b>			
	—	3.9	Completed by the end of 2020
<b>Modernisation of transmission network</b>			
<b>Total</b>	<b>1,342 MW</b>	<b>18.3</b>	<b>—</b>
TPP Plomin C <sup>(2)</sup>	500 MW	6.5	Completed by the end of 2021

(1) The Group intends to enter into a joint venture (50%/50%) with a strategic partner in order to finance the construction of this facility. Expected amount of investment indicated in the table represents the Group's share (50%) of investment which corresponds to the part of expected installed capacity of the facility allocated to the Group, i.e. to 152 MW.

(2) The Group intends to enter into a joint venture (50%/50%) with a strategic partner in order to finance the construction of this facility and to jointly operate the plant for next 20 years after the commencement of operations. The amount of investment indicated in the table represents the price of the EPC required to construct the plant with the installed capacity of 500 MW. The Group's share of investment will depend on the adopted business model which will be determined further to the negotiations with a strategic partner.

Due to technical obsolescence and environmental constraints, the Group expects to retire around 1,100 MW of its thermal generation capacity over the next seven years. Therefore, the Group's medium-term investment strategy for the next seven years includes, among other things, the construction of an additional three thermal power plants (KKE Osijek 500, EL-TO Zagreb and Plomin C), commencement of the construction of two hydro power plants (HPP Dubrovnik II and HPP Kosinj/Senj II), an increase in the generating capacity and efficiency of its existing facilities, in particular through the revitalisation of its hydro power plants and a thermal power plant, and further modernisation and expansion of the transmission network in order to reduce network losses.

Additionally, in order to increase its renewable energy portfolio, in 2016 the Group is planning to start the construction of two biomass fuelled plants in Osijek and Sisak, with an installed electricity generation capacity of 3 MW each and with an installed thermal energy generation capacity of 11MW each. The Group is also considering the acquisition of renewable energy projects developed by third parties in Croatia and abroad. As part of its strategy to expand into regional markets, the Group is also considering the acquisition of companies operating in the retail electricity markets of neighbouring regions.

In addition, the Group is also committed to modernising and expanding its distribution network in order to further reduce network losses, meet the country's growing need for electricity and connect new customers, in particular in the major cities, tourist and industrial areas.

### ***Contingent Liabilities and Commitments***

The table below sets out the Group's contingent liabilities and commitments at 30 June 2015.

	<b>At 30 June 2015</b>
	<i>(Unaudited)</i>
	<i>(HRK in</i>
	<i>thousands)</i>
Liabilities under given letters of credit under accepted payment and insurance instruments .....	82,656
Other given payment instruments .....	3,772
Provisions for court disputes .....	379,023
Received payment instruments .....	229,797
Funds invested in Bosnia and Herzegovina and Serbia .....	1,243,970
<b>Total</b> .....	<b>1,939,218</b>

The Group also has long-term financial investments in Bosnia and Herzegovina and Serbia, which in 1994 had a historical cost of HRK 1,243,970 thousand. When HEP was reorganised as a joint stock company, this amount was excluded from the net asset value of these investments. For the description of provisions for court disputes, please see “*Business—Legal Proceedings.*”

### ***Material Contracts***

The following are the Group's material long-term and short-term loan agreements, with the outstanding loan amounts given as of 30 June 2015.

#### ***Long-Term Loan Agreements***

##### ***Loan Agreement with KfW***

On 17 December 2008, HEP entered into a loan agreement with KfW, as since amended by Annex No. 1 dated 1 November 2013, for finance investments for projects promoting renewable energy and energy efficiency, governed by German law, for €50,000 thousand (equivalent to approximately HRK 375,505 thousand) of which €43.454 thousand is still available for disbursement until 30 December 2017. The agreement provides for a negative pledge and a *a pari passu* security interests undertaking, with a basket of €5,000 thousand, which must be complied with at all times up until full repayment of the loan. The loan is to be repaid in equal semi-annual instalments up until 30 December 2023. There are also events of default, such as an event of default if negotiations are entered into with any third party creditor for the waiver of the debts of HEP and a cross default provision on any financial indebtedness exceeding €5,000 thousand.

##### ***Financing Agreement with KfW***

On 3 February 2009, HEP entered into a financing agreement with KfW, governed by German law, for €600 thousand (equivalent to HRK 4,506 thousand). This agreement was amended once, by Annex no.1 dated 28 October 2013. This agreement provides for financial contributions to HEP by KfW which are only repayable if the funds are not applied in accordance with the terms of the agreement. These are to use the funds for advisory services in relation to the Croatian Climate Protection Programme, to contribute their own funds in relation to these services and to ensure the funds provided under the agreement are not applied to any taxes and public charges payable by HEP.

##### ***Club loan agreement with Privredna banka Zagreb d.d., Raiffeisen Bank Austria d.d. Zagreb and Zagrebačka banka d.d.***

On 4 October 2011, HEP entered into a club loan agreement with Privredna banka Zagreb d.d., Raiffeisen Bank Austria d.d. Zagreb and Zagrebačka banka d.d as lenders and Privredna banka Zagreb d.d. as facility agent for €150,000 thousand, of which €123,529 thousand was still outstanding at 30 June 2015. The loan is used for the general corporate purposes of the Group and for the implementation of its investment plan. The loan agreement includes certain financial covenants, breach of which would also constitute an event of default, including, among other things, the

maintenance of consolidated net tangible asset value, a ratio of EBITDA to net financial expenses and a ratio of indebtedness to consolidated net tangible assets. As security, HEP was obliged to provide one blank promissory note for each of the lenders in the amount of €50,000 thousand and one debenture note for each of the lenders in the amount of €50,000 thousand. The final repayment date of the club loan agreement is 4 October 2018.

#### *Loan agreement with Croatian Bank for Reconstruction and Development*

On 13 March 2002, HEP entered into a loan agreement with the Croatian Bank for Reconstruction and Development for €123,000 thousand of which €44,455 thousand was still outstanding at 30 June 2015. The original issued amount was decreased by Annex no. 2 to €18,762 thousand. This agreement has been amended several times: (i) Annex no.1 dated 4 April 2002; (ii) Annex no. 2 dated 20 July 2005; (iii) Annex no. 3 dated 31 March 2006 and (iv) Annex no. 4 dated 20 June 2007. The funds borrowed are to be used for the reconstruction and development of the transmission network (utilities infrastructure related to Program Žerjavinec i Program Ernestinovo). The loan agreement contains periodic information covenants however it does not contain financial or operating covenants. The final repayment date of the loan agreement is 30 December 2019. The difference between the original amount of the loan and the loan amount, as decreased by Annex No. 2 (€4,237 thousand (equivalent to HRK 31,000 thousand)) was granted to HEP under a separate loan agreement executed with the Croatian Bank for Reconstruction and Development on 20 July 2005, as amended by Annex No. 1 dated 31 March 2006 for the purposes of financing utilities infrastructure related to Program Split (investment in the transmission and distribution networks, including reconstruction of two substations near Split). The loan agreement, dated 20 July 2005, was entered into on terms similar to those of the loan agreement dated 13 March 2002, including with respect to the final repayment date of 30 December 2019.

#### *Loan agreement with Croatian Postal Bank*

On 28 September 2011, HEP entered into a loan agreement with Croatian Postal Bank for €20,000 thousand, of which €15,249 thousand was still outstanding at 30 June 2015. The funds borrowed are to be used for the financing of capital investments and for liquidity purposes. As security, HEP provided two blank promissory notes and two blank debenture bonds, each in the amount of HRK 1,000 thousand, and one debenture bond in the amount of €20,000 thousand. The final repayment date of the loan agreement is 28 September 2018.

#### **Short-Term Loan Agreements**

The Group has entered into a number of short-term loan agreements with domestic and foreign banks in order to maintain reserves in case of liquidity shortage. At 30 June 2015 the Group did not have any amounts outstanding under its short-term financing facilities, and HRK 1,323,561 thousand was available for drawing.

As security for its obligations arising under all of the short-term loan agreements and related agreements executed with ERSTE FACTORING d.o.o., which are due on 31 December 2015, HEP issued a debenture bond in the amount of HRK 362,000 thousand. Additionally, as security for HEP's obligations arising under all of the short-term loan agreements and related agreements executed with Zagrebačka banka d.d., HEP issued a debenture bond in the amount of HRK 300,000 thousand.

## Related Party Transactions

The following table sets forth balances due to and from related parties at 30 June 2015 and 31 December 2014, 2013 and 2012:

	Sales revenue					Purchase costs				
	Year ended 31 December			30 June		Year ended 31 December			30 June	
	2012	2013	2014	2014	2015	2012	2013	2014	2014	2015
	(Unaudited)					(Unaudited)				
	(HRK in thousands)									
Enterprises controlled by the Government										
Croatian Railways.....	112,500	137,709	104,993	52,367	52,692	12,765	67,997	3,297	1,626	1,358
INA-Oil Industry (Parent) .....	155,192	156,430	131,359	60,564	68,951	132,403	54,506	983,943	329,131	666,726
Natural Gas .....	—	—	—	—	—	2,531,088	2,002,330	457,863	378,079	—
Plinacro.....	2,136	2,298	2,274	1,268	584	34,760	64,278	73,949	34,392	32,544
Croatia Osiguranje – Insurance Co .....	5,508	5,618	5,136	2,582	1,644	16,371	17,543	14,223	7,443	818
Croatian Post .....	23,245	23,210	20,226	11,650	6,263	60,553	44,539	22,493	17,821	9,765
Croatian Forests .....	6,474	5,529	3,260	1,861	1,814	6,087	2,261	5,464	2,712	1,718
Jadrolinija .....	1,102	870	650	304	304	647	4,031	658	261	566
Official Gazette.....	2,590	1,618	2,385	787	1,202	5,120	4,438	3,932	1,946	1,733
Croatian radio and television .....	12,437	13,735	13,127	6,811	6,476	1,185	1,194	1,158	519	634
Plovput .....	579	578	446	275	146	692	165	349	140	68
Croatia Airlines.....	780	981	768	384	390	—	66	6	61	—
Petrokemija Kutina .....	29,028	3,488	18,537	10,855	10,258	118	82	61	30	10
Ministry of Foreign and European Affairs.....	525	513	455	227	229	—	—	—	—	—
Ministry of Defence .....	22,530	24,358	22,182	12,188	10,686	—	—	—	—	—
Ministry of Interior .....	25,187	26,510	13,074	6,962	7,303	—	—	—	—	—
Primary and secondary schools ...	82,888	88,078	78,055	45,233	44,232	—	—	—	17	1
Judicial institutions .....	12,185	13,758	8,188	4,672	4,473	—	173	74	46	31
Universities and Institutes of Technology .....	31,594	33,610	27,792	15,581	15,434	4,145	3,715	1,172	736	402
Legislative, executive and other government bodies.....	30,482	29,040	26,129	13,777	13,799	6,572	6,345	5,426	3,142	1,833
Health institutions and organisations.....	89,538	122,821	112,742	58,890	54,233	3,233	3,194	1,168	754	300
Other users .....	12,024	16,619	11,342	6,159	7,392	16,669	6,577	5,124	1,853	1,821
	658,524	707,371	603,120	313,397	308,505	2,832,408	2,283,434	1,580,360	780,709	720,328

	Amount of receivables				Amount of liabilities			
	Year ended 31 December			30 June	Year ended 31 December			30 June
	2012	2013	2014	2015	2012	2013	2014	2015
	(Unaudited)				(Unaudited)			
	(HRK '000)							
Enterprises controlled by the Government								
Croatian Railways.....	45,902	79,781	31,811	23,693	2,460	39,792	541	265
INA-Oil Industry (Parent).....	18,927	18,298	14,544	13,168	12,707	11,075	163,640	91,077
Natural Gas.....	—	—	—	1	297,100	153,148	—	97
Plinacro.....	355	400	125	98	—	8,670	11,446	4,512
Croatia Osiguranje – Insurance Co.....	610	611	705	301	4,356	5,119	2,779	353
Croatian Post.....	3,107	3,211	1,282	845	3,791	8,786	2,725	1,008
Croatian Forests.....	1,041	530	474	251	365	49	4	13
Jadrolinija.....	178	57	49	127	592	1,274	581	395
Official Gazette.....	263	163	289	390	1,361	1,226	838	608
Croatian radio and television.....	2,385	2,399	2,653	1,919	152	147	39	31
Plovput.....	65	74	24	5	102	51	165	51
Croatia Airlines.....	148	217	95	58	276	—	—	—
Petrokemija Kutina.....	5,026	9,488	3,675	3,741	—	—	13	13
Ministry of Defence.....	3,260	4,090	4,311	1,879	—	—	—	—
Ministry of Interior.....	3,402	6,592	2,069	1,162	—	—	—	—
Primary and secondary schools.....	15,191	20,491	16,526	7,495	—	—	—	—
Judicial institutions.....	3,841	4,532	1,838	563	—	—	—	—
Universities and Institutes of Technology.....	4,847	4,619	4,161	5,124	—	—	—	—
Legislative, executive and other government bodies.....	5,825	5,572	5,131	2,486	—	—	—	—
Health institutions and organisations.....	18,789	27,855	20,202	13,510	—	—	—	—
Other users.....	3,569	4,191	21,623	21,436	6,351	3,513	10,317	4,296
	136,731	193,171	131,587	98,252	329,613	232,850	193,088	102,719

The Group's transactions with related parties relate to receivables and revenue from the sale of electricity, thermal energy and gas, as well as to the Group's obligations and costs incurred on the basis of services rendered and goods delivered. Delivery of goods principally includes the deliveries by INA – Industrija nafte d.d. ("INA Group") (the national oil company), Natural Gas and Plinacro



for motor fuel and natural gas for the Group's generation facilities and gas sales on the wholesale market.

The Group has a 50% holding in NEK and as a result receives 50% of total electricity that it produces. The price for such electricity is set according to the total generation costs incurred by NEK.

### ***Quantitative and Qualitative Disclosures about Market Risk***

#### ***Market Risk***

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market prices comprise two types of risk: currency risk and interest rate risk. Market risk exposures are supplemented by sensitivity analysis—for additional information about market risk and certain sensitivity information relating to the risks discussed below, see Note 36 “*Financial Instruments*” to the Annual Financial Statements.

#### ***Currency Risk***

The Group is exposed to transactional foreign currency risk in two main ways: (i) on expenses (particularly in relation to costs for fuel and purchased electricity) and, although to a much lesser extent, on revenues that are denominated in currencies other than Kuna; and (ii) because a significant portion of the Group's debt (including the 2017 Notes) is denominated in currencies other than the Kuna, the Group is sensitive to domestic currency depreciation.

The Group also presents its consolidated results in Kuna. Accordingly its reported financial results are subject to movements in exchange rates on the translation of financial information of areas of the Group's business where the functional currency is not the Kuna.

At 30 June 2015, the Group's exposure to currency risk accounted for 95.0% of its total debt.

#### ***Interest Rate Risk***

The Group's exposure to interest rate risk relates primarily to the costs of its floating rate borrowings benchmarked against EURIBOR, amongst others. 29.9% of the Group's external borrowings (HRK 1,401,638 thousand) at 30 June 2015 were issued with a variable interest rate. The Group manages its interest rate exposure by maintaining an appropriate mix between fixed and floating rate borrowings and by utilising interest rate swap contracts.

#### ***Capital Risk***

The Group's objective when managing capital is to safeguard the Group's ability to be able to continue as a going concern.

The Group monitors capital using a gearing ratio, which is net debt divided by equity. The Group includes within net debt its interest-bearing loans and borrowings less cash. Management monitors the capital structure on a semi-annual basis and may adjust its capital management policies and targets following changes in its operating environment, market sentiment or its development strategy. The Group's aim is to keep the gearing ratio below the level of three times EBITDA. For further information in relation to capital risk, see Note 36 “*Financial Instruments*” to the Annual Financial Statements.

#### ***Commodity Risk***

The Group's exposures to changes in commodity prices are primarily associated with the purchase of fuel for its power plants and the purchase and sale of electricity at variable prices.

Currently the Group does not use any financial derivatives to hedge or manage combat commodity risk due to the lack of an effective derivatives market in the region. Instead the Group uses long-term

bilateral contracts (most frequently annual and quarterly contracts) to fix the price for the purchase of electricity.

However, as a majority of the Group's electricity is sold under the public tariff system (50% at 31 December 2014) and a stable revenue stream arises also from public tariffs collected for the regulated activities of transmission and distribution of electricity, the Group is able to predict consumption levels and therefore plan for its fuel consumption requirements for any year and in so doing be able to purchase required fuel on the market at optimal times and prices.

Further, the Group's annual contracts allow for the ability to cancel the delivery of electricity. This allows the Group to manage price, quantity and, to a certain extent, given the Group's reliance on output from hydro power plants, weather related factors. The Group covers approximately 60% of its balance sheet needs by way of annual contracts with the remaining portion covered by purchase on a quarterly, monthly, weekly or daily basis.

In addition the Group seeks to protect itself from fluctuations in electricity prices by choosing the optimal moment to call for tenders for the purchase of necessary quantities of electricity.

#### *Credit Risk*

Credit risk is the risk that the Group will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Group is the sole supplier of electricity in the Republic of Croatia to Tariff Customers and as such it has a public responsibility to provide services to all users and locations across the country, regardless of the credit risks associated with particular customers.

Although trade receivables, net, are spread across a wide geographical area and across industries and customer bands resulting in the Group being largely protected from any significant credit risk exposure to any single counterparty or any Group of counterparties having similar characteristics, the ongoing economic crisis, the condition of the Croatian economy and consequential illiquidity and unemployment, has resulted in the Group being exposed to increasing levels of bad and doubtful debts and the Group has faced increasing difficulty in debt recovery.

In addition, there are restrictions under Croatian law with respect to disconnecting non-paying customers, which impacts the Group's subsidiaries that supply the Non-Tariff Customers. Under Croatian law, HEP-Supply is not permitted to disconnect its Non-Tariff customers in the event of non-payment of invoices. In the event that a customer fails to pay for its electricity in a timely fashion, the only recourse of HEP-Supply is the termination of the supply contract with such customer. In the event that a customer's contract is terminated, such customer will return to the tariffed supply system where it will be charged in accordance with the tariffs set by HERA; however it will still receive electricity. The customer may only be disconnected whilst in the public system. The result of this situation is that debt collection is more difficult and the process is relatively time-consuming.

The Group has had greater success with debt collection from Households than Commercial Customers. Debt collection has been significantly impacted by low liquidity of Commercial Customers, coupled with slow business activities due to frequent instances of accounts being blocked as a result of historic payment issues and Commercial Customers operating at a loss.

The Group has been continuously implementing measures aimed at improving the collection of receivables by using already existing methods and instruments for improved collection, including regular supervision of bill collection, supervision of due dates to avoid their statute of limitations being passed, regular submission of reminders, providing extended time periods for settling debt under the threat of disconnection (where legally possible), disconnections (where legally possible), compensation claims, filing legal charges, debt reprogramming and other instruments for collecting payments. In addition, the Group has also started requiring its Commercial Customers to enter into payment insurance instruments (such as blank promissory notes) and implemented a policy of

maintaining regular and close contact with senior management within such customers in order to ensure timely collection of receivables.

Despite the less than favourable economic situation, the collection period is currently considered by Management to be satisfactory (on average 52 days at 30 June 2015 and 54 days at 30 June 2014) as a result of these measures and activities for improving and enhancing debt collection.

For further information relating to the impact on the Group of credit risks, see Note 36 “*Financial Instruments*” to the Group’s Annual Financial Statements.

#### *Liquidity Risk*

The Group is subject to liquidity risk to the extent that its current assets and available sources of funds may not be sufficient to meet current liabilities. The Group’s approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when they are due, under both normal and stressed conditions, without incurring unacceptable losses. The Group aims to maintain the level of its reserves in an amount in excess of expected cash outflows on financial liabilities. The Group also maintains lines of credit for financing the working capital needs and future commitments.

At 30 June 2015, the Group had access to financing facilities in an aggregate amount equal to HRK 1,732,960 thousand, of which HRK 1,652,972 thousand remain unused.

#### **Critical Accounting Policies and Estimates**

The Group prepares its Financial Statements in compliance with IFRS as adopted by the EU. As such, its management is required to make certain estimates, judgments and assumptions that it believes are reasonable based on the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the Financial Statements, the reported amounts of income and expenses during the periods presented and the related disclosure of contingent assets and liabilities.

The Group evaluates its estimates on an ongoing basis, using previous experience, consultation with experts and other methods considered reasonable in the particular circumstances to ensure full compliance with IFRS and best practice. Actual results may differ significantly from the Group’s estimates, the effect of which is recognised in the period in which the facts that gave rise to the revision became known.

The Group’s material accounting policies are set out in full in Note 2 “*Summary of Significant Accounting Policies*” to the Annual Financial Statements. Certain of the Group’s accounting policies have been identified as critical accounting policies including those policies involving particularly complex or subjective decisions or assessments, and these are discussed below. The discussion below should be read in conjunction with the full statement of accounting policies.

When applying accounting policies described in Note 2 “*Summary of Significant Accounting Policies*” to the Annual Financial Statements, the Management made certain judgments that had a significant impact on the amounts stated in the 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***

The Group reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. In 2014 useful lives of gas pipelines were extended from 20-25 year to 40 years.

#### ***Impairment of trade and other receivables***

The Management uses its judgment when estimating whether trade and other receivables have suffered an impairment loss.

### ***Provisions for environmental protection***

The applicable regulations, specifically the environmental protection legislation, do not specify requirements, activities or technology to be applied.

In determining the level of provisions for environmental protection and decommissioning, the Management relies on prior experience and its own interpretation of the related legislation. Pursuant to Article 4.1 of the Act on Acknowledging the Contract between the Croatian Government and the Government of the Republic of Slovenia on Regulating the Status and other Legal Relations regarding Investment, Exploitation and Decommissioning of the NPPK, on 28 April 2006 the Croatian Government issued a Regulation on the payment of funds for decommissioning and disposal of radioactive waste and consumed nuclear fuel of NPPK.

Provision for decommissioning of thermal power plants represents present value of the estimated decommissioning costs of the Group's thermal power plants.

### ***Recognition of revenues from sale of electricity***

As revenue 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 (e.g. five-year average, a linear approximation), Management chose the method of logarithmic regression as the most appropriate. The amount of losses on the distribution network is calculated using the percentage of the logarithmic regression function on the total amount of purchased energy from the transmission network; the result is the amount of electricity lost in the distribution network for the current year in MWh. The difference between initially estimated revenues and actual prepayments is recognised in the statement of financial position as other short-term liabilities or other short-term receivables.

### ***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. Impairments of non-current assets are disclosed in the Note 3 to the Annual Financial Statements.

### ***Availability of taxable profits for which deferred tax assets could be recognised***

Deferred tax assets are recognised 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. The carrying amount of deferred tax assets at 31 December 2014 amounted to HRK 653,907 thousand, at 31 December 2013 to HRK 756,647 thousand and at 31 December 2012 to HRK 724,929 thousand.

### ***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 364,497 thousand at 31 December 2014, to HRK 271,527 thousand at 31 December 2013 and to HRK 329,484 thousand at 31 December 2012.

### ***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.

## BUSINESS

### Overview

According to the most recent Annual Energy Report of the Ministry of Economy for 2013, the Group is the leading power generation, transmission, distribution and supply company in Croatia. The Group is a vertically integrated power utility company, operating across the entire electricity market spectrum from generation to end-consumer distribution organisation. As part of its operations, the Group is also engaged in, *inter alia*, thermal energy (heat) generation, distribution and supply, and gas distribution and supply on the wholesale and retail markets in Croatia, as well as in electricity trading. The Group operates under the trading name “HEP”.

According to Management’s estimates, the Group accounted for approximately 84% of electricity generated, approximately 92% of installed electricity generation capacity, 100% of electricity distribution (in terms of the number of connection points) and approximately 85% of all electricity sold in Croatia in the year ended 31 December 2014.

In order to comply with EU regulation, the Group has implemented legal, financial, accounting, IT and managerial barriers between its subsidiaries engaging in regulated activities, such as transmission and distribution, and those engaging in other activities, such as generation and supply (unbundling). Each company within the Group is tasked with specific roles within the various energy segments of the market. The Group comprises 15 wholly owned subsidiaries and one jointly controlled power plant. The power plant is the Krško nuclear power plant (NPPK), located in the Republic of Slovenia and co-owned with GenE. In addition, HEP jointly owns, together with Plinacro d.o.o., LNG Hrvatska d.o.o. (“**LNG Hrvatska**”), which joint venture was formed for the purpose of developing a liquefied natural gas regasification terminal in Omišalj on the island of Krk, Croatia.

Electricity, thermal energy and gas consumption is seasonal and is mainly affected by weather conditions. In Europe, electricity consumption is generally higher during the summer and winter months, and the Group is generally affected by these trends in customer consumption.

### Financial Overview

In the years ended 31 December 2012, 2013 and 2014 and the six months ended 30 June 2015, the Group had a total operating income of HRK 14,024,630 thousand, HRK 14,709,185 thousand, HRK 13,599,174 thousand and HRK 7,143,902 thousand, respectively, loss for the year ended 31 December 2012 of HRK 43,941 and profit for the years ended 31 December 2013 and 2014 and the six months ended 30 June 2015 of HRK 1,267,874 thousand, HRK 2,465,424 thousand and HRK 1,345,146 thousand, respectively.

At 31 December 2014 and 30 June 2015, the Group had total assets of HRK 35,856,718 thousand and HRK 35,751,984 thousand, respectively. At 31 December 2014 and 30 June 2015, the Group had approximately 12,061 employees and 12,000 employees, respectively.

### Tariff System and Classification of Customers

The Croatian energy sector has been fully liberalised since 2008. Nevertheless, certain activities, including the transmission, distribution and public supply of electricity and the distribution of thermal energy and gas, are regulated activities. Such regulated activities are subject to fixed tariff rates which are set by HERA. The Group’s customers in Croatia can be split between Commercial Customers, which include commercial and industrial entities, and Households, which are residential customers. As part of the Accession, the Croatian Government has adopted EU regulations for the energy market which allow, pursuant to the Electricity Market Act, all electricity customers to choose a Market Supplier which offers non-tariff based rates, rather than remaining with the public supply system (see “*Regulation—Accession of the Republic of Croatia to the EU*” for further details). Customers who choose a Market Supplier typically pay lower rates than the tariffed rates under the public supply system, but they may be more exposed to price fluctuations in market rates. In the event that a customer fails to choose a Market Supplier or its contract with a Market Supplier is terminated, such customer is supplied by the public supply system, and is charged in accordance with the tariffs set by HERA. Customers who are supplied through the public supply system (either within universal service for Households or guaranteed supply for Commercial Customers) are referred to as Tariff Customers

and customers who are supplied by Market Suppliers (including HEP-Supply) are referred to as Non-Tariff Customers.

### ***Principal Activities***

The Group's principal activities are the generation, transmission, distribution and supply of electricity.

#### ***Generation***

The Group operates a portfolio of power generation assets with an aggregate installed capacity of 4,232 MW at 31 December 2014. The Group's electricity and thermal energy generation operations are carried out by HEP-Proizvodnja d.o.o. ("**HEP-Generation**"), a wholly owned subsidiary of HEP established on 17 June 2002, which is responsible for the generation of electricity and thermal (heat) energy.

The Group benefits from a diversified generation mix, which includes 26 hydro power plants with an aggregate total installed capacity of 2,214 MW and the NPPK with an installed capacity of 696 MW (of which 348 MW is allocated to the Group). The Group's generation mix also includes eight thermal power plants (including TE Sisak and TE Rijeka which are currently not operating) with an aggregate installed capacity of 1,670 MW, of which 482 MW is natural gas, 892 MW is oil and 297 MW is coal. The Group uses its oil-fired thermal power plants primarily to meet high electricity demand or during adverse weather conditions, such as prolonged dry periods, during which the hydro power plants are not operating at full capacity.

The following chart shows the Group's electricity generation mix for the year ended 31 December 2014 and for the six months ended 30 June 2015.

	<b>For the year ended 31 December 2014</b>		<b>For six months ended 30 June 2015</b>	
	<b>GWh</b>	<b>%</b>	<b>GWh</b>	<b>%</b>
<i>Electricity Generation:</i>				
Hydro power plants .....	8,356	58.5	3,625	58.3
Nuclear power plant .....	3,030	21.2	1,192	19.2
Thermal power plants .....	2,891	20.3	1,395	22.5
<b>Total:</b> .....	<b>14,277</b>	<b>100</b>	<b>6,212</b>	<b>100</b>

#### ***Transmission***

Further to the Accession and in order to comply with the Third Energy Package and the Electricity Market Act, the Group was required to unbundle the Group's transmission operations from its generation and supply operations. HEP opted for the independent transmission operator ("**ITO**") model of unbundling, which prescribes that the transmission system operator ("**TSO**") shall be equipped with all human, technical, physical, financial and IT resources necessary for fulfilling their obligations and carrying out the activity of electricity transmission. In particular, assets that are necessary for the activity of electricity transmission (including the transmission system) shall be owned by the TSO, and personnel necessary for the performance of electricity transmission (including all corporate tasks) shall be employed by the TSO. As of 2 July 2013, the Group's transmission operator, HEP-Operator prijenosnog sustava d.o.o., was renamed to Hrvatski operator prijenosnog sustava d.o.o. ("**HOPS**") and restructured to ensure legal, financial, accounting, IT and managerial independence from the Group's generation and supply operations. The unbundling process of HOPS has not been completed and the Group is awaiting the required approval and certification of HERA and the European Commission. HOPS submitted its certificate request to HERA for review in July 2015 and is currently expecting HERA to prepare and submit the draft certificate to the European Commission in October 2015. For more information, see "*Regulation—Third Energy Package*" and "*Risk Factors—The Group's restructuring required under EU energy laws has not yet been completed*".

HOPS is the sole operator of the Croatian electricity transmission system and is responsible for its maintenance, development and further construction costs. HOPS transfers electricity produced by Croatian power plants or imported from other countries to its Croatian customers and transfers Croatian-produced electricity for export purposes and non-HEP generated electricity to Non-Tariff Customers from other Market Suppliers. See "*Tariff System and Classification of Customers*" below for further details. At 30 June 2015 HOPS operated 7,648 kilometres of 400/220/110 kV lines and 173 accompanying sub-stations across Croatia.

### *Distribution*

The Group's distribution operations transfer electricity through its distribution network from sub-stations to electricity suppliers, including the Group's competitors. The Group's electricity distribution operations are run by HEP-Operator distribucijskog sustava d.o.o. ("**HEP-ODS**"), a wholly owned subsidiary of HEP established on 13 June 2002. Pursuant to the Electricity Market Act, HEP-ODS is the sole supplier of electricity to Tariff Customers in Croatia. See "*Tariff System and Classification of Customers*" below for further details.

In the year ended 31 December 2014 the Group distributed a total of approximately 14,183 GWh of electricity in Croatia and at 31 December 2014 the Group had a market share of 100% for the distribution of electricity and public supply services to the Tariff Customers in Croatia.

### *Supply*

The Group supplies Non-Tariff Customers with electricity through HEP Opskrba d.o.o. ("**HEP-Supply**"), a wholly owned subsidiary of HEP established on 20 January 2003.

While there is no competition for Tariff Customers, competition for Non-Tariff Customers has significantly increased as a result of the Accession and liberalisation of the electricity supply market in Croatia and further intensified as a result of a significant decrease in electricity prices in the Croatian wholesale market during the second quarter of 2013.

In the year ended 31 December 2014 the Group sold 12,908 GWh of electricity to end-consumers in Croatia. According to Management's estimates, the Group's share of electricity sold to end-consumers in Croatia was 98.6%, 95.5% and 86.8% for the years ended 31 December 2012, 2013 and 2014, respectively, and 85.1% for the six months ended 30 June 2015. In order to prevent any further loss of market share in electricity supply to Non-Tariff Customers, the Group is currently focusing on a number of supply projects, such as offering new products and energy services to its customers, including renewable energy products, introducing electronic billing and online payment options, tailoring the pricing plans to the individual customer's needs and emphasising customer relations as being at the forefront of its operations.

### *Other Activities*

The Group also has a trading platform in electricity, thermal and gas operations and other ancillary businesses related to energy services.

### *Trading*

The Group's trading platform, HEP-Trgovina d.o.o. ("**HEP-Trade**"), a wholly owned subsidiary of HEP established on 30 October 2006, buys and sells electricity and is responsible for the optimisation of the Group's power plant operation and intermediation in the domestic and international markets. The Group operates in the wholesale electricity market in Croatia and abroad, through its local balance groups (Austria, Hungary, Slovenia, Germany) and HEP-Trade's subsidiaries located in Hungary, Bosnia and Herzegovina, Slovenia, Serbia and Kosovo. HEP-Trade also operates in the retail electricity market through HEP Energija d.o.o. Ljubljana, its subsidiary in Slovenia, and trades gas on the wholesale market, green certificates and CO<sub>2</sub> emissions allowances.

### *Thermal Energy (heat)*

In addition to electricity, the Group is actively engaged in thermal energy generation, distribution and supply through HEP-Toplinarstvo d.o.o. ("**HEP-Top**"), a wholly owned subsidiary of HEP established on 18 May 2001. At 31 December 2014, the Group had a total installed capacity of 2,137 MW<sub>heat</sub>. Thermal energy is primarily generated as a by-product of electricity generation at the Group's thermal power plants and is distributed to the cities of Zagreb, Osijek, Sisak, Zaprešić, Velika Gorica and Samobor. At 31 December 2014, the Group distributed thermal energy to more than 124,000 customers covering approximately 80% of the district heating market in Croatia, making the Group the largest of 19 distributors of thermal energy in the



country (according to the most recent report of HERA, for 2014). In the year ended 31 December 2014 the Group distributed a total of approximately 1,859 GWh\* of thermal energy to end-consumers in Croatia.

	For the year ended 31 December 2014		For six months ended 30 June 2015	
	GWh	%	GWh	%
<i>Thermal Energy Generation:</i>				
Thermal Power Plants .....	2,058	92.8	1,237	92.2
District Boiler Stations <sup>(1)</sup> .....	159	7.2	105	7.8
<b>Total:</b> .....	<b>2,217</b>	<b>100</b>	<b>1,342</b>	<b>100</b>

(1) Stations for distributing thermal energy generated in a centralised location for residential and commercial heating requirements.

### *Gas-Wholesale*

Pursuant to the decision of the Croatian Government, HEP was chosen as the sole supplier to the Croatian wholesale gas market for the period from 1 April 2014 until 31 March 2017. HEP Opskrba plinom d.o.o. (“**HEP Gas Supply**”), a wholly owned subsidiary of HEP established on 5 May 2014, acts as an agent for HEP and performs its obligations (i) to distribute gas under regulated terms to suppliers in Croatia for further sale to household customers and (ii) to ensure a reliable and safe gas supply in Croatia. HEP entered into gas supply/sales agreements with 35 companies (public service suppliers), including its subsidiary HEP-Plin d.o.o. (“**HEP-Plin**”). HEP also entered into gas procurement contracts with two companies, a transmission system operator and a storage system operator. In 2014, the Group distributed a total of approximately 3,022 million GWh (or 315 million m<sup>3</sup>) of gas on the wholesale market.

### *Gas-Retail*

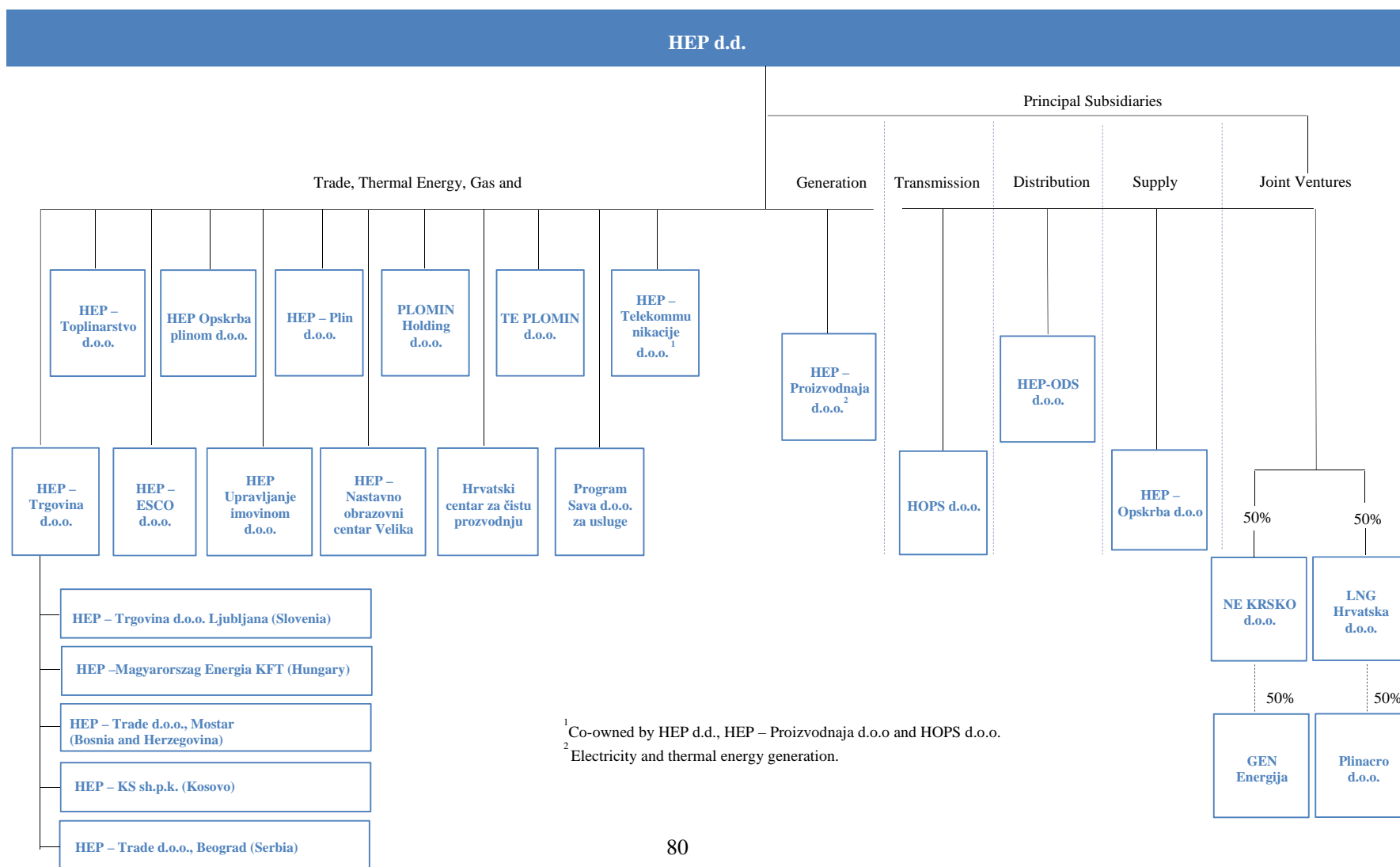
The Group is also engaged in gas distribution and supply in the retail market through HEP-Plin, a wholly owned subsidiary of HEP established on 5 June 2001. In the year ended 31 December 2014 the Group distributed a total of approximately 1,114 GWh (or 115 million m<sup>3</sup>) of gas to end-consumers in Croatia. According to Management’s estimates, at 31 December 2014 the Group had a market share of approximately 10.5% for the distribution and supply of gas in the retail market.

### *Other*

The Group’s other businesses involve the preparation, construction and use of renewable energy sources (including wind, biofuel, small hydro and geothermal water), energy efficiency projects, environmental protection, tourism and hospitality services, infrastructure and entrepreneurial projects and training and education services. The income of these other companies accounted for less than 0.5 % of the Group’s profit for the year ended 31 December 2014.

\* The quantity of thermal energy generated is different to the quantity distributed to end-consumer as a result of network losses. Losses totalled 358 GWh for the year ended 31 December 2014.

The below chart shows the Group's organisational structure at the date of this Offering Circular:



The table below sets forth certain information relating to the Group's generation, distribution and supply businesses for the periods indicated.

		For the year ended 31 December			For six months ended 30 June	
	Unit	2012	2013	2014	2014	2015
<b>Electricity:</b>						
Installed capacity.....	MW	4,153	4,201	4,232	4,232	4,232
Electricity generated .....	GWh	12,094	14,650	14,277	7,279	6,212
Electricity distributed to end-consumers <sup>(1)</sup> .....	GWh	15,326	15,219	14,868	7,433	7,572
Electricity sold .....	GWh	16,378	16,768	15,202	7,552	7,369
<b>Thermal energy:</b>						
Installed capacity <sup>(2)</sup> .....	MW <sub>heat</sub>	1,549	1,685	1,670	1,685	1,685
Thermal energy generated <sup>(3)</sup> .....	GWh	2,557	2,544	2,217	1,246	1,342
Thermal energy distributed to end-consumers <sup>(4)</sup> .....	GWh	2,557	2,544	2,217	1,246	1,342
Thermal energy sold .....	GWh	2,214	2,209	1,859	1,096	1,164
<b>Gas:</b>						
Gas distributed on wholesale market	GWh	—	—	3,022	678	3,574
Gas distributed to end-consumers.....	GWh	1,298	1,212	1,114	563	652

(1) Data relates to all end-consumers, including those connected directly to a high voltage transmission network (with 600 GWh, 387 GWh and 370 GWh total capacity for the years ended 31 December 2012, 2013 and 2014, respectively, and 184 GWh and 175 GWh, for the six months ended 30 June 2014 and 2015, respectively).

(2) Includes capacity of TE Sisak and TE Rijeka which are currently not operating.

(3) Includes thermal energy generated in district boiler rooms of city neighbourhoods totalling 208 GWh, 202 GWh, 159 GWh and 105 GWh for the years ended 31 December 2012, 2013 and 2014 and six months ended 30 June 2015, respectively.

(4) The quantity of thermal energy generated is different to the quantity distributed to end-consumers as a result of network losses. Losses totalled 343 GWh, 335 GWh, 358 GWh and 178 GWh for the years ended 31 December 2012, 2013 and 2014 and the six months ended 30 June 2015, respectively.

## Strengths and Strategy

### *The Group's key strengths*

The Group has a number of key competitive strengths, which it believes benefit its current market position and provide an opportunity for future growth.

#### *Vertically integrated power utility with economies of scale*

The Group is a vertically integrated power utility company, operating across the entire electricity market spectrum from generation to end-user distribution. HEP, the parent company, is responsible for the corporate management of the Group and can best allocate resources and make decisions to benefit the overall profitability of the Group, in particular with respect to capital expenditure and investments, subject to limitations prescribed by the Third Energy Package and the Electricity Market Act, such as unbundling and independency of transmission and distribution network operators. As a result, the Group is able to take advantage of a range of economies of scale, such as cost savings associated with purchasing of goods and services, technology and cost savings associated with marketing, including advertising.

#### *Leading position in Croatian electricity, gas and thermal energy markets benefitting from state ownership and support*

In the past, entry into the Croatian energy sector by competitors has been relatively minimal, due to significant barriers to entry, such as regulatory restrictions and a tariff system that was not fully reflective of operating and generation costs, which impacted profit margins. Further to the liberalisation of the Croatian energy market in 2008 and the Accession, competition in the retail electricity market has increased; however, the Group continues to hold a leading position in the Croatian energy market.

The Croatian Government has highlighted the energy sector as one of its strategic priorities by passing the Energy Development Strategy. The Energy Development Strategy is focused on the development

and renovation of the generation, transmission and distribution grids, with significant investment capital allocated to these programmes. Management believes that such development capabilities supported by the Croatian Government will further benefit the Group, strengthen its position in the Croatian energy market and potentially increase the Group's presence in neighbouring countries.

#### *Stable and predictable revenue stream*

HERA sets the tariff rates for transmission and distribution of electricity based on approved transmission and distribution costs plus approved capital rate of return (see “*Regulation*” section for further details). HERA sets the tariff rates for public supply of electricity within the universal service (for Households) and guaranteed supply (for Commercial Customers) based on approved costs of electricity procurement, operational costs, and an approved supply margin. At 31 December 2014, approximately 6,478 GWh, or 50.2%, of the Group's electricity sold to end-consumers was sold under the public supply system to Households and Commercial Customers. Furthermore, all Market Suppliers must use the Group's transmission and distribution networks, since HOPS is the sole TSO, and HEP-ODS is the sole distributor of electricity in Croatia. Together, the income derived from such operations accounted for 77.8% of the Group's revenue from sales of electricity for the year ended 31 December 2014. As a result, the Group has a stable and highly predictable revenue stream, as demonstrated by the steady revenues generated by the Group since 2012.

In the years ended 31 December 2012, 2013 and 2014 and the six months ended 30 June 2015, the Group recorded total operating income from electricity sales of HRK 11,630,275 thousand, HRK 11,947,939 thousand, HRK 10,575,290 thousand and HRK 5,244,063 thousand, respectively.

#### *Favourable and diversified power generation mix with access to low-cost generation facilities*

The Group is not solely reliant on any one form of electricity generation and therefore can ensure security of supply while keeping the cost of generation as low as possible. The Group currently operates 26 hydro power plants, eight thermal power plants and one nuclear power plant. The hydro power plants and nuclear power plant provide low-cost electricity generation. The Group uses its oil-fired thermal power plants primarily to meet high electricity demand or during adverse weather conditions, such as prolonged dry periods, during which the hydro power plants are not operating at full capacity.

The Group is also not reliant on any one fuel type with respect to its thermal power plants, operating a combination of oil, coal, natural gas and fuel oil-fired thermal power plants.

As a result of its diversified generation and fuel mixes, the Group also has reduced exposure to commodity prices and as a result can minimise costs, reduce price volatility and prevent supply disruptions.

#### *Strong commitment to social policies*

The Group maintains a social policy that Management believes fosters positive relations with the Group's employees, trade unions and the communities in which the Group operates. The Group organises annual competitions for registered associations, clubs and Croatian institutions to propose community projects under the categories of youth, art and cultural heritage, humanitarian action or the environment, the winners of which would see their projects implemented with partial financing from the Group. Further examples of the Group's social projects include sponsoring eco-schools in Croatia, national mathematics and physics contests and students attending vocational electrical schools. The Group believes that such projects increase its presence and brand-recognition in the community and help it to remain connected to its market, employees and customers.

#### *Strategy*

The Group's overarching goal is to improve profitability and increase generation capacity in Croatia in the medium term, primarily in order to achieve self-sufficiency without a need for power imports. The Group intends to achieve these goals through the following key strategies:

### *Improve operating efficiencies and cost structure*

The Group will continue to implement measures to improve its corporate and operating procedures and increase operating efficiency, in order to reduce operating costs and overhead costs.

The Group's management seeks to align its operating performance with the highest benchmarks in power generation, transmission, distribution and supply in terms of the operational efficiency, number of employees, maintenance costs per MW and per MWh and production levels. In particular, the Group intends to introduce various measures to speed up vertical communication within the Group and further improve labour productivity and operational performance, as well as its occupational health and safety standards.

Furthermore, the Group is currently undergoing an organisational restructuring with the aim of, among other things, introducing certain new functions and increasing the level of centralisation primarily in corporate, M&A investment strategy, capital investments management and marketing; decentralise certain market activities such as trading and sales in order to promptly respond to new market conditions in Croatia and neighbouring markets; and reducing the number of organisational units in order to make the Group's organisational structure more flexible to the extent permitted under the Electricity Market Act and the EU Third Energy Package (in terms of unbundling of transaction and distribution activities from market activities).

### *Construct new generation facilities and expand generation capacity of its existing assets*

The Group intends to invest approximately HRK 18.3 billion until 2028 in the construction of (i) two thermal power plants (KKE Osijek 500 and EL-TO Zagreb) to replace older, less efficient units which are expected to be decommissioned within the next few years; and (ii) subject to necessary regulatory approvals, two hydro power plants (HPP Dubrovnik II and HPP Kosinj/Senj II), which, in aggregate with other measures undertaken by the Group within its investment program, are expected to increase the Group's aggregate installed generation capacity by 1,342 MW. In addition, the Group intends to enter into a joint venture with a strategic partner in order to finance the construction of a new thermal power plant, Plomin C, which would require approximately HRK 6.5 billion in aggregate investments and which is expected to increase the Group's installed generation capacity by 500 MW. The Group expects that KKE Osijek 500 and EL-TO Zagreb will be commissioned by the end of 2020, Plomin C by the end of 2021, while construction of HPP Dubrovnik II is expected to commence in 2018 and construction of HPP Kosinj/Senj in 2022. Within the next five years, HEP expects to invest mainly in thermal power plants. However, the Group regularly monitors and considers other investment opportunities. In addition, commissioning is already underway for a natural gas combined-cycle cogenerating unit at Sisak thermal power plant, which is due to become operational in early 2016. It is expected that the Sisak unit will increase the Group's installed generation capacity by 230 MW<sub>el</sub> and 50 MW<sub>heat</sub>. A number of further generation projects are also being considered. In addition, the Group intends to invest approximately HRK 2.1 billion until 2022 in a revitalisation of the existing 12 hydro power plants and a thermal power plant in order to increase their generation capacity and efficiency. The Group aims to significantly increase its generation capacity across its diverse range of generation facilities, primarily to ensure security of supply and to enable the Group to generate sufficient excess electricity to be able to increase its cross-border sales to Serbia, Hungary, Slovenia and Bosnia and Herzegovina, thereby increasing its profitability. See "*Risk Factors—Risks Related to the Group's Business—The merits of investing in the construction or development of hydro power plants are unclear.*"

### *Improve customer service experience and introduce new services*

Management believes that the Group's continued success in maintaining a leading position in the market, particularly following Croatia's Accession, and further opening up of the energy market is in part dependent on its ability to appeal to its customers. The Group intends to further improve its customer service and widen its service and product offering to its customers, with a view towards increasing customer satisfaction and loyalty. In particular the Group intends to further develop its electronic billing and online payment options and develop and consolidate its existing call centres into

one centralised call centre to operate on a continuous basis, as well as to implement new business processes such as customer analytics and strategy, product and service management, sales channel and account management, customer care and experience, integration of marketing and resource planning and further improvement of back-office and middle-office support.

#### *Expand business operations into regional markets*

Further to its entry into the Slovenian electricity supply market, the Group has been carefully analysing the possibility of expanding its business operations into other regional markets by way of investments into generation facilities, primarily renewable energy sources, electricity and gas trade and supply and energy efficiency projects. The Group plans to increase its presence in neighbouring countries, by entering the wholesale and retail electricity markets directly or through subsidiaries, as well as by further increasing its market share in the wholesale electricity and gas markets in Hungary, Slovenia, Serbia, Bosnia and Herzegovina, and Kosovo, as well as in the retail electricity market in Slovenia.

#### *Improve and expand its distribution and transmission network*

The Group will continue investing in the modernisation and expansion projects related to its transmission network. The Group intends to invest approximately HRK 3.9 billion during the next five years in order to further reduce network losses, ensure reliable and safe operation of its new and upgraded plants and facilities as well as to ensure adequate levels of availability of interconnector capacity to access other markets. The Group also intends to modernise and expand its distribution network by investing approximately HRK 4.9 billion during the next five years in order to further reduce network losses, meet the country's growing need for electricity and connect new customers, in particular in the major cities, tourist and industrial areas. Due to the limitations prescribed by the Third Energy Package and the Electricity Market Act in relation to unbundling of transmission and distribution operations from the generation and supply, such investments are made through the Company's subsidiaries, HOPS and HEP-ODS. The Group believes such projects will not only serve to enhance the security and stability of the energy sector within Croatia but, together with the Group's generation plans, will also stimulate the local economy during their construction.

#### *Expand use of renewable energy sources*

The Group is committed to expanding its use of renewable energy sources and may build power plants that generate electricity and thermal power from renewable energy sources. These new plants will include small hydro power plants (up to 10 MW), wind farms, biomass fuelled power plants and photovoltaic and solar power collecting plants. The Group is also considering and seeking the optimal way to build photovoltaic and solar/ thermal power collection systems at all of its existing plants and facilities in order to expand its generation capacity. The Group believes that such expansion will further diversify its generation mix, thereby reducing the Group's greenhouse gas emissions, and lowering its dependency on fuel. This, in turn, will reduce the impact of fuel price volatility, and all such actions will reduce operating expenses, and allow the Group to increase profitability. Additionally, the Group is considering the acquisition of renewable energy projects developed by third parties in Croatia and abroad by investing approximately HRK 620 million within the next five years in order to further diversify its generation mix.

### **History and Development of the Group**

HEP was incorporated as a joint stock company with unlimited duration under the laws of Croatia on 31 December 1994. HEP is 100% owned by the Republic of Croatia, represented by the Ministry of Economy and is registered in the Court's Register administered by the Commercial Court in Zagreb with identification numbers MBS: 080004306 and OIB: 28921978587. At 30 June 2015 HEP had a registered share capital of HRK 19,792,159,200. The registered office is Ulica grada Vukovara 37, Zagreb, Republic of Croatia. The Group operates under various licences that are routinely renewed, subject to compliance with applicable licencing requirements. See “—Licences” and “Regulation” sections for further details.

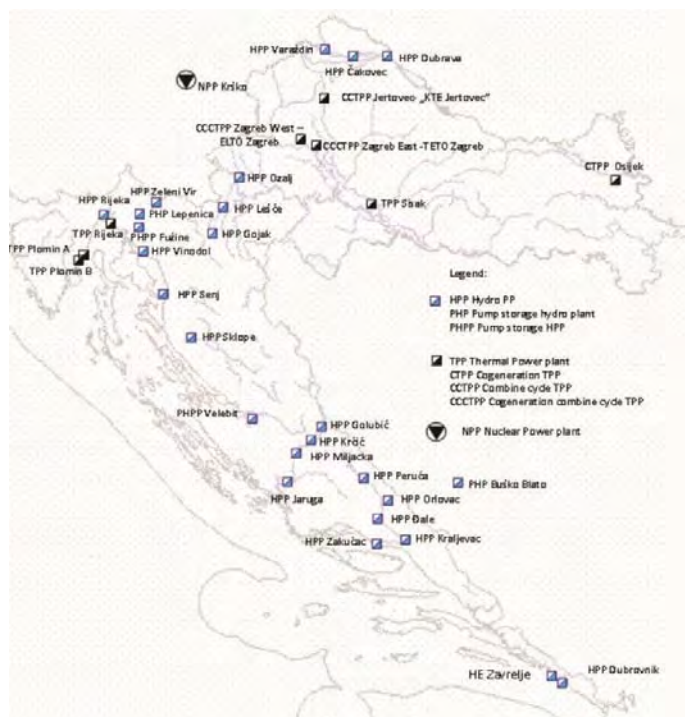
Principal events during the Group's history and development include:

- 1990** Public enterprise *Hrvatska elektroprivreda* is established on 9 August 1990, the consolidation of formerly state-owned power generation and distribution entities into a single Croatian state-owned company charged with the generation, transmission and distribution of electricity.
- 1994** HEP becomes a joint stock company in accordance with the 1994 amendment to the Act on Electric Power Industry.
- 1995** HEP was re-organised in accordance with the new Companies Act, which entered into force on 1 January 1995. The Companies Act introduced new structural requirements for Croatian companies and resulted in HEP instituting a new management structure and creating a Supervisory Board.
- 1997** HEP obtains a credit rating from S&P and becomes one of the first Croatian companies to receive an international investment credit ratings.
- 2000** Plomin II thermal power plant ("**Plomin II**") becomes operational.
- 2001** HEP becomes an independent member of the Union for the Coordination of the Transmission of Electricity.
- 2002** The Law on the Privatisation of HEP was passed by the Croatian Parliament on 19 March 2002 and entered into force on 5 April 2002. However, the law was never enforced and was repealed on 5 February 2010.  
  
In accordance with the requirements of the 2001 Energy Act and 2001 Energy Market Act, which came into force on 1 January 2002, HEP restructures its operations, forming separate companies for each of its main business operations. As a result of the restructuring, the company starts trading as "HEP".
- 2003** All of the hydro power plants operated by the Group receive a "green certificate" (certifying that 100% of electricity generated by these plants comes from renewable energy sources).
- 2004** On 3 December 2004, the Croatian Parliament approves amendments to the Energy Act, the Electricity Market Act and the Act on the Regulation of Energy Activities.  
  
Croatia reconnects to the synchronous grid of Continental Europe.
- 2005** Croatia signs the Energy Community Treaty and promises to align its legislation with the EU Energy Directives.
- 2008** The Croatian Government promulgates an official decision on the Electricity Generation Tariff Model, the Electricity Transmission Tariff Model, the Electricity Distribution Tariff Model and the Electricity Supply Tariff Model and fully liberalises the Croatian energy market for all customers from 1 July 2008. The Group has been applying the tariff model in its operations since 1 July 2008.
- 2011** HEP obtains a credit rating from Moody's.
- 2012** HEP appoints a team to prepare proposals aimed at restructuring the Group in line with EU energy regulations in anticipation of the Accession, including a detailed list of undertakings which must be completed during the restructuring process.
- 2013** Accession of Croatia to the EU. In accordance with the Third Energy Package, the Group initiated activities for the unbundling of the transmission operator HOPS to ensure its independence from the Group's generation and supply activities.
- 2014** HEP was chosen by the Croatian Government as the sole supplier of gas on the wholesale market for a three-year period ending 31 March 2017.
- 2015** In May 2015 the Group assumed a 50% share in TE Plomin from RWE in accordance with a joint venture agreement entered into in November 1996, and currently holds 100% of the shares in TE Plomin.  
  
Group began operating in the wholesale gas markets in Slovenia and Austria.

## Business Activities

The Group's core business activities include the generation of electricity and thermal power in Croatia, the transmission of electricity, distribution and supply of electricity and thermal power to end-consumers in Croatia, supply of gas in the wholesale market, distribution and sale of gas to end-consumers in Croatia and the trading of electricity in the wholesale market for sale to the Group's end-consumers.

The following map shows the location of the power plants operated by the Group.



In the year ended 31 December 2014, 92.0% of the Group's total installed electricity generation capacity, 78.8% of its total electricity generated, 100% of its total electricity distributed to end-consumers and 84.9% of its total sales of electricity were in Croatia. In the year ended 31 December 2014, the Group's electricity operations in Croatia were HRK 9,815,887 thousand, or 92.8%, of its operating income.

According to the Group's internal energy data, electricity consumption by end-consumers in Croatia decreased by 352 GWh, or 2.7%, to 14,868 GWh for the year ended 31 December 2014 from 15,287 GWh for the year ended 31 December 2013. Since 2010, there has been a decrease in electricity consumption growth rate in Croatia, primarily due to economic recession.

The Group also generates, distributes and sells thermal power in Croatia, primarily in Zagreb, Osijek, Sisak, Zaprrešić, Velika Gorica and Samobor, and is Croatia's biggest producer and supplier of thermal power. In the year ended 31 December 2014, the Group's thermal energy operations were HRK 671,946 thousand, or 4.9% of its operating income.

The Group also acts as the sole distributor of gas on the Croatian wholesale market. In the year ended 31 December 2014, the Group's gas operations on the wholesale market were HRK 689,575, or 5.1% of its operating income. In addition, the Group distributes and sells gas to end-consumers in Croatia, primarily in Osijek-Baranja County, Požega-Slavonija County and Virovitica-Podravina County and is the second largest gas distributor on the Croatian retail market according to the Croatian Gas Association. In the year ended 31 December 2014, the Group's gas operations on retail market were HRK 371,490 thousand, or 2.7% of its operating income.



## Electricity Generation

### Overview

The Group operates a diversified mix of power plants, but primarily relies on low-cost hydro and nuclear power plants for electricity generation. At 30 June 2015 the Group operated 26 hydro power plants with total installed electricity generation capacity of 2,214 MW, eight thermal power plants with total installed generation electricity capacity of 1,670 MW (including TE Sisak and TE Rijeka which are currently not operating) and jointly owned NPPK with a total installed electricity generation capacity of 696 MW (with 348 MW allocated to the Group). At 31 December 2014, the Group operated generation facilities with a total installed electricity generation capacity of 4,232 MW. At 31 December 2014, 3,864 MW, or 91.7%, of the Group's total installed electricity generating capacity was in Croatia. At 31 December 2014 2,214 MW, or 52.1%, of total installed electricity generation capacity was from hydro powered plants, 1,670 MW, or 39.6%, was from thermal oil, gas and coal powered plants and 348 MW, or 8.3%, was from the NPPK.

The following table sets forth a breakdown of the total installed electricity generation capacity of the Group's power plants for the periods indicated.

	At 31 December					
	2012		2013		2014	
	(MW)	(%)	(MW)	(%)	(MW)	(%)
<b>Hydro power plants:</b>						
Generation Area North <sup>(1)</sup>	248	5.97	250	5.73	250	5.93
Generation Area West <sup>(2)</sup>	474	11.43	476	11.30	476	11.30
Generation Area South <sup>(3)</sup>	1,192	28.65	1,239	29.41	1,250	29.41
Dubrovnik <sup>(4)</sup>	216	5.20	228	5.41	236	5.41
Zavrelje	2	0.05	2	0.04	2	0.04
<b>Total installed hydro capacity</b>	<b>2,132</b>	<b>51.3</b>	<b>2,194</b>	<b>52.1</b>	<b>2,214</b>	<b>52.1</b>
<b>Nuclear power plant:</b>						
NPPK <sup>(5)</sup>	348	8.38	348	8.30	348	8.30
<b>Thermal power plants:</b>						
Sisak	396	9.54	396	9.40	396	9.40
Rijeka	303	7.30	303	7.19	303	7.19
Plomin I	105	2.53	105	2.49	105	2.49
Plomin II	192	4.62	192	4.55	192	4.55
KTE Jertovec	74	1.78	74	1.75	74	1.75
TE TO Zagreb	422	10.16	422	10.01	422	10.01
EL TO Zagreb	90	2.17	89	2.11	89	2.11
TE TO Osijek	90	2.17	89	2.11	89	2.11
<b>Total installed thermal capacity</b>	<b>1,672</b>	<b>40.27</b>	<b>1,670</b>	<b>39.6</b>	<b>1,670</b>	<b>39.6</b>

- (1) Includes three hydro power plants that were built on the Drava river: Varaždin (1975), Čakovec (1982) and Dubrava (1989). They are multi-purpose hydro power plants, with their main purposes being electricity generation, water supply, flood control, land erosion protection, irrigation, drainage and transport.
- (2) Includes 10 hydro power plants which utilise water of the rivers Kupa (Ozalj hydro power plant), Ogulinska Dobra and Zagorska Mreznica (Gojak hydro power plant), Lokvarka, Kriz stream, Licanka, Lepenica, Kostanjevica, Potkosa and Benkovac stream (Vinodol hydro power system with HPP Vinodol, PHPP Fužine, PHPP Lepenica, HPP Zeleni Vir), Rječina (Rijeka), Lika and Gacka (Senj hydro power system with HPP Senje, HPP Sklope) and Dobra (Lešće hydro power plant).
- (3) Includes 11 hydro power plants in the basin of the river Cetina (Peruća, Orlovac, Đale, Zakućac, Kraljevac hydro power plants and Buško Blato pumping station), the basin of the river Krka (Golubić, Krčić, Miljacka, Jaruga) and on the Gracac Plateau (Velebit pumped storage hydro power plant).
- (4) One unit of Dubrovnik hydro power plant operates for Bosnia and Herzegovina.
- (5) Total capacity provided in the table is only for the Group's portion of the generation capacity (the total generation capacity of the NPPK is 696 MW).

The following table sets forth a breakdown of the Group's total electricity generated by power plants for the periods indicated.

	For the year ended 31 December					
	2012		2013		2014	
	(GWh)	(%)	(GWh)	(%)	(GWh)	(%)
<b>Hydro power plants:</b>						
Generation Area North <sup>(1)</sup>	1,222	10.1	1,366	9.3	1,691	11.8
Generation Area West <sup>(2)</sup>	1,222	10.1	2,046	14.0	2,447	17.1
Generation Area South <sup>(3)</sup>	1,686	13.9	3,851	26.3	3,445	24.1
Dubrovnik <sup>(4)</sup>	1,640	5.3	787	5.4	766	5.4
Zavrelje	3	0.02	4	0.0	7	0.1
<b>Total electricity generated by hydro power plants</b>	<b>4,773</b>	<b>39.5</b>	<b>8,054</b>	<b>55.0</b>	<b>8,356</b>	<b>58.5</b>
<b>Nuclear power plant:</b>						
NPPK	2,622	21.7	2,518	17.2	3,030	21.2
<b>Thermal power plants:</b>						
Sisak	89	0.7	24	0.2	—	—
Rijeka	159	1.3	41	0.3	—	—
Plomin I	652	5.4	736	5.0	693	4.9
Plomin II	1,372	11.4	1,448	9.9	1,441	10.1
KTE Jertovec	16	0.1	3	0.0	2	0.0
TE TO Zagreb	1,936	16.0	1,363	9.3	390	2.7
EL TO Zagreb	366	3.0	356	2.4	263	1.8
TE TO Osijek	109	0.9	108	0.7	102	0.7
<b>Total electricity generated by thermal power plants</b>	<b>4,699</b>	<b>38.8</b>	<b>4,078</b>	<b>27.8</b>	<b>2,891</b>	<b>20.2</b>
<b>Total generated energy</b>	<b>12,094</b>	<b>100</b>	<b>14,650</b>	<b>100</b>	<b>14,277</b>	<b>100</b>

- (1) Includes three hydro power plants that were built on the Drava river: Varaždin (1975), Čakovec (1982) and Dubrava (1989). They are multi-purpose hydro power plants, with their main purposes being electricity generation, water supply, flood control, land erosion protection, irrigation, drainage and transport.
- (2) Includes 10 hydro power plants which utilise water of the rivers Kupa (Ozalj hydro power plant), Ogulinska Dobra and Zagorska Mreznica (Gojak hydro power plant), Lokvarka, Kriz stream, Licanka, Lepenica, Kostanjevica, Potkosa and Benkovac stream (Vinodol hydro power system with HPP Vinodol, PHPP Fužine, PHPP Lepenica, HPP Zeleni Vir), Rječina (Rijeka), Lika and Gacka (Senj hydro power system with HPP Senje, HPP Sklope). In 2011, on the Dobra River, Lešće, a 42.3 MW hydro power plant, was put into commercial operation.
- (3) Includes 11 hydro power plants in the basin of the river Cetina (Peruća, Orlovac, Đale, Zakučac, Kraljevac hydro power plants and Buško Blato pumping station), the basin of the river Krka (Golubić, Krčić, Miljacka, Jaruga) and on the Gracac Plateau (Velebit pumped storage hydro power plant).
- (4) One unit of Dubrovnik hydro power plant operates for Bosnia and Herzegovina.

### Hydro power plants

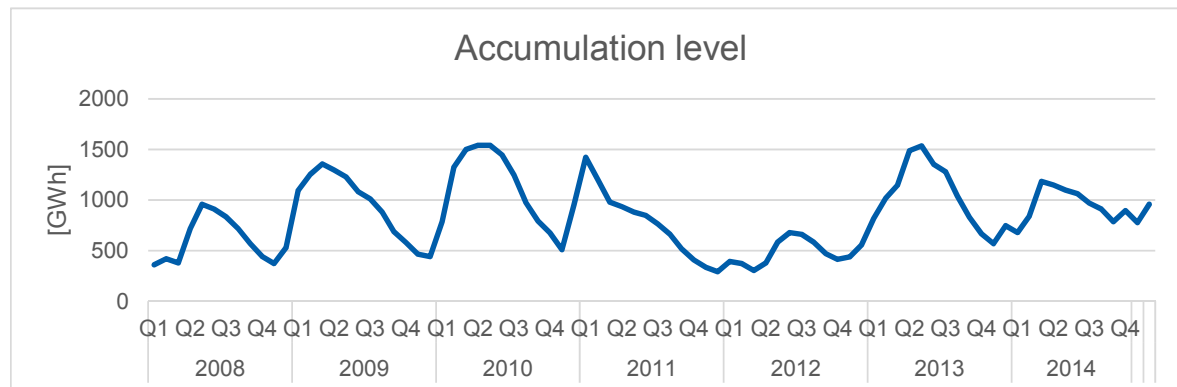
The Group operates all 26 of Croatia's hydro power plants. Hydro power plants operated by the Group include 11 reservoir power plants, two pumped storage units, one reversible pump turbine, one pumping station and five small-scale hydro power plants. The hydro power plants are situated in various locations throughout Croatia, the largest concentration being in Generation Area South (which includes 11 hydro power plants located on the Cetina and Krka rivers and on the Gracac Plateau). In 2014 the hydro power plants generated 58.5% of the total electricity generated by the Group and 74.3% of the total electricity generated in Croatia.

The hydro power plants have installed capacity of 2,214 MW at 31 December 2014. In the year ended 31 December 2014 the hydro power plants generated 8,356 GWh of electricity as compared to 8,054 GWh generated in the year ended 31 December 2013, representing an increase of 3.7%. This slight increase was primarily due to higher water inflows as compared to 2013.

The following table sets forth a breakdown of the Croatian hydrological conditions and hydro electricity generation for the periods indicated.

	For the years ended 31 December		
	2012	2013	2014
	GWh		
Generation by hydro power plants	4,773	8,054	8,356
Energy value of water inflows	5,197	7,893	8,700

The following table sets out total accumulation levels for the hydro power plants operated by the Group.



The following table sets forth certain information regarding the 26 hydro power plants operated by the Group for the periods indicated.

	Installed capacity at 31 December	Generated Electricity For the years ended			Start of operation	Type of plant	Licence expires
	2014	2012	2013	2014			
<b>Generation Area North:</b>	<b>MW</b>		<b>GWh</b>				
Varaždin .....	92.5	457	521	636	1975	run of river	2032
Čakovec .....	77.4	378	427	511	1982	run of river	2032
Dubrava .....	79.8	387	418	544	1989	run of river	2032
<b>Generation Area West:</b>							
Ozalj .....	5.5	21	25	32	1908	run of river	2019
Gojak .....	55.5	175	255	316	1959	run of river	2032
HPP System Vinodol <sup>(1)(2)</sup> .....	97.1	133	203	241	1952	storage	2032
Rijeka .....	36.8	79	115	112	1968	run of river	2032
HPP System Senj <sup>(1)(3)</sup> .....	238.5	737	1,330	1,602	1965	storage	2032
Lešće .....	42.3	77	118	144	2010	storage	2059
<b>Generation Area South:</b>							
Peruća .....	61.2	56	179	176	1960	storage	2032
Kraljevac .....	46.4	39	72	77	1961	storage	2032
Zakućac .....	543	827	2,127	2,005	1962	storage	2032
HPP System Orlovac <sup>(1)(4)</sup> .....	244.5	128	519	327	1973	storage	2032
Đale .....	40.8	78	172	126	1989	storage	2032
Velebit .....	276	470	635	584	1984	pumping	2032
Golubić .....	6.5	12	24	20	1981	run of river	2019
Krčić .....	0.3	1	1	2	1988	run of river	2041
Miljacka .....	24	51	86	93	1906	run of river	2032
Jaruga .....	7.2	24	36	35	1903	run of river	2019
<b>Other:</b>							
Dubrovnik <sup>(5)</sup> .....	234	640	787	766	1965	storage	2032
Zavrelje .....	2	3	4	7	1953	storage	2041
<b>Total</b> .....	<b>2,214</b>	<b>4,773</b>	<b>8,054</b>	<b>8,356</b>			

(1) HPP production system consisting of several hydro power plants joined in one generator system.

(2) Comprising Vinodol, PS Fuzine, PS Lepenica and Zeleni Vir.

(3) Comprising Senj and Sklope.

(4) Comprising Orlovac and PS Buško Blato (the latter of which is situated on the Buško Blato lake in Bosnia and Herzegovina).

(5) One unit of Dubrovnik hydro power plant operates for Bosnia and Herzegovina.

### Description of operations

Hydro power plants have a high degree of flexibility in the regulation of their output. The ability to control hydro power plants centrally permits the Group to commence operation rapidly thereby facilitating the regulation of electricity output. In addition, neither conventional storage nor pump storage hydro power plants produce greenhouse gas emissions, which is important since the Group is required to purchase quotas for greenhouse gas emissions produced by its power plants. These plants also represent an inexpensive source of electricity, particularly in periods of peak demand. In

addition, pump storage power plants allow the productive use of excess electricity generated by base load plants by operating storage pumps in periods of low demand.

The hydro power plants operated by the Group have a diversified age profile that is affected by various factors, including the availability of steady water supply, scheduled maintenance projects and regulatory and concession licences, among others. The hydro power plants are located throughout Croatia and their generation capacity directly correlates with the amount of available water. Lower river flows could significantly reduce the amount of water available for electricity generation and the risk of flow shortage may increase as a result of climate change or other weather patterns. For additional information on water supply, see “—*Electricity generation—Overview*”. Since 1 January 2012, the Group has invested approximately HRK 1,795 million towards increasing its generation capacity and improving its operational efficiency, HRK 1,330 million to improve its electricity transmission network, HRK 2,958 million to improve its electricity distribution networks and HRK 1,189 million towards improving its thermal energy and gas distribution network and information and telecommunication infrastructure. For information on the Group’s capital expenditures, please see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Expenditures and Acquisitions*”.

The hydro power plants operate under various concession licences, with different expiration dates. These concession licences include maritime licences, water usage licences and fish and farming concession licences (with regards to the Group’s impact on these activities). In addition, the current status of the respective concession licences is unclear, since they were approved to HEP and transferred to its subsidiaries without clear transfer approval from the concession provider. However, HEP believes that it is not required to seek explicit approval of the Croatian Government for the transfer of concession licences to its subsidiaries, since HEP’s restructuring and transformation (as a result of which HEP’s subsidiaries, including HEP Generation, have become in charge of the relevant activities which require concession licences) were conducted in accordance with the Energy Act and Electricity Market Act. For additional information, see “*Regulation—Concession Licences*” and “*Risk Factors—Risks Related to the Group’s Business—The Group’s activities require various administrative permits, authorisations and licences that may be difficult to obtain, maintain or renew or whose grant may be subject to conditions that may become significantly more stringent*”.

In addition, all of the hydro power plants operated by the Group have been issued a certificate for electricity generation from renewable sources and hydro power plants located in Generation Area North and Generation Area West have received certificates for quality assurance (ISO 9001) and environmental protection (ISO 14001). The Group aims to receive similar certification for the Generation Area South, Dubrovnik and Zavrelje by the end of 2015. All of the thermal power plants have also received certificates for quality assurance (ISO 9001) and environmental protection (ISO 14001).

According to the Land Registry, the Company is registered as an owner of real estate connected to nine hydro power plants operated by the Group. The ownership title with respect to real estate connected to the remaining hydro power plants are registered in the name of either the Republic of Croatia, municipal authorities or other third parties, including natural persons. For further information, see “—*Legal Proceedings—Proceedings relating to hydro power plants*” and “*Risk Factors—Risks Related to the Group’s Business—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group’s right to operate such plants in the future.*”

#### *Geographic location*

The hydro power plants located in Generation Area North were built on the river Drava in Croatia. They are multi-purpose hydro power plants, primarily focused on electricity generation, water supply, flood control, land erosion protection, irrigation, drainage and transport. These power plants operate by diverting the water supply and have small electricity generating units located at the dam. All three

power plants are controlled by a control centre situated in Varaždin, which optimises electricity generation across the three power plants. The Generation Area North plants have a total installed generation capacity of 250 MW and generated 1,222 GWh, 1,366 GWh and 1,691 GWh of electricity for the years ended 31 December 2012, 2013 and 2014, respectively.

The hydro power plants located in Generation Area West were built on 14 different western Croatian rivers. They are multi-purpose hydro power plants and are primarily focused on electricity generation. Most of these plants operate as part of a large power system and include primarily run-of-the-river turbine plants. The Generation Area West plants have a total installed generation capacity of 476 MW and generated 1,222 GWh, 2,046 GWh and 2,447 GWh of electricity for the years ended 31 December 2012, 2013 and 2014, respectively.

The hydro power plants located in Generation Area South were built on the Croatian rivers Cetina and Krka and on the Gracac Plateau. This power system contains the Peruća reservoir, which is part of the Cetina River power system, the Zakućac hydro power plant, which is the largest plant in the Cetina River basin and the largest hydro power plant in Croatia by its installed capacity and potential power generation, the Orlovac hydro power plant, which is a high pressure diversion plant whose facilities are situated in both Bosnia and Herzegovina and Croatia, as well as other hydro power plants, water pumps and reservoirs. These power plants are controlled by a control centre situated in Bisko, Croatia. The Generation Area South plants have a total installed generation capacity of 1,250 MW and generated 1,686 GWh, 3,851 GWh and 3,445 GWh of electricity for the years ended 31 December 2012, 2013 and 2014, respectively.

Dubrovnik and the Zavrulje power plants are the last step in the Trebisnjica River hydro system and are both storage plants. Dubrovnik and Zavrulje use the waters of the Trebisnjica River from the Bileća reservoir situated in Bosnia and Herzegovina. The Dubrovnik and the Zavrulje power plants have a total generation capacity of 238 MW and generated 643 GWh, 791 GWh and 773 GWh of electricity for the year ended 31 December 2012, 2013 and 2014, respectively.

The Group is in the process of developing and preparing to start the construction in 2018 of a new Dubrovnik II hydro power plant, which will add capacity of 152 MW, and in 2022 of a new Kosinj/Senj hydro power plant on the rivers Lika and Gacka, which will add capacity of 410 MW. The Group intends to enter into a joint venture with a strategic partner in order to finance the construction of the new hydro power plant Dubrovnik II, which require investment of approximately HRK 1.4 billion towards HEP's 50% share in a joint venture. The final dynamics of the investments into construction of hydro power plants will depend on the terms of governmental permits.

The Group also plans to invest approximately HRK 2.1 billion during the next seven years in a number of other projects to increase the generation capacity and efficiency of its current facilities, including 12 existing hydro power plants and a thermal power plant, with the aim of increasing total generation capacity of these plants by 144 MW.

However, due to the mandatory provisions of the Water Act, any investment in either existing or new hydro power plants under current legislation has unclear legal status, but is expected to be defined through legislative amendments and/or concessions. For additional information, see “—*Legal Proceedings—Proceedings relating to hydro power plants*” and “*Risk Factors—Risks Related to the Group's Business—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group's right to operate such plants in the future.*”

#### *Ownership*

According to the Land Registry, the Company is registered as an owner of the real estate connected to nine hydro power plants operated by the Group, but ownership titles with respect to the real estate connected to the remaining 17 Croatian hydro power plants are registered in the name of either the Republic of Croatia, municipal authorities or other third parties, including natural persons. Moreover,

the State Prosecutor's Office and the Ministry of Agriculture of the Republic of Croatia have initiated several proceedings contesting the ownership title over certain real estate, including dams, reservoirs and land plots currently registered in the Land Registry in the name of the Company, on which the hydro power plants operated by the Group had been built, claiming that the various legislative acts by which the Group was transformed from a so-called "social company" into a joint stock company in 1994 did not give the Group title to the real estate related to the hydro power plants. For more information, see "*Business—Legal Proceedings—Proceedings related to hydro power plants*".

Generally, the current Croatian land title recording system is suffering from inherited issues predating Croatia's time as a market economy with private ownership of land. As a result of the limited land registry and recording systems in the Republic of Croatia, it is sometimes difficult to obtain secure title to individual property rights, as well as to ascertain the validity and enforceability of title to land or other real property in the Republic of Croatia and the extent to which it is encumbered. Therefore, in certain cases, the relevant information in the Land Registry is inconclusive, contradictory and/or outdated (with certain properties still indicated in the Land Registry as objects of "social ownership" or "national property"), which complicates or, in some cases, makes it impossible to establish the definitive ownership title over these properties. Therefore, in order to confirm its ownership over these assets, the Company may need to initiate proceedings in the competent municipal courts which then decide on the ownership registration in the Land Registry.

The Company, the State Prosecutor's Office, the Ministry of Agriculture and the Ministry of Economy have entered into discussions aimed at clarifying and potentially resolving the uncertainties related to the ownership of the real estate connected to the hydro power plants. The preferred solution put forward by the Group to all relevant stakeholders was for the working group to prepare draft legislation for consideration by the Croatian Government and, if approved by the Government, to eventually put such draft legislation to a vote in Parliament. If passed, the Group expects that such legislation would be a first step in helping to clarify who the registered owner of the hydro power plant-related real estate is or should be, who has the right to operate the plants and who has the right to occupy the related real estate for that purpose. Accordingly, the Company has officially proposed amendments to the relevant legislation, which have been supported by the Ministry of Economy and are now under consideration by the Ministry of Agriculture. The resolution of these issues, if any, would be expected to apply to all 26 of the hydro power plants currently operated by the Group in Croatia as well as any future hydro power plants that the Group may construct.

It is unclear when a comprehensive legislative proposal will be put forward to the Croatian Government and, further, when such proposal will be passed on to Parliament, if at all. Given the recent dissolution of the Parliament and upcoming parliamentary elections, it is even more unclear when a resolution may be passed into law, if at all. Furthermore, it is currently unclear what solution will be provided by and what ownership and operator rights, if any, the Group will continue to have in the real estate and the attached hydro power plants if new legislation is passed. Such rights could range in form from clean title to an easement of some kind to a right and/or a need to enter a competitive tender to operate the assets. The legislation may result in a less definitive solution, which could require the Group to pursue additional legislative, contractual, licensing or other steps before any rights to the subject assets in favour of the Group would crystallise, if at all.

In the event that a comprehensive legislative solution is not adopted, and in the event that the Group is unable to defeat the various claims made by the State Prosecutor's Office and the Ministry of Agriculture or any future claims and/or support its claims in the municipal courts in the registration proceedings, the Group risks losing its current *de facto* ownership interest in the assets for which it holds registered title, and potentially the ability to operate some or all of its hydro power plants.

Should the Group lose its current right to operate some or all of the hydro power plants, it is unclear what the ramifications to the Group would be. The Company believes that in such case consideration should also be made to the amount of the Company's investments in the contested properties and the amounts of revenues distributed in the form of dividends to the Republic of Croatia as the sole shareholder of the Company. However there is no way currently to predict what would be the form or

amount of such compensation, if any. In addition, the Republic of Croatia may consider holding public tender procedures for the right to operate these assets and, only if the Group provides the most favourable proposal in accordance with the terms of the public tender, it may be granted concession rights with respect to the assets, but could be required to make regular rental or similar payments and to comply with other terms of such concession agreements.

In addition, if the courts decide that the contested properties were unlawfully transferred to the Group as part of its transformation in 1994, the courts may order the Group to compensate the Republic of Croatia for unjust enrichment with respect to the revenues generated from operation of such properties, subject to statute of limitation provisions under applicable Croatian laws.

### ***Nuclear power plant***

#### *Overview*

The Group, together with GenE, operates one nuclear power plant, the Krško nuclear power plant (NPPK), located in Slovenia. In the year ended 31 December 2014, nuclear electricity generation accounted for approximately 21.2% of the total electricity generated by the Group, compared with approximately 17.2% during the year ended 31 December 2013. Every 18 months the power plant is required to discontinue its operations for approximately one month in order to replace nuclear fuel, allow for maintenance, repair of its facilities and fuel replacement. The last scheduled shutdown occurred in mid-April and May of 2015 and the next scheduled shutdown is due in October 2016. The NPPK has a total generation capacity of 696 MW (with 348 MW allocated to the Group as part of its 50% holding in the plant) and has generated 2,622 GWh, 2,518 GWh and 3,030 GWh (amounts allocated to the Group) of electricity for the year ended 31 December 2012, 2013 and 2014, respectively. In the year ended 31 December 2014 the Group's nuclear power plant accounted for 8.3% of the Group's total generation capacity.

#### *Historical*

The construction of the NPPK commenced in 1975. The plant was connected to the power grid on 2 October 1981 and went into commercial operation on 15 January 1983. It was built as a joint venture by the Slovenian and Croatian Governments, which were then both part of Yugoslavia. The legal status of the NPPK was regulated by an inter-republic agreement and various agreements between the founders from 1974 to 1982. Pursuant to the stated agreements, HEP had a 50% interest in NEK and the other 50% was held by ELES GEN d.o.o. (renamed Gen Energija in 2006) which was the legal successor to the Slovenian power utility. GenE was founded in June 2001 as a subsidiary of Elektro-Slovenija d.o.o. ("ELES"). In 2006 GenE, following a decision of the Slovenian Government, broke away from ELES and ownership was transferred directly to the state.

Under the current agreement the generated electricity is divided equally between GenE and the Group and the price of the electricity is determined based on the total generation costs. HEP started to receive electricity from the NPPK on 19 April 2003 and expects to receive approximately 2,700-3,000 GWh annually until 2023, representing approximately 15% of total electricity consumption in Croatia. The operational licence for the NPPK was reissued in 2012 for an indefinite period of time.

#### *Description of operations*

In 2014, the World Association of Nuclear Operators ("WANO") carried out an extensive review of the performance of the NPPK. As a result of the review, WANO ranked the NPPK in "Assessment Category 1", the highest rank according to WANO's methodology, which places the NPPK among the top nuclear plants currently in operation around the world. While WANO recognised the NPPK's overall performance as exemplary, WANO's review also made certain minor improvement recommendations relating to, among other things, management effectiveness, foreign material exclusion and equipment reliability.

The projected lifetime of the NPPK is 40 years (which ends in 2023). In July 2012, the Slovenian Nuclear Safety Administration approved the amendments to the Ageing Management Programs and USAR (Updated Safety Analyses Report), which allow consideration of the extension of the lifetime of the NPPK subject to its economic viability. In 2014, HEP and GenE initiated preparation of a study to comment on whether the proposed plant lifetime extension for 20 years is more economically viable than replacing its generating capacities with alternative power generation or import of electricity from 2024 onwards. An international consulting company that was conducting this study recognised a standardised cost of electricity (LCOE) as a criterion for comparison of the costs of electricity generation in each of the proposed future options. Results of the study show that the option of the plant's lifetime extension has the lowest LCOE (35,41 EUR/MWh), while the option with the second lowest LCOE (importation) is much more expensive (43,74 EUR/MWh). Further to this study, in November 2014, the supervisory board of the NPPK adopted a resolution on investments into extension of the plant's lifetime for an additional 20 years, until 2043.

In line with the practices adopted by the majority of the European countries, the plant is subject to a Periodical Safety Review ("PSR") every 10 years. There have been no material incidents affecting the environment and the NPPK. Safety recommendations identified during the most recent PSR for the ten-year period ended in 2014 are currently being implemented.

### *Safety practices*

HEP and GenE have implemented routine modernisation and refurbishment programmes of the NPPK and have strengthened inspection and maintenance practices, including proactively repairing or replacing equipment and components before they fail.

In 2014, the Group and GenE jointly contributed approximately €48,600 thousand (€24,300 thousand each) (approximately HRK 372,347 thousand or HRK 186,173 thousand each) towards a technical and safety upgrade programme (SUP) at the NPPK, which included, among others, preparation for reactor vessel up-flow conversion, replacement of an auxiliary feedwater turbine-driven pump, preparation of in-core instrumentation, reconstruction of the switch yard load power supply system and improvement of flood safety of facilities at the NPPK. The Group and GenE jointly intend to invest an additional €287,000 thousand (approximately HRK 2,198,800 thousand) over the course of the next five years towards upgrading nuclear safety and operating procedures at the plant. The cost of such safety upgrade programme will be financed from sales of electricity during 2015 through 2019.

### *Post Fukushima Stress Tests Results*

According to the latest report of the European Nuclear Safety Regulators Group (ENSREG) published on 17 June 2015, it was recognised that the NPPK made significant progress in the implementation of the issues identified as a result of stress testing, subsequent action plans and peer review processes conducted in 2012-2014, while further upgrades are currently being implemented as part of the Group's safety upgrade programme (SUP).

### *Decommissioning*

According to the agreement between Slovenia and Croatia, the decommissioning of the NPPK and disposal of radioactive waste and used nuclear fuel from the NPPK is a joint obligation of Slovenia and Croatia. Accordingly, the decommissioning costs of the NPPK will be a joint obligation of GenE and HEP, with each party paying half of the expected costs into a special decommissioning fund held within their respective country. HEP is required to pay an annual fee of €14,250 thousand (approximately HRK 109,176 thousand) per year into the decommissioning account, but this amount may change in the future due changes in expected decommissioning costs, revisions of national radioactive waste policies or other regulatory changes.

The total nominal costs of the disposal of radioactive waste, used nuclear fuel and the decommissioning of the NPPK (for both the Croatian and Slovenian owners) were evaluated to be in



the range of approximately €1,149,000 thousand to €1,689,000 thousand (approximately HRK 8,803,030 thousand to HRK 12,940,224 thousand), while the corresponding discounted cost fluctuates somewhere between approximately €38,000 thousand and €345,000 thousand (approximately HRK 2,589,577 thousand and HRK 2,643,207 thousand), at 2002 prices. This evaluation was done by a joint Slovenian and Croatian Project Team and Advisory Board and reviewed by independent experts from Electricité de France (EDF). It is expected that the total discounted cost will be secured through 19 equal annuities in the amount of €28,500 thousand paid during the period from 2004 until 2022.

For the period of six months ended 30 June 2015, HEP had paid a total of HRK 54,240 thousand (€7,425 thousand) into the fund. In order to accumulate an adequate amount of funds to cover the ultimate costs of decommissioning of the plant, expert organisations nominated by both the Croatian and Slovenian Governments periodically review the decommissioning cost estimates and update their decommissioning provisions. The second audit of the decommissioning programme is scheduled to commence in the end of 2015 with the results published in 2016.

### ***Thermal power plants***

The Group owns and operates all eight of Croatia's thermal power plants. The Group's thermal power plants comprise one oil fired plant (TPP Rijeka), two coal fired plants (TPP Plomin I and II), two oil and natural gas fired power plants (TPP Sisak and TE TO Osijek), one natural gas and oil fired plants (Combined cycle gas turbine ("CCGT") —EL TO Zagreb), one oil and natural gas or extra light oil fired plant (Combined cycle cogeneration gas turbine ("CCCGT") – TE TO Zagreb) and one natural gas or extra light fuel fired plant (CC- KTE Jertovec) and are situated in various locations throughout Croatia, the largest concentration being in the Zagreb area. In 2014, the Group's thermal power plants generated 20.2% of the total electricity of the Group.

Oil-fired power plants are primarily used to meet high electricity demand or during periods when the hydro power plants are not operating at full capacity, such as during prolonged dry spells or droughts. In addition, the Group has access to a diversified fuel mix and can choose which type of generation method to use in order to minimise costs, reduce price volatility and prevent supply disruptions.

The following table sets forth certain information regarding the electricity generating capacity of the Group's thermal power plants for the periods indicated.

Plant	Installed electricity capacity	Generated Electricity	Generated Electricity	Generated Electricity	Start of operation	Type of plant	Fuel <sup>(1)</sup>	Licence expires
	2014 (MW)	2012	2013 GWh	2014				
TE Sisak.....	396	89	24	—	1970	Condensation	Oil and gas	2018
TE Rijeka.....	303	159	41	—	1978	Condensation	Oil	2028
TE Plomin I.....	105	652	736	693	1969	Condensation	Coal	2018
TE Plomin II.....	192	1,372	1,448	1,441	2000	Condensation	Coal	2018
KTE Jertovec.....	74	16	3	2	1956	CCGT	Gas or EL Oil	2021
TE TO Zagreb.....	422	1,936	1,363	390	1979	CCCGT CHP*	Oil and Gas or EL Oil	2028
EL TO Zagreb.....	89	366	356	263	1970	CHP	Oil and Gas	2020
TE TO Osijek.....	89	109	106	102	1976	CHP	Oil and Gas	2022
<b>Total.....</b>	<b>1,670</b>	<b>4,699</b>	<b>4,078</b>	<b>2,891</b>				

(1) "Oil and Gas" indicates usage of both fuel types simultaneously; "Gas or EL Oil" indicates alternative usage. The primary fuel is gas.

\* CHP means combined heat and power.

In the year ended 31 December 2014, the Group's power plants in Croatia consumed 28,600 tons of heavy fuel oil and 1,000 tons of extra light fuel oil. For information on the Group's purchases of oil from third parties, please see "*Fuel—Fuel Oil.*" In the year ended 31 December 2014, the Group's power plants in Croatia consumed 918,000 tons of black coal. For information on the Group's purchases of coal from third parties, please see "*Fuel—Fuel Coal.*" In the year ended 31 December 2014, the Group's power plants in Croatia consumed 367.3 million m<sup>3</sup> of gas. For information on the Group's purchases of gas from third parties, please see "*Fuel—Gas.*"

## Plomin II

Plomin II was connected to the power grid in 1999 and went into commercial operation in April of 2000. Plomin II has a 192 MW generation capacity and uses hard coal for its generation operations. The power plant is connected to the power grid by a 220 kV switchyard. Connection between 220 kV and 110 kV networks is performed by regulating autotransformers.

The Group is in the process of commissioning a natural gas combined-cycle cogenerating unit, Sisak thermal power plant, which is due to become operational in early 2016 and which will increase the Group's generation capacity by 230 MW. In addition, in 2016 the Group is planning to start the construction of a new thermal power plant, Plomin C, which expected to increase the Group's electricity generation capacity by 500 MW. Furthermore, in 2016 the Group is planning to start the construction of two gas-fired thermal power plants, KKE Osijek (500 MW) and EL-TO Zagreb (130 MW), which, in aggregate with other measures undertaken by the Group within its investment program, are expected to increase the Group's electricity generation capacity by 1,342 MW.

## Thermal Energy (heat) Generation

The Group owns four power plants in Croatia capable of producing thermal energy. At 31 December 2014, the Group's thermal energy (heat) generation power plants had a total installed capacity of 1,755 MWh and its district boiler rooms had a total installed capacity of 382 MWh. The Group's thermal energy is generated as a by-product of the generation of electricity from the Group's thermal power plants. The thermal energy supplied by the Group's power plants in Croatia is sold to tariff and non-tariff customers. Thermal energy is supplied to customers through steam/hot water pipelines that are owned and operated by the Group. In the year ended 31 December 2014, the Group's thermal power plants generated 2,034 GWh of thermal energy and its district boiler rooms of city neighbourhoods generated 183 GWh of thermal energy. In 2014, the Group's thermal power plants generated 92% of the total thermal energy generated by the Group for that year. For additional information on the thermal energy producing facilities, please see “—Electricity Generation—Thermal Power Plants”.

The following table sets forth certain information regarding the Group's thermal power plants thermal energy generating capacity.

	Generated thermal energy For the year ended 31 December			Installed thermal capacity installed at 31 December 2014	Start of operation	Type of plant	Fuel	Licence expires
	2012	2013	2014	(MW <sub>heat</sub> )				
	GWh							
TE TO Zagreb...	1,054	1,059	897	850	1979	CCCGT/CHP	Oil and Gas or EL Oil	2028
EL TO Zagreb...	871	846	758	645	1970	CHP	Oil and Gas	2035
TE TO Osijek....	301	309	273	190	1976	CHP	Oil and Gas	2035
TE Sisak.....	95	100	106	70	1989	Steam Boiler	Oil and Gas	2018
District boiler rooms <sup>(1)</sup> .....	236	230	183	382				
<b>Total</b> .....	<b>2,557</b>	<b>2,544</b>	<b>2,217</b>	<b>2,137</b>				

(1) Comprises data from 29 district boiler rooms in Zagreb, 14 in Velika Gorica, four in Samobor, eight in Zaprešić, one in Sisak and two in Osijek.

## Renewables

The Group is investing in a range of renewable energy projects and is involved in developing numerous rooftop solar power systems on the buildings of existing power plants operated by HEP Generation. The Group has also been involved in the development of a number of wind farm projects, as well as small hydro projects which involve installing small water turbines into existing facilities. In addition, in 2016 the Group is planning to start the construction of two biomass fuelled plants in Osijek and Sisak, with an installed electricity generation capacity of 2MW each and with an installed thermal energy generation capacity of 10MW each. In July 2015, HEP and RWE signed a joint

venture agreement to form a new company, Novenerg, in order to develop renewable energy projects in Croatia and potentially in other countries of south-eastern Europe. The newly established company will be responsible for the strategic assessment and analysis of potential investments in the production of electricity from renewable energy sources, project development aimed at increasing the efficiency of existing generation facilities and general consulting services.

## Transmission of Electricity

### Overview

The Group provides electricity transmission services within the Croatian power system to network users within Croatia. This transmission service is provided by HOPS, which is in the process of unbundling in accordance with the ITO model. For more information, see “*Regulation—Third Energy Package*” and “*Risk Factors—The Group’s restructuring required under EU energy laws has not yet been completed*”.

HOPS is the only TSO in Croatia. As a result, all suppliers, including the Group’s competitors, must use HOPS’ transmission network under the same conditions. All network users connected directly to the high voltage transmission network pay an initial connection fee. All users pay transmission tariffs which are determined by HERA in line with prescribed methodology. See “*Regulation—Electricity Sector—Electricity Transmission Tariff Model*” for further details.

The Croatian transmission network is also connected to the neighbouring systems of Serbia, Bosnia and Herzegovina, Slovenia and Hungary, which, in aggregate, have a total capacity that exceeds the Croatian peak load by several times. All electricity transits that are carried through HOPS’ and other EU and Energy Community TSO transmission grids are regulated by Regulation (EU) 838/2010 which came into force on 3 March 2011 and replaced the previous transmission agreements. HOPS has the required regulatory licences to carry out electricity transmission operations in Croatia and is currently in the process of obtaining the certificate from HERA and the European Commission in accordance with the EU Third Energy Package.

The following tables set forth certain information regarding the two way capacity of HOPS’ transmission network for the periods indicated.

	Average Network Capacity import			Average Network Capacity export		
	For the year ended 31 December					
	2012	2013	2014	2012	2013	2014
	MW			MW		
<b>Border</b>						
Serbia.....	380	419	465	420	495	490
Bosnia and Herzegovina .....	663	649	684	533	663	637
Slovenia.....	1,164	1,192	1,388	990	988	233
Hungary.....	1,186	1,200	1,182	990	1,000	982
<b>Total</b> .....	<b>3,393</b>	<b>3,460</b>	<b>3,719</b>	<b>2,933</b>	<b>3,146</b>	<b>3,342</b>

	Volume Transferred import			Volume Transferred export		
	For the year ended 31 December					
	2012	2013	2014	2012	2013	2014
	TWh			TWh		
Border						
Serbia.....	0.6	0.9	1.0	1.1	0.8	2.0
Bosnia and Herzegovina .....	1.3	3.3	1.6	2.6	1.3	1.3
Slovenia.....	6.8	5.1	7.0	3.0	4.7	3.5
Hungary.....	8.0	5.2	5.4	2.4	3.2	3.5
Total .....	16.7	14.5	15.0	9.1	10.0	10.3

### *Available Transmission Capacities trading*

The TSOs of neighbouring countries coordinate the allocation and use of available transmission capacities (“ATC”). The TSOs have at their disposal 50% of the determined capacity in the direction of import and export, unless otherwise agreed by mutual bilateral rules.

At the border with Serbia, HOPS and EMS carry out bilateral yearly, monthly and daily auctions for ATC in accordance with the Yearly and Monthly Auction Rules on Croatia-Serbia Interconnection Capacity and Daily Auction Rules.

In the end of 2014 the South East Europe Co-ordinated Auction Office (“**SEE CAO**”) was established by seven transmission system operators of Turkey, Greece, Croatia, Montenegro, Bosnia and Herzegovina, Albania and Kosovo in order to streamline and facilitate cross-border auctions within the region. SEE CAO is yet to extend its auction process to all borders within the region, but auctions at the Croatian border with Bosnia and Herzegovina are already being held in accordance with the Rules for Capacity Allocation in SEE CAO.

At the border with Slovenia and Hungary, yearly, monthly and daily auctions are held by the CAO Central Allocation Office GmbH, a common auction office for allocating cross-border transmission capacity across the CEE region, based on separate Rules for Coordinated Auction of Transmission Capacity at the border with Hungary and Slovenia which are fully consistent with the rules applied in the CEE Region.

In addition, HOPS, as a shareholder of SEE CAO, and 19 other transmission system operators are involved in a Joint Allocation Office project (“**JAO**”). In order to contribute to the creation of an EU Internal Electricity Market, JAO will be founded in September 2015 by merging two regional allocation platform operators, Central Allocation Office and Capacity Allocation Service Company. The first auctions will be held in 2016.

Auction rules and other important information are published on the websites of the relevant auction offices and distributed by them.

### *The Transmission Network*

HOPS is the only operator of the Croatian electricity transmission system and is responsible for its maintenance, development and construction. HOPS aims to provide high quality electricity service, while minimising transmission costs and guaranteeing reliability and security. In order to satisfy the transmission requirements of the network users and to achieve a high quality reliable transmission service, the network needs to be continuously maintained in accordance with prescribed standards and developed, built and extended to meet increasing electricity demand. This maintenance includes the repair and replacement of overhead lines and underground cables, primary and secondary equipment, auxiliary plants, telecommunications equipment and building structures in sub-stations and switchyards.

Pursuant to the Electricity Market Act HOPS is required to adopt and approve with HERA a 10-year, three-year and one-year transmission network development investment plan in accordance with the Ten-Year Network Development Plan (ENTSO-E TYNDP) on the EU level.

According to the above mentioned plans, HOPS intends to continue to modernise and expand the transmission network with an estimated investment of approximately HRK 2.9 billion by 2019 and to further reduce network losses. HOPS is in the process of constructing 110 kV underground cables to connect three sub-stations in Rijeka, implementing the “Transmission Lines Renewal Project” that includes replacing or repairing approximately 700 kilometres of overhead lines and underground cables by 2020, replacing the old 110kV submarine cables, and connecting the Sisak thermal power plant to the network via new 2x220 kV line in 220kV Mraclin-Prijedor line. In addition, HOPS is in the preparation stages for the construction of the 400kV Plomin—Melina line to integrate TPP Plomin C with the network and the new 400 kV Osijek-Ernestinovo line to integrate CCGT Osijek with the

network. HOPS is also installing compensating devices for regulation of high voltages in the 220kV and 400kV networks and developing a network to connect new renewable energy facilities.

## **Distribution and Sale of Electricity, Thermal Energy and Gas**

### *Overview*

The Group is the sole distributor of electricity, the biggest distributor of thermal energy, the sole distributor of gas on the wholesale market and one of the leading distributors of gas to end-consumers in Croatia. All suppliers, including the Group's competitors, must use the Group's distribution network for distribution of electricity, gas and thermal energy under the same conditions. HERA sets distribution tariff rates for electricity, as well as for thermal power and gas. See "*Regulation—Electricity Sector—Price of Electricity*" "*Regulation—Thermal Energy Sector—Thermal Energy Prices*" and "*Regulation—Gas Sector—Price of Gas*" for further details.

At 31 December 2014, the Group operated 135,784 kilometres of high-, medium- and low-voltage electricity distribution lines, 351 kilometres of insulated pipelines for thermal energy distribution and 2,552 kilometres of low pressure gas pipelines.

### *Distribution and Sale of Electricity*

At 31 December 2014, the Group was the sole distributor of electricity to more than 2.3 million customers in Croatia, covering an area of approximately 57,000 square kilometres. The Group's supply business sells electricity (procured by its trading business and generated by the Group's power plants) to end-consumers in Croatia, through the Company's subsidiaries HEP-Supply and HEP-ODS, and to a lesser extent to the neighbouring countries, through the Company's subsidiary HEP-Trade (see "*—Trading*" for further information on the Group's trading operations).

The Group is currently the only electricity supplier operating in the public supply system and supplying electricity services to Tariff Customers.

HEP-Supply supplies Non-Tariff Customers that have opted for a Market Supplier. According to Management's estimates, HEP-Supply executes approximately 43.3% of all electricity sales in Croatia and approximately 74.6% of total sales in Croatia to the Non-Tariff Customers sector. Market Suppliers not part of the Group held approximately 13.2% of the electricity market at 31 December 2014 and 14.9% at 30 June 2015.

Similar to transmission activities, the distribution of electricity in Croatia is a regulated activity, with distribution tariffs approved by HERA. In order to obtain a change in the tariff rates, the Group is required to submit a request to HERA and propose a new tariff rate. See "*Regulation—Electricity Sector—Price of Electricity*" for further details.

Competition for Non-Tariff Customers has significantly increased as a result of the Accession and liberalisation of electricity supply market in Croatia. According to the information available on HERA's website, 22 Market Suppliers (three Market Suppliers are part of the Group) of electricity were registered and operating in Croatia as of 1 October 2015. Currently, the Group competes primarily with RWE Energija, GEN-I and Proenergy, and the Group expects higher competition in the short to medium-term for Non-Tariff Customers. In the year ended 31 December 2014, the Group sold 12,908 GWh of electricity to end-consumers of which 56.3% was sold to Commercial Customers (29.8% to high and medium voltage customers, predominantly industrial customers and 26.5% to low-voltage customers) and 43.7% to Households (low-voltage). According to Management's estimates, the Group's share of the electricity sold to end-consumers in Croatia was 98.6%, 95.5%, 86.8% and 85.1%, respectively, for the years ended 31 December 2012, 2013 and 2014 and six months ended 30 June 2015. The Group's distribution grid losses were 1,257 GWh of electricity in the year ended 31 December 2014, representing a decrease of 202 GWh, or 13.8%, from 1,459 GWh in the year ended 31 December 2013.

Commercial Customers who are supplied by a Market Supplier (the “**Commercial Non-Tariff Customers**”) generally purchase their electricity through annual contracts. However, the Commercial Non-Tariff Customers that need to comply with public procurement rules typically sign four-year agreements, which are subject to an annual price review. In the year ended 31 December 2014, approximately 60% of the Group’s total electricity sold to end-consumers, was sold to Commercial Non-Tariff Customers on one-year contracts.

### *Classification of Customers*

The Group’s customers can be split between Commercial Customers and Households. Customers who choose a Market Supplier typically pay lower rates than the tariffed rates under the public supply system. In the event that a customer fails to choose a Market Supplier or its contract with a Market Supplier is terminated, such customer will be supplied by the public supply system where it is charged in accordance with the tariffs set by HERA. The table below sets forth the volume of electricity sold by type of end-consumer for the years ended 31 December 2012, 2013 and 2014.

	For the year ended 31 December						For the six months ended 30 June	
	2012		2013		2014		2015	
	GWh	%	GWh	%	GWh	%	GWh	%
<b>Households:</b>								
Tariff Customers .....	6,465	100	6,244	100	5,580	99.0	2,829	98.4
Non-Tariff Customers .....	—	—	—	—	54	1.0	47	1.6
<b>Total Households.....</b>	<b>6,465</b>	<b>100</b>	<b>6,244</b>	<b>100</b>	<b>5,634</b>	<b>100</b>	<b>2,876</b>	<b>100</b>
<b>Commercial Customers:</b>								
Tariff Customers .....	1,370	15.9	1,377	16.7	898	12.3	321	9.0
Non-Tariff Customers .....	7,269	84.1	6,890	83.3	6,376	87.7	3,250	91.0
<b>Total Commercial Customers ..</b>	<b>8,640</b>	<b>100</b>	<b>8,267</b>	<b>100</b>	<b>8,900</b>	<b>100</b>	<b>3,571</b>	<b>100</b>

### *Electricity Prices*

Electricity prices in Croatia are lower than in most other countries in Europe. This is especially the case with regard to prices for domestic consumers, with prices for industrial consumers also being lower than many other European countries. Electricity prices for both industrial and domestic consumers are set out in the tables below, comparing Croatia to other major countries in Europe.

	Half-yearly electricity prices—domestic consumers							
	2010	2011		2012		2013		2014
	December 31	June 30	December 31	June 30	December 31	June 30	December 31	December 31
	EUR per Kwh							
European Union.....	0.1485	0.1542	0.1585	0.1614	0.1675	0.1699	0.1729	0.1787
Croatia.....	0.0937	0.0925	0.0932	0.0971	0.1107	0.1098	0.1080	0.1059
Belgium.....	0.1631	0.1765	0.1760	0.1924	0.1838	0.1783	0.1826	0.1883
Czech Republic.....	0.1159	0.1244	0.1220	0.1247	0.1250	0.1261	0.1234	0.1053
Germany.....	0.2049	0.2124	0.2127	0.2181	0.2249	0.2453	0.2455	0.2499
Spain.....	0.1568	0.1679	0.1770	0.1856	0.1880	0.1841	0.1878	0.1956
France.....	0.1155	0.1182	0.1220	0.1190	0.1244	0.1257	0.1355	0.1492
Italy.....	0.1751	0.1811	0.1882	0.1938	0.2085	0.2083	0.2111	0.2125
Hungary.....	0.1259	0.1345	0.1243	0.1230	0.1285	0.1111	0.1051	0.0946
Netherlands.....	0.1480	0.1463	0.1544	0.1561	0.1577	0.1583	0.1583	0.1505
Austria.....	0.1608	0.1655	0.1638	0.1646	0.1686	0.1735	0.1682	0.1656
Poland.....	0.1132	0.1196	0.1099	0.1153	0.1243	0.1203	0.1168	0.1155
Slovenia.....	0.1189	0.1201	0.1243	0.1285	0.1285	0.1342	0.1358	0.1338
Serbia.....						0.0470	0.0507	0.0506
Bosnia and Herzegovina.....	0.0629	0.0637	0.0671	0.0683	0.0687	0.0686	0.0680	0.0676
UK.....	0.1380	0.1365	0.1509	0.1603	0.1701	0.1658	0.1712	0.1826

- (1) Source: Eurostat—half yearly prices. These indicators present electricity prices charged to final consumers. Electricity prices for household consumers are defined as follows: average national price in Euro per Kwh without taxes applicable for the first semester of each year for medium size household consumers.

Half-yearly electricity prices—industrial consumers									
	2010	2011		2012		2013		2014	
	December 31	June 30	December 31	June 30	December 31	June 30	December 31	June 30	December 31
	EUR per Kwh								
European Union.....	0.1052	0.1102	0.1116	0.1150	0.1157	0.1193	0.1182	0.1230	0.1201
Croatia.....	0.0904	0.0907	0.0893	0.0899	0.0940	0.0949	0.0944	0.0956	0.0918
Belgium.....	0.1054	0.1098	0.1147	0.1076	0.1107	0.1078	0.1099	0.1094	0.1086
Czech Republic.....	0.1081	0.1108	0.1082	0.1039	0.1029	0.1023	0.0990	0.0829	0.0819
Germany.....	0.1190	0.1248	0.1243	0.1277	0.1297	0.1425	0.1444	0.1586	0.1520
Spain.....	0.1093	0.1137	0.1156	0.1214	0.1196	0.1224	0.1202	0.1246	0.1167
France.....	0.0716	0.0849	0.0808	0.0949	0.0788	0.0958	0.0853	0.0964	0.0908
Italy.....	0.1443	0.1523	0.1660	0.1648	0.1778	0.1680	0.1718	0.1720	0.1735
Hungary.....	0.1053	0.0998	0.0995	0.0948	0.0999	0.0963	0.0980	0.0914	0.0899
Netherlands.....	0.0975	0.0977	0.0936	0.0967	0.0966	0.0962	0.0940	0.1031	0.0888
Austria.....	0.1128	0.1126	0.1128	0.1102	0.1116	0.114	0.1108	0.1089	0.1055
Poland.....	0.0987	0.1014	0.0941	0.0917	0.0956	0.0931	0.0878	0.0825	0.0833
Slovenia.....	0.1005	0.0987	0.0964	0.0948	0.0941	0.0967	0.0945	0.0866	0.0847
Serbia.....						0.0572	0.0662	0.0514	0.0666
Bosnia and Herzegovina.....	0.0616	0.0613	0.0644	0.0646	0.655	0.0653	0.0655	0.0652	0.0621
UK.....	0.100	0.0982	0.1044	0.1143	0.1193	0.1165	0.1196	0.1289	0.1338

(1) Source: Eurostat - half yearly prices

### ***Distribution and Sale of Thermal Energy***

The Group's supply business sells thermal energy generated by the Group's thermal power plants and district boiler rooms to end-consumers in Croatia. Sales of thermal energy to customers are regulated, with the tariff rates approved by HERA. In order to obtain a change in tariff rates, the Group is required to submit a request to HERA and propose a new tariff rate. See "*Regulation—Thermal Energy Sector—Thermal Energy Tariff Model*" for further details.

The Group distributes thermal energy to more than 124,000 customers covering approximately 80% of the district heating market in Croatia (according to the most recent report published by HERA, for 2014), making the Group the largest of 19 distributors of thermal energy in the country. In the year ended 31 December 2014, the Group distributed a total of 1,859 GWh of thermal energy to customers, of which 100% was distributed to end-consumers in Croatia. The Group's distribution grid losses were 358 GWh of thermal energy in the year ended 31 December 2014, representing an increase of 23 GWh, or 6.9%, from 335 GWh in the year ended 31 December 2013.

The table below sets forth the volume of thermal energy sold by the Group according to the type of end-consumer in the year ended 31 December 2014.

For the year ended 31 December 2014							
Household		Commercial		Industrial		Total	
(GWh)	(%)	(GWh)	(%)	(GWh)	(%)	(GWh)	(%)
1,099	59.1%	397	21.3%	363	19.5%	1,859	100%

The Group's heating operations have generated a loss in each of 2014, 2013 and 2012 primarily due to the low tariff rates the Group is required to charge.

The Group's initial focus is to make the district heating business economically viable. However, the Group also aims to expand TE Sisak's heating business by finishing the construction of a new unit at Sisak thermal power plant, continue the renewal projects of the hot water and steam networks, construct heating systems in Zagreb and Velika Gorica, connect existing customers to the district heating system, close separate boiler plants, implement technical and economic optimisation of the district heating system and renew heating sub-stations.

### ***Distribution and Sale of Gas***

#### ***Wholesale Market***

Pursuant to the decision of the Croatian Government, HEP was chosen as the sole supplier to the Croatian wholesale gas market for the period from 1 April 2014 until 31 March 2017. HEP Gas Supply acts as an agent for HEP and performs HEP's obligations (i) to distribute gas under regulated

terms to suppliers in Croatia for further sale to household customers and (ii) to ensure a reliable and safe gas supply in Croatia. HEP entered into gas supply/sales agreements with 35 companies (public service suppliers), including its subsidiary HEP-Plin. HEP also entered into gas procurement contracts with two companies, a transmission system operator and a storage system operator.

Distribution of gas to public service suppliers is regulated, with the sales prices approved by the Croatian Government, on the recommendation of HERA. In the year ended 31 December 2014 the Group distributed a total of approximately 3,022 million GWh (or 315 million m<sup>3</sup>) of gas on the wholesale market.

#### *Retail Market*

The Group's supply business sells gas (procured by HEP-Plin) exclusively to end-consumers in Croatia. At 30 June 2015, the Group distributed gas to 74,968 customers and/or metering points, making the Group the second largest of more than 50 suppliers of gas currently operating in Croatia in terms of volume of gas sold to end-consumers, according to data provided by Eurostat.

Sales of gas to Households are regulated, with the tariff rates approved by HERA. In order to obtain a change in the tariff rates, the Group is required to submit a request to HERA and propose a new tariff. See "*Regulation—Gas Sector*" for further details.

In the year ended 31 December 2014, the Group distributed a total of 114.9 million m<sup>3</sup> of gas to customers and/or metering points, of which 100% was distributed to end-consumers (46.2% to Commercial Customers and 53.8% to Households). The Group's distribution grid losses were 4.4 million m<sup>3</sup> of gas in the year ended 31 December 2014, representing a decrease of 1.4 million m<sup>3</sup>, or 24%, from 5.8 million m<sup>3</sup> in the year ended 31 December 2013.

The table below sets forth certain information regarding the volume of gas distributed by the Group (including grid losses) and volume of gas sold by type of end-consumer in the year ended 31 December 2014 for HEP Plin.

	For the year ended 31 December 2014	
	(m <sup>3</sup> million)	(%)
<b>Distribution volumes:</b>		
Customers.....	114.2	95.7
Other <sup>(1)</sup> .....	0.7	0.6
Grid losses.....	4.4	3.7
<b>Total.....</b>	<b>119.4</b>	<b>100</b>
<b>Sale volumes:</b>		
Households.....	61.8	53.8
Commercial.....	33.8	29.0
Industrial.....	19.8	17.2
<b>Total.....</b>	<b>114.9</b>	<b>100</b>

(1) Gas distributed to others mainly includes gas distributed to the Group's distribution centres, specifically to certain of the Group's heating substations for their consumption.

In the year ended 31 December 2014, approximately 100% of the Group's total gas sold to end-consumers was sold on a forward basis as part of one-year contracts, primarily to industrial customers.

The Group has expanded its gas supply operations with the establishment of a gas supply route via Hungary, which became operational in 2011. The Group plans to further develop the natural gas distribution and supply businesses by expanding the existing gas network in the Slavonia and Baranja areas in Hungary. Preparations are also being made for the development and construction of an LNG (liquefied natural gas) terminal on Croatia's Adriatic Coast at Omišalj on the island of Krk, providing a significant alternative supply route for the Group. Consideration is also being given to the construction of a gas-fired power plant to be built on land adjacent to the LNG terminal. However no capital expenditure plans with respect to the construction have so far been made. The project is being



undertaken by LNG Hrvatska, which the Company owns together with Plinacro. The estimated value of the LNG terminal project is approximately €600,000 thousand. The LNG terminal project is one of the strategic projects for the Republic of Croatia and the European Union, with the new terminal is expected to provide a range of services, including berthing and unloading, storage and re-gasification/transmission. Commencement of operations of the LNG terminal is scheduled for the fourth quarter of 2019.

## Trading

### Overview

The Group's trading business is carried out by its subsidiary HEP-Trade which is responsible for the optimisation of the Group's power plant operation and intermediation in the domestic and international markets, purchase of electricity and gas in order to meet anticipated consumption levels and sale of excess electricity and gas, as appropriate. HEP-Trade does not engage in speculative trading for profit or otherwise. The Group operates in the wholesale electricity and gas markets in Croatia and abroad, through its local balance groups (Austria, Hungary, Slovenia, Germany) and HEP-Trade's subsidiaries located in Hungary, Bosnia and Herzegovina and Kosovo. HEP-Trade also operates in the retail electricity market in Slovenia through its subsidiary, HEP Energija d.o.o. Ljubljana, and trades gas on the wholesale market, as well as green certificates and CO<sub>2</sub> emissions allowances.

The following table sets forth a breakdown of the volume of electricity and gas purchased and sold by the Group in the wholesale markets for the periods indicated.

	For the year ended 31 December			For six months ended 30 June
	2012	2013	2014	2015
			(Gwh)	
<b>Wholesale trading in electricity<sup>(1)</sup></b> .....	<b>8,198</b>	<b>8,435</b>	<b>6,763</b>	<b>3,314</b>
Electricity purchased in the wholesale market .....	6,865	4,837	2,810	1,753
Electricity purchased from other producers.....	426	667	933	592
Electricity sold in the wholesale market.....	908	2,930	3,020	970
Balance of wholesale trading in electricity <sup>(2)</sup> .....	6,383	2,574	724	1,375
			(million m <sup>3</sup> )	
<b>Gas purchased in the wholesale market</b> .....	—	—	<b>435.8</b>	<b>227.4</b>

(1) Total volume (purchase plus sales)

(2) Net volume purchased (purchase less sales)

### Trading performance

The Group imports electricity largely in response to fluctuations in the levels of capacity of hydro power plants. Fluctuations in the generation of electricity in hydro power plants are generally compensated by imports which allow the optimisation of costs of available electrical power.

In the six months ended 30 June 2015, the Group procured a total of 8,555 GWh of electricity (1,753 GWh of electricity in the wholesale market, 592 GWh of electricity from other producers and 6,210 GWh of electricity generated by the Group) and it sold a total of 7,417 GWh of electricity (970 GWh of electricity in the wholesale market and 6,447 GWh of electricity to end-consumers). During the six months ended 30 June 2015, the purchases on the wholesale market decreased by approximately 24.5% as compared to the same period last year, primarily due to lower water inflows as compared to the same period last year and due to an increased trading volumes procured by HEP's subsidiaries. The sale on the wholesale market in the six months ended 30 June 2015 was 43% lower as compared to the same period last year due to the lower production level of hydro power plants as a result of the lower energy value of water inflows.

In the year ended 31 December 2014, the Group procured a total of 18,020 GWh of electricity (2,810 GWh of electricity in the wholesale market, which accounted for 16.5% of the Group's total needs, 933 GWh from other producers (eligible and private production) and 14,277 GWh of electricity generated by the Group) and it sold a total of 3,020 GWh of electricity. The balance of 724 GWh comprised consumption by the Group and network losses.

In 2014, the Group's purchases of electricity on the wholesale market decreased by 41.9% as compared to 2013, primarily due to the decrease of the Group's market share in the electricity market. Sales on the wholesale market in 2014 decreased by 3.0% due to slightly higher water inflows as compared to the same period last year.

### *Description of trading operations*

Further to the Accession, the Group received direct access to the Western European energy market (which includes Slovenia, Hungary, Germany and Austria) and transferred its trading activities on the wholesale electricity market to HEP in order to achieve higher liquidity and reduce operating costs. In addition, HEP-Trade conducts international electricity trading through its foreign subsidiaries located in Slovenia, Hungary, Serbia, Bosnia and Herzegovina and Kosovo.

- *Slovenia.* The Group sells and purchases electricity on the wholesale market in Slovenia, on the Slovenian Power Exchange (BSP) and with bordering states (cross border trading—Austria, Croatia). Pricing is carried out on the basis of market prices for sold and purchased electricity with added margins for operational costs. Trading limits are set on the basis of the counterparty's actual collateral position recorded on its clearing account with Borzen SouthPool Exchange. Trading is carried out on the basis of daily, weekly and monthly contracts for physical deliveries. To date, the Group has not engaged in derivatives trading in Slovenia. The Group intends to further intensify customer supply activities in Slovenia in the short-term through its subsidiary in Slovenia in cooperation with HEP-Supply and HEP-Trade.
- *Hungary.* The Group sells and purchases electricity mainly on the Hungarian Power Exchange (HUPX) and with bordering states (cross border trading—Croatia). Pricing is carried out on the basis of market prices for sold and purchased electricity with added margins for operational costs. Trading limits are set on the basis of the companies' actual collateral position on their accounts held by UniCredit Czech Republic (the HUPX clearing house). Trading is carried out on the basis of daily contracts for physical deliveries. To date, the Group has not engaged in derivatives trading in Hungary.
- *Austria / Germany.* Since 2014 the Group is active on the European Power Energy Exchange (EPEX Spot) and European Energy Exchange (EEX), enabling the Group to access the liquid European spot (intraday and day ahead) and derivatives market.
- *Serbia.* The Group sells and purchases electricity mainly in the wholesale market in Serbia and with bordering states (cross border trading—Croatia and Kosovo). Pricing is carried out on the basis of market prices for sold and purchased electricity with added margins for operational costs. The Group plans to commence customer supply activities in Serbia in 2015 through its subsidiary in Serbia in cooperation with HEP-Trade and HEP-Supply.
- *Bosnia and Herzegovina.* The Group sells and purchases electricity mainly in the wholesale market in Bosnia and Herzegovina and with bordering states (cross border trading—Croatia). Pricing is carried out on the basis of market prices for sold and purchased electricity with added margins for operational costs. The Group plans to commence customer supply activities in Bosnia and Herzegovina in 2015 through its subsidiary in Serbia in cooperation with HEP-Trade and HEP-Supply.
- *Kosovo.* The Group sells and purchases electricity in the wholesale market in Kosovo and with bordering states (cross border trading—Serbia). Pricing is carried out on the basis of

market prices for sold and purchased electricity with added margins for operational costs. The Group is currently finalizing the process of obtaining the licence for customer supply in Kosovo.

In addition, the Group began operating in the wholesale gas market in Croatia in 2014 and in the wholesale gas markets in Slovenia and Austria in 2015. The Group is also engaged in trading green certificates and CO<sub>2</sub> emissions allowances. See “*Regulation*” for further details.

The Group is a member on the most important liquid energy exchanges in Central Europe such as European Energy Exchange, European Power Exchange, Hungarian Power Exchange, Borzen SouthPool Exchange and Central European Gas Hub:

- *Electricity.* The Group sells and purchases electricity bilaterally, through broker platforms and on the exchange spot market (intraday and day ahead) as well as on the exchange futures market (week physical futures) of derivatives. The Group plans to increase its activities on the exchange electricity futures market.
- *CO<sub>2</sub> emissions allowances.* The Group trades with CO<sub>2</sub> emissions allowances bilaterally and on the exchange market (participating on the primary auctions on the European Energy Exchange, secondary market and futures market).
- *Gas.* The Group trades with gas bilaterally. In May 2015, the Group became a member of the Central European Gas Hub, the leading hub for gas trading in the Central and Eastern Europe, and is entitled to participate in virtual trading at the hub.

The Group also plans to increase the volume of its trading operations by increasing its presence in Croatia’s neighbouring markets.

## Commodities

The Group purchases 100% of its required fuel from third parties. The purchase of imported fuel is centralised within the Group while locally sourced fuel is purchased by individual subsidiaries. Due to the Group’s stable and predictable revenues it is able to predict fuel consumption requirements for any year and in so doing, purchase required fuel on the market at optimal times and prices.

Commodities are subject to significant changes in supply and demand and the prices of heating oil, gas, coal and nuclear fuel have been volatile since 2009. The global financial crisis, the growth of large emerging market countries (such as China), and the geopolitical conditions in the key oil producing regions have had a substantial impact on the prices of commodities used by the Group.

The table below sets forth information relating to the total amount of fuel consumed by the Group’s thermal power plants and the amount which was purchased from third parties for the periods indicated.

	For the year ended 31 December					
	2012		2013		2014	
	Total consumed	Purchased from others	Total consumed	Purchased from others	Total consumed	Purchased from others
Black coal (1000t) .....	855.5	738.5	932.6	1,044.4	918.9	843.3
Heavy fuel oil (1000t) .....	109.8	90.0	46.3	—	28.6	—
Extra light fuel oil (1000t) .....	1.7	1.7	0.9	0.9	1.0	1.0
Gas (1,000,000m <sup>3</sup> ) .....	701.2	701.2	599.2	599.2	367.3	367.3

The Group maintains minimal fuel stocks year on year to ensure stability of supply.

The Group does not undertake any hedging transactions with regards to commodity products and any significant increases in commodity prices could have an adverse effect on the Group’s operating results and financial condition, especially if the Group is not able (or not permitted by regulatory authorities) to shift production from cogeneration units to lower-cost commodities or to adjust its rates

to offset such increases in prices. As the Group does not typically enter into long-term commodity supply agreements, its annual results are subject to substantial variation depending on its ability to generate electricity through hydro power plants operated by the Group and the need to purchase significant amounts of oil, coal, fuel, gas and other commodities in order to power its thermal and nuclear power plants. In addition, from 2013, thermal generation is subject to increased costs associated with emissions allowances. Accordingly, during the years where weather conditions are poor for hydro electricity generation, the Group might be required to switch its operations to less cost effective production methods and this may incur significant additional costs.

### ***Coal***

At 30 June 2015, two of the Group's power plants burn black coal. In the year ended 31 December 2014, the Group's power plants in Croatia consumed 918,900 tons of black coal. The Group does not use brown coal in its operations, which is not as efficient as black coal and generates more CO<sub>2</sub> emissions. The price of black coal has decreased since 2012 with prices down by approximately 21.3% in 2014 from 2012 and has shown a further decrease by approximately 17.5% in the first half of 2015, compared with the same period in 2014.

In the year ended 31 December 2014, approximately 84.66% of the black coal used in the Group's power plants in Croatia was supplied by Glencore International AG, with the remainder purchased from Macquarie Bank Limited (approximately 15.34%).

Contracts for the purchase of coal are subject to tender and are entered into two or three times a year. The Group does not purchase coal on the spot market.

### ***Fuel Oil***

At 31 December 2014, five of the Group's thermal power plants burn heavy fuel oil and one of the Group's power plants burns extra light fuel oil. Two of the Group's power plants also use extra light fuel oil as a start-up fuel. Both heavy fuel oil and extra light fuel oil are generally supplied by one company in Croatia, INA d.d., however the Group also purchases heavy fuel oil on the international oil market at prices based on Platts (a global energy supplier) price quotations. HEP-Top also uses fuel oil in district boiler rooms for the generation of thermal energy.

The Group purchases greater amounts of fuel oil for its operations in winter as during the heating season it must utilise its fuel oil fired power stations to a greater extent to generate sufficient capacity to supply the country with heat. Due to a lack of availability from former suppliers and stronger emission regulations in Croatia, the Group has switched to the more expensive low-sulphur fuel oil and has started to purchase fuel oil on the Mediterranean market. This has impacted its generation operations as it has resulted in two thermal power plants no longer being suitable for electricity generation.

In the year ended 31 December 2014, the Group consumed 28,600 tons of heavy fuel oil and 1,000 tons of extra light fuel oil. In the years ended 31 December 2013 and 2014, the Group did not make any purchases of heavy fuel oil due to an obligation to spend fuel oil reserves with high content of sulphur, while extra light fuel oil was purchased for district boilers from several suppliers.

### ***Gas***

At 31 December 2014, five of the Group's power plants were gas fired. Since July 2015, a new 230Mwe/50MWth CCGT unit has been in the commissioning phase at the thermal power plant Sisak. The Group expects the new CCGT unit to commence its operations in June 2016. In the year ended 31 December 2014, the Group's power plants in Croatia consumed 367.3 million cubic metres of gas. The Group has agreements with two suppliers for purchase of gas, which, in aggregate, supply the Group with a total of 346 million cubic metres of gas per annum. However, the Group's gas requirements exceed the volumes of gas supplied, so the Group has to purchase additional gas on the open market.

The Group's cost of gas has significantly decreased since 2012, with a decrease of 54.9% in 2014 as compared with 2012 and a further decrease of 7.9% in the first six months of 2015, compared with the same period in 2014. These decreases are primarily attributable to a decrease in electricity generation at the Group's gas-firing thermal power plants.

### ***Nuclear Fuel***

NEK is in charge of nuclear fuel procurement. NEK procures nuclear fuel materials (uranium) and services (conversion and enrichment) pursuant to medium-term contracts with its suppliers. NEK's nuclear fuel procurement policy is developed by NEK's management, however must be agreed with HEP and GenE as co-owners of the plant. HEP covers one half of the annual fuel costs as part of the price that it pays for electricity generated from the nuclear plant.

NEK purchases uranium and enrichment services from the UK company URENCO Limited pursuant to an eight-year contract that expires in 2021. The fuel elements are provided by Westinghouse Electric Company pursuant to a life-time contract.

### ***Spent nuclear fuel storage***

Spent nuclear fuel is stored on the premises of the plant in the spent fuel pit. The pit was enlarged in 2002 to ensure that it will have sufficient capacity to contain all spent fuel through to the end of the plant's regular lifecycle, which is planned for 2043. However, motivated by the incident at Fukushima and globally adopted practices, NEK decided to opt for dry storage of spent nuclear fuel for a portion of the spent fuel elements. The construction of this new storage facility was approved in July 2015 and is expected to be completed in 2019.

### ***Property, Plant and Equipment***

The Group operates all of its significant generation facilities and other properties and holds the title to or has the right to use by virtue of leases part of the land underlying its facilities. The Group's plant, property and equipment mainly comprise power plants, transmission and distribution networks, administrative buildings and other assets.

At 30 June 2015, the Group owned buildings with a total net book value of HRK 10,702,976 thousand, plant and equipment with a net book value of HRK 13,232,598 thousand and land with a net book value of HRK 1,091,086 thousand.

The Group's owned buildings accounted on its balance include hydro power plants and land plots on which such hydro power plants were constructed, however the ownership title to these assets is currently contested by the State Prosecutor's Office. For additional information, see "*Legal Proceedings*" and "*Risk Factors—Risks Related to the Group's Business— The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group's right to operate such plants in the future.*"

### **Employees and Health and Safety**

#### ***Employees***

The Group had 13,562, 11,877, 12,061 and 12,000 employees at 31 December 2012, 2013 and 2014 and 30 June 2015, respectively, the vast majority located in Croatia with a small team located in Bosnia and Herzegovina.

As a result of a high average age of the Group's employees (47.61 as of 31 December 2014), the Group expects a significant number of retirements in the next three to five years, and a reduction of up to 6% in the Group's total workforce is possible within the next two years by means of attrition and/or redundancies in connection with the Group's ongoing organisational restructuring (10-20% of the employees of the Group may be affected by the programme). The main purposes of the ongoing

restructuring are to, among other things, introduce certain new functions and increase the level of centralisation primarily in corporate, M&A and investment strategy, capital investments management and marketing; decentralise certain market activities, such as trading and sales, in order to promptly respond to new market conditions; and reduce the number of organisational units in order to make the Group's organisational structure more flexible to the extent permitted under the Electricity Market Act and the EU Third Energy Package. While the Group does not anticipate any significant issues with this restructuring, it is conscious of the need to preserve experience and knowledge within its businesses and to ensure key personnel do not depart; therefore, in tandem with its restructuring, it will further increase staff training and ensure an adequate hand-over is conducted by departing employees to ensure that relevant expertise is passed on to the remaining and/or new team members.

At 1 October 2014, all of the Group's employees in Croatia (except for employees of HOPS) were covered by a collective bargaining agreement (the "**Collective Agreement**") in accordance with Croatian law. This Agreement is valid until 30 June 2016. Staff costs are determined by the Collective Agreement, while salary increases are linked to the growth of the consumer prices in the previous year. In addition, the Group has agreed to a set of regulations with the Group's registered unions for dealing with employee disputes.

In line with Croatian employment legislation, the Group contributes to a state pension fund. Payments under such schemes are made by the state directly to the retiree. Once such contributions have been made, the Group has no further obligations to make payments. In addition, pursuant to the Collective Agreement, the Group, at the cost of employees makes contributions to a voluntary pension fund.

In accordance with Article 214 of the Labour Act (Official Gazette 93/14) (the "**Labour Act**"), at the request of the employer, the trade union and the employer jointly prepare and adopt, in addition to a collective bargaining agreement, separate rules relating to potential strikes or lockouts by the trade union. According to the Labour Act, the employer must specify in the agreement with the trade union exactly which operating activities would need to continue during a strike or lockout and how many employees would need to continue performing these activities. The Group believes that its essential operating activities include the generation, distribution and supply of electricity and heat to the general public and industry and expects these activities to continue during a strike or lockout. The Group made proposals in accordance with the Labour Act to the relevant trade unions, and, while some of the Group's companies and trade unions have already agreed and adopted the rules, the other companies and trade unions have not yet reached an agreement and formal arbitration proceedings are now underway to formulate such rules.

### ***Employee Education***

In recent years, the Group has promoted activities and projects focused on improving employee performance and drive, talent management and professional development both in Croatia and abroad, as well as working and social conditions.

The Group's employees attend seminars and workshops to be trained with respect to their duties and activities in relation to environmental and nature protection legislation and energy efficiency and renewable energy sources. The Sustainable Development and Quality Improvement Department continuously follows and prepares analyses of the legal requirements arising from Croatian, EU and other relevant environmental legislation. The Group also provides technical support to its employees through its Environmental Protection Coordination and Standardisation team. This team is charged with analysing and evaluating the environmental activities of the Group with an emphasis on planning, coordination, internal communication and preparation of proposals regarding the Group's compliance with relevant legislation.

### ***Health and Safety***

The Group is committed to ensuring the health and safety of its employees and customers.

Each organisational unit within the Group has a Safety at Work Committee which holds regular meetings to ensure compliance with the Group's policies and regulations; a Work Safety and Fire Protection Section of HEP oversees all of the Safety at Work Committees. Each Safety at Work Committee also ensures that employees are sufficiently trained for the role they are fulfilling.

The below table illustrates the number of injuries and fatalities in the last five years in the workplace. The number of industrial accidents has decreased since 2010.

	For the year ended 31 December				
	2010	2011	2012	2013	2014
Fatal injuries .....	30	24	27	26	25
Injuries at the workplace .....	226	205	206	165	134

## Licences

The Group holds all licences necessary for the operation of its businesses. With respect to the Group's principal subsidiaries these are as follows:

- HEP-Generation—the licences for electricity generation and for thermal energy generation were both issued by HERA on 10 December 2003 and expire in December 2018.
- TE Plomin—the licence for electricity generation was issued by HERA on 11 December 2003 and expires in December 2018.
- HEP-ODS—the licence for distribution of electricity was issued by HERA on 12 November 2003 and expires in November 2018 and the licence for the electricity supply was issued by HERA on 17 May 2014 and expires in May 2021.
- HOPS—the licence for electricity transmission was issued by HERA on 10 December 2003 and expires in December 2018.
- HEP-Supply—the licence for electricity supply was issued by HERA on 14 December 2011 and expires in December 2016.
- HEP-Top—the licences for thermal energy generation, distribution and thermal energy supply operations were issued by HERA on 12 December 2003, 11 December 2003 and 11 December 2003, respectively and expire in December 2018. In addition, HEP-Top holds the licence for electricity supply issued on 10 February 2013, which expires in February 2016.
- HEP-Plin—the licences for the Group-Plin's gas distribution and supply operations were issued by HERA on 10 December 2003 and 12 December 2007, respectively and expire in December 2018 and December 2022, respectively.
- HEP Gas Supply—the licence for the supply operations was issued by HERA on 2 April 2015 and expires in April 2018.
- HEP-Trade—the licences to trade electricity and gas supply were issued by HERA on 24 May 2013 and 27 February 2013, respectively, and expire in May 2016 and February 2016, respectively.
- HEP – the licences to trade electricity and gas supply were issued by HERA on 10 December 2003 and 8 May 2013, respectively, and expire in December 2018 and May 2016, respectively.

For further information on licences and permissions required under Croatian law and under other applicable regulations, please see “*Regulation—The Republic of Croatia—Electric Energy Sector—Licensing Regime*”.

## Emission Rights and the Kyoto Protocol

Through Accession, Croatia joined the EU's emissions trading system (the "EU-ETS") pursuant to which companies in member states can buy and sell emission allowances to reduce the cost of emission cuts. The EU-ETS is the cornerstone of the EU's efforts to meet its obligations under the Kyoto Protocol. On 1 January 2013, Croatia and HEP became an integrated part of the EU-ETS.

The Group owns large thermal power plants which emit large quantities of greenhouse gases into the atmosphere. From 1 January 2013, these plants became part of the EU-ETS for CO<sub>2</sub>, meaning that the Group is required to buy CO<sub>2</sub> emission rights for all of its installations which solely produce electricity and a portion of its installations which produce thermal generation (see "ETS Third Trading Period" below for further details).

	For the year ended 31 December		
	2012	2013	2014
Electricity produced from thermal power plants GWh .....	7,333	6,695	5,225
CO <sub>2</sub> /kt .....	3,726	3,490	2,947

### ETS Third Trading Period

The entry of the Group into the EU-ETS coincided with the start of the EU-ETS' Third Trading Period which will run through 2020 and implements certain changes to the current system with a view to harmonising the system and making it more efficient and fairer. This will include a gradual reduction (by 21%) of the caps on emissions across the region.

#### Electricity generation

Installations which solely produce electricity no longer receive any free allowances under the Third Trading Period. Therefore, since 2013 the Group has had to buy a quota for the greenhouse gases which it produces covering 100% of its CO<sub>2</sub> emissions from electricity production.

#### Thermal Generation

For the generation of thermal (heat) energy, there are transitional regulations which will allow a gradual phasing out of the available free allowances. Free allowances will therefore decrease in line with the Carbon Leakage Exposure Factor ("CLEF") coefficient and will fall from 80% of emissions in 2013 to 30% in 2020, as shown below:

	2013	2014	2015	2016	2017	2018	2019	2020
CLEF .....	0.8	0.7286	0.6571	0.5857	0.5143	0.4429	0.3714	0.3

In accordance with the approval of the Ministry of Environmental and Nature Protection ("MZOP") the Group was allocated free emission units for the generation of thermal energy which is transmitted to the central thermal system ("CTS") on the CLEF basis during the ETS Third Trading Period.

Management estimates the cost of purchasing necessary allowances will be approximately €8,000 thousand in 2015.

### Evaluation of CO<sub>2</sub> emissions

The level of the Group's annual CO<sub>2</sub> emissions is evaluated based upon the Croatian Energy Balance which is an analysis of all the forms of energy utilised in Croatia. It includes data related to the performance of each generation facility and the level of fossil fuels used at each facility.

When considering the level of funds to be reserved for the purchase of emissions allowances on the market, the Group must consider a range of factors. These include the level of its annual CO<sub>2</sub> emissions, the price of emissions units on the market (for the EU Allowance, Certified Emission Reductions ("CER") and Emission Reduction Units ("ERU")), market availability of these units, the



percentage of cheaper CER and ERU which can be used for the coverage of the annual quota, and the percentage of free allocated quotas allowed for the generation of thermal energy transmitted to CTS.

The following table sets forth the Group's emissions for the periods indicated.

	For the year ended 31 December		
	2012	2013	2014
		(in tons)	
SO <sub>2</sub> Emissions .....	8,055	6,025	3,747
Nox Emissions .....	5,156	5,286	4,779
CO <sub>2</sub> Emissions .....	3,726,274	3,490,584	2,947,102
Particulates .....	179	93	145

With respect to the level of the Group's emissions, hydrological conditions play an extremely important role as the hydro power plants can generate between 31% and 53% (based on figures for the last 10 years) of its required electricity, depending on conditions.

A further factor to be considered will be the impact of the Group's planned construction of new fossil fuel thermal power plants (TPP Plomin C-500 with expected commissioning in 2021, KKE Osijek 500 with expected commissioning in 2020, EL-TO Zagreb with expected commissioning in 2020), which could increase the level of CO<sub>2</sub> emissions produced by the Group.

### Intellectual Property

HEP has a trademark which is regulated by HEP's company statutes and which is yet to be registered with the competent trademark registry. In addition, HEP-Supply holds registered trademarks "nature friendly green energy", "elen:" and "ZelEn".

The Group does not own rights to any patents, utility models or industrial designs.

### Information Technology

The Group has its own corporate information system, HEP information system ("HEP IS"), which provides IT support to business processes and operations of internal users, as well as applications for communication with customers and business partners (ERP and Billing) of the Group. HEP IS server infrastructure is located in four data centres (Zagreb, Split, Rijeka and Osijek) and is built on highly available standard components, while ensuring the necessary redundancy for all critical services. All essential services are configured to have a secondary location where production can be migrated, if necessary, and the business data is backed up on a daily basis in case of an eventual system crash.

HEP IS is managed by the information and communication technology department within HEP. The development and the implementation of information systems and applications are aimed at providing support to the business processes and providing an integrated and centralised system for the Group.

### Insurance

The Group maintains several types of insurance coverage to protect itself against potential liabilities. In accordance with the Public Procurement Act, HEP has entered into a two-year Framework Agreement with Allianz Zagreb d.d., pursuant to which the Group enters into annual policies which cover four types of insurance: (i) combined collective insurance against accidental injuries (only in case of a fatality or critical injury), collective insurance against accidental injuries (for employees that work in mined fields) and insurance against accidental injuries for drivers, passengers and workers; (ii) all-risk (*hull*) motor vehicle insurance; (iii) third-party vehicle liability insurance; and (iv) liability insurance against losses and damages of third parties and/or the Group's employees in the course of the Group's business activities. Pursuant to the terms of the Collective Agreement, HEP has also entered into a two-year Framework Agreement for supplemental health insurance for its employees with Croatia zdravstveno osiguranje d.d. In addition, HEP has entered into a life and travel insurance for the members of the Management Board with Croatia osiguranje d.d.

The Group does not have sabotage or terrorism insurance.

In addition to the above insurance policies, TE Plomin has a policy for machinery insurance and general and products insurance policy, both with Allianz Zagreb d.d.

With respect to insurance for the NPPK, the Group does not have any insurance coverage for the NPPK and must rely on insurance coverage obtained by NEK. NEK holds insurance for property, employees and third party liability, all of which are in compliance with the applicable legislation in force in the Republic of Slovenia and the practices of the nuclear industry.

Operations at the NPPK are covered by a €700,000 thousand (approximately HRK 5,306,462 thousand) material damage policy (“MD”) which insures the plant’s property against nuclear hazards, fire, terrorism risk, a machinery breakdown policy (policy limit €400,000 thousand (approximately HRK 3,032,264 thousand) within the annual MD limit of €700,000 thousand) and a SDR 150,000 thousand (approximately HRK 1,470,250\* thousand) third party liability policy.

In addition to these specific types of insurance, the employees of NEK are covered by a collective accident insurance policy and all vehicles are covered by regular and mandatory vehicle insurance required in Slovenia. The total annual insurance cost for all policies in the year ended 31 December 2014 amounts to €2,236 thousand (approximately HRK 17,131 thousand). Insurance costs are an integral part of the price of the electricity generated at the NPPK and therefore HEP covers half these costs.

In the event of a nuclear incident with consequences outside the boundaries of the NPPK, the governing law is the Slovenian Law on Liability for Nuclear Damage (the “**Nuclear Law**”), which became effective on 4 April 2011. The Nuclear Law has been brought into compliance with the Paris Convention on Nuclear Third Party Liability and the Brussels Convention with the 2004 additional protocol on the liability for nuclear damage (the “**Additional Protocol**”). As a result of such amendments to the Nuclear Law, certain maximum compensation levels have been included, although they will not come into effect until the Additional Protocol becomes effective which will take place when it is ratified by two thirds of the signatory states. The third party liability insurance costs for the NPPK are calculated according to the former Slovenian regulations and amount to €389,000 (approximately HRK 2,974,000 thousand) with a total insured amount of SDR 150,000 thousand (approximately HRK 1,429,265\* thousand).

Upon ratification of the Additional Protocol and the changes to the Nuclear Law coming into effect, the basic liability of the user of a nuclear plant will amount to €700,000 thousand (approximately HRK 5,306,462 thousand), the liability of the state in which the nuclear plant is located will amount to a further €500,000 thousand (approximately HRK 3,790,330) and the joint funds of all the signatories of the Additional Protocol will insure another €300,000 thousand (approximately HRK 2,274,198 thousand) in the event of a nuclear incident. The annual third party liability insurance costs of NEK are, as a result, expected to increase to approximately €1,500,000 thousand (approximately HRK 11,370,990 thousand).

### **Quality Management**

The hydro power plants located in Generation Area North and Generation Area West have received certificates for quality assurance (ISO 9001) and environmental protection (ISO 14001). The Group aims to receive similar certification for the Generation Area South, Dubrovnik and Zavrelje by the end of 2015. All of the thermal power plants have also received certificates for quality assurance (ISO 9001) and environmental protection (ISO 14001). HEP-ODS has implemented the quality and management system in its distribution areas and received a certificate for environmental protection (ISO 14001).

---

\* Based on an exchange rate of €1.256940 to one SDR at 30 June 2015.

## **Nuclear Safety**

Responsibility for nuclear safety lies solely with NEK's management. Since the NPPK is located in Slovenia, the Slovenian nuclear regulator Uprava Republike Slovenije za nuklearno sigurnost ("URSJV") is responsible for supervising the safe operation of the nuclear power plant.

URSJV supervises regulatory compliance and reviews the operation of nuclear facilities, the quality of selected activities, repair and maintenance, and personnel training. URSJV representatives are permanently on site at the NPPK to monitor its performance and its compliance with safety standards and operating procedures and to make sure that any improvements made are appropriate. As part of this supervisory role, URSJV continuously monitors the levels of radiation in the immediate vicinity of the plants. There have been no controlled or uncontrolled radiation leakages, above legal limits, recorded at the NPPK.

The NPPK operates with a Westinghouse pressurised water reactor with two coolant loops. The nuclear island together with the design and fabrication of the initial cores with 16 x 16 fuel assemblies were supplied by Westinghouse Electric Corporation, while the replacement Steam Generators were provided in 1999 by the consortium Siemens-Framatome. The large dry containment consists of a cylindrical steel shell with a hemispherical dome and ellipsoidal bottom designed to accommodate normal operating loads, functional loads resulting from a loss-of-coolant accident and the most severe loading predicted for seismic activity. A concrete shield building surrounds the steel shell to provide biological shielding for both normal and accident conditions and to provide collection and hold up for leakage from the containment vessel. Inside the containment structure, the reactor and other safety components are shielded with concrete. In addition to a containment spray system, a containment recirculation and cooling system is provided to remove post-accident heat. The enforced concrete reactor building was designed by Gilbert Associates, Inc.

Following the Fukushima incident the NPPK has initiated a nuclear Safety Upgrade Program (SUP) which amounts to €20,000 thousand and is expected to be completed in 2021. The SUP comprises eight elements: alternative cooling of spent nuclear fuel pit, alternative cooling of reactor building and reactor systems, installation of additional pilot operated relief valve in pressuriser, protection against flooding of nuclear facilities, installation of plant ventilation and passive autocatalytic recombiners, setting up emergency control room and technical support centre and alternative heat sink. Most of these elements (except for a solution for alternative heat sink) either have already been completed or are in the process of completion.

The NPPK is connected to the 400 kV national grid by three power lines, one of them toward Zagreb, and two toward Maribor and Ljubljana. For start-up and emergency, the NPPK is also connected to the 110 kV grid by the power line Krško NPP—GPP Brestanica. The reactor is designed to operate at core power levels up to 1994 MWt, which corresponds to a net electrical output of 696 Mwe. First criticality was achieved in September 1981. The plant is designed in accordance with the U.S. NRC regulations and standards. In addition, as one of the safety improvement initiatives, the installation of the third diesel generator in a new earthquake and flooding resistant bunker building was completed in 2013.

The plant is regularly upgraded and modernised in accordance with new industrial and regulatory requirements and standards. The Slovenian "Ionising Radiation Protection and Nuclear Safety Act", requires periodic safety reviews every 10 years, which are the means for assessment of plant design and condition of systems structures and components, safety analyses, performance and feedback of experience, management, environment impact, licensing and regulatory requirements with latest standards and good industry practices.

## **Environmental Matters**

The Group is compliant in all material respects with the requirements of the Environmental Protection Act (OG 80/2013 and 153/2013), the Regulation on Information and Participation of the Public and Public Concerned with Environmental Protection Issues (OG 64/2008 and 80/2013), the Permit

Regulation (OG 8/2014), the Kyoto Protocol and other relevant acts, as well as having its own internal policies in place to inform employees about environmental and nature protection legislation.

Aside from the Environment Protection Act, the most important laws for the Group are the Air Protection Act, Waste Act, Waters Act and Nature Protection Act. The Group is compliant in all material respects with the requirements of such acts.

Since 2000, the Sustainable Development and Quality Improvement Department has monitored the developments of new legal regulations as well as amendments to the current legal regulations in the field of environmental and nature protection which influence the work and development of electricity system. Monitoring of the legal regulations referred to above takes place on a monthly basis in the form of 12 reports during the year which are sent to the coordinators of the environmental protection of companies within the Group by e-mail. Environmental protection coordinators pass them on to the leading personnel of companies and employees at the plants. At the end of the reporting period, the final document is collated and published in the Bulletin HEP Vjesnik and on the Group's intranet.

In the process of aligning Croatia's environmental legislation with that of the EU, in the last few years Croatia has made progress in transposing the Integrated Pollution Prevention and Control (IPPC) Directive (2008/1/EC) into national legislation. The IPPC Directive 2008/1/EC has been transposed into Croatian legislation through the Environment Protection Act, the Regulation on Information and Participation of the Public and Public Concerned in Environmental Protection Issues and the Environmental Permit Regulation.

According to the Environmental Permit Regulation, the integrated environmental protection requirements are determined for installations that may cause emission which pollute the soil, air, water and sea and new installations in which once constructed (during reconstruction and commissioning) such activities will be carried out. Within the meaning of the subject regulation, the activities/installations which may cause emission polluting the soil, air, water and sea are described in Annex I of Environmental Permit Regulation, and they are further divided into chapters referring to: (i) Energy industries, (ii) Production and processing of metals, (iii) Mineral industry, (iv) Chemical industry, (v) Waste management and (vi) Other activities. The installations listed under chapter (i) Energy industries, are combustion installations with a rated thermal input exceeding 50 MW, mineral oil and gas refineries, coke ovens, coal gasification and liquefaction plants and other gasification and liquefaction plants with a rated thermal input exceeding 20 MW

### **Legal Proceedings**

From time to time the Group has been, and expects to continue to be, subject to legal and regulatory proceedings and claims, including those described below. Other than the proceedings described below, there are no, and have not been any, governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which HEP is aware), which may have, or have had during the 12 months prior to the date of this Offering Circular, a significant effect on the financial position or profitability of HEP.

#### ***Proceedings related to hydro power plants***

##### ***Administrative proceedings***

The State Prosecutor's Office and the Ministry of Agriculture of the Republic of Croatia initiated several proceedings contesting the ownership title over certain real estate properties, including dams, reservoirs and land plots on which hydro power plants had been built, which were transferred to the Company as a result of its transformation into a joint stock company in 1994. Both the State Prosecutor's Office and the Ministry of Agriculture of the Republic of Croatia claim that pursuant to the provisions of the law valid at the time of the transformation (Act on Maritime Domain, Water Estate, Ports and Terminals (OG 19/74, 39/75, 17/77 and 18/81)), any objects of maritime domain or water estate were considered to be a part of the social ownership belonging to the people of Croatia, and as such were not subject to disposal or transfer. In addition, according to the State Prosecutor's

Office, the First Water Act (OG 107/95 and 150/2005) stipulated that objects of public water estate (including land plots on which the hydro power plants were built, dams and reservoirs which had previously been registered in the Land Registry as objects of social ownership) should have been transferred to state ownership and registered in the Land Registry in the name of the Republic of Croatia. Furthermore, the currently applicable Water Act, in effect since 2010, clarified that public water estate included, among other things, water buildings (such as hydro power plants). As a result of these proceedings, some of which are still ongoing, certain properties such as dams, reservoirs and/or land plots that are connected to hydro power plants Čakovec and Dubrava were registered in the Land Registry as part of the “public water estate” and the ownership title over such properties was transferred to the Republic of Croatia.

The Company contests the position of the Ministry of Agriculture and the State Prosecutor’s Office and believes that, according to the information in the Land Registry, the contested land plots do not constitute public water estate. Moreover, the Company (or its predecessors) paid for its claimed interest over such land plots, and consequently, in the Company’s opinion, any transfer of the land plots into state ownership without proper compensation to the Company contradicts the provisions of the Constitution of the Republic of Croatia. In 2013, on the basis of the aforementioned and certain other grounds, the Company filed lawsuits with the Administrative Court of Zagreb challenging the resolutions of the Ministry of Agriculture of the Republic of Croatia, on the basis of which the ownership title over properties connected to the Čakovec and Dubrava hydro power plants was transferred to the Republic of Croatia. The Administrative Court of Zagreb has not yet rendered its decisions with respect to the lawsuits filed by the Company, and it is currently difficult to predict the outcome of these proceedings.

#### *Constitutional Court proceedings*

The Water Act establishes state ownership over electricity generation facilities constructed by entities controlled by the Republic of Croatia, and therefore the merits of investing in the construction or development of hydro power plants are currently unclear.

In February 2013, the Company submitted a claim with the Constitutional Court of the Republic of Croatia contesting the validity of the relevant provisions of the Water Act. The Constitutional Court has not yet rendered its decision with respect to the Company’s claim.

Pending the resolution of the above issues, certain real estate properties of the Company and other members of the Group have unresolved legal status, and as a result of the ambiguities in the Croatian legislation, there is no assurance that the Company will be able to successfully defend the claims of the State Prosecutor’s Office and the Ministry of Agriculture and/or support its claim with the Constitutional Court. See *“Risk Factors—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group’s right to operate such plants in the future.”*

#### ***International Arbitration related to the NPPK***

HEP is currently the plaintiff in a dispute for damages against the Slovenian Government for failure to supply electricity to HEP from the NPPK during the period from 1 July 2002 to 18 April 2003. The disputed amount is estimated to be approximately €29.5 million plus interest. The arbitration tribunal rendered its award in favour of HEP on 12 June 2009, when it confirmed that Slovenia should have supplied electricity to HEP during the relevant period. The arbitration tribunal confirmed that HEP was entitled to damages if it provided evidence of the loss it suffered. In a subsequent ruling on 6 October 2010, the arbitration tribunal rendered a decision that on the basis of the available data it could not determine the loss actually suffered by HEP and requested that an independent expert be appointed in order to determine the actual amount of damage. The expert finalised his report in February 2014 and gave his oral statements at the hearings in March 2015. The final ruling of the tribunal is expected by the end of 2015.

***Court proceedings related to reconstruction of the hydro power plant Peruća***

HEP is currently the defendant in a court proceeding initiated by five individuals who claim that their land plots were used without their consent during the reconstruction of the hydro power plant Peruća. The aggregate amount of the individuals' claims amounts to approximately HRK 380 million (including interest and court costs), and the Group has made provisions in its financial accounts in respect of this matter. At 30 June 2015, provision made by the Group with respect to this proceeding amounted to HRK 165 million. In October 2007 and November 2012 the competent court of the first instance rendered a decision in favour of the plaintiffs in the full amount of their claims. In December 2012 HEP filed an appeal complaint with the competent court of the second instance, no hearings on the merits of HEP's appeal have been scheduled.

***Court proceedings related to fees for waste water treatment plant***

HEP-Generation is currently the defendant in four court proceedings initiated by Zagrebački Holding d.o.o. relating to payment for waste water treatment services. The aggregate amount of claims is approximately HRK 84,871 thousand. At 30 June 2015, provision made by the Group with respect to these proceedings amounted to HRK 76,179 thousand. The court of first instance rejected claims of Zagrebački Holding d.o.o., and the plaintiff appealed the decisions of the court of the first instance. The competent court of appeal has confirmed decision of the court of the first instance with respect to one of the proceedings, while others remain pending on appeal.

## **MANAGEMENT**

### **General Overview**

The Company has a tiered system of management, consisting of a General Assembly, a Supervisory Board and a Management Board. The General Assembly elects the Supervisory Board and exercises other powers pursuant to the Articles of Association. The Supervisory Board appoints and oversees the Management Board. The Management Board is responsible for day-to-day running of the business, although the Articles of Association require prior consent from the Supervisory Board for certain decisions. The Group's General Assembly, a Supervisory Board and a Management Board are located at Ulica grada Vukovara 37, Zagreb, Republic of Croatia with telephone number +385 1 6322 111.

### **General Assembly**

The General Assembly consists of shareholders of the Company or their proxies. The Company has one shareholder, the Republic of Croatia. The General Assembly decides on certain issues as required by the law and by the Articles of Association.

The General Assembly's powers include, among other powers, the power to:

- Approve the Articles of Association of the Company, as well as any amendments;
- Elect and terminate members of the Supervisory Board;
- Approve key decisions regarding the Annual Financial Statements
- Approve the Financial Statements and any distributions of profit;
- Approve the work of Supervisory Board and Management Board members;
- Decide on the status changes and winding up of the Company;
- Appoint the Company's auditors; and
- Approve any changes in the share capital of the Company.

Meetings of the General Assembly are convened by the Management Board. A meeting must also be held following a request by the Supervisory Board or by a Group of shareholders holding at least 20% of the Company's share capital. As stated above, Croatia is the sole shareholder of the Company and so it alone can exercise this power.

### **Supervisory Board**

The Company's Supervisory Board consists of seven members of whom six are appointed by the General Assembly, which also has the power to replace its appointed members with valid reason. The remaining member is appointed by the employees of the Company pursuant to the Labour Act who can also replace such member discharged by the employees. The term of office for the Supervisory Board members is four years and members can be re-elected to the Supervisory Board at the end of this period.

The Supervisory Board's powers include, among other powers, the power to:

- Nominate and replace members of the Management Board;
- Examine securities and other documents pertaining to the business operations of the Company;
- Approve the annual financial statements submitted by the Management Board;

- Approve decisions of the Management Board when required to do so by the Articles of Association; and
- Submit to the General Assembly reports on operating performance of the Company.

The members of the Supervisory Board are set out below:

Name	Age	Position	Since
Nikola Bruketa	72	Chairman of the Supervisory Board	23 February 2012
Dubravka Kolundžić	55	Member of the Supervisory Board	1 June 2015
Juraj Bukša	40	Member of the Supervisory Board	5 June 2014
Igor Džajić	43	Member of the Supervisory Board	19 September 2012
Žarko Primorac	78	Member of the Supervisory Board	23 February 2012
Ivo Uglešić	63	Member of the Supervisory Board	23 February 2012
Mirko Žužić	64	Member of the Supervisory Board	19 September 2013

**Nikola Bruketa.** Nikola Bruketa has been the Chairman of the Supervisory Board since 23 February 2012. Prior to joining the Supervisory Board, Nikola Bruketa held various posts within the Group since 1973, including as the Director of the Development Department. Nikola Bruketa graduated from the Faculty of Electrical Engineering in Zagreb in 1967.

**Dubravka Kolundžić.** Dubravka Kolundžić has been a member of the Supervisory Board since 1 June 2015. Dubravka Kolundžić has worked in the Group since 1983, when she was first employed as an engineer in Elektroslanija Osijek, and then as an independent engineer since 1993 and coordinator since 2007 in HEP, Zagreb. She graduated from the Faculty of Electrical Engineering, University of Zagreb in 1983. Dubravka Kolundžić also received a Master of Science degree from the Faculty of Electrical Engineering, University of Zagreb in 2000.

**Juraj Bukša.** Juraj Bukša has been a member of the Supervisory Board since 5 June 2014. Juraj Bukša is a teacher of nautical group of subjects at the Maritime School Bakar, Croatia. Prior to this, he held various positions with Lošinjska plovidba-Brodarstvo d.o.o. Rijeka since 2003, including the Director of General Affairs and Human Resources and Deputy Head of Commercial Line. From 2005 to 2009 Juraj Bukša also served as the Head of Short Sea Shipping Promotion Center, Rijeka. Juraj Bukša graduated from the Faculty of Maritime Studies, University of Rijeka in 1998. He also received a Master of Science degree from the Faculty of Maritime Studies, University of Rijeka in 2004 and a doctorate from the Faculty of Maritime Studies, University of Rijeka in 2011.

**Igor Džajić.** Igor Džajić has been a member of the Supervisory Board since 19 September 2012. Prior to joining the Supervisory Board, Igor Džajić worked as a director of Adista d.o.o. and held a range of roles within the brewing industry, including roles with Heineken Croatia. Igor Džajić graduated from the University of Osijek with a degree in Economics.

**Žarko Primorac.** Žarko Primorac has been a member of the Supervisory Board since 23 February 2012. Prior to joining the Supervisory Board, Žarko Primorac worked as Regional Chairman with Deloitte Zagreb. He also held the role of Minister of Finance of the Republic of Bosnia and Herzegovina and acted as the President of the Sarajevo Chamber of Commerce. Žarko Primorac graduated from the Faculty of Economics, Sarajevo with a degree in Economics in 1964, going on to complete a Masters and a Doctorate in the same field.

**Ivo Uglešić.** Ivo Uglešić has been a member of the Supervisory Board since 23 February 2012. Ivo Uglešić is a tenured Professor at the Faculty of Electrical Engineering, University of Zagreb. Prior to this, he held a series of professorships, after completing his graduate, masters and doctorate degrees in Electrical Engineering at the University of Zagreb.

**Mirko Žužić.** Mirko Žužić has been a member of the Supervisory Board since 19 September 2013. He also held the position of the director and the president of the Managing Council of OAZA DOM d.o.o. since 2011. Mirko Žužić graduated from Faculty of Mechanical Engineering and Naval Architecture, University of Zagreb with a degree in Mechanical Engineering in 1980.



There are no conflicts of interest between the duties of the Members of the Supervisory Board to the Group and to their private interests or other duties.

### Management Board

Members of the Management Board are appointed and replaced by the Supervisory Board. The Management Board is composed of four members. The term of office of the Chairman and the other members of the Management Board is four years. The decision on whether or not to extend a term of office of any board member is based on an evaluation their performance as compared to previous results.

The Management Board makes decisions in adherence to domestic and international regulations, the Articles of Association, the Internal Rules of Procedure for the Management Board and Company bye-laws.

The Management Board's powers include, among other powers, the power to:

- Manage the business activities of the Company;
- Establish and implement operating strategy;
- Implement decisions of the Supervisory Board and the General Assembly;
- Approve internal acts of the Company and organizational documents;
- Submit annual financial statements, statements on the status of the Company and the consolidated annual financial statements of the Group to the Supervisory Board;
- Approve hiring and staff policies and plans;
- Propose and implement special measures which secure the business of the Company and the security and functioning of the electricity system;
- Act on behalf of the Company in establishing contractual arrangements, pursuant to the applicable law and to the Articles of Association;
- Nominate members of the General Assembly and/or members of the Supervisory Board in companies controlled by HEP; and
- Grant special authorisations and responsibilities to the Company employees and officers.

The members of the Management Board are set out below:

Name	Age	Position	Since
Perica Jukić	46	Chairman of the Management Board	12 September 2014
Zvonko Ercegovic	50	Head of Production	23 February 2012
Saša Dujmić	45	Head of Regulated and Market Activities, Supporting and Regulatory Functions	4 December 2014
Tomislav Rosandić	40	Head of Finance	2 January 2015

**Perica Jukić.** Perica Jukić has been a member of the Management Board since 10 May 2013 and the Chairman of the Management Board since 12 September 2014. Perica Jukić has worked with the Group since 1996, when he was first employed as an independent engineer in thermal power plant – Heating plant (“TE-TO”) Zagreb, then becoming the Head of Generation and the facilities’ director since 2008. Previously he was the Director of the Thermal Power Plants Department in HEP-Generation (from 2009) and the Head of the joint HEP/RWE Operation and Maintenance Committee. Perica Jukić graduated from the Faculty of Mechanical Engineering and Naval Architecture, University of Zagreb in 1996. He also received a Master of Science degree in

cogeneration facilities and distribution of heat energy from the Faculty of Mechanical Engineering and Naval Architecture, University of Zagreb in 2005.

**Zvonko Ercegovac.** Zvonko Ercegovac has been a member of the Management Board since 23 February 2012. Previously he was a director in the Supply Department at HEP Plin from 1989. He served as a member of the HERA council from 2006-2010. He graduated from the Faculty of Electrical Engineering at J.J. Strossmayer University, Osijek and undertook further post-graduate study in electrical engineering in 2005 and economics in 2008.

**Saša Dujmić.** Saša Dujmić has been a member of the Management Board since 4 December 2014. Previously he worked in HEP-ODS, Elektrodolmacija Split, as an engineer and supervising engineer (1996-2012) and as a director (2012-2014). Saša Dujmić has also been an associate fellow in Electrical Equipment Maintenance and Testing at the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture, University of Split since 2007. He obtained a degree in Electrical Engineering at the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture, University of Split in 1995 and completed a graduate specialist programme in Energy Sector Economy at the Faculty of Economics, University of Rijeka, in 2013.

**Tomislav Rosandić.** Tomislav Rosandić has been a member of the Management Board since 2 January 2015. From 2012 to 2014 he was a member of the management board and the Chief Financial Officer at Eurocable group d.d. Prior to this, he worked as the Chief Financial Officer of Nexe grupa d.d. (2005-2012), then becoming a member of the management board of Nexe grupa d.d. (2008-2012). Tomislav Rosandić also worked as a branch manager at Zagrebačka banka d.d. (2000-2002) and as securities analyst and a director of Retail Banking at Cibalae banka d.d. (1997-2000). Tomislav Rosandić graduated from the Faculty of Economics at the University of Zagreb in 1997.

There are no conflicts of interest between the duties of the Members of the Management Board to the Group and to their private interests or other duties.

### **Compensation**

For the year ended 31 December 2014, members of the Supervisory Board and members of the Management Board were paid a total of HRK 32,827 thousand in salaries, wages and other payments by the Company.

### **Ownership**

HEP, the parent company of the Group is 100% owned by the Republic of Croatia, which is represented by the Ministry of Economy. As a state-owned company, the Group must follow general guidelines issued by the state, which govern all such companies. These guidelines relate to specific areas of management, such as payroll budgets, decisions on personnel, the remuneration of management and negotiations with unions regarding collective bargaining.

As the Group's sole shareholder, the Republic of Croatia has the power to nominate, elect and replace six of the seven members of the Group's Supervisory Board through proposals made to the Group's General Assembly. The seventh member is elected by the employees. Supervisory Board members are elected for a four year term. The Supervisory Board elects members of the Management Board. The Group's Management Board is elected for a four year term and is replaced after their four year term expires at the request of the Croatian Government through its Supervisory Board members. Consequently, the Republic of Croatia, through the General Assembly and the Supervisory Board, has and will continue to have, directly and indirectly, the power to affect the Group's operations and strategic planning. As a result, certain of the Group's decisions may reflect Croatian Government policy, including the Croatian energy policy. This policy may lead the Group to make decisions that are different from those that it would have made without this influence. Complying with any such decisions could lead to significant expenditures by the Group, including debt capacity risks, which

could have a material adverse effect on the Group's ratings, business, results of operations and financial condition.

In September 2014, at the request of the Croatian Government through the General Assembly, the Group replaced the Chairman and two members of the Management Board, since, in the opinion of the representatives of the Croatian Government, such members of the Management Board were not successful in implementing measures to maintain the Group's market share in the electricity market. This was the third time since January 2012 when the Chairman of the Management Board was replaced at the request of the Croatian Government that members of the Management Board had been replaced. For further information, please see *"Risk Factors—The Republic of Croatia, which owns 100% of share capital of HEP, controls the Group's policies by electing members of the Supervisory and Management Boards and may pursue decisions that reflect Croatian Government policy."*

### **Internal Audit**

The Internal Audit Committee acts on behalf of the Management Board, to monitor decision making processes and the implementation of decisions by all levels on management. It reports any irregularities to the Management Board. This ensures systematic and regular monitoring of all business processes within the Company.

### **Risk Management**

The Group continues to develop its integrated risk management system in order to increase its fundamental value.

In 2015 the Company adopted new Regulations on the Organization and Systematization, in accordance with which the risk management is the responsibility of the Controlling Department, while the Internal Audit Department (the **"IAD"**) is in charge of evaluation of risk management processes in the Group.

The IAD reports directly to the Chairman of the Management Board as well as to the audit committee (the **"Audit Committee"**), through which the Group aims to achieve its independence. The IAD is primarily in charge of conducting audits of, and producing reports into, the Group's business operations (excluding TE Plomin and NPPK which each have their own risk management teams) in accordance with an annual plan approved by the Management Board and agreed with the Audit Committee. The IAD also liaises with the Group's external auditors in relation to the Group's financial and internal controls. The IAD bases its annual plans on its findings during the previous years and on the results of discussions with and management letters received from the Group's external auditors, as well as on the operational risk assessment provided by the reorganizational units throughout the Group.

In exceptional circumstances and at the request of the Management Board, the IAD can also perform additional activities beyond the approved plan. The purpose and the objective of the internal audits and reports is to provide Management with a reasonable guarantee of the security, efficiency and effectiveness of the business system and processes, the reliability and accuracy of information, compliance of business operations with laws, regulations and HEP internal rules as well as plans, programmes and business policy.

Based on these audits for the three years ended 31 December 2014, it has been assessed that the Group's internal control system is reliable and the main business risks have been identified and well managed. The IAD also submits semi-annual and annual reports on its work to its Management Board and quarterly reports to the Audit Committee.

The Audit Committee comprises three members, of whom two members are Supervisory Board members, while the third external member, who must be familiar with accounting and audit, is nominated by the Supervisory Board following a motion by the Supervisory Board President. Messrs. Žarko Primorac (Chairman), Mirko Žužic and Boris Tušek (external member) serve as members of the Company's Audit Committee for a period until February 2016. The Audit Committee is primarily

responsible for the effectiveness of the Group's internal controls and risk management systems, integrity of the Group's financial statements, internal and external auditors' reports, terms of appointment and remuneration of external auditors. The Audit Committee supervises, monitors and advises the Supervisory Board on risk management and control systems, supervises the preparation and submission of the Group's financial statements and performs a number of other audit-related functions.

## REGULATION

*Below is a brief summary of the rules and regulations applicable to the Group within the Republic of Croatia. In connection with the Accession the Republic of Croatia adopted and implemented the rules and regulations of the EU, however respective implementation procedures are still ongoing, and this summary will therefore reflect the progress made in implementing these regulations. This summary does not purport to be complete and may be subject to the laws of the Republic of Slovenia with respect to Nuclear energy where relevant.*

### Accession of the Republic of Croatia to the EU

In October 2001, Croatia started accession negotiations with the EU. This required the signing of the Stabilisation and Association Agreement between the Republic of Croatia and the EU (the “SAA”), which entered into force on 1 February 2005. On the basis of the SAA, Croatia became a candidate for accession to the EU and commenced formal negotiations in October 2005. Negotiations took place concerning 35 chapters of EU law.

By signing the SAA, the Republic of Croatia was obliged to implement EU law in the energy industry. It was necessary to develop and liberalise the Croatian energy market in order to integrate it in the EU single market. The chapter of EU law dealing with the energy sector (Chapter 15) was closed in November 2009, settling the obligation of Croatia to comply with the requirements of the EU Third Energy Package.

Following the completion of negotiations in June 2011, Croatia signed the Accession Treaty with the EU. On 22 January 2012, the accession of Croatia to the EU was approved in a national referendum, with this being ratified by the Croatian Parliament on 9 March 2012. Croatia obtained full membership of the EU on 1 July 2013 further to the ratification of the Accession Treaty by the legislative body of each EU member state.

### *Third Energy Package*

In June 2009, the EU adopted the Third Energy Package. This included but was not limited to Directive 2009/72/EC concerning Common Rules for an International Market in Electricity (“**EU Third Electricity Directive**”), Directive 2009/73/EC concerning Common Rules for the International Market in Natural Gas (“**EU Third Gas Directive**”), Regulation (EC) No. 714/2009 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity (“**EU Regulation on Cross-Border Exchanges**”) and Regulation (EC) No. 715/2009 on Conditions for Access to Natural Gas Transmission Networks (“**EU Regulation on Natural Gas Transmission Regulation**”). The Third Energy Package was designed to complete the liberalisation of the electricity and gas markets within the EU. It aims to create a market with the basic elements of a high standard of public service, customer protection, unbundling and the establishment of independent national energy regulators. The Third Energy Package contemplates a further separation of supply and generation activities from transmission network operations. There are three options by which a Member State can achieve this goal:

- Full ownership unbundling (“**OU**”)—entailing the sale of the gas and electricity grid to an independent operator by any vertically integrated energy provider including the handing over of the management of all network operations.
- Independent system operator (“**ISO**”)—where any vertically integrated energy provider maintains the ownership of the gas and electricity grids, but they are obliged to designate an independent operator for the management of all network operations.
- ITO—this is a modification of an ISO whereby the vertically integrated energy provider does not have to designate an Independent System Operator, but must instead abide by strict rules ensuring a separation between supply and transmission.

In addition, new legislation designed to harmonise the Croatian system with the requirements of the EU Third Energy Package has been adopted. See “*Regulation—The Republic of Croatia—General Overview*” for further details.

Pursuant to the resolution of the General Assembly adopted on 9 April 2013 the Company opted for the ITO model of unbundling. And as of 2 July 2013 the Group’s transmission operator, HEP-Operator prijenosnog sustava d.o.o., was renamed to HOPS. HOPS has also been restructured to ensure its legal, financial, accounting, IT and managerial independence from the Group’s generation and supply activities. The unbundling process of HOPS has not been completed and the required approval and certification of HERA and the European Commission are pending. See “*Risk Factors—The Group’s restructuring required under EU energy laws has not yet been completed.*”

## **The Republic of Croatia**

### ***General Overview***

The Croatian energy sector is governed by a wide range of laws and regulations. The key law governing the energy sector is the Energy Act (OG 120/2012, 14/2014 and 95/2015) (the “**Energy Act**”). This provides a legal basis for the conduct of business in the energy sector and facilitates the obtaining of any necessary licences in the sector.

The Energy Act provides a framework for the energy sector in several ways. It establishes measures for the secure supply of energy, ensuring efficient generation and use. It lays down regulations upon which energy policies and strategies are undertaken and allows energy activities to be undertaken both on the free market and as a public service. It also regulates key issues relevant for the energy sector concerning environmental protection.

Other laws related to the energy sector include, but are not limited to:

- The Electricity Market Act (OG 22/2013, 95/2015 and 102/2015) (“**Electricity Market Act**”);
- The Act on Regulation of Energy Activities (OG 120/2012 and 14/2014) (the “**Act on Regulation of Energy Activities**”);
- The Gas Market Act (OG 28/2013 and 14/2014);
- The Thermal Energy Market Act (OG 80/2013, 14/2014 and 95/2015);
- The Act on Radiological and Nuclear Safety (OG 141/2013 and 39/2015).

### ***The Energy Development Strategy of the Republic of Croatia***

The Energy Development Strategy of the Republic of Croatia (OG 130/2009) (the “**Strategy**”) is the umbrella document which sets out the national policy and future development of the energy sector in Croatia, up to 2020. The main goals pursued by the Strategy are security of energy supply, the establishment of a competitive energy sector and sustainable development of the energy sector. Croatia has therefore chosen an open, liberalised and efficient energy sector aligned with EU law. It envisages an increase in the total consumption of electricity up to 2020 and the closure of existing conventional thermal power plants. The Strategy therefore envisages the construction of generation facilities running on coal and gas and large hydro power plants. In addition to these conventional sources, the Strategy provides for the construction of new renewable energy facilities. The objective is to maintain the share of generation from large hydro power and renewable energy sources in total electricity consumption at its present level (35%) up to 2020. Besides generating plants, the Strategy envisages further development of the transmission and distribution networks.

## *Energy Act*

Energy Act achieves the following outcomes: (i) the amendment of existing definitions, i.e. introducing new definitions based on the EU legislation, (ii) introducing a system of guarantee on the origin of electricity which will serve as a basis to implement Directive 2009/28/EC on the Promotion of the Use of Energy from Renewable Sources, (iii) the equal treatment of electricity consumers, i.e. the termination of the existing separation between Non-Tariff and Tariff Customers in the gas and electricity sectors, to enable a full liberalisation of the market, (iv) ensuring that the market is responsible for securing a regular supply of energy within the Republic of Croatia, (v) transfer control over the tariff rates in the tariff systems (including the adoption of price rates in accordance with established methodology) from the Croatian Government to HERA, (vi) the separation of the existing general regulations for energy supply into different sets of regulations, in order to achieve consistency in division of rights and responsibilities between the Croatian Government, HERA and the energy subjects (vii) the adoption by HERA of general energy supply regulations, which will contain consumer protection measures; (viii) the adoption by the energy suppliers of energy supply regulations, which are in line with the general energy supply regulations, (ix) the introduction of rules on energy quality by HERA, (x) ensuring the adoption of intelligent measuring equipment, and (xi) the protection of some end consumers who require it due to their social status or security reasons.

Energy Act defines procedures for construction of energy facilities, their maintenance and use and undertaking energy activities as being of interest to the Republic of Croatia.

Furthermore, Energy Act promotes the secure supply of energy to the Republic of Croatia and infrastructure safety and development, the following objects, *inter alia*, are declared as objects of interest to the Republic of Croatia: electricity transmission and distribution networks, electricity and thermal energy generation facilities, cogeneration plants, thermal energy and gas distribution systems. Owners of these facilities are obliged to maintain and develop them in accordance with the Strategy and interest of the Republic of Croatia, as provided in the special provisions.

According to the Energy Act, activities related to generation, transmission, storage, supply and trade of the energy, managing the energy system as well as organising the energy market are considered to be energy activities, which may be performed exclusively based on a licence issued by HERA. In addition, Energy Act prescribes minimum requirements for the issuance of permits for performing the energy activities, as well as for providing both public and market energy activities. In general, permits are granted for a definite period of time. After their expiration, HERA will re-examine fulfilment of technical requirements for prolongation of respective permits. Potential outcome of such re-evaluation may not be predicted in advance.

### ***Regulatory Authorities***

The main governmental authorities supervising the energy sector are the Ministry of Economy of the Republic of Croatia (“**Croatian Ministry of Economy**”), the Ministry of Environmental and Nature Protection of the Republic of Croatia (“**Croatian Environmental Ministry**”) and HERA.

Generally speaking, HERA acts as the national regulatory body for the sector. It is an independent and non-profit public institution responsible for regulatory issues in the energy sector. HERA’s obligations, authorities and responsibilities are based on the Act on Regulation of Energy Activities, the Energy Act and other acts regulating specific energy sectors. HERA issues licences for carrying out energy activities, and also temporarily and permanently revokes these licences. HERA also issues rulings on the grant of the status of “eligible producer”, and also temporarily and permanently revokes these rulings.

Pursuant to the Act on Regulation of Energy Activities, the establishment of an efficient and competitive energy market and the protection of energy buyers and operators are among the aims of regulation. In pursuit of these aims, HERA has certain powers which could be used as a way of controlling any abuse of the market. The Act on Regulation of Energy Activities lays down a duty for HERA to supervise energy operators (energy operators are defined in the Energy Act as any “*legal or*

*natural person that performs one or more energy activities and is licensed to perform energy activities”), cooperate with ministries and market inspection authorities, collect and process data regarding the activities of energy operators and file requests for the initiation of any misdemeanour proceedings. HERA is also required to conduct its activities so that the energy market performs in an objective, transparent and unbiased manner, taking into account the interests of energy operators and buyers. All energy operators have a general duty to respond to HERA queries. Regarding energy activities that are conducted on a market basis, HERA shall apply the rules for the protection of competition, which in particular means that it must monitor the extent to which a transmission system operator or distribution system operator fulfils its tasks in accordance with the Energy Act and the level of transparency in market competition. For these purposes, HERA is authorised to require the implementation of certain measures in order to ensure the principles of transparency, objectivity and the absence of bias are adhered to. Furthermore, the Energy Act, transfers control over the tariff rates (including the adoption and approval of new tariff rates) from the Croatian Government and local municipalities to HERA.*

### ***Electricity Sector***

The new Electricity Market Act, which implements the EU Third Energy Package into Croatian legislation, entered into force on 2013. The Electricity Market Act regulates the following energy activities with regard to electricity: generation, transmission, distribution, supply and trade, and organisation of the electricity market.

Electricity activities can be divided in two groups:

- (i) Market electricity activities which include the generation, supply and trade of electricity; and
- (ii) Public (regulated) activities which include the transmission and distribution of electricity, electricity market organisation and supply of electricity within the universal service and guaranteed supply.

Regulated activities are performed as public services, whereby (i) the HROTE is responsible for the organisation of the electricity market, (ii) HOPS is responsible for electricity transmission and system balancing, and (iii) HEP-ODS is responsible for electricity distribution and supply of electricity within the universal service and guaranteed supply.

According to the Electricity Market Act all customers in Croatia hold Eligible Customer status from 1 July 2008. An “**Eligible Customer**” can freely choose a Market Supplier and negotiate the price of electricity, and if it fails to do so, it will be supplied within the universal service (for Households) or guaranteed supply (for Commercial Customers).

### ***Organisation of the electricity market***

HROTE was formed in the process of the restructuring of the Croatian energy sector and began operations on 4 April 2005 as part of the Group for the purpose of organising the market in electricity and gas. It was fully separated from the Group in 2007 and since then it is 100% owned by the Republic of Croatia instead. It has a licence to organise the electricity market (issued on 24 January 2012), valid for 5 years. HROTE organises the electricity and gas market as a public service, under the supervision of HERA.

### ***Licensing regime***

All energy market participants in Croatia require an energy licence, issued by HERA. Such licences are issued for a period of 3-30 years (depending on the energy activity). Based on the Energy Act, in effect at the time when most of the licences were granted to the Company and its subsidiaries, a licence might be issued to an applicant if the following conditions were met: (i) the applicant is registered for the conduct of energy activities, (ii) it was technically qualified for the conduct of energy activities, (iii) it employed a sufficient number of expert employees for the conduct of energy activities, (iv) it had the necessary funds to undertake the energy activities, (v) an energy licence was



not revoked as regards the applicant in the last 10 years, and (vi) there had been no board members convicted of a criminal offence relating to economic activities in the last 3 years. The Croatian Government, with the prior consent of the Ministry of the Economy and on the proposal of HERA, was entitled to decide the term of any energy licence issued. The new Energy Act has introduced some amendments in this respect, primarily with regards to condition (v) above, including shortening the licensing period to five years with regards to energy activity for which the licence is requested, and point (vi), stating that *“there have been no board members respectively no other persons responsible to the board members in the subject legal entity convicted of a criminal offence relating to economic activities in the last 5 years; or the physical person has not been convicted of a criminal offence relating to economic activities in the last 3 years.”* Furthermore, the conditions referred to under (ii) and (iii), as well as the period for which the licence is issued and the form, content and manner of keeping register of issued and withdrawn licences is provided for by the minister of economy in a special regulation, with obtained opinion of HERA. A full list of current license holders can be found on the official website of HERA.

In addition, Energy approvals issued by the Ministry of Economy are required for the construction of each power plant. This is a part of the regular process of issuing permits necessary for power plant construction. Furthermore, approval of connection to the grid is obtained from the transmission system operator, HOPS, or the distribution system operator, HEP-ODS, depending on the connection power and voltage level.

Energy approvals and preliminary energy approvals are to be distinguished from energy licences. An energy approval is required for the construction of a power plant and is issued by the Ministry of Economy, whereas energy licences issued by HERA are required for performing the energy-related commercial activities themselves.

Based on information provided by HERA, there are currently (i) 33 licences issued for the generation of electricity (HEP-Generation and TE Plomin hold two of these licences), (ii) one licence issued for the transmission of electricity (HOPS holds this licence), (iii) one licence issued for the distribution of electricity (HEP— ODS holds this licence), and (iv) 22 licences issued for supply of electricity (HEP—ODS, HEP-Supply and HEP-Toplinarstvo hold three of these licences).

#### *Concessions Licences*

Pursuant to the Croatian Concessions Act (OG 143/2012) (the “**Concessions Act**”), there are three types of concessions. They are (i) concession licences for economic exploitation of common or other goods (ii) public works concession licence and (iii) public services concession licence. The Concessions Act incorporates (i) Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004, on the Procurement Procedures of Entities Operating in the Water, Energy, Transport and Postal Services Sectors, (ii) Directive 2004/18/EC of the European Parliament and the European Council of 31 March 2004 on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts and (iii) Directive 2007/66/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directives 89/665/EC and 92/13/EEC on Improvement of the Effectiveness of Review Procedures for the Award of Public Works Contracts. It subjects all concession licences to public procurement procedures.

Depending on type of concession license, it may be awarded by (i) the Croatian parliament, the Croatian Government, central bodies of the state administration on behalf of the Republic of Croatia, (ii) competent bodies of local and regional governments on behalf of the respective local and regional authorities or (iii) legal entities authorised for issuing concessions by special regulations. The grant of a concession is a two-step process, whereby a beneficiary is granted a concession, after which a concession contract is entered into, detailing the rights and obligations of the parties.

The period of each concession is variable and depends on the type of concession, the competent body issuing the concession and any specific legal requirements for each type of concession. For example, a maritime concession can be issued for a period of five to 99 years.

The Group currently holds 22 major concessions, as follows (i) ten maritime concessions (for the purpose of the construction and use of the coastline for the delivery of coal and for water cooling systems, and for the special-purpose port at Plomin (issued for a 28 year period, expiring in 2025)), (ii) seven concessions for the use of water power for the generation of electricity (at the hydro power plants at Varaždin, Čakovec, Dubrava, Rijeka, Vinodol, Senj, Gojak, Peruća, Orlovac, Đale, Zakućac, Kraljevac, Miljacka, Velebit, Dubrovnik) issued for a period of 33 years (until 2042), (iii) four concessions for water intake for technological needs (at Plomin, Jertovec, TETO Zagreb, Osijek, and ELTO Zagreb) issued for a period of 20 years (until 2019) and (iv) one concession for natural gas supply in the city of Osijek, issued for a period of 30 years (until 2026).

Concession entitlements are not transferrable to third parties without explicit, prior and written consent of the concession provider. Such provision is stipulated by each concession agreement and prescribed by applicable legislation. According to the currently applicable legislation, violation of respective stipulation may result in termination of the concession agreement. Therefore, the current status of the respective concession licences is unclear, since they were approved to HEP and transferred to its subsidiaries without clear transfer approval from the concession provider. However, HEP believes that it is not required to seek explicit approval of the Croatian Government for the transfer of concession licences to its subsidiaries, since HEP's restructuring and transformation (as a result of which HEP's subsidiaries, including HEP Generation, have become in charge of the relevant activities which require concession licences) were conducted in accordance with the Energy Act and Electricity Market Act. For additional information, see *"Risk Factors—Risks Related to the Group's Business—The Group's activities require various administrative permits, authorisations and licences that may be difficult to obtain, maintain or renew or whose grant may be subject to conditions that may become significantly more stringent."*

#### *Electricity Generation*

Energy generators are entitled to: (i) use the energy sources considered most favourable in their plants, in compliance with necessary regulation; (ii) conclude contracts for the sale of its own electricity under conditions provided in the Electricity Market Act and other relevant regulations and (iii) have access to the transmission and distribution network.

Pursuant to the Electricity Market Act generation of electricity is considered to be a market activity, thus no specific organisational requirements (similar to the requirements applicable to the distribution and transmission system operators) apply to electricity generators. However, both Electricity Market Act and Directive 2009/72/EC prescribe specific tendering procedures in relation to the construction of new generation capacities which need to be complied with in order to receive an energy approval.

If an energy generator wishes to construct a power plant, energy approval must be obtained. The procedure for obtaining energy approval should be objective, transparent and neutral and should take into account the following factors: (i) ensuring a reliable and safe electricity system, (ii) the protection of public health and safety, (iii) environmental protection, (iv) regulating the use of land, (v) managing the use of public property, (vi) energy efficiency and (vii) the technical, economic and financial status of the investor.

If the energy approval system is insufficient, a public tender process (or any procedure equivalent in terms of transparency and non-discrimination) for the construction of power plants can be adopted, in order to ensure safe supply and energy efficiency/ demand-side management measures and provide for new capacity. Croatian Government is also entitled to pass decision for initiation of tender for construction of new generation capacity, based on the request of the Ministry of Economy of the Republic of Croatia.

Electricity generator is obliged to execute an agreement with the transmission system operator for providing auxiliary services, and such agreement should regulate providing, usage and invoicing of respective services, as well as other related terms and conditions.

The status of “eligible producer” may be obtained by a producer of electrical energy or a producer of electrical and thermal energy. An eligible producer may be an energy entity producing both electrical and thermal energy in a single production plant or using waste or renewable energy sources in an economically appropriate manner taking into account environmental protection. The status of eligible producer is decided upon by HERA; whereby HERA first issues a preliminary decision during the construction of the relevant plant, accompanied by a preliminary energy approval issued by the transmission system operator. The final decision will then be issued. As stated by HERA and HROTE, the timing of this process is specific to each request.

Eligible producers qualify for an incentive price as prescribed by the Croatian Government. The incentive price is paid for through incentive fees. The level of the incentive price is calculated in compliance with the tariff system for the production of electricity from renewable energy sources and cogeneration in force at the time of concluding the electricity purchase contract with HROTE. HROTE calculates, collects and distributes incentive fees to electricity generators based on electricity purchase contracts with incentivised eligible producers, for electricity produced from renewable energy sources and cogeneration.

#### *Thermal power plants*

The operation of a thermal power plant requires a power generation license, as well as any other necessary licences and authorisations. Thermal power plants must comply with the Croatian Air Protection Act (OG 130/2011 and 47/2014), with respect to the emission of greenhouse gases. The Croatian Environment Agency (CEA) collects data on air quality and engages in environmental monitoring. For this purpose, CEA operates the Quality Information System, which is an integral part of the Environmental Information System. Furthermore, according to the Environmental Protection Act, CEA is obliged to prepare information for further reporting to the European Commission by the competent Ministry.

The adoption of the Regulation on Greenhouse Emission Allowances Trading (OG 69/2012 and 154/2014) is a step towards greenhouse gas emissions allowance trading in conjunction with the Air Protection Law. By ratifying the Kyoto protocol, Croatia has undertaken to reduce greenhouse gas emissions. The EU Accession Treaty requires Croatia to join the EU-ETS. From 1 January 2013, the Group’s thermal power plants are governed by the EU-ETS for carbon dioxide, meaning that HEP has to buy all carbon dioxide emission rights at auction and include any additional costs in the price of their products (electricity and thermal energy). Since joining EU-ETS, HEP has surrendered emission allowances on its accounts with the EU Registry on a timely basis.

For the generation of thermal (heat) energy, there are transitional regulations which will allow a gradual phasing out of the currently available free allowances. Free allowances will therefore decrease in line with the CLEF coefficient and will fall from 80% of emissions in 2013 to 30% in 2020, as seen below:

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
CLEF .....	0.8	0.7286	0.6571	0.5857	0.5143	0.4429	0.3714	0.3

In accordance with the approval of MZOP the Group was allocated free emission units for the generation of thermal energy which is transmitted to CTS on the CLEF basis during the ETS Third Trading Period.

The Act on Environmental Protection and the Energy Efficiency Fund (OG 107/03 and 144/2012) establishes special fees on polluters. The Environmental Protection and Energy Efficiency Fund collects these fees. Other fees include those for damaging the environment and those for pollution of industrial or dangerous waste.

The Croatian Government issued the Regulation on the Quality of Liquefied Oil Fuels (OG 113/2013, 76/2014 and 56/2015) which regulates the quality of fuel, laying down requirements as to quality (the content of sulphur in fuel oil must not amount to more than 1.0% m/m). The use of fuel oil exceeding

this limit is governed by the Regulation on Border values of Emissions from Polluting Substances from Immovable Sources (OG 117/12, 90/14). None of Group's thermal power plants using liquefied fuel purchased during 2011 and earlier meet requirements for the emission of sulphur dioxide. However, the Group has given a request to the Ministry of Economy and the Ministry for Environmental and Nature Protection that it be allowed to use any remaining fuel stocks that do not meet these requirements, up until the end of 2015. From 1 January 2012, the Group has purchased only fuel oil low that is low in sulphur and therefore meets the necessary requirements.

### *Renewable energy*

The European Climate and Energy Policy has set laid out targets for energy, in cutting greenhouse houses, reducing energy consumption and increasing the use of renewable energy to 20% of total energy generation. The Strategy recognises developments in this area and notes the favourable conditions within Croatia for a significant increase in the use of renewable energy sources. In line Directive 2009/28/EC on the Promotion of the Use of Energy from Renewable Sources (the "**Renewable Sources Directive**"), it is provided in the Strategy that the Republic of Croatia will aim to ensure that renewable energy accounts for 20% of gross energy consumption by 2020.

### *Renewable energy sources and cogeneration*

The development and utilisation of renewable energy has been facilitated by a new legislative framework. Five sets of Regulations, made using powers in the Energy Act and the Act on the Electricity Market, have been implemented in this area. These govern the use, obligations, incentive measures, organisation and institutions related to renewable. Thereby Directive 2001/77/EC on Promotion of Electricity from Renewable Sources has been implemented through both primary and secondary legislation.

The secondary legislation regulating the field is as follows:

- The Regulation on Fees for Promoting Electricity Production from Renewable Energy Sources and Cogeneration (OG 128/2013). The incentive fee is collected from suppliers, who are, in turn, invoicing these fees to their customers. For the year 2015, the incentive fee was set at 0.035 kn per kilowatt-hour (kn/kWh) + VAT, except for the buyers which are obliged to obtain permit for emission of greenhouse gasses by the legislation regulating air protection (0.005 kn per kilowatt-hour (kn/kWh) + VAT).
- The Tariff System for Production of Electricity from Renewable Energy Sources and Cogeneration (OG 133/2013, 151/2013, 20/2014 and 107/2014),
- The Ordinance on the Use of Renewable Energy Sources and Cogeneration (OG 88/2012 and 112/2012), and
- The Ordinance on Acquisition of Status of an Eligible Electricity Producer (OG132/2013, 81/2014, 93/2014 and 24/2015).

The status of eligible producer for a specific plant is decided upon by HERA.

The new Law on Renewable Energy Sources and High-efficient Cogeneration (OG 100/2015) which enters into force on 1 January 2016 will introduce, in addition to guaranteed tariffs (feed-in tariff), market premium price. Market premium price is calculated as the difference between the reference value of market price and the price obtained through an auction process.

### *Nuclear Energy*

The State Office for Radiological and Nuclear Safety ("**SORNS**") was created in 2005 in Croatia under the Act on Radiological and Nuclear Safety as a competent body for radiological and nuclear safety. Under the Act any legal entity which plans to engage in nuclear activity has to announce its intention to SORNS. Approval is required from SORNS before any nuclear activity can take place. If

the owner fails in the future to meet the requirements of this Act and any secondary legislation, SORNS has the power to withdraw approval. The holder of the approval shall be liable to implement protection measures and shall bear any expenses incurred in so doing.

#### *Nuclear incident liability*

In the event of a nuclear incident with consequences outside the boundaries of the NPPK, the governing law is the Slovenian Act on Liability for Nuclear Damage, which became effective on 4 April 2011. The Act on Liability for Nuclear Damage has been brought into compliance with the Paris Convention on Nuclear Third Party Liability and the Brussels Convention with the Additional Protocol. As a result of such amendments to the Act, certain maximum compensation levels have been included, although they will not come into effect until the Additional Protocol becomes effective which will take place when it is ratified by two thirds of the signatory states.

#### *Nuclear safety*

Pursuant to the Act on Radiological and Nuclear Safety, SORNS is responsible for granting approval of any nuclear activity, conducting independent safety analyses, issuing resolutions and consents for the positioning, planning, construction, use and decommissioning of nuclear sites, monitoring the safety of nuclear power plants and evaluating the risk of possible nuclear accidents. However, SORNS exercises limited supervision over the Nuclear power plant Krško, since the plant is located in the Republic of Slovenia and the Slovenian Nuclear Safety Administration (SSNA) oversees its operations.

#### *Nuclear fuel and nuclear waste*

The Croatian Government, in accordance with article 11 of 2001 Agreement designates an institution to finance all activities relating to the decommissioning of the plant and managing radioactive waste and spent nuclear fuel. Pursuant to legislation (OG 107/07), a fund to finance the decommissioning of the Nuclear power plant Krško was set up in 2007 in Croatia. The fund collects finance for the future decommissioning process that must take place at the plant including the disposal of nuclear waste and spent nuclear fuel in accordance with the partnership agreement between HEP and GenE (“**Krško agreement**”) (OG—International agreements no 9/02). HEP is liable for payments into the fund of €14,250 thousand a year.

#### *Nuclear power plant Krško*

In Slovenia, nuclear safety is regulated by the “Ionising Radiation Protection and Nuclear Safety Act” (*Zakon o zaščiti od ionizirajućih zračenja i nuklearnoj sigurnosti*) (OG—Uradni list RS 67/02). Some specific areas are regulated in more detail by secondary legislation.

The Slovenian Nuclear Safety Administration (*Uprava Republike Slovenije za nuklearnu sigurnost*) is responsible for supervising and regulating nuclear and radiological safety of nuclear facilities at the Nuclear power plant Krško, nuclear trade, the transport and handling of nuclear and radioactive materials, the accountability and control of nuclear materials, physical protection of nuclear facilities and nuclear materials, liability for nuclear damage, the professional qualifications of personnel operating nuclear facilities and early notification in case of nuclear or radiological accidents.

#### *International Atomic Energy Agency*

Croatia and Slovenia are both members of the International Atomic Energy Agency (the “**IAEA**”) and, as a result, the IAEA has carried out a number of on-site operational safety reviews (“**OSART**”).

The last OSART review at the NPPK took place in 2003. The OSART team concluded that the Krško plant has several good features that will lead to the future safe operation of the plant; most significantly, a well-educated, highly motivated, professional and experienced staff.

The follow up of the OSART review from 2003 took place in 2005. The review team established that Krško had implemented all of the recommendations made by the review team in a satisfactory way. It also confirmed that the power plant had invested sufficient effort in terms of additional training and the development of the evaluation and promotion of a safety culture.

In 1991, IAEA and the Nuclear Energy Agency of the OECD introduced a seven-grade international nuclear events scale (“**INES**”), an internationally recognised standard used to inform the public of the significance of a nuclear event. Levels 4 to 7 are termed “accidents” with a significant radiation exposure off-site, while Levels 1 to 3 are termed “incidents” with effects on the nuclear facilities only. Level 0 is referred to as “below scale” or as an anomaly and refers to events that do not affect safety.

Only a few operating events in the operating history of the Krško plant have been classified 1 per the INES scale not leading to an impact on the environment. All other events were below INES classification.

#### *Post Fukushima Stress Tests*

Stress tests of nuclear power plants are required by the European Council. These are defined as focused assessments of safety margins and of the resistance of nuclear plants in light of the events that occurred at the Fukushima-Daiichi nuclear power plant in Japan following a tsunami on 11 March 2011.

The assessment of the Krško plant was carried out by experts in nuclear safety, design of nuclear facilities, accident management, emergency preparation and phenomenology research of severe accidents. These experts evaluated on the basis of successive failures of all preventative actions during any extreme scenario.

The Republic of Slovenia prepared a National Report on the Nuclear Stress Test. Croatia only made comments on some parts of this report.

The report identified some areas for possible improvements, such as increasing the robustness of the nuclear power plant against beyond-design basis accidents, flooding, loss of offsite power and loss of ultimate heat sink however it noted that several safety improvements have already been implemented as a result of the stress tests. The report also noted that the effects of a critical disruption of plant supplies due to the destruction of infrastructure have been considered.

On 4 October 2012, the European Commission published a report following its completion of stress tests of Europe’s nuclear power plants. The report is based on the conclusions of peer reviews of nuclear power plants, which were produced in April 2012 by the European Nuclear Safety Regulators Group (ENSREG).

Each power plant was assessed on the basis of 11 measures recognised as being useful and necessary to mitigate the effects of extreme natural and other disasters in the vicinity of a nuclear power plants. According to the European Commission’s report, the NPPK is the only power plant to have already implemented, or be shortly implementing, all 11 measures.

Following the Fukushima incident the NPPK has initiated a nuclear Safety Upgrade Program (SUP) which amounts to €20,000 thousand and is expected to be completed in 2021. The SUP comprises eight elements: alternative cooling of spent nuclear fuel pit, alternative cooling of reactor building and reactor systems, installation of additional pilot operated relief valve in pressuriser, protection against flooding of nuclear facilities, installation of plant ventilation and passive autocatalytic recombiners, setting up emergency control room and technical support centre and alternative heat sink. Most of these elements (except for a solution for alternative heat sink) either have already been completed or are in the process of completion. (See “*Business—Electricity Generation—Nuclear Power Plant*” for further details.)

### *Transmission and distribution of electricity*

As part of the restructuring of the Croatian energy sector, which started with adoption of the 2001 Energy Act, the 2001 Electricity Market Act and the 2004 Electricity Market, the transmission and distribution of electricity were divided into separate companies within the Group.

The term “electricity transmission” refers to the transmission of electricity on high and very high voltage interconnected networks in order to deliver electricity to end consumers or to a distribution system operator. This does not include supply. The national electricity transmission system is operated by HOPS and it is the only body registered for electricity transmission. HOPS is 100% owned by the Company. HOPS was established on 23 March 2005 under the name of HEP-OPS (after merging HEP Prijenos d.o.o. with System Operation part of CROISMO Ltd.) with its main goal, as a transmission system operator, to transmit electricity and to operate, maintain, construct and develop the transmission network as well as to perform system control of Croatian electricity system.

The HOPS transmission network includes a transmissions grid of 400 kV, 220 kV and 110 kV of voltage levels with accompanying transformation stations. HOPS is a co-founder and member of the European Network of Transmission System Operators for Electricity (ENTSO—E).

The Electricity Market Act provides for the adoption of rules on the allocation and use of cross-border transmission capacities. HOPS has adopted such rules bilaterally and multilaterally with neighbouring and other relevant transmission system operators.

Further to the Accession and in order to comply with the Third Energy Package and the Electricity Market Act the Group was required to conduct unbundling of its transmission operations from the generation and supply activities. Pursuant to the resolution of the General Assembly adopted on 9 April 2013 the Company opted for the ITO model of unbundling.

ITO model prescribes that the transmission system operators shall be equipped with all human, technical, physical financial and IT resources necessary for fulfilling their obligations under the Directive 2009/72/EC and carrying out the activity of electricity transmission, in particular:

- assets that are necessary for the activity of electricity transmission, including the transmission system, shall be owned by the transmission system operator;
- personnel necessary for the performance of electricity transmission, including all corporate tasks, shall be employed by the transmission system operator;
- leasing of personnel and rendering services to and from any other parts of the vertically integrated undertaking shall be prohibited; and
- subject to the decisions of the Supervisory Body, appropriate financial resources for future investment projects and/or for the replacement of existing assets shall be made available to the transmission system operator in due time by the vertically integrated undertaking following an appropriate request from the transmission system operator.

However, both Directive 2009/72/EC and Electricity Market Act provide that a transmission system operator may render services to the vertically integrated undertaking as long as (i) the provision of those services does not discriminate any of the system users, is available to all system users on the same terms and conditions and does not restrict, distort or prevent competition in generation or supply, and (ii) the terms and conditions applicable to the provisions of these services are approved by the regulatory authority.

Furthermore, the following restrictions apply to the relationship between the transmission system operator and vertically integrated undertaking:

- transmission system operator shall not, in its corporate identity, communication, branding and premises, create confusion in respect of the separate identity of the vertically integrated undertaking or any part thereof;
- transmission system operator shall not share IT systems or equipment, physical premises and security access systems with any part of the vertically integrated undertaking nor use the same consultants or external contractors for IT systems or equipment, and security access systems;
- accounts of transmission system operators shall be audited by an auditor other than the one auditing the vertically integrated undertaking or any part thereof;
- without prejudice to the decisions of the Supervisory Body, the transmission system operator shall have:
  - effective decision-making rights, independent from the vertically integrated undertaking, with respect to assets necessary to operate, maintain or develop the transmission system; and
  - the power to raise money on the capital market in particular through borrowing and capital increase;
- transmission system operator shall at all times act so as to ensure it has the resources it needs in order to carry out the activity of transmission properly and efficiently and develop and maintain an efficient, secure and economic transmission system;
- prohibition of direct or indirect shareholding in the transmission system operator by subsidiaries of the vertically integrated undertaking performing functions of generation or supply;
- prohibition of direct or indirect shareholding in any subsidiary of the vertically integrated undertaking performing functions of generation or supply by the transmission system operator, as well as receiving dividends or any other financial benefit from respective subsidiaries;
- prohibition of direct or indirect determination of the competitive behaviour of the transmission system operator in relation to the day to day activities of the transmission system operator and management of the network, or in relation to activities necessary for the preparation of the ten-year network development plan develop by the vertically integrated undertaking;
- non-discriminatory behaviour of the transmission system operators against different persons or entities, as well as prohibition of restrictions, distortions or prevention of competition in generation or supply;
- compliance of all commercial and financial relations between the vertically integrated undertaking and the transmission system operator (including loans from the transmission system operator to the vertically integrated undertaking) with market conditions;
- prior approval of regulatory authority for all commercial and financial agreements with the vertically integrated undertaking;
- mandatory notification of transmission system operators to the regulator authority on the financial resources available for future investment projects and/or for the replacement of existing assets;



- refrain of vertically integrated undertaking from any action impeding or prejudicing the transmission system operator from complying with its obligations and obligating transmission system operator to seek for permission in fulfilling respective obligations;
- mandatory certification of transmission system operator by the regulatory authority;
- limitations related to nomination of persons responsible for the executive management and/or as members of the administrative bodies of the transmission system operator, as well as for all the persons belonging to the executive management and to those directly reporting to them on matters related to the operation, maintenance or development of the network:
  - no professional position or responsibility, interest or business relationship, directly or indirectly, with the vertically integrated undertaking or any part of it or its controlling shareholders other than the transmission system operator shall be exercised for a period of three years before the appointment of the persons responsible for the management and/or members of the administrative bodies of the transmission system operator (six months for other persons);
  - persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall have no other professional position or responsibility, interest or business relationship, directly or indirectly, with any other part of the vertically integrated undertaking or with its controlling shareholders;
  - persons responsible for the management and/or members of the administrative bodies, and employees of the transmission system operator shall hold no interest in or receive any financial benefit, directly or indirectly, from any part of the vertically integrated undertaking other than the transmission system operator;
  - after termination of their term of office in the transmission system operator, the persons responsible for its management and/or members of its administrative bodies shall have no professional position or responsibility, interest or business relationship with any part of the vertically integrated undertaking other than the transmission system operator, or with its controlling shareholders for a period of not less than four years;
- competence's limitation of the supervisory body and preconditions for nomination of their members:
  - in charge of taking decisions which may have a significant impact on the value of the assets of the shareholders within the transmission system operator, in particular decisions regarding the approval of the annual and longer-term financial plans, the level of indebtedness of the transmission system operator and the amount of dividends distributed to shareholders;
  - decisions related to the day to day activities of the transmission system operator and management of the network and to activities necessary for the preparation of the ten-year network development plan are explicitly excluded;
  - Supervisory Body shall be composed of members representing the vertically integrated undertaking, members representing third party shareholders (if any) and, where the relevant members representing other interested parties such as employees of the transmission system operator (as prescribed by mandatory legislation);
  - at least to half of members of the Supervisory Body, above mentioned limitations related to nomination of persons responsible for the executive management and/or as

members of the administrative bodies of the transmission system operator, shall apply;

- preparation of mandatory compliance programme and nomination of compliance officer.

Certification procedure is designed to confirm the compliance with, among others, these independency requirements. According to the Directive 2009/72/EC, regulatory authorities are entitled to monitor the continuing compliance of transmission system operators with the independency requirements, as well as to initiate a certification procedure to ensure such compliance.

HOPS initiated its certification procedure in March 2014, when it filed the first application with HERA. Since 2014, HOPS' application has been amended twice at the request of HERA, and in April 2015, HERA requested to make further changes in the application. On 19 June 2015, HOPS submitted a revised application with HERA.

According to applicable legislation, once HERA receives completed certification request, it is obliged to prepare within 4 months a draft of the certificate and submit it to the European Commission for review. After receiving opinion of European Commission, HERA is obliged to issue the certificate within 2 months.

The term "electricity distribution" refers to the distribution of electricity through the high, medium and low voltage distribution network for the purpose of its delivery to end-customers, but does not include supply.

HEP-ODS, a subsidiary of the Company, is the only entity registered for electricity distribution in Croatia. The distribution system operator takes the electricity from the transmission network and electricity generators connected to distribution network and transmit it to end consumers. The distribution system operator is responsible for the operation, maintenance and development of the network.

In accordance with the mandatory legislation if the distribution system operator is a part of a vertically integrated undertaking (such as HEP-ODS being a part of the Group), it shall be independent at least in terms of its legal form, organisation and decision making from other activities not relating to distribution. Following criteria shall apply to ensure respective independency:

- persons responsible for the management of the distribution system operator must not participate in company structures of the integrated electricity undertaking responsible, directly or indirectly, for the day-to-day operation of the generation, transmission or supply of electricity;
- appropriate measures must be taken to ensure that the professional interests of the persons responsible for the management of the distribution system operator are taken into account in a manner that ensures that they are capable of acting independently;
- the distribution system operator must have effective decision making rights, independent from the integrated electricity undertaking, with respect to assets necessary to operate, maintain or develop the network; and
- the distribution system operator must establish a compliance programme, which sets out measures taken to ensure that discriminatory conduct is excluded, and ensure that observance of it is adequately monitored.

Furthermore, the distribution system operator shall have at its disposal all the necessary resources including human, technical, physical and financial resources. However, this should not prevent the existence of appropriate coordination mechanisms to ensure that the economic and management supervision rights of the parent company in respect of return on assets in a subsidiary are protected. Accordingly, HEP is entitled to approve the annual financial plan (or its equivalent) of HEP-ODS and to set global limits on the levels of its indebtedness, however giving instructions regarding it's

day-to-day operations, taking individual decisions concerning the construction or upgrading of distribution lines exceeding the terms of the approved financial plan (or its equivalent) are explicitly prohibited by Directive 2009/72/EC.

Additionally, Directive 2009/72/EC provides that if the distribution system operator is part of a vertically integrated undertaking (such as HEP-ODS being a part of the Group), the Member States shall ensure that the activities of the distribution system operator are monitored by regulatory authorities or other competent bodies so that it cannot take advantage of its vertical integration to distort competition. In particular, vertically integrated distribution system operators shall not, in their communication and branding, create confusion in respect of the separate identity of the supply branch of the vertically integrated undertaking.

Electricity Market Act also prescribes that any cross-subsidizing between the companies providing the public services (transmission and distribution of electricity, managing with the electricity system as well as supply with electricity performed as the public services) and companies providing the market services (remaining services) in a vertically or horizontally integrated undertaking is prohibited. Similar restrictions apply to the cross-subsidizing between services provided by the same company. These restrictions shall apply without any exceptions to HEP – ODS, since it performs two public services, distribution of electricity, supply of electricity to the Tariff Customers).

Strict compliance with mandatory provisions of the Croatian legislation is particularly important for both the Group and HEP-ODS, since the Croatian Government may decide (based on the proposal of competent Ministry and/or HERA) on mandatory ownership unbundling of the distribution system operator from the vertically integrated undertaking if determined that their connections disable market development and provide for a preferential status of vertically integrated undertaking or its part.

### *Supply*

There are 22 companies\* which hold a licence for electricity supply in the Republic of Croatia. However, the vast majority of electricity is supplied by HEP-ODS and HEP-Supply (in 2014: 85%).

From 1 July 2008, when market liberalisation reforms were adopted, several customer groups were created:

- Tariff Customers, comprising of Households who opt to be supplied under a regulated regime (supplying final customers within universal service) and Commercial Customers whose contract with their market supplier has been terminated (supplying final customers within guaranteed supply). HERA sets regulated tariff rates for Households and Commercial Customers which are generally higher than market prices.

---

\* HEP—Opskrba d.o.o, for supply of customers with electricity, heat and gas; KORLEA d.o.o. for trade and services; HEP-Operator distribucijskog sustav d.o.o.; HEP-Toplinarstvo d.o.o. for generation and production of heat; GEN-I Zagreb d.o.o. for trade and supply with electricity; CRODUX PLIN d.o.o. for trade and services; RWE ENERGIJA d.o.o. for the electricity supply; NOX GRUPA d.o.o. for trade and services; EL-EN SOLUTIONS d.o.o. for trade and services; PETROL d.o.o. for trade, oil and oil derivatives transportation; Proenergy d.o.o. for electricity generation; Axpo Trgovina d.o.o. for trade and services; PRVO PLINARSKO DRUŠTVO – TRGOVINA ENERGIJOM d.o.o.; Hrvatski Telekom d.d.; ISKON INTERNET d.d. for informatic and telecommunication; Danske Commodities d.o.o. for trade with gas and electricity; ENERGY DELIVERY SOLUTION d.o.o. for trade and services; 220V d.o.o. for trade electricity; LUKA PLOČE ENERGIJA d.o.o. for electricity generation; TRGOVINA I OPSKRBA ENERGIJOM d.o.o. for trade and services; MET Croatia Energy Trade d.o.o. for trade and services and EFT HRVATSKA d.o.o. for trade and services.

- Non-regulated or “Non-Tariff Customers” comprising of Households and Commercial Customers which opt to be supplied by a Market Supplier, under the competitive market prices lower than regulated tariff rates, based on the supply agreement. Further to the enactment of the Electricity Market Act all customers are entitled to opt for a Market Supplier and therefore to switch to a non-regulated category. Households are also entitled to opt for supply within the universal service. Commercial Customers may return to a regulated category (supply within the guaranteed services) if their contracts with Market Suppliers are terminated or their Market Supplier stops operating (and they do not find a new Market Supplier within the next 30 days).

Pursuant to the Electricity Market Act the Croatian Government chose HEP-ODS as a sole supplier of electricity to the customers in a regulated category, both within universal services and guaranteed services supply.

### *Trading*

There is only one electricity market in Croatia, which is primarily governed by bilateral agreements. Certain “Market Rules” regulate relations and activities in the electricity market, as well as laying out the obligations and duties of market participants. These Rules are binding for all electricity market participants.

Currently there are 15 companies which have licences to trade electricity (including the Company and HEP Trade)\* and 4 companies which have licences for trading, mediation and representation on the energy market.

In accordance with Electricity Market Act electricity trades should be independent from transmission and distribution of electricity. Electricity trades include purchasing and selling of electricity (including resale) to the buyers on the wholesale market, except for selling the electricity to final costumers.

Furthermore, pursuant to the Electricity Market Act HEP as a holder of the licence for electricity trading is obliged to present all relevant information related to the agreements executed with (i) the buyers on the wholesale market, (ii) transmission system operator, and (iii) distribution system operator, at the request of HERA or other competent EU authorities, for the past five years. Failure to comply with this obligation may result in a fine up to approximately EUR 65,000.

### *Participants*

Based on the above, the following categories of electricity market participants exist in the Republic of Croatia: (i) generators (producers), (ii) transmission system operator (HOPS), (iii) distribution system operators (HEP-ODS), (iv) energy market operator (HROTE), (v) electricity traders, and (vi) electricity suppliers.

### *Price of Electricity*

Energy Act provides that prices contain: (i) part of the price that is freely negotiated, (ii) part of the price in accordance with the tariff, for energy activities to which the tariff system applies and (iii) other costs and fees, if provided by special laws.

---

\* HRVATSKA ELEKTROPRIVREDA d.d., INA-INDUSTRIJA NAFTE d.d., CROPLIN d.o.o. for gas supply., INAS-INVEST d.o.o. for services and trade, Alpiq Energija Hrvatska d.o.o. for services and trade, KORLEA d.o.o. for trade and services, ELEKTRO GRUPA d.o.o. for trade and representation, EZPADA d.o.o., GEN-I Zagreb d.o.o. electricity trade and sale, EFT Hrvatska d.o.o. for trade and services, HSE Adria d.o.o. for trade, mediation and representation on the energy market, TLM Tvornica Laki Metal d.d., Repower Hrvatska d.o.o. for trade and services, Interenergo d.o.o. for trade and services, PRIRODNI PLIN d.o.o. for procurement and supply of gas and HEP-trgovina d.o.o. for electricity trade.

The tariff system consists of a prescribed methodology and tariff rates. The methodology is based on the reasonable costs of business activity, maintenance, replacement, construction or reconstruction of facilities and environment protection, whereby it shall ensure a reasonable return on the invested funds, and may be based on the method of incentive regulation or some other method of economic regulation. The methodology is determined by HERA.

Tariff rates are covered by methodology and are determined according to type of energy service, power/ capacity, quantity, quality and other elements related to the delivered energy, whereby they may differ depending on type of customer, delivery period and seasonal or daily dynamics of delivery.

The energy companies shall file their request for tariff rate determination and tariff rate changes with HERA, which may independently determine tariff rates based on the abovementioned methodology.

HERA adopts tariff methodologies for the distribution and transmission, i.e. transport of energy. Apart from these energy activities, HERA adopts methodology for a particular energy activity if provided by special law. HERA also adopts tariff methodologies for energy activities of generation, distribution and supply of thermal energy.

#### *Electricity Tariff Models*

Tariff system consists of a prescribed methodology and tariff rates. The methodology is based on the reasonable costs of business activity, maintenance, replacement, construction or reconstruction of facilities and environment protection, and it shall ensure a reasonable return on the invested funds, and may be based on the method of incentive regulation or another method of economic regulation.

Tariff rates are included in the methodology and they depend on the type, power/capacity, quantity, quality and other elements of the supplied energy. HERA sets tariff rates for the electricity market, save for the tariff rates for generation of electrical and/or thermal energy from renewable energy sources and cogeneration and generation of bio fuel which are set out by the Croatian Government.

The following tariff models are currently in force on the electricity market and apply to the Group: (i) Electricity tariff model for supplying final customers within universal service; (ii) Electricity tariff model for supplying final customers within guaranteed supply; (iii) Electricity distribution tariff model; (iv) Electricity transmission tariff model; and (v) Electricity tariff model for generation of electricity from renewable resources.

Electricity supply tariff model for supplying final customers within universal service is applicable to the final customers – Households and is regulated by the Methodology on Electricity supply tariff model for supplying final customers within universal service. Based on respective Methodology, the Decision on tariff rates for supplying final customers within universal service is passed twice a year.

Electricity supply tariff model for supplying final customers within guaranteed supply is applicable to the final customers which lost their suppliers (except for Households), namely for Commercial Customers and is regulated by the Methodology on Electricity supply tariff model for supplying final customers within guaranteed supply of electricity. Based on respective Methodology, the Decision on tariff rate for guaranteed supply of electricity is passed twice a year.

Methodology for distribution of electricity and Methodology for transmission of electricity were published in the Official Gazette No. 104/2015 and entered into force on 1 October 2015.

#### *Electricity Generation from Renewable Energy Sources and Cogeneration Tariff Model*

In accordance with the Energy Act, Croatian Government passed the Tariff system for electricity generation from renewable energy sources and cogeneration, which determines the incentive price for electricity generated from generation facilities that use renewable energy sources and cogeneration facilities, and which price the market operator pays to the eligible electricity generator.

Renewable Sources Directive defines a mandatory target of at least a 20 % share of energy from renewable sources in the Community's gross final consumption of energy in 2020. Croatian Government has decided to transpose Renewable Sources Directive in a separate Act on renewable energy sources and high-efficient cogeneration ("**RES Act**"), thus meeting a specific national target and measures that should be applied in each member states. A procedure of adopting RES Act is underway.

Furthermore, the Commission Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01) prescribes, the obligation for beneficiaries to sell their electricity directly in the market and are subject to market obligations. Thus, incentivising the market integration of electricity production from renewable sources. Consequently, from 1 January 2016 the new aid schemes and measures should be applied and the following cumulative conditions should be satisfied:

- (a) aid is granted as a premium in addition to the market price (premium) whereby the generators sell its electricity directly in the market;
- (b) beneficiaries are subject to standard balancing responsibilities, unless no liquid intra-day markets exist; and
- (c) measures are put in place to ensure that generators have no incentive to generate electricity under negative prices.

Resulting from above mentioned, a new premium model is planned to be introduced in Croatia from 1 January 2016.

Currently, the amount of the incentive price is based on the reasonable costs of business activity, construction, replacement, reconstruction and maintenance of facilities that use renewable energy sources and cogeneration facilities.

The electricity generator is entitled to collect the incentive price for the generation facility that uses renewable energy sources or cogeneration, if the following conditions are cumulatively fulfilled:

- (ii) generator possesses a final decision regarding its status as a privileged electricity generator;
- (iii) generator executed an agreement with the market operator on electricity purchase, in accordance with the stipulations of the respective Tariff system;
- (iv) generator installed equipment in the generation facility, if the supplier of the respective equipment is present in Republic of Croatia;
- (v) generator fulfilled other conditions prescribed by the respective Tariff system;
- (vi) generator exercised the right for permanent connection to the electricity network, if the respective facilities are considered as simple buildings.

The respective Tariff system prescribes the amount of the incentive price I (kn/kWh) as follows:

- 1. For generation facilities that use renewable energy sources installed power up to and including 5 MW:

Type of generation facility	C
a. solar power plants	
a.1. integrated solar power plants power up to and including 10 kW	1,91
a.2. integrated solar power plants power higher than 10 kW up to and including 30 kW	1,70
a.3. integrated solar power plants power higher than 30 kW up to and including 300 kW	1,54
a.4. non- integrated solar power plants	RC
b. hydro power plants	

b.1. hydro power plants installed power up to and including 300 kW	1,07
b.2. hydro power plants installed power higher than 300 kW up to and including 2 MW	0,93
b.3. hydro power plants installed power higher than 2 MW	0,88
c. wind power plants	RC
d. biomass power plants	
d.1. biomass power plants installed power up to and including 300 kW	1,30
d.2. biomass power plants installed power higher than 300 kW up to and including 2 MW	1,25
d.3. biomass power plants installed power higher than 2 MW	1,20
e. geothermal power plants	1,20
f. biogas power plants	
f.1. biogas power plants installed power up to and including 300 kW	1,34
f.2. biogas power plants installed power higher than 300 kW up to and including 2 MW	1,26
f.3. biogas power plants installed power higher than 2 MW	1,18
g. liquid biofuel power plants	RC

- 2. For generation facilities that use renewable energy sources installed power higher than 5 MW:

Type of generation facility	C
a. hydro power plants	RC
b. wind power plants	RC
c. biomass power plants	RC
d. biogas power plants	RC
e. liquid biofuel power plants	RC

- 3. For cogeneration facilities that do not use renewable energy sources:

Type of cogeneration facility	C
cogeneration facilities installed electric power up to and including 30 kW, so-called micro cogenerations and cogeneration facilities that use hydrogen fuel cells	RC
cogeneration facilities installed electric power higher than 30 kW up to and including 1 MW, so-called small cogenerations	RC
cogeneration facilities installed electric power higher than 1 MW up to including 35 MW, so-called medium cogenerations connected to the distribution or transmission network	RC
cogeneration facilities installed electric power higher than 35 MW, so-called large cogenerations and all cogeneration facilities connected to the transmission network	RC

Respective Tariff system defines the RC as a reference price of electricity, and prescribes that it is equal to the amount of currently valid tariff rate for active energy in the framework of the universal service at a unique daily tariff for tariff model Blue, determined in accordance with Methodology for determining the tariff rates for electricity supply within the universal service.

In addition, it is prescribed that the condition for the realization of the incentive price and execution of the agreement with the market operator for the facilities from categories 1.d.1., 1.d.2., 1.d.3., 2.c., 1.f.1., 1.f.2., 1.f.3. and 2.d is that the total annual facility's efficiency ( $\eta_k$  OIE) in conversion of primary energy fuel to electricity (Eu) and generated useful heat (Hk) is at least 50%.

The total annual facility's efficiency  $\eta_k$  OIE is calculated in accordance with the formula:

$$\eta_k \text{ OIE} = ((3600 \times Eu) + Hk) / Q$$

Whereby the individual items are as follows: (i)  $\eta_k$  OIE – the total annual facility’s efficiency, (ii)  $E_u$  – generated electricity [MWh], (iii)  $H_k$  – generated useful heat [MJ], and (iv)  $Q$  – primary energy fuel [MJ].

Respective Tariff model also prescribes correction of the determined incentive prices for certain categories of the generation facilities in accordance with the correction coefficients prescribed.

In generation facilities from categories 1.a.1, 1.a.2 and 1.a.3, the generation of electricity is stimulated only if the condition of the consumption on the generating spot is fulfilled (one Cadastral plot).

Tariff system prescribes that the agreement with the market operator on electricity purchase should be executed for the period of 14 years, starting from the date of realization of the right to collect the incentive price. In addition, for the facilities in use before the submission of the application for the execution of respective agreement with the market operator, the 14 year period decreases for the time in which the facility was in use, and is determined in accordance with the final decision regarding its status as a privileged electricity generator. Existing facilities that use renewable energy sources that are older than 14 years are not entitled for the collection of incentive price. However, it is prescribed that two above mentioned restrictions do not apply in case of planned reconstruction of hydro power plants older than 25 years, if the total cost of the reconstruction is at least 20% of the projected income of the respective facility, whereby the projected generation of the hydro power plant must be higher than the average generation in the past 10 years.

However, it is also prescribed that if the project investor was the user of any support for the construction of the respective facility, the market operator shall decrease the amount of the incentive price for the amount of the previously granted support.

#### *Electricity Distribution Tariff Model*

The method of regulation applied in Electricity Distribution Tariff Model is based on “approved operational costs”. Total costs of the electricity distribution operator (UTP) are determined on a yearly basis, i.e. for the regulatory year and are equal to:

$$UTP = T_{ppos} + T_{pkap} - T_{msu}$$

Whereby the individual items are as follows: (i)  $T_{ppos}$  – OPEX [kn], (ii)  $T_{pkap}$  – costs of capital (CAPEX) [kn], and (iii)  $T_{msu}$  costs of providing non-standard services [kn].

The cost of capital is equal to:

$$T_{pkap} = Prim + A$$

Whereby the individual items are as follows  $Prim$  – revenues from regulated assets (regulated asset base – RAB) [kn] and  $A$  – depreciation of the regulated assets in the considered year [kn]

#### *Electricity Transmission Tariff Model*

The method of regulation applied in the Electricity Transmission Tariff Model with is based on “approved operational”.

Total costs of the electricity transmission operator (UTP) are determined on a yearly basis, i.e. for the regulatory year and are equal to:

$$UTP = T_{ppos} + T_{pkap} - T_{msu} - T_{ppk}$$

Whereby the individual items are as follows: (i)  $T_{ppos}$  – OPEX [kn], (ii)  $T_{pkap}$  costs of capital (CAPEX) [kn], (iii)  $T_{msu}$  costs for providing non-standard services [kn] and (iv)  $T_{ppk}$  - incomes from granting the cross - border exchanges in accordance with Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.



### *Electricity Supply Tariff Model within the Universal Service*

The Methodology for determining the tariff rates for electricity supply within the universal service prescribes that the tariff elements are active energy and supplying fees.

The main principle of respective Methodology is that the total revenues of the supplier generated by application of tariff rates for active energy and by application of tariff rates for supplying fees shall cover the approved total costs of the supplier.

Regulation period is half of the calendar year, namely from 1 January to 30 June. The determination of any tariff rate for the following regulatory period is based on approved operating costs from the prior regulatory period, realised and estimated operating costs for the current regulatory period and the accepted planned costs for the future regulatory period.

The total costs of the supplier (UTO) are determined for each regulation period, and are equal to:

$$UTO = UTE + UTP$$

Whereby the individual items are as follows: (i) UTE – total costs of electricity procurement [kn], and (ii) UTP – total operational costs of the supplier [kn].

The total costs of electricity procurement (UTE) are equal to:

$$UTE = Ten + Tep + Teu$$

Whereby the individual items are as follows: (i) Ten – costs of electricity procurement [kn], (ii) Tep – costs of electricity purchased from market operator in the incentive system [kn], and (iii) Teu – costs of electricity system balancing for deviations [kn].

The total operational costs of the supplier (UTP) are equal to:

$$UTP = Tppos + D - Trnsu$$

Whereby the individual items are as follows: (i) Tppos – operational costs of the supplier [kn], (ii) D – profit, and (iii) Trnsu – costs of providing non-standard services [kn].

Respective Methodology also prescribes that the supplier's profit before taxation can amount maximum 2.0% of the total costs of electricity procurement (UTE).

The revenue of the supplier generated by application of tariff rates for active energy shall be equal or higher than the total costs of electricity procurement (UTE). Calculation of the tariff rates for active energy is based on the average cost of the electricity procurement  $Ts^{°NN,N}$ .

The average cost of the electricity procurement  $Ts^{°NN,N}$  in the following regulation period is equal to:

$$Ts^{°NN,N} = UTE / UNE$$

Whereby the individual items are as follows: (i) UTE – total costs of electricity procurement [kn], and (ii) UNE – total electricity procured [kWh].

The revenue of the supplier generated by application of tariff rates for supplying fees shall be equal or higher than total operational costs of the supplier (UTP).

The average amount of the supplying fee  $Ts^{°NN,N}$  in the following regulation period is equal to:

$$Ts^{°NN,N} = UTP / 6NUK$$

Whereby the individual items are as follows: (i) UTP – total operational costs of the supplier [kn], and (ii) NUK – average number of the billing points in calendar year (on a monthly basis).

Tariff rates for supplying fees in each tariff model are calculated by multiplying the average amount of the supplying fee  $Ts^{°NN,N}$  with the prescribed coefficient for each tariff model (coefficient for tariff models Blue, White and Red amounts 1.0 and coefficient for tariff model Black amounts 0.05).

#### *Electricity Supply Tariff Model within the Guaranteed Supply*

The Methodology for determining the tariff rates for guaranteed supply of electricity prescribes that the average price of electricity in tariff model “j” is equal to:

$$C_{pj} = \frac{1}{100} \cdot \sum_{i=1}^n [u_{i,j} \cdot C_{i,j}]$$

Whereby the individual items are as follows: (i) n – number of relevant suppliers (suppliers with share in total sale of electricity higher than 0.5%), (ii)  $u_{i,j}$  – share of the relevant supplier I in a tariff model “j” [%], and (iii)  $C_{i,j}$  – average price of electricity of the supplier I in a tariff model “j” [kn/kWh].

Tariff rate for active energy at a lower daily rate for customers on high voltage, on medium voltage and for tariff models White and Red is determined as follows:

$$Ts_{j,ENT} = \frac{C_{pj}[ENvtj + ENntj]}{1.7 ENvtj + ENntj}$$

Whereby the individual items are as follows: (i)  $Ts_{j,ENT}$  – tariff rate for active energy at a lower daily rate in a tariff model “j” [kn/kWh], (ii)  $ENvtj$  – active energy at a higher daily rate taken by the customers in a tariff model “j” [kWh], and (iii)  $ENntj$  – (iii) active energy at a lower daily rate taken by the customers in a tariff model “j” [kWh].

The relation between the tariff rate for active energy at a higher daily rate and the tariff rate for active energy at a lower daily rate for tariff rates equals 1.7:1.

Tariff rates for active energy at a unique daily tariff for tariff models Blue and Yellow is equal to the average price of electricity determined above.

Tariff rates for guaranteed supply of electricity are calculated by multiplying the tariff rates for active energy determined above with the correction coefficient for guaranteed supply of electricity. For the first two months of usage of guaranteed supply of electricity, the correction coefficient equals 1.2 and afterwards the correction coefficient equals 1.5.

#### ***Thermal Energy Sector***

The thermal energy sector in Croatia is regulated by the Energy Act and the Thermal Energy Market Act. Based on these, thermal energy generators, distributors and suppliers must obtain a license from HERA.

#### *Thermal Energy Prices*

The system of calculating prices is the very similar to the system for electrical energy (please see section “*Price of Electricity*”). According to the Thermal Energy market Act, prices for following activities should be calculated based on methodologies approved by HERA):

- thermal energy generation, exceeding 60% of thermal energy requirements from the centralised thermal energy system; and
- distribution of thermal energy.

Supply with the thermal energy is market activity and therefore the prices are freely negotiated.

#### *The Thermal Energy Tariff Model—section for generation of thermal energy*

According to HERA's Methodology for determining the tariff rates for thermal energy generation, respective Methodology is based on the regulation of maximal income from generation of thermal energy. The regulation period is a calendar year, i.e. from 1 January-31 December.

Allowed maximal income of the generator of thermal energy in a regulatory year shall cover the costs of performing the business activity of generation of thermal energy and provide an income from regulated assets. Total allowed maximal income from thermal energy generation for tariff customers DPt is determined on a yearly basis, for a regulatory year and is equal to:

$$DPt = T_{fixt-1} \cdot (1 + It-1) \cdot (1 - X) + T_{vart} + At-1 + PROt \quad [kn]$$

Whereby the individual items are as follows: (i) DPt – allowed maximal income in a regulatory year [kn], (ii) Tfixt-1 – fixed operational costs in a base year t-1 [kn], (iii) It-1 – the index of consumer prices in a base year t-1, (iv) X – the efficiency coefficient ( $0 \leq X < 1$ ), (v) Tvar – the variable costs in a regulatory year t (kn), (vi) At-1 – amortisation of regulated assets in a base year t-1 [kn], and (vii) PROt – income from regulated assets in a regulatory year t [kn].

Fixed operational costs include material costs, other external costs – cost of services, personnel costs – salaries, other operational costs, costs of value adjustment, costs of reservation, other business costs. Fixed operational costs do not include costs of performing the business activity of generation of thermal energy in central thermal energy system that HERA would consider unjustified.

#### *The Thermal Energy Tariff Model—section for distribution of thermal energy*

HERA's Methodology for determining the tariff rates for thermal energy distribution is based on the regulation of maximal income from distribution of thermal energy. The regulation period is a calendar year, namely from 1 January-31 December.

Allowed maximal income of the distributor of thermal energy in a regulatory year shall cover the costs of distribution of thermal energy and provide an income from regulated assets. Total allowed maximal income from thermal energy distribution for tariff customers DPt is determined on a yearly basis, i.e. for a regulatory year and is equal to:

$$DPt = OPEXt-1 \cdot (1 + It-1) \cdot (1 - X) + TGt + At-1 + PROt \quad [kn]$$

Whereby the individual items are as follows: (i) DPt – allowed maximal income in a regulatory year [kn], (ii) OPEXt-1 – operational costs in a base year t-1 [kn], (iii) It-1 – the index of consumer prices in a base year t-1, (iv) X – the efficiency coefficient ( $0 \leq X < 1$ ), (v) TGt – costs of losses in a distribution network in the regulatory year t, (vi) At-1 – amortisation of regulated assets in a base year t-1 [kn], and (vii) PROt – income from regulated assets in a regulatory year t [kn].

Operational costs OPEXt-1 include material costs, other external costs – cost of services, personnel costs – salaries, other operational costs, costs of value adjustment, costs of reservation, other business costs. Fixed operational costs do not include costs of performing the business activity of distribution of thermal energy in central thermal energy system that HERA would consider unjustified.

### **Gas Sector**

The Third Energy Package regulates, among others, the relations between market participants on the gas market in Croatia. The Energy Act is the main law whilst relations between market participants are established and regulated through The Gas Market Act, The Act on the Regulation of Energy Activities, Rules on the Natural Gas Market Organization (HROTE 12/2014), Rules on the Gas Transmission System (PLINACRO, 12/2014), Rules on the Gas Storage System (Podzemno skladište plina d.o.o, 12/2014) (HROTE, 12/2014) the General Conditions for the Natural Gas Supply (OG 158/2013). Thus, Republic of Croatia has created the preconditions for a fully open gas market.

### *Licensing Regime*

HERA issues the following licences for activities in the gas sector: gas production, natural gas production, gas transmission, gas storage, gas distribution, management of terminals for liquefied natural gas, gas supply, gas trade, and organisation of the gas market. The licences are granted for a specific period of time, namely from 3 to 30 years. HROTE has a licence issued for 5 years (issued on 9 December 2014) by HERA for the organisation of the gas market.

### *General overview*

The only company registered for the natural gas production is INA. After numerous reorganisations, INA Group became a joint stock company after being privatised. INA Group obtained respective license in December 2014, lasting for 7 years.

Plinara d.o.o. Pula (“**Plinara**”) is registered for gas production activity. The company was established in 1998, and is owned by the company INA Group (49%), the city of Pula (41%) and Istrian County (10%). Plinara obtained its last license for gas generation in February 2014, for 5 years.

The company Plinacro d.o.o. (“**Plinacro**”) is registered for gas transmission, for 15 years starting from 2003. Plinacro was established in 2001 as an INA Group subsidiary. In 2002 the company was separated from the group and since then it has been owned by the Republic of Croatia. It engages in natural gas transmission as a regulated energy activity under the supervision of HERA.

There are 35 companies registered for gas distribution. A large number of distribution system operators used to be part of communal companies. After the adoption of energy laws in Croatia, distribution system operators must be organised as separate legal entities and must be independently from activities outside the gas sector. An additional reason for the existence of the large number of distribution system operators is that each municipality used to have its own operator.

Podzemno skladište plina d.o.o. is the only company registered for natural gas storage. Since 2009 it has been owned by Plinacro and it obtained its last license for gas storage in January 2014, for 5 years.

A gas supplier is a person (whether legal or natural) who supplies gas. There are 57 companies registered as gas suppliers.

Pursuant to the Gas Market Act and in light of the Group’s regulated activities gas distribution and gas supply are considered to be regulated activities, while gas supply to end-customers is not a regulated activity.

Gas supply activities may be provided as:

- (i) public service supply of gas – gas supply performed based on regulated preconditions to households as well as to energy undertakings, legal entities and individuals who generates the thermal energy from the gas to supply the households with respective thermal energy in accordance with the thermal energy legislation;
- (ii) guaranteed gas supply – gas supply to end-customers which lost their suppliers;
- (iii) supplying the final/end customers with the gas on gas market.

Gas Market Act prescribes that services for gas distribution and construction of gas distribution system shall be performed on the basis of a concession licence granted by the local municipality. Respective concession may be granted for the period from 20 up to 30 years. Distribution system operator will be obliged to pay the concession fee stipulated by respective agreement, which is defined as a variable fee related to incomes of respective distribution system operator, achieved by its regular business related to gas distribution in the respective territory in a previous business year.

Gas trading is performed as a market activity. Two companies are registered for gas trading, namely LUKOS ENERGIJA d.o.o. za energetske djelatnosti, which obtained its licence in September 2013 for 3 years, and Alpiq Energija Hrvatska d.o.o. za trgovinu i usluge, which obtained its licence in September 2015 for 3 years.

#### *Price of Gas*

The methodology of calculating gas prices is very similar to the methodology for electrical energy (please see section *Price of Electricity*). According to The Gas Market Act and due to the HEP's registered activities, gas distribution and gas supply (supplying the gas as public services and guaranteed gas supply) are considered as regulated activities. Supplying the final/end customers with the gas on gas market is not regulated activity.

Regulated activities (gas distribution, supplying the gas as public services and guaranteed gas supply) should be provided in accordance with the methodologies and tariff rates determined by the competent regulatory (HERA).

The tariff models for the gas sector currently in force are (i) the tariff model for natural gas supply as a public service and guaranteed supply, and (ii) the tariff model for natural gas distribution.

#### *Tariff system for gas distribution*

HERA passed the Methodology for determining the tariff rates for gas distribution. Respective Methodology is based on the method of incentive regulation and on the regulation of maximal allowed income. Methodology prescribes that the tariff rates for gas distribution for all the billing points in the same tariff model of the distribution system shall be equal, regardless of the length of distribution route.

In the year that precedes the first year of the regulation period (year T-1) projected allowed income for each year of the regulation period is determined. The projected allowed income shall cover the justified operating costs of the distributor and provide an income from regulated assets, and the projected allowed income in regulatory year t is calculated in accordance with the following formula:

$$DP_t^P = OPEX_t^P + A_t^P + PRO_t^P + PV\delta_t - (PPRIK_t^P + PNU_t^P POST_t^P)$$

Whereby the individual items are as follows: (i)  $DP_t^P$  – projected allowed income in regulatory year t [kn], (ii)  $OPEX_t^P$  – projected operational costs in regulatory year t [kn], (iii)  $A_t^P$  – projected amortisation of the regulated assets [kn], (iv)  $PRO_t^P$  – projected income from the regulated assets in regulatory year t [kn], (v)  $PV\delta_t$  – part of the residual between revised allowed income and generated income in previous regulation period, presented in regulatory year t [kn], (vi)  $PPRIK_t^P$  – projected income from the connection fee and the increase of connection capacity in regulatory year t [kn], regarding exclusively the part of the fee related to the implementation of the connections, and regardless of the irretrievably obtained funds, (vii)  $PNU_t^P$  – projected income from non-standard services in regulatory year t [kn], and (viii)  $POST_t^P$  – projected other business income that are not related to core business of the distributor, on which income are registered items in operational costs of the distributor and that are not, through the item irretrievably obtained funds, excluded from amortisation and the value of the regulated assets, in regulatory year t [kn].

The tariff elements in the Methodology for determining the tariff rates for gas distribution are tariff rate for distributed quantity of gas (Ts1) and tariff rate for fixed monthly charge (Ts2) which is intended for coverage of part of the fixed costs of conducting gas distribution related to the billing point.

The tariff rates for certain tariff models Ts1Tmi and Ts2Tmi are determined in a mode that the expected total income in a certain regulatory year t is not higher than the amount of the levelled allowed income in a certain regulatory year t.

The tariff rate for distributed quantity of gas  $Ts1$  for tariff model  $Tmi$  in a regulatory year  $t$  [kn/kWh] is defined by multiplying coefficient of consumption  $kP,Tmi$  for tariff model  $Tmi$  and the amount of the basic tariff rate  $Ts10$ , according to the formula:

$$Ts1Tmi = kP,TmixTs10$$

Whereby the individual items are as follows: (i)  $Ts1Tmi$  – unit price of distributed quantity of gas for tariff model  $Tmi$  in a regulatory year  $t$  [kn/kWh], (ii)  $kP,Tmi$  – coefficient of consumption for tariff model  $Tmi$ , and (iii)  $Ts10$  – basic tariff rate for distributed quantity of gas [kn/kWh].

The tariff rate for fixed monthly charge  $Ts2$  for tariff model  $Tmi$  in a regulatory year  $t$  [kn] is defined by multiplying coefficient of the billing point  $kOMM,Tmi$ , for tariff model  $Tmi$  and the amount of the basic tariff rate  $Ts20$ , according to the formula:

$$Ts2Tmi = kOMM,Tmi \times Ts20$$

Whereby the individual items are as follows: (i)  $Ts2Tmi$  – fixed monthly charge for tariff model  $Tmi$  in a regulatory year  $t$  [kn], (ii)  $kOMM,Tmi$  – coefficient of the billing point for tariff model  $Tmi$ , and (iii)  $Ts20$  – basic tariff rate [kn].

The amounts of coefficient of consumption and the amounts of coefficient of the billing point are prescribed for each tariff model by the respective Methodology.

#### *Tariff system for gas supply*

HERA passed the Methodology for determining the tariff rates for gas supply as a public service and guaranteed supply. The method of regulation applied in the respective Methodology is based on the regulation of maximal final price of the supply. The final price of the gas supply shall cover the justified costs of gas procurement and the justified operating costs of the supplier. The supplier is obliged to calculate the same final price for all final customers connected to the same distribution system and in the same tariff model regarding the stipulations of the Methodology for determining the tariff rates for gas distribution.

The tariff elements in the Methodology for determining the tariff rates for gas supply are tariff rate for delivered quantity of gas ( $Ts1$ ) and tariff rate for fixed monthly charge ( $Ts2$ ).

The final price of the gas supply (the maximal final price determined for gas supply as a public service conducted by a particular supplier) consists of the tariff rate for delivered quantity of gas  $Ts1$  and the tariff rate for fixed monthly charge  $Ts2$ .

The tariff rate for delivered quantity of gas for tariff model  $Tmi$  in regulatory year  $t$  is calculated in accordance with the following formula:

$$Ts1TTMi = Tnab + Ts1dis,Tmi + Ts0$$

Whereby the individual items are as follows: (i)  $Ts1TTMi$  – tariff rate for delivered quantity of gas for tariff model  $Tmi$  [kn/kWh], (ii)  $Tnab$  – unit cost of gas procurement [kn/kWh], (iii)  $Ts1dis,Tmi$  – tariff rate for distributed quantity of gas for tariff model  $Tmi$  [kn/kWh], and (iv)  $Ts0$  = unit operating cost of the supplier [kn/kWh].

Fixed monthly charge for tariff model  $Tmi$  in regulatory year  $t$  is determined in the amount of fixed monthly charge for gas distribution, which is intended for coverage of part of the fixed costs of conducting gas distribution related to the billing metering point and determined for tariff model  $Tmi$  in regulatory year  $t$  in accordance with the Methodology for determining the tariff rates for gas distribution, as follows:

$$Ts2Tmi = Ts2dis, Tmi$$

Whereby the individual items are as follows: (i)  $Ts2Tmi$  – tariff rate for fixed monthly charge [kn], and (ii)  $Ts2dis, Tmi$  – tariff rate for fixed monthly charge for gas distribution [kn].

The final price of the gas supply determined above is the maximal final price determined for gas supply as a public service conducted by a particular supplier.

Tariff rates for guaranteed gas supply are as follows:

- for the final customers which were supplied with the gas on gas market:
  - gas supply of regular customers:
    - within first month of guaranteed supply – amounting to the last gas price invoiced by the gas supplier;
    - following 2 months – amounting to the last gas price invoiced by the gas supplier increased by 10%;
    - afterwards – supply in accordance with the market terms;
  - gas supply of customers which are obliged by the public tender's legislation:
    - within initial 3 months of guaranteed supply – amounting to the last gas price invoiced by the gas supplier;
    - following 3 months - amounting to the last gas price invoiced by the gas supplier increased by 10%;
    - afterwards – supply in accordance with the market terms;
- for the final customers supplied with the gas as public service:
  - within initial 3 months of guaranteed supply – amounting to the tariff rates for the gas supply as public service on respective territory, specified by the Methodology for the tariff rates for supplying the gas as the public service and guaranteed supply;
  - following 3 months - amounting to the tariff rates for the gas supply as public service on respective territory, specified by the Methodology for the tariff rates for supplying the gas as the public service and guaranteed supply, increased by 10%;
  - afterwards – supply by the new supplier of gas as the public service or in accordance with the market terms.

#### *Tariff system for the gas transmission*

Transmission system capacities at the entry point and the transmission system capacities at the exit point are available through different types of services and may be contracted independently. The transmission system operator provides services of using firm and interruptible capacity and backhaul on a yearly, monthly and daily basis, pursuant to transport contracts entered into by the transmission system operator and transmission system users. The transmission system operator shall offer only those services that it can provide considering the technical parameters of the transmission system and the liabilities under the existing transport contracts.

The amounts of the tariff items for the gas transmission are determined by the Methodology for determining tariff items for the gas transmission (OG 85/13, 158/13). The Methodology for determining the amounts of tariff items for the natural gas transmission is based on the method of incentive based regulation, that is, the allowed revenue cap method. Allocation of allowed revenues

and determination of the tariff items is based on the entry-exit model. The amounts of the tariff items for the natural gas transmission are determined for a particular type of a transmission system entrance and a transmission system exit for particular years of the regulation period. Duration of the first regulation period is three years (from 2014 to 2016) and of the subsequent regulation periods five years.

Types of tariff items for gas transmission are the following:

- Tariff item for entry at interconnection;
- Tariff item for entry from production;
- Tariff item for entry from gas storage;
- Tariff item for exit at interconnection;
- Tariff item for exit in Croatia; and
- Tariff item for the amount of gas.

On 31 July 2013 HERA set the tariff items for the natural gas transmission for Plinacro (OG 102/13) with effect from 1 January 2014.

On 8 June 2015 in accordance with the Methodology for determining the amounts of tariff items for the natural gas transmission HERA adopted a decision on the tariff items for the natural gas transmission for energy entity Plinacro (OG 65/15) with effect from 1 October 2015. The decision was adopted following the completion of an official procedure of an extraordinary audit of the tariff rates at the request of Plinacro.

New amounts of tariff items for 2015 increased by 14% for the entry tariff item, 60% for the exit tariff item and 16% for the gas amount tariff item. Tariff items for 2016 are lower by an average of 1% as compared to the amount of tariff items for 2015 in effect from 1 October 2015.

### ***Environmental matters***

In the process of aligning Croatia's environmental legislation with that of the EU, in the last few years Croatia has made progress in transposing the Integrated Pollution Prevention and Control (IPPC) Directive (2008/1/EC) into national legislation and the Directive on industrial emission ("IED") 2010/75/EC. IED is the main EU instrument regulating pollutant emissions from industrial installations. The IED was adopted on 24 November 2010. It is based on a Commission proposal recasting seven previously existing directives (including in particular the IPPC Directive). The IED has been transposed into Croatian legislation through the Environmental Protection, the Air Protection Act, the Regulation on Information and Participation of the Public and Public Concerned in Environmental Protection Issues and the Environmental Permit Regulation.

#### ***The Environmental Protection Act***

The Environmental Protection Act regulates the following issues: principles of environmental protection and sustainable development, documentation related to sustainable development and environmental protection, instruments of environmental protection, environmental monitoring, participation of the public in environmental issues, administration and inspectional supervision.

The Environmental Protection Act and Regulation on Environmental Impact Assessment (OG 61/2014), regulate the procedure of environmental impact assessment ("EIA"). By the adoption of this legislation, the law in this area has been harmonised with the corresponding EU directives (Directive 2011/92/EU of 13 December 2011 and Directive 2010/75/EU of 24 November 2010).

The EIA is a procedure for assessing the acceptability of a planned project with regard to the environment. It acts to determine the necessary measures for the protection of the environment, in



order to reduce any impact to a minimum and achieve the best possible preservation of the environment. The assessment process is carried out at an early stage in the planning of a project, prior to the issuance of a location permit or other early approvals for the project. There are various projects for which EIA is obligatory, such as power plants with capacity greater than 100 MW, wind power stations capacity of over 20 MW, nuclear power stations and other nuclear reactors. Members of public are allowed to participate in the EIA process subject to requirements stipulated in the Croatian Environmental Protection Act and the Regulation on Information and Participation of the Public.

#### *Environmental Permit Regulation*

Environmental Permit Regulation, together with the Environmental Protection Act and the Regulation on Information and Participation of the Public and Public Concerned in Environmental Protection Issues, transposes the basic requirements for the integrated prevention and control of pollution prescribed by the Council Directive 2008/1/EC and Council Directive on industrial emission 2010/75. This integrated approach to pollution control, taking into account waste management, aims to prevent emissions into the air, water or soil wherever this is possible, and if not, to reduce them to a minimum in order to achieve a high level of protection of the environment as a whole.

According to the Environmental Permit Regulation, the integrated environmental protection requirements are determined for installations that may cause emission which pollute the soil, air, water and sea and new installations in which once constructed (during reconstruction and commissioning) such activities will be carried out. Within the meaning of the subject regulation, the activities/installations which may cause emission polluting the soil, air, water and sea are described in Annex I of Environmental Permit Regulation, and they are further divided into chapters referring to: (i) Energy industries, (ii) Production and processing of metals, (iii) Mineral industry, (iv) Chemical industry, (v) Waste management and (vi) Other activities. The installations listed under chapter (i) Energy industries, are combustion installations with a rated thermal input exceeding 50 MW, mineral oil and gas refineries, coke ovens, coal gasification and liquefaction plants and other gasification and liquefaction plants with a rated thermal input exceeding 20 MW.

The determination of integrated environmental protection requirements for a particular plant may refer to one or more parts of a plant in which a polluting activity may take place. The MZOP issues decisions on the integrated environmental protection requirements.

According to the provisions of the Regulation, HEP has submitted to MZOP requests and technical-technological solutions for establishing integrated environmental protection requirements for all the existing HEP thermal power plants with nominal thermal power exceeding 50 MW. Until 30 of June 2015 five environmental permits in HEP Group were issued to existing plants – the Osijek plant of HEP District Heating and TE-TO Osijek cogeneration plant, TTP Sisak, TPP Rijeka and CPP Jertovec and two to new plants – TPP Plomin C and Block C Sisak. Procedures regarding other plants are underway.

#### ***Regulation on information and participation of the public and public concerned in environmental protection issues***

According to this Regulation, the majority of the documentation that HEP has to compile in accordance with environmental and nature protection is open for inspection to the public and the public concerned. HEP participates in public inspections and public debates in order to provide information to the public and the public concerned. Representatives of companies which hold permits empowering them to compile documents on environmental protection (issued by the Ministry for Environmental and Nature Protection) also take part in these inspections and debates. In order to inform further the public and the public concerned, HEP collates reports on the emission of pollutants into the environment and on activities taking place to protect the environment in fulfilment of its legal obligations. HEP publishes this data in its annual report on Group as well as within a specialised report entitled Sustainable growth.

### ***Nature Protection Act and the Regulation on Declaration of an Ecological Network***

The Nature Protection Act (OG 80/2013) regulates the carrying out of nature impact assessments (NIA) as an ecological assessment which deals with the consequences of projects on specific habitats and species of a certain site. The new Croatian legislation on environmental protection integrates the Environmental Impact Assessment (EIA) and the NIA procedure for future projects.

According to the Regulation on Declaration of an Ecological Network (124/2013), the National Ecological Network is included as an ecologically significant area of EU—within NATURA 2000. In October 2012, HEP applied to the Ministry of Environment and Nature Protection for an exemption for 17 locations that are listed in the “Strategy and Programme for Physical Planning within the Republic of Croatia” which have been entered into the National Ecological Network and NATURA 2000 proposal. Ministry of Environment and nature Protection refused HEP’s application for exemption.

Under the provisions of the Environmental Protection Act and the Regulation, protected areas and ecological network areas are subject to measures applicable to all physical persons and legal entities using natural resources and performing actions or operations under the relevant legislation in these areas, Group included. The protection measures stipulated in the Act and the Regulation create some uncertainty regarding the construction of planned power plants or the continued operation of Group’s existing power plants within these areas. This may therefore affect energy production and the security of electricity supply. The Act and the Regulation also make it harder to meet the Croatian and EU obligations on reducing greenhouse gases and other pollutant emissions, as well the requiring regular plant maintenance, environmental protection and work safety.

However, there are parts of the Nature Protection Act which can be used to overcome the limitations imposed. For example, if it is established that a planned procedure (i.e. a construction project) has a damaging influence on the ecological network and there are no acceptable alternatives, a request for determining the existence of an overriding public interest could be made (e.g. the supply of electrical energy for a certain area) and compensation could be given. The Ministry of Environment and Nature or in some cases the Croatian Government (after public consultation) will decide on any such request.

### ***Overview of the Croatian Insolvency Act***

Pre-insolvency and insolvency proceedings in Croatia are regulated by the Insolvency Act (Official Gazette No. 71/15) (“**Insolvency Act**”).

Pursuant to the Insolvency Act, pre-insolvency proceedings can be commenced if the court determines that a failure to meet payment obligations is threatened. Such inability will be found to exist if the debtor will not be able to meet payment obligations when due and if it has outstanding obligations registered with the financial agency as a competent banks accounts registry, or is 30 days behind in payment of salaries to its employees, or is 30 days behind in the payment of mandatory salary contributions.

Pre-insolvency proceedings can be commenced either by a debtor or by a creditor, if the debtor gives its consent. The main purpose of the procedure is to reach a mutually acceptable arrangement with all of its creditors. The procedure is supervised by a competent commercial court and results in the execution of a pre-insolvency settlement. The debtor is obliged to submit a restructuring plan in which, among other things, it has to disclose the conditions that have led to its financial difficulties, as well as measures of operational restructuring. The financial agency acts as an administrative agent for the collection of claims by the creditors and delivers them to the commercial court, which conducts the proceedings. This is followed by a creditors’ vote on the proposed restructuring plan. If the majority prescribed by the Insolvency Act is met, and if the court finds that all other conditions are fulfilled, it then confirms the restructuring plan.

Insolvency proceedings can be commenced either in case of insolvency or over-indebtedness of the debtor. The debtor is deemed to be insolvent if it has one or more outstanding obligations registered

with the financial agency as a competent bank accounts registry for a period in excess of 60 days and which, based on valid grounds for collection (such as a judgment), should have been collected from any of debtor's accounts without its consent, or if the debtor has not paid three consecutive salaries to its employees. A debtor shall also be considered over-indebted if its debts exceed its existing assets. Under the terms of the Insolvency Act, solvency proceedings can be commenced either by a debtor or by a creditor. In circumstances where a company is either insolvent or holds too much debt, the company is required to promptly file a petition for insolvency without delay or no later than 21 days after the occurrence of insolvency or over-indebtedness.

### *Categories and Ranking of Creditors*

The Insolvency Act differentiates between four categories of creditors: (i) creditors of the insolvency estate; (ii) creditors with exemption rights; (iii) separate creditors; and (iv) insolvency creditors.

### *Creditors of the Insolvency Estate*

During insolvency proceedings, the costs incurred in connection with such proceedings and "other obligations" of the insolvency estate shall be met first (e.g. court expenses, trustee expenses, etc.). "Other obligations" include:

- (i) Liabilities incurred by the action or inaction of the trustee in connection with the insolvency proceedings or in connection with the management of the insolvency estate or the liquidation or distribution of the assets of the insolvency estate, which are not costs of the insolvency proceedings;
- (ii) Claims of attorneys for their services rendered during the six months immediately prior to the commencement of the insolvency proceedings in connection with the protection of the debtor's rights upon the debtor's entry into the insolvency estate; and
- (iii) Other items provided under the Insolvency Act.

The costs incurred in connection with the insolvency proceedings and other obligations of the insolvency estate shall be settled in the order in which they became due.

### *Creditors with Exemption Rights*

Persons able to prove, based on a material or personal right, that a specific asset is actually owned by them and does not belong to the insolvency estate, shall not be considered an insolvency creditor. The right to exempt such assets from the insolvency proceedings shall be determined according to the provisions of the general law of Croatia outside the insolvency regime.

### *Separate Creditors*

Creditors who have a separate claim against real estate, fixtures or rights that are registered with a public register (for example, land register, register of vessels, aircraft register, register of intellectual property and similar registers) shall have the right to separate satisfaction of their claim in accordance with the provisions of the Croatian Enforcement Procedure Act.

### *Insolvency Creditors*

These creditors are personal creditors of the debtor who, at the time of the commencement of the insolvency proceedings have legally based claims against the debtor. Creditors are ranked according to their priority, which is based on the nature of their claim. Creditors of a lower priority may be satisfied only after creditors of a higher priority have been satisfied in full. Creditors that rank *pari passu* rank with the same priority and are satisfied in proportion to the amount of their claims.

### *Insolvency Creditors of a Higher Payment Priority*

Claims of creditors with a higher payment priority are classified in order of the “first higher priority” and the “second higher priority.” Claims of the first higher priority include claims of the debtor’s employees and ex-employees incurred until the time of the commencement of the proceeding, any dismissal wages up to the amount specified by law or collective agreement, and damages for industrial injury or professional illness. Claims of the second higher priority include all other claims against the debtor that are not categorised as a lower priority claim.

### *Insolvency Creditors of a Lower Payment Priority*

The following claims of a lower payment priority are satisfied in the following order:

- (i) Interest on claims of insolvency creditors incurred since the date of the commencement of the insolvency proceedings;
- (ii) Costs incurred by the creditors during their participation in the insolvency proceedings;
- (iii) Monetary fines for criminal acts or infringements, as well as costs resulting from a penalty for a criminal act or infringement;
- (iv) Claims demanding a free performance by debtor; and
- (v) Claims for the repayment of a loan extended to a member of the debtor where the loan was extended in exchange for capital or claims of a similar nature.

### *Creditors’ Claims*

Creditors must report their claims to the trustee in bankruptcy in writing. A claim shall be considered established if, during an examination hearing, it has not been refuted by the trustee or any of the other creditors, or, if it has already been refuted, such refutation has been withdrawn. If the trustee in insolvency or any of the creditors has refuted a claim, the court shall direct the creditor to institute legal proceedings in order to establish the claim.

*Investors may experience difficulties in enforcing foreign judgments under laws other than the Croatian law, including under U.S. federal securities laws.*

The Issuer is a corporation organised under the laws of the Republic of Croatia. All of the officers and directors of the Issuer are residents of the Republic of Croatia and all or a substantial portion of the assets of the Issuer and its officers and directors are located in the Republic of Croatia. As a result, it may not be possible for an investor to effect service of process outside the Republic of Croatia upon the Issuer or such persons, or to enforce any judgments against them obtained in courts outside the Republic of Croatia predicated upon civil liabilities of the Issuer or such directors and officers under laws other than Croatian law, including any judgments predicated upon United States federal or state securities laws.

There is doubt as to the enforceability in Croatia of original actions, or actions for the enforcement of judgments of the U.S. courts, of civil liabilities predicated solely upon the laws of England or federal laws of the United States. Croatia is not a party to any multilateral or bilateral treaty under which the judgments of the U.S. courts would be recognised and enforced, and Croatian courts have not established the “factual reciprocity” with the U.S. courts. See “*Service of Process and Enforcement of Civil Liabilities.*”

## CONDITIONS OF THE NOTES

*The following is the text of the Conditions of the Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates (if issued) in respect of the Notes:*

The U.S.\$550,000,000 5.875% Notes due 2022 (the “**Notes**”, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 17 and forming a single series with the Notes) of Hrvatska Elektroprivreda d.d (the “**Issuer**”) issued on 23 October 2015 (the “**Issue Date**”) are constituted by, subject to and have the benefit of a Trust Deed dated 23 October 2015 (as amended or supplemented from time to time, the “**Trust Deed**”) made between the Issuer and Deutsche Trustee Company Limited (the “**Trustee**”, which expression shall include its successor(s)) as trustee for the holders of the Notes (the “**Noteholders**”).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the Agency Agreement dated 23 October 2015 (as amended or supplemented from time to time, the “**Agency Agreement**”) made between the Issuer and Deutsche Bank Trust Company Americas and Deutsche Bank Luxembourg S.A. as registrars (the “**Registrars**”), the other paying and transfer agents named therein (together, the “**Agents**”) and the Trustee are available for inspection during normal business hours by the Noteholders at the registered office for the time being of the Trustee, being at the date of issue of the Notes at Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom and at the specified office of each of the Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them.

### 1. FORM, DENOMINATION AND TITLE

#### 1.1 Form and Denomination

The Notes are issued in registered form in amounts of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof (referred to as the “**principal amount**” of a Note and each an “**Authorised Holding**”). A note certificate (each a “**Certificate**”) will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the relevant Registrar.

#### 1.2 Title

Title to the Notes passes only by registration in the register of Noteholders. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on (other than a duly executed transfer thereof in the form endorsed thereon), or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions “**Noteholder**” and (in relation to a Note) “**holder**” means the person in whose name a Note is registered in the register of Noteholders.

### 2. TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

#### 2.1 Transfers

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the relevant Registrar or any of the Agents.

## **2.2 Delivery of new Certificates**

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the relevant Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the relevant Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer. For the purposes of this Condition, “**business day**” shall mean a day on which banks are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.

## **2.3 Formalities free of charge**

Registration of a transfer of Notes will be effected without charge by or on behalf of the Issuer or any Agent but upon payment (or the giving of such indemnity as the Issuer or any Agent may require) in respect of any taxes, duties, or other governmental charges which may be imposed in relation to such transfer.

## **2.4 Closed Periods**

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium or interest on that Note.

## **2.5 Regulations**

All transfers of Notes and entries on the register of Noteholders will be made subject to the detailed regulations concerning transfers of Notes scheduled to the Trust Deed. The regulations may be changed by the Issuer with the prior written approval of the Registrars and the Trustee (such approval not to be unreasonably withheld or delayed). A copy of the current regulations will be mailed (free of charge) by the Registrars to any Noteholder who requests one.

## **2.6 Authorised Holdings**

No Note may be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a holder are being transferred) the principal amount of the balance of the Notes not transferred are Authorised Holdings.

## **3. STATUS**

The Notes are direct, general, unsubordinated, unconditional and (subject to the provisions of Condition 4) unsecured obligations of the Issuer and rank and will rank *pari passu* amongst themselves and at least *pari passu* in right of payment, without any preference among themselves, with all other outstanding unsecured and unsubordinated obligations of the Issuer, present and future, but, in the event of insolvency, only to the extent permitted by applicable laws relating to creditors' rights.

## **4. NEGATIVE PLEDGE**

So long as any of the Notes remains outstanding (as defined in the Trust Deed) the Issuer will ensure that no Relevant Indebtedness will be secured by any mortgage, charge, lien, pledge or other security interest (each a “**Security Interest**”), other than a Permitted Security Interest (as defined below), upon, or with respect to, any of the present or future business, undertaking, assets or revenues (including any uncalled capital) of the Issuer or any of its

Material Subsidiaries (as defined below) unless the Issuer, in the case of the creation of a Security Interest, before or at the same time and, in any other case, promptly, takes any and all action necessary to ensure that:

- (i) all amounts payable by it under the Notes and the Trust Deed are secured by such Security Interest equally and rateably with the Relevant Indebtedness to the satisfaction of the Trustee; or
- (ii) such other Security Interest or other arrangement (whether or not it includes the giving of a Security Interest) is provided either (i) as the Trustee shall in its discretion deem not materially less beneficial to the interests of the Noteholders or (ii) as is approved by an Extraordinary Resolution (which is defined in the Trust Deed as a resolution duly passed by a majority of not less than three-fourths of the votes cast thereon) of the Noteholders.

For the purposes of these Conditions:

**“Group”** means the Issuer and its Subsidiaries from time to time;

**“Material Subsidiary”** means, at any time:

- (i) each of:
  - HEP-Proizvodnja d.o.o.;
  - HEP-Operator prijenosnog sustava d.o.o.;
  - HEP-Operator distribucijskog sustava d.o.o.; and
  - HEP Opskrba d.o.o.;(in each case unless and until such company ceases to be a Subsidiary of the Issuer solely as a result of an Ownership Unbundling Event (as defined in Condition 7.4)); and
- (ii) any Subsidiary of the Issuer whose total assets or total revenues then equal or exceed 5% of the consolidated total assets or consolidated total revenues of the Group; or
- (iii) when the aggregate of the total assets and total revenues of each Subsidiary described in paragraphs (i) and (ii) above, together with the total revenues of the Issuer does not equal or exceed 90% of the consolidated total assets and consolidated total revenues of the Group, any Subsidiary of the Issuer such that the aggregate of the total assets and total revenues of the Subsidiaries described by paragraphs (i) and (ii) above and included under this paragraph (iii), together with the total assets and total revenues of the Issuer, equal or exceed 90% of the consolidated total assets and consolidated total revenues of the Group.

For the purpose of this definition, total assets, total revenues, consolidated total assets and consolidated total revenues will be determined by reference to the latest audited financial statements of the relevant Subsidiary of the Issuer and the Issuer (and, in the case of the total assets or total revenues of a Subsidiary) will include only those assets or revenues which contribute to the consolidated total assets or consolidated total revenues of the Group). If there is any dispute as to whether or not a company is a Material Subsidiary, a certificate of the Auditors (as defined in the Trust Deed) whether or not addressed to the Trustee shall (in the absence of manifest error) be conclusive and binding on all parties.

**“Permitted Security Interest”** means any Security Interest over or affecting any assets or revenues of any company in the Group where such Security Interest secures Project Finance Indebtedness only;

“**Person**” means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality;

“**Project Finance Indebtedness**” means any indebtedness incurred by a debtor to finance the ownership, acquisition, construction, development and/or operation of an asset, assets or portfolio of assets in respect of which the Person or Persons to whom such indebtedness is, or may be, owed has/have no recourse whatsoever for the repayment of or payment of any sum relating to such indebtedness other than:

- (i) recourse to such debtor for amounts limited to the aggregate cash flow or net cash flow (other than historic cash flow or historic net cash flow) from such asset, assets or portfolio of assets; and/or
- (ii) recourse to such debtor generally, which recourse is limited to a claim for damages (other than liquidated damages and damages required to be calculated in a specified way) for breach of an obligation, representation or warranty (not being a payment obligation, representation or warranty or an obligation, representation or warranty to procure payment by another or an obligation, representation or warranty to comply or to procure compliance by another with any financial ratios or other test of financial condition) by the Person against whom such recourse is available; and/or
- (iii) if such debtor has been established specifically for the purpose of constructing, developing, owning and/or operating the relevant asset, assets or portfolio of assets and such debtor owns no other significant assets and carries on no other business, recourse to all of the assets and undertaking of such debtor and the shares in the capital of such debtor;

“**Relevant Indebtedness**” means (i) any present or future indebtedness (whether being principal, premium, interest or other amounts) for or in respect of any notes, bonds, debentures, debenture stock, loan stock or other securities which are for the time being quoted, listed or ordinarily dealt in on any stock exchange, over-the-counter or other securities market and (ii) any guarantee or indemnity of any such indebtedness; and

“**Subsidiary**” means, in relation to the Issuer, any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

## **5. INTEREST**

### **5.1 Interest Rate and Interest Payment Dates**

The Notes bear interest from and including the Issue Date at the rate of 5.875% per annum (the “**Rate of Interest**”), payable semi-annually in arrear on 23 April and 23 October in each year (each an “**Interest Payment Date**”). The first payment (for the period from and including 23 October 2015 to but excluding 23 April 2016 and amounting to U.S.\$29.375 per U.S.\$1,000 principal amount of Notes) shall be made on 23 April 2016. Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the first or the next Interest Payment Date, respectively, is herein called an “**Interest Period**”.

### **5.2 Interest Accrual**

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld



or refused or unless default is otherwise made in respect of payment in which event interest will continue to accrue as provided in the Trust Deed.

### **5.3 Calculation of Interest for an Interest Period**

The amount of interest payable in respect of each Note for any Interest Period shall be calculated by applying the Rate of Interest to the principal amount of such Note and dividing the product by two.

### **5.4 Calculation of Broken Interest**

When interest is required to be calculated in respect of a period of less than half a year, it shall be calculated on the basis of a 360 day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

## **6. PAYMENTS**

### **6.1 Payments in respect of Notes**

Payment of principal, premium (if any) and interest will be made by transfer to the Registered Account of the Noteholder. Payments of principal, premium (if any) and interest due otherwise than on an Interest Payment Date will only be made against surrender (or, in the case of part payment only, endorsement) of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the register of Noteholders at the close of business on the date (the “**Record Date**”) being the fifteenth day before the relevant Interest Payment Date.

For the purposes of this Condition, a Noteholder’s “**Registered Account**” means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the register of Noteholders at the close of business, in the case of principal and premium (if any), on the second Business Day (as defined below) before the due date for payment and, in the case of interest, on the relevant Record Date.

### **6.2 Payments subject to Applicable Laws**

Payments in respect of principal, premium and interest on the Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 8.

### **6.3 No commissions**

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

### **6.4 Payment on Business Days**

Where payment is to be made by transfer to a Registered Account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value the first following day which is a Business Day) will be initiated on the Business Day preceding the due date for payment or, in the case of a payment of principal and premium (if any) or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so).

In this Condition “**Business Day**” means a day (other than a Saturday or Sunday) on which commercial banks are open for business in London, New York City and, in the case of presentation of a Certificate, the place in which the Certificate is presented.

## **6.5 Partial Payments**

If the amount of principal, premium (if any) or interest which is due on the Notes is not paid in full, the relevant Registrar will annotate the register of Noteholders with a record of the amount of principal, premium (if any) or interest in fact paid.

## **6.6 Agents**

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that:

- (a) there will at all times be a Principal Paying Agent;
- (b) there will at all times be an Agent (which may be the Principal Paying Agent) having a specified office in a European city;
- (c) the Issuer undertakes that it will ensure that it maintains a Paying Agent in a Member State of the EU that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive;
- (d) there will at all times be an Agent in a jurisdiction within continental Europe, other than the jurisdiction in which the Issuer is incorporated; and
- (e) there will at all times be a Registrar or Registrars.

Notice of any termination or appointment and of any changes in specified offices given to the Noteholders promptly by the Issuer in accordance with Condition 13.

## **7. REDEMPTION AND PURCHASE**

### **7.1 Redemption at Maturity**

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on 23 October 2022 (the “**Maturity Date**”).

### **7.2 Redemption for Taxation Reasons**

If the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that:

- (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 8), or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 23 October 2015, on the next Interest Payment Date the Issuer would be required to pay additional amounts as provided or referred to in Condition 8; and
- (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may at its option, having given not less than 30 nor more than 60 days’ notice to the Noteholders in accordance with Condition 13 (which notice shall be irrevocable), redeem all the Notes, but not some only, at any time at their principal amount together with interest

accrued to but excluding the date of redemption. Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Trustee a certificate signed by two Directors of the Issuer stating that the requirement referred to in (a) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders.

Upon the expiry of any notice as is referred to in this Condition 7.2 the Issuer shall be bound to redeem the Notes in accordance with the terms of this Condition.

### **7.3 Redemption at the Option of the Noteholders upon a Change of Control**

If, at any time while any of the Notes remains outstanding, a Change of Control (as defined below) occurs, each Noteholder shall have the option (unless, prior to the giving of the Change of Control Notice (as defined below), the Issuer shall have given notice under Condition 7.2) to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Noteholder's Note(s) at 101% of the principal amount of the Notes then outstanding together with (or, where purchased, together with an amount equal to) interest (if any) accrued to (but excluding) the Change of Control Put Date (as defined below). Such option (the **"Change of Control Put Option"**) shall operate as set out below.

If a Change of Control occurs the Issuer shall, within 14 days of the occurrence of such Change of Control, give notice (a **"Change of Control Notice"**) to the Noteholders in accordance with Condition 13 specifying the nature of the Change of Control and the procedure for exercising the option contained in this Condition 7.3.

To exercise the Change of Control Put Option, the Noteholder must deliver at the specified office of any Agent on any Business Day (as defined in Condition 6) falling within the period (the **"Change of Control Put Period"**) of 45 days after that on which a Change of Control Notice is given, a duly signed and completed notice of exercise in the form (for the time being current and which may, if the Certificate for such Notes is held in a clearing system, be any form acceptable to the clearing system delivered in any manner acceptable to the clearing system) obtainable from any specified office of any Agent (a **"Change of Control Put Notice"**) and in which the holder must specify a bank account complying with the requirements of Condition 6 to which payment is to be made under this Condition 7.3, accompanied by the Certificate for such Notes or evidence satisfactory to the Agent concerned that the Certificate for such Notes will, following the delivery of the Change of Control Put Notice, be held to its order or under its control.

The Issuer shall redeem or, at its option, purchase (or procure the purchase of) the relevant Note on the date (the **"Change of Control Put Date"**) being the fifteenth day after the date of expiry of the Change of Control Put Period, unless previously redeemed or purchased and cancelled. Payment in respect of any Note so delivered shall be made, if the holder duly specifies a bank account in the Change of Control Put Notice to which payment is to be made on the Change of Control Put Date, by transfer to that bank account, subject in any such case as provided in Condition 6.1.

A Change of Control Put Notice given by a holder of any Note shall be irrevocable except where, prior to the due date of redemption, an Event of Default has occurred and is continuing in which event such holder, at its option, may elect by notice to the Issuer to withdraw the Change of Control Put Notice and instead to give notice that the Note is immediately due and repayable under Condition 10.

**"Change of Control"** means, in relation to the Issuer, where the Republic of Croatia ceases to control the Issuer or ceases to own, directly or indirectly, more than 50% of the entire issued share capital of the Issuer, and for the purposes of this definition, "control" shall mean the

power to direct the management and policies of the Issuer or to control the composition of its board of directors or other equivalent body, whether through the ownership of voting capital, by contract or otherwise.

#### **7.4 Redemption at the Option of the Noteholders upon an Ownership Unbundling Event**

If, at any time while any of the Notes remains outstanding, an Ownership Unbundling Event (as defined below) occurs, each Noteholder shall have the option (unless, prior to the giving of the Ownership Unbundling Event Notice (as defined below), the Issuer shall have given notice under Condition 7.2) to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Noteholder's Note(s) at their principal amount together with (or, where purchased, together with an amount equal to) interest (if any) accrued to (but excluding) the Ownership Unbundling Event Put Date (as defined below). Such option (the "**Ownership Unbundling Event Put Option**") shall operate as set out below.

If an Ownership Unbundling Event occurs the Issuer shall, within 14 days of the occurrence of such Ownership Unbundling Event, give notice (an "**Ownership Unbundling Event Notice**") to the Noteholders in accordance with Condition 13 specifying the nature of the Ownership Unbundling Event and the procedure for exercising the option contained in this Condition 7.4.

To exercise the Ownership Unbundling Event Put Option, the Noteholder must deliver at the specified office of any Agent on any Business Day (as defined in Condition 6) falling within the period (the "**Ownership Unbundling Event Put Period**") of 45 days after that on which an Ownership Unbundling Event Notice is given, a duly signed and completed notice of exercise in the form (for the time being current and which may, if the Certificate for such Notes is held in a clearing system, be any form acceptable to the clearing system delivered in any manner acceptable to the clearing system) obtainable from any specified office of any Agent (an "**Ownership Unbundling Event Put Notice**") and in which the holder must specify a bank account complying with the requirements of Condition 6.1 to which payment is to be made under this Condition 7.4, accompanied by the Certificate for such Notes or evidence satisfactory to the Agent concerned that the Certificate for such Notes will, following the delivery of the Ownership Unbundling Event Put Notice, be held to its order or under its control.

The Issuer shall redeem or, at its option, purchase (or procure the purchase of) the relevant Note on the date (the "**Ownership Unbundling Event Put Date**") being the fifteenth day after the date of expiry of the Ownership Unbundling Event Put Period, unless previously redeemed or purchased and cancelled. Payment in respect of any Note so delivered shall be made, if the holder duly specifies a bank account in the Ownership Unbundling Event Put Notice to which payment is to be made on the Ownership Unbundling Event Put Date, by transfer to that bank account, subject in any such case as provided in Condition 6.1.

An Ownership Unbundling Event Put Notice given by a holder of any Note shall be irrevocable except where, prior to the due date of redemption, an Event of Default has occurred and is continuing in which event such holder, at its option, may elect by notice to the Issuer to withdraw the Ownership Unbundling Event Put Notice and instead to give notice that the Note is immediately due and repayable under Condition 10.

For the purposes of these Conditions:

**"Governmental Authority"** means the Republic of Croatia or any entity exercising executive, legislative, judicial, regulatory or administrative functions of, or pertaining to, the Republic of Croatia;

**“Ownership Unbundling Event”** means any reorganisation of the holding of the Regulated Assets pursuant to or in accordance with any order or act of a Governmental Authority implementing Directive 2009/72/EC in the Republic of Croatia following the consummation of which the Regulated Assets cease to be owned by any member of the Group; and

**“Regulated Assets”** means those assets of the Group relating to the transmission of electricity to, from and within the Republic of Croatia in respect of which the Issuer and its Subsidiaries earn revenues regulated, directly or indirectly, by the Croatian Regulatory Agency for Energy (HERA).

## **7.5 Purchases**

The Issuer or any of its Subsidiaries may at any time purchase Notes in any manner and at any price. The Notes so purchased may be held or resold (provided that such resale is outside the United States and is otherwise in compliance with all applicable laws).

## **7.6 Cancellations**

All Notes which are (a) redeemed will forthwith be, or (b) purchased by or on behalf of the Issuer or any of its Subsidiaries may at the option of the Issuer be, cancelled, and any Notes so cancelled may not be reissued or resold.

# **8. TAXATION**

## **8.1 Payment without Withholding**

All payments in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (**“Taxes”**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction; except that no additional amounts shall be payable with respect to:

- (a) any Taxes that would not have been imposed but for the existence of any present or former connection between the holder or the beneficial owner of the Notes (or between a fiduciary, settlor, beneficiary, partner of, member or shareholder of, or possessor of a power over, the relevant holder, if the relevant holder is an estate, trust, nominee, partnership, limited liability company or corporation) and the Relevant Jurisdiction (including being or having been a citizen, resident, or national thereof or being or having been present or engaged in a trade or business therein or having had a permanent establishment therein), but excluding any connection arising merely from the holding of such Note, the enforcement of rights under such Note or the receipt of any payments in respect of such Note; or
- (b) any estate, inheritance, gift, sales, transfer, personal property or similar Taxes; or
- (c) any Taxes imposed or withheld by reason of the failure of the holder or beneficial owner of Notes, following the Issuer’s written request, which is made at a time that would enable the holder or beneficial owner acting reasonably to comply with that request, to comply with any certification, identification, information or other reporting requirements, whether required by statute, treaty, regulation or administrative practice of a Relevant Jurisdiction, as a precondition to exemption from, or reduction in the rate of deduction or withholding of, Taxes imposed by the Relevant Jurisdiction (including, without limitation, a certification that the holder or beneficial owner is not

resident in the Relevant Jurisdiction), but in each case, only to the extent the holder or beneficial owner is legally entitled to provide such certification or documentation; or

- (d) any Taxes imposed as a result of the presentation of a Note for payment in the Republic of Croatia; or
- (e) any Taxes withheld, deducted or imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (f) any Taxes imposed on or with respect to a payment to a holder or beneficial owner who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the EU; or
- (g) any Taxes imposed as a result of the presentation of a Note for payment more than 30 days after the Relevant Date (as defined below) except to the extent that a holder would have been entitled to additional amounts on presenting the same for payment on the last day of the period of 30 days assuming that day to have been a Business Day (as defined in Condition 6); or
- (h) any combination of items (a) through (g) above.

Notwithstanding anything to the contrary in the preceding paragraph, none of the Issuer any paying agent or any other person shall be required to pay any additional amounts with respect to any withholding or deduction imposed on or in respect of any Note pursuant to Sections 1471 to 1474 of the U.S. Internal Revenue Code of 1986, as amended (“**FATCA**”), any treaty, law, regulation or other official guidance promulgated under or implementing FATCA, or any intergovernmental agreement enacted by any Relevant Jurisdiction implementing FATCA, or any agreement between the Issuer and the United States or any authority thereof implementing FATCA.

For the purposes of these Conditions:

“**Relevant Date**” means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by an Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 13; and

“**Relevant Jurisdiction**” means the Republic of Croatia or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal, premium (if any) and interest on the Notes.

## **8.2 Additional Amounts**

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

## **9. PRESCRIPTION**

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date, as defined in Condition 8.

## 10. EVENTS OF DEFAULT

The Trustee at its discretion may, and if so requested in writing by the holders of at least one-fifth in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders shall (subject in each case to being indemnified and/or secured and/or pre-funded to its satisfaction), (but, in the case of the happening of any of the events described in subparagraphs (b) to (d) (other than the winding up or dissolution of the Issuer) and, I to (h) inclusive below, only if the Trustee shall have certified in writing to the Issuer that such event is, in its opinion, materially prejudicial to the interests of the Noteholders) give notice to the Issuer that the Notes are, and they shall accordingly forthwith become, immediately due and repayable at their principal amount, together with accrued interest as provided in the Trust Deed, if any of the following events (“**Events of Default**”) occurs and is continuing:

- (a) if default is made in the payment of any principal or interest due in respect of the Notes or any of them and the default continues for a period of 7 days in the case of principal or 14 days in the case of interest; or
- (b) if the Issuer fails to perform or observe any of its other obligations under these Conditions or the Trust Deed and (except in any case where the Trustee considers the failure to be incapable of remedy, when no continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days (or such longer period as the Trustee may permit) following the service by the Trustee on the Issuer of notice requiring the same to be remedied; or
- (c) if (i) any Indebtedness for Borrowed Money (as defined below) of the Issuer or any of its Material Subsidiaries becomes, or becomes capable of being declared, due and repayable prematurely by reason of an event of default (however described); (ii) the Issuer or any of its Material Subsidiaries fails to make any payment in respect of any Indebtedness for Borrowed Money when due (after the expiration of any originally applicable grace period); (iii) any security given by the Issuer or any of its Material Subsidiaries for any Indebtedness for Borrowed Money becomes enforceable; or (iv) default is made by the Issuer or any of its Material Subsidiaries in making any payment due under any guarantee and/or indemnity given by it in relation to any Indebtedness for Borrowed Money of any other person provided that no event described in this Condition 10.1I shall constitute an Event of Default unless the relevant amount of Indebtedness for Borrowed Money or other relative liability due and unpaid, either alone or when aggregated (without duplication) with other amounts of Indebtedness for Borrowed Money and/or other liabilities due and unpaid relative to all (if any) other events specified in (i) to (iv) above, amounts to at least €5,000,000 (or its equivalent in any other currency); or
- (d) if any order is made by any competent court or resolution is passed for the winding up or dissolution of the Issuer or any of its Material Subsidiaries, save for the purposes of (i) reorganisation on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders; or (ii) (in the case of a Material Subsidiary only) a Permitted Reorganisation; or
- (e) if the Issuer or any of its Material Subsidiaries ceases to carry on the whole or a substantial part of its business, save for the purposes of (i) a reorganisation on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders or (ii) a Permitted Reorganisation, or the Issuer or any of its Material Subsidiaries stops payment of, or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or

- (f) if (i) proceedings are initiated against the Issuer or any of its Material Subsidiaries under any applicable liquidation, insolvency, composition, reorganisation or other similar laws or an application is made (or documents filed with a court) for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Issuer or any of its Material Subsidiaries or, as the case may be, in relation to the whole or any part of the undertaking or assets of any of them or an encumbrancer takes possession of the whole or any part of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against the whole or any part of the undertaking or assets of any of them, and (ii) in any such case (other than the appointment of an administrator) unless initiated by the relevant company, is not discharged within 45 days; or
- (g) if the Issuer or any of its Material Subsidiaries (or their respective directors or shareholders) initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws (including the obtaining of a moratorium) or, in each case save for the purposes of a Permitted Reorganisation, makes a conveyance or assignment for the benefit of, or enters into any composition with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for a composition with its creditors generally (or any class of its creditors); or
- (h) if any event occurs which, under the laws of any Relevant Jurisdiction, has or may have, in the Trustee's opinion, an analogous effect to any of the events referred to in subparagraphs (d) to (g) above.

For the purposes of this Condition:

**"Indebtedness for Borrowed Money"** means any indebtedness (whether being principal, premium, interest or other amounts) for or in respect of any notes, bonds, debentures, debenture stock, loan stock or other securities or any borrowed money or any liability under or in respect of any acceptance or acceptance credit;

**"Permitted Reorganisation"** means (a) an Ownership Unbundling Event or (b) a Permitted Unbundling Event; and

**"Permitted Unbundling Event"** means any reorganisation of the holding of the Regulated Assets in the Group pursuant to or in accordance with any order or act of a Governmental Authority implementing Directive 2009/72/EC in the Republic of Croatia following the consummation of which any member of the Group continues to own the Regulated Assets.

## 11. ENFORCEMENT

- 11.1 The Trustee may at any time, at its discretion and without notice, take such proceedings and/or other steps or action (including lodging an appeal in any proceedings) against or in relation to the Issuer as it may think fit to enforce the provisions of the Trust Deed and the Notes or otherwise, but it shall not be bound to take any such proceedings or any other action or steps in relation to the Trust Deed or the Notes unless (a) it shall have been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-quarter in principal amount of the Notes then outstanding, and (b) it shall have been indemnified and/or secured and/or pre-funded to its satisfaction.
- 11.2 The Trustee may refrain from taking any action in any jurisdiction if the taking of such action in that jurisdiction would, in its opinion based upon legal advice in the relevant jurisdiction, be contrary to any law of that jurisdiction. Furthermore, the Trustee may also refrain from taking such action if it would otherwise render it liable to any person in that jurisdiction or if,



in its opinion based upon such legal advice, it would not have the power to do the relevant thing in that jurisdiction by virtue of any applicable law in that jurisdiction or if it is determined by any court or other competent authority in that jurisdiction that it does not have such power.

- 11.3** No Noteholder shall be entitled to (i) take any steps or action against the Issuer to enforce the performance of any of the provisions of the Trust Deed or the Notes or (ii) take any other proceedings (including lodging an appeal in any proceedings) in respect of or concerning the Issuer unless the Trustee, having become bound so to take any such action, steps or proceedings, fails so to do within a reasonable period and the failure shall be continuing.

## **12. REPLACEMENT OF CERTIFICATES**

If any Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the relevant Registrar or any Agent upon payment by the holder of such Certificate of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

## **13. NOTICES**

### **13.1 Notices to the Noteholders**

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the register of Noteholders maintained by the relevant Registrar or if the Certificates are held in a clearing system, may be given through the clearing system in accordance with its standard rules and procedures and, in each case and so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require, published via the website of the Luxembourg Stock Exchange ([www.bourse.lu](http://www.bourse.lu)). The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

### **13.2 Notices from the Noteholders**

Notices to be given by any Noteholder shall be in writing and given by lodging the same, together with the relative Certificate, with the relevant Registrar or if the Certificates are held in a clearing system, may be given through the clearing system in accordance with its standard rules and procedures.

## **14. MEETINGS OF NOTEHOLDERS, MODIFICATION, WAIVER AND AUTHORISATION**

### **14.1 Meetings of Noteholders**

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than 50% in principal amount of the Notes for the time being outstanding, or at any adjourned such meeting one or more persons present whatever the principal amount of the Notes held or represented by him or them, except that at any meeting the business of which includes any matter defined in the Trust Deed as a Reserved Matter, the necessary quorum for passing an Extraordinary Resolution will be one or more persons present holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, of the principal amount of the Notes for the time being

outstanding. The Trust Deed provides that (i) a resolution passed at a meeting duly convened and held in accordance with the Trust Deed by a majority consisting of not less than three-fourths of the votes cast on such resolution, (ii) a resolution in writing signed by or on behalf of the holders of not less than three-fourths in principal amount of the Notes for the time being outstanding or (iii) consent given by way of electronic consents through the relevant clearing system(s) (in a form satisfactory to the Trustee) by or on behalf of the holders of not less than three-fourths in principal amount of the Notes for the time being outstanding, shall, in each case, be effective as an Extraordinary Resolution of the Noteholders. The Trust Deed does not contain any provisions requiring higher quorums in any circumstances. An Extraordinary Resolution passed by the Noteholders will be binding on all Noteholders, whether or not they are present at any meeting and whether or not they voted on the resolution.

#### **14.2 Modification, Waiver, Authorisation and Determination**

The Trustee may without the consent or sanction of the Noteholders at any time and from time to time concur with the Issuer in making any modification (a) to the Trust Deed, the Notes or the Agency Agreement which in the opinion of the Trustee it may be proper to make PROVIDED THAT the Trustee is of the opinion that such modification is not materially prejudicial to the interests of the Noteholders or (b) to the Trust Deed, the Notes or the Agency Agreement if in the opinion of the Trustee such modification is of a formal, minor or technical nature or to correct a manifest error or an error which is, in the opinion of the Trustee, proven. The Trustee may without the consent or sanction of the Noteholders and without prejudice to its rights in respect of any subsequent breach, Event of Default or Potential Event of Default from time to time and at any time but only if and in so far as in its opinion the interests of the Noteholders shall not be materially prejudiced thereby waive or authorise any breach or proposed breach by the Issuer of any of the covenants or provisions contained in these Conditions or determine that any Event of Default or Potential Event of Default shall not be treated as such.

#### **14.3 Trustee to have Regard to Interests of Noteholders as a Class**

In connection with the exercise by it of any of its trusts, powers, authorities and discretions under the Trust Deed and these Conditions (including, without limitation, any modification, waiver, authorisation or determination), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 8 and/or any undertaking given in addition to, or in substitution for, Condition 8 pursuant to the Trust Deed.

#### **14.4 Notification to the Noteholders**

Any modification, abrogation, waiver or authorisation shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any modification shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 13.

### **15. PROVISION OF INFORMATION**

The Issuer shall, during any period in which it is not subject to or in compliance with the reporting requirements of Section 13 or 15(d) of the United States Securities Exchange Act of

1934, as amended (the “**Exchange Act**”) nor exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, duly provide to any holder of a Note which is a “restricted security” within the meaning of Rule 144(a)(3) under the Securities Act or to any prospective purchaser of such securities designated by such Noteholder, upon the written request of such Noteholder or (as the case may be) prospective Noteholder addressed to the Issuer and delivered to the Issuer or to the Specified Office of the relevant Registrar, the information specified in Rule 144A(d)(4) under the Securities Act.

## **16. INDEMNIFICATION OF THE TRUSTEE AND THE TRUSTEE CONTRACTING WITH THE ISSUER**

### **16.1 Indemnification of the Trustee**

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility and liability towards the Issuer and the Noteholders, including (i) provisions relieving it from taking action unless indemnified and/or secured and/or pre-funded to its satisfaction and (ii) provisions limited or excluding its liability in certain circumstances. The Trust Deed provides that, when determining whether an indemnity or any security or pre-funding is satisfactory to it, the Trustee shall be entitled to require that any indemnity or security given to it by the Noteholders or any of them be given on a joint and several basis and be supported by evidence satisfactory to it as to the financial standing and creditworthiness of each counterparty and/or as to the value of the security and an opinion as to the capacity, power and authority of each counterparty and/or the validity and effectiveness of the security.

### **16.2 Trustee Contracting with the Issuer**

The Trust Deed also contains provisions pursuant to which the Trustee is entitled, *inter alia*, (i) to enter into business transactions with the Issuer and/or any of the Issuer’s Subsidiaries and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer and/or any of the Issuer’s Subsidiaries, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Noteholders, and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

## **17. FURTHER ISSUES**

The Issuer is at liberty from time to time without notice to or the consent of the Noteholders to create and issue further notes or bonds (whether in bearer or registered form) either (a) having the same terms and conditions as the Notes in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the Notes and/or the further notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed or (b) upon such terms as to ranking, interest, conversion, redemption and otherwise as the Issuer may determine at the time of the issue thereof. Any further notes or bonds which are to form a single series with the Notes and/or the further notes or bonds of any series (including the Notes) constituted by the Trust Deed or any supplemental deed shall, and any other further notes or bonds may (with the consent of the Trustee), be constituted by a deed supplemental to the Trust Deed. The Trust Deed contains provisions for convening a single meeting of the Noteholders and the holders of notes or bonds of other series in certain circumstances where the Trustee so decides.

*Noteholders should note that additional securities that are treated as a single series for non-tax purposes may be treated as a separate series for U.S. federal income tax purposes. In such case, the new securities may be considered to have been issued with original issue discount, as defined in the U.S. Internal Revenue Code of 1986, as amended, and the U.S.*

*Treasury regulations issued thereunder, which may affect the market value of the Notes since such additional securities may not be distinguishable from the Notes.*

## **18. GOVERNING LAW AND DISPUTE RESOLUTION**

### **18.1 Governing Law**

The Trust Deed and the Notes, and any non-contractual obligations arising out of or in connection with the Trust Deed and the Notes, are governed by, and will be construed in accordance with, English law.

### **18.2 Arbitration**

Subject to Condition 18.3, any dispute, claim, difference or controversy arising out of, relating to or having any connection with the Trust Deed and the Notes (including any dispute as to their existence, validity, interpretation, performance, breach or termination or the consequences of their nullity and any dispute relating to any non-contractual obligations arising out of or in connection with them) (a “**Dispute**”) shall be referred to and finally resolved by arbitration under the LCIA Arbitration Rules (the “**Rules**”), which Rules (as amended from time to time) are incorporated by reference into this Condition. For these purposes:

- (a) the seat of arbitration shall be London;
- (b) there shall be three arbitrators, each of whom shall be disinterested in the arbitration, shall have no connection with any party thereto, one of whom shall be nominated by the Claimant(s), one by the Respondent(s) and the third of whom, who shall act as Chairman, shall be nominated by the two party-nominated arbitrators, provided that if the third arbitrator has not been nominated within thirty days of the nomination of the second party-nominated arbitrator, such third arbitrator shall be appointed by the LCIA Court. The parties may nominate and the LCIA Court may appoint arbitrators from among the nationals of any country, whether or not a party is a national of that country; and
- (c) the language of the arbitration shall be English.

### **18.3 Court of Law**

Notwithstanding Condition 18.2 above, any Noteholder may, in the alternative, and at its sole discretion, by notice in writing to the Issuer:

- (a) within 28 days of service of a Request for Arbitration (as defined in the Rules); or
- (b) in the event no arbitration is commenced within 28 days of service of a Request for Arbitration (as defined in the Rules),

require that a Dispute be heard by a court of law (subject to Condition 18.4 below). If any Noteholder gives such notice, the Dispute to which such notice refers shall be determined in accordance with Condition 18.4 and, subject as provided below, any arbitration commenced under Condition 18.2 in respect of that Dispute will be terminated. Each of the parties to the terminated arbitration will bear its own costs in relation thereto.

If any notice to terminate is given after service of any Request for Arbitration in respect of any Dispute, the relevant Noteholder must also promptly give notice to the LCIA Court and to any Tribunal (each as defined in the Rules) already appointed in relation to the Dispute that such Dispute will be settled by the courts. Upon receipt of such notice by the LCIA Court, the arbitration and any appointment of any arbitrator in relation to such Dispute will immediately terminate. Any such arbitrator will be deemed to be *functus officio*. The termination is without prejudice to:

- (a) the validity of any act done or order made by that arbitrator or by the court in support of that arbitration before his appointment is terminated;
- (b) his entitlement to be paid his proper fees and disbursements; and
- (c) the date when any claim or defence was raised for the purpose of applying any limitation bar or any similar rule or provision.

#### **18.4 Jurisdiction of the English courts**

In the event that a notice pursuant to Condition 18.3 is issued, the following provisions shall apply:

- (a) subject to paragraph (c) below, the courts of England shall have exclusive jurisdiction to settle any Dispute and the Issuer submits to the exclusive jurisdiction of such courts;
- (b) the Issuer agrees that the courts of England are the most appropriate and convenient courts to settle any Dispute and, accordingly, that it will not argue to the contrary; and
- (c) this Condition 18.4 is for the benefit of the Trustee and the Noteholders only. As a result, and notwithstanding Condition 18.4(a) above, the Trustee and the Noteholders may take any suit, action or proceeding relating to a Dispute (“**Proceedings**”) in any other court of competent jurisdiction. To the extent allowed by law, the Trustee and the Noteholders may take concurrent Proceedings in any number of jurisdictions.

#### **18.5 Appointment of Process Agent**

The Issuer has, in the Trust Deed, irrevocably and unconditionally appointed Law Debenture Corporate Services Limited of Fifth Floor, 100 Wood Street, London EC2V 7EX, United Kingdom at its registered office for the time being as its agent for service of process in England in respect of any Proceedings and have undertaken that in the event of such agent ceasing so to act it will appoint such other person as the Trustee may approve as its agent for that purpose.

#### **18.6 Sovereign Immunity and Enforcement**

The Issuer has in the Trust Deed, to the fullest extent permitted by law, irrevocably and unconditionally with respect to any Proceedings (i) waived any right to claim sovereign or other immunity from jurisdiction, recognition or execution and any similar argument in any jurisdiction and (ii) consented to the giving of any relief (whether by way of injunction, attachment, specific performance or other relief) or the issue of any related process in any jurisdiction, whether before or after final judgment, including without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order, judgment or award in connection with any Proceedings or Disputes.

Under the Trust Deed, the Issuer has agreed that an arbitral award or judgment or order of an English or other court in connection with any Dispute shall be binding on it and may be enforced against it in the courts of any competent jurisdiction. For the purposes of the foregoing, in respect of any proceedings arising out of or connected with the enforcement

and/or execution of any award or judgment made against the Issuer, the Issuer has expressly submitted under the Trust Deed to the jurisdiction of any court in which any such proceedings are brought.

**19. RIGHTS OF THIRD PARTIES**

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

## THE GLOBAL CERTIFICATES

*The Global Certificates contain the following provisions which apply to the Notes in respect of which they are issued whilst they are represented by the Global Certificates, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 6 below.*

### 1. ACCOUNTHOLDERS

For so long as any of the Notes are represented by a Global Certificate, each person (other than another clearing system) who is for the time being shown in the records of DTC, Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Notes (each an “**Accountholder**”) (in which regard any certificate or other document issued by DTC, Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Notes standing to the account of any person shall, in the absence of manifest error, be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Notes and, in the case of DTC or its nominee, voting, giving consents and making requests pursuant to the Trust Deed, (and the expression “**Noteholders**” and references to “**holding of Notes**” and to “**holder of Notes**” shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Issuer and the Trustee, solely in the nominee for the relevant clearing system (the “**Relevant Nominee**”) in accordance with and subject to the terms of the relevant Global Certificate. Each Accountholder must look solely to DTC, Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Relevant Nominee.

### 2. CANCELLATION

Cancellation of any Note following its redemption or purchase by the Issuer or any of its Subsidiaries will be effected by reduction in the aggregate principal amount of the Notes in the relevant register of Noteholders and by the annotation of the appropriate schedule to the relevant Global Certificate.

### 3. PAYMENTS

Payments of principal and interest in respect of Notes represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the relevant Notes, against presentation and surrender of such Global Certificate to or to the order of the relevant Registrar or such other Agent as shall have been notified to the holders of the relevant Global Certificate for such purpose.

Distributions of amounts with respect to book-entry interests in the Regulation S Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the relevant Registrar, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant clearing system’s rules and procedures.

Holders of book-entry interests in the Rule 144A Notes held through DTC will receive, to the extent received by the relevant Registrar, all distributions of amounts with respect to book-entry interests in such Notes from the relevant Registrar through DTC. Distributions in the United States will be subject to U.S. tax laws and regulations.

A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Certificate by or on behalf of the relevant Registrar and shall be *prima facie* evidence that payment has been made.

#### 4. NOTICES

So long as the Notes are represented by a Global Certificate or Global Certificates and such Global Certificate(s) is/are held on behalf of a clearing system or clearing systems, notices to Noteholders may be given by delivery of the relevant notice to the relevant clearing system(s) for communication by it/them to entitled Accountholders in substitution for notification as required by Condition 13 except that, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require, notices shall also be published in a daily newspaper having general circulation in Luxembourg (which is expected to be the *Luxembourg Wort* or the *Tageblatt*) and/or via the website of the Luxembourg Stock Exchange ([www.bourse.lu](http://www.bourse.lu)). Any such notice shall be deemed to have been given to the Noteholders on the second day after the day on which such notice is delivered to the relevant clearing system(s) as aforesaid.

Whilst any of the Notes held by a Noteholder are represented by a Global Certificate, notices to be given by such Noteholder may be given by such Noteholder (where applicable) through Euroclear or Clearstream, Luxembourg or DTC (as applicable) and otherwise in such manner as the Trustee and Euroclear or Clearstream, Luxembourg or DTC (as applicable) may approve for this purpose.

#### 5. REGISTRATION OF TITLE

Registration of title to Notes in a name other than that of the Relevant Nominee will not be permitted unless Euroclear or Clearstream, Luxembourg or DTC, as applicable notifies the Issuer that it is unwilling or unable to continue as a clearing system in connection with a Global Certificate or, in the case of DTC only, DTC ceases to be a clearing agency registered under the U.S. Securities Exchange Act of 1934, and in each case a successor clearing system approved by the Trustee is not appointed by the Issuer within 90 days after receiving such notice from Euroclear, Clearstream, Luxembourg or DTC or becoming aware that DTC is no longer so registered (as applicable). In these circumstances title to a Note may be transferred into the names of holders notified by the Relevant Nominee in accordance with the Conditions, except that Certificates in respect of Notes so transferred may not be available until 21 days after the request for transfer is duly made.

The Registrars will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 15 calendar days preceding the due date for any payment of principal, premium (if any) or interest in respect of the Notes.

If only one of the Global Certificates (the “**Exchanged Global Certificate**”) becomes exchangeable for Certificates in accordance with the above paragraphs, transfers of Notes may not take place between, on the one hand, persons holding Certificates issued in exchange for beneficial interests in the Exchanged Global Certificate and, on the other hand, persons wishing to purchase beneficial interests in the other Global Certificate.

#### 6. TRANSFERS

Transfers of book-entry interests in the Notes will be effected through the records of Euroclear, Clearstream, Luxembourg and DTC and their respective participants in accordance with the rules and procedures of Euroclear, Clearstream, Luxembourg and DTC and their respective direct and indirect participants, as more fully described under “*Clearing and Settlement Arrangements*”. For additional transfer restrictions, see “*Transfer Restrictions*”.



## TAXATION

This is a general summary of certain United States Federal, Luxembourg and Croatian income tax considerations in connection with an investment in the Notes. This summary does not address all aspects of United States Federal, Luxembourg and Croatian income tax laws and does not discuss any state or local tax considerations. While this summary is considered to be a correct interpretation of existing laws in force on the date of this Offering Circular, there can be no assurance that those laws or the interpretation of those laws will not change. This summary does not discuss all of the income tax consequences that may be relevant to an investor in light of such investor's particular circumstances or to investors subject to special rules, such as regulated investment companies, certain financial institutions or insurance companies. Prospective investors are advised to consult their tax advisers with respect to the tax consequences of the purchase, ownership or disposition of the Notes (or the purchase, ownership or disposition of beneficial interests therein) as well as any tax consequences that may arise under the laws of any state, municipality or other taxing jurisdiction.

### **Certain U.S. Federal Income Tax Consequences**

The following is a summary of certain U.S. federal income tax consequences of the acquisition, ownership, retirement or other disposition of Notes by a U.S. Holder (as defined below). This description only applies to Notes held as capital assets by a U.S. Holder and does not address, except as set forth below, aspects of U.S. federal income taxation that may be applicable to holders that are subject to special tax rules, such as:

- financial institutions;
- insurance companies;
- real estate investment trusts;
- regulated investment companies;
- grantor trusts;
- tax-exempt organisations;
- persons that will own Notes through partnerships or other pass-through entities;
- dealers or traders in securities or currencies;
- certain former citizens or long-term residents of the United States;
- holders that will hold a Note as part of a position in a straddle or as part of a hedging, conversion or integrated transaction for U.S. federal income tax purposes; or
- holders that have a functional currency other than the U.S. dollar.

Moreover, this description does not address the U.S. federal estate and gift tax or alternative minimum tax consequences of the acquisition, ownership, retirement or other disposition of Notes and does not address the U.S. federal income tax treatment of holders that do not acquire Notes as part of the initial distribution at their initial issue price, including the purchasers of additional Notes. The "issue price" of a Note is generally equal to the first price at which a substantial amount of Notes are sold for money to investors (excluding sales to bond houses, brokers or similar persons or organisations acting in the capacity of underwriters, placement agents or wholesalers). Each prospective purchaser should consult its tax adviser with respect to the U.S. federal, state, local and non U.S. tax consequences of acquiring, holding and disposing of Notes.

This description is based on the Internal Revenue Code of 1986, as amended ("**Code**") existing and proposed U.S. Treasury Regulations ("**Regulations**") administrative pronouncements and judicial decisions, each as available and in effect on the date hereof. All of the foregoing is subject to change,

possibly with retroactive effect, or differing interpretations which could affect the tax consequences described herein.

For purposes of this description, a U.S. Holder is a beneficial owner of Notes who, for U.S. federal income tax purposes, is:

- an individual who is a citizen or resident of the United States;
- a corporation (or any other entity that is treated as a corporation for U.S. federal income tax purposes) organised in or under the laws of the United States, any State thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust (1) that has a valid election in effect to be treated as a U.S. person for U.S. federal income tax purposes or (2) (a) the administration over which a U.S. court can exercise primary supervision and (b) all of the substantial decisions of which one or more U.S. persons have the authority to control.

If a partnership (or any other entity treated as a partnership for U.S. federal income tax purposes) holds Notes, the tax treatment of the partnership and a partner in such partnership generally will depend on the status of the partner and the activities of the partnership. Such partner or partnership should consult its own tax adviser as to its consequences.

#### *Interest*

It is expected and this discussion assumes that either the issue price of the Notes will equal the stated principal amount of the Notes or the Notes will be issued with no more than a *de minimis* amount of Original Issue Discount (“**OID**”). Therefore, interest paid to a U.S. Holder on a Note, including any additional amounts with respect thereto as described under “*Conditions of the Notes—Taxation*”, will be includible in such holder’s gross income as ordinary interest income in accordance with such holder’s usual method of tax accounting. In addition, interest on the Notes will be treated as foreign source income for U.S. federal income tax purposes.

In certain circumstances (see “*Conditions of the Notes—Redemption and Purchase*”), the Issuer may be obligated to pay amounts in excess of stated interest or principal on the Notes. Under the contingent payment debt instrument Regulations (“**CPDI Regulations**”), the possibility of a contingent payment on a Note may be disregarded if the likelihood of the contingent payment, as of the issue date, is remote or incidental. The Issuer believes that, as of the expected issue date of the Notes, the likelihood that the Issuer will be obligated to make any such payment is purpose remote and, therefore, the Issuer does not intend to treat the Notes as contingent payment debt instruments (“**CPDIs**”). This determination, however, is not binding on the Internal Revenue Service, and if the IRS were to challenge this determination, a U.S. Holder may be required to accrue income on the Notes that such holder owns in excess of stated interest, and to treat as ordinary income rather than capital gain any income realised on the taxable disposition of such Notes before the resolution of the contingency. In the event that such contingency were to occur, it would affect the amount and timing of the income that a U.S. Holder recognises. U.S. Holders are urged to consult their tax advisers regarding the potential application to the Notes of the CPDI rules and the consequences thereof. This discussion assumes that the Notes will not be treated as CPDIs.

#### *Sale, Exchange, Retirement or Other Disposition*

Upon the sale, exchange, retirement or other disposition of a Note, a U.S. Holder will recognise taxable gain or loss equal to the difference, if any, between the amount realised on the sale, exchange, retirement or other disposition, other than accrued but unpaid interest which will be taxable as interest, and such U.S. Holder’s adjusted tax basis in the Note. A U.S. Holder’s adjusted tax basis in a Note generally will equal the cost of the Note to such holder, and any such gain or loss will be capital

gain or loss. For a non-corporate U.S. Holder, the maximum marginal U.S. federal income tax rate applicable to the gain will be lower than the maximum marginal U.S. federal income tax rate applicable to ordinary income (other than certain dividends) if such U.S. Holder's holding period for the Notes exceeds one year (i.e., such gain is long-term capital gain). Any gain or loss realized on the sale, exchange, retirement or other disposition of a Note generally will be treated as U.S. source gain or loss, as the case may be.

#### *U.S. Backup Withholding Tax and Information Reporting*

A backup withholding tax and information reporting requirements apply to certain payments of principal of, and interest on, an obligation and to proceeds of the sale or redemption of an obligation, to certain U.S. Holders. Information reporting generally will apply to payments of principal of, and interest on, Notes, and to proceeds from the sale or redemption of, Notes within the United States, or by a U.S. payor or U.S. middleman, to a U.S. Holder (other than an exempt recipient and certain other persons). The payor will be required to backup withhold on payments made within the United States, or by a U.S. payor or U.S. middleman, on a Note to a U.S. Holder, other than an exempt recipient, if the holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with, or establish an exemption from, the backup withholding requirements. The backup withholding tax rate is 28%.

Backup withholding is not an additional tax. A U.S. Holder generally will be entitled to credit any amounts withheld under the backup withholding rules against such holder's U.S. federal income tax liability provided the required information is furnished to the IRS in a timely manner.

#### *Further Issues*

Further notes or bonds that are treated for non-tax purposes as a single series with the Notes may be treated as part of a separate issuance for U.S. federal income tax purposes. In such a case, for U.S. federal income tax purposes, the new notes or bonds may be considered to have been issued with a different amount of original issue discount than the Notes, which may affect the market value of the Notes since such further notes or bonds may not be distinguishable from the Notes.

#### *Foreign Asset Reporting*

Certain U.S. Holders who are individuals are required to report information relating to an interest in the Notes, subject to certain exceptions (including an exception for Notes held in accounts maintained by financial institutions). U.S. Holders are urged to consult their tax advisors regarding their information reporting obligations, if any, with respect to their ownership and disposition of the Notes.

#### *Medicare Tax*

A U.S. Holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from such tax, is subject to a 3.8% tax on the lesser of (1) such U.S. Holder's "net investment income" (or undistributed "net investment income" in the case of estates and trusts) for the relevant taxable year and (2) the excess of such U.S. Holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individuals will be between \$125,000 and \$250,000, depending on the individual's circumstances). A U.S. Holder's net investment income will generally include its gross interest income and its net gains from the disposition of the Notes, unless such interest or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. Holder that is an individual, estate or trust, you are urged to consult your tax advisor regarding the applicability of this tax to your income and gains in respect of your investment in the Notes.

U.S. Holders are urged to consult their tax advisers regarding their information reporting obligations, if any, with respect to their ownership and disposition of the Notes.

**The above description is not intended to constitute a complete analysis of all tax consequences relating to the ownership and disposition of the Notes. Prospective purchasers of Notes should consult their tax advisers concerning the tax consequences of their particular situations.**

## **Republic of Croatia**

The following summary is of a general nature and is included herein solely for information purposes. The discussion describes certain material tax matters under Croatian tax law with respect to the Notes. The discussion does not purport to be a comprehensive description of all the tax considerations that may be relevant to a decision to purchase Notes. The discussion is based on the tax laws in Croatia in effect on the date of this Offering Circular, and may be subject to change during the life of the Notes. Prospective investors in the Notes should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Croatian tax law, to which they may be subject.

### ***Taxation of Interest***

No payment of interest on the Notes is subject to payment of value added tax.

Interest on the Notes (including amounts of interest realised on a sale of the Notes) received by Croatian legal entities is included in the relevant Noteholder's tax base for the purposes of corporate income tax (profit tax), which is imposed at a rate of 20%. However, the Issuer is not required to make any withholding or deduction from any payment of interest on the Notes made to any such Croatian legal entity.

Interest on the Notes received by natural persons who are taxpayers in the Republic of Croatia is not considered as 'income' and is not included in the relevant Noteholder's tax base for the purposes of income tax, and is therefore not subject to taxation.

Under current Croatian laws and regulations, the Issuer is not required to make any withholding or deduction from any payment of interest on Notes held by foreign legal entities or foreign natural persons.

### ***Taxation of Principal***

Under current Croatian laws and regulations, payments of principal on the Notes are not subject to payment of any taxes in Croatia.

### ***Taxation of Capital Gains***

Revenue realised upon any sale of the Notes, equal to the difference between the price at which the relevant Notes were sold and the price at which they were paid-up or purchased, will constitute a 'capital gain'.

Any capital gain realised by a Croatian legal entity and branches of foreign legal entities in Croatia who purchase the Notes i.e. taxpayers of corporate income tax (profit tax) in Croatia, is included in the relevant Noteholder's tax base for the purposes of corporate income tax (profit tax), which is imposed at a rate of 20%.

Any capital gain realised upon any sale of the Notes by a natural person who is tax resident in Croatia taxpayer of the income tax, will be included in the relevant Noteholder's tax base for the purposes of income tax, and is therefore a subject to taxation according to The Income Tax Act as of January 1 2016. Capital gains realised by persons other than Croatian legal entities and Croatian tax-resident natural persons are not subject to taxation in Croatia.

According to The Income Tax Act Official Gazette 143/14 from March 12 2014 – the holder of financial assets, a natural person who is tax resident in Croatia taxpayer of the income tax, is obliged to withheld and pay advance tax on income from capital on the basis of capital gains according the Article 30 paragraph 16 and 17 of this Act, within eight days from the day of realisation of such

capital gain and related to each individual such realized source of capital gains at the rate of 12% without recognition of the personal allowance.

However, in accordance with the transitional and final provisions of the Income Tax Act Official Gazette 143/14 from March 12 2014, part of the Act relating to the taxation of capital gains shall enter into force on January 1 2016.

#### ***Taxation upon inheritance of the Notes or receipt of the Notes as a gift***

Subject to any applicable double taxation treaty, any natural person or legal entity who inherits or receives gifts (including the Notes) with individual value higher than HRK 50,000.00 in the Republic of Croatia is under an obligation to pay Croatian tax in respect of such inheritance or gift at a rate of 5%.

Provided the Notes are received outside of the Republic of Croatia, no Croatian taxes will be payable in respect of such inheritance of gift.

#### **Luxembourg Taxation**

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Notes should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

#### ***Withholding Tax***

(i) Non-resident holders of Notes

Under Luxembourg general tax laws currently in force and subject to the laws of 21 June 2005 (the “**Laws**”) mentioned below, there is no withholding tax on payments of principal, premium or interest made to non-resident holders of Notes, nor on accrued but unpaid interest in respect of the Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Notes held by non-resident holders of Notes.

Pursuant to the law dated 25 November 2014 amending the Laws, implementing EC Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments and ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the “**Territories**”), Luxembourg adopted the automatic exchange of information as foreseen under the EU Savings Directive. Consequently, as from January 1, 2015, no withholding tax is levied under the Laws on interest payments made by a Luxembourg paying agent (as defined in the Laws) to or for the immediate benefit of an individual beneficial owner or a residual entity, which is a resident of, or established in, another EU Member State or one of the Territories.

(ii) Resident holders of Notes

Under Luxembourg general tax laws currently in force and subject to the law of 23 December 2005 (the “**Law**”) mentioned below, there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Notes, nor on accrued but unpaid interest in respect of Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Notes held by Luxembourg resident holders of Notes.

Under the Law payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 10%. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the

withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Notes coming within the scope of the Law would be subject to withholding tax of 10%.

### **EU Savings Directive**

Under the Savings Directive, EU Member States are required to provide to the tax authorities of another EU Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other EU Member State; however, for a transitional period, Austria is instead required (unless during that period Austria elects for one or of the two information exchange procedures available) to apply a withholding system in relation to such payments, deducting tax at a current rate of 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to the exchange of information relating to such payments.

A number of non-EU countries and territories including Jersey, Switzerland and the Cayman Islands have adopted similar measures (either provision of information or transitional withholding) in relation to payments of interest or similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in an EU Member State.

In addition, the EU Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments of interest or similar income paid by a person in an EU Member State to, or collected by such a person for, an individual resident or limited types of entity established in one of those territories.

If a payment were to be made or collected through Austria and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any paying agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. The Issuer is required to maintain a paying agent in an EU Member State that is not obliged to withhold or deduct tax pursuant to the Savings Directive.

On 24 March 2014, the European Council formally adopted EU Council Directive 2014/48/EU amending the EU Savings Directive (the "**Amending Directive**"). The Amending Directive broadens the scope of the requirements described above. Member States have until 1 January 2016 to adopt the national legislation necessary to comply with the Amending Directive and are required to apply these new requirements from 1 January 2017. The changes made under the Amending Directive include extending the scope of the EU Savings Directive to payments made to, or collected for, certain other entities and legal arrangements. They also broaden the definition of "interest payment" to cover income that is equivalent to interest.

However, the European Commission has proposed the repeal of the Savings Directive from 1 January 2017 in the case of Austria and from 1 January 2016 in the case of all other Member States (subject to on-going requirements to fulfil administrative obligations such as the reporting and exchange of information relating to, and accounting for withholding taxes on, payments made before those dates). This is to prevent overlap between the Savings Directive and a new automatic exchange of information regime to be implemented under Council Directive 2011/16/EU on Administrative Cooperation in the field of Taxation (as amended by Council Directive 2014/107/EU). The proposal also provides that, if it proceeds, Member States will not be required to apply the new requirements of the Amending Directive.

## CLEARING AND SETTLEMENT ARRANGEMENTS

*The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg (together, the “Clearing Systems”) currently in effect. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Issuer and any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Notes held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.*

### Clearing Systems

#### *Euroclear and Clearstream, Luxembourg*

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are worldwide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of either system.

#### *DTC*

DTC has advised the Issuer that it is a limited purpose trust company organised under the New York Banking Law, a “banking organisation” within the meaning of the New York Banking Law, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to Section 17A of the Exchange Act. DTC holds securities that its participants deposit with DTC. DTC also facilitates the settlement among its participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerised book-entry changes in participants’ accounts. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a direct participant, either directly or indirectly.

### Registration and Form

Book-entry interests in the Regulation S Notes held through Euroclear and Clearstream, Luxembourg will be represented by the Unrestricted Global Certificate registered in the name of a nominee of, and held by, a common depository for Euroclear and Clearstream, Luxembourg. Book-entry interests in the Rule 144A Notes held through DTC will be represented by the Restricted Global Certificate registered in the name of Cede & Co., as nominee for DTC, and held by a custodian for DTC. As necessary, the Registrars will adjust the amounts of Notes on each Register for the accounts of Euroclear, Clearstream, Luxembourg and DTC to reflect the amounts of Notes held through Euroclear, Clearstream, Luxembourg and DTC, respectively. Beneficial ownership of book-entry interests in Notes will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream, Luxembourg and DTC.

The aggregate holdings of book-entry interests in the Notes in Euroclear, Clearstream, Luxembourg and DTC will be reflected in the book-entry accounts of each such institution. Euroclear,

Clearstream, Luxembourg or DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the Notes, will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the Notes. The Registrar which maintains the Register of Notes held through DTC will be responsible for maintaining a record of the aggregate holdings of Notes registered in the name of a nominee for DTC, and the Registrar which maintains the Register of Notes held through Euroclear and Clearstream, Luxembourg will be responsible for maintaining a record of the aggregate holdings of Notes registered in the name of a common nominee for Euroclear and Clearstream, Luxembourg, and/or, in each case if individual Certificates are issued in the limited circumstances described under “*The Global Certificates—Registration of Title*”, holders of Notes represented by those individual Certificates. The Principal Paying Agent will be responsible for ensuring that payments received by it from the Issuer for holders of book-entry interests in the Notes holding through Euroclear and Clearstream, Luxembourg are credited to Euroclear or Clearstream, Luxembourg, as the case may be, and the Principal Paying Agent will also be responsible for ensuring that payments received by the Principal Paying Agent from the Issuer for holders of book-entry interests in the Notes holding through DTC are credited to DTC.

The Issuer will not impose any fees in respect of holding the Notes; however, holders of book-entry interests in the Notes may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream, Luxembourg or DTC.

## **Clearing and Settlement Procedures**

### *Initial Settlement*

Upon their original issue, the Notes will be in global form represented by the two Global Certificates. Interests in the Notes will be in uncertified book-entry form. Purchasers electing to hold book-entry interests in the Notes through Euroclear and Clearstream, Luxembourg accounts will follow the settlement procedures applicable to conventional Eurobonds. Book-entry interests in the Notes will be credited to Euroclear and Clearstream, Luxembourg participants’ securities clearance accounts on the business day following the Closing Date against payment (value the Closing Date). DTC participants acting on behalf of purchasers electing to hold book-entry interests in the Notes through DTC will follow the delivery practices applicable to securities eligible for DTC’s Same Day Funds Settlement system. DTC participants’ securities accounts will be credited with book-entry interests in the Notes following confirmation of receipt of payment to the Issuer on the Closing Date.

### *Secondary Market Trading*

Secondary market trades in the Notes will be settled by transfer of title to book-entry interests in the Clearing Systems. Title to such book-entry interests will pass by registration of the transfer within the records of Euroclear or Clearstream, Luxembourg or DTC, as the case may be in accordance with their respective procedures. Book-entry interests in the Notes may be transferred within Euroclear and within Clearstream, Luxembourg and between Euroclear and Clearstream, Luxembourg in accordance with procedures established for these purposes by Euroclear and Clearstream, Luxembourg. Book-entry interests in the Notes may be transferred within DTC in accordance with procedures established for this purpose by DTC. Transfer of book-entry interests in the Notes between Euroclear or Clearstream, Luxembourg and DTC may be effected in accordance with procedures established for this purpose by Euroclear, Clearstream, Luxembourg and DTC.

## **General**

Neither Euroclear, Clearstream, Luxembourg or DTC is under any obligation to perform or continue to perform the procedures referred to above, and such procedures may be discontinued at any time.

Neither the Issuer, the Trustee or any of their agents will have any responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective participants of their respective



obligations under the rules and procedures governing their operations or the arrangements referred to above.

## SUBSCRIPTION AND SALE

Each of Banca IMI S.p.A, Morgan Stanley & Co. International plc and UniCredit Bank AG (together, the “**Joint Lead Managers**”) has, pursuant to a subscription agreement entered into with the Issuer dated 22 October 2015 (the “**Subscription Agreement**”), severally agreed to subscribe or procure subscribers for the respective principal amount of Notes set out opposite its name below, subject to the provisions of the Subscription Agreement:

Name of Joint Lead Manager	Amount of Notes
Banca IMI S.p.A .....	U.S.\$183,333,000
Morgan Stanley & Co. International plc .....	U.S.\$183,334,000
UniCredit Bank AG .....	U.S.\$183,333,000
<b>Total</b> .....	U.S.\$550,000,000

The Issuer has been informed that the Joint Lead Managers propose to resell the Notes at the offering price set forth on the cover page of this Offering Circular within the United States to persons reasonably believed to be QIBs in reliance upon Rule 144A, and to persons other than U.S. persons outside the United States in reliance upon Regulation S. See “*Transfer Restrictions*”. The price at which the Notes are offered may be changed at any time without notice. The Issuer will also reimburse the Joint Lead Managers in respect of certain of their expenses, and has agreed to indemnify the Joint Lead Managers and their controlling persons against certain liabilities (including liabilities under the Securities Act), incurred in connection with the issue of the Notes. The Subscription Agreement may be terminated in certain circumstances prior to payment of the issue price to the Issuer.

The Notes are a new issue of securities for which there currently is no market. The Issuer cannot provide assurance that the prices at which the Notes will sell in the market after this offering will not be lower than the initial offering price or that an active trading market for the Notes will develop and continue after this offering. Certain of the Joint Lead Managers have advised the Issuer that following the completion of the offering of the Notes, they intend to make a market in the Notes. They are not obligated to do so, however, and any market-making activities with respect to the Notes may be discontinued at any time at their sole discretion without notice. In addition, such market-making activity will be subject to the limits imposed by the Securities Act and the Exchange Act. Accordingly, the Issuer cannot give any assurance as to the development of any market or the liquidity of any market for the Notes.

In connection with the offering of the Notes, the Joint Lead Managers may engage in over-allotment, stabilising transactions and syndicate covering transactions. Over-allotment involves sales in excess of the offering size, which creates a short position for the Joint Lead Managers. Stabilising transactions involve bids to purchase the Notes in the open market for the purpose of pegging, fixing or maintaining the price of the Notes. Syndicate covering transactions involve purchases of the Notes in the open market after the distribution has been completed in order to cover short positions. Any of these activities may prevent a decline in the market price of the Notes, and may also cause the price of the Notes to be higher than it would otherwise be in the absence of these transactions. The Joint Lead Managers may conduct these transactions in the over-the-counter market or otherwise. If the Joint Lead Managers commence any of these transactions, they may discontinue them at any time.

Certain of the Joint Lead Managers and their affiliates have performed certain investment and commercial banking or financial advisory services for the Issuer and its affiliates from time to time, for which they have received customary fees and commissions, and they expect to provide these services to the Issuer and its affiliates in the future, for which they expect to receive customary fees and commissions. Certain of the Joint Lead Managers and their affiliates acted as, and will continue to act as, arrangers, agents and/or other lenders under the Group’s loan agreements (see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Long-Term Loan Agreements*” and “*—Short-Term Loan Agreements*”), and in such capacity, may

receive a portion of the net proceeds from this offering used to repay borrowings outstanding under the Group's loan agreements.

In addition, in the ordinary course of their business activities, the Joint Lead Managers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Issuer or its affiliates. If the Joint Lead Managers or their affiliates have a lending relationship with the Issuer, they routinely hedge their credit exposure to the Issuer consistent with their customary risk management policies. Typically, the Joint Lead Managers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in the Issuer's securities, including potentially the Notes. Any such short positions could adversely affect future trading prices of the Notes. The Joint Lead Managers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

### **United States**

The Notes have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to, or for the account or benefit of, a U.S. person except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (a) outside the United States to persons other than U.S. persons as defined in Regulation S in offshore transactions in reliance on, and in compliance with, Regulation S and (b) in the United States to a limited number of QIBs as defined in the Securities Act in connection with resales by the Joint Lead Managers, in reliance on, and in compliance with, Rule 144A.

Each Joint Lead Manager has represented and agreed that it has offered and sold, and will offer and sell, the Notes (a) as part of its distribution at any time and (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S or Rule 144A. Accordingly, neither such Joint Lead Manager nor its affiliates, nor any persons acting on its or their behalf, have engaged or will engage in any directed selling efforts (as defined in Regulation S) with respect to the Notes, and such Joint Lead Manager, its affiliates and all persons acting on its or their behalf have complied and will comply with the offering restrictions requirement of Regulation S. Each Joint Lead Manager has agreed that, at or prior to confirmation of sale of the Notes (other than a sale pursuant to Rule 144A), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases the Notes from it during the restricted period a confirmation or notice to substantially the following effect:

*"The Notes covered hereby have not been registered under the U.S. Securities Act of 1933, as amended (the "U.S. Securities Act") and may not be offered and sold within the United States or to, or for the account or benefit of, U.S. persons (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, except in either case in accordance with Regulation S or Rule 144A under the U.S. Securities Act. Terms used above have the meanings given to them by Regulation S."*

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

## **United Kingdom**

Each Joint Lead Manager has represented and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

## **Republic of Croatia**

Each Joint Lead Manager has represented and agreed that it will only offer and sell the Notes, and it will only distribute this Offering Circular and any other offering material in relation to the Notes, in the Republic of Croatia to persons who are qualified investors (*kvalificirani ulagatelji*) within the meaning of Article 343, point 6 of the Capital Market Act (Official Gazette of the Republic of Croatia Narodne novine Nos. 88/2008, 146/2008, 74/2009, 54/2013, 159/2013 and 18/2015) (the “Capital Market Act” *Zakon o tržištu kapitala*). The definition of the “qualified investors” under the above-mentioned provision of the Capital Market Act corresponds in its material scope to the definition of the same term under the Prospectus Directive. Any offer, sale, or resale of the Notes in Croatia may only be made in accordance with the Capital Market Act and other applicable laws. The Issuer does not intend to file a securities prospectus with the Croatian Financial Services Supervisory Agency, and accordingly, the Notes may not be, and are not being to, offered or advertised publicly in Croatia.

## **General**

No action has been taken or will be taken in any jurisdiction by the Issuer or any of the Joint Lead Managers that would, or is intended to, permit a public offer of the Notes or possession or distribution of this Offering Circular or any other offering material in any country or jurisdiction where any such action for that purpose is required. Persons into whose hands this Offering Circular comes are required by the Issuer and the Joint Lead Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Offering Circular or any other offering material relating to the Notes, in all cases at their own expense.

## TRANSFER RESTRICTIONS

Because the following restrictions will apply with respect to the Notes, purchasers of the Notes are advised to consult legal counsel prior to making an offer, resale, pledge or transfer of any of the Notes.

The Issuer has not registered the Notes under the Securities Act or the laws of any state securities commission and, therefore, the Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (1) to QIBs, in compliance with Rule 144A under the Securities Act and (2) to persons other than U.S. persons outside the United States in compliance with Regulation S under the Securities Act.

By its purchase of Notes, each purchaser of Notes will be deemed to have acknowledged, represented and agreed with the Joint Lead Managers and the Issuer as follows:

1. that the Notes have not been registered under the Securities Act or any other applicable securities law and that the Notes are being offered for resale in transactions not requiring registration under the Securities Act or any other securities law, including sales pursuant to Rule 144A under the Securities Act, and, unless so registered, may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities law, or pursuant to an exemption therefrom or in a transaction not subject thereto, and in each case in compliance with the conditions for transfer set forth in paragraph (4) below.
2. it is not an “**affiliate**” (as defined in Rule 144 under the Securities Act) of the Issuer and it is not acting on the Issuer’s or their behalf and it is either (i) a QIB and is aware that any sale of Notes to it will be made in reliance on Rule 144A and such acquisition will be for its own account or for the account of another QIB or (ii) not a “**U.S. person**” (as defined in Regulation S under the Securities Act) or purchasing for the account or benefit of a U.S. person (other than a distributor) and it is purchasing Notes in an offshore transaction in accordance with Regulation S under the Securities Act.
3. that none of the Issuer or the Joint Lead Managers, or any person representing the Issuer or the Joint Lead Managers, has made any representation to it with respect to the Issuer or the offer or sale of any of the Notes, other than the information contained in this Offering Circular, which has been delivered to it and upon which it is relying in making its investment decision with respect to the Notes. It acknowledges that the Joint Lead Managers make no representation or warranty as to the accuracy or completeness of this Offering Circular. It has had access to such financial and other information concerning the Issuer and the Notes as it has deemed necessary in connection with its decision to purchase the Notes, including an opportunity to ask questions of and request information from the Issuer and the Joint Lead Managers.
4. it is purchasing the Notes for its own account, or for one or more investor accounts for which it is acting as a fiduciary or agent, in each case for investment, and not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act. It agrees on its own behalf and on behalf of any investor account for which it is purchasing Notes, and each subsequent holder of the Notes by its acceptance thereof will agree, to offer, sell or otherwise transfer such Notes prior to (x), the date which is one year (or such shorter period of time as permitted by Rule 144 under the Securities Act or any successor provision thereunder) after the later of the date of the original issue of the Notes and the last date on which the Issuer or any affiliate of the Issuer was the owner of such Notes (or any predecessor thereto), or (y), such later date, if any, as may be required by applicable law (the “**Resale Restriction Termination Date**”), only (a) to the Issuer, (b) pursuant to a registration statement which has been declared effective under the Securities Act, (c) for so long as the

Notes are eligible for resale pursuant to Rule 144A, to a person it reasonably believes is a QIB that purchases for its own account or for the account of another QIB to whom it gives notice that the transfer is being made in reliance on Rule 144A, (d) in an offshore transaction complying with Rule 903 or 904 of Regulation S under the Securities Act, or I pursuant to any other available exemption from the registration requirements of the Securities Act, subject in each of the foregoing cases to compliance with any applicable state securities laws. The foregoing restrictions on resale will not apply subsequent to the Resale Restriction Termination Date. It acknowledges that the Issuer reserves the right prior to any offer, sale or other transfer of the Notes pursuant to clause (d) or I above, to require the delivery of an opinion of counsel, certifications and/or other information satisfactory to the Issuer.

Each purchaser acknowledges that each Rule 144A Note will contain a legend substantially in the following form:

THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR OTHER SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE OFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION UNLESS THE TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT.

THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT), (2) AGREES ON ITS OWN BEHALF AND ON BEHALF OF ANY INVESTOR ACCOUNT FOR WHICH IT HAS PURCHASED SECURITIES THAT IT WILL NOT PRIOR TO (X), THE DATE WHICH IS ONE YEAR (OR SUCH SHORTER PERIOD OF TIME AS PERMITTED BY RULE 144 UNDER THE SECURITIES OR ANY SUCCESSOR PROVISION THEREUNDER) AFTER THE LATER OF THE ORIGINAL ISSUE DATE THEREOF (OR OF ANY PREDECESSOR OF THIS NOTE) OR THE LAST DAY ON WHICH THE ISSUER OR ANY AFFILIATE (AS DEFINED IN RULE 144) OF THE ISSUER WAS THE OWNER OF THIS NOTE (OR ANY PREDECESSOR OF THIS NOTE), OR (Y), SUCH LATER DATE, IF ANY, AS MAY BE REQUIRED BY APPLICABLE LAW (THE “**RESALE RESTRICTION TERMINATION DATE**”), OFFER, SELL OR OTHERWISE TRANSFER SUCH NOTE EXCEPT (A) TO THE ISSUER, (B) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE SECURITIES ACT, (C) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE SECURITIES ACT, TO A PERSON IT REASONABLY BELIEVES IS A “QUALIFIED INSTITUTIONAL BUYER” AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT, (D) PURSUANT TO OFFERS AND SALES TO PERSONS OTHER THAN U.S. PERSONS THAT OCCUR OUTSIDE THE UNITED STATES WITHIN THE MEANING OF REGULATION S UNDER THE SECURITIES ACT OR I PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND, IN EACH CASE, IN COMPLIANCE WITH THE RELEVANT SECURITIES LAWS OF ANY OTHER JURISDICTION, AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THIS NOTICE IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND; *PROVIDED THAT* THE ISSUER AND THE ISSUING AND PAYING AGENT SHALL HAVE THE RIGHT PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER PURSUANT TO CLAUSE (D) OR I ABOVE TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATIONS AND/OR OTHER INFORMATION

REASONABLY SATISFACTORY TO THE ISSUER AND THE ISSUING AND PAYING AGENT. THIS LEGEND WILL BE REMOVED UPON THE REQUEST OF THE HOLDER AFTER THE RESALE RESTRICTION TERMINATION DATE. AS USED HEREIN, THE TERMS “OFFSHORE TRANSACTION”, “UNITED STATES” AND “U.S. PERSON” HAVE THE MEANINGS GIVEN TO THEM BY REGULATION S UNDER THE SECURITIES ACT.

5. if it is a purchaser in a sale that occurs outside the United States within the meaning of Regulation S, it acknowledges that until the expiration of the “40-day distribution compliance period” within the meaning of Rule 903 of Regulation S, any offer or sale of the Notes shall not be made by it to a U.S. person or for the account or benefit of a U.S. person within the meaning of Rule 902 under the Securities Act.
6. if it purchases the Notes, it will also be deemed to acknowledge that the foregoing restrictions apply to holders of beneficial interests in the Notes as well as to holders of the Notes.
7. that the Registrars will not be required to accept for registration of transfer any Notes acquired by it, except upon presentation of evidence satisfactory to the Issuer and the Registrars that the restrictions set forth herein have been complied with.
8. that:
  - (a) the Issuer, the Trustee, the Joint Lead Managers and others will rely upon the truth and accuracy of its acknowledgements, representations and agreements set forth herein and it agrees that if any of its acknowledgements, representations or agreements herein cease to be accurate and complete, it will notify the Issuer and the Joint Lead Managers promptly in writing; and
  - (b) if it acquires any Notes as fiduciary or agent for one or more investor accounts, it represents with respect to each such account that:
    - (i) it has sole investment discretion; and
    - (ii) it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account and that each such investment account is eligible to purchase the Notes.
9. that it will give to each person to whom it transfers the Notes notice of any restrictions on the transfer of the Notes.
10. that no action has been taken in any jurisdiction (including the United States) by the Issuer or the Joint Lead Managers that would permit a public offering of the Notes or the possession, circulation or distribution of this Offering Circular or any other material relating to the Issuer or the Notes in any jurisdiction where action for that purpose is required. Consequently, any transfer of the Notes will be subject to the selling restrictions set forth under “*Transfer Restrictions*” and “*Subscription and Sale*”.

## GENERAL INFORMATION

### Authorisation

The issue of the Notes was duly authorised by a resolution of the Management Board of the Issuer dated 19 October 2015 and by a resolution of the Supervisory Board of the Issuer dated 19 October 2015.

### Approval, admission to trading and listing

Application has been made to the CSSF to approve this document as a prospectus. Application has also been made to the Luxembourg Stock Exchange for the Notes to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

The Issuer estimates that the total expenses related to the admission to trading of the Notes on the regulated market of the Luxembourg Stock Exchange are approximately €4,590.

### Clearing Systems

The Regulation S Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. Application has been made for acceptance of the Rule 144A Notes into DTC's book-entry settlement system. The ISIN for the Regulation S Notes is XS1309493630 and for the Rule 144A Notes is US443293AB13. The Common Code for the Regulation S Notes is 130949363 and for the Rule 144A Notes is 131093179 and the CUSIP number for the Rule 144A Notes is 443293AB1.

### No significant change

There has been no material adverse change in the prospects of the Issuer or the Issuer and its subsidiaries since 31 December 2014.

There has been no significant change in the financial or trading position of the Issuer or the Issuer and its subsidiaries since 30 June 2015.

### Litigation

Except as disclosed in *“Risk Factors—Risks Related to the Group's Business—The Group does not hold registered ownership title with respect to certain properties, including real estate connected to 17 out of 26 of the hydro power plants which it currently operates in the Republic of Croatia, and the absence of such title might affect the Group's right to operate such plants in the future”* on page 1 of this Offering Circular and *“Business—Legal Proceedings”* on page 114 of this Offering Circular, neither the Issuer nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position of the Issuer or the Issuer and its subsidiaries.

### Auditors

The auditors of the Issuer for each of the three financial years ended 31 December 2012, 2013 and 2014 and the review of the six months ended 30 June 2015, were BDO, who audited the Issuer's accounts for the three financial years ended 31 December 2012, 2013 and 2014 and reviewed the Issuer's accounts for the six months ended 30 June 2015, without qualification, in accordance with the International Standards on Auditing. The Issuer maintains its financial books and records and prepares its Financial Statements in HRK in accordance with IFRS and IAS 34. BDO has no interest in the Issuer.



BDO is a member of the Croatian Chamber of Auditors, has audited the Issuer's Financial Statements in accordance with the International Standards on Auditing, as stated in its reports appearing in this Offering Circular.

### **Documents**

For the period of 12 months following the date of this Offering Circular, copies of the following documents will be available for inspection from the registered office of the Issuer and from the specified offices of the Trustee and the Paying Agents for the time being in London and Luxembourg:

- (a) the constitutional documents (with an English translation thereof) of the Issuer;
- (b) the Annual Financial Statements of the Issuer for the three years ended 31 December 2014, 2013 and 2012, together with the audit report in connection therewith. The Issuer currently prepares audited consolidated accounts on an annual basis;
- (c) the Interim Financial Statements of the Issuer in respect of the six months ended 30 June 2015 together with the review report prepared in connection therewith. The Issuer currently prepares reviewed interim accounts on a semi-annual basis;
- (d) the Trust Deed;
- (e) the Agency Agreement; and
- (f) the Offering Circular.

In addition, copies of this Offering Circular are available on the Luxembourg Stock Exchange's website at [www.bourse.lu](http://www.bourse.lu).

### **Post-issuance information**

The Issuer does not intend to provide any post-issuance information in relation to this issue of Notes.

### **Yield**

On the basis of the issue price of the Notes of 98.594% of their principal amount, the yield on the Notes is 6.125% on an annual basis.

### **Interest of natural and legal persons involved on the issue**

Save for any fees payable to the Joint Lead Managers, so far as the Issuer is aware, no person involved in the issue of the Notes has an interest material to the offer.

## GLOSSARY OF TERMS AND DEFINITIONS

Terms and definitions used in this Offering Circular have the meanings set forth below:

Term/Definition	Meaning
<b>2001 Agreement</b>	The agreement between the Croatian and Slovenian Governments 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).
<b>2017 Notes</b>	The U.S.\$500,000,000 6.00% Notes due 2017 of the Issuer.
<b>Accession</b>	The entrance of the Republic of Croatia into the EU.
<b>Accession Treaty</b>	The treaty signed on 9 December 2011 on the accession of Croatia to the EU.
<b>Accountholder</b>	Each person (other than another clearing system) who is for the time being shown in the records of DTC, Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of any of the Notes.
<b>Act on Regulation of Energy Activities</b>	The Act on Regulation of Energy Activities (OG 120/2012 and 14/2014)
<b>Additional Protocol</b>	The 2004 Additional Protocol on Liability for Nuclear Damage implementing the Paris Convention on Nuclear Third Party Liability and the Brussels Convention.
<b>Affiliate</b>	As defined in Rule 144 under the Securities Act.
<b>Agents</b>	The Registrars and the other paying and transfer agents named in the Agency Agreement.
<b>Agency Agreement</b>	The Agency Agreement dated 23 October 2015 made between the Issuer, the Registrars, the Agents and the Trustee, as amended or supplemented from time to time.
<b>Annual Financial Statements</b>	The audited consolidated financial statements at and for the three years ended 31 December 2012, 2013 and 2014.
<b>ATC</b>	Available transmission capacities.
<b>Audit Committee</b>	The audit committee of HEP.
<b>Authorised Holding</b>	Amounts of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof.
<b>BDO</b>	BDO Croatia d.o.o.
<b>business day</b>	A day on which banks are open to business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.
<b>Business Day</b>	A day (other than a Saturday or Sunday) on which commercial banks are open for business in London, New York City and, in the case of presentation of a Certificate, the place in which the Certificate is presented.

<b>Term/Definition</b>	<b>Meaning</b>
<b>CBS</b>	Croatian Bureau of Statistics.
<b>CCGT</b>	A combined cycle gas turbine.
<b>CCCGT</b>	A combined cycle cogeneration gas turbine.
<b>CEFTA</b>	Central Europe Free Trade Agreement.
<b>CER</b>	Certified Emission Reductions.
<b>Certificate</b>	A Note certificate.
<b>Change of Control</b>	If the Republic of Croatia ceases to control the Issuer or ceases to own, directly or indirectly, more than 50% of the entire issued share capital of the Issuer, and for this purpose <b>control</b> shall mean the power to direct the management and policies of the Issuer or to control the composition of its board of directors or other equivalent body, whether through the ownership of voting capital, by contract or otherwise.
<b>Change of Control Notice</b>	Notice given to the Noteholders pursuant to Condition 7.3 and in accordance with Condition 13 of the Notes.
<b>Change of Control Put Date</b>	The fifteenth day after the date of expiry of the Change of Control Put Period.
<b>Change of Control Put Notice</b>	A duly signed and completed notice of exercise in the form obtainable from any specified office of any Agent for the exercise of a Change of Control Put Option.
<b>Change of Control Put Option</b>	The option to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) a Noteholder's Note(s) at 101% of their principal amount pursuant to Condition 7.3.
<b>Change of Control Put Period</b>	The period of 45 days after that on which a Change of Control Notice is given.
<b>CHP</b>	Combined heat and power.
<b>Clearing Systems</b>	DTC, Euroclear and Clearstream, Luxembourg.
<b>Clearstream, Luxembourg</b>	Clearstream Banking, société anonyme.
<b>CLEF</b>	Carbon Leakage Exposure Factor.
<b>Closing Date</b>	23 October 2015, being the date on which delivery of the Global Certificates will be made or such later date as may be agreed.
<b>CNB</b>	Croatian National Bank.
<b>Code</b>	The Internal Revenue Code of 1986, as amended.
<b>Collective Agreement</b>	The collective bargaining agreement of the employees of the Group (excluding HOPS).
<b>Commercial Customers</b>	Customers operating in either the industrial or commercial sectors (i.e. are not Households).

<b>Term/Definition</b>	<b>Meaning</b>
<b>Commercial Non-Tariff Customers</b>	Commercial Customers who are supplied by a Market Supplier.
<b>Companies Act</b>	The 1995 Croatian Companies Act (Official Gazette nos. 111/93, 34/99, 52/00, 118/03, 107/07, 146/2008, 137/2009, 111/2012, 125/2011 and 68/2013) was passed on November 23, 1993 and came into force on January 1, 1995.
<b>Concessions Act</b>	The Croatian Concessions Act (OG 143/2012).
<b>CPDI Regulations</b>	Contingent payment debt instrument regulations.
<b>CPDIs</b>	Contingent payment debt instruments.
<b>CRA Regulation</b>	The Regulation (EC) No. 1060/2009 on Credit Rating Agencies as amended by Regulation (EU) No. 513/2011.
<b>Croatia</b>	The Republic of Croatia.
<b>Croatian Environmental Ministry</b>	Ministry of Environmental and Nature Protection of the Republic of Croatia.
<b>Croatian Government</b>	The government of the Republic of Croatia.
<b>Croatian Ministry of Economy</b>	Ministry of Economy of the Republic of Croatia.
<b>CSSF</b>	<i>Commission de Surveillance du Secteur Financier.</i>
<b>CTS</b>	Central thermal system.
<b>Dispute</b>	Any dispute, claim, difference or controversy arising out of or having any connection with the Trust Deed and the Notes (including any dispute as to their existence, validity, interpretation, performance, breach or termination or the consequences of their nullity and any dispute relating to any non-contractual obligations arising out of or in connection with them).
<b>DTC</b>	The Depository Trust Company.
<b>EIA</b>	Environmental impact assessment.
<b>Ecofin Council</b>	Council composed of Economics and Finance Ministers of the Member States.
<b>Electricity Market Act</b>	The Electricity Market Act (OG 22/2013, 95/2015 and 102/2015).
<b>ELES</b>	Elektro-Slovenija d.o.o.
<b>Eligible Customer</b>	An electricity customer who can freely choose a Market Supplier and negotiate the price of electricity, and if it fails to do so, it will be supplied through the public supply system within the universal service (for Households) or guaranteed supply (for Commercial Customers).
<b>EMFs</b>	Electromagnetic fields.
<b>Energy Act</b>	Key Croatian law governing the energy sector (OG 120/2012,

<b>Term/Definition</b>	<b>Meaning</b>
	14/2014, 95/2015 and 102/2015).
<b>ERM II</b>	The Exchange Rate Mechanism.
<b>ERU</b>	Emission Reduction Units.
<b>ESMA</b>	European Securities and Markets Authority.
<b>EU</b>	The European Union.
<b>EU Climate and Energy Package</b>	Range of measures adopted by the European Parliament on December 2008, as further amended and supplemented, to fight against the climate change.
<b>EU-ETS</b>	EU's emissions trading system.
<b>EU Regulation on Cross-Border Exchanges</b>	Regulation (EC) No. 714/2009 on Conditions for Access to the Network for Cross-Border Exchanges in Electricity.
<b>EU Regulation on Natural Gas Transmission</b>	Regulation (EC) No. 715/2009 on Conditions for Access to Natural Gas Transmission Networks.
<b>EU Third Electricity Directive</b>	Directive 2009/72/EC concerning Common Rules for an International Market in Electricity.
<b>EU Third Gas Directive</b>	Directive 2009/73/EC concerning Common Rules for the International Market in Natural Gas.
<b>Euro, EUR, €</b>	Currency introduced at the start of the third stage of the European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.
<b>Euroclear</b>	Euroclear Bank SA/NV.
<b>Events of Default</b>	Events so defined under Condition 10 of the Conditions of the Notes.
<b>Excessive Deficit Procedure</b>	Procedure to which a Member State whose general budget deficit exceeds the reference value of 3 per cent. of its GDP, in whose ratio of Government debt to GDP exceeds the reference value of 60 per cent. is submitted.
<b>Exchange Act</b>	The United States Securities Exchange Act of 1934, as amended.
<b>Exchanged Global Certificate</b>	Any Global Certificate that has been exchanged for Certificates.
<b>FATCA</b>	Sections 1471 to 1474 of the Code.
<b>Financial Statements</b>	The Annual Financial Statements and Interim Financial Statements.
<b>GDP</b>	Gross domestic product.
<b>GenE</b>	Gen Energija.
<b>General Assembly</b>	HEP's general assembly of shareholders.

<b>Term/Definition</b>	<b>Meaning</b>
<b>Generation Area North</b>	Includes three hydro power plants that were built on the Drava river: Varaždin (1975), Čakovec (1982) and Dubrava (1989). They are multi-purpose hydro power plants, the main purposes being: electricity generation, water supply, flood control, land erosion protection, irrigation, drainage, transport.
<b>Generation Area South</b>	Includes 10 hydro power plants in the basin of the river Cetina (Peruća, Orlovac, Đale, Zakučac, Kraljevac hydro power plants and Buško Blato pumping station), the basin of the river Krka (Golubić, Krčić, Miljacka, Jaruga) and on the Gracac Plateau (Velebit pumped storage hydro power plant).
<b>Generation Area West</b>	Includes six hydro power plants which utilise water of the rivers Krka (Ozalj hydro power plant), Ogulinska Dobra and Zagorska Mreznica (Gojak hydro power plant), Lokvarka, Kriz stream, Licanka, Lepenica, Kostanjevica, Potkosa and Benkovac stream (Vinodol hydro power system), Rječina (Rijeka), Lika and Gacka (Senj hydro power system). In 2011, on the Dobra River, Lešće, a 42.3 MW hydro power plant, was put into commercial operation.
<b>Global Certificates</b>	Global certificates in registered form representing the Notes.
<b>Governmental Authority</b>	The Republic of Croatia or any entity exercising executive, legislative, judicial, regulatory or administrative functions of, or pertaining to, the Republic of Croatia.
<b>Group or HEP Group</b>	“The Group”, “Group” or “HEP Group” means HEP together with its Subsidiaries from time to time.
<b>GW</b>	Gigawatt, which is equal to 1,000 MW.
<b>GWh</b>	Gigawatt-hour, representing one hour of electricity consumption at a constant rate of 1GW.
<b>HEP</b>	Hrvatska Elektroprivreda d.d.
<b>HEP Gas Supply</b>	HEP Opskrba plinom d.o.o.
<b>HEP-Generation</b>	HEP-Proizvodnja d.o.o.
<b>HEP IS</b>	HEP corporate information system.
<b>HEP-ODS</b>	HEP-Operator distribucijskog sustava d.o.o.
<b>HOPS</b>	Hrvatski operator prijenosnog sustava d.o.o. (formerly HEP-Operator prijenosnog sustava d.o.o.).
<b>HEP-Plin</b>	HEP-Plin d.o.o.
<b>HEP-Supply</b>	HEP Opskrba d.o.o.
<b>HEP-Top</b>	HEP-Toplinarstvo d.o.o.
<b>HEP-Trade</b>	HEP-Trgovina d.o.o.
<b>HERA</b>	Croatian Energy Regulatory Agency.
<b>Households</b>	Residential customers.

<b>Term/Definition</b>	<b>Meaning</b>
<b>HRK, Kuna</b>	The lawful currency of the Republic of Croatia.
<b>HROTE</b>	The Croatian Energy Market Operator.
<b>IAD</b>	Internal Audit Department.
<b>IAED</b>	International Atomic Energy Agency.
<b>IAE</b>	The procedure on environmental impact assessment.
<b>IED</b>	Directive 2010/75/EC on industrial emission.
<b>IFRS</b>	The International Financial Reporting Standards.
<b>IMF</b>	International Monetary Fund.
<b>INA Group</b>	INA – Industrija nafte d.d.
<b>Indebtedness for Borrowed Money</b>	Any indebtedness (whether being principal, premium, interest or other amounts) for or in respect of any notes, bonds, debentures, debenture stock, loan stock or other securities or any borrowed money or any liability under or in respect of any acceptance or acceptance credit.
<b>INES</b>	International nuclear events scale.
<b>Interest Payment Date</b>	23 April and 23 October in each year.
<b>Interest Period</b>	Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the first or the next Interest Payment Date, respectively.
<b>Interim Financial Statements</b>	The reviewed condensed consolidated interim financial statements for the six months ended 30 June 2015.
<b>Insolvency Act</b>	Insolvency Act (Official Gazette No. 71/15).
<b>Investor's Currency</b>	The currency or currency unit in which an investor's financial activities are principally denominated.
<b>IRS</b>	Internal Revenue Service.
<b>ISO</b>	Independent system operator.
<b>Issue Date</b>	23 October 2015.
<b>Issuer</b>	Hrvatska Elektroprivreda d.d.
<b>ITO</b>	Independent transmission operator.
<b>JAO</b>	A Joint Allocation Office project.
<b>Joint Lead Managers</b>	Banca IMI S.p.A., Morgan Stanley & Co. International plc and UniCredit Bank AG.
<b>kV</b>	Kilovolt, a unit of electromotive force.
<b>KW</b>	Kilowatt, representing the rate at which energy is produced.

<b>Term/Definition</b>	<b>Meaning</b>
<b>KWh</b>	Kilowatt-hour, representing one hour of electricity consumption at a constant rate of 1 kW.
<b>Krško agreement</b>	A partnership agreement between HEP and GenE.
<b>Labor Act</b>	Labour Act (Official Gazette 93/14).
<b>Land Registry</b>	Land registry of the Republic of Croatia.
<b>Law</b>	Luxembourg law of 23 December 2005.
<b>Laws</b>	Luxembourg laws of 21 June 2005.
<b>LNG Hrvatska</b>	LNG Hrvatska d.o.o.
<b>Maastricht Treaty</b>	Treaty on European Union of February 1992.
<b>Management Board</b>	HEP's management board.
<b>Market Supplier</b>	A supplier offering non-tariff based rates.
<b>Material Subsidiary</b>	As defined in Condition 4 of the Notes.
<b>Maturity Date</b>	23 October 2022.
<b>MD</b>	Material damage policy.
<b>Moody's</b>	Moody's Investors Service Ltd.
<b>MW</b>	Megawatt, which is equal to 1,000 kW.
<b>MZOP</b>	Ministry of Environmental and Nature Protection.
<b>New York Convention</b>	1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
<b>Non-Tariff Customers</b>	Households and Commercial Customers that have selected a particular Market Supplier and are supplied on the basis of non-tariffed rates.
<b>Noteholder or holder</b>	Means the person in whose name a Note is registered in the relevant register of Noteholders.
<b>Notes</b>	U.S.\$550,000,000 5.875% Notes due 2022 of the Issuer.
<b>NEK</b>	Nuklearna elektrana Krško d.o.o.
<b>NPPK</b>	Krško nuclear power plant.
<b>Nuclear Law</b>	Slovenian Law on Liability for Nuclear Damage.
<b>Offering Circular</b>	The offering circular dated 22 October 2015.
<b>OID</b>	Original Issue Discount.
<b>OSART</b>	IAEA operational safety reviews.
<b>OU</b>	Full ownership unbundling.
<b>Ownership Unbundling</b>	Any reorganisation of the holding of the Regulated Assets pursuant to or in accordance with any order or act of a Governmental



<b>Event</b>	Authority implementing Directive 2009/72/EC in the Republic of Croatia following the consummation of which the Regulated Assets cease to be owned by any member of the Group.
<b>Ownership Unbundling Event Notice</b>	Notice given to the Noteholders pursuant to Condition 7.4 and in accordance with Condition 13 of the Notes.
<b>Ownership Unbundling Event Put Date</b>	The fifteenth day after the date of expiry of the Ownership Unbundling Event Put Period.
<b>Ownership Unbundling Event Put Notice</b>	A duly signed and completed notice of exercise in the form obtainable from any specified office of any Agent for the exercise of an Ownership Unbundling Event Put Option.
<b>Ownership Unbundling Event Put Option</b>	The option to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) a Noteholder's Note(s) at their principal amount pursuant to Condition 7.4.
<b>Ownership Unbundling Event Put Period</b>	The period of 45 days after that on which an Ownership Unbundling Event Notice is given.
<b>Pact</b>	The Stability and Growth Pact among EU Member States.
<b>Permitted Reorganisation</b>	An Ownership Unbundling Event or a Permitted Unbundling Event.
<b>Permitted Security Interest</b>	Any Security Interest over or affecting any assets or revenues of any company in the Group where such Security Interest secures Project Finance Indebtedness only.
<b>Permitted Unbundling Event</b>	Any reorganisation of the holding of the Regulated Assets in the Group pursuant to or in accordance with any order or act of a Governmental Authority implementing Directive 2009/72/EC in the Republic of Croatia following the consummation of which any member of the Group continues to own the Regulated Assets.
<b>Person</b>	Any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality.
<b>Plinacro</b>	Plinacro d.o.o.
<b>Plinara</b>	Plinara d.o.o. Pula.
<b>Plomin II</b>	Plomin II thermal power plant.
<b>Principal amount</b>	The amounts of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof in which the Notes are issued.
<b>Proceedings</b>	Any suit, action or proceeding taken by the Trustee or Noteholders arising out of or in connection with the Trust Deed or the Notes.
<b>Project Finance Indebtedness</b>	As defined in Condition 4 of the Notes.
<b>Prospectus Act 2005</b>	The Luxembourg Act dated 10 July 2005 on prospectuses for securities.
<b>Prospectus Directive</b>	Directive 2003/71/EC, as amended.

<b>PSR</b>	Periodical Safety Review.
<b>QIB</b>	Qualified institutional buyers (within the meaning of Rule 144A under the Securities Act).
<b>RAB</b>	Regulated Asset Base.
<b>Rate of Interest</b>	5.875% per annum.
<b>Rating Agency</b>	S&P, Moody's, or any of their respective successors, or any other rating agency of international standing.
<b>Record Date</b>	The fifteenth day before the relevant Interest Payment Date.
<b>Registered Account</b>	Means the U.S. dollar account maintained by or on behalf of a Noteholder with a bank that processes payments in U.S. dollars, details of which appear on the relevant register of Noteholders at the close of business, in the case of principal and premium (if any), on the second Business Day before the due date for payment and, in the case of interest, on the relevant Record Date.
<b>Registrars</b>	Deutsche Bank Trust Company Americas and Deutsche Bank Luxembourg S.A.
<b>Regulated Assets</b>	Assets of the Group relating to the transmission of electricity to, from and within the Republic of Croatia in respect of which the Issuer and its Subsidiaries earn revenues regulated, directly or indirectly, by the Croatian Regulatory Agency for Energy (HERA).
<b>Regulations</b>	U.S. Treasury Regulations.
<b>Regulation S</b>	Regulation S under the Securities Act.
<b>Regulation S Notes</b>	Those Notes offered and sold in reliance on Regulation S.
<b>Relevant Date</b>	Means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by an Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 13.
<b>Relevant Indebtedness</b>	Any present or future indebtedness (whether being principal, premium, interest or other amounts) for or in respect of any notes, bonds, debentures, debenture stock, loan stock or other securities which are for the time being quoted, listed or ordinarily dealt in on any stock exchange, over-the-counter or other securities market and any guarantee or indemnity of any such indebtedness.
<b>Relevant Jurisdiction</b>	Means the Republic of Croatia or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal, premium (if any) and interest on the Notes.
<b>Relevant Nominee</b>	The nominee for DTC or for the common depositary for Euroclear and Clearstream, Luxembourg, as applicable.

<b>Renewable Sources Directive</b>	Directive 2009/28/EC on the Promotion of the Use of Energy from Renewable Sources.
<b>RES Act</b>	Croatian separate Act on renewable energy sources and high-efficiency cogeneration which is under adoption procedure.
<b>Resale Restriction Termination Date</b>	The date which is one year (or such shorter period of time as permitted by Rule 144 under the Securities Act or any successor provision thereunder) after the later of the date of the original issue of the Notes and the last date on which the Issuer or any affiliate of the Issuer was the owner of such Notes (or any predecessor thereto), or such later date, if any, as may be required by applicable law.
<b>Restricted Global Certificate</b>	The Global Certificate issued in respect of the Rule 144A Notes.
<b>Rule 144A</b>	Rule 144A under the Securities Act.
<b>Rule 144A Notes</b>	Those Notes offered and sold in reliance on Rule 144A.
<b>Rules</b>	The LCIA Arbitration Rules.
<b>RWE</b>	RWE Energie Aktiengesellschaft.
<b>S&amp;P</b>	Standard & Poor's Credit Market Services Europe Limited.
<b>SAA</b>	Stabilisation and Association Agreement between the Republic of Croatia and the EU.
<b>Savings Directive</b>	EC Council Directive 2003/48/EC on the Taxation of Savings Income.
<b>SDR</b>	Special Drawing Rights, a reserve currency created by the IMF.
<b>SEE CAO</b>	The South East Europe Co-ordinated Auction Office.
<b>Securities Act</b>	The United States Securities Act of 1933, as amended.
<b>Security Interest</b>	Any mortgage, charge, lien, pledge or other security interest.
<b>SORNS</b>	State Office for Radiological and Nuclear Safety.
<b>Stabilising Manager</b>	UniCredit Bank AG
<b>Strategy</b>	Energy Development Strategy of the Republic of Croatia (OG 130/2009).
<b>Subscription Agreement</b>	The Subscription Agreement dated 22 October 2015 made between the Issuer and the Joint Lead Managers.
<b>Subsidiary</b>	Any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.
<b>Supervisory Board</b>	HEP's supervisory board.
<b>Tariff Customers</b>	All Households and Commercial Customers that have not chosen a Market Supplier and are supplied through the public supply system

	in the electricity market.
<b>Taxes</b>	Any present or future taxes, duties, assessments or governmental charges of whatever nature.
<b>TE or TPP</b>	Thermal power plant.
<b>TE Plomin</b>	TE Plomin d.o.o.
<b>TE-TO</b>	Thermal power plant—Heating plant.
<b>Tender Offer</b>	The tender offer launched by the Issuer on 7 October 2015 pursuant to a tender offer memorandum of the same date, as supplemented.
<b>Territories</b>	Luxembourg and certain dependent and associated territories of EU Member States.
<b>Third Energy Package</b>	(i) EU Third Electricity Directive, (ii) EU Third Gas Directive; (iii) EU Regulation on Cross-Border and (iv) EU Regulation on Natural Gas Transmission Regulation.
<b>Trust Deed</b>	Trust Deed dated 23 October 2015 made between the Issuer and the Trustee, as amended or supplemented from time to time.
<b>Trustee</b>	Deutsche Trustee Company Limited.
<b>TSO</b>	Transmission system operator.
<b>unbundling</b>	Regulated activities such as distribution and transmission of electricity being separate and independent from the generation and supply of electricity.
<b>Unrestricted Global Certificate</b>	The Global Certificate issued in respect of the Regulation S Notes.
<b>URSJV</b>	Slovenian nuclear regulator Uprava Republike Slovenije za nuklearnu sigurnost.
<b>U.S. dollars, dollars, U.S. \$, \$</b>	United States dollars.
<b>U.S. person</b>	As defined in Regulation S under the Securities Act.
<b>WANO</b>	World Association of Nuclear Operators.
<b>Water Act</b>	Water Act (OG 153/2009, 130/2011, 56/2013 and 14/2014).

## INDEX TO THE FINANCIAL STATEMENTS

	Page
<b>Interim Financial Statements of the Group as of and for the six months ended 30 June 2015</b>	
Independent Auditor's Report on Review of Condensed Consolidated Interim Financial Information of the HEP Group.....	F-4
Condensed Consolidated Statement of Comprehensive Income of the HEP Group.....	F-6
Condensed Consolidated Statements of Financial Position of the HEP Group.....	F-8
Condensed Consolidated Statement of Changes in Equity of the HEP Group.....	F-10
Condensed Consolidated Statement of Cash Flows of the HEP Group.....	F-11
Notes to the Condensed Consolidated Interim Financial Statements of the HEP Group.....	F-13
<b>Annual Financial Statements of the Group as of and for the years ended 31 December 2012, 2013 and 2014</b>	
Responsibility for the Consolidated Financial Statements.....	F-37
Independent Auditor's Report.....	F-38
Consolidated Statement of Comprehensive Income.....	F-40
Consolidated Statements of Financial Position.....	F-42
Consolidated Statement of Changes in Equity.....	F-44
Consolidated Statement of Cash Flows.....	F-45
Notes to the Consolidated Financial Statements of the HEP Group.....	F-47



**HRVATSKA ELEKTROPRIVREDA d.d. Zagreb**

Condensed consolidated interim financial  
statements for the period ended  
30 June 2015

## Contents

---

	<i>Page</i>
Independent Auditor's Report on Review of Condensed Consolidated Interim Financial Information of the HEP Group	1-2
Condensed consolidated statement of comprehensive income of the HEP Group	3-4
Condensed consolidated statement of financial position of the HEP Group	5-6
Condensed consolidated statement of changes in equity of the HEP Group	7
Condensed consolidated statement of cash flows of the HEP Group	8-9
Notes to the condensed consolidated interim financial information of the HEP Group	10-31

## **Independent Auditor's Report on Review of condensed consolidated Interim Financial Information**

**To the Owner of Hrvatska Elektroprivreda d.d.:**

### ***Introduction***

We have reviewed the accompanying condensed consolidated statement of financial position of Hrvatska Elektroprivreda d.d. and its subsidiaries ("the Group") as of 30 June 2015 and the related condensed consolidated statement of comprehensive income, condensed consolidated statement of changes in equity and condensed consolidated statement of cash flows for the six months period then ended, and notes to the condensed consolidated interim financial information. Management is responsible for the preparation and presentation of these condensed consolidated interim financial information in accordance with IAS 34 Interim Financial Reporting.

Our responsibility is to express a conclusion on this condensed consolidated interim financial statements based on our review.

### ***Scope of Review***

We conducted our review in accordance with International Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### ***Conclusion***

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated financial statements as at 30 June 2015 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.



**Emphasis of matter**

1. As described in the Note 12 to the condensed consolidated interim financial information, as at 30 June 2015, the Group stated clearing debt liability in the amount of HRK 822,604 thousand (31 December 2014: HRK 759,089 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 on Review of condensed consolidated interim financial information, it has not been clearly defined whether it relates to a loan or a government grant.

2. As described in the Note 16 to the condensed consolidated interim financial information, 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 (canals, dams, etc.) 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 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.

During 2015, the Ministry of Agriculture has launched amendment procedure to the Water Act and the Ministry of Economy issued an opinion with approval of the Company's initiative to amend the Water Act.

In Zagreb, 10 September 2015

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



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

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

# Condensed consolidated statement of comprehensive income of the HEP Group

For the six months period ended 30 June 2015

	Notes	For the six months period ended	
		30 June 2015	30 June 2014
		HRK '000 Unaudited	HRK '000 Unaudited
Revenue from electricity sales	4,6	5,244,063	5,236,859
Revenue from thermal power sales	4	389,556	374,844
Revenue from sale of gas on wholesale market	4,5	789,773	155,879
Revenue from sale of gas to customers	4	220,291	181,557
<b>Sales revenue</b>		<b>6,643,683</b>	<b>5,949,139</b>
Other operating income		500,219	544,190
<b>Total operating income</b>		<b>7,143,902</b>	<b>6,493,329</b>
Electricity purchase cost	6	(774,794)	(481,639)
Fuel cost	6	(976,073)	(986,482)
Costs of gas sold	5	(808,823)	(165,663)
Staff cost		(942,642)	(901,948)
Depreciation and amortization costs		(922,212)	(933,853)
Other operating expenses		(1,207,581)	(1,241,176)
<b>Total operating expenses</b>		<b>(5,632,125)</b>	<b>(4,710,761)</b>
<b>Operating profit</b>		<b>1,511,777</b>	<b>1,782,568</b>
Financial income	7	423,584	76,294
Financial expenses	7	(239,547)	(162,861)
<b>Net profit /(loss) from financial activities</b>		<b>184,037</b>	<b>(86,567)</b>
<b>Profit before taxation</b>		<b>1,695,814</b>	<b>1,696,001</b>
Corporate income tax expense	8	(350,668)	(373,039)
<b>Profit for the period</b>		<b>1,345,146</b>	<b>1,322,962</b>
<b>Attributable to:</b>			
Owners of the parent		1,344,184	1,321,052
Non-controlling interest		962	1,910
		<b>1,345,146</b>	<b>1,322,962</b>

The accompanying notes form an integral part of these condensed consolidated interim financial information.

Condensed consolidated statement of comprehensive income of the HEP Group  
(continued)

For the six months period ended 30 June 2015

	For the six months period ended	
	30 June 2015	30 June 2014
	HRK '000	HRK '000
	Unaudited	Unaudited
<b>Profit for the period</b>	<b><u>1,345,146</u></b>	<b><u>1,322,962</u></b>
<b>Other comprehensive income</b>		
Exchange gains arising on translation of foreign operations	(17,420)	(318)
Net gain on AFS financial assets	<u>42,771</u>	<u>10,230</u>
<i>Net other comprehensive income to be reclassified to profit/(loss) in subsequent periods</i>	<u>25,351</u>	<u>9,912</u>
<b>Other comprehensive income, net</b>	<b><u>25,351</u></b>	<b><u>9,912</u></b>
<b>Total comprehensive income for the period, net of tax</b>	<b><u>1,370,497</u></b>	<b><u>1,332,874</u></b>
<b>Total comprehensive income attributable to:</b>		
Owners of the parent	1,369,792	1,331,190
Non-controlling interest	<u>705</u>	<u>1,684</u>
	<b><u>1,370,497</u></b>	<b><u>1,332,874</u></b>

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

Signed on behalf of the Company on 9 September 2015:

Perica Jukić

President of the Board



Tomislav Rosandić

Member of the Board



# Condensed consolidated statements of financial position of the HEP Group

As at 30 June 2015

ASSETS	Notes	30 June	31 December
		2015	2014
		HRK '000 Unaudited	HRK '000 Audited
<b>Non-current assets</b>			
Property, plant and equipment		25,026,661	25,334,813
Assets under construction		4,469,740	4,188,741
Prepayment for property, plant and equipment		58,766	41,486
Intangible assets		65,876	77,046
Investment property		236,155	236,153
Long-term loans and deposits		4,533	4,533
Available-for-sale and other investments		234,352	192,676
Other long-term assets		47,813	49,804
Derivative financial instruments	11	349,469	1,473
Deferred tax assets		628,360	653,907
<b>Total non-current assets</b>		<b>31,121,725</b>	<b>30,780,632</b>
<b>Current assets</b>			
Inventories		1,477,801	1,613,297
Trade receivables		1,496,073	1,864,680
Other short-term receivables		479,799	518,209
Cash and cash equivalents		1,176,586	1,079,900
<b>Total current assets</b>		<b>4,630,259</b>	<b>5,076,086</b>
<b>TOTAL ASSETS</b>		<b>35,751,984</b>	<b>35,856,718</b>

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

Condensed consolidated statements of financial position of the HEP Group (continued)  
As at 30 June 2015

EQUITY AND LIABILITIES	Notes	30 June 2015	31 December 2014
		HRK '000 Unaudited	HRK '000 Audited
Share capital	9	19,792,159	19,792,159
Revaluation reserves		97,718	54,947
Retained earnings	9	3,528,286	2,201,265
<b>Equity Attributable to Owners of the Parent</b>		<b>23,418,163</b>	<b>22,048,371</b>
Non-controlling interest	9	0	29,202
<b>Total equity</b>		<b>23,418,163</b>	<b>22,077,573</b>
<b>Non-current liabilities</b>			
Long-term loan liabilities	10	1,081,637	1,262,036
Long-term liabilities to the State		20,245	21,690
Long-term provisions		924,041	902,779
Liabilities under issued bonds	11	3,116,606	3,194,986
Other long-term liabilities	12	4,445,408	4,499,502
Deferred tax liabilities		13,573	13,573
<b>Total non-current liabilities</b>		<b>9,601,510</b>	<b>9,894,566</b>
<b>Current liabilities</b>			
Trade payables		967,353	1,590,745
Current portion of long-term bonds	11	93,380	93,380
Current portion of long-term loans	10	385,004	416,349
Short-term loans	13	-	8,981
Taxes and contributions		145,993	361,095
Interest payable		37,384	38,263
Liabilities to employees		147,655	151,240
Other short-term liabilities		955,542	1,224,526
<b>Total current liabilities</b>		<b>2,732,311</b>	<b>3,884,579</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>35,751,984</b>	<b>35,856,718</b>

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

Signed on behalf of the Company on 9 September 2015:

Perica Jukić

President of the Board



Tomislav Riosandić

Member of the Board



# Condensed consolidated statement of changes in equity of the HEP Group

For the six months period ended 30 June 2015

	Share capital	Revaluation reserves	Retained earnings	Equity attributable to Owners of the Parent	Non controlling interest	Total equity
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
<b>Balance at 1 January 2014</b>	<b>19,792,159</b>	<b>2,617</b>	<b>18,809</b>	<b>19,813,585</b>	<b>31,977</b>	<b>19,845,562</b>
Distribution of dividends	-	-	(284,918)	(284,918)	-	(284,918)
Profit for the period	-	-	1,321,052	1,321,052	1,910	1,322,962
Other comprehensive income	-	10,230	(92)	10,138	(226)	9,912
<b>Total comprehensive income</b>	<b>-</b>	<b>10,230</b>	<b>1,320,960</b>	<b>1,331,190</b>	<b>1,684</b>	<b>1,332,874</b>
<b>Balance as at 30 June 2014, unaudited</b>	<b>19,792,159</b>	<b>12,847</b>	<b>1,054,851</b>	<b>20,859,857</b>	<b>33,661</b>	<b>20,893,518</b>
<b>Balance at 1 January 2015</b>	<b>19,792,159</b>	<b>54,947</b>	<b>2,201,265</b>	<b>22,048,371</b>	<b>29,202</b>	<b>22,077,573</b>
Profit for the period	-	-	1,344,184	1,344,184	962	1,345,146
Other comprehensive income	-	42,771	(17,163)	25,608	(257)	25,351
<b>Total comprehensive income</b>	<b>-</b>	<b>42,771</b>	<b>1,327,021</b>	<b>1,369,792</b>	<b>705</b>	<b>1,370,497</b>
Distribution of dividends - RWE	-	-	-	-	(4,054)	(4,054)
Distribution of capital reserves - RWE	-	-	-	-	(25,853)	(25,853)
<b>Balance as at 30 June 2015, unaudited</b>	<b>19,792,159</b>	<b>97,718</b>	<b>3,528,286</b>	<b>23,418,163</b>	<b>0</b>	<b>23,418,163</b>

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

Signed on behalf of the Company on 9 September 2015:

Perica Jukić

President of the Board



Tomislav Rosandić

Member of the Board





# Condensed consolidated statement of cash flows of the HEP Group

For the six months period ended 30 June 2015

	For the six months period ended	
	30 June 2015	30 June 2014
	HRK '000 Unaudited	HRK '000 Unaudited
<b>Cash flows from operating activities</b>		
Profit for the period	1,345,146	1,322,962
Corporate income tax expense recognized in profit	325,121	374,066
Net (profit) / loss from financial activities	(184,037)	86,567
Depreciation and amortization	922,212	933,853
Increase in impairment of receivables	50,914	44,033
(Decrease) / increase in impairment of inventories	(291)	1,928
(Decrease) in provisions	(13,520)	(6,412)
<i>Operating cash flows before movements in working capital</i>	<i>2,445,545</i>	<i>2,756,997</i>
Decrease in trade receivables	317,693	161,398
Decrease/(increase) in inventories	135,787	(287,951)
Decrease in other current assets	39,883	204,927
(Increase) in long-term receivables	-	(503)
(Decrease) in trade payables	(623,392)	(548,500)
(Decrease)/increase in other current liabilities	(332,065)	258,821
(Decrease) in other non-current liabilities	(72,702)	(115,323)
Increase in provisions	34,782	36
<b>Cash generated from operations</b>	<b>1,945,531</b>	<b>2,429,902</b>
Corporate income tax (paid)	(506,715)	(427,408)
Interests paid	(150,940)	(149,174)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>1,287,876</b>	<b>1,853,320</b>
<b>INVESTING ACTIVITIES</b>		
Interests receipts	5,596	7,244
Increase in property, plant and equipment	(883,889)	(702,481)
Other non-current assets	(16,049)	2,909
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(894,342)</b>	<b>(692,328)</b>

# Condensed consolidated statement of cash flows of the HEP Group (continued)

For the six months period ended 30 June 2015

	For the six months period ended	
	30 June 2015	30 June 2014
	HRK '000 Unaudited	HRK '000 Unaudited
<b>FINANCING ACTIVITIES</b>		
Bond repayments	(46,690)	(46,690)
Long-term loans received	26,611	-
Repayments of long-term loans	(223,277)	(103,702)
Repayments of short-term loans	(8,981)	(558,266)
Dividends and capital reserves paid – RWE	(44,511)	-
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(296,848)</b>	<b>(708,658)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>96,686</b>	<b>452,334</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD</b>	<b>1,079,900</b>	<b>260,844</b>
<b>CASH AND CASH EQUIVALENTS AT END OF THE PERIOD</b>	<b>1,176,586</b>	<b>713,178</b>

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

Signed on behalf of the Company on 9 September 2015:

Perica Jukić

President of the Board



Tomislav Rosandić

Member of the Board





## 1. BASIS OF PREPARATION

These condensed consolidated interim financial information are prepared in accordance with International Accounting Standard 34 *Interim Financial Reporting*. The preparation of the unaudited condensed consolidated interim financial information for the six months period ended 30 June 2015 requires from management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as at the date of the condensed consolidated interim financial information, and actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

The annual consolidated financial statements of Hrvatska Elektroprivreda d.d. and its subsidiaries ("the HEP Group") are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by EU. The condensed consolidated interim financial information have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' ('IAS 34'). The condensed consolidated financial information for the six month period ended 30 June 2015 have been prepared under the same accounting policies as the consolidated financial statements for the year ended 31 December 2014.

Certain information and disclosures normally included in the annual consolidated financial statements prepared in accordance with IFRS adopted by EU have been condensed or omitted as permitted by IAS 34. The condensed consolidated statement of financial position as at 30 June 2015 was derived from audited annual consolidated financial statements as at 31 December 2014, but does not include all disclosures required by IFRS adopted by EU. However, the Group's management believes that disclosures are adequate to make the information presented not misleading.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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. The accounting records of the Group's subsidiaries in Croatia and abroad are maintained in accordance with the requirements of the respective local jurisdictions.

The condensed consolidated interim financial information 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 condensed consolidated interim financial information are presented in thousands of Croatian Kuna (HRK '000) as the Group's functional currency.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

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

The accounting policies adopted in the preparation of the accompanying condensed consolidated interim financial information are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2014, except for the adoption of new standards and interpretations effective as of 1 January 2015. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Although these new standards and amendments apply for the first time in 2015, they do not have a material impact on the accompanying condensed consolidated interim financial information for the period ended 30 June 2015. The nature and the impact of each new standard or amendment are described below:

### ***Standards and Interpretations effective for the current period***

Annual Improvements 2011-2013 Cycle - effective in EU for accounting periods beginning on or after 1 January 2015, with earlier application permitted and it is not expected that they will have any significant impact on the Group. They include:

- IFRS 3 Business Combinations,
- IFRS 13 Fair Value Measurement,
- IAS 40 Investment Property

IFRIC 21 Levies (Effective in EU for accounting periods beginning on or after 17 June 2014, with earlier application permitted).

Application of the above mentioned Standards did not have effect on the on the accompanying condensed consolidated interim financial information for the period ended 30 June 2015.

### ***New and revised IFRSs adopted by the EU in issue but not yet effective***

The Group has not applied the following new and revised IFRSs and Interpretations that have been issued and adopted by the EU but are not yet effective in the EU:

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions – IAS 19 requires subjects to consider employee or third party contributions in accounting defined earning. This amendment is effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted. The Company does not expect this amendment to be relevant to the Group.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### ***New and revised IFRSs adopted by the EU in issue but not yet effective (continued)***

- Annual Improvements 2010-2012 Cycle, these amendment are effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted and it is not expected that they will have any significant impact on the Group. 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

### ***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 endorsed for use in EU yet:

- 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 affect the classification and measurement of financial instruments.
- 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 Company prepares its Financial Statements in accordance with IFRS and does not apply this standard.
- 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.
- 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.

- 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)
- 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)
- 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)

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Group's Management anticipates that the application of said standards, amendments and interpretations will not have a materially significant impact on the consolidated financial statements in the period of their initial application, except for IFRS 15 and IFRS 9 for which the Group's Management is conducting detail analysis regarding possible effects from the application of this Standard on the consolidated financial statements and which is still in progress.

### ***Use of estimates in preparation of the condensed consolidated interim financial information***

Preparation of the condensed consolidated interim financial information in conformity with International Accounting Standard 34 Interim Financial Reporting, 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 condensed consolidated interim financial information 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.

There were no changes in the use of estimates or critical judgments applied in preparation of the annual consolidated financial statements for the year ended 31 December 2014 with respect of those applied in preparation of these condensed consolidated interim financial statements.

## 3. GENERAL

Changes in the Management Board in 2015:

Mr. Tomislav Rosandić – Member elected on 2 January 2015

Mr. Željko Štromar – Member revoked on 31 March 2015.

Changes in the Supervisory Board in 2015:

Mr. Jadranko Berlengi – Member, revoked on 31 May 2015

Ms. Dubravka Kolundžić – Member, elected on 1 June 2015

On 15 May 2015, the company APO d.o.o., for environmental protection was merged with the Company.

On 24 April 2015, the company HEP Odmor i rekreacija d.o.o. changed its name to HEP Upravljanje imovinom d.o.o.



#### 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	
	Six months period ended 30 June							
	2015	2014	2015	2014	2015	2014	2015	2014
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited	Unaudited
Revenue	5,244,063	5,236,859	389,556	374,844	1,010,064	337,436	6,643,683	5,949,139
Other segment income	369,356	493,474	31,738	33,311	99,125	17,405	500,219	544,190
<b>Profit / (loss) from operations</b>							<b>1,511,777</b>	<b>1,782,568</b>
Net financial income/(cost)							184,037	(86,567)
Corporate income tax (expense)							(350,668)	(373,039)
<b>Net profit</b>							<b>1,345,146</b>	<b>1,322,962</b>

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 Krško Nuclear Power Plant (hereinafter: 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	
	30 June 2015	31 December 2014	30 June 2015	31 December 2014
	HRK '000	HRK '000	HRK '000	HRK '000
	Unaudited	Audited	Unaudited	Audited
Electricity	27,903,597	27,807,534	6,026,347	6,613,995
Heating	1,092,338	1,184,190	172,585	203,167
Gas	347,334	389,202	99,150	104,419
Unallocated	6,408,715	6,475,792	6,035,739	6,857,564
<b>Total Group</b>	<b>35,751,984</b>	<b>35,856,718</b>	<b>12,333,821</b>	<b>13,779,145</b>

#### 4. SEGMENT INFORMATION (continued)

##### 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:

	Six months period ended 30 June	
	2015	2014
	HRK '000	HRK '000
	Unaudited	Unaudited
Croatia	4,962,809	4,905,584
EU member states	266,361	320,472
Non - EU member states	14,893	10,803
	<b><u>5,244,063</u></b>	<b><u>5,236,859</u></b>

## **5. GAS SALES**

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 Group has rented 70% of warehouse capacities in underground gas storage facilities.

In the period from 1 April 2014 to 31 March 2015 the Group agreed rent of capacities of 3.600 million kWh, in the period of 1 April 2015 to 31 March 2016, the Group agreed rent of capacities of rent of 3.550 million kWh, and in the period from 1 April 2016 to 31 March 2017 the Group agreed rent of capacities of 3.500 million kWh.

HEP d.d. as a supplier on the wholesale market sells gas as public service and under regulated conditions to local suppliers for household customers, and is obligated to provide secure and reliable gas supply.

## **6. FLUCTUATIONS IN OPERATIONS**

The demand for electricity and thermal energy, as well as natural gas is characterized by fluctuations which have the impact on the total results of operations of the Group, and may occur as a consequence of weather conditions, economic conditions in which the Group operates and the activities of other suppliers outside the Group as well as the prices they offer to the customers.

Total operating expenses are influenced by hydrological conditions, with reference to generation of electricity in hydropower plants, market prices of fuel for generation of electricity and heating energy, market prices for purchasing of electricity and customers demand for energy.

In the first six months of 2015, revenues from electricity sales were realized in the amount of HRK 5,244,063 thousand while in the same period last year they were realized in the amount of HRK 5,236,859 thousand.

In the first six months of 2015 cost of electricity purchased amounted to HRK 774,794 thousand, while in the period ended 30 June 2014 amounted to HRK 481,639 thousand and were increased due to unfavourable hydrological conditions and consequently growth of import.

Cost of fuel in the first six months of 2015 amounted to HRK 976,073 thousand, while in the period ended 30 June 2014 amounted to HRK 986,482 thousand.

## 7. FINANCIAL INCOME AND EXPENSES

Financial income	Six months period ended	
	30 June 2015	30 June 2014
	HRK '000 Unaudited	HRK '000 Unaudited
Foreign exchange gains	70,322	55,105
Interests	3,472	5,981
Fair value of cross currency swap (Note 11)	347,616	13,914
Dividend income	18	31
Interests - NEK d.o.o.	2,124	1,263
Other financial income	32	-
<b>Total financial income</b>	<b>423,584</b>	<b>76,294</b>
<b>Financial expenses</b>		
Interests	(149,108)	(148,388)
Foreign exchange losses	(87,480)	(13,658)
Interests - NEK d.o.o.	(1,832)	(786)
Other financial expenses	(1,127)	(29)
<b>Total financial expenses</b>	<b>(239,547)</b>	<b>(162,861)</b>
<b>Net profit/ (loss) from financial activities</b>	<b>184,037</b>	<b>(86,567)</b>

## 8. CORPORATE INCOME TAX EXPENSE

Corporate income tax expense and current taxes during the six months period ended 30 June 2015 and 30 June 2014 are accounted on the basis of actual results and the profit tax rate of 20%.



## 9. EQUITY AND RESERVES

Share capital consists of 10,995,644 ordinary shares, with a nominal value of HRK 1,800.00 each.

Retained earnings in the amount of HRK 3,527,482 thousand comprise legal reserves in the amount of HRK 304,399 thousand, retained earnings in the amount of HRK 1,878,741 thousand and profit for the period attributed to the Owner of the Parent in the amount of HRK 1,343,380 thousand.

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. A number of agreements were signed, which regulated the relationship between the joint venture partners and their respective relationships with the new company.

In accordance with the 1996 Asset Contribution Agreement, HEP d.d. contributed property, plant and equipment previously acquired for the project valued at DEM 50,000 thousand (HRK 179,138 thousand) as a contribution in kind to TE Plomin. Of this amount, HRK 50 thousand was allocated as share capital, while HRK 179,088 thousand was allocated to reserves.

In accordance with the Joint Venture Agreement, RWE contributed an equal amount of cash over the period of construction. The initial cash contribution of HRK 50 thousand was allocated as share capital and the remain amount to reserves.

The Agreement signed between HEP and RWE expired on 28 May 2015 and upon expiration HEP d.d. become the sole owner of TE Plomin d.o.o., as HEP exercised 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. without charge.

By the end of May 2015, TE Plomin d.o.o. paid all liabilities to RWE as follows: the principal sum of HRK 25,853 thousand, non-capitalized interest in the amount of HRK 8,981 thousand, dividend from retained earnings for 2012 and 2013 in the amount of HRK 14,605 thousand, dividend for 2014 in the amount of HRK 3,092 thousand and interim dividend prepayments for 2015 in the amount of HRK 961 thousand.

# 10. LONG-TERM LOAN LIABILITIES

	Interest rate	30 June 2015 HRK '000 Unaudited	30 June 2014 HRK '000 Unaudited
Domestic bank loans	EURIBOR+ (1.00%-4.75%)	1,405,634	1,640,285
Foreign bank loans	Fixed 2.71%	49,623	23,183
Finance leases	Fixed 5.6%	20,413	22,362
Total		<b>1,475,670</b>	<b>1,685,830</b>
Deferred loan originated fees		(3,996)	(4,611)
<b>Total long-term loans</b>		<b>1,471,674</b>	<b>1,681,219</b>
Current portion for long-term loans		(385,004)	(416,349)
Current portion of finance lease		(5,033)	(2,834)
<b>Long-term portion</b>		<b>1,081,637</b>	<b>1,262,036</b>

## 10. 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 Company's 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 Statement of comprehensive income. The Company 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 Company's exposure to credit risk, liquidity risk and market risk, which would result from a possible non-compliance with covenants is minimal.

At 30 June 2015 covenants were not breached and the Group has met all contractual financial indicators.

The Group monitors the covenants continuously during the period on a monthly basis, meets the requirements of all the contractual obligations and the Management currently expects no problems with complying with the requirements in future.

The Group's total exposure to loan liabilities subject to covenant conditions as at 30 June 2015 amounts to EUR 123,529 thousand.

At 30 June 2015 the Group doesn't have any liabilities covered by *sovereign loan guarantees*.

# 10. LONG-TERM LOAN LIABILITIES (continued)

## Loans in use

In 2nd quarter of 2015 the Group had available funds from long-term loan approved in 2008 by KfW Entwicklungsbank in the amount of EUR 50 million for the financing of energy efficiency and renewable energy projects. Funds from aforementioned loan was utilized in 2nd quarter of 2015, and as of 30 June 2015 KfW loan balance amounts to EUR 6.55 million, and the amount of EUR 43.45 million were unutilised.

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

	HRK'000
2015	194,608
2016	383,502
2017	389,551
2018	382,855
2019	88,466
After 2019	32,692
<b>Total</b>	<b><u>1,471,674</u></b>

Overview of long-term loans stated in foreign currency (in thousands) is shown as follows:

Currency	30 June 2015	30 June 2014
	HRK'000	HRK'000
EUR	194,292	239,713

# 11. LIABILITIES UNDER ISSUED BONDS

	30 June 2015	31 December 2014
	HRK'000	HRK'000
	Unaudited	Audited
Nominal value of bonds - domestic	233,100	279,790
Discount value	(125)	(170)
Current portion of bonds	(93,380)	(93,380)
	<b>139,595</b>	<b>186,240</b>
Nominal value of bonds - foreign	3,008,746	2,999,389
Exchange differences	(31,735)	9,357
	<b>2,977,011</b>	<b>3,008,746</b>
<b>Total liabilities for issued bonds</b>	<b>3,116,606</b>	<b>3,194,986</b>

## *Bonds issued in the Republic of Croatia*

Bonds in the amount of HRK 700,000 thousand, issued at the end of 2007, 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 HEP d.d. 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, fully mature in November 2017 and are bearing fixed interest of 6%. Bonds of HEP d.d. are listed at Luxembourg stock - exchange and they are actively traded.

In order to hedge against exchange rate fluctuations, respectively to reduce exposure to currency risk, cross currency swap was contracted.

## *Cross currency swap*

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Group has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is transformed in EUR for all period of bond duration, respectively until its outermost maturity date at 9 November 2017. The purpose of this swap was, beside reduce of the currency risk, recommendations of credit agencies related to strategic management of currency risks in order to reduce impact on the Group's business result.

## 11. LIABILITIES UNDER ISSUED BONDS (continued)

### *Cross currency swap (continued)*

As at the time of contracting it was not possible to realize currency swaps USD / HRK, the Group entered into swap USD / EUR due to the fact that the monetary system in Croatia is highly euroised and the main goal of Croatian National Bank monetary policy is stability of the currency which is secured through maintenance of the stable HRK rate against EUR, specially due to expected introduction of EUR as official currency in Croatia.

Cross-currency swap covers principal and interest. According to the agreement, annual interest rate paid by the Group semi-annually is fixed and amounts to 6.53% (include swap cost).

The Group measures the fair value of the cross currency swap according to the calculation of Mark-to-market ("MTM") value. The fair value of the cross currency swap as at 30 June 2015 is stated in the amount of HRK 349,469 thousand. Increase in cross currency swap fair value in the amount of HRK 347,616 thousand is recognized as financial income (Note 7). The main reason for significant change in the fair value of the cross-currency swap was a strengthening of the US dollar against the EUR, especially in the first quarter of 2015.

## 12. OTHER LONG-TERM LIABILITIES

	30 June 2015	31 December 2014
	HRK'000	HRK'000
	Unaudited	Audited
Deferred income - assets financed by third parties	3,620,721	3,738,553
Long term liabilities for assets financed from clearing debt	822,604	759,089
Other	2,083	1,860
	<b>4,445,408</b>	<b>4,499,502</b>

Deferred income relate to fixed assets ceded by customers and others without charge. The income from these assets is recognized over the same period as the related assets are amortized, 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 30 June 2015 the Group stated clearing debt liability in the amount of HRK 822,604 thousand in respect of a clearing debt (2014: HRK 759,089 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.

### 13. SHORT-TERM LOAN LIABILITIES

	30 June 2015	31 December 2014
	HRK'000	HRK'000
	Unaudited	Audited
Current portion of RWE loan (Note 9)	-	8,981
	<u>-</u>	<u>8,981</u>

For the purpose of providing solvency reserves for the following mid-term period, in 2013 the Group has concluded with domestic banks multi-purpose overdraft agreements in the total amount up to HRK 1 billion.

Funds from agreed overdrafts the Group 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.

In the 2nd quarter of 2015 the Group did not use funds from preapproved mid-term multipurpose overdraft agreements, so no balance of short-term loans is reported as at 30 June 2015. However, the Group is using preapproved funds for issuing guarantees on regular basis.

The Group has signed overdraft agreement for reverse factoring in the amount of EUR 50 million until 31 December 2015.

As of 30 June 2015 the Group has available funds from above stated overdraft agreements in total amount of up to HRK 1,323.6 million.



#### 14. 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 the Group 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:

<b>NEK</b>	<b>30 June 2015</b>	<b>31 December 2014</b>
	HRK'000	HRK'000
	Unaudited	Audited
Liabilities for purchased electricity	-	62,830
	<b>Six months period ended</b>	
	<b>30 June 2015</b>	<b>30 June 2014</b>
	HRK'000	HRK'000
	Unaudited	Unaudited
Costs of purchased electricity	334,089	372,385

Remunerations to the Management Board members and executive management of the Group companies:

	<b>Six months period ended</b>	
	<b>30 June 2015</b>	<b>30 June 2014</b>
	HRK'000	HRK'000
	Unaudited	Unaudited
Gross salaries	11,219	11,883
Pension contributions	2,533	2,685
Other (benefits in kind)	1,442	1,571
	<b>15,194</b>	<b>16,139</b>

There were no other payments to members of the Management Boards besides regular salaries and benefits in kind.



**14. RELATED PARTY TRANSACTIONS (continued)**

in HRK'000	Sales revenue		Purchase costs	
	Six months period ended 30 June		Six months period ended 30 June	
	2015	2014	2015	2014
	Unaudited	Unaudited	Unaudited	Unaudited
<b>Companies partially owned by the State</b>				
Hrvatske Željeznice	52,692	52,367	1,358	1,626
INA	68,951	60,564	666,726	329,131
Prirodni Plin	-	-	-	378,079
Plinacro	584	1,268	32,544	34,392
Croatia osiguranje	1,644	2,582	818	7,443
Hrvatska pošta	6,263	11,650	9,765	17,821
Hrvatske šume	1,814	1,861	1,718	2,712
Jadrolinija	304	304	566	261
Narodne novine	1,202	787	1,733	1,946
Hrvatska radio televizija	6,476	6,811	634	519
Plovput	146	275	68	140
Croatia Airlines	390	384	-	61
Petrokemija Kutina	10,258	10,855	10	30
Ministry of Foreign Affairs	229	227	-	-
Ministry of Defence	10,686	12,188	-	-
Ministry of the Interior	7,303	6,962	-	-
Elementary and high schools	44,232	45,233	1	17
Judicial institutions	4,473	4,672	31	46
Colleges and universities	15,434	15,581	402	736
Legislative, executive and other bodies of Republic of Croatia	13,799	13,777	1,833	3,142
Health institutions and organizations	54,233	58,890	300	754
Other users	7,392	6,159	1,821	1,853
<b>TOTAL</b>	<b>308,505</b>	<b>313,397</b>	<b>720,328</b>	<b>780,709</b>

**14. RELATED PARTY TRANSACTIONS (continued)**

In HRK'000	Receivables		Liabilities	
	30 June 2015	31 December 2014	30 June 2015	31 December 2014
	Unaudited	Audited	Unaudited	Audited
<b>Companies partially owned by the State</b>				
Hrvatske Željeznice	23,693	31,811	265	541
INA	13,168	14,544	91,077	163,640
Prirodni Plin	1	-	97	-
Plinacro	98	125	4,512	11,446
Croatia osiguranje	301	705	353	2,779
Hrvatska pošta	845	1,282	1,008	2,725
Hrvatske šume	251	474	13	4
Jadrolinija	127	49	395	581
Narodne novine	390	289	608	838
Hrvatska radio televizija	1,919	2,653	31	39
Plovput	5	24	51	165
Croatia Airlines	58	95	-	-
Petrokemija Kutina	3,741	3,675	13	13
Ministry of Defence	1,879	4,311	-	-
Ministry of the Interior	1,162	2,069	-	-
Elementary and high schools	7,495	16,526	-	-
Judicial institutions	563	1,838	-	-
Colleges and universities	5,124	4,161	-	-
Legislative, executive and other bodies of Republic of Croatia	2,486	5,131	-	-
Health institutions and organizations	13,510	20,202	-	-
Other users	21,436	21,623	4,296	10,317
<b>TOTAL</b>	<b>98,252</b>	<b>131,587</b>	<b>102,719</b>	<b>193,088</b>

#### 14. RELATED PARTY TRANSACTIONS (continued)

As of 30 June 2015 the Group owned the following subsidiaries:

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-Opskrba d.o.o.	Croatia	100	Electricity supply
HEP-Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP-Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	100	Electricity generation
APO d.o.o., usluge zaštite okoliša	Croatia	100	Environmental protection services and special waste management
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.	BH	100	Maintenance of hydro power plants
HEP-Upravljanje imovinom d.o.o.	Croatia	100	Accommodation and recreation services
HEP-NOC Velika	Croatia	100	Accommodation and training
HEP-Obnovljivi izvori energije d.o.o.	Croatia	100	Electricity generation
Program Sava d.o.o.	Croatia	100	Spatial planning, design, construction and supervision
HEP-Trgovina d.o.o. Ljubljana	Slovenia	100	Electricity trading
HEP- Magyarorszag Energia KFT	Hungary	100	Electricity trading
HEP-Trade d.o.o., Mostar	BH	100	Electricity trading
HEP-Trade d.o.o., Beograd	Serbia	100	Electricity trading
HEP – KS sh.p.k.	Kosovo	100	Electricity trading, transmission and distribution
HEP-Telekomunikacije d.o.o.	Croatia	100	Telecommunication services
HEP – Opskrba plinom d.o.o.	Croatia	100	Gas distribution

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. The company HEP-Telekomunikacije d.o.o. was founded in 2013 and HEP-Opskrba plinom d.o.o. in 2014.

The Agreement signed between HEP and RWE expired on 28 May 2015 and upon expiration HEP d.d. become the sole owner of TE Plomin d.o.o. (Note 9).

## 15. FAIR VALUE OF FINANCIAL INSTRUMENTS

### *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 (excluding derivative instruments) 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 analyzes 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.

## 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

	1 <sup>st</sup> level HRK '000	2 <sup>nd</sup> level HRK '000	3 <sup>rd</sup> level HRK '000	Total HRK '000
<b>30 June 2015, unaudited</b>				
Available-for-sale assets	234,352	-	-	<b>234,352</b>
Cross currency swap	-	-	349,469	<b>349,469</b>
Investment property	-	236,155	-	<b>236,155</b>
<b>31 December 2014, audited</b>				
Available-for-sale assets	192,676	-	-	<b>192,676</b>
Cross currency swap	-	-	1,473	<b>1,473</b>
Investment property	-	236,153	-	<b>236,153</b>

## 16. CONTINGENT LIABILITIES

### *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 consider overall electrical energy security of the Republic of Croatia, and the fact that the Company has built and invested significant resources in these facilities, that the Company maintains these facilities, and is the owner of all equipment necessary for the operation and functionality of the above mentioned hydro-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. Furthermore, in 2015 the Ministry of Agriculture has launched amendment procedure to the Water Act. As part of this process and with consideration of all of the above mentioned, the Company has submitted a proposal for amendment of the provisions of the Water Act, with the aim of clearing the property-legal relations and ownership of the Republic of Croatia over facilities for electricity production built by legal persons in the majority ownership of the Republic of Croatia. The competent Ministry of Economy issued an opinion with approval of the Company's initiative to amend the Water Act.

## 17. EVENTS AFTER THE REPORTING PERIOD

On 23 July 2015, companies HEP – Proizvodnja d.o.o. and HEP – Obnovljivi izvori energije d.o.o. concluded an Merger agreement by which the company HEP - Obnovljivi izvori energije d.o.o. is merged to the company HEP – Proizvodnja d.o.o..

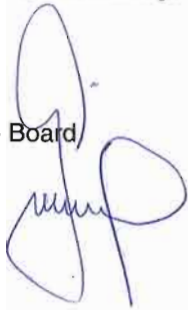
## 18. APPROVAL OF THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

These condensed consolidated interim financial statements were approved by the Management Board and authorised for issue on 9 September 2015.

Signed on behalf of the Management Board on 9 September 2015:

Perica Jukić

President of the Board



Tomislav Rosandić

Member of the Board





**HRVATSKA ELEKTROPRIVREDA**

**HRVATSKA ELEKTROPRIVREDA d.d. Zagreb**

Consolidated financial statements

As of 31 December 2014,

31 December 2013 and 31 December 2012

together with Independent Auditor's Report

## Contents

---

	<i>Page</i>
Responsibility for the Consolidated Financial Statements	1
Independent Auditor's Report	2 - 3
Consolidated statement on Comprehensive Income	4 - 5
Consolidated Statement of Financial Position	6 - 7
Consolidated Statement of Changes in Equity	8
Consolidated Statement of Cash Flows	9 - 10
Notes to the Consolidated Financial Statements	11 - 96



## Responsibility for the Consolidated Financial Statements

---

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 years 2014, 2013 and 2012 are prepared in accordance with the Accounting Act (Official Gazette No 109/07, 54/13) and International Financial Reporting Standards as adopted by EU, to give a true and fair view of the consolidated financial position, the consolidated results of operations, consolidated changes in equity and consolidated cash flows of the Company for that period.

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

In preparing these consolidated financial statements, the Board is responsible that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable financial reporting standards are followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- the consolidated financial statements are prepared on the going concern basis unless such assumption is not appropriate.

The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the consolidated financial position and the consolidated results of operations of the Company and their compliance with the Accounting Act (Official Gazette No 109/07, 54/13) and the International Financial Reporting Standards as adopted by EU. The Board is also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed for and on behalf of the Management Board

*Perica Jukić*

Perica Jukić

President of the Management Board

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

Hrvatska elektroprivreda d.d.

Ulica grada Vukovara 37

10000 Zagreb

Republic of Croatia

30 June 2015

## **INDEPENDENT AUDITOR'S REPORT**

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

1. We have audited the accompanying annual consolidated financial statements of the company HRVATSKA ELEKTROPRIVREDA d.d., Zagreb, (hereinafter "the Company") for the years ended 31 December 2014, 31 December 2013 and 31 December 2012, which comprise of the consolidated Statement of financial position as at 31 December 2014, 31 December 2013 and 31 December 2012; consolidated Statement of comprehensive income; consolidated Statement of changes in equity; consolidated Cash Flows Statement for the years then ended; and the accompanying Notes to the consolidated Financial Statements which concisely set out the significant accounting policies and other explanatory notes.

### **Management's Responsibility**

2. The Management is responsible for the preparation and a fair presentation of the enclosed consolidated financial statements according to the International Financial Reporting Standards adopted by EU and also for those internal controls which are determined by the Company's management as necessary to enable preparation of the consolidated financial statements free from material misstatements whether due to fraud or error.

### **Auditor's Responsibility**

3. Our responsibility is to express an opinion on the enclosed consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement in the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

4. In our opinion, the enclosed consolidated financial statements, in all material aspects, give a true and fair view of the consolidated financial position of the company HRVATSKA ELEKTROPRIVREDA d.d., Zagreb as at 31 December 2014, 31 December 2013 and 31 December 2012, and its consolidated financial performance and consolidated Statement of cash flows for 2014, 2013 and 2012 in accordance with the Accounting Act and International Financial Reporting Standards as adopted by EU.

## Emphasis of matter

5. As described in the Note 28 to the consolidated financial statements, at 31 December 2014, the Company stated clearing debt liability in the amount of HRK 759,089 thousand (2013: HRK 668,377 thousand, 2012: HRK 689,792 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 government grant.

6. As described in the Note 26 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 (canals, dams, etc.) 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.

7. We draw attention to the Note 3 to the consolidated financial statements in which are presented restatements of the accompanying consolidated financial statements for 2012 and 2013, related to impairment of property, plant and equipment, the final calculation of electricity facilities value, purchased from Hrvatske autoceste d.o.o. and changes in the accounting model for investment in Krško Nuclear Power Plant as a result of application of IFRS 11.

In Zagreb, 30 June 2015

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



Zdenko Balen, Member of the  
Management Board

**BDO**

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



Ivana Jadrešić, certified auditor

# Consolidated statement of comprehensive income

For the years ended 31 December 2014, 2013 and 2012

	Notes	2014 HRK '000	2013 HRK '000 Restated	2012 HRK '000 Restated
Revenue from electricity sales	4	10,575,290	11,947,939	11,630,275
Revenue from thermal power sales	4	671,946	763,461	585,485
Revenue from sale of gas on wholesale market	4, 34	689,575	-	-
Revenue from sale of gas to customers	4	371,490	406,167	395,956
<b>Sales revenue</b>		<b>12,308,301</b>	<b>13,117,567</b>	<b>12,611,716</b>
Other operating income	4,5	1,290,873	1,591,618	1,412,914
<b>Total operating income</b>		<b>13,599,174</b>	<b>14,709,185</b>	<b>14,024,630</b>
Electricity purchase cost		(1,200,023)	(1,942,301)	(3,085,280)
Fuel cost		(1,777,077)	(2,734,741)	(3,434,478)
Costs of gas sold	34	(717,721)	-	-
Staff cost	6	(1,880,519)	(1,868,718)	(1,990,410)
Depreciation and amortization costs	10, 11	(1,897,190)	(1,883,970)	(1,855,158)
Other operating expenses	7	(2,926,195)	(3,943,827)	(3,396,984)
<b>Total operating expenses</b>		<b>(10,398,725)</b>	<b>(12,373,557)</b>	<b>(13,762,310)</b>
<b>Operating profit</b>		<b>3,200,449</b>	<b>2,335,628</b>	<b>262,320</b>
Financial income	8	433,671	64,434	69,398
Financial expenses	8	(556,577)	(875,370)	(355,317)
<b>Net loss from financial activities</b>		<b>(122,906)</b>	<b>(810,936)</b>	<b>(285,919)</b>
<b>Profit before taxation</b>		<b>3,077,543</b>	<b>1,524,692</b>	<b>(23,599)</b>
Corporate income tax expense	9	(612,119)	(256,818)	(20,342)
<b>Profit for the year</b>		<b>2,465,424</b>	<b>1,267,874</b>	<b>(43,941)</b>
<b>Attributable to:</b>				
Owners of the Parent		2,462,332	1,261,926	(52,648)
Non-controlling interest		3,092	5,948	8,707
		<b>2,465,424</b>	<b>1,267,874</b>	<b>(43,941)</b>

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

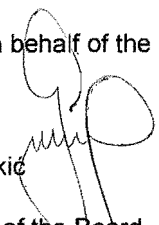
# Consolidated statement of comprehensive income(continued)

For the years ended 31 December 2014, 2013 and 2012

	2014 HRK '000	2013 HRK '000 Restated	2012 HRK '000 Restated
<b>Profit /(loss) for the year</b>	<b><u>2,465,424</u></b>	<b><u>1,267,874</u></b>	<b><u>(43,941)</u></b>
<b>Other comprehensive income</b>			
Exchange gains arising on translation of foreign operations	2,216	21,531	164
Net gain/(loss) on AFS financial assets	<u>52,330</u>	<u>(3,429)</u>	<u>6,046</u>
Net other comprehensive income to be reclassified to income/ (loss) in subsequent periods	<u>54,546</u>	<u>18,102</u>	<u>6,210</u>
<b>Other comprehensive income, net</b>	<b><u>54,546</u></b>	<b><u>18,102</u></b>	<b><u>6,210</u></b>
<b>Total comprehensive income for the year, net of tax</b>	<b><u>2,519,970</u></b>	<b><u>1,285,976</u></b>	<b><u>(37,731)</u></b>
<b>Total comprehensive income attributable to:</b>			
Owners of the Parent	2,516,797	1,279,627	(46,603)
Non-controlling interest	<u>3,173</u>	<u>6,349</u>	<u>8,872</u>
	<b><u>2,519,970</u></b>	<b><u>1,285,976</u></b>	<b><u>(37,731)</u></b>

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

Signed on behalf of the Company on 30 June 2015:

*kn*  
  
 Perica Jukic  
 President of the Board

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

# Consolidated statements of financial position

For the years ended 31 December 2014, 2013 and 2012

ASSETS	Notes	31 December	31 December	31December
		2014	2013	2012
		HRK '000	HRK '000	HRK '000
			Restated	Restated
<b>Non-current assets</b>				
Property, plant and equipment	10, 14	25,334,813	25,318,021	25,249,062
Assets under construction	10	4,188,741	4,076,885	3,931,957
Prepayments for property, plant and equipment	13	41,486	57,766	72,318
Intangible assets	11	77,046	69,433	73,968
Investment property	12	236,153	233,057	235,841
Long-term loans and deposits	16	4,533	6,160	514
Available-for-sale and other investments	17	192,676	125,166	129,353
Other non-current assets	18	49,804	58,812	67,852
Deferred tax assets	9	653,907	756,647	724,929
		<b>30,779,159</b>	<b>30,701,947</b>	<b>30,485,794</b>
<b>Current assets</b>				
Inventories	19	1,613,297	1,154,404	1,246,376
Trade receivables	20	1,864,680	1,800,076	1,879,409
Other short-term receivables	21	519,682	654,169	309,006
Cash and cash equivalents	22	1,079,900	260,844	605,081
		<b>5,077,559</b>	<b>3,869,493</b>	<b>4,039,872</b>
<b>TOTAL ASSETS</b>		<b>35,856,718</b>	<b>34,571,440</b>	<b>34,525,666</b>

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

# Consolidated statements of financial position (continued)

For the years ended 31 December 2014, 2013 and 2012

EQUITY AND LIABILITIES	Notes	31 December 2014	31 December 2013	31 December 2012
		HRK '000	HRK '000 Restated	HRK '000 Restated
Share capital	23	19,792,159	19,792,159	19,792,159
Revaluation reserves	23	54,947	2,617	6,046
Retained earnings /(loss carried forward)	23	2,201,265	18,809	(1,265,597)
<b>Equity Attributable to Owners of the Parent</b>		<b>22,048,371</b>	<b>19,813,585</b>	<b>18,532,608</b>
Non-controlling interest	15	29,202	31,977	47,283
<b>Total equity</b>		<b>22,077,573</b>	<b>19,845,562</b>	<b>18,579,891</b>
Long-term loan liabilities	24	1,262,036	1,722,010	1,894,864
Long-term liabilities to the State	25	21,690	24,451	27,544
Long-term provisions	26	902,779	808,382	686,333
Liabilities under issued bonds	27	3,194,986	3,278,893	3,335,608
Other long-term liabilities	28	4,499,502	5,038,526	4,912,601
Deferred tax liabilities		13,573	654	1,511
<b>Total non-current liabilities</b>		<b>9,894,566</b>	<b>10,872,916</b>	<b>10,858,461</b>
Trade payables	32	1,590,745	1,580,440	2,556,759
Current portion of long-term bonds issued	27	93,380	93,380	593,380
Current portion of long-term loans	24	416,349	208,838	132,084
Short-term loans	29	8,981	692,654	430,914
Taxes and contributions	30	361,095	165,670	347,817
Interests payable		38,263	41,132	45,574
Liabilities to employees	31	151,240	145,940	149,747
Other non-current liabilities	32	1,224,526	924,908	831,039
<b>Total current liabilities</b>		<b>3,884,579</b>	<b>3,852,962</b>	<b>5,087,314</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>35,856,718</b>	<b>34,571,440</b>	<b>34,525,666</b>

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

Signed on behalf of the Company on 30 June 2015:

Perica Jukić

President of the Board

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

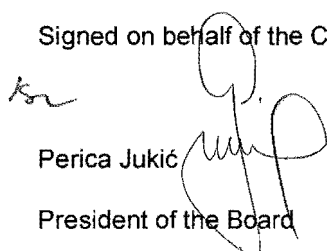
# Consolidated statement of changes in equity

For the years ended 31 December 2014, 2013 and 2012

	Share capital	Revaluation reserves	Retained earnings / Loss carried forward	Equity attributable to Owners of the Parent	Non controlling interests	Total equity
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Balance as at 31 December 2012</b>	<b>19,792,159</b>	<b>6,046</b>	<b>118,915</b>	<b>19,917,120</b>	<b>47,283</b>	<b>19,964,403</b>
<i>Restatement effects</i>	-	-	(1,384,512)	(1,384,512)	-	(1,384,512)
<b>Balance as at 1 January 2013 Restated</b>	<b>19,792,159</b>	<b>6,046</b>	<b>(1,265,597)</b>	<b>18,532,608</b>	<b>47,283</b>	<b>18,579,891</b>
Profit for the year	-	-	1,261,926	1,261,926	5,948	1,267,874
Other comprehensive income	-	(3,429)	21,130	17,701	401	18,102
<i>Total comprehensive income</i>	-	(3,429)	1,283,056	1,279,627	6,349	1,285,976
Land surpluses	-	-	1,350	1,350	-	1,350
Distribution of dividends to (RWE)	-	-	-	-	(21,655)	(21,655)
<b>Balance as at 31 December 2013 Restated</b>	<b>19,792,159</b>	<b>2,617</b>	<b>18,809</b>	<b>19,813,585</b>	<b>31,977</b>	<b>19,845,562</b>
Profit for the year	-	-	2,462,332	2,462,332	3,092	2,465,424
Other comprehensive	-	52,330	2,135	54,465	81	54,546
<i>Total comprehensive income</i>	-	52,330	2,464,467	2,516,797	3,173	2,519,970
Land surpluses	-	-	2,907	2,907	-	2,907
Distribution of dividends	-	-	(284,918)	(284,918)	-	(284,918)
Distribution of dividends to (RWE)	-	-	-	-	(5,948)	(5,948)
<b>Balance at 31 December 2014</b>	<b>19,792,159</b>	<b>54,947</b>	<b>2,201,265</b>	<b>22,048,371</b>	<b>29,202</b>	<b>22,077,573</b>

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

Signed on behalf of the Company on 30 June 2015:

  
Perica Jukić  
President of the Board

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



# Consolidated statement of cash flows

For the years ended 31 December 2014, 2013 and 2012

	2014 HRK '000	2013 HRK '000 Restated	2012 HRK '000 Restated
<b>Cash flows from operating activities</b>			
Profit/ (loss) for the year	2,465,424	1,267,874	(43,941)
Corporate income tax expense recognized in profit / (loss)	509,764	296,377	88,757
Net loss from financial activities	122,906	810,936	285,919
Property surpluses	(3,954)	(4,907)	-
Decrease in other non-current assets	(49,311)	(20,179)	78,608
Unrealized gain / (loss) from derivatives fair value measurement	393,281	(391,808)	-
Value adjustment of non-current assets	73,518	195,296	245,195
Depreciation and amortization	1,897,190	1,883,970	1,855,158
Increase in impairment of receivables	56,689	25,811	110,079
Increase in impairment of inventories	19,892	47,987	539
Increase / (decrease) in provisions	94,397	115,744	(117,218)
<i>Operating cash flows before movements in working capital</i>	5,579,796	4,227,101	2,503,096
Increase in trade receivables	(121,293)	67,305	(487,088)
Decrease in inventories	(478,785)	30,418	81,340
(Increase) / decrease in other current assets	(60,454)	(162,397)	171,491
(Decrease)/ increase in trade payables	(67,470)	(639,960)	65,314
Increase in other short-term liabilities	798,242	(68,023)	264,768
(Decrease) in other long-term liabilities	(607,062)	93,585	(213,755)
<b>Cash generated from operations</b>	<b>5,042,974</b>	<b>3,548,029</b>	<b>2,385,166</b>
Corporate income tax paid/ Corporate income tax return	(465,018)	(364,946)	33,983
Interests paid	(404,220)	(378,355)	(306,517)
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>4,173,736</b>	<b>2,804,728</b>	<b>2,112,632</b>
<b>INVESTING ACTIVITIES</b>			
Interest receipts	13,210	13,817	3,766
Increase in property, plant and equipment	(2,063,723)	(2,365,662)	(2,843,449)
Disposal of property, plant and equipment	20,845	33,507	16,138
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(2,029,668)</b>	<b>(2,318,338)</b>	<b>(2,823,545)</b>

# Consolidated statement of cash flows (continued)

For the years ended 31 December 2014, 2013 and 2012

	2014 HRK '000	2013 HRK '000 Restated	2012 HRK '000 Restated
<b>FINANCING ACTIVITIES</b>			
Receipts from bonds issued	-	-	2,955,595
Long-term loans received	-	23,955	505,905
Short-term loans received	-	478,000	1,081,682
Repayments of long-term loans	(258,848)	(134,547)	(2,242,525)
Repayments of bonds issued	(93,380)	(593,380)	(93,380)
Repayments of short-term loans	(681,866)	(583,000)	(1,273,970)
Dividends paid to the owner	(284,970)	-	-
Dividends paid to RWE	(5,948)	(21,655)	(24,436)
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(1,325,012)</b>	<b>(830,627)</b>	<b>908,871</b>
<b>NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>819,056</b>	<b>(344,237)</b>	<b>197,958</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR</b>	<b>260,844</b>	<b>605,081</b>	<b>407,123</b>
<b>CASH AND CASH EQUIVALENTS AT END OF THE YEAR</b>	<b>1,079,900</b>	<b>260,844</b>	<b>605,081</b>

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

Signed on behalf of the Company on 30 June 2015:

Perica Jukić  
President of the Board

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

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

---

## 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 35.

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 2014 the Group employed 12,707 employees (2013: 12,512; 2012: 14,177).

These consolidated financial statements are presented in Croatian Kuna as the Group'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), and
- the Heat Energy Market Act (adopted on 21 June 2013).

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, 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 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.

In accordance with provisions of the Electricity Market Act, on March 2013 HERA issued Methodology for setting tariff items for electricity supply within the universal service, and on 17 December 2013 Methodology for setting the tariff items for guaranteed electricity supply.

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.

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 dated 12 June 2014.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

---

## 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
---------------	--------	-------------------------------

### **Supervisory Board**

#### *Members of the Supervisory Board in 2014*

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Ante Ramljak	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

#### *Supervisory Board in 2013*

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Ante Ramljak	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Mirko Žužić	Member	Member since 19 September 2012
Jadranko Berlengi	Member	Member since 3 June 2008

#### *Supervisory Board in 2012*

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Hubert Bašić	Member	Member since 23 February to 7 May 2012
Ivo Uglešić	Member	Member since 23 February 2012
Ante Ramljak	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Alen Leverić	Member	Member since 23 February 2012 to 9 April 2013
Jadranko Berlengi	Member	Member since 3 June 2008

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

---

### 1. GENERAL (continued)

#### *Management Board in 2014*

Perica Jukić	President	Member since 10 May 2013, President since 12 September 2014
Tomislav Šerić	President	President since 10 May 2013 to 12 September 2014
Zvonko Ercegovac	Member	Member since 23 February 2012
Ivan Matasić	Member	Member since 23 February 2012 to 12 September 2014
Krunoslava Grgić-Bolješić	Member	Member since 23 February 2012 to 12 September 2014
Željko Štromar	Member	Member since 16 December 2013 to 31 March 2015
Saša Dujmić	Member	Member since 4 December 2014

#### *Management Board in 2013*

Tomislav Šerić	President	President since 10 May 2013
Zlatko Koračević	President	President to 10 May 2013
Zvonko Ercegovac	Member	Member since 23 February 2012
Ivan Matasić	Member	Member since 23 February 2012
Krunoslava Grgić-Bolješić	Member	Member since 23 February 2012
Perica Jukić	Member	Member since 10 May 2013
Rodoljub Lalić	Member	Member to 10 May 2013
Željko Štromar	Member	Member since 16 December 2013

#### *Management Board in 2012*

Zlatko Koračević	President	President since 23 February 2012
Zvonko Ercegovac	Member	Member since 23 February 2012
Ivan Matasić	Member	Member since 23 February 2012
Krunoslava Grgić-Bolješić	Member	Member since 23 February 2012
Rodoljub Lalić	Member	Member since 23 February 2012
Tomislav Šerić	Member	Member since 23 February 2012

## **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 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU.

The International Financial Reporting Standards ("IFRS") issued by the Committee for Financial Reporting Standards nominated by the Government of the Republic of Croatia (Official Gazette No 136/09, 8/10, 18/10, 27/10, 65/10, 120/10, 58/11, 140/11, 15/12, 118/12, 45/13, 69/13, 73/13), which were in effect until Croatian accession to the European Union (1 July 2013), are in accordance with International Financial Reporting Standards ("IFRS") set forth by the European Commission and published in Official Gazette of European Union.

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. The accounting records of the Group's subsidiaries in Croatia and abroad are maintained in accordance with the requirements of the respective local jurisdictions.

The Group's consolidated financial statements are presented in thousands of Croatian Kuna (HRK'000).

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

- IFRS 10 "Consolidated Financial Statements," issued in May 2011 and amended in 2012 replaces the preceding IAS 27 version (2008) "Consolidated and Separate Financial Statements" effective for the annual period beginning on or after 1 January 2014);
- IFRS 11 "Joint Arrangements," issued in May 2011 and amended in 2012 replaces the preceding IAS 31 "Interest in Joint Ventures," (effective for the annual period beginning on or after 1 January 2014);
- IFRS 12 "Disclosure of Interests in Other Entities," issued in May 2011 and supplemented in 2012 (effective for the annual period beginning on or after 1 January 2014);
- IAS 27 "Separate Financial Statements," (amended and supplemented in 2011), consolidated requirements previously described in IAS 27 (2008) are revised and contained in IFRS 10 "Consolidated Financial Statements," (IAS 27 in force (amendment and supplement in 2011) is applied to the annual period beginning on or after 1 January 2014);
- IAS 28 "Investments in Associates and Joint Ventures," (amended and supplemented in 2011). This version replaces IAS 28 (2003) Investments in Associates," (IAS 28 in force (amended and supplemented in 2011) is applied to the annual period beginning on or after 1 January 2014);
- IFRIC 21 "Levies," – issued in May 2013, (effective for the annual period beginning on or after 1 January 2014);
- Amendments to IAS 32 – Offsetting financial assets and financial liabilities (effective for the annual period beginning on or after 1 January 2014);
- Amendments to IAS 39 – Novation of Derivatives and continuation of Hedge Accounting (effective for the annual period beginning on or after 1 January 2014).

The Company presented comparatives as per requirements. Application of the above mentioned Standards (except for IFRS 11) did not have effect on the consolidated financial statements as at 1 January 2014. Application of IFRS 11 had impact on the accounting treatment of investment in Krško Nuclear Power Plant. The effects of said change are disclosed in the Note 3.



## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *New and revised IFRSs adopted by the EU in issue but not yet effective*

The Group has not applied the following new and revised IFRSs and Interpretations that have been issued and adopted by the EU but are not yet effective in the EU:

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions – IAS 19 requires subjects to consider employee or third party contributions in accounting defined earning. This amendment is effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted. The Company does not expect this amendment to be relevant to the Company
- Annual Improvements 2010-2012 Cycle, these amendment are effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted and it is not expected that they will have any significant impact on the Company. 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
- Annual Improvements 2011-2013 Cycle - effective in EU for accounting periods beginning on or after 1 January 2015, with earlier application permitted and it is not expected that they will have any significant impact on the Company. They include:
  - IFRS 3 Business Combinations,
  - IFRS 13 Fair Value Measurement,
  - IAS 40 Investment Property
- IFRIC 21 Levies (Effective in EU for accounting periods beginning on or after 17 June 2014, with earlier application permitted).

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### ***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 endorsed for use in EU yet:

- 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 affect the classification and measurement of financial instruments.
- 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 Company prepares its Financial Statements in accordance with IFRS and does not apply this standard
- 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.
- 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)
- 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)
- 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 Group's Management anticipates that the application of said standards, amendments and interpretations will not have a materially significant impact on the consolidated financial statements in the period of their initial application, except for IFRS 15 for which the Group's Management is conducting detail analysis regarding possible effects from the application of this Standard on the consolidated financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### ***The basis for preparation of the Group's financial statements***

The Group's financial statements represent aggregate amounts of assets, liabilities and equity, and the results of the Group's operations for the years 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 35. 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 (except TE Plomin) 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.

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).

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *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 (Notes 3 and 14).

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Employee benefits*

The Group 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 Group'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.

	2014, 2013, 2012
Pension insurance contributions	20%
Health insurance contributions	15%, (13%*)
Employment Fund contribution	1.7%
Occupational injury	0.5%

### *Health insurance contributions*

\*From 1 May 2012 until 31 March 2014 rate of 13% was applied, and as of 1 April 2014 the rate is 15%.

The Group companies have the obligation to withhold the pension insurance 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 6).

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) 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 October 2014 (which covers all of the 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 the retirement, for each completed year of continuous employment at the employer. The effective date of the Collective contract is until 30 June 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:

	<b>2014, 2013 and 2012</b>
<b>Buildings</b>	
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
<b>Plant and equipment</b>	
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
<b>Other equipment and vehicles</b>	
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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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.

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 in other income.

### *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 a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Intangible assets*

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

### *Investment property*

Investment properties are properties held for the purposes of earning rentals and/or capital appreciation, including property under construction for such purposes. Investment properties are measured initially at cost, including transaction costs. Subsequently, investment properties are measured at fair value. Gains and losses arising from changes in the fair value of investment properties are included in profit or loss for the period in which they arise.

An investment property is derecognized upon sale or retirement and when no future economic benefits are expected from its disposal. Any gain or loss arising 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 2014 and 2013. Operating lease payments are recognized as an expense in the statement of comprehensive income 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 aging 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:

Receivables ageing structure	Impairment percentage in 2014, 2013 and 2012
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, 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<sub>2</sub> emission rights. After Croatia joined to the European system for greenhouse gas emissions trading (EU ETS), the Group as an electricity and thermal energy generator, is obligated to purchase greenhouse gas emission units in the amount corresponding to verified emissions of CO<sub>2</sub> generated from the fossil fuel combustion in thermal power plants, as a result of which CO<sub>2</sub> is emitted. The Group is obligated to have defined quantities of CO<sub>2</sub> emission rights at 30 April (yearly cycle). Due to withdrawal of IFRIC 3 *Emission Rights* and insufficient provisions of IFRS, the Group has analyzed different accounting models for CO<sub>2</sub> emission rights, and among other EFRAG discussion papers. Occasionally, the Group trades with CO<sub>2</sub> emission rights. Due to that the Group 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 Group measures inventories based on the weighted average price (Notes 19 and 32).

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.

## 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 the 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 as profit or loss in the period in which they incurred. Exchange differences arising on retranslation of non-monetary assets carried at fair value are stated as profit or loss, 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 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 equity and presented in other comprehensive income. In the year in which foreign entity is sold, exchange differences are transferred to profit or loss.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### ***Taxation***

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

#### *Current tax*

Current tax liability is based on taxable profit for the year. Taxable profit differs from profit for the year as stated in the 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.

#### *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 arises 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 statement of comprehensive income, 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.

## 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 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*

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 or 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.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

### ***Financial liabilities (continued)***

#### ***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.

#### ***Derivative financial instruments***

The Group 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 27.

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. The resulting gain or loss is recognized in profit or 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, as adopted by EU, 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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *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.

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. Thereby the total generated and purchased energy quantities are corrected for losses in the distribution network based on logarithmic regression. The price of electricity is regulated by the Croatian Energy Regulatory Agency. The Group accounting model do not include any accrual or deferral of revenue, or any associated assets or liabilities, related to price regulation and thus the Group measure revenue from the sale of electricity based on regulated prices. Alternatively, the Group provides option for their customers to choose market price model, in which case revenue is recognized in accordance with 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's accounting model do not include any deferral of revenue related to price regulation and thus the Group measure revenue from the gas sale based on regulated prices.

### *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 Company must recognize the asset in its 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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### ***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.

### ***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. In 2014 useful lives of gas pipelines are extended from 20-25 year to 40 years.

#### *Impairment of trade and other receivables*

As described in the Note 20, the Management uses its judgment when estimating whether trade and other receivables have suffered an impairment loss.

#### *Provisions for environmental protection*

The applicable regulations, specifically the environmental protection legislation, do not specify requirements, activities or technology to be applied.

In determining the level of provisions for environment protection and decommissioning, the Management relies on the prior experience and its own interpretation of the related legislation. Pursuant to Article 4.1 of the Act 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 regarding Investment, Exploitation and Decommissioning of the Nuclear Power Plant Krško (hereinafter: NEK), on 28 April 2006 the Croatian Government issued a Regulation on the payment of funds for decommissioning and disposal of radioactive waste and consumed nuclear fuel of NEK.

Provision for decommissioning of thermal power plants represent present value of the estimated decommissioning costs of the Group's thermal power plants.



## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Recognition of revenues from sale of electricity*

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 analyzing 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 amount of losses on the distribution network is calculated using the percentage of the logarithmic regression function on the total amount of purchased energy from the transmission network - the result are the losses of electricity distribution network in the current year in MWh. The difference between initially estimated revenues and actual prepayments is recognized in the statement of financial position as other short-term liabilities or other short-term receivables.

### *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. Impairments of non-current assets are disclosed in the Note 3.

### *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 2014 amounted to HRK 653,907 thousand, as at 31 December 2013 to HRK 756,647 thousand and as at 31 December 2012 to HRK 724,929 thousand (Note 9).

### *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 364,497 thousand as at 31 December 2014, to HRK 271,527 thousand as at 31 December 2013 and to HRK 329.484 thousand as at 31 December 2012 (Note 26).

### *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 26).

### 3. RESTATEMENTS

#### **Takeover of facilities from HAC d.o.o. (Croatian motorways)**

In the period from 2007 to 2009, HEP d.d. and HAC d.o.o. signed multiple contracts on mutual relations and joint financing of the construction of electric power generating facilities necessary for the supply of electricity as a mutual interest in terms of the Building Act, Public Roads Act, Energy Act and Electricity Market Act. By adoption of the amendments of the Public Roads Act and Roads Act as well as agreed documentation and specification of all electric power generating facilities, the contracting parties signed Annexes to above mentioned contracts, by which HEP overtook electric power generating facilities built by the HAC d.o.o. as part of the construction of public roads.

Based on the Contract on takeover of electric power generating facilities signed between HEP d.d. and HAC d.o.o. on 25 March 2015, HEP d.d. has recorded transactions in its business ledgers in accordance with IAS 8, paragraph 42, by restating previous periods. The reason for restating previous periods was the fact that HEP was unconditionally entitled to the facilities, and used those facilities, from 2009 in their regular course of business. No other entity was or is permitted to use those facilities. The only reason HEP did not recognize those facilities in its business ledger in 2009 was incomplete documentation and technical specification for those facilities constructed by HAC. Based on this, the Group has recognized those facilities at construction cost, net of depreciation that would have been calculated from the moment those assets were brought in to the location and condition necessary to be capable of operating in the manner intended by the Group.

#### **Investment in Nuclear Power Plant Krško d.o.o.**

Based on the adoption of International Financial Reporting Standards (IFRS) 11 Joint Arrangements, which replaced the International Accounting Standard (IAS) 31 Interests in joint ventures, investment in NEK is classified in accordance with IFRS 11 as a joint operation. The Company recognizes its share in assets and liabilities, income and expenses based on its share in the joint operation of NEK. Prior to adoption of IFRS 11, the Company measured investment in NEK using the equity method. Within the restatement, amount recognized based on the equity method has been replaced by individual items of assets and liabilities. The difference between the equity method and the method of accounting of assets and liabilities is stated within retained earnings. Although the investment in NEK was realized through separate entity, the Group and other investor (GEN energija d.o.o.) in accordance with the Article of association are deciding by consensus. Furthermore, as NEK can sell energy only to investors and they are obliged to buy the energy, based on the guidance in paragraphs B29-B33 of Appendix B of IFRS 11, the Group has concluded that this is a joint operation.

### 3. RESTATEMENTS (continued)

#### **The property of thermal power plants**

Based on determined indicators for impairment of assets and calculation of recoverable amount in accordance with IAS 36, carrying amount of thermal power plant was impaired as at 31 December 2014 in the amount of HRK 2,389,405 thousand. Impairment included buildings, equipments and plants. Market prices of electricity significantly lower than the cost electricity generation in thermal power plants represent key impairment indicator. Due to that the Group engaged an independent appraiser for measurement of assets recoverable amounts. Consequently, based on evaluation from the independent appraiser, the Group has identified that the circumstances that led to impairment existed also in previous years. Accordingly, the Group has determined the recoverable amounts in previous years and accordingly restated the comparative financial statements. Consequently, most of the assets impairment relate to periods prior to the end of 2012, in the total amount of HRK 2,500,125 thousand.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 3. RESTATEMENTS (continued)

### Consolidated statement of financial position for the year ended 31 December 2012

Detailed overview of restatements in consolidated statements of financial position for the year ended 31 December 2012

	31.12.2012 before restatement HRK '000	HEP Proizvodnja d.o.o. HRK '000	HAC HRK '000	NEK d.o.o. HRK '000	Total restatement HRK '000	31.12.2012 HRK '000 Restated
<b>NON-CURRENT ASSETS</b>						
Property, plant and equipment	25,304,113	(2,500,125)	957,950	1,487,124	(55,051)	25,249,062
Assets under construction	3,915,002	-	-	16,955	16,955	3,931,957
Investment property	233,917	-	-	1,924	1,924	235,841
Investment in NEK	1,754,419	-	-	(1,754,419)	(1,754,419)	0
Other non-current assets	67,318	-	-	534	534	67,852
Deferred tax assets	224,904	500,025	-	-	500,025	724,929
	<b>31,775,826</b>	<b>(2,000,100)</b>	<b>957,950</b>	<b>(247,882)</b>	<b>(1,290,032)</b>	<b>30,485,794</b>
<b>CURRENT ASSETS</b>						
Inventories	981,641	-	-	264,735	264,735	1,246,376
Trade receivables	1,873,245	-	-	6,164	6,164	1,879,409
Other short-term receivables	243,614	-	-	65,392	65,392	309,006
Cash and cash equivalents	605,024	-	-	57	57	605,081
	<b>3,703,524</b>	<b>0</b>	<b>0</b>	<b>336,348</b>	<b>336,348</b>	<b>4,039,872</b>
<b>TOTAL ASSETS</b>	<b>35,479,350</b>	<b>(2,000,100)</b>	<b>957,950</b>	<b>88,466</b>	<b>(953,684)</b>	<b>34,525,666</b>
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000 Restated
<b>EQUITY AND LIABILITIES</b>						
Retained earnings	118,915	(2,000,100)	711,799	(96,211)	(1,384,512)	(1,265,597)
<b>Equity attributable to Owners of the Parent</b>	<b>19,917,120</b>	<b>(2,000,100)</b>	<b>711,799</b>	<b>(96,211)</b>	<b>(1,384,512)</b>	<b>18,532,608</b>
<b>Total equity</b>	<b>19,964,403</b>	<b>(2,000,100)</b>	<b>711,799</b>	<b>(96,211)</b>	<b>(1,384,512)</b>	<b>18,579,891</b>
Long-term loans	1,839,630	-	-	55,234	55,234	1,894,864
Long-term provisions	661,411	-	-	24,922	24,922	686,333
Other non-current liabilities	4,911,633	-	-	968	968	4,912,601
<b>TOTAL NON-CURRENT LIABILITIES</b>	<b>10,777,337</b>	<b>0</b>	<b>0</b>	<b>81,124</b>	<b>81,124</b>	<b>10,858,461</b>
Trade payables	2,492,729	-	-	64,030	64,030	2,556,759
Current portion long-term borrowings	410,843	-	-	20,071	20,071	430,914
Taxes and contributions	179,441	-	168,376	-	168,376	347,817
Liabilities to employees	140,568	-	-	9,179	9,179	149,747
Other short-term liabilities	742,991	-	77,775	10,273	88,048	831,039
<b>TOTAL CURRENT LIABILITIES</b>	<b>4,737,610</b>	<b>0</b>	<b>246,151</b>	<b>103,553</b>	<b>349,704</b>	<b>5,087,314</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>35,479,350</b>	<b>(2,000,100)</b>	<b>957,950</b>	<b>88,466</b>	<b>(953,684)</b>	<b>34,525,666</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 3. RESTATEMENTS (continued)

### Consolidated statement of comprehensive income for the year ended 31 December 2012

Detailed overview of restatements in consolidated statements of comprehensive income for the year ended 31 December 2012

	2012 before restatement	HEP Proizvodnja d.o.o.	HAC	NEK d.o.o.	Total restatement	2012
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000 Restated
Other operating income	1,407,862	-	-	5,052	5,052	1,412,914
<b>Total operating income</b>	<b>14,019,578</b>	<b>-</b>	<b>-</b>	<b>5,052</b>	<b>5,052</b>	<b>14,024,630</b>
Electricity purchase cost	3,793,038	-	-	(707,758)	(707,758)	3,085,280
Fuel cost	3,319,512	-	-	114,966	114,966	3,434,478
Staff cost	1,863,235	-	-	127,175	127,175	1,990,410
Depreciation and amortization	1,778,400	(198,020)	40,718	234,060	76,758	1,855,158
Other operating expenses	2,916,120	245,195	-	235,669	480,864	3,396,984
<b>Total operating expenses</b>	<b>13,670,305</b>	<b>47,175</b>	<b>40,718</b>	<b>4,112</b>	<b>92,005</b>	<b>13,762,310</b>
<b>Operating profit</b>	<b>349,273</b>	<b>(47,175)</b>	<b>(40,718)</b>	<b>9,164</b>	<b>(86,953)</b>	<b>262,320</b>
Financial income	67,929	-	-	1,469	1,469	69,398
Financial expenses	352,908	-	-	2,409	2,409	355,317
<b>Net (loss) from financial activities</b>	<b>(284,979)</b>	<b>-</b>	<b>-</b>	<b>(940)</b>	<b>(940)</b>	<b>(285,919)</b>
<b>Profit before taxation</b>	<b>64,294</b>	<b>(47,175)</b>	<b>(40,718)</b>	<b>-</b>	<b>(87,893)</b>	<b>(23,599)</b>
Corporate income tax expense	28,486	0	(8,144)	-	(8,144)	20,342
<b>Profit for the year</b>	<b>35,808</b>	<b>(47,175)</b>	<b>(32,574)</b>	<b>-</b>	<b>(79,749)</b>	<b>(43,941)</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 3. RESTATEMENTS (continued)

### Consolidated statement of financial position for the year ended 31 December 2013

Detailed overview of restatements in consolidated statements of financial position for the year ended 31 December 2013

	31.12.2013 before restatement HRK '000	HEP Proizvodnja d.o.o. HRK '000	HAC HRK '000	NEK d.o.o. HRK '000	Other HRK '000	Total restatement HRK '000	31.12.2013 HRK '000 Restated
<b>NON-CURRENT ASSETS</b>							
Property, plant and equipment	25,504,613	(2,503,815)	919,654	1,397,569	-	(186,592)	25,318,021
Assets under construction	4,062,813	-	-	14,072	-	14,072	4,076,885
Investment property	231,285	-	-	1,772	-	1,772	233,057
Prepayments for PPE	57,288	-	-	478	-	478	57,766
Investment in NEK	1,754,419	-	-	(1,754,419)	-	(1,754,419)	-
Deferred tax assets	255,884	500,763	-	-	-	500,763	756,647
	<b>32,125,873</b>	<b>(2,003,052)</b>	<b>919,654</b>	<b>(340,528)</b>	<b>0</b>	<b>(1,423,926)</b>	<b>30,701,947</b>
<b>CURRENT ASSETS</b>							
Inventories	903,236	-	-	251,168	-	251,168	1,154,404
Trade receivables	1,780,129	-	-	19,947	-	19,947	1,800,076
Other short-term receivables	490,929	-	-	193,519	(30,279)	163,240	654,169
Cash and cash equivalents	260,755	-	-	89	-	89	260,844
	<b>3,435,049</b>	<b>0</b>	<b>0</b>	<b>464,723</b>	<b>(30,279)</b>	<b>434,444</b>	<b>3,869,493</b>
<b>TOTAL ASSETS</b>	<b>35,560,922</b>	<b>(2,003,052)</b>	<b>919,654</b>	<b>124,195</b>	<b>(30,279)</b>	<b>(989,482)</b>	<b>34,571,440</b>
<b>EQUITY AND LIABILITIES</b>							
Retained earnings / loss carried forward	1,415,473	(2,003,052)	673,503	(75,080)	7,966	(1,396,663)	18,810
<b>Equity attributable to Owners of the Parent</b>	<b>21,210,249</b>	<b>(2,003,052)</b>	<b>673,503</b>	<b>(75,080)</b>	<b>7,966</b>	<b>(1,396,663)</b>	<b>18,810</b>
<b>TOTAL EQUITY</b>	<b>21,242,226</b>	<b>(2,003,052)</b>	<b>673,503</b>	<b>(75,080)</b>	<b>7,966</b>	<b>(1,396,663)</b>	<b>19,845,563</b>
Long-term loans	1,686,418	-	-	35,591	-	35,591	1,722,009
Long-term provisions	781,797	-	-	26,585	-	26,585	808,382
Other long-term liabilities	5,037,592	-	-	934	-	934	5,038,526
<b>TOTAL NON-CURRENT LIABILITIES</b>	<b>10,809,805</b>	<b>0</b>	<b>0</b>	<b>63,110</b>	<b>0</b>	<b>63,110</b>	<b>10,872,915</b>
Trade payables	1,485,965	-	-	94,475	-	94,475	1,580,440
Short-term loans	672,338	-	-	20,316	-	20,316	692,654
Taxes and contributions	35,540	-	168,375	-	(38,245)	130,130	165,670
Liabilities to employees	135,168	-	-	10,772	-	10,772	145,940
Other short-term liabilities	836,530	-	77,776	10,602	-	88,378	924,908
<b>TOTAL CURRENT LIABILITIES</b>	<b>3,508,891</b>	<b>0</b>	<b>246,151</b>	<b>136,165</b>	<b>(38,245)</b>	<b>344,071</b>	<b>3,852,962</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>35,560,922</b>	<b>(2,003,052)</b>	<b>919,654</b>	<b>124,195</b>	<b>(30,279)</b>	<b>(989,482)</b>	<b>34,571,440</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 3. RESTATEMENTS (continued)

### Consolidated statement of comprehensive income for the year ended 31 December 2013

Detailed overview of restatements in consolidated statements of comprehensive income for the year ended 31 December 2013

	2013 before restatement	HEP Proizvodnja d.o.o.	HAC	NEK d.o.o.	Total restatement	2013
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Other operating income	1,585,316	-	-	6,302	6,302	1,591,618
<b>Total operating income</b>	<b>14,702,883</b>	<b>-</b>	<b>-</b>	<b>6,302</b>	<b>6,302</b>	<b>14,709,185</b>
Electricity purchase cost	2,670,155	-	-	(727,854)	(727,854)	1,942,301
Fuel cost	2,609,803	-	-	124,938	124,938	2,734,741
Staff cost	1,739,964	-	-	128,754	128,754	1,868,718
Depreciation	1,799,217	(191,607)	47,169	229,191	84,753	1,883,970
Other operating expenses	3,498,481	195,296	-	250,050	445,346	3,943,827
<b>Total operating expenses</b>	<b>12,317,620</b>	<b>3,689</b>	<b>47,169</b>	<b>5,079</b>	<b>55,937</b>	<b>12,373,557</b>
<b>Operating profit</b>	<b>2,385,263</b>	<b>(3,689)</b>	<b>(47,169)</b>	<b>1,223</b>	<b>(49,635)</b>	<b>2,335,628</b>
Financial income	62,541	-	-	1,893	1,893	64,434
Financial expenses	873,287	-	-	2,083	2,083	875,370
<b>Net (loss) from financial activities</b>	<b>(810,746)</b>	<b>-</b>	<b>-</b>	<b>(190)</b>	<b>(190)</b>	<b>(810,936)</b>
<b>Profit before taxation</b>	<b>1,574,517</b>	<b>(3,689)</b>	<b>(47,169)</b>	<b>1,033</b>	<b>(49,635)</b>	<b>1,524,692</b>
Corporate income tax expense	266,989	(738)	(9,433)	-	(10,171)	256,818
<b>Profit for the year</b>	<b>1,307,528</b>	<b>(2,951)</b>	<b>(37,736)</b>	<b>1,033</b>	<b>(39,654)</b>	<b>1,267,874</b>

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

### 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	
	2014	2013	2012	2014	2013	2012	2013	2012
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Revenue	10,575,290	11,947,939	11,630,275	671,946	763,461	395,956	13,117,567	12,611,716
Other segment income	1,191,846	1,480,459	1,321,220	69,886	66,928	26,035	1,577,350	1,407,862
<b>Profit / loss from operations</b>	<b>3,265,346</b>	<b>2,505,045</b>	<b>717,194</b>	<b>(135,068)</b>	<b>(166,615)</b>	<b>2,240</b>	<b>2,335,628</b>	<b>262,320</b>
Net finance costs						(122,906)	(810,936)	(285,919)
Corporate income tax (expense)						(612,119)	(256,818)	(20,342)
<b>Net profit</b>						<b>2,465,424</b>	<b>1,267,874</b>	<b>(43,941)</b>



# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 4. SEGMENT INFORMATION (continued)

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		
	2014	2013	2012	2014	2013	2012
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>		<b>Restated</b>	<b>Restated</b>
Electricity	27,807,534	27,706,562	28,709,171	6,613,995	6,481,463	7,585,191
Heating	1,184,190	1,227,066	1,215,719	203,167	178,558	222,638
Gas	389,202	347,338	350,638	104,419	153,035	176,210
Unallocated	6,475,792	5,290,474	4,250,138	6,857,564	7,912,822	7,961,736
<b>Total Group</b>	<b>35,856,718</b>	<b>34,571,440</b>	<b>34,525,666</b>	<b>13,779,145</b>	<b>14,725,878</b>	<b>15,945,775</b>

### Customer information

In 2014 electricity sales amounts to HRK 10,575,290 thousand (2013: HRK 11,947,939 thousand; 2012: HRK 11,630,275 thousand).

Heating energy sales for the year 2014 amounts to HRK 671,946 thousand (2013: HRK 763,461 thousand; 2012: HRK 585,485 thousand).

In 2014 gas sales in wholesale market amounts to HRK 689,575 thousand and gas sales to customers in the amount of HRK 371,490 thousand (2013: HRK 406,167 thousand; 2012: HRK 395,956 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:

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>
Croatia	9,815,887	11,236,233	11,197,595
EU member states	604,645	330,581	92,566
Non - EU member states	154,758	381,125	340,114
	<b>10,575,290</b>	<b>11,947,939</b>	<b>11,630,275</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 5. OTHER OPERATING INCOME

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Network/grid connection services	352,047	349,864	365,869
Income from assets received free of charge	234,482	233,050	233,362
Reversal of impaired receivables (Note 20)	99,549	90,064	119,555
Services rendered	141,733	148,855	155,657
Capitalized assets	88,905	95,988	99,693
Penalty interests	58,664	107,097	77,418
Income from sale of materials	39,510	40,812	61,968
Income from sale of cross – border transmission capacity	75,731	61,041	43,047
Revenues from inter-compensation (HOPS) - cross-border	35,747	40,044	3,497
Reversal of severance payments based on termination of employment contract	-	204,712	-
Reversal of long-term provisions – vacation accrual	70	11,489	432
Reversal of long-term provisions for retirement benefits and jubilee awards	4,696	62,666	28,935
Reversal of long-term provisions – court costs	42,487	25,259	87,407
Reversal of other provisions	20	28,529	49,634
Income in respect of the electricity payments reminders	5,334	5,493	13,392
Income from balancing energy	8,389	-	8,537
Income in respect of court costs on claims	1,012	7,022	6,996
Surplus of non-current assets	7,654	3,079	77
Income from sale of tangible assets	1,603	5,375	2,362
Recovery of written-off receivables	8,906	6,000	2,155
Other income - NEK d.o.o.	5,094	5,052	6,302
Other	79,240	60,127	46,619
	<b>1,290,873</b>	<b>1,591,618</b>	<b>1,412,914</b>

In 2014 the Group realized income from network/grid connection services in the amount of HRK 352,047 thousand (2013: HRK 349,864 thousand; 2012: HRK 365,869 thousand) pursuant to IFRIC 18 (Transfers of assets from Customers).

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 6. STAFF COST

	<b>2014</b>	<b>2013</b>	<b>2012</b>
	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>
Net salaries	1,038,540	1,052,623	1,122,716
Net salaries NEK d.o.o.	94,546	85,983	87,650
Taxes and contributions	703,240	687,340	740,519
Taxes and contributions NEK d.o.o.	44,193	42,772	39,525
	<b>1,880,519</b>	<b>1,868,718</b>	<b>1,990,410</b>

### Total staff costs:

	<b>2014</b>	<b>2013</b>	<b>2012</b>
	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>
Gross salaries	1,741,780	1,739,962	1,863,235
Gross salaries NEK d.o.o.	138,739	128,756	127,175
Reimbursement of costs to employees (Note 7)	112,542	128,388	146,309
Employee benefits (Note 7)	73,244	518,370	83,691
Unused vacation (Note 7)	17,677	552	1,359
	<b>2,083,982</b>	<b>2,516,028</b>	<b>2,221,769</b>

### Remunerations to the Board Members and executives:

	<b>2014</b>	<b>2013</b>	<b>2012</b>
	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>
Gross salaries	24,034	22,230	21,531
Pension contributions	5,439	4,976	4,821
Other benefits	3,354	2,635	3,022
	<b>32,827</b>	<b>29,841</b>	<b>29,374</b>

**6. STAFF COST (continued)**

Reimbursement of costs to employees includes commuting costs in the amount of HRK 72,539 thousand (2013: HRK 76,613 thousand; 2012: HRK 87,751 thousand), daily allowances and travelling expenses in the amount of HRK 18,024 thousand (2013: HRK 17,368 thousand; 2012: 16,620 thousand), additional health insurance amounting to HRK 6,770 thousand (2013: HRK 13,219 thousand; 2012: HRK 15,498 thousand) and other similar expenses in the amount of HRK 15,209 thousand (2013: HRK 21,155 thousand; 2012: HRK 26,440 thousand).

Employee benefit costs mostly include benefits under the Collective Agreement which amounts to HRK 49,974 thousand, and to a minor extent to solidarity support, jubilee awards, family separation allowances and fieldwork bonuses, child benefits and other.

There were no other payments to the Management Board members in addition to regular salaries and benefits in kind (2014: HRK 3,354 thousand; 2013: HRK 2,635 thousand).

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 7. OTHER OPERATING EXPENSES

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Maintenance costs (service and material)	600,137	550,142	580,204
Impairment of trade receivables (Note 20)	221,014	277,866	250,972
Gas costs	224,733	361,296	361,070
Cost of services	252,775	259,342	331,541
Chargeable services and supplies	130,910	106,409	165,386
Cost of material	89,895	83,888	87,508
Compensation for lower quantities of gas than contracted	2,611	144,859	20,296
CO2 emission allowances cost	108,972	98,661	-
Value adjustment of inventory	16,993	48,347	904
Employee benefits (Note 6)	112,542	128,388	146,309
Other employees benefits (Note 6)	73,244	518,370	83,691
NE Krško – decommissioning expense	108,719	107,937	106,835
Taxes and contributions	85,221	87,121	87,396
Litigation provisions	29,668	196,837	40,079
Contributions and concession for water fees	67,198	71,310	64,961
Provision for unused vacation	17,677	552	1,359
Fee for the usage of power plant facilities	87,654	76,043	37,401
Compensation for water-purification and drainage	14,893	16,301	15,503
Property, plant and equipment write off	21,318	32,150	14,328
Cost of materials sold	25,777	29,870	50,045
Calculation and collection costs	34,372	36,973	39,743
Provisions for retirement benefits and jubilee awards	97,666	3,065	2,450
Provisions for severance payments based on the termination of employment contract	53,568	133,092	249,174
Provisions for other expenses - employees	-	-	28,087
Insurance premiums	22,584	23,943	24,418
Environmental protection fees	3,319	4,591	18,210
Compensation for damages	12,929	19,556	49,632
Bad debts write off	12,510	13,691	7,242
Provisions for decommissioning of fossil fuelled power plants	7,920	8,427	4,297
Impairment of property, plant and equipment	73,518	195,296	245,195
Other operating expenses NEK d.o.o.	222,642	250,050	235,669
Other	93,216	59,454	47,079
	<b>2,926,195</b>	<b>3,943,827</b>	<b>3,396,984</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 8. FINANCIAL INCOME AND EXPENSES

	2014	2013	2012
Financial income	HRK '000	HRK '000 Restated	HRK '000 Restated
Foreign exchange gains	22.437	47.608	64.147
Interests	13.210	13.817	3.766
Fair value of cross currency swap (Note 27)	393.281	-	-
Dividend income	3.000	1.116	16
Interest on deposits - NEK d.o.o.	1.743	1.893	1.469
<b>Total financial income</b>	<b>433.671</b>	<b>64.434</b>	<b>69.398</b>
<b>Financial expenses</b>			
Interests	(404.211)	(382.687)	(323.307)
Foreign exchange losses	(152.571)	(59.685)	(46.391)
Fair value of cross currency swap	-	(391.808)	-
Fair value of shares	(202)	(36.136)	-
Other financial expenses	(5.647)	(9.387)	(2.740)
<b>Financial expenses</b>	<b>(562.631)</b>	<b>(879.703)</b>	<b>(372.438)</b>
Less: Capitalized borrowing cost	6.054	4.333	17.121
<b>Total financial expenses</b>	<b>(556.577)</b>	<b>(875.370)</b>	<b>(355.317)</b>
<b>Net loss from financial activities</b>	<b>(122.906)</b>	<b>(810.936)</b>	<b>(285.919)</b>

Borrowing costs were capitalized at a rate of 6.53%.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 9. CORPORATE INCOME TAX EXPENSE

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Current tax	509,764	286,206	88,757
Deferred tax expense / (income) relating to the origination and reversal of temporary differences	102,355	(29,388)	(68,415)
<b>Corporate income tax expense</b>	<b>612,119</b>	<b>256,818</b>	<b>20,342</b>

Adjustments of deferred tax assets are as follows:

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Balance at 1 January	756,647	724,929	156,489
Restatement effects	-	738	500,025
Reversal of deferred tax assets	(155,853)	(115,401)	(26,971)
Recognition of deferred tax assets	53,113	146,381	95,386
<b>Balance at 31 December</b>	<b>653,907</b>	<b>756,647</b>	<b>724,929</b>

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 statement of comprehensive income is set out below:

	2014	2013	2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Profit before taxation	3,077,543	1,516,726	(23,599)
<b>Income tax at the applicable rate in the Republic of Croatia of (20%)</b>	<b>615,509</b>	<b>303,345</b>	-
Tax unrecognized income	(138,582)	(38,233)	(29,030)
Tax effect on permanent differences	102,355	(32,663)	(63,700)
Tax effect on losses carried forward	(768)	(17,097)	-
Unrecognized deferred tax assets from companies operating with loss	33,605	41,466	113,072
<b>Tax expense for the year</b>	<b>612,119</b>	<b>256,818</b>	<b>20,342</b>

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

### 9. CORPORATE INCOME TAX EXPENSE (continued)

The Group and its subsidiaries are subject to income tax, according to the tax laws and regulations of the Republic of Croatia. Other subsidiaries in the Group including HEP d.d. stated total tax losses in the amount of HRK 1,528,456 thousand (2013: HRK 1,476,528 thousand), while the Group stated total corporate income tax expense in the amount of HRK 509,764 thousand (2013: HRK 296,377 thousand) and deferred tax assets in the amount of HRK 102,355 thousand (2013: HRK 29,388 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 Group	Year of expiry
2010	152,800	2015
2011	434,935	2016
2012	565,360	2017
2013	207,334	2018
2014	168,027	2019
	<u>1,528,456</u>	

The Group recognized deferred tax assets in 2012 and 2013 arising from tax losses carried forward only in HEP plin d.o.o. as that company is only one in the Group expecting to utilize tax losses carried forward. Tax losses carried forward were utilized in full in 2014. Other 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 2014, the Group has determine that it cannot recognize deferred tax assets arising from tax losses carried forward in the amount of HRK 1,528,456 thousand.



# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 9. 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:

	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
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>As at 31 December 2012</b>	<b>29,946</b>	<b>115,086</b>	<b>4,112</b>	<b>3</b>	<b>500,048</b>	<b>17,097</b>	<b>58,637</b>	<b>724,929</b>
Credited to profit and loss for the year	8,598	(47,734)	1,275	78,359	715	(16,329)	6,834	31,718
<b>As at 31 December 2013</b>	<b>38,544</b>	<b>67,352</b>	<b>5,387</b>	<b>78,362</b>	<b>500,763</b>	<b>768</b>	<b>65,471</b>	<b>756,647</b>
Credited to profit and loss for the year	3,699	15,062	1,521	(78,362)	(22,882)	(768)	(21,010)	(102,740)
<b>As at 31 December 2014</b>	<b>42,243</b>	<b>82,414</b>	<b>6,908</b>	<b>-</b>	<b>477,881</b>	<b>-</b>	<b>44,461</b>	<b>653,907</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 10. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Fixtures and equipment	Assets under construction	Total
	HRK '000	HRK '000	HRK '000	HRK '000
<b>COST</b>				
<b>At 31 December 2012</b>	<b>35,847,411</b>	<b>35,732,868</b>	<b>3,915,002</b>	<b>75,495,281</b>
Restated for HAC	-	1,039,329	-	1,039,329
Restated for NEK d.o.o.	1,055,935	4,596,150	16,955	5,669,040
<b>At 31 December 2012, restated</b>	<b>36,903,346</b>	<b>41,368,347</b>	<b>3,931,957</b>	<b>82,203,650</b>
Reclassification	14,917	(16,194)	(2,883)	(4,160)
Additions	32,662	289,131	2,032,485	2,354,278
Additions - HAC	-	143,353	-	143,353
Provisions for litigation	-	-	4,642	4,642
Transfer from assets under construction	539,876	1,314,060	(1,872,068)	(18,132)
Inventory surpluses	3,916	4,322	-	8,238
Disposals	(46,501)	(235,843)	(17,248)	(299,592)
<b>At 31 December 2013</b>	<b>37,448,216</b>	<b>42,867,176</b>	<b>4,076,885</b>	<b>84,392,277</b>
Reclassification	1,700	(1,694)	-	6
Additions	22,011	123,350	1,893,731	2,039,092
Transfer from assets under construction	521,174	1,277,754	(1,825,274)	(26,346)
Inventory surpluses	3,707	3,646	236	7,589
Disposals	(92,338)	(262,510)	(6,165)	(361,013)
Additions for assets of NEK d.o.o.	6,522	38,802	49,328	94,652
<b>At 31 December 2014</b>	<b>37,910,992</b>	<b>44,046,524</b>	<b>4,188,741</b>	<b>86,146,257</b>
<b>ACCUMULATED DEPRECIATION</b>				
<b>At 31 December 2012</b>	<b>23,114,175</b>	<b>23,161,991</b>	-	<b>46,276,166</b>
Restated HAC	-	81,379	-	81,379
Restated HEP Proizvodnja d.o.o.	661,047	1,839,078	-	2,500,125
Restated for NEK d.o.o.	755,923	3,409,038	-	4,164,961
<b>At 31 December 2012, restated</b>	<b>24,531,145</b>	<b>28,491,486</b>	-	<b>53,022,631</b>
Restated exchange differences	9,355	41,861	-	51,216
Restated HEP Proizvodnja d.o.o.	168,145	27,152	-	195,297
Depreciation	552,764	1,306,243	-	1,859,007
Reclassification	5,116	(5,408)	-	(292)
Disposal	(43,716)	(224,588)	-	(268,304)
Inventory surplus	745	2,591	-	3,336
<b>At 31 December 2013</b>	<b>25,223,554</b>	<b>29,639,337</b>	-	<b>54,862,891</b>
Disposal HEP Proizvodnja d.o.o.	10,115	63,403	-	73,518
Depreciation	680,388	948,798	-	1,629,186
Depreciation NEK	24,328	221,511	-	245,839
Reclassification	1,034	(341)	-	693
Disposal	(84,018)	(243,521)	-	(327,539)
Inventory surpluses	-	3,635	-	3,635
<b>At 31 December 2014</b>	<b>25,855,401</b>	<b>30,632,822</b>	-	<b>56,488,223</b>
<b>CARRYING AMOUNT</b>				
<b>At 31 December 2014</b>	<b>12,055,591</b>	<b>13,279,222</b>	<b>4,188,741</b>	<b>29,523,554</b>
<b>At 31 December 2013 restated</b>	<b>12,224,662</b>	<b>13,093,359</b>	<b>4,076,885</b>	<b>29,394,906</b>
<b>At 31 December 2012 restated</b>	<b>12,372,201</b>	<b>12,876,861</b>	<b>3,931,957</b>	<b>29,181,019</b>

**10. 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. 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 2015.

*Public water resources*

The Water 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 (canals, dams, etc.) 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.

**11. INTANGIBLE ASSETS**

	<b>Licenses</b>
	HRK '000
<b>COST</b>	
<b>At 31 December 2012, restated</b>	<b>614.353</b>
<b>Reclassification</b>	<b>1.277</b>
<b>Additions</b>	<b>3.511</b>
Transfer in use	18.132
Disposals	(10.282)
<b>At 31 December 2013, restated</b>	<b>626.991</b>
<b>Reclassification</b>	<b>(6)</b>
<b>Additions</b>	<b>3.442</b>
Transfer in use	26.346
Disposals	(371)
<b>At 31 December 2014</b>	<b>656.402</b>
<b>ACCUMULATED AMORTIZATION</b>	
<b>At 31 December 2012, restated</b>	<b>540.385</b>
Reclassification	273
Amortization	24.963
Disposal	(8.063)
<b>At 31 December 2013, restated</b>	<b>557.558</b>
Reclassifications	2
Amortization	22.165
Disposal	(369)
<b>At 31 December 2014</b>	<b>579.356</b>
<b>CARRYING AMOUNT</b>	
<b>At 31 December 2014</b>	<b>77.046</b>
<b>At 31 December 2013 restated</b>	<b>69.433</b>
<b>At 31 December 2012 restated</b>	<b>73.968</b>

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

### 12. INVESTMENT PROPERTY

As of 31 December 2014, 2013 and 2012 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.

<b>At fair value</b>	<b>31 Dec 2014</b>	<b>31 Dec 2013</b>	<b>31 Dec 2012</b>
	HRK '000	HRK '000	HRK '000
		<b>Restated</b>	<b>Restated</b>
Fair value	<b>231,285</b>	<b>233,917</b>	<b>234,760</b>
Net fair value adjustment	3,378	(6,192)	(331)
Other changes	(112)	3,560	1,412
<b>Closing balance at fair value</b>	<b>234,551</b>	<b>231,285</b>	<b>235,841</b>
Investment property NEK	1,602	1,772	-
<b>Balance at the end of the year</b>	<b>236,153</b>	<b>233,057</b>	<b>235,841</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 13. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
JSC Tehnopromexport –TE Sisak	17,727	25,182	49,659
Končar GIM	5,550	10,311	15,528
Litostroj Slovenija	284	2,174	2,444
VOITH Siemens Austrija	689	1,887	2,288
Končar inženjering Zagreb	1,002	2,732	-
Spegra Inženjering	-	2,836	-
Đuro Đaković holding	1,844	4,361	-
Končar Inženjering d.d. - TE Sisak	-	-	622
Siemens	1,130	1,999	-
Other	13,260	6,284	1,777
	<b>41,486</b>	<b>57,766</b>	<b>72,318</b>

Prepayments for PPE relate to construction of production facilities.

#### 14. 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). Still there are some outstanding off-balance receivables from HEP d.d. to NEK and Slovenia from the past, which do not have any influence on the current business relations, but are related to compensating for damages that the Company is seeking from the Republic of Slovenia for undelivered electricity from NEK for the period 1 July 2002 until 18 April 2003. The dispute was referred to international arbitration in 2005 before the International Centre for Settlement of Investment Disputes in Washington. Because of the circumstances indicating that this is joint operation in accordance with IFRS 11, the Group recognizes its share in assets, liabilities, revenues and expenses of NEK in its financial statements. Until the adoption of IFRS 11, the Group measured this investment using the equity method (Note 3).

#### **14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)**

##### **Current status**

##### **Payments to the Fund for Decommissioning of NEK**

At the end of 2001 was signed 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 regarding Investment, Exploitation and Decommissioning of the Nuclear Power Plant Krško, and Articles of Association between HEP d.d. i ELES GEN d.o.o.. As defined by the Contract, decommissioning of NEK and disposal of radioactive waste is obligation of both countries. Each country will provide half of the funds necessary to prepare the decommissioning plan and implementation cost of the program. Each country will allocate funds for this purpose to a separate Fund in the amounts estimated by the decommissioning plan. According to the current program of decommissioning of NEK and the disposal of radioactive waste and used nuclear fuel, HEP is obligated to contribute the amount of EUR 14,250 thousand to the Fund per year payable quarterly. Payments to the Fund are carried out under 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. HEP is obliged to secure decommissioning contribution to the Fund established in the Republic of Croatia.

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, as of 2006, until end of 2014 the Group paid total amount of HRK 1,159,652 thousand to the above mentioned Fund.

The Fund is responsible for estimate of the decommissioning costs. The Group's only obligation is to pay annual contribution for decommissioning and there is no other obligation which could result in additional payments to third parties. The Group recognizes its obligation as expense. As the Fund is State owned, the Group doesn't recognize any interests in Fund for decommissioning of NEK (out of scope of IFRIC 5).

##### **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.

##### **Accounting of NEK joint operation**

Until 2014, investments in NEK were measured by using the equity method. Pursuant to International Financial Reporting Standard (IFRS) 11 - Joint Arrangements, which replaced International Accounting Standard (IAS) 31 – Interest in Joint Ventures, investment in NEK is classified as joint operation.



## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

### 14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)

#### Extract from financial statements

In table below is shown an extract from financial statements of NEK in full (100%) amounts at 31 December 2014, 2013 and 2012:

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
Property, plant and equipment	2,495,642	2,823,284	3,008,158
Capital and reserves	3,382,788	3,358,677	3,316,417
Gross sales	1,494,330	1,468,111	1,419,092
Cash flows from operating activities	401,719	560,324	674,550
Profit for the year	19,842	2,080	-

### 15. 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. A number of agreements were signed, which regulated the relationship between the joint venture partners and their respective relationships with the new company.

In accordance with the 1996 Asset Contribution Agreement, HEP d.d. contributed property, plant and equipment previously acquired for the project valued at DEM 50,000 thousand (HRK 179,138 thousand) as a contribution in kind to TE Plomin. Of this amount, HRK 50 thousand was allocated as share capital, while HRK 179,088 thousand was allocated to reserves.

In accordance with the Joint Venture Agreement, RWE contributed an equal amount of cash over the period of construction. The initial cash contribution of HRK 50 thousand was allocated as share capital and the remain amount to reserves. The RWE capital contributed is distributed back to RWE over the term of the joint venture of 15 years, starting from the date of operation of the power plant at 30 April 2000.

Agreement between HEP d.d. and RWE will expire 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.. Signing of the Agreement on transfer of shares is expected in the period from 30 April until 31 May 2015. As agreed, in 2014 the return of invested capital was not paid to RWE and in 2013 the return on capital amounted to HRK 12,948 thousand. As at 31 December 2014 a further HRK 26,060 thousand remained unpaid (2013: HRK 25,979 thousand). Payment is expected until 30 April 2015.

**15. INVESTMENT IN THE TE PLOMIN (continued)**

Under the Articles of association of TE Plomin, RWE is entitled to an annual return during the term of the joint venture of 14% to 17% on invested capital (based on the actual number of hours of peak exploitation during the year). The invested capital includes RWE undistributed equity contribution as the unpaid portion of the accrued cumulative interest earned on investment during construction.

During the period of construction, the accrued cumulative interest on the RWE capital amounted to HRK 54,717 thousand (EUR 7,536 thousand) and is payable evenly during the period of exploitation. At 31 December 2014, accrued undistributed interest amounted to HRK 5,116 thousand (2012: HRK 8,846 thousand).

The RWE annual return on invested capital, through preferred dividend, is paid out from net profit of TE Plomin. The rate for 2014 and 2013 is 17%. In 2014, dividends for 2013 were not paid according to the decision of the Company, and is stated as short-term liabilities and amounts to HRK 5,948 thousand (Note 32); in 2013 dividend for 2012 also was not paid in accordance to the decision of the Company, and is stated as a short term liability in the amount of HRK 8,707 thousand. Payment was realized in May 2015 (note 37).

These dividends have priority in relation to HEP d.d. interest in the results of the joint venture and any other payments to HEP d.d. since HEP d.d. share has been used to pay RWE interest on capital since 2000, HEP d.d. has not realized any portion of profits earned by TE Plomin.

The joint venture partners entered into a number of agreements necessary for power plant operations, including: operation and maintenance agreements, a joint use and supply agreement and a power purchase agreement ('PPA'). The PPA agreement regulates the sale of electric energy to the Group by TE Plomin d.o.o.. HEP d.d. is obligated to purchase all electricity produced by TE Plomin d.o.o. at prices calculated in accordance with specified formulas in the PPA, which are designed to cover all costs of operations of TE Plomin, and ensure the guaranteed return on capital to RWE.

The Company recognizes in its financial statements this investment as subsidiary due to a fact that it has control. Although it has a 50% interest (other 50% RWE) HEP has determined that it has control because the arrangement with RWE; RWE really just funds the project; and HEP is obliged to purchase all electricity produced by TE Plomin and RWE has right on return on investment plus yield of 17% until 2015, upon project completion.

The Company manages operations of TE Plomin. The prices at which HEP buys electricity is determined in accordance with specified formulas in the PPA, designed to cover all costs of operations of TE Plomin, and ensure the guaranteed return on capital to RWE. Previously mentioned conditions in price determination, operational management and obligation of HEP to buy shares of RWE in TE Plomin, indicate the control of HEP over TE Plomin.

In 2015, HEP has bought the remaining shares from RWE and became the sole shareholder (Note 37).

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 15. INVESTMENT IN THE TE PLOMIN (continued)

### Extract from financial statements

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

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
Property, plant and equipment	187,183	286,116	421,253
Capital and reserves	195,310	211,115	226,421
Gross sales	747,784	782,951	843,726
Operating profit	30,323	13,102	12,084
Net profit	3,092	5,948	8,708
Cash flows from operating activities	24,197	20,677	88,504

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
Opening balance of non-controlling interest	31,977	47,283	62,847
Equity payoff	-	(12,948)	(12,922)
Liabilities for dividend / Dividend payment	(5,948)	(8,707)	(11,514)
Increase for current year's profit	3,092	5,948	8,707
Exchange differences	81	401	165
<b>Closing balance</b>	<b>29,202</b>	<b>31,977</b>	<b>47,283</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 16. LONG TERM LOANS AND DEPOSITS

	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 Restated	31 Dec 2012 HRK '000 Restated
Loans given	4,743	6,379	808
Impairments	(74)	(83)	(158)
Current portion of long-term loans given	(136)	(136)	(136)
<b>Long-term portion</b>	<b>4,533</b>	<b>6,160</b>	<b>514</b>

Loans given to third parties:

	Year loan approved	Repayment period	Loan amount	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 Restated	31 Dec 2012 HRK '000 Restated
City of Dubrovnik	2013	5 years	5,707	4,207	5,707	-
City of Pregrada	2006	10 years	1,358	407	543	679
Did d.o.o.	2007	4 years	1,010	129	129	129
<b>Total</b>				<b>4,743</b>	<b>6,379</b>	<b>808</b>
Impairment				(74)	(83)	(158)
Current portion				(136)	(136)	(136)
<b>Long-term portion</b>				<b>4,533</b>	<b>6,160</b>	<b>514</b>

## 17. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS

	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 Restated	31 Dec 2012 HRK '000 Restated
Available-for-sale investments	191,611	124,101	128,288
Other investments	1,065	1,065	1,065
	<b>192,676</b>	<b>125,166</b>	<b>129,353</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 17. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS (continued)

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

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Opening balance	124,101	128,288	120,605
Changes in fair value of available-for-sale investments	65,157	(4,286)	7,470
Investment in shares	2,353	99	213
	<b>191,611</b>	<b>124,101</b>	<b>128,288</b>

Changes in fair value of available-for-sale investments shown in the table above are presented in the gross amount. In the statement of comprehensive income 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 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
<b>Available-for-sale investments:</b>			
Jadranski Naftovod d.d.	188,878	123,616	127,935
Viktor Lenac d.d.	128	166	133
Đuro Đaković d.d.	5	5	5
Kraš d.d.	2	2	2
Pevec d.d.	312	312	213
Jadran d.d.	365	-	-
Industrogradnja grupa d.d.	490	-	-
Optima Telekom d.d.,	1,099	-	-
Institut IGH d.d.,	178	-	-
Međimurje beton d.d.	104	-	-
HTP Korčula d.d.	50	-	-
	<b>191,611</b>	<b>124,101</b>	<b>128,288</b>
<b>Other investments</b>			
Geopodravina d.o.o.	200	200	200
LNG Hrvatska d.o.o.	865	865	865
	<b>1,065</b>	<b>1,065</b>	<b>1,065</b>
	<b>192,676</b>	<b>125,166</b>	<b>129,353</b>

**17. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS (continued)**

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. Shares of Jadranski Naftovod were classified as available for sale. Transfer of shares was registered at Central Depository Agency on 19 March 2009.

In 2014 and 2013 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 2014 was HRK 3,499 and 2013 HRK 2,290. By fair valuation of the investment in Jadranski Naftovod as of 31 December 2014 total amount of investment was increased by HRK 65,262 thousand (2013: increased by HRK 4,318 thousand). The fair valuation in 2014 and 2013 was recognised through equity (revaluation reserves), and adjusted for 20% by increasing deferred tax liabilities.

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. 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, heat and gas sold, the Group has become a stakeholder in seven companies by converting their outstanding debts into shares (equity) in the amount of HRK 2,145 thousand.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 18. OTHER NON-CURRENT ASSETS

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Housing loan receivables	25,572	29,672	33,649
Energy efficiency receivables – long-term portion	10,992	19,003	24,616
Capitalized interests – RWE	1,283	5,116	8,846
Other non-current assets	11,957	5,021	741
	<b>49,804</b>	<b>58,812</b>	<b>67,852</b>

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 financial statements at their discounted net present values, determined using an interest rate of 7.0%. The liability to the State, which represent 65% of the value of sold apartments, are included in non-current liabilities to the State (Note 25). The receivables are secured by mortgages over the sold apartments.

Pursuant to the Statute of TE Plomin, interest was accrued on all funds invested by RWE during the construction phase of the power station at a rate of 17% (intercalary interest). Accrued intercalary interest in the total amount of HRK 55,653 thousand (EUR 7,536 thousand) has been entirely recognized as accrued expense subject to straight-line amortization over a period of 15 years.

Repayment of intercalary interest is done along with the repayment of invested funds from RWE and it started after the electric power plant was finished. In 2014 it was agreed not to repay the amount of EUR 502 thousand related to liability for 2013. In 2013 the total amount repaid was HRK 3,817 thousand (EUR 502 thousand and 2012: EUR 502 thousand equivalent to HRK 3,809 thousand). Complete payment of interest is due up to 31 May 2015.

As at 31 December 2014 accrued expenses for the intercalary interest amounted to EUR 168 thousand or HRK 1,283 thousand (2013: EUR 670 thousand or HRK 5,116 thousand). Foreign exchange differences are recognized as financial expense for the year in which they incurred.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 19. INVENTORIES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Inventories of fuels and chemicals	292,215	425,168	526,542
Electric materials	298,635	276,886	217,167
Spare parts	191,943	176,671	221,934
Building material	38,193	94,694	87,378
Construction material	432,559	-	-
CO <sub>2</sub> emission units	219,270	67,613	-
Other inventories	64,812	47,777	66,206
Nuclear fuel and other material - NEK d.o.o.	281,135	251,168	264,735
	<b>1,818,762</b>	<b>1,339,977</b>	<b>1,383,962</b>
Write-off of obsolete materials and spare parts	(205,465)	(185,573)	(137,586)
	<b>1,613,297</b>	<b>1,154,404</b>	<b>1,246,376</b>

In 2013, inventories are started to be written-off based on their ageing structure as follows: materials ageing 2 – 3 years – 30% of value; materials ageing 3-4 years – 60% of value and materials ageing over 4 years -100% of value.



# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 20. TRADE RECEIVABLES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Electricity – Corporate customers	1,410,548	1,563,413	1,606,227
Electricity – Households	445,353	478,131	478,424
Export of electricity	33,699	26,026	53,207
Heating, gas and services	846,967	531,501	502,643
Connection to transmission network	2	57,022	41,233
Receivables from NEK d.o.o.	42,501	19,947	6,164
Other	59,789	41,526	83,190
	<b>2,838,859</b>	<b>2,717,566</b>	<b>2,771,088</b>
<b>Provisions for bad and doubtful receivables</b>	(974,179)	(917,490)	(891,679)
	<b>1,864,680</b>	<b>1,800,076</b>	<b>1,879,409</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 20. TRADE RECEIVABLES (continued)

Ageing analysis of unimpaired trade receivables:

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Undue	1,194,793	1,025,984	1,021,996
up to 30 days	363,326	427,207	437,422
from 31 to 60 days	122,393	150,482	161,682
from 61 to 90 days	59,883	64,919	75,704
from 91 to 180 days	59,278	87,281	89,315
from 181 to 365 days	55,330	32,657	71,078
365 days and over	9,677	11,546	22,212
	<b>1,864,680</b>	<b>1,800,076</b>	<b>1,879,409</b>

Movements in impairments were as follows:

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
<b>Balance at 1 January</b>	<b>917,490</b>	<b>891,679</b>	<b>781,600</b>
Impairment of trade receivables (Note 7)	221,014	277,866	250,972
Derecognition of previously impaired trade receivables	(64,776)	(161,991)	(21,338)
Reversal of impairments (Note 5)	(99,549)	(90,064)	(119,555)
<b>Balance at 31 December</b>	<b>974,179</b>	<b>917,490</b>	<b>891,679</b>

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.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 21. OTHER SHORT-TERM RECEIVABLES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
VAT receivables	-	104,274	142,908
Prepayments	3,544	638	706
Receivables from the State for employees	4,387	35,634	15,366
Interest receivables	340	3,123	2,995
Demand and term deposits with maturity over 3 months	209,950	90,075	21,220
Demand and term deposits with maturity over 3 months NEK	216,160	191,514	63,831
Borrowing receivables	10,500	90,000	-
Accrued income from the sale of electricity to households	-	58,207	-
Other receivables NEK	2,005	2,032	1,561
Other short-term receivables	72,796	78,672	60,419
	<u>519,682</u>	<u>654,169</u>	<u>309,006</u>

In August 2013 HEP has concluded a short-term borrowing agreement with a public legal entity in the amount of HRK 90,000 thousand for the period of one year, with interest rate in the amount of HNB (Croatian National Bank) discount rate. Borrowing was fully repaid in 2014.

In November 2014, the company has concluded a short-term borrowing agreement with the company from Croatia in the amount of HRK 10,500 thousand for the period of 180 days, and interest rate in the amount of HNB (Croatian National Bank) discount rate. Borrowing was fully repaid in 2015.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 22. CASH AND CASH EQUIVALENTS

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Current accounts - HRK	448,172	150,543	156,084
Current accounts – Foreign currency	193,425	39,227	118,482
Current accounts for special purposes	21,473	9,222	7,403
Petty cash - HRK	231	281	280
Short term deposits - up to 90 days	30,012	4,685	159,225
Daily deposits	386,551	56,797	163,550
Current and special purposes bank account - NEK d.o.o.	36	89	57
	<b>1,079,900</b>	<b>260,844</b>	<b>605,081</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 23. 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.

### Revaluation reserves

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Opening balance	2,617	6,046	(438,957)
Transfer to retained earnings	-	-	438,957
Other comprehensive income, net	52,330	(3,429)	6,046
	<b>54,947</b>	<b>2,617</b>	<b>6,046</b>

### Retained earnings

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Opening balance	18,809	(1,265,597)	(685,340)
Increase/(decrease) in retained earnings of NEK	2,135	21,130	(96,211)
Land surpluses	2,907	1,350	7,559
Transfer from reserves	-	-	(438,957)
Dividends paid	(284,918)	-	-
Profit / (loss) for the period	2,462,332	1,261,926	(52,648)
	<b>2,201,265</b>	<b>18,809</b>	<b>(1,265,597)</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 24. LONG-TERM LOAN LIABILITIES

	Interest rate	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 <b>Restated</b>	31 Dec 2012 HRK '000 <b>Restated</b>
Domestic bank loans	EURIBOR+ (1.00 p.p.- 5.35 p.p.)	1,640,285	1,853,007	1,961,548
Foreign bank loans	2.71%, fixed	23,183	23,588	25,585
Finance leases	5.6%, fixed	22,362	25,898	-
Loan RWE		-	1,279	5,055
Loan NEK		-	35,592	55,234
<b>Total</b>		<b>1,685,830</b>	<b>1,939,364</b>	<b>2,047,422</b>
Deferred loan originated fees		(4,611)	(5,841)	(20,474)
<b>Total long-term loans</b>		<b>1,681,219</b>	<b>1,933,523</b>	<b>2,026,948</b>
Current portion of long-term loans		(416,349)	(208,838)	(132,084)
Current portion of finance lease (Note 32)		(2,834)	(2,675)	
<b>Long-term portion</b>		<b>1,262,036</b>	<b>1,722,010</b>	<b>1,894,864</b>

Loans from domestic banks are secured by bills of exchange and promissory notes. At 31 December 2014 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 2014 the Group used funds from loans in use.

### Loans in use

During 2014 the Group 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 2014 KfW loan balance was EUR 3,1 million, and the amount of EUR 46,9 million were unutilised.

## 24. LONG-TERM LOAN LIABILITIES (continued)

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

2015	419,183
2016	389,900
2017	389,784
2018	383,017
2019	85,490
After 2019	13,845
Total	<b>1,681,219</b>

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 Company's 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 Statement of financial position and the Statement of comprehensive income. The Company 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 Group could be in breach of covenants, the Group 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 Group can obtain a "waiver" from the creditors, given that timely payment of liabilities to financial institutions represent priority obligation of the Group and the Group 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.

#### 24. LONG-TERM LOAN LIABILITIES (continued)

As of 31 December 2014 covenants were not breached and the Group has met all contractual financial indicators.

The Group monitors the covenants continuously during the period on a monthly basis, meets the requirements of all the contractual obligations and the Management currently expects no problems with complying with the requirements in future.

The Group's total exposure to loan liabilities subject to covenant conditions as of 31 December 2014 amounts to EUR 141,176 thousand.

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

Currency	31 Dec 2014	31 Dec 2013	31 Dec 2012
EUR	219,596	245,703	263,349

#### 25. LONG-TERM LIABILITIES TO THE STATE

Long-term liabilities to the State amounted to HRK 21,690 thousand in 2014 (2013: HRK 24,451 thousand; 2012: HRK 27,544 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.



# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 26. LONG-TERM PROVISIONS

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Provisions for court disputes	363,052	375,870	204,292
Provisions for severance payments	319,691	231,911	285,739
Provisions for jubilee awards	44,806	39,616	43,745
Provisions for decommissioning of fossil fuelled power plants	120,689	112,769	104,341
Provision for electricity purchased from wind power plants	21,631	21,631	21,631
Provisions for severance payments, jubilee awards and other - NEK	32,910	26,585	26,585
	<b>902,779</b>	<b>808,382</b>	<b>686,333</b>

Provisions for decommissioning of fossil fuelled power plants in the amount of HRK 120,689 thousand represent discounted value of the estimated decommissioning costs of the Group's fossil fuel power plants.

Movements in provisions during the three year period were as follows:

	Legal disputes	Provisions for severance payments	Jubilee awards	Decommissioning of FFPPs	Other	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>At 31 December 2012</b>	<b>204,292</b>	<b>285,739</b>	<b>43,745</b>	<b>104,341</b>	<b>48,216</b>	<b>686,333</b>
Additional provisions	196,705	19,859	3,612	-	-	220,176
Decrease in provisions (amounts paid)	(12,441)	(11,644)	(4,466)	8,428	-	(20,123)
Decrease in provisions based on estimates	(12,686)	(62,043)	(3,275)	-	-	(78,004)
<b>At 31 December 2013</b>	<b>375,870</b>	<b>231,911</b>	<b>39,616</b>	<b>112,769</b>	<b>48,216</b>	<b>808,382</b>
Additional provisions	29,667	93,820	5,924	7,920	6,325	143,656
Decrease in provisions (amounts paid)	(26,258)	(1,652)	(721)	-	-	(28,631)
Decrease in provisions based on estimates	(16,227)	(4,388)	(13)	-	-	(20,628)
<b>At 31 December 2014</b>	<b>363,052</b>	<b>319,691</b>	<b>44,806</b>	<b>120,689</b>	<b>54,541</b>	<b>902,779</b>

## 26. 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 76,130 thousand in 2014 and relate to dispute for waste water treatment plant fees.

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, the City of Dubrovnik amounting to HRK 4,345 thousand, the Konavle Municipality amounting to HRK 3,760 thousand and Dubrovnik-Neretva County amounting to HRK 1,966 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. 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.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 26. 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:

	<b>Retirement benefits</b>	<b>Jubilee bonuses</b>	<b>Total</b>
	HRK '000	HRK '000	HRK '000
<b>At 31 December 2012</b>	<b>285,739</b>	<b>43,745</b>	<b>329,484</b>
Cost of services	8,408	1,687	10,095
Interest expense	11,451	1,925	13,376
Benefits paid	(11,644)	(4,466)	(16,110)
Actuarial (loss)	(62,043)	(3,275)	(65,318)
<b>At 31 December 2013</b>	<b>231,911</b>	<b>39,616</b>	<b>271,527</b>
Cost of services	11,364	2,248	13,612
Interest expense	11,857	1,635	13,492
Benefits paid	(14,525)	(7,068)	(21,593)
Past service cost	1,347	227	1,574
Actuarial (loss)	77,737	8,148	85,885
<b>At 31 December 2014</b>	<b>319,691</b>	<b>44,806</b>	<b>364,497</b>

The following assumptions were used in preparing the calculations:

- The termination rate is from 0% to 6.18% percent and is based on the statistical fluctuation rates for the Group in the period from 2006 to 2014.
- The probability of death by age and sex is based on 2000-2002 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 in 2014 there will be no annual salary growth.
- Present value of the obligation was determined using a 4.0% discount rate for all subsidiaries and HEP d.d.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 27. LIABILITIES UNDER ISSUED BONDS

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Nominal value of bonds - domestic	279,790	373,170	966,550
Discount value	(170)	(286)	(814)
Current portion of bonds	(93,380)	(93,380)	(593,380)
	<b>186,240</b>	<b>279,504</b>	<b>372,356</b>
Nominal value of bonds issued abroad	2,999,389	2,963,252	2,955,595
Exchange difference	9,357	36,137	7,657
	<b>3,008,746</b>	<b>2,999,389</b>	<b>2,963,252</b>
<b>Total liabilities under issued bonds</b>	<b>3,194,986</b>	<b>3,278,893</b>	<b>3,335,608</b>

### *Bonds issued in the Republic of Croatia*

Bonds issued in 2006 amounting to HRK 500,000 thousand with a maturity in November 2013 were entirely paid out. Bonds in the amount of HRK 700,000 thousand, issued at the end of 2007, 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 HEP d.d. 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, fully mature in November 2017 and are bearing fixed interest of 6%. Bonds of HEP d.d. are listed at Luxembourg stock - exchange and they are actively traded.

In order to hedge against exchange rate fluctuations, respectively to reduce exposure to currency risk, cross currency swap was contracted.

### *Cross currency swap*

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Group has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is transformed in EUR for all period of bond duration, respectively until its outermost maturity date at 9 November 2017.

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

### 27. LIABILITIES UNDER ISSUED BONDS (continued)

#### *Cross currency swap (continued)*

The purpose of this swap was, beside reduce of the currency risk, recommendations of credit agencies related to strategic management of currency risks in order to reduce impact on the Group's business result. As at the time of contracting it was not possible to realize currency swaps USD / HRK, the Group entered into swap USD / EUR due to the fact that the monetary system in Croatia is highly euroised and the main goal of CNB monetary policy is stability of the currency which is secured through maintenance of the stable HRK rate against EUR, specially due to expected introduction of EUR as official currency in Croatia.

According to the agreement, annual interest rate paid by the Group semi-annually is fixed and amounts to 6.53% (include swap cost).

The Group measures the fair value of the cross currency swap according to the calculation of Mark-to-market ("MTM") value. The fair value of the cross currency swap as at 31 December 2014 is stated in the amount of HRK 1,473 thousand. Increase in cross currency swap fair value in the amount of HRK 393,281 thousand is recognized as financial income (Note 8).

### 28. OTHER LONG-TERM LIABILITIES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Deferred income – assets financed by third parties	3,738,553	3,975,988	4,220,301
Long-term liabilities for assets financed from clearing debt	759,089	668,377	689,792
Cross currency swap (Note 27)	-	391,808	-
Other long-term liabilities	1,860	2,353	2,508
	<b>4,499,502</b>	<b>5,038,526</b>	<b>4,912,601</b>

Deferred income relate to fixed assets ceded by customers and others without charge. The income from these assets is recognized over the same period as the related assets are amortized, 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.

## Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

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

At 31 December 2014 the Group stated clearing debt liability in the amount of HRK 759,089 thousand (2013: HRK 668,377 thousand, 2012: HRK 689,792 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.

### 29. SHORT-TERM LOAN LIABILITIES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Loans from domestic banks and subsidiaries of foreign banks, denominated in various currencies under following conditions:	-	295,000	400,000
Interest rate EURIBOR/TZ MF + margin (2.75 p.p.– 3.20 p.p.)	-	-	-
Secured by bills of exchange	-		
Other short-term loans	-	369,664	3,261
Current portion of RWE loan	8,981	7,674	7,582
Short term-loan	-	20,316	20,071
	<b>8,981</b>	<b>692,654</b>	<b>430,914</b>

By July 2014 the Group has repaid all its short-term liabilities. However, for the purpose of providing solvency reserves for the following mid-term period, in 2013 the Group has concluded with domestic banks multi-purpose overdraft agreements in the total amount of up to HRK 1,0 billion. Funds from agreed overdrafts the Group 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 2014, due to good liquidity, the Group did not concluded short-term loans from preapproved mid-term multipurpose overdraft agreements.

By June 2014 the Group has repaid all its liabilities arising from the reverse factoring, and have available complete approved funds from overdraft agreement for reverse factoring until 31 December 2015.

As of 31 December 2014 the Group has available the amount of up to HRK 1,328 million from short-term financing sources.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 30. TAXES AND CONTRIBUTIONS

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
VAT liability	120,567	-	-
Corporate income tax liability	180,250	130,129	302,222
Utility and other fees	30,731	13,641	17,519
Contributions and taxes for benefits in kind	22,570	18,650	20,111
Other	6,977	3,250	7,965
	<b>361,095</b>	<b>165,670</b>	<b>347,817</b>

## 31. LIABILITIES TO EMPLOYEES

	31 Dec 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
		Restated	Restated
Net salaries	79,123	71,589	75,220
Contributions	39,397	37,749	39,179
Net salaries NEK d.o.o.	10,620	10,772	9,179
Other	22,100	25,830	26,169
	<b>151,240</b>	<b>145,940</b>	<b>149,747</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 32. TRADE PAYABLES AND OTHER NON-CURRENT LIABILITIES

TRADE PAYABLES	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 Restated	31 Dec 2012 HRK '000 Restated
Domestic trade payables	1,401,253	1,126,964	2,246,352
Foreign trade payables	68,243	187,926	246,377
Foreign trade payables - EU	105,355	171,075	-
Trade payables - NEK d.o.o.	15,894	94,475	64,030
	<b>1,590,745</b>	<b>1,580,440</b>	<b>2,556,759</b>

OTHER NON-CURRENT LIABILITIES	31 Dec 2014 HRK '000	31 Dec 2013 HRK '000 Restated	31 Dec 2012 HRK '000 Restated
Prepayments received for connection fees	330,859	287,181	216,610
Other prepayments	121,033	116,797	98,344
Accrued expenses for unused vacations	71,436	53,828	64,827
Deferred income from electricity sale to households	40,467	-	19,426
Liabilities for fees for renewable energy sources	45,128	47,541	11,477
Accrued severance payments to employees	231,123	177,555	249,174
Accrued interest expenses	122,926	44	755
Accrued expenses for CO <sub>2</sub> emissions	111,806	98,508	-
Accrued expenses to HAC	77,775	77,775	77,775
Other accrued expenses	1,703	5,126	28,324
Liability for payment of dividend to RWE (Note 15)	14,807	8,707	-
Current portion of liabilities for finance lease (Note 24)	2,834	2,675	-
NEK d.o.o. liabilities	39,999	10,602	10,273
Other	12,630	38,569	54,054
	<b>1,224,526</b>	<b>924,908</b>	<b>831,039</b>



**32. TRADE PAYABLES AND OTHER NON-CURRENT LIABILITIES (continued)**

Correction of household income as at 31 December 2013 was obtained by calculating the logarithmic curve using network losses of 8.68% in the amount of HRK 58,207 thousand, while for the year ended 31 December 2012, stated percentage of loss used in the calculation was 8.85%. The result is an increase in revenue in the amount HRK 77,632 thousand in comparison to the previous year: reversed deferred income liability in the amount of HRK 19,425 thousand and stated receivable in the amount of HRK 58,207 thousand (Note 21).

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, the Group has been classified as the obligator of the EU ETS system.

The Group is required to obtain a permit for greenhouse gas emissions and to monitor emissions from facilities in accordance with the approved monitoring plan and to submit verified reports the Environmental Protection Agency by 31 March each year, on the total CO<sub>2</sub> 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.

Pursuant to the above, the cost of greenhouse gas emissions fee consists of the amount of CO<sub>2</sub> 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 incurred.

### 33. 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 the Group 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 2014	31 Dec 2013	31 Dec 2012
	HRK '000	HRK '000	HRK '000
<b>NEK</b>			
Liabilities for purchased electricity	62,830	63,373	61,119
Costs of purchased electricity	747,165	727,855	707,758

Management remunerations are explained in the Note 6.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 33. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue			Purchase costs		
	2014	2013	2012	2014	2013	2012
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Companies partially owned by the State</b>						
Hrvatske Željeznice	104,993	137,709	112,500	3,297	67,997	12,765
INA	131,359	156,430	155,192	983,943	54,506	132,403
Prirodni Plin	-	-	-	457,863	2,002,330	2,531,088
Plinacro	2,274	2,298	2,136	73,949	64,278	34,760
Croatia osiguranje	5,136	5,618	5,508	14,223	17,543	16,371
Hrvatska pošta	20,226	23,210	23,245	22,493	44,539	60,553
Hrvatske šume	3,260	5,529	6,474	5,464	2,261	6,087
Jadrolinija	650	870	1,102	658	4,031	647
Narodne novine	2,385	1,618	2,590	3,932	4,438	5,120
Hrvatska radio televizija	13,127	13,735	12,437	1,158	1,194	1,185
Plovput	446	578	579	349	165	692
Croatia Airlines	768	981	780	6	66	-
Petrokemija Kutina	18,537	3,488	29,028	61	82	118
Ministry of Foreign Affairs	455	513	525	-	-	-
Ministry of Defense	22,182	24,358	22,530	-	-	-
Ministry of the Interior	13,074	26,510	25,187	-	-	-
Elementary and high schools	78,055	88,078	82,888	-	-	-
Judicial institutions	8,188	13,758	12,185	74	173	-
Colleges and universities	27,792	33,610	31,594	1,172	3,715	4,145
Legislative, executive and other bodies of Republic of Croatia	26,129	29,040	30,482	5,426	6,345	6,572
Health institutions and organizations	112,742	122,821	89,538	1,168	3,194	3,233
Other users	11,342	16,619	12,024	5,124	6,577	16,669
<b>TOTAL</b>	<b>603,120</b>	<b>707,371</b>	<b>658,524</b>	<b>1,580,360</b>	<b>2,283,434</b>	<b>2,832,408</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 33. RELATED PARTY TRANSACTIONS (continued)

	Receivables			Liabilities		
	31 December	31 December	31 December	31 December	31 December	31 December
	2014	2013	2012	2014	2013	2012
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Companies partially owned by the State</b>						
Hrvatske						
Željeznice	31,811	79,781	45,902	541	39,792	2,460
INA	14,544	18,298	18,927	163,640	11,075	12,707
Prirodni Plin	-	-	-	-	153,148	297,100
Plinacro	125	400	355	11,446	8,670	-
Croatia						
osiguranje	705	611	610	2,779	5,119	4,356
Hrvatska pošta	1,282	3,211	3,107	2,725	8,786	3,791
Hrvatske šume	474	530	1,041	4	49	365
Jadrolinija	49	57	178	581	1,274	592
Narodne						
novine	289	163	263	838	1,226	1,361
Hrvatska radio						
televizija	2,653	2,399	2,385	39	147	152
Plovput	24	74	65	165	51	102
Croatia Airlines	95	217	148	-	-	276
Petrokemija						
Kutina	3,675	9,488	5,026	13	-	-
Ministry of						
Defense	4,311	4,090	3,260	-	-	-
Ministry of the						
Interior	2,069	6,592	3,402	-	-	-
Elementary						
and high						
schools	16,526	20,491	15,191	-	-	-
Judicial						
institutions	1,838	4,532	3,841	-	-	-
Colleges and						
universities	4,161	4,619	4,847	-	-	-
Legislative,						
executive and						
other bodies of						
Republic of						
Croatia	5,131	5,572	5,825	-	-	-
Health						
institutions and						
organizations	20,202	27,855	18,789	-	-	-
Other users	21,623	4,191	3,569	10,317	3,513	6,351
<b>TOTAL</b>	<b>131,587</b>	<b>193,171</b>	<b>136,731</b>	<b>193,088</b>	<b>232,850</b>	<b>329,613</b>

### **34. CONTINGENT LIABILITIES AND COMMITMENTS**

#### **Court disputes**

In 2014 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.

#### **Operating commitments**

As part of regular investment activities, at 31 December 2014 the Group had concluded agreements for investments in various facilities and equipment that has commenced but has not been completed. In 2014 the value of the most significant contracted investments in progress amounted to HRK 1,411,115 thousand (2013: HRK 1,300,391 thousand).

#### **Environmental and nature protection**

HEP 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 HEP ensures timely and objective reporting to the relevant institutions, local government and the public. 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.

The Company's 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 Protection, Physical Planning and Construction to unify environmental protection conditions. Part of thermal-power plants have obtained environmental licenses - TE Sisak, TE-TO Osijek, KTE Jertovec and Pogon Osijek HEP-Toplinarstvo d.o.o., and for other plants procedures are still in progress.

The CO<sub>2</sub> emissions trading system was officially set up in 2012 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 2013 and in 2014 HEP entered information verifying CO<sub>2</sub> 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<sub>2</sub> emissions. In 2014 activities for the preparation of non-financial statements for 2013 and 2014 for the HEP Group in accordance with Global Reporting Initiative (GRI 4) guidelines were started. Implementation of Environment management system in accordance with ISO 14001 in HEP's generation facilities is in progress.

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

In 2014, the Group continued on 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 and managing data on environmental permits.

Information about investments into environment protection and energy efficiency projects at HEP Group level was submitted to Energy Efficiency and Environmental Protection Fund which resulted in obtaining stimulating corrective factors by which penalty fees for emission of air pollutants were decreased by 50%.

##### **Unbundling of HEP Operator prijenosnog sustava d.o.o. (Hrvatski operator prijenosnog sustava d.o.o.)**

The Electricity Market Act (Official Gazette 22/2013) came into force on 2 March 2013 (hereinafter: the EM Act). Subordinate legislation stated in the EM Act are to be adopted within twelve months after entering into force and subordinate legislation prescribed by the Energy Act (Official Gazette 120/2012, hereinafter: the Act) within six months after entering into force. Pursuant to the provisions of the EM Act, HEP d.d, as the parent within the vertically integrated company and the owner of the transmission system, conducted unbundling of the transmission system operator pursuant to the provisions of the EM Act and undertook all activities to fulfil the unbundling requirements with the aim of certification.

On 9 April 2013 the General Assembly of HEP d.d. has adopted Decisions on unbundling of the transmission operator system under the ITO model - Independent Transmission Operator.

In July 2013, statutory transformation of HEP Operator prijenosnog sustava d.o.o. (now: Hrvatski operator prijenosnog sustava d.o.o., abbreviated HOPS d.o.o.) was conducted with the objective of unbundling in accordance with the ITO model and pursuant with the Electricity Market Act and decision of the HEP's General Assembly.

Assets used by HEP Operator prijenosnog sustava d.o.o. in its operations were transferred to the ownership of HEP Operator prijenosnog sustava d.o.o. and any outstanding receivables were transferred to its equity.

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

##### **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 Group has rented 70% of warehouse capacities in underground gas storage facilities.

In the period from 1 April 2014 to 31 March 2015 the Group agreed rent of capacities of 3.600 million kWh, in the period of 1 April 2015 to 31 March 2016, the Group agreed rent of capacities of rent of 3.550 million kWh, and in the period from 1 April 2016 to 31 March 2017 the Group agreed rent of capacities of 3.500 million kWh.

HEP d.d. as a supplier on the wholesale market sells gas as public service and under regulated conditions to local suppliers for household customers, and is obligated to provide secure and reliable gas supply.

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 35. SUBSIDIARIES

As at 31 December 2014, 2013 and 2012 the Group 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-Opskrba d.o.o.	Croatia	100	Electricity supply
HEP-Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP-Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	50	Electricity generation
APO d.o.o., usluge zaštite okoliša	Croatia	100	Environmental protection services and special waste management
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.	BH	100	Maintenance of hydro power plants
HEP-Odmor i rekreacija d.o.o.	Croatia	100	Accommodation and recreation services
HEP-NOC Velika	Croatia	100	Accommodation and training
HEP-Obnovljivi izvori energije d.o.o.	Croatia	100	Electricity generation
Program Sava d.o.o.	Croatia	100	Spatial planning, design, construction and supervision
HEP-Trgovina d.o.o. Ljubljana	Slovenia	100	Electricity trading
HEP- Magyarorszag Energia KFT	Hungary	100	Electricity trading
HEP-Trade d.o.o., Mostar	BH	100	Electricity trading
HEP-Trade d.o.o., Beograd	Serbia	100	Electricity trading
HEP – KS sh.p.k.	Kosovo	100	Electricity trading, transmission and distribution
HEP-Telekomunikacije d.o.o.	Croatia	100	Telecommunication services
HEP – Opskrba plinom d.o.o.	Croatia	100	Gas distribution

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*.



**36. 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 consist of debt, which includes loans and issued bonds disclosed in the Notes 24, 27 and 28, cash and cash equivalents and equity attributable to Owners of the parent, comprising of share capital, legal and other reserves and retained earnings.

***Gearing ratio***

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

	<b>31 December 2014</b>	<b>31 December 2013</b>	<b>31 December 2012</b>
	HRK '000	HRK '000	HRK '000
Debt	4,975,732	5,995,775	6,386,850
Cash and cash equivalents	(1,079,900)	(260,844)	(605,081)
Net debt	3,895,832	5,734,931	5,781,769
Equity	22,077,573	19,845,562	18,445,411
Net debt to equity ratio	<b>18%</b>	<b>29%</b>	<b>31%</b>

***Significant accounting policies***

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

***Categories of financial instruments***

	<b>31 December 2014</b>	<b>31 December 2013</b>	<b>31 December 2012</b>
	HRK '000	HRK '000	HRK '000
<b>Financial assets</b>			
Available-for-sale	192,676	125,166	129,452
Loans and receivables (including cash and cash equivalents)	3,385,074	2,534,330	2,563,609
Other non-current assets	54,337	64,971	67,732
<b>Financial liabilities</b>			
Non-current liabilities	5,749,390	6,390,110	5,894,114
Current liabilities	2,316,043	2,854,940	3,814,947

**36. FINANCIAL RISK MANAGEMENT (continued)*****Financial risk management objectives***

The Group's Treasury function provides services to the business, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Group companies through internal risk reports which analyze 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 has 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:

	<b>Assets</b>			<b>Liabilities</b>		
	<b>31</b>	<b>31</b>	<b>31</b>	<b>31</b>	<b>31</b>	<b>31</b>
	<b>December</b>	<b>December</b>	<b>December</b>	<b>December</b>	<b>December</b>	<b>December</b>
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<i>HRK '000</i>	<i>HRK '000</i>	<i>HRK '000</i>	<i>HRK '000</i>	<i>HRK '000</i>	<i>HRK '000</i>
European Union (EUR)	23,260	4,900	44,664	626,788	729,763	683,215
United States (USD)	30	-	1,492	5,954	158	8,449

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

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

	<b>2014</b>	<b>2013</b>	<b>2012</b>
	HRK '000	HRK '000	HRK '000
<b>EUR change effect</b>			
Profit or loss	462,391	553,624	481,826
<b>USD change effect</b>			
Profit or loss	3,393	91	3,984

### 36. FINANCIAL RISK MANAGEMENT (continued)

#### *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 based on the interest rate exposure of the Group to financial instruments at the date of the statement of financial position. For floating interest rates, the analysis is prepared assuming that the amount of outstanding liability at the reporting date, 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:

- The Group's profit for the year ended 31 December 2014 would decrease/increase by HRK 8,201 thousand (2013: HRK 12,349 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 33.12% of all interest bearing loans in 2014 (41.63% in 2013); and
- the Group's sensitivity to interest rates would increase during current period mainly due to increase in floating interest rate loans.

#### *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 domestic 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 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.

**36. 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
<b>2014</b>							
Interest free		2,366,041	801,454	337,149	39,131	910	3,544,685
Floating interest bearing		131	-	-	-	-	131
Fixed interest bearing	6.00%	62	10,618	522	-	-	11,202
<b>Total</b>		<b>2,366,234</b>	<b>812,072</b>	<b>337,671</b>	<b>39,131</b>	<b>910</b>	<b>3,556,018</b>
<b>2013</b>							
Interest free		914,345	787,697	206,655	409,260	2,224	2,320,181
Floating interest bearing	7.00%	535	1,018	92,331	-	-	93,884
<b>Total</b>		<b>914,880</b>	<b>788,715</b>	<b>298,986</b>	<b>409,260</b>	<b>2,224</b>	<b>2,414,065</b>
<b>2012</b>							
Interest free		1,582,046	662,390	448,507	65,559	2,156	2,760,658
Floating interest bearing	5.00%	23	46	66	-	-	135
<b>Total</b>		<b>1,582,069</b>	<b>662,436</b>	<b>448,573</b>	<b>65,559</b>	<b>2,156</b>	<b>2,760,793</b>

# Notes to the consolidated financial statements of the HEP Group (continued)

For the years ended 31 December 2014, 2013 and 2012

## 36. FINANCIAL RISK MANAGEMENT (continued)

### Liquidity and interest rate risk tables (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 HRK'000	1 - 3 months HRK'000	3 -12 months HRK'000	1 - 5 years HRK'000	Over 5 years HRK'000	Total HRK'000
<b>2014</b>							
Interest free		1,980,663	862,644	89,568	846,629	118,889	3,898,403
Floating interest bearing	2.60	81,010	54,902	323,469	1,440,009	-	1,899,390
Fixed interest bearing	6.50	-	956	312,552	3,634,269	14,526	3,962,303
<b>Total</b>		<b>2,061,673</b>	<b>918,502</b>	<b>725,589</b>	<b>5,920,907</b>	<b>133,415</b>	<b>9,760,096</b>
<b>2013</b>							
Interest free		1,481,347	628,489	28,808	1,075,760	5,704	3,220,108
Floating interest bearing	3.17	14,585	49,118	824,881	1,656,115	78,835	2,623,534
Fixed interest bearing	6.46	473	45,774	315,464	3,921,980	25,510	4,309,201
<b>Total</b>		<b>1,496,405</b>	<b>723,381</b>	<b>1,169,153</b>	<b>6,653,855</b>	<b>110,049</b>	<b>10,152,843</b>
<b>2012</b>							
Interest free		1,337,387	881,754	470,775	707,064	536	3,397,516
Floating interest bearing	4.37	14,532	52,140	543,036	1,792,940	387,757	2,790,405
Fixed interest bearing	5.60	-	-	824,881	5,004,943	15,926	5,845,570
<b>Total</b>		<b>1,351,919</b>	<b>933,894</b>	<b>1,838,692</b>	<b>7,504,947</b>	<b>404,219</b>	<b>12,033,671</b>

The Group has access to sources of financing. The total unused amount at the end of the reporting period was HRK 1,687,895 thousand. The Group expects to meet its other obligations from operating cash flows and proceeds from matured financial assets.

**36. 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 (excluding derivative instruments) 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 analyzes 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.

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

	<b>1<sup>st</sup> level</b> HRK '000	<b>2<sup>nd</sup> level</b> HRK '000	<b>3<sup>rd</sup> level</b> HRK '000	<b>Total</b> HRK '000
<b>2014</b>				
Available-for-sale assets	192,676	-	-	<b>192,676</b>
Cross currency swap	-	-	1,473	<b>1,473</b>
Investment property	-	236,153	-	<b>236,153</b>
<b>2013</b>				
Available-for-sale assets	125,166	-	-	<b>125,166</b>
Cross currency swap	-	-	(391,808)	<b>(391,808)</b>
Investment property	-	233,057	-	<b>233,057</b>
<b>2012</b>				
Available-for-sale assets	129,353	-	-	<b>129,353</b>
Cross currency swap	-	-	-	<b>-</b>
Investment property	-	235,841	-	<b>235,841</b>

### 37. EVENTS AFTER THE REPORTING DATE

The Agreement signed between HEP and RWE expired on 28 May 2015 and upon expiration HEP d.d. become the sole owner of TE Plomin d.o.o.

By the end of May 2015, the Company paid all liabilities to RWE as follows: the principal sum of HRK 25,803 thousand, non-capitalized interest in the amount of HRK 8,893 thousand, dividend from retained earnings for 2012 and 2013 in the amount of HRK 14,645 thousand, dividend for 2014 in the amount of HRK 3,066 thousand and interim dividend prepayments for 2015 in the amount of HRK 955 thousand.

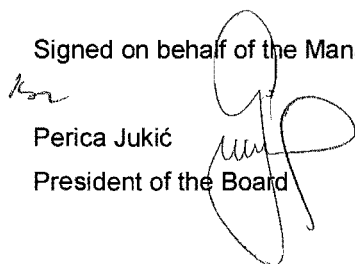
On 15 May 2015, the company APO d.o.o., for environmental protection was merged with the Company.

On 24 April 2015, the company HEP Odmor i rekreacija d.o.o. changed its name to HEP Upravljanje imovinom d.o.o.

### 38. APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

These consolidated financial statements were approved by the Management Board and authorized for issue on 30 June 2015.

Signed on behalf of the Management Board on 30 June 2015:

  
Perica Jukić  
President of the Board

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



**THE ISSUER**  
**Hrvatska Elektroprivreda d.d.**  
Ulica Grada Vukovara 37  
10 000 Zagreb  
Croatia

**TRUSTEE**  
**Deutsche Trustee Company Limited**  
Winchester House  
1 Great Winchester Street  
London EC2N 2DB  
United Kingdom

**PRINCIPAL PAYING AGENT AND TRANSFER AGENT**  
**Deutsche Bank AG, London Branch**  
Winchester House  
1 Great Winchester Street  
London EC2N 2DB  
United Kingdom

**REGISTRARS, PAYING AGENTS AND TRANSFER AGENTS**

*In respect of the Rule 144A Notes*

Deutsche Bank Trust Company Americas  
Trustee and Agency Services  
60 Wall Street, 16<sup>th</sup> Floor  
MS: NYC60-1630  
New York, NY 10005  
United States

*In respect of the Regulation S Notes*

Deutsche Bank Luxembourg S.A.  
2, boulevard Konrad Adenauer  
1115 Luxembourg  
Luxembourg

**LEGAL ADVISERS**

*To the Issuer  
as to Croatian law*

**Mamić Perić Reberski Rimac Law Firm LLC**  
Radnička cesta 80  
10000 Zagreb  
Croatia

*To the Issuer  
as to English law and United States law*

**White & Case LLP**  
5 Old Broad Street  
London EC2N 1DW  
United Kingdom

*To the Joint Lead Managers and the Trustee  
as to Croatian law*

**Šavorić & Partners LLC**  
Ilica 1/A  
10000 Zagreb  
Croatia

*To the Joint Lead Managers and the Trustee  
as to English and United States law*

**Latham & Watkins (London) LLP**  
99 Bishopsgate  
London EC2M 3XF  
United Kingdom

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

**LISTING AGENT**  
**Deutsche Bank Luxembourg S.A.**  
2, Boulevard Konrad Adenauer  
1115 Luxembourg  
Luxembourg

**JOINT LEAD MANAGERS**

**Banca IMI S.p.A.**  
Largo Mattioli, 3  
20121 Milan  
Italy

**Morgan Stanley & Co. International plc**  
25 Cabot Square  
Canary Wharf  
London E14 4QA  
United Kingdom

**UniCredit Bank AG**  
Moor House  
120 London Wall  
London EC2Y 5ET  
United Kingdom