

Annual consolidated financial statements for the year 2018

MANAGEMENT BOARD'S REPORT ON FINANCIAL POSITION AND ANALYSIS OF BUSINESS RESULTS

In 2018, the HEP Group (Hrvatska elektroprivreda d.d., together with its subsidiaries, hereinafter: HEP), fulfilled its mission of safe, high quality and reliable energy supply, and according to the revised financial statements consolidated net profit of HRK 1,364.8 million was achieved.

The growth of economic activities resulted in the increase of electricity consumption by domestic commercial customers by 3.3% compared to 2017, during which HEP Opskrba (supply) and HEP Elektra recorded a 12.9% increase of their sale. HEP's sale of electricity to households decreased by 2.5% due to moderate winter and summer weather conditions compared to 2017. In 2018, the total market share in the electricity supply to domestic customers rose from 84.7% in 2017 to 89.1%.

In light of warmer weather during key heating months, the sale of heat energy and gas was reduced. Gas sales increased as a result of gas supply expansion outside the territory covered by HEP's distribution network in Eastern Slavonia.

As 2018 was characterized by favourable hydrology, hydropower plants generated 6.9 TWh of electricity which was by 1.9 TWh (38.7%) more than in 2017. Production by thermal power plants was lower by 838 GWh (20.7%) as well as the electricity purchase on the market, including the purchase from renewable energy sources and cogeneration, in total by 863 GWh (11.0%). Nuclear power plant Krško produced 2,745 GWh of electricity.

Operating income of HRK 15,198.3 m increased compared to the year before by HRK 229.0 m (1.5%).

Income from the sale of electricity increased by HRK 156.7 m (1.4%) to HRK 11,650.3 million.

Said income generated domestically was the result of increased consumption demand as well as of HEP's increased share in the sale to commercial customers, and the rise of the average selling price for commercial customers supplied by HEP Opskrba. Income from the sale of electricity abroad decreased as the result of lower sales in Slovenia and lower export volumes of electricity surplus and electricity resale.

Income from the sale of heat was HRK 664.4 million decreased by HRK 18.8 m (2.8%) due to a 4.7% lower demand. Income from gas wholesale of HRK 932.2 million represented a 3.3% decrease of HRK 31.6 million compared to the year before as a result of decreased sale by 4.5%. Income from the sale of gas to end customers of HRK 990.5 m increased by HRK 673.9 m as a result of sale of gas to domestic customers in 2018.

Operating expenses in 2018 amounted to HRK 13,539.8 million, which is an increase by HRK 865.4 million (6.8%).

Due to lower volumes of consumed natural gas and coal, as a result of lower thermal production due to favourable hydrology, the cost of energy fuel was reduced by HRK 207.8 million (10.9%).

The cost of electricity procurement of HRK 2,831.2 million was increased by HRK 44.7 million (1.6%), as the result of less procured electricity volumes on the market.

In the structure of total procurement cost, the cost of import was reduced as a result of less imported electricity volumes, while the cost of purchase from RES and cogeneration increased due to higher electricity volumes purchased from HROTE (Energy Market Operator).

The purchase value of sold wholesale gas amounted to HRK 1,823.7 million, which is an increase compared to 2017 by HRK 693.5 million (61.4%) due to gas supply to domestic customers which was not carried out in 2017.

As of 31 December 2018, net debt of HEP amounted to HRK 941.0 million, which is a decrease by HRK 1.3 billion due to increase in cash and loan repayments.

Pursuant to the decision of the General Assembly, HEP d.d. paid HRK 218.4 m into the State Budget as dividend, which accounts for 60% of profit after tax generated in 2017.

HEP Group continued to be one of the biggest investors in Croatia in 2018 with made investments of HRK 2.4 billion. The investments were financed by Group's own funds due to good liquidity which was the result of a good business year. The funding for the construction of the high-efficiency combined cycle Unit L in EL-TO Zagreb CCPP the loan was arranged in July with the European Bank for Reconstruction and Development and the European Investment Bank. The Long-Term Service Agreement was also signed with FATA S.p.A. In 2018, wood biomass-fired cogeneration biopower plants BE-TO Osijek and BE-TO Sisak were put into commercial operation. Continuous equipment replacements, reconstructions and revitalizations of existing production facilities as well as of transmission and distribution network were carried out, primarily under contracts signed with Croatian producers and contractors.

Good liquidity management was acknowledged by Standard & Poor's rating agency which affirmed the standalone credit rating of Hrvatska elektroprivreda in 2018 (bb) as well as its overall credit rating (BB), and upgraded the rating outlook from stable to positive as a result of the upgrade of Croatia's sovereign rating. In March 2018, Moody's affirmed HEP's long-term credit rating (Ba2) as well as HEP's stable rating outlook.