

Annual consolidated financial statements for the year 2021

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

In the previous financial year HEP's business operations were conducted in extremely complex, even crisis circumstances. Nevertheless, in the second year of Covid-19 pandemic we showed high resistance, so we continued and launched a series of investments with a high national component. Along with the measures adopted by the Croatian Government, our activities contributed to a quick recovery of the Croatian economy and historically the highest GDP rise in Q3 2021.

The beginning of the year was marked by a catastrophic earthquake which struck the region of Banovina and the central part of Croatia on 29 December 2020. From the first day, the employees of HEP-Operator distribucijskog sustava d.o.o. contributed fully to the implementation of activities to eliminate the consequences of the earthquake. In line with the conclusions of the Croatian Government, HEP Group's companies conducted measures of writing off debt for energy consumed in households in the regions struck by the earthquake throughout 2021. The total of HRK 79.1 million was written off.

Stated crisis circumstances were followed by a rise of wholesale prices of fuels and electricity. This trend of price increase, noticeable since the half of the year extremely intensified in Q4 of 2021, and it was the main reason of operating profit decrease as compared to 2020.

In spite of difficult business conditions, our increasingly efficient management of risk and overall financial position brought still good business results. According to audited financial reports HEP Group (Hrvatska elektroprivreda d.d. together with its affiliated companies) achieved consolidated net profit of HRK 1,019.5 million, marking a decrease of HRK 444.3 million in comparison to 2020.

Operating income amounts to HRK 1,168.0 million, which despite higher achieved income marks a decrease of HRK 989.8 million (45.8%) when compared to 2020, primarily as a result of increased variable operating expenses. Profit from financial activities totals at HRK 76.4 million, whereby in 2020 there was a loss from financial activities totalling at HRK 344.4 million.

The total electricity consumption in Croatia was 16.5 TWh, with an increase of billed electricity to commercial customers by 746 GWh and to household customers by 364 GWh.

The total sale of HEP Group's suppliers in the Republic of Croatia increased by 780 TWh (5.6%) in comparison to 2020, and it totals at 14,683 GWh (89.0% of the market). The sale of HEP Opskrba amounted to 8,090 GWh marking an increase by 267 GWh, and the market share was reduced from 50.9% to 49%, in comparison to 2020. The sale of HEP Elektra totalled at 6,593 GWh, which marked an increase by 513 GWh, whereas the market share rose from 39.5% to 40.0%.

2021 was marked by favourable hydrology, so hydro power plants generated 6,805 GWh, which is 1,466 GWh (27.5%) more than in 2020. Thermal power plants and combined heat and power plants generated 4,020 GWh, which is 52 GWh less than in 2020. Nuclear power plant Krško delivered 2.7TWh, marking a decrease by 311 GWh (10.3%), taking into consideration a regular overhaul conducted in April 2021. HEP's solar power plants and biomass-fired combined heat and power plants generated the total of 23 GWh, whereas HEP's first windfarm, Korlat which became operational in 2021, generated 173 GWh.

Operating income amounts to HRK 15,969.6 million, marking an increase of HRK 1,587.0 million in comparison to 2020, primarily as a result of increased income from electricity sale totalling at HRK 1,918.0 million (16.7%), income from the lease of LNG terminal capacity totalling at HRK 174.2 million (the terminal became operational as at 1 January 2021) and income from gas sale to the customers of gas supply by HRK 106.2 million (24.4%).

Through electricity sale, the Group generated HRK 13.4 billion, marking 84% of its operating income. The increase of 16.7% (HRK 1,918.0 million), in comparison to the year before is a result of higher income from electricity billed to commercial and household customers, along with higher prices of electricity supply to commercial customers as well as higher export of electricity along with higher prices of exported electricity

Income from the sale of heat energy totals at HRK 707.9 million, and makes up 4.8% of operating income. It is by HRK 33.8 million higher, due to an increase in demand by HRK 8.4%, along with a 3.1% lower average selling price.

As of 1 April 2014 HEP d.d. performed the activity of wholesale gas market supplier, which included the sale of gas to suppliers under the public service of gas supply to households. In line with the Decision of HERA adopted in October 2020, it performed this activity until 31 March 2022. The Group achieved an income of HRK 19.5 million on this basis, which is a decrease of HRK 456.1 million in comparison to 2020.

Income from gas sale to end customers amounts to HRK 541.8 million, making up 3% of operating income, which is an increase of HRK 106.2 million in comparison to 2020, due to the rise in gas sale (17.4%) as a result of expanding supply on other distribution areas and the takeover of customers from Gradska plinara Krapina d.o.o and Darkom distribucija plina d.o.o., marking an increase of sale in other distribution areas by 36.1%.

Operating expenses amount to HRK 14,800.6 million, marking an increase of HRK 2,586.8 million, when compared to 2020. The increase was affected by higher expenses of electricity procurement by HRK 1,244.2 million (52.0%) as a result of a higher purchase price of electricity, higher import and higher fuel expenses by HRK 900.6 million (60.0%). This was primarily a result of higher prices of coal and natural gas, as well as of higher costs of CO₂ emission units by HRK 355.8 million (78.3%), due to higher price and larger quantities of emission units.

The cost of gas procurement for market supply totals at HRK 408.4 million and is higher by HRK 214.6 million in comparison to 2020, as a result of higher gas procurement along with a higher average gas purchase price. Following the cessation of activity of wholesale gas market supplier after 31 March 2021 and a reduced number of suppliers under the obligation of public service, which chose to procure gas from HEP d.d. after 31 March 2020, the purchase value of gas, the costs of gas transport and storage were reduced by HRK 516.7 million in comparison to 2020 and they amount to HRK 77.8 million.

HEP Group's liquidity was satisfactory, so favourable debt indicators on contracted loans were achieved, as well as all other business indicators. Liabilities to the suppliers were settled within maturity date, exclusively from regular business income. The dividend from profit in 2020 was paid in favour of the State Budget totalling at HRK 840.6 million.

HEP Group was one of the biggest investors in Croatia in 2020 as well. Its investments totalled at HRK 3.08 billion, including the investment of HRK 239.6 million in NPP Krško.

Regarding size and significance, the investment in Kosiinj Hydropower system (HRK 1.54 billion) stands out. Under the Decision of the Croatian Government in July last year this project was declared a strategic investment project. Works on ancillary utility infrastructure in the construction area were conducted last year. Project documentation for obtaining location permits was prepared for the second part of the full project, hydro power plant Senj 2 (390 MW; HRK 1.9 billion). The realization of a multi-annual cycle of hydro power plant reconstructions and revitalizations continued in the sector of hydro power, which in 2021 encompassed five power plants. Regarding other projects of capital generation facilities, the construction of highly-effective combined cogeneration block in Combined heat and power plant Zagreb continued (150 MWe/114 MWt; HRK 920 million).

HEP's first windfarm, Korlat (58 MW, HRK 495 million) was put into regular operation in 2021. The cycle of investment in solar power plants continued. Solar power plants Kaštelir 2 (connecting capacity 2 MW), Marići (1 MW) and Kosore Jug near the town of Vrlika (2.1 MW) were put into operation. The construction of currently the biggest solar power plant in Croatia, Obrovac (7.35 MW connecting capacity and 8.7 MW installed capacity) was completed and the procedure of obtaining operational licence was launched. The same goes for solar power plant Stankovci (2.5 MW). In September

2021 HEP d.d. signed a cooperation agreement with six municipalities and the Town of Valpovo regarding the development of solar power plant projects, with the total power of 60 MW and estimated investment value of HRK 380 million. Together with 11 power plants from the first round of concluded agreements, these make up the total of 168 MW and the investment higher than a billion kuna. Including completely independent projects, at the end of the year HEP Group had 40 solar power plant projects in different developmental phases.

Regarding investments in the field of electricity, a significant part referred to the activities of transmission and distribution, where a series of capital projects of construction and reconstruction of substations and power lines was completed, continued or launched. By the end of the year more than 80 percent of the Smart Grid Pilot Project was completed, and with the share of HRK 150 million it was co-financed through non-reimbursement grants from the European Regional Development Fund.

Investments in the field of heat energy were also marked by projects co-financed through grants from the European Regional Development Fund. The first of three phases of revitalization of the City of Zagreb's hot-water network, worth HRK 700 million was completed. The revitalization encompasses 63 kilometres, i.e. one third of the hot-water network. The realization of the project of replacing the connecting hot-water line from combined heat and power plant Osijek to Heat plant Pogon Osijek started at the end of the year and its value amounts to HRK 78 million.

Regarding investments in HEP's third key business segment, gas operations, the most important investment was the liquefied natural gas terminal on the island of Krk, which was completed and put into operation as of 1 January 2021. The investment was realized by LNG Hrvatska, a company co-founded by HEP d.d. HEP d.d also appears as a lessee of the capacity in the liquefied natural gas terminal, and in the first year of operation, the terminal proved itself as an important additional direction of gas procurement. Other investments in gas operations, apart from investment in gas network, primarily referred to the continuation of acquisition activities. HEP Plin took over Gradska plinara Krapina in April, and it took over Darkom distribucija plina in the town of Daruvar in June.

Regarding investments in other business segments, one should mention the continuation of eMobility project. In 2021, 43 public ELEN charging stations and 6 internal charging stations were installed, so by the end of the year the total number of HEP's charging stations rose to 302, 256 of which are publicly available.