

Annual unconsolidated financial statements for the year 2016

MANAGEMENT BOARD'S REPORT ABOUT FINANCIAL POSITION AND ANALYSIS OF BUSINESS RESULTS – REPORT OF THE MANAGEMENT

According to revised annual financial reports, in 2016 Hrvatska elektroprivreda d.d. achieved a net profit of HRK 1,323.8mn, whereas achieved net profit in 2015 totalled at HRK 1,624.3mn.

Operating income in 2016 amounted to HRK 7.867.9mn marking a decrease of 6.3%, in comparison to 2015 as a result of lowering revenue from sale of gas on wholesale market by HRK 229.7mn. The sale of gas in 2016 totaled at 6,310 GWh, which is an increase of 255 GWh when compared to the year before. In spite of that, the achieved income was lower, amounting to HRK 1,235.8mn, due to the lowering of sale price, which is determined by the Government of the Republic of Croatia. Pursuant to the decision of the Croatian Government, Hrvatska elektroprivreda d.d. was defined as the supplier on the wholesale gas market for the period between 1 April 2014 and 31 March 2017, during which it sold gas under regulated conditions to suppliers with the obligation of public service of gas supply for household customers.

The revenue from electricity sale is HRK 6,012.6mn, which is a decrease of HRK 60.6mn, as a result of lower income from electricity sale in Croatia by HRK 360.0mn (6.5%) due to the decreased sale prices. However, revenue from electricity sale in foreign market increased by HRK 301.6mn (61.6%) and amounted to HRK 790.8mn, which is a result of a bigger engagement and increased activities on the regional market.

Operating expenses amount to HRK 7,002.6mn, which is a decrease of HRK 112.1mn (1.6%) when compared to the year before as a result of lower costs of electricity purchase. Even though extra 716 GWh of electricity was procured during 2016, the costs of electricity purchase outside the system amounted to HRK 1,957.8mn are lower by HRK 151.0mn compared to last year, due to a reduced purchase price by 15.8% on average. The costs of electricity purchase within the system amounted to HRK 584.9mn, which marks an increase of HRK 120.5mn.

Net profit of HRK 640.2mn was achieved from **financial activities**. Financial income amounts to HRK 988.6mn, which is a decrease of 12.1% when compared to the year before. The biggest part of the financial income, HRK 614.2mn refers to the transfer of achieved profit of affiliated companies from 2015, which is by HRK 279.5mn lower compared to 2015. Apart from that, income from interest rates decreased by HRK 35.0mn and amounted to HRK 161.6mn. Financial expenses total at HRK 348.5mn, which is a decrease of 42.0% when compared to the year before, mostly as a result of the costs of repurchasing bonds in 2015.

At the end of October, Standard & Poor's rating agency upgraded the stand-alone credit rating of Hrvatska elektroprivreda (HEP) from b+ onto bb as well as HEP's overall credit rating from BB- onto BB, which levelled HEP's overall credit rating with the sovereign rating of the Republic of Croatia. In mid-

March 2017 Moody's rating agency confirmed HEP's long-term credit rating (Ba2) and increased the credit rating outlook from negative to stable, after the outlook upgrade of Croatia's sovereign rating.

During the whole 2016 all due obligations were paid in due time, and own funds were used to finance investments and long-term loans were used to finance the construction of forest biomass-fired cogeneration plants.. In 2016 there was no new short-term debt, so as at 31 December 2016 the company has no liabilities for short-term loans.. HEP d.d. contracted several mid-term frameworks, used to ensure mid-term financial reserve and to ensure good and stable sources of financing working capital.

Liabilities for loans and issued bonds amounted to HRK 5,256.2mn and decreased by HRK 367.8mn, due to a decrease in long-term liabilities by HRK 243.3mn as well as liabilities for issued bonds by HRK 124.5mn. Current maturity of loans and bonds increased by HRK 518.4mn and amounted to HRK 995.3mn, due to current maturity of bonds issued in 2012, with a maturity date in November 2017. Due to the stated, a long-term part in the total loan debt and issued bonds decreased to 81.1% in 2016, when compared to 91.5% the year before. As a result of favourable liquidity during the year, there was no need for contracting new long-term source of financing.

In 2016 HRK 360.1mn of investment was realized through investing into the development of new energy facilities, construction of forest biomass-fired cogeneration plants and proceedings and equipment of computer-communication infrastructure. Compared to previous year investments made by Hrvatska elektroprivreda d.d. in 2016 increased by 70.1%.

As at 31 December 2016 HEP d.d. has 428 employees. When compared to the year before, the number of employees decreased by 13.

A new Collective Agreement was signed in 2016. It has been applied in the period between 1 July 2016 and 31 December 2017.