

Annual unconsolidated financial statements for the year 2019

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

According to audited annual financial reports, net profit of Hrvatska elektroprivreda d.d. in 2019 was HRK 1,107.3 m, whereas achieved net profit in 2018 totalled at HRK 354.0 m.

Operating income in 2019 amounted to HRK 9,315.2 m, marking an increase of HRK 623.9 m in comparison to 2018 (7.2%), primarily as a result of sale of electricity at the market and affiliated companies, which increased by 15.4%.

The income from sale of electricity amounted to HRK 7,642.5 m, which is an increase of HRK 1,021.7 in comparison to the year before. The reasons for this increase include: the increase of sale and the rise of average selling price for domestic customers from commercial category, the increase of sale and the rise of average selling price at the foreign market, and the increase of income from the sale of electricity to cover the losses in transmission and distribution network, due to the rise of the selling price.

In line with the Gas Market Act and the decisions of the Croatian Energy Regulatory Agency (HERA), HEP d.d. performs the activity of the supplier at the wholesale gas market. This activity refers to the sale of gas to the suppliers under obligation of public service for the supply of household customers that choose HEP d.d. In line with HERA's decision as at 28 October 2019, HEP d.d. shall perform this activity until 31 March 2021. In 2019 the sale of gas to suppliers under public service obligation decreased by 1.8%, but since the average selling price was 6.4% higher, achieved income from the sale of gas at the wholesale market increased by HRK 36.2 m, totalling at HRK 971.9 m. Achieved income from the sale of gas at the market amounted to HRK 2.4 m, whereas in 2018 achieved income was HRK 657.6, due to the sale of gas to domestic customer.

Operating expenses are HRK 8,870.0 m, which is an increase of HRK 204.5 m (2.4%) in comparison to the year before, due to the increase of costs of electricity procurement at the market. The share of these costs in operating expenses is 36.0%, and they amount to HRK 3,157.7, marking an increase of HRK 856.2 m, due to higher electricity procurement at the market as a result of lower electricity generation in hydro power plants, the increase of market prices and higher electricity sale. Moreover, the increase of total operating expenses was affected by the decrease of obligation of repurchasing generated electricity in the incentive system from 100% onto 70%. The costs of gas procurement at the wholesale market decreased as well, and they amounted to HRK 1,152.9 m, as a result of a decrease in sale by 108 GWh (1.8%) and lower expenses of gas transport.

Positive result was achieved through **financial activities**, totaling at HRK 693.1 m. Achieved financial income was HRK 1,204.6 m, which is by 66.7% higher than in the year before. Most of the financial income, HRK 828.3 m refers to the transfer of achieved profit of affiliated

companies in 2018, which increased by HRK 488.1 m in comparison to the year before. Unrealized gains from financial assets totalled at HRK 231.5 m, HRK 226.7 m of which refer to market-to-market value.

Financial expenses amount to HRK 511.6 m, marking an increase of HRK 72.3 m in comparison to the year before, primarily due to the correction of value of HEP's d.d. share in affiliated companies totaling at HRK 270.1 m.

At the end of April 2019, rating agency Moody's confirmed long-term credit rating of Hrvatska elektroprivreda (Ba2) and it upgraded its credit rating outlook from stable to positive. Due to methodology and criteria used by Moody's when rating HEP, the upgrade ensued upon the upgrade of credit rating outlook for the Republic of Croatia. Moody's report states that HEP shall maintain a strong financial profile in the forthcoming periods.

At the end of November, rating agency Standard & Poor's confirmed the long-term credit rating of Hrvatska elektroprivreda (BB+) and it set the stand-alone credit rating of Hrvatska elektroprivreda d.d. at bb+. In the report by Standard & Poor's it is stated that HEP improved its management regarding the exposure to extremely variable hydrology and fluctuations of energy fuel prices. They believe that HEP is going to be affected by volatility specific to generation of hydro power plants, but it is going to control it better. The report also emphasizes that HEP restructured its business, in order to ensure long-term efficiency and flexible structure of costs at the Group level, so HEP is expected to continue achieving good business results.

During 2019 investments were financed by own means and long-term loans for financing the project of combined-cycle cogeneration plant at the location of EL-TO Zagreb. There were no new short-term loans in 2019, so as at 31 December 2019 the company has no short-term loan commitments. HEP d.d. concluded several mid-term framework agreements, which ensured mid-term financial reserves, and good and stable sources of financing working capital.

Loan and issued bond commitments total at HRK 3,737.2 m, which is a decrease of HRK 152.7 m, as a result of decreasing current maturity of long-term loans by HRK 75.8 m, issued bond commitments by HRK 41.7 m and long-term loan commitments by HRK 35.2 m. Long-term share amounts to HRK 3,700.9 m and it makes up 99% of the total amount of loans and bonds. Own bonds were redeemed on several occasions in 2019 at secondary market, in the amount of HRK 64.5 m, so the total book value of corporate bond as at 31 December 2019 was lowered by performed redemption.

As at 4 July 2019 the Assembly of HEP d.d. adopted a decision on the payment of dividend for 2018 amounting to HRK 212.4 m (representing 60% of after-tax income of the parent company HEP d.d. for 2018 – HRK 354.0 m). As at 16 July HEP paid the dividend into the national budget.

In line with the decision of the Assembly, in February 2019 HEP d.d. increased the equity of LNG Hrvatska d.o.o. in the amount of HRK 216.1 m, by which it increased its share in the ownership of that company onto 84.8%.

HRK 176.9 m of investment was achieved in 2019 through investment into the preparation of construction and construction of new energy facilities as well as procurement and construction of computer – communication infrastructure. In comparison to the year before, the investment of Hrvatska elektroprivreda d.d. increased by 109.7%.