HRVATSKA ELEKTROPRIVREDA d.d. Zagreb

Condensed consolidated interim financial statements for the period ended 30 June 2016

Contents

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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 2016, 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 statements ("the condensed consolidated interim financial information of the HEP Group").

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 2016 is not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Registrirano kod Trgovačkog suda u Zagrebu pod brojem 080044149

OIB 76394522236

Emphasis of matter

As described in the Note 12 to the condensed consolidated interim financial information, as at 30 June 2016, the Group stated clearing debt liability in the amount of HRK 818,034 thousand (31 December 2015: HRK 842,162 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.

As described in the Note 17 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, 29 August 2016

BDO Croatia d.o.o.
Trg J. F. Kennedy 6b
10000 Zagreb

Irena Jadrešić, Certified auditor

Zdenko Balen, Member of the Management Board

	Note	For the six months period ended 30 June 2016 HRK '000 Unaudited	30 June 2015 HRK '000 Unaudited
Revenue from electricity sales	3,5	5,406,437	5,244,063
Revenue from thermal power sales	3	382,046	389,556
Revenue from sale of gas on wholesale market	3,4	647,559	789,773
Revenue from sale of gas to customers	3	186,931	220,291
Sales revenue		**6,622,973**	**6,643,683**
Other operating income		551,392	500,219
Total operating income		**7,174,365**	**7,143,902**
Electricity purchase cost	5	(971,827)	(774,794)
Fuel cost	5	(765,093)	(976,073)
Costs of gas sold	4	(705,672)	(808,823)
Staff cost		(924,670)	(942,642)
Depreciation and amortization costs		(884,374)	(922,212)
Other operating expenses		(1,169,771)	(1,207,581)
Total operating expenses		**(5,421,407)**	**(5,632,125)**
Operating profit		**1,752,958**	**1,511,777**
Financial income	6	148,290	423,584
Financial expenses	6	(207,234)	(239,547)
Net profit /(loss) from financial activities		**(58,944)**	**184,037**
Profit before taxation		**1,694,014**	**1,695,814**
Corporate income tax expense	7	(348,988)	(350,668)
Profit for the period		**1,345,026**	**1,345,146**
Attributable to:			
Owners of the parent		1,345,026	1,344,184
Non-controlling interest		-	962
		1,345,026	**1,345,146**

Condensed consolidated statement of comprehensive income of the HEP Group (continued)

For the six months period ended 30 June 2016

	For the six months period ended	
	30 June 2016	**30 June 2015**
	HRK '000	HRK '000
	Unaudited	Unaudited
Profit for the period	**1,345,026**	**1,345,146**
Other comprehensive income		
Exchange gains arising on translation of foreign operations	(28,065)	(17,420)
Net gain on AFS financial assets	6,090	42,771
Net other comprehensive income to be reclassified to profit/(loss) in subsequent periods	*(21,975)*	*25,351*
Other comprehensive income, net	**(21,975)**	**25,351**
Total comprehensive income for the period, net of tax	**1,323,051**	**1,370,497**
Total comprehensive income attributable to:		
Owners of the parent	1,323,051	1,369,792
Non-controlling interest	-	705
	1,323,051	**1,370,497**

The accompanying notes form an integral part of these condensed consolidated interim financial statements

Signed on behalf of the Company on 29 August 2016:

Perica Jukić — President of the Board

Tomislav Rosandić — Member of the Board

ASSETS	Note	30 June 2016	31 December 2015
		HRK '000	HRK '000
		Unaudited	Audited
Non-current assets			
Property, plant and equipment		25,213,849	25,722,455
Assets under construction	8	4,821,208	4,386,574
Prepayment for property, plant and equipment		37,142	37,880
Intangible assets		117,278	121,437
Investment property		236,883	236,778
Long-term loans and deposits		46,922	28,605
Available-for-sale and other investments		254,771	245,910
Other long-term assets		123,660	115,795
Deferred tax assets		622,687	650,681
Total non-current assets		**31,474,400**	**31,546,115**
Current assets			
Inventories		1,456,245	1,489,289
Trade receivables		1,544,081	1,847,063
Other short-term receivables		586,306	835,753
Cash and cash equivalents		3,118,869	2,493,166
Total current assets		**6,705,501**	**6,665,271**
TOTAL ASSETS		**38,179,901**	**38,211,386**

The accompanying notes form an integral part of these condensed consolidated interim financial statements.

EQUITY AND LIABILITIES	Note	30 June 2016 HRK '000 Unaudited	31 December 2015 HRK '000 Audited
Share capital	9	19,792,159	19,792,159
Revaluation reserves		106,926	100,836
Retained earnings	9	5,449,169	4,132,208
Total equity		**25,348,254**	**24,025,203**
Non-current liabilities			
Long-term loan liabilities	10	821,954	936,243
Long-term liabilities to the State		17,291	18,774
Long-term provisions		928,610	969,501
Liabilities under issued bonds	11	4,115,262	4,223,883
Other long-term liabilities	12	4,333,979	4,444,970
Deferred tax liabilities		21,278	21,816
Total non-current liabilities		**10,238,374**	**10,615,187**
Trade payables	14	932,807	1,740,910
Current portion of long-term bonds	11	93,380	93,380
Current portion of long-term loans	10	380,399	386,509
Taxes and contributions		209,394	199,288
Interest payable		42,893	45,693
Liabilities to employees	13	141,826	226,510
Other short-term liabilities		792,574	878,706
Total current liabilities		**2,593,273**	**3,570,996**
TOTAL EQUITY AND LIABILITIES		**38,179,901**	**38,211,386**

The accompanying notes form an integral part of these condensed consolidated interim financial statements.

Signed on behalf of the Company on 29 August 2016:

Perica Jukić	Tomislav Rosandić
President of the Board	Member of the Board

Condensed consolidated statement of changes in equity of the HEP Group

For the six months period ended 30 June 2016

	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
Balance at 1 January 2015	**19,792,159**	**54,947**	**2,201,265**	**22,048,371**	**29,202**	**22,077,573**
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
Total comprehensive income	**-**	**42,771**	**1,327,021**	**1,369,792**	**705**	**1,370,497**
Distribution of dividends - RWE	-	-	-	-	(29,907)	(29,907)
Balance as at 30 June 2015, unaudited	**19,792,159**	**97,718**	**3,528,286**	**23,418,163**	**-**	**23,418,163**
Balance at 1 January 2016	**19,792,159**	**100,836**	**4,132,208**	**24,025,203**	**-**	**24,025,203**
Profit for the period	-	-	1,345,026	1,345,026	-	1,345,026
Other comprehensive income		6,090	(28,065)	(21,975)	-	(21,975)
Total comprehensive income	**-**	**6,090**	**1,316,961**	**1,323,051**	**-**	**1,323,051**
Distribution of dividends - RWE		-				
Balance as at 30 June 2016, unaudited	**19,792,159**	**106,926**	**5,449,169**	**25,348,254**	**-**	**25,348,254**

The accompanying notes form an integral part of these condensed consolidated interim financial statements.

Signed on behalf of the Company on 29 August 2016:

Perica Jukić — President of the Board

Tomislav Rosandić — Member of the Board

	For the six months period ended	
	30 June 2016	30 June 2015
	HRK '000 Unaudited	HRK '000 Unaudited
Cash flows from operating activities		
Profit for the period	1,345,026	1,345,146
Corporate income tax expense recognized in profit	348,988	325,121
Net (profit) / loss from financial activities	58,944	(184,037)
Depreciation and amortization	884,374	922,212
Value adjustments of receivables	(14,071)	50,914
Value adjustments of inventories	4,181	(291)
Provisions	(40,891)	21,262
Operating cash flows before movements in working capital	*2,586,551*	*2,480,327*
Decrease in trade receivables	317,053	317,693
Decrease in inventories	28,863	135,787
Decrease in other current assets	249,447	39,883
(Decrease) in trade payables	(808,103)	(623,392)
(Decrease) in other current liabilities	(417,453)	(332,065)
(Decrease) in other non-current liabilities	(116,444)	(72,702)
Cash generated from operations	**1,839,914**	**1,945,531**
Corporate income tax (paid)	(74,416)	(506,715)
Interests paid	(143,249)	(150,940)
NET CASH FROM OPERATING ACTIVITIES	**1,622,249**	**1,287,876**
INVESTING ACTIVITIES		
Interests receipts	20,021	5,596
Increase in property, plant and equipment	(806,243)	(883,889)
Other non-current assets	(62,460)	(16,049)
NET CASH USED IN INVESTING ACTIVITIES	**(848,682)**	**(894,342)**

	For the six months period ended	
	30 June 2016	**30 June 2015**
	HRK ‘000	HRK ‘000
	Unaudited	Unaudited
FINANCING ACTIVITIES		
Bond repayments	(46,690)	(46,690)
Long-term loans received	90,398	26,611
Repayments of long-term loans	(191,572)	(223,277)
Repayments of short-term loans	-	(8,981)
Dividends and capital reserves paid – RWE	-	(44,511)
NET CASH USED IN FINANCING ACTIVITIES	**(147,864)**	**(296,848)**
NET INCREASE IN CASH AND CASH EQUIVALENTS	**625,703**	**96,686**
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	**2,493,166**	**1,079,900**
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	**3,118,869**	**1,176,586**

The accompanying notes form an integral part of these condensed consolidated interim financial statements.

Signed on behalf of the Company on 29 August 2016:

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 2016 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 and 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 2016 have been prepared under the same accounting policies as the consolidated financial statements for the year ended 31 December 2015

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 2016 was derived from audited annual consolidated financial statements as at 31 December 2015, 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 2015, except for the adoption of new standards and interpretations effective as of 1 January 2016. 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 2016, they do not have a material impact on the accompanying condensed consolidated interim financial information for the period ended 30 June 2016. The nature and the impact of each new standard or amendment are described below:

Standards and Interpretations effective for the current period

- 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
- 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)
- 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.
- Annual Improvements 2010-2012 Cycle, these amendments are effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted. 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;

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 2016.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Adoption of new and revised International Financial Reporting Standards (continued)

Standards and Interpretations effective for the current period (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 adopted by the 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. It is still not defined for which period IFRS 9 will be effective. 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. EU will not adopt 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. IFRS 15 is effective for the annual period beginning on or after 1 January 2018, earlier applications are permitted.
- IFRS 16 Leases – IFRS 16 was issued in January 2016 and represents and specifies recognition, measurement and disclosure of leases. IFRS 16 is effective for the annual period beginning on or after 1 January 2019, earlier applications are permitted.
- 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). The application of this standard has been postponed until further notice.
- 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 12 – Recognition of Deferred Tax Assets for Unrealised Losses (issued in January 2016).
- Amendments to IAS 7 – part of its disclosure initiative (issued in January 2016)
- Clarifications to IFRS 15 Revenue from Contracts with Customers (issued in April 2016).
- Amendments to IFRS 2 – classification and measurement of share based payment transactions (issued in June 2016).

The Company'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 Company'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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 2015 with respect of those applied in preparation of these condensed consolidated interim financial statements.

3. 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							
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
	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	5,406,437	5,244,063	382,046	389,556	834,490	1,010,064	6,622,973	6,643,683
Other segment income	519,693	466,610	25,121	26,004	6,578	7,605	551,392	500,219
Profit / (loss) from operations	**1,788,936**	**1,585,545**	**(65,658)**	**(172,926)**	**29,680**	**99,158**	**1,752,958**	**1,511,777**
Net financial income/(cost)							(58,944)	184,037
Corporate income tax (expense)							(348,988)	(350,668)
Net profit							**1,345,026**	**1,345,146**

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 2016	**31 December 2015**	**30 June 2016**	**31 December 2015**
	HRK '000	HRK '000	HRK '000	HRK '000
	Unaudited	Audited	Unaudited	Audited
Electricity	29,643,903	29,030,695	5,309,166	6,125,754
Heating	1,130,636	1,204,678	141,877	187,850
Gas	349,286	383,816	90,812	101,933
Unallocated	7,056,076	7,592,197	7,289,792	7,770,646
Total Group	**38,179,901**	**38,211,386**	**12,831,647**	**14,186,183**

3. 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	
	30 June 2016	**30 June 2015**
	HRK '000	HRK '000
	Unaudited	Unaudited
Croatia	4,876,858	5,004,398
EU member states	469,254	182,078
Non - EU member states	60,325	57,587
	5,406,437	**5,244,063**

4. GAS SALES

By a Decision of the Government of the Republic of Croatia in April 2014, the Company 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 Company 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.

The Company 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.

5. 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 2016, revenues from electricity sales were realized in the amount of HRK 5,406,437 thousand while in the same period last year they were realized in the amount of HRK 5,244,063 thousand. Increase is realized due to higher export of electricity.

In the first six months of 2016 cost of electricity purchased amounted to HRK 971,827 thousand, while in the period ended 30 June 2015 amounted to HRK 774,794 thousand. The costs are increased compared to the same period last year due to unfavourable hydrological conditions and consequently growth of import.

Cost of fuel in the first six months of 2016 amounted to HRK 765,093 thousand, while in the period ended 30 June 2015 amounted to HRK 976,073 thousand. Cost of fuel is decrease due to lower prices of natural gas and coal and because this year is not used heating oil in operations of thermal power plants.

6. FINANCIAL INCOME AND EXPENSES

	Six months period ended	
Financial income	**30 June 2016** HRK '000 Unaudited	**30 June 2015** HRK '000 Unaudited
Foreign exchange gains	140,858	70,322
Interests	7,009	3,472
Fair value of cross currency swap	-	347,616
Dividend income	26	18
Interests - NEK d.o.o.	397	2,124
Other financial income	-	32
Total financial income	**148,290**	**423,584**
Financial expenses		
Interests	(124,411)	(149,108)
Foreign exchange losses	(48,600)	(87,480)
Interests - NEK d.o.o.	(518)	(1,832)
Losses from fair valuation of cross currency swap	(33,633)	-
Other financial expenses	(72)	(1,127)
Total financial expenses	**(207,234)**	**(239,547)**
Net profit/(loss) from financial activities	**(58,944)**	**184,037**

7. CORPORATE INCOME TAX EXPENSE

Corporate income tax expense and current taxes during the six months period ended 30 June 2016 and 30 June 2015 are accounted on the basis of actual results and the profit tax rate of 20%.

8. INVESTMENTS UNDER CONSTRUCTION

As at 30 June 2016 investments under construction amount to HRK 4,821,208 thousand (31 December 2015 amounted to HRK 4,386,574 thousand).

Most significant investments relates to investment in cogeneration plants on forest biomass BE -TO Sisak in the amount of HRK 97,156 thousand, B- TO Osijek in the amount of HRK 89,641 thousand and Block C – TE Sisak in the amount of HRK 1,706,821 thousand, as well as to the preparatory work for construction of a replacement block TE Plomin in the amount of HRK 211,750 thousand and investment in the project EDM / ECM in the amount of HRK 112,481 thousand.

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 5,449,169 thousand comprise legal reserves in the amount of HRK 385,616 thousand, retained earnings in the amount of HRK 3,718,527 thousand and profit for the period attributed to the Owner of the Parent in the amount of HRK 1,345,026 thousand.

10. LONG-TERM LOAN LIABILITIES

	Interest rate	**30 June 2016**	**31 December 2015**
		HRK ‘000	HRK ‘000
		Unaudited	Audited
Domestic bank loans	EURIBOR+ (1.00%-2.90%)	1,011,485	1,219,772
Foreign bank loans	Fixed 0.07%	179,030	90,296
Finance leases	Fixed 5.6%	14,605	16,066
Total		**1,205,120**	**1,326,134**
Deferred loan originated fees		(2,767)	(3,382)
Total long-term loans		**1,202,353**	**1,322,752**
Current portion for long-term loans		(377,381)	(383,525)
Current portion of finance lease		(3,018)	(2,984)
Long-term portion		**821,954**	**936,243**

10. LONG-TERM LOAN LIABILITIES (continued)

Loans from domestic banks are secured by bills of exchange and promissory notes. 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 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 Group 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 Group’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 2016 covenants were not breached and the Group has met all contractual financial indicators.

The Group’s total exposure to loan liabilities subject to covenant conditions as at 30 June 2016 amounts to EUR 88,235 thousand.

At 30 June 2016 the Group doesn't have any liabilities covered by sovereign loan guarantees.

10. LONG-TERM LOAN LIABILITIES (continued)

Loans in use

In the first six months of 2016 the Group had available funds from long-term loan approved by KfW Entwicklungsbank in the amount of EUR 50 million for the financing of energy efficiency and renewable energy projects.

As of 30 June 2016 KfW loan balance was EUR 23,830 thousand, and the amount of EUR 26,170 thousand was unutilised.

Annual principal repayment schedule of long-term loans in next five years is stated as follows:

	HRK ‘000
2016	191,376
2017	409,363
2018	429,871
2019	138,121
2020	36,389
After 2020	0
Total	**1,205,120**

10. LONG-TERM LOAN LIABILITIES (continued)

Overview of long-term loans stated in foreign currency (in thousands) is shown as follows:

Currency	30 June 2016	31 December 2015
	HRK '000	HRK '000
EUR	160,410	173,690

Available financing sources

For the purpose of providing solvency reserves 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's needs. In the 2nd quarter of 2016 the Company, due to good liquidity did not use funds from preapproved mid-term multipurpose overdraft agreements, so no balance of short-term loans is reported as at 30 June 2016. However, the Company is using preapproved funds for issuing guarantees on regular basis. Also, the Company has signed overdraft agreement for reverse factoring in the amount of EUR 50 million until 31 December 2016.

As of 30 June 2016 the Company has available funds from above stated overdraft agreements in total amount of up to HRK 1,334,070 thousand.

11. LIABILITIES UNDER ISSSUED BONDS

	30 June 2016	31 December 2015
	HRK '000	HRK '000
	Unaudited	Audited
Nominal value of 2006 bonds - domestic	139,720	186,410
Discount value of bonds	(52)	(84)
Current portion of bonds	(93,380)	(93,380)
	46,288	**92,946**
Nominal value of 2012 bonds issued abroad	498,617	3,008,746
Repurchase of bonds (83.37%)	-	(2,806,955)
Exchange differences	(7,988)	296,826
	490,629	**498,617**
Nominal value of 2015 bonds issued abroad	3,706,988	3,703,533
Exchange differences	(59,384)	3,455
Discount value of bonds	(47,268)	(50,941)
	3,600,336	**3,656,047**
Accrued bond costs	(21,991)	(23,727)
	3,578,345	**3,632,320**
Total liabilities for issued bonds	**4,115,262**	**4,223,883**

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 and are bearing fixed interest of 6%. Bonds of HEP d.d. are listed at Luxembourg stock - exchange and they are actively traded.

11. LIABILITIES UNDER ISSSUED BONDS (continued)

Refinancing

In October 2015, bonds issued in 2012 were refinanced from the new bond issue and repaid 83.37% of the principal, respectively, USD 416,852 thousand. As at 30 June 2016, the amount of undue principal on bonds issued in 2012 amounts to USD 83,148 thousand.

Cross currency swap

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company 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.

According to the agreement on cross currency swap from 2012, annual interest rate paid by the Company semi-annually is fixed and amounts to 6.53% (include swap cost).
As at 30 June 2016, agreement on the cross currency swap from 2012 is in effect for undue principal in the amount of USD 83,148 thousand, until its outermost maturity date at 9 November 2017.

New bond issue

In October 2015, the Company issued new corporate bonds in the amount of USD 550,000 thousand with maturity of 7 years and annual fixed interest rate of 5.875%, and with the issue price of 98.594%. Bonds issued in 2015 are mainly used for the repurchase of 83.37% of the bonds issued in 2012 (repurchase of USD 416,852 thousand). The remaining issue amount is intended to finance the Company's business. The Bonds are listed at Luxembourg stock - exchange and they are actively traded.

Cross currency swap

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company 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 23 October 2022.

According to the agreement on cross currency swap from 2015, annual weighted interest rate paid by the Company semi-annually is fixed and amounts to 4.851% (include swap cost).

11. LIABILITIES UNDER ISSSUED BONDS (continued)

Derivative financial instruments

Cross currency swap

The Company has concluded cross currency swap agreements, by which liabilities upon bonds issued abroad in 2012 and 2015 in USD is transformed in EUR for all period of bond duration, respectively until its outermost maturity dates. The purpose of this swaps 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 Company's business result.

Annual interest rate paid by the Company semi-annually for Bonds issued in 2012 is fixed and amounts to 6.53% and for Bonds issued in 2015 weighted fixed interest rate of 4.851%.

The Company measures the fair value of the cross currency swap for reporting period according to the official banks calculation of Mark-to-market ("MTM") value.

A positive "MTM" value is recorded as a receivable and financial income for the period, and a negative "MTM" value is recorded as a liability and the financial expense for the reporting period.

After a final maturity of derivative financial instruments, subject receivables or liabilities will be debited to expenses or credited to revenues of the Group.

As at 30 June 2016 by this method of calculation, on bonds issued in 2012 it is stated fair value of assets in the amount of HRK 64,825 thousand (Note 16).

As at 30 June 2016 by this method of calculation, on bonds issued in 2015 it is stated fair value of liabilities in the amount of HRK 109,435 thousand (Note 16).

12. OTHER LONG-TERM LIABILITIES

	30 June 2016	**31 December 2015**
	HRK '000	HRK '000
	Unaudited	Audited
Deferred income - assets financed by third parties	3,392,061	3,505,750
Long term liabilities for assets financed from clearing debt	818,034	842,162
Derivative financial liabilities from swap transactions	109,435	81,876
Other long-term liabilities	14,449	15,182
	4,333,979	**4,444,970**

12. OTHER LONG-TERM LIABILITIES (continued)

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 2016 the Group stated clearing debt liability in the amount of HRK 818,034 thousand in respect of a clearing debt (2015: HRK 842,162 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. LIABILITIES TO EMPLOYEES

	30 June 2016 HRK '000	**31 December 2015** HRK '000
Net salaries	75,822	79,744
Contributions	37,150	40,435
Severance payments upon retirement	282	60,718
Severance payments upon cancelation of Employment contract	-	12,406
Salaries - NEK d.o.o.	8,087	11,601
Other	20,485	21,606
	141,826	**226,510**

14. TRADE PAYABLES

	30 June 2016 HRK '000	**31 December 2015** HRK '000
Trade payables – current assets	235,803	545,015
Trade payables – fixed assets	343,534	622,273
Purchase of gas on wholesale market	93,755	184,807
Other	259,715	388,815
	932,807	**1,740,910**

15. 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:

NE Krško d.o.o.

	30 June 2016	31 December 2015
	HRK '000	HRK '000
	Unaudited	Audited
Liabilities for purchased electricity	51,692	62,830

	Six months period ended	
	30 June 2016	30 June 2015
	HRK '000	HRK '000
	Unaudited	Unaudited
Costs of purchased electricity	312,681	334,089

As at 30 June 2016 the Group stated loan receivables from the company LNG Hrvatska d.o.o. in the amount of HRK 44,163 thousand (31 December 2015: HRK 25,840 thousand).

Remunerations to the Management Board members and executive management of the Group companies:

	Six months period ended	
	30 June 2016	30 June 2015
	HRK '000	HRK '000
	Unaudited	Unaudited
Gross salaries	14,657	11,219
Pension contributions	3,271	3,096
Other (benefits in kind)	1,730	1,780
	19,658	**16,095**

There were no other payments to members of the Management Boars besides regular salaries and benefits in kind.

15. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchase costs	
	Six months period ended 30 June		Six months period ended 30 June	
HRK '000	**2016**	**2015**	**2016**	**2015**
	Unaudited	Unaudited	Unaudited	Unaudited
Companies partially owned by the State				
Hrvatske Željeznice	50,043	52,692	628	1,358
INA	66,984	68,951	554,399	666,726
Prirodni Plin	-	-	-	-
Plinacro	610	584	44,142	32,544
Croatia osiguranje	1,544	1,644	587	818
Hrvatska pošta	6,086	6,263	18,849	9,765
Hrvatske šume	1,570	1,814	1,428	1,718
Jadrolinija	283	304	254	566
Narodne novine	1,098	1,202	1,667	1,733
Hrvatska radiotelevizija	6,006	6,476	727	634
Plovput	142	146	82	68
Croatia Airlines	422	390	-	-
Petrokemija Kutina	8,454	10,258	77	10
Ministry of Foreign Affairs	232	229	-	-
Ministry of Defence	11,548	10,686	-	-
Ministry of the Interior	11,517	7,303	-	-
Elementary and high schools	42,506	44,232	18	1
Judicial institutions	4,690	4,473	74	31
Colleges and universities	16,176	15,434	243	402
Legislative, executive and other bodies of Republic of Croatia	13,699	13,799	1,940	1,833
Health institutions and organizations	53,446	54,233	287	300
Other users	5,016	7,392	3,947	1,821
TOTAL	**302,072**	**308,505**	**629,349**	**720,328**

15. RELATED PARTY TRANSACTIONS (continued)

	Receivables		Liabilities	
HRK '000	**30 June 2016** Unaudited	**31 December 2015** Audited	**30 June 2016** Unaudited	**31 December 2015** Audited
Companies partially owned by the State				
Hrvatske Željeznice	23,575	28,735	135	400
INA	14,423	16,269	98,589	138,417
Prirodni Plin	-	-	-	-
Plinacro	106	119	5,798	22,950
Croatia osiguranje	260	302	174	656
Hrvatska pošta	790	1,249	4,993	2,381
Hrvatske šume	252	361	3	2
Jadrolinija	59	91	10	487
Narodne novine	359	459	355	778
Hrvatska radiotelevizija	1,747	2,850	28	35
Plovput	9	8	51	51
Croatia Airlines	66	109	-	-
Petrokemija Kutina	3,036	3,773	-	152
Ministry of Defence	1,798	4,366	-	-
Ministry of the Interior	2,786	3,587	-	-
Elementary and high schools	7,344	14,658	-	-
Judicial institutions	756	1,254	-	-
Colleges and universities	4,107	9,979	-	-
Legislative, executive and other bodies of Republic of Croatia	2,669	4,442	-	-
Health institutions and organizations	15,553	17,261	-	-
Other users	18,867	21,731	12,417	19,212
TOTAL	**98,562**	**131,603**	**122,553**	**185,521**

15. RELATED PARTY TRANSACTIONS (continued)

As of 30 June 2016 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–Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	100	Electricity generation
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 –Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP Energija d.o.o. Ljubljana	Slovenia	100	Electricity trading
HEP -MagyarorszagEnergiaKft	Hungary	100	Electricity trading
HEP- Trade d.o.o. Mostar	BH	100	Electricity trading
HEP KS sh.p.k. Priština	Kosovo	100	Electricity trading
HEP- Trade d.o.o. Beograd	Serbia	100	Electricity trading
Program Sava d.o.o.	Croatia	100	Spatial planning, design, construction and supervision
HEP Opskrba plinom d.o.o.	Croatia	100	Gas distribution
HEP-Telekomunikacije d.o.o.	Croatia	100	Telecommunication services
Hrvatski centar za čistiju proizvodnju	Croatia	100	Training and consulting in the field of cleaner production and environmental management systems

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. In 2014 the company HEP- RVNP d.o.o. changed its name to *Program Sava d.o.o.* and new company HEP Opskrba plinom d.o.o. was founded.

The company APO d.o.o., for environmental protection was merged with the Company and the company HEP OIE d.o.o. was merged to the company HEP Proizvodnja d.o.o.

In 2015 the company HEP NOC Velika was transferred to the ownership of the company HEP Operator distribucijskog sustava d.o.o..

16. 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, which 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

16. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

The levels of fair value recognized in the consolidated statement of financial position:

	1st level	2nd level	3rd level	Total
	HRK '000	HRK '000	HRK '000	HRK '000
30 June 2016, unaudited				
Available-for-sale assets	254,771	-	-	**254,771**
Derivative financial assets			64,825	**64,825**
Derivative financial liabilities		-	109,435	**109,435**
Investment property	-	236,883	-	**236,883**
31 December 2015, audited				
Available-for-sale assets	245,910	-	-	**245,910**
Derivative financial assets	-	-	70,900	**70,900**
Derivative financial liabilities	-	-	81,876	**81,876**
Investment property	-	236,778	-	**236,778**

17. CONTIGENT 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.

17. CONTIGENT LIABILITIES (continued)

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.

18. EVENTS AFTER THE REPORTING PERIOD

On 28 July 2016, the General Assembly adopted a decision on dividend payment for 2014 and 2015 in favour of the State Budget of the Republic of Croatia in the amount of HRK 607,000 thousand.

19. APPROVAL OF THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

These condensed consolidated interim financial statements for six months period ended 30 June 2016 were approved by the Management Board and authorised for issue on 29 August 2016.

Signed on behalf of the Management Board on 29 August 2016:

Perica Jukić

President of the Board

Tomislav Rosandić

Member of the Board