Croatian Transmission System Operator Ltd.

CROATIAN TRANSMISSION SYSTEM OPERATOR Ltd.,

ZAGREB

Annual Report

as of and for the year that ended on 31 December 2018

Contents

CROATIAN TRANSMISSION SYSTEM OPERATOR Ltd.,

MANAGEMENT BOARD REPORT

FOR THE YEAR 2018

Zagreb, April 2019

BASIC CHARACTERISTICS OF THE BUSINESS YEAR

In accordance with the current legislative and regulatory framework, Croatian Transmission System Operator Ltd. (hereinafter: Company, or HOPS), has regularly performed its basic tasks: operating the electric power system (hereinafter: EPS) of the Republic of Croatia, electric power transmission, maintenance, development and construction of the transmission network, enabling the connection of new customers to the network under equal, clear and non-discriminating terms, supporting the development and functioning of the Croatian electricity market, as well as its linkage to the neighbouring electricity markets of the European Union (hereinafter: EU) and the Energy Community.

In line with the Management Board's Plan for the period 2018-2022, the set operating objectives were mostly realized in 2018.

- **Electric power indicators**

The business year 2018 was characterized by secure and reliable operation of the transmission network and the entire EPS, without major disturbances and interruptions in electricity supply, and in this respect the Company fulfilled its statutory duties and tasks. In addition to engaging all the resources of the Company, this was also greatly helped by the realization of the maintenance and investment plans to a high extent.

In 2018, the total electricity demand in the transmission network of the Republic of Croatia was 17.30 TWh, which is 0.13% less than in 2017.

The peak load of the EPS of 3168 MW was recorded on 26. February 2018 at 20.00 h.

In 2018, 23.83 TWh of electricity was transmitted, which was an increase by 7.84 % over 2017.

Losses in the transmission network amounted to 533.7 GWh, or 2.24% of the total electricity transmitted, which was 27.95% more than in 2017. The losses in the transmission network in 2018 were at the level of losses of other transmission system operators in the EU.

- **Operating performance**

In 2018, the income totalled HRK 1,764.6 million, and expenditures were HRK 1,548.5 million. Pre-tax profit amounting to HRK 216.1 million was reduced by HRK 39.9 million corporate income taxes (the current tax amounting to HRK 45.5 million was reduced by the deferred tax assets amounting to HRK 5.7 million), so the profit for the period (2018) was HRK 176.2 million. The pre-tax profit consists of the difference between the income and expenditures from the allocation of cross-border transmission capacities amounting to HRK 76.2 million, and the balance of other revenues and expenditures amounting to HRK 139.9 million.

The after-tax profit in 2018 was HRK 112.8 million or 39% lower than in 2017. The greatest share in the revenue from operations was accounted for by the provision of the public service of electric power transmission, which in 2018 amounted to HRK 1,407.6 million or 79.8% of the total profit.

- **Certification of Independent Transmission Operator**

The decision on issuing the certificate to HOPS as an independent transmission system operator (22 February 2016) by the Croatian Energy Regulatory Agency (hereinafter: Agency) completed the demanding and complex process of the certification implementation that had started four years earlier.

Since the certificate laid down the terms and conditions (network utilization contracts, supporting services, separation of telecommunications, business premises), their fulfilment was a high priority for the Company, and this was carefully organized and supervised throughout the year and successfully completed, for the most part, according to the schedule.

In September 2018, the last requirement of the Certificate was fulfilled i.e. the Lease Agreement for the office building in Opatija that was owned by HEP d.d. and used by HOPS (Rijeka Transmission Area) was terminated.

With the submission of the proof of termination of the mentioned Agreement HOPS full implemented all the activities i.e. submitted all relevant proofs of the fulfilment of the ordered activities in sections 2 to 5 of the Certificate Issuance Decision, so that the certification procedure for HOPS as an independent transmission operator was completed.

In accordance with Articles 22 and 23 of the Electricity Market Act (Official Gazette of the Republic of Croatia 22/13, 95/15, 102/15, 68/18) (hereinafter: EMA) and the HOPS Compliance Program, the activities of continuing control of the fulfilment of the requirement of the separation between the independent transmission system operator and the vertically integrates entity are in the regular competence of the Agency and the HOPS Compliance Officer.

- **Integration of renewable energy sources**

In 2018, activities were continued to create the prerequisites for the further integration of renewable energy sources (hereinafter: RES) into Croatia's EPS based on the obligations contained in the EMA and the Law on Renewable Energy and High-efficiency Cogeneration. In 2018, an agreement was concluded for the connection of a wind farm with 156 MW output, and activities were conducted for the preparation of 3 additional contracts for the connection of 3 new wind farm projects with investors who expressed interest in signing the contracts. The total power output of the mentioned wind farms is 136 MW. Also, in 2018, interest was expressed in commissioning solar farms with 420 MW total output.

- **Investments**

In 2018, the Company realized HRK 417.57 mil. investment or 99.35% of the plan. When we add HRK 4.93 mil. own investment (capitalized cost of labour), the investment in 2018 totalled HRK 422.50 mil. The high realization of the Investment Plan resulted from raising the quality of planning and periodic monitoring of the plan realization, including corrective measures. The biggest portion included investment in replacement and reconstruction of the existing transmission facilities, construction of new facilities and revitalization of transmission network facilities.

In 2018, the construction of the new 110/(10)20 kV Zamet substation was completed with primary and secondary equipment installed and tested, except for the testing from the Rijeka network centre that will be carried out after the construction of the cable connection. At the Melina substation, works were completed on the replacement of the disconnectors for the systems of the main and auxiliary busbars of the 400 kV facility. In 2018, works continued on the replacement of the primary equipment and secondary systems at the Lovran 110/20 kV substation. The construction of the office building for the Rijeka Transmission Area in Matulji and the process of staff relocation were finished and the final occupancy permit obtained.

The reconstruction and construction of the 2x110 kV Slavonski Brod – S. Brod 2 transmission line was also begun, which is the continued replacement of the old and worn out 110 kV Sl. Brod – Sl. Brod 2 transmission line with a new double 110 kV transmission line. Works were also completed on the reconstruction of the 110kV Slavonski Brod-Andrijevci transmission line, within the scope of replacement of the old Đakovo-Andrijevci-Slavonski Brod 110 kV transmission line with a new double 110 kV transmsission line. The public tendering procedure took place for the works on the revitalisation and the replacement of power transformers at SS 110/35/10 kV Osijek 2. The manufacture and delivery of a 40 MVA power transformer was contracted for SS 110/35 kV Dolinka.

A valid building permit for the reconstruction of SS 110/20 kV Split 3 has been obtained, with a contract for the production and delivery of 110 kV GIS plants with detailed designs. A contract on mutual relations between HEP ODS and HOPS was signed regarding the preparation for the construction of the SS 110/20 (10) kV Sućidar. The contract for the reconstruction of the 220 kV Orlovac switchyard was concluded. Works on the reconstruction of the secondary systems at SS 400/220/110 kV Konjsko continued according to schedule. At SS 110/35 kV Zadar, works were completed to replace the primary and secondary equipment, bus systems and auxiliary power supply systems and the reconstruction of the control building. TR2 power transformers (63 MVA) at the Trogir substation and TR1 (40 MVA) at the Nerežišća substation were replaced.

In the Transmission Area Zagreb, the reconstruction of the 110 kV line began at SS 110/35 kV Pračno and the reconstruction and extension of the 110 kV line at SS 110/35 kV Ivanić Grad. Purchase of power transformers was initiated at the Mraclin and Koprivnica substations. At SS 110/35 kV Koprivnica, the installation of primary and secondary equipment in the 110 kV fields was completed.

In 2018, the process of modernizing the WAN communication platform continued between the management centres and electric power facilities. Cybernetic security was enhanced by expanding control mechanisms with the implementation of monitoring tools and systems.

As part of the SINCRO GRID project in 2018, a building permit was issued for SVC Konjsko (the last remaining building permit required) and public procurement procedures were initiated for the delivery and commissioning of compensating plants at SS 400/220/110 kV Melina (VSR 200 MVAr), SS 220/110 kV Mraclin (VSR 100 MVAr) and SS 400/220/110 kV Konjsko (SVC 250 MVAr) and the improvement of the process technical systems (TK, IT, SCADA, EMS, DTR) necessary for the implementation of the project under the Grant Agreement. In October 2018, contracts were concluded for the delivery and commissioning of a compensating plant at SS 220/110 kV Mraclin (VSR 100 MVAr) and the improvement of the process technical systems (TK, IT, SCADA, EMS, DTR). The completion of the remaining public procurement procedures is expected in the first half of 2019.

In 2018, HOPS issued 12 prior electric power approvals for plants connected to the transmission network (RPP Korita, HPP Senj, HPP Senj 2, WF Svilaja, WF Udbina, WF Vrataruša II, SF Promina, TPSS Zdenčina, TPSS Mrzlo Polje, TPSS Novska, TPSS Ludina and the facility of the network user Istrabenz Plin). In 2018, technical inspection took place at WF Lukovac on 20 February 2018, followed by the acceptance of the connection of WF Lukovac on 5 July 2018, and thus SS 30/110 kV Lukovac became the property of HOPS with its 2x110 kV transmission line.

One preliminary connection contract was concluded (HPP Varaždin), two connection contracts (WF Senj and CCPP Zagreb), and one contract for network usage (own consumption at CPP Osijek).

For the purpose of aligning the network usage contracts with the existing legislation, in 2018, HOPS issued 69 electric power approvals and 15 amendments to the electric power approvals to HEP Proizvodnja d.o.o. and signed 4 contracts for network usage with them, where the calculation of the network usage fee was defined by the billing point.

The 10-year network development plan 2019-2028 with a detailed plan for the initial three-year and one-year periods (hereinafter: 10-year plan) was submitted to the Agency for review and approval in September 2018. The process of approving the 10-year plan is in progress and it is in line with the current ten-year development plan for the European transmission network (ENTSO-E TYNDP) and the neighbourhood regarding the connection to the transmission network, and it is the basic development document of the Company.

- **Activities of the Croatian Power Exchange**

After in March 2017 the Croatian Power Exchange (hereinafter: CROPEX) and HOPS formally joined the regional IBWT (Italian Borders Working Table) project, which formally started the process of connecting the Croatian Day Ahead Market to the multi-regional coupling (MRC) electricity market, in June 2018 there was the first operative connection the Day Ahead Market with the MRC market. It was the project that was an intermediary step toward s fulfilling the requirement of the Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management (hereinafter: CACM Regulation). For the sake of market connection, HOPS made available to electric power exchange its total daily cross-zonal capacity for allocation in indirect manner. The first auction in the connected mode of operation resulted in the total volume of 8,283 MWh, with the highest hourly trade of 619 MW in the 20th hour. In the following months, on multiple occasions record hourly and record daily volumes of trade were reached in CROPEX. For instance, in the auction on 29th December 2018, on the Day Ahead Market for the supply of electric power on 30 December, the electric power trade volume totalled 20,329.0 MWh, which was the highest daily volume since the beginning of CROPEX operation.

The first difference in the prices on the Day Ahead Market resulting from market connection occurred for the delivery day 8 September 2019, when in the Slovenia-Croatia direction all available cross-border transmission capacity of 921 MW was utilized, and thus resulted in different prices on BSP Southpool and CROPEX exchanges amounting to 15.9 €/MWh. Accordingly, there was the first calculation of the income from congestion undertaken by the BSP, and the funds were distributed to HOPS and ELES in accordance with joint agreement with JAO.

Within the MRC project there was intensive work on the drafting of the operative agreement for the Single Day Ahead Coupling (SDAC) market to regulate the target project of connecting markets as recognized in the CACM Regulation.

In September 2018, through the decision of the MRC Joint Steering Committee (JSC), CROPEX and HOPS became full members of the MRC project. As the target model, CACM selected the unique solution based on the existing MRC project, but with simultaneous harmonization of the process of capacity calculation based on the calculation of power flows.

Towards the end of 2018, negotiations began with CROPEX concerning potential organization of auctions for the procurement of electric power to cover the losses in Croatia's EPS, to be conducted by CROPEX on a platform of its own.

- **International activities of the Company**

In accordance with its legal obligations, the Company cooperates on the European and regional levels with TSOs and market participants from outside Croatia, and with a number of European institutions in the area of electric power transmission (European Commission /hereinafter: EC/, Energy Union Secretariat, ACER etc.) and associations of which it is a member (ENTSO-E, RGI etc.), participating in several projects aimed at preparing the implementation of the obligations under new EU regulations or the realization of investment in infrastructure and R&D activities. As regards the questions and topics of common interest, the Company coordinates its activities with the competent Ministry for Environmental Protection and Energy and the Agency.

This was particularly pronounced in the process of the adoption of the EC regulations with network codes and guidelines as the implementing regulations of the so-called Third Energy

Package of the EU) which are directly applicable in all EU Member States. Particularly extensive were the activities for the implementation of the CACM Regulation and the Commission Regulation (EU) 2016/1719 of 26 September 2016 establishing the guidelines for long-term capacity allocation (FCA) on the Core CCR level stretching from the Adriatic to the Baltic Sea and from the North Sea to the Black Sea, which include the preparation and drafting of a number of documents (in particular, the methodologies) for public debate and/or approval by various national authorities within the Core CCR in accordance with the requirements of the relevant provisions of the CACM and FCA. On the EU level activities were intensified to implement the Commission Regulation (EU) 2017/1485 of 2 August 2017 establishing a guideline on electricity transmission system operation (SOGL) and the Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing (GLEB).

In the context of its numerous and extensive international activities and obligations, the Company continued to participate in the activities of the ENTSO-E, its working bodies (boards and groups) and its Assembly, thereby joining the current processes on the pan-European and regional levels. Of particular importance were the activities focused on the region of Southeast Europe primarily concerning the market where the representatives of HOPS play a prominent role in the ENTSO-E contacts with the EC and the Energy Union (within their initiatives such as CESECe /Central-East South-East Connectivity for electricity/ and WB6 /Western Balkans 6/) and their support for the extension of the MRC to Southeast Europe.

The activities for the adoption of the remaining legislation proposed by the EC are at their final stage to pass new and amend the existing energy legislation of the EU in the package titled "Clean Energy for All Europeans", related inter alia to a new electricity market design, more intensive (regional) cooperation in terms of security of supply, etc. ENTSO-E, together with its members, also intensified its activities at regional levels, in collaboration with the EC, the European Parliament, the European Council, ACER and other interested parties, in order to achieve the best possible legislative framework for the EU energy sector through extensive discussions and harmonization.

Since in accordance with different provisions of multiple relevant regulations HOPS is a co-founder and co-owner of the following companies abroad: TSCNET Services (Transmission System Operators Security Cooperation, 1/13 share), SEE CAO (Coordinated Auction Office in South East Europe, 1/8 share), and JAO (Joint Allocation Office, 1/20 share), their operation and service provision is continually monitored and services provided with discussions and decisions on proposed relevant documents (contracts, plans …) .

In accordance with the EU recommendations and provisions contained in Regulation 714/2009, and in particular with the Operational Network Security Rules, the Company continues to participate in the cooperation of Transmission System Operator Security Cooperation (TSC) between North and Central Europe. In 2018, the Company continued to use TSC services even after the establishment of a joint office in Munich (Germany) and its transformation from an initiative into a joint limited liability company under German law (TSCNET Services GmbH). In 2018, the Company re-joined the MRA Agreement (Multilateral Remedial Action, hereinafter: MRA) – coordinated multilateral elimination of congestion between 3 or more operators within the TSC. This contract raised electric power supply security to a higher level. Also, power plants of Croatia's EPS were given the opportunity to participate with their generation in the multilateral elimination of congestion.

In March 2018, following the appropriate procedures for publishing the invitation to express interest, preparing the list of potential bidders, publishing the call to submit binding offers, and selecting the best bidder, the Company signed the Grant Agreement with the EBRD (European Bank for Reconstruction and Development) to EUR 1.3 million, and the Consultancy Contract with the selected consortium of consultants (Energetski institut Hrvoje

Požar /leader/, Dalekovod-Projekt d.o.o. and AF-Consult Ltd.) for the preparation of the Feasibility Study for strengthening the main Croatian North-South transmission axis enabling new interconnection development. Intensive activities of the consultants, HOPS and its partners (Elektroprijenos BiH and Nezavisni operator sustava u Bosni i Hercegovini /NOS BiH/) in the realization of the aforementioned contracts will be completed within 12 months from their signature. The project for which the mentioned study is being prepared, also includes in addition to internal lines in Croatia, the new 400kV Banja Luka-Lika transmission line

Activities with the neighbouring TSOs were also continued in a series of topical meetings on different levels with Slovenian ELES, Serbian EMS, and Bosnian-Herzegovinian NOS BiH, as well as within the Slovenia-Croatia-BiH control-regulation block, to discuss subjects of common interest.

- **Personnel**

In 2018, the Company employed 68 new employees, while in the same period 50 employees left the Company. As of 31 December 2018, the Company had 1,123 employees or 18 more than on 31 December 2017. The increase in the number of employees is in accordance with the Management Operation Program and ensuring the necessary number of operators to fulfil the Company's legal obligations.

- **Restructuring**

The existing Rules on Organization and Systematization of the Company (hereinafter: ROS) was adopted in 2013 in accordance with the needs of the time. Meanwhile, there were many major changes in the international and domestic environment of the energy sector that require that ROS be amended and supplemented in accordance with the new conditions in most organizational units of the Company, while respecting the principles of modern and cost-effective management.

On 17 October 2018, the Management Board adopted a Decision on the Establishment of the Team to draft a proposal for the reorganization of HOPS.

The team's task is to make a proposal for a new organizational structure aimed at optimizing the staffing and organizational structure of HOPS and implementing the key activities needed for the reorganization in 2018 and 2019.

The first phase of the reorganization was carried out in accordance with the amendments to ROS whose implementation began on 1 December 2018, and they related to:

- Creation of a new organizational unit - Internal Audit
- Grouping of network centres from the transmission areas in the EPS Management Service, the Sector for EPS and Market Management
- In the transmission areas, creation of a new department within the Secondary Systems Service - Infrastructure and Security Department
- In the transmission areas, creation of a new department within the Joint Services Department - Procurement Department.

In 2019, the two remaining phases of the reorganization are planned, the first one to be implemented from 1 April 2019, and the second one from 1 July 2019.

In the first phase of the reorganization, the Sector for Electricity Market will be established to perform the basic activities of the Company laid out in EMA i.e. in the Declaration of Incorporation of the Company in the part concerning the congestion management (allocation of cross-border transmission capacities), securing potentials for power plant re-dispatching, securing of necessary supporting services, balancing the system, purchasing electricity to cover the losses and balancing the system, and activities related to the calculation of the deviation of the balance groups and the service of utilizing the transmission network. In order to unify and define the business processes of the Company in one place, the Sector will monitor and implement the European and national legislation and by-laws, draft and adopt by-laws, regulate relations with participants in the electricity market, transmission system operators, auction offices and electric power stock exchanges, contract, bill, invoice and collect payment for products and services from the scope of the Sector.

In the second phase, the entire organization of the Company will be arranged differently.

Changes will consist in adding, deleting and changing the names of organizational units, modifying the Catalogue of Job Types, i.e. names of work groups and jobs, and other changes that will enable greater internal rotation of workers, reduce duplication of structures in organizational units, and allocate human resources to appropriate jobs bearing in mind the complexity of work and the necessary competences of the workers.

In order to implement the organizational changes, two new internal acts are needed: ROS and the Work Rules. The change of these acts, which will regulate the organization and systematization of the Company in a different way, will result in offering a new, changed employment contract to all employees of the Company. The new ROS will apply from 1 July 2019.

- **Collection of payment**

The total net receivables from customers as of 31 December 2018 were HRK 30.75 million. The receivables mostly referred to two basic services of the Company, specifically:

a) Utilization of the transmission network, and

b) Liabilities for the deviation of Balance Group Leaders (hereinafter BGL).

There are 47 network users connected directly to the Company's transmission network, with 101 measuring points. Customers connected to the high voltage network (110 kV) are major industrial customers (construction industry, ironworks, petrochemicals, railway traffic, power generation plants etc.).

Total receivables from customers relate to the remuneration for the transmission network from customers connected to the transmission network totalled HRK 11.7 mil., of which HRK 4.6 mil. was suspicious and debatable.

Suspicious and debatable receivables are related to the companies in bankruptcy (Adria Čelik d.o.o. HRK 4.6 mil.) that are wholly corrected against the period when bankruptcy proceedings were initiated or the claim for debt recovery was filed with the court.

After the completion of the pre-bankruptcy settlement agreement for Adrial Plus, the Commercial Court of the Republic of Croatia issued the decision to write off 70% (HRK 2.6 mil.) of HRK 3.7 mil. total claims, whereas 30% (HRK 1.1 mil.) are to be paid without interest in 36 equal monthly instalments, and this was regularly done in 2018. The total suspicious receivables were fully paid by the debtor in the beginning of 2019.

The bankruptcy proceedings of Adria Čelik d.o.o.in which the Company claims HRK 4.6 mil. have not been completed until the date of this report.

Receivables from the external balance group leaders for balance energy as of 31 December 2018 totaled HRK 8.5 mil., and as of 31 December they are all unmatured. HOPS collected outstanding receivables by activating the security.

The following activities are being undertaken for the collection of debts: continuous monitoring of collection, issuance of reminders, activation of payment securities, execution of enforcement procedures, continuous contact with the customers by telephone and electronic means.

- **Legal framework**

In August 2018, the Law Amending the Electricity Market Act, which was adopted by the Croatian Parliament on 13 July 2018, entered into force.

In 2018, following the public debate and obtaining the approval of the Agency, the Company issued the following acts:

- Rules for intra-day allocation of capacity between the trading zone of the Croatian Transmission System Operator and MAVIR (beginning of March 2018)
- Rules for the allocation of intraday capacity for the border between the trading zone of the Croatian Transmission System Operator d.o.o. and Elektromreža Srbije d.d. Belgrade (beginning of January 1, 2019).

In 2018, HOPS also participated actively and cooperated with relevant institutions and other stakeholders in the preparation or adoption of the following implementing acts:

- Amendments to the Methodology for Determining the Fees for Connecting to the Power Grid and Increasing the Connected Power.
- Regulation on the issuance of energy approvals and establishing conditions and deadlines for connection to the power grid.
- Rules on connection to the transmission network.
- Amendments to the Transmission System Network Rules.
- Rules for managing congestion within Croatian EPS, including connecting lines.

At the end of 2018, the Croatian energy market operator (hereinafter: HROTE) adopted the Rules for the Management of the ECO balance group that regulate its functioning, as well as the obligation to supply the data necessary for power generation planning by members of the ECO balance group and transmission system operators.

At the end of 2018, the Company obtained the decision to extend the license for engaging in electric power transmission for a period of fifteen years.

- **Strengthening the internal control function**

In the last quarter of 2018, the Management Board amended ROS (in effect since 1 December 2018) and changed the organizational position of the internal audit function from a Board office (reporting to the Head of the Board Office) to an independent supporting organizational unit reporting to the Chairman of the Board. The internal audit function was established by setting up a new Internal Audit Unit with two employees. Internal Audit is organized as an independent, advisory function of the Management Board and the Supervisory Board and lies outside the competence of line managers and other advisory functions of the Company. The responsibilities of the Internal Audit include planning, implementation, reporting on internal audits and their follow-up, and verifying the compliance of internal acts with the laws, decisions of regulatory bodies and other regulations, and other activities in accordance with internal acts.

As regards activities for setting up the function, the Management Board adopted the Rules on Internal Audit (in effect from 1 January 2019) that more closely determines the position and mode of operation of the Internal Audit in the Company (definition, basic principles, organizational position, mode of operation, etc.).

With such activities HOPS strengthened the organizational position of the Internal Audit and the capacity required for effective control of the business processes in the Company, considering the importance of the internal audit as one of the basic functions and responsibilities of the management.

- **Information system**

In 2018, the „Law/Regulation on Cyber Security of Key Service Operators and Digital Service Providers“ (implementation of the EU NIS Directive No. 2016/1148: *„Directive on Security of Network and Information Systems“* in the national legislation) entered into effect that is binding on HOPS as the provider of the key service of electric power transmission. Accordingly, HOPS continued its modernization and upgrade of the communications and security infrastructure between the management centres and electric power facilities. The cyber security of the HOPS' ICT system was improved through the extension of the automated control mechanisms, with the implementation including surveillance tools, systems for the control and security of web and mail traffic, and the central security SIEM system with the function of controlling the network and security equipment at management centres. There began projects of modernization and extension of data centres and virtualization platform. In 2018, the initial draft of the „Rules on HOPS Information System Security“ was prepared as required by ISO 27001 (Information Security Management System) and the guidelines and recommendations of ISO 27002 (Code of Practice in Information System Security Management).

In 2018, the Business Information System (BIS) of HOPS was upgraded in compliance with the General Data Protection regulation (GDPR).

Among the upgrades of the IT processing system, the following projects stood out in 2018:

- Implementation of the legally prescribed obligation of ENTSO-E in the HOPS processing system
- Implementation of the CGMES (*Common Grid Model Exchange Standard)* for exchanging process data/models of electric power networks between TSOs,
- Technical solution for the IGCC project (*International Grid Control Cooperation)* - HOPS access to the European platform for the balance exchange process,
  Implementation of a new chapter of Policy 2 ENTSO-E RGCE of the Operating Manual (*Scheduling*) – new process of delivery of agreed exchanges by border and compensations on the verification platform (VP) RGCE,
- Implementation of the process of intra-day allocation of the cross-border transmission capacity TTC on the HR-HU border
- Support for CROPEX operation and the process of market coupling on the Croatian-Slovenian border,
- Further automatization of the process IT system for the support of the business process of managing auxiliary services and balance energy.

- **Research and development**

In 2018, the Company was active in the field of research and development. As in the years before that, the dynamics of the preparation of studies in the electric power transmission relevant to the improvement of the Company operation on domestic and international markets. Noteworthy are the activities in preparing the feasibility study for the consolidation of the main Croatian transmission axis North-South that enables the development of new interconnection cross-border transmission lines funded by the EBRD, whose completion is planned for the first quarter of the year 2019.

In 2018, the Company continued to participate actively in scientific projects together with the Faculty of Electrical Engineering and Computing, University of Zagreb, in accordance with the agreement signed with the Croatian Science Foundation (HRZZ) on a "Partnership in Research" grant for the project of Smart Integration of RENewables (SIREN). The project was officially completed on 31.11.2018, and it produced 12 papers in Q1 and Q2 category magazines, 13 papers for international conference, 7 papers for domestic conferences, and 7 technical reports. In 2018, activities were undertaken to submit a project application for the Horizon 2020 that brought together multiple participants from the HEP Group as well as partners from scientific institutions and industry with a view to jointly seeking the most acceptable technical and business solution to the decarbonization of the power system for the islands and to increase the supply security of Lošinj; however, the application was not accepted.

In 2018, the Company continued to actively participate in the WINDLIPS project (WIND Energy integration in Low Inertia Power System). The projects researches renewable energy sources (RES) in providing the initial inertia response and auxiliary services of the system, and the development of regulatory and technical frameworks to enable such operation. It will identify the situation of Croatia's EPS, the shares and types of individual power plants and the influence of the existing renewable energy sources on the inertia constant. It will analyze the strategies for the development of Croatia's EPS and the planning of new generation from RES, as well as the technical requirements of the network connection rules for RES in SEE states. The second part of the research will focus on the use of wind farms to support the stability of system frequency by managing their inertia response and the effective power in a short time after the disruption has occurred. The project will thoroughly analyse the primary regulation of the EPS frequency and the dynamic characteristics of the system response in case of disruption under the existing conditions and under the conditions of higher integration of wind farms in the EPS. By signing the agreement with the project partners at the end of 2017, HOPS joined the CROSSBOW project („CROSS Border management of variable renewable energies and storage units enabling a transnational wholesale market“) funded from the Horizon 2020 Framework. Other partners from Croatia include the Faculty of Electrical Engineering and Computing and Končar–KET. The CROSSBOW project consortium has 24 partners and brings together transmission system operators from eight SEE countries. The consortium began to operate in November 2017, foreseeably for a period of four years. During the project, HOPS will participate with 122 man-months with the approved funding grant of EUR 550,000. The goal of the CROSSBOW project is to demonstrate the possibility of cross-border management of non-stable energy from the renewable sources and energy storage in SEE countries, additionally enabling the development of the transnational wholesale electric power market. CROSSBOW consists of six sub-projects and nineteen work packages, of which HOPS manages sub-project 6. „Integration and demonstration“, and work package 13. „Large scale demonstration activities of the integrated CROSSBOW eco system“, and it also participates in other work packages. System operators are the core of the project that among other things will also increase the joint usage of the resources among the system operators. E.g. the project will propose new options for energy storage, virtual power plants, all with a view to increasing flexibility ad extension of the base of auxiliary service providers. In 2018, the staff members of the Company included in the CROSSBOW project intensively participated in the work on work packages by preparing conceptual documents and reviewing the same. There were also several consortium meetings that all partners in the project attended.

- **Fleet renewal**

In April 2018, with a view to increasing the safety of its staff and other traffic participants by renewing the existing obsolete fleet and creating conditions for the normal work in power transmission and EPS operation, the Company concluded contracts for the purchase of 34 passenger cars and 30 4WD vehicles that were delivered by the end of July 2018. Additionally, one more vehicle was ordered and delivered in November 2018.

At the end of the year, further requirements concerning vehicles was analysed and the plan is to initiate the purchase of additional passenger and 4WD vehicles with additions in the first half of 2019.

The purchase of new vehicles will significantly increase the traffic safety of the staff, directly raising the efficiency of their work, reducing the cost of maintenance of the fleet, reducing fuel costs and reducing the negative impact on the environment. These are the reasons for considering the renewal of the fleet.

- **Non-financial Report**

HOPS will publish its 2018 Non-financial Report, in accordance with the Accounting Act (Official Gazette of the Republic of Croatia 78/15, 134/15, 120/16, 116/18), as a separate report on HOPS website within 6 months of the balance sheet date i.e. by 30 June 2019. In preparing the report, HOPS will use the guidelines of the Global Reporting Initiative (GRI standard) and the indicators of the mentioned standard. Then report will be published on the following link:

https://www.hops.hr/wps/portal/hr/web/dokumenti/Publikacije/godisnjiizvjestaji.

1. DEVELOPMENT AND ORGANIZATION OF THE COMPANY

- **Activities of the Company**

As an Independent Transmission System Operator in the Republic of Croatia, the Company is organized as a Limited Liability Company based in Zagreb, Kupska 4, registered with the Companies Register of the Commercial Court in Zagreb under registration number MBS 080517105, OIB 13148821633, with the share capital of HRK 4,948,627,300.00, engaging in regulated activity of electric power transmission.

The Company is registered with the State Bureau of Statistics under MB 1924427 for electric power transmission.

Its basic tasks include: managing the electric power system of the Republic of Croatia, transmission of electricity, maintenance, development and construction of the transmission network to ensure reliable supply to users with minimal costs and great care for environmental protection, and support for the development and functioning of the Croatian electricity market, taking care of its interconnection with neighbouring electricity markets of the EU and the Energy Community.

The operation of the Company has been successfully organized and carried out in the territory of the Republic of Croatia over a period of more than 60 years, in several organizational forms.

- **Organization of the Company**

The bodies of the Company are: Assembly, Supervisory Board and Management Board.

Assembly:

Frane Barbarić – Chairman since 1 December 2018;

Supervisory Board:

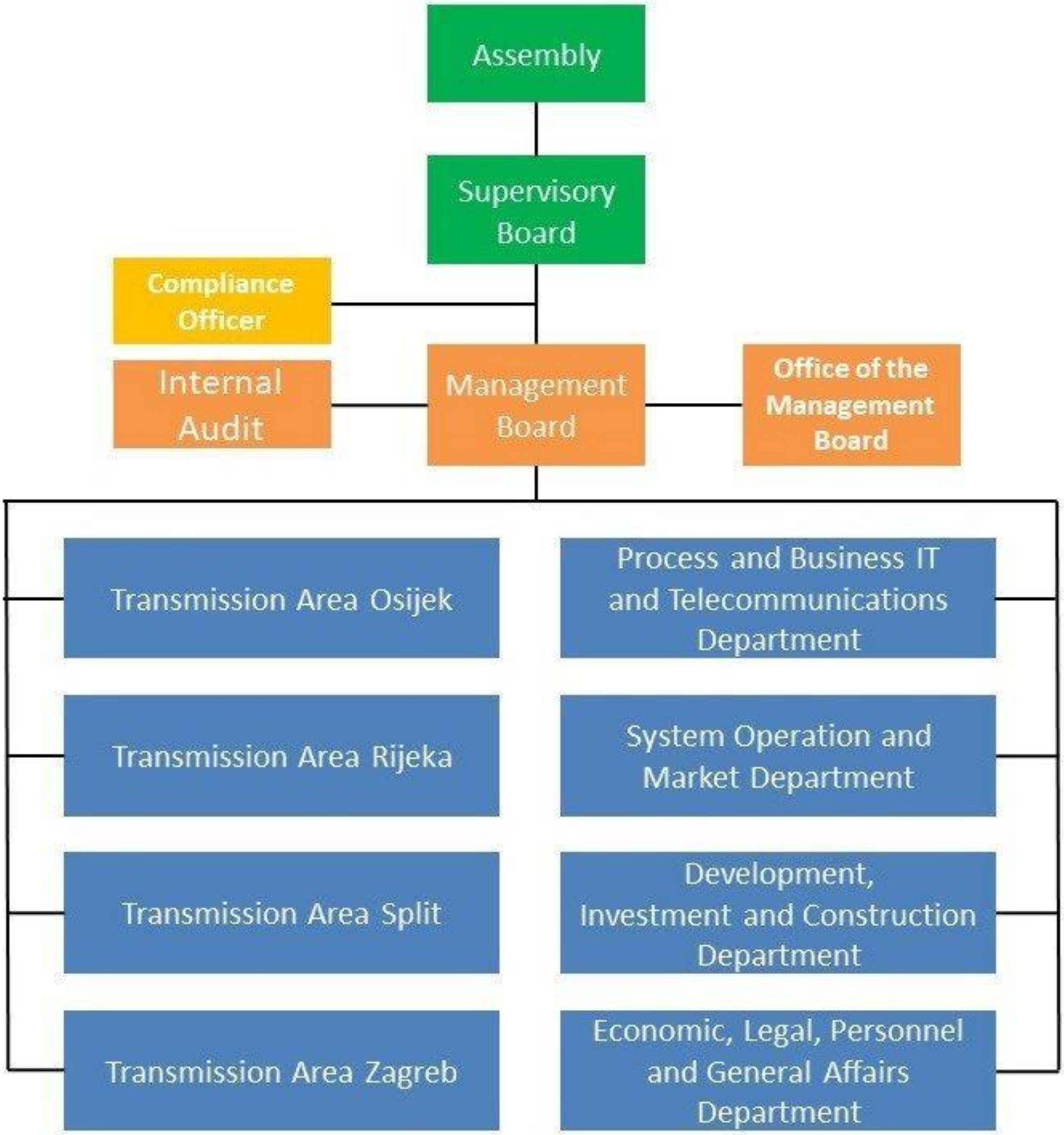
1. Kažimir Vrankić – Chairman
2. Alina Kosek - Vice-chairperson
3. Ante Pavić - Member
4. Marijan Kalea - Member
5. Denis Geto - Member – employee representative until 31 March 2018
6. Dinko Andabaka - employee representative until 31 December 2018
7. Sandro Abram - employee representative until 1 January 2019

Management Board:

1. Miroslav Mesić – Chairman – until 15 April 2018
2. Zdeslav Čerina – Member – until 15 April 2018
3. Darko Belić – Member – until 15 April 2018
4. Mario Gudelj – Chairman – since 16 April 2018
5. Ivica Modrić – Member – from 16 April 2018 to 11 April 2019
6. Zlatko Visković – Member – since 16 April 2018

The Company is functionally organized by sectors at the centre and by transmission areas regionally, in order to carry out its work throughout the Republic of Croatia efficiently.

Figure 1. Organigram of the Company, as of 31 December 2018



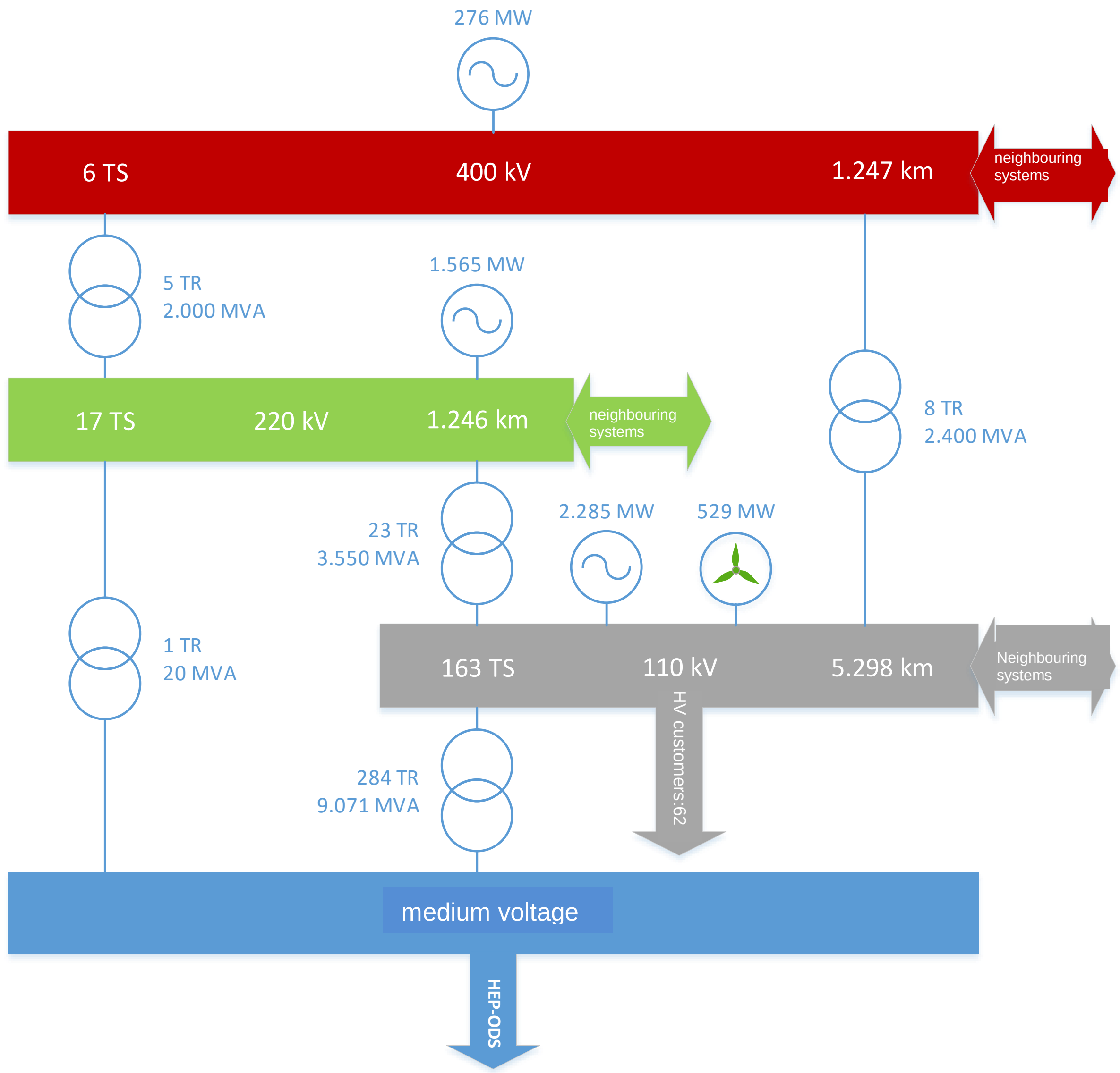
2. REPORT ON SUPPLY SECURITY IN THE ELECTRIC POWER SYSTEM OF CROATIA IN 2018

2.1 ELECTRIC POWER SYSTEM OF CROATIA

Croatia's EPS consists of generation facilities and plants, a transmission and distribution network and electricity customers in the Republic of Croatia. For safe and high quality electricity supply and electricity exchange, Croatia's EPS is connected to the EPSs of neighbouring countries and systems of other ENTSO-E members, which together constitute the synchronous network of continental Europe. Customers in Croatia are supplied with electricity from power plants in Croatia and with electricity purchased from abroad. In terms of size, Croatia's EPS is among the smaller systems in Europe.

Croatia's transmission system today (situation at the end of 2018) is networked in six 400 kV substations and seventeen 220 kV substations/facilities. There are one hundred and sixty-three 110 kV switchyards and 110/x kV substations.

Figure 2. Technical indicators of the EPS in Croatia by voltage – situation at the end of 2018



Croatia's EPS is connected through 400 kV, 220 kV and 110 kV voltage levels to the systems of the neighbouring countries. It is connected by 400 kV overhead lines (seven lines, of which three are two-system and four are one-system models) to the systems of:

- **Bosnia and Herzegovina (400 kV Ernestinovo-Ugljevik transmission line and 400 kV Konjsko-Mostar transmission line),**
- **Serbia (400 kV Ernestinovo–Sremska Mitrovica 2 transmission line),**
- **Hungary (2x400 kV Žerjavinec–Hévíz transmission line, 2x400 kV Ernestinovo–Pécs transmission line),**
- **Slovenia (2x400 kV Tumbri–Krško transmission line, 400 kV Melina–Divača transmission line).**

The 400 kV transmission network is not networked on the state territory but extends from its eastern part (Ernestinovo), across the northwestern (Zagreb) to the western (Rijeka) and the southern (Split) parts.

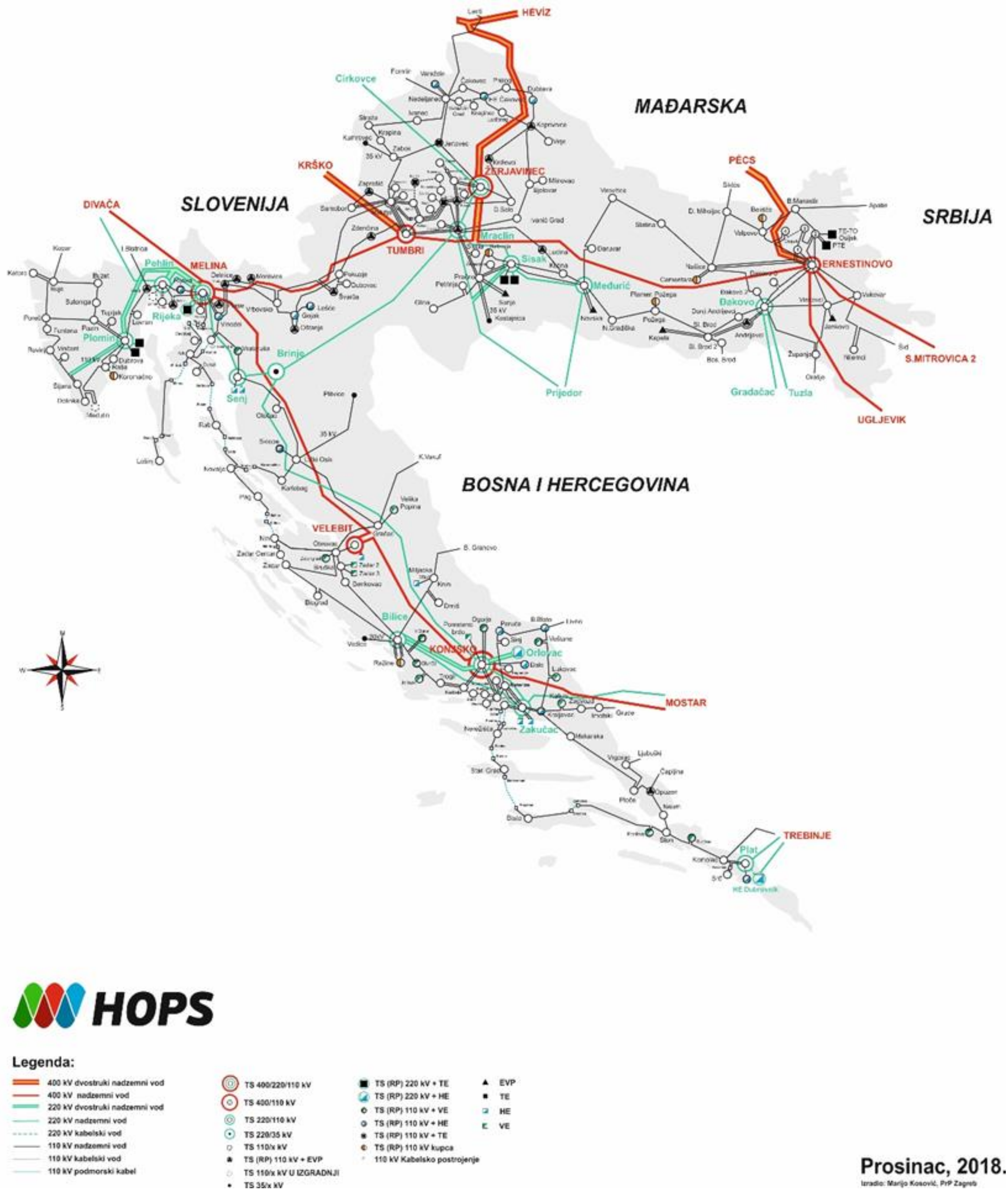
Of the generation facilities, only the Velebit reversible hydroelectric power plant is connected to the 400 kV network.

The interconnection of Croatia's system with the neighbouring ENTSO-E members features eight 220 kV overhead lines. Croatia's system is also networked with the surrounding systems on a 110 kV level (18 overhead lines in permanent or occasional operation). Good connections with neighbouring systems enable significant export, import and transit of electricity through the transmission network, and make the Republic of Croatia an important link between the Central and the Southeast Europe' power systems.

In Croatia's transmission system (situation at the end of 2018) HOPS owns 7,791 km of high voltage 400 kV, 220 kV and 110 kV networks (Figure 3). The total length of the transmission network includes overhead lines that were constructed as 110 kV lines, but are currently in operation at medium voltage.

The transmission network is sufficiently developed to enable substantial exchanges (primarily imports) with neighbouring EPSs. Substantial amounts of electricity, with satisfactory security, are imported from Slovenia (Krško nuclear power plant), Bosnia and Herzegovina and Hungary.

Figure 3. The 400-220-110 kV transmission network in the Republic of Croatia, situation at the end of 2018

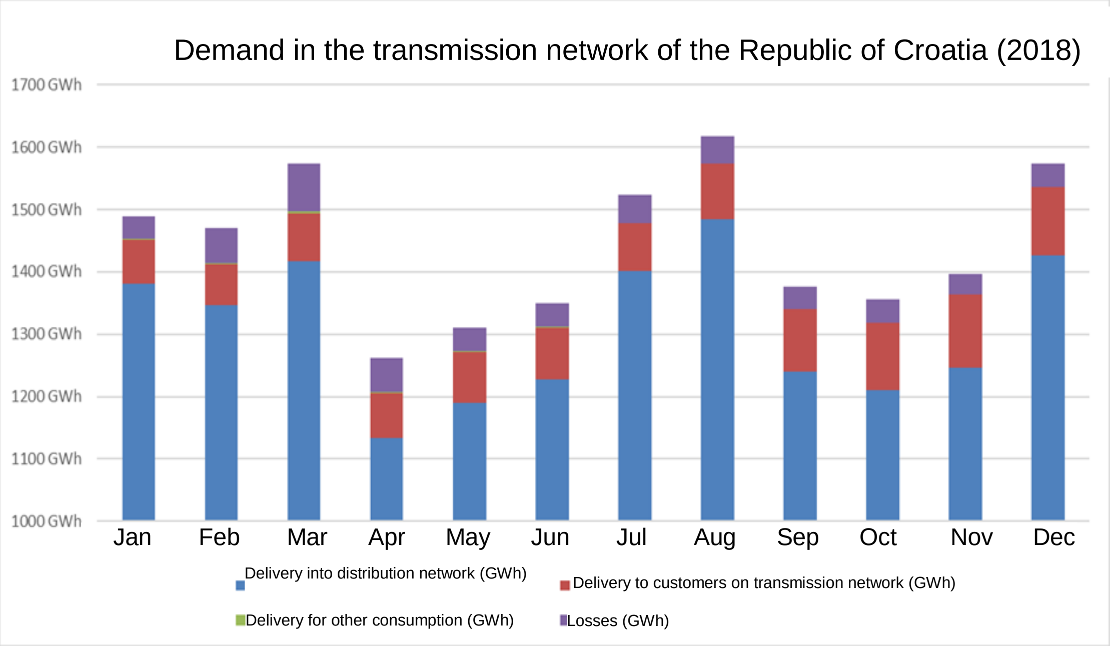


2.2 SECURITY OF SUPPLY IN 2018

The required quantities of electricity for end-users in Croatia's EPS are secured through the suppliers and operators of the transmission system, through the generation units within Croatia's EPS and through secured cross-border transfer capacities at the HOPS interface with other transmission system operators. Figure 4 shows electricity demand in the transmission network of the Republic of Croatia by month in 2018.

The peak hourly load in Croatia's EPS was recorded in February, while the maximum total monthly electricity demand in the transmission network was recorded in August (1618 GWh).

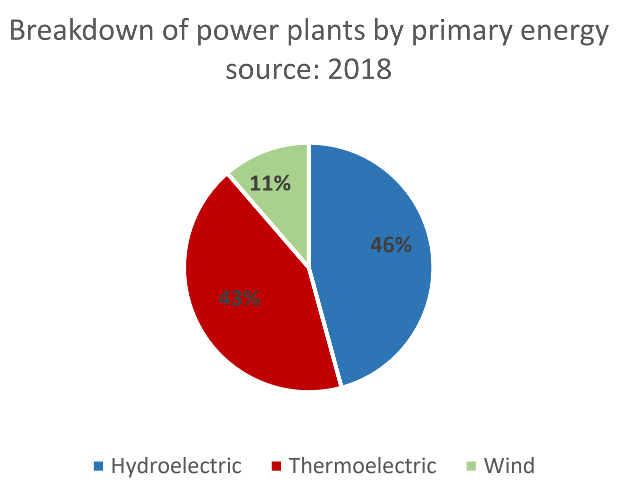
Figure 4. Demand in the transmission network of the Republic of Croatia in 2018



Available generation units presented according to the approved connection power and the primary source of energy, are shown in Figure 5.

Figure 5. Connection power of the power plants in the transmission network in the Republic of Croatia in 2018

Type of plant	Connection power /MW/	/%/
Hydroelectric	2111	45,50%
Thermoelectric	2001	43,13%
Wind	529	11,40%
Σ	**4640**	**100,00%**



The possibility of the import of electricity into the EPS of Croatia is determined by the cross-border transfer capacities. Figure 6 and Figure 7 show the cross-border transfer capacities.

Figure 6. Cross-border transfer capacities – import NTC capacities (comparison table)

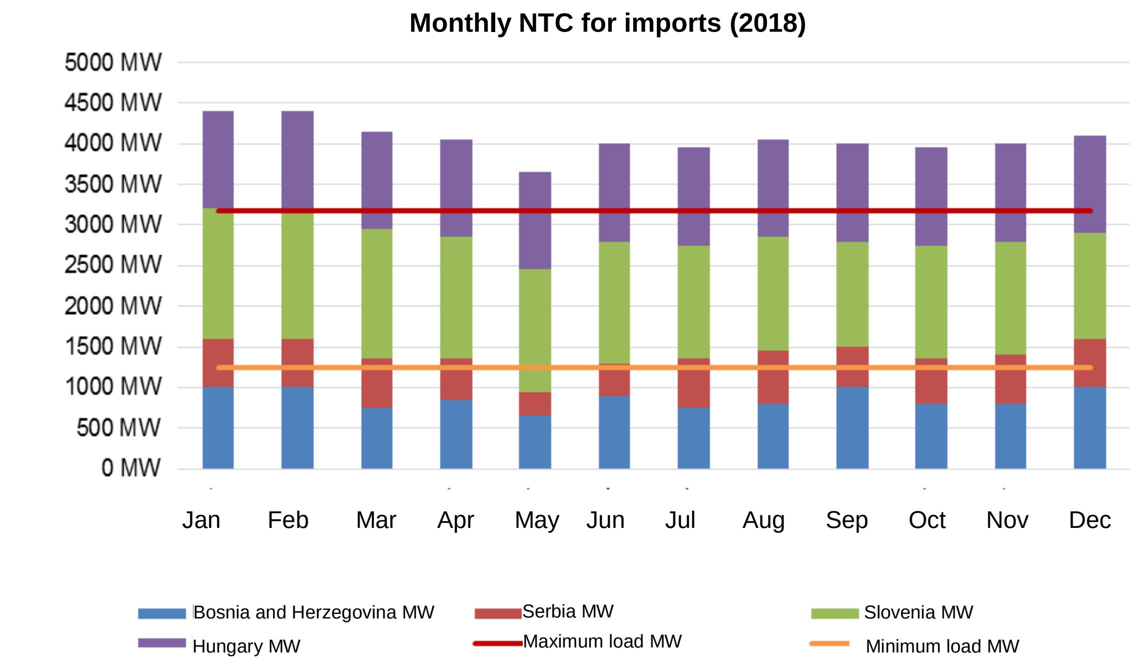
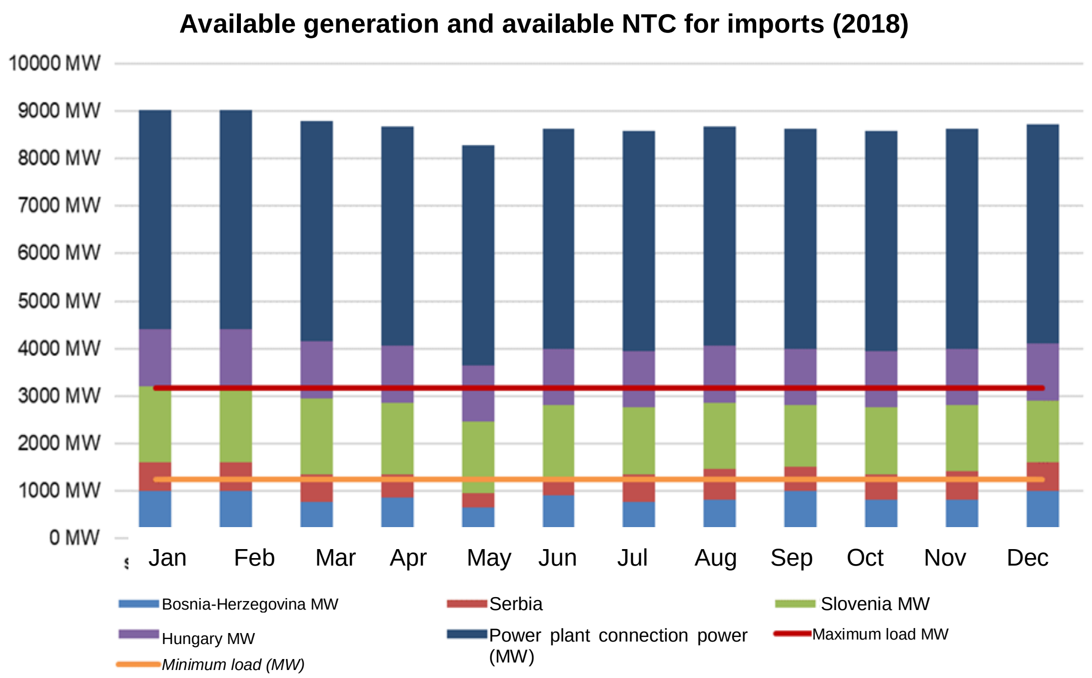


Figure 7. Available generation and available cross-border transfer capacities in relation to the minimum and maximum load in the transmission network



2.3 LOSSES IN THE TRANSMISSION NETWORK IN 2018

The total losses in the transmission network are calculated as the balance between the electricity supplied and delivered in the transmission network, based on the collected and verified data from the measuring points. Total losses include the losses in the transmission network and on the cross-border connection lines. The monthly losses in 2018 totalling 533.7 GWh are shown in Figure 8.

Figure 8. Losses in 2018, by month

From the aspect of the transmission system operator, losses in transmission network are usually viewed depending on the total transmitted power in the transmission network. The total transmitted power in the transmission network is calculated as a sum of the electric power generated in the transmission network and the electric power that entered the transmission network. In 2018, the total power transmitted in the transmission network was 23.830 GWh or 7.84 % more than in 2017. The share of the losses in the energy transmitted in 2018 was 2.23%. The total losses in the transmission network in 2018 were greater than in 2017 by 27.95 %. The increase was caused by low temperatures, increased hydrology and considerably increased transits (particularly the export).

HOPS procures electricity to cover the losses through public tender to minimize the total expense, on transparent, non-discriminatory and market-based principles. Consequently, the procurement of electricity to cover the losses in 2017 was carried out over the long term (long-term contract) and over the short-term for the day ahead.

The long-term contract means procurement through public tender for known amounts of electricity, the selection criterion being the lowest bid price that meets all bidding requirements.

Short-term procurement means the procurement of electricity on a short-term basis (day ahead) through purchase on CROPEX to cover the losses.

3. OPERATING PERFORMANCE AND FINANCIAL STATUS OF THE COMPANY IN 2018

The Company's operating performance in 2018 is presented in the Comprehensive Income Statement for the period from 1 January 2018 to 31 December 2018, and the financial status in the Financial Status Report as of 31 December 2018. Below are the above-mentioned statements featuring the most important items.

3.1 OPERATING PERFORMANCE

The Company finished the business year 2018 with pre-tax profit for the period of HRK 216.1 mil. Total realized profit consisted of the balance of income and expenses related to the allocation of cross-border transfer capacity amounting to HRK 76.2 million and the balance of other income and expenditures amounting to HRK 139.9 million. In relation to the previous year, the realized profit was down 38.9% while the after-tax profit was down 39.0%.

The profit decrease was mostly influenced by the decline in the income from the balancing electricity charges that was 52.0% down year on year, balancing energy sales that were 23.1% lower, and the costs of the losses that were 51.7% higher than in the preceding year.

Total income consisted mostly of power transmission services (79.8%), allocation of cross-border transmission capacities (6.3%), charging balancing electricity (5.0%), balancing energy sales (2.6%) and revenues from the Inter-TSO Compensation (ITC) fees (2,1%). Other operating income refers to the revenues generated from: properties received from others, and in accordance with the provisions of IFRS 15 revenues from telecommunications services, revenues generated from the use of our own products and services, collected written-off receivables, revenues from property received free of charge, revenues from non-standard services, termination of provisions and other business and financial revenues.

As of 1 January 2018, International Financial Reporting Standard (IFRS) 15 Revenues from Contracts with Customers entered into effect that in the portion of the contracts for transmission network connections replaced IFRIC 18. Pursuant to the provisions of IFRS 15, network connection is considered non-refundable payment of a fee for the network connection related to the future network utilization contract and the electricity supply contract. The period of recognition for the revenue from the connection fee is extended even after the initially contracted time, considering that on the basis of the realization of the connection contract the customer is entitled to using the transmission network and to be supplied with electricity. The revenue is thus systematically distributed over the period of the useful life-cycle of the built facility or transferred facility used to provide permanent service, and the fee received from the customers for the connection is recorded as deferred income, and the income for the period is recognized simultaneously with the depreciation of the respective assets (connections). In terms of the implementation of the provisions of IFRS 15, in 2018, the Company recognized income equal to the depreciation of assets financed from the connection fee amounting to HRK 13.4 mil.).

The main items of total expenditures were depreciation expense (21.6%), staff expenses (14.3%), maintenance expenses (6.7%), and from other operating expenses, the supporting services expenses together with balancing electricity expenses (30.5%) and transmission network losses (11.5%).

Financial expenditures mainly related to interest and exchange rate exposure.

The corporation income tax in 2018 was HRK 39.9 million, lower than in the previous year by 38.3%.

Table 1 shows the Comprehensive Income Statement (Profit and Loss Statement) with the most important items and a comparison with the previous year's performance.

Table 1. Excerpt from the Comprehensive Income Statement (in HRK million)

Description	2018	2017	Balance	2018/2017
1	2	3	4 (2-3)	5 (2/3)
Revenues from sales and other business incomes	1,755.5	1,854.3	(98.8)	-5.3%
Business expenditures	1,524.2	1,475.8	48.4	3.3%
PROFIT FROM BUSINESS ACTIVITIES	**231.3**	**378.5**	(147.2)	**-38.9%**
Financial income	9.1	7.4	1.7	22.2%
Financial expenditures	24.3	32.3	(8.0)	-24.8%
Net financial expenditures	**(15.2)**	**(24.9)**	**(6.3)**	**-38.8%**
TOTAL INCOME	**1,764.6**	**1,861.7**	**(97.1)**	**-5.2%**
TOTAL EXPENDITURES	**(1,548.5)**	**(1,508.1)**	**(40.4)**	**2.7%**
Pre-tax profit	216.1	353.6	(137.6)	-38.9%
Income tax	(39.9)	(64.6)	24.7	-38.3%
PROFIT FOR THE PERIOD	**176.2**	**289.0**	**(112.8)**	**-39.0%**

Based on the above items, as shown in Table 2, earnings before net financial expenditures and current tax (EBIT) were HRK 231.33 million, which is 38.9% less than in 201. EBITDA (EBIT excluding depreciation) was HRK 566.47 million, which is 18.6% lower than in 2017.

Table 2. Financial indicators (in HRK million)

Description	2018	2017
EBIT (pre-tax profit and net financial expenditures)	231,33	378,50
EBITDA (EBIT without the effect of amortization)	566,47	695,78
EBIT margin	13%	20%
EBITDA margin	32%	38%
Net profit margin	10%	16%

3.2 FINANCIAL STATUS

The financial status of the Company is presented in the Financial Status Report as of 31 December 2018.

Table 3 shows the Financial Status Report (Balance Sheet) with the most important items and a comparison with the previous year's performance.

Table 3. Extract from the Financial Status Report of the Company (in HRK million)

Description	31 December 2018	% share	31 December 2017	% share	2018/17
1	2	3	4	5	6 (2/4)
Fixed assets	6.134,5	91,6%	6.033,1	91,4%	1,7%
Current assets	563,8	8,4%	566,9	8,6%	-0,5%
Total assets	**6.698,3**	**100,0%**	**6.600,0**	**100,0%**	**1,5%**
Capital and reserves	5.101,9	76,2%	5.223,7	79,1%	-2,3%
Long-term liabilities	938,0	14,0%	662,5	10,0%	41,6%
Short-term liabilities	658,4	9,8%	713,8	10,8%	-7,8%
Total liabilities and capital	**6.698,3**	**100,0%**	**6.600,0**	**100,0%**	**1,5%**

The total value of assets as of 31 December 2018 was HRK 6,.698.3 million and compared to 31 December 2017 it was up HRK 98.3 million or 1,5 %.

As a result of investment in 2018, fixed assets increased by HRK 101.4 million and now amount to HRK 6,134.5 million. The share of fixed assets in total assets, compared to 2017, increased by 0.2 %.

Current assets amount to HRK 563.8 million and they decreased by HRK 3.1 million compared to the previous year, mainly due to the decrease in the receivables from related companies, which are down by HRK 29.7 million. The share of current assets in total assets decreased by 0,2%. The largest share of current assets as of 31 December 2018 related to non-matured receivables from HEP-ODS d.o.o. and HEP Proizvodnja d.o.o. concerning the power transmission fee amounting to HRK 248.7 million.

Capital and reserves, which cover 76.2% of the total assets of the Company, decreased by HRK 121.8 million due to the lower realized profit in 2018, so the share is 3.0% lower than in 2017.

The Company's share capital as of 31 December 2018 was HRK 4,929.2 million and it did not change in 2018. In March 2019, the share capital of the Company was increased by HEP d.d. bringing in assets worth HRK 19.4 mil., so that the share capital totalled HRK 4,948.6 mil.

Since the provisions of IFRS 15, referred to in the previous section, represent a change in the current method of recording revenue from the connection fee, and the return to revenue recognition method prior to 2009 and the application of IFRIC 18, the standard requires retroactive application. Consequently, the Company recognized the cumulative effect of the initial application of this standard as a restatement of the initial balance of retained earnings, deferred tax assets and deferred income. Pursuant to the provisions of IFRS 15, regarding the linkage between the connection contract and the contract for the supply of electricity, for the assets recorded pursuant to IFRIC 18 that was not fully depreciated, retained earnings were restated for part of the revenue recognized at the time of connection to the network, which includes the connections registered from 1 July 2009 to 31 December 2017.

For the period ended 31 December 2018, the Company revised the initial balance on 1 January 2018 in the following positions: deferred income was increased by HRK 316.4 mil., deferred tax assets were increased by HRK 18.4 mil., and the transferred loss amounting to HRK 298.0 mil. was noted.

Total liabilities amounted to HRK 1,596.4 million, which is up HRK 220.1 million over 2017, and their share in liabilities increased from 20.8% to 23.8%. Long-term liabilities account for 58.8% and short-term liabilities for 41.2% of total liabilities as of 31 December 2018.

Based on the indicators derived from the balance-sheet data it can be stated that the Company has indicators of indebtedness in accordance with the activity performed. The Company finances most of current investment from its own funds, regularly repays its long-term liabilities and regularly funds its normal operation from its earnings.
The indebtedness factor (total liabilities/net income and depreciation) of the Company for 2018 was 3.12 years and it is higher than in the previous year by 0.85 years.

4. INVESTMENTS

In 2018, investment totalled HRK 422,50 million. The largest share consists of investment in replacement and reconstruction of existing transmission infrastructure, construction of new facilities and renewal of transmission network facilities and plants. The level of realized investment in 2018 was down 4.7% from the previous year, mostly due to lower investment activity co-financed by foreign investors.

Table 4. Investment in 2018 (HRK)

Type of investment	31 December 2018	% share	31 December 2017	% share	2018/2017
1	2	3	4	5	6 (2/4)
Preparation of investment	12.285.790	2,9%	8.894.918	2,0%	38,1%
Replacement and reconstruction	161.581.930	38,2%	159.636.145	36,0%	1,2%
Revitalization	71.918.463	17,0%	72.452.618	16,3%	-0,7%
Repairs and renewal	0		0		
New facilities	97.127.202	23,0%	86.046.461	19,4%	12,9%
Other investments	60.755.445	14,4%	55.289.373	12,5%	9,9%
Electrical power conditions for connection	18.831.604	4,5%	61.145.734	13,8%	-69,2%
Total	**422.500.434**	**100,0%**	**443.465.249**	**100,0%**	**-4,7%**

4.1 THE MOST IMPORTANT INVESTMENTS

Listed below are the most important investments that were partly or entirely realized in 2018.

SINCRO.GRID PCI PROJECT (calculated in 2018.: HRK 18,000,650)

Within the SINCRO.GRID project, the investment can be divided into 4 major groups: 1) installation of compensation facilities at SS 400/220/110 kV Melina (VSR 200 MVAr), 2) SS 220/110 kV Mraclin (VSR 100 MVAr), 3) SS 400/220/110 kV Konjsko (SVC 250 MVAr), and 4) improvement of process technical system (TK, IT, SCADA, EMS, DTR) necessary for the realization of the project. In 2018, the main project was completed for the installation of the SVC facility at the Konjsko substation (about HRK 300,000 in 2018), TC equipment was delivered (network switches) for the communications connection (about HRK 4,900,000 in 2018), and the detailed plans and licences for the support/upgrade of the process technical system (VVC function, DTR system) necessary for the realization of the project (about HRK 12,600,000 in 2018). The completion of all works is scheduled in 2021.

SS 110/20 kV Sućidar (calculated in 2018: HRK 11,881,233)

Preparatory activities were carried out for drafting a conceptual design, which showed that it was not necessary to obtain the location permit because the future site on which to build the substation was owned by HOPS; main projects were prepared, and the process of integrating the cadastral plots was initiated on the basis of a geodetic paper. The Agreement on Relations between HEP-ODS and HOPS was signed regarding the construction of the Sućidar substation with a connection to the 110 kV network. The production of GIS 110 kV plant is pending completion. The public tendering procedure for the procurement of primary and secondary equipment is under way, as well as preparation of some detailed plans, construction and power installation works, removal of the fleet, carrying out construction works for the access road, construction and power installation works.

TL 110 kV Sl. Brod - Andrijevci (calculated in 2018: HRK 7,983,223)

According to the building permit, the reconstruction of the pipeline sections from the 220/110 kV Đakovo substation to TPSS Donji Andrijevci and from the 110/35 kV Slavonski Brod substation to TPSS Donji Andrijevci was completed, with power connection per a group of three reconstructed lines between the mentioned hubs, and occupancy permits were obtained. The construction of the electric power connection between the 220/110 kV Đakovo substation and the 110/35 kV Slavonski Brod substation is nearing completion (connections to the 220/110 kV Đakovo substation and the 110/35 kV Slavonski Brod substation are pending). To accomplish this, it is necessary to complete the interventions in the 110 kV transmission network pursuant to other construction permits (construction of the 110 kV line bay at the 220/110 kV Đakovo substation and reconstruction of the 110 kV Slavonski Brod-Slavonski Brod 2 transmission line as a two-system line and the 110 kV line bay at the 110 / 35 kV Slavonski Brod 2 substation) which is prerequisite to the completion of the works and obtaining the occupancy permit.

TL 2x110 kV Sl. Brod - Sl. Brod 2 (calculated in 2018: HRK 4,270,695)

Valid building permit obtained for he reconstruction of the 2x110 kV Slavonski Brod-Slavonski Brod 2 transmission line, contract for the preparation of a detailed plan, procurement of conductors, insulators and the protective rope with integrated optic ground wire (OPGW), coupling and suspension equipment, manufacture of steel-grid columns.

Building and electrical installation works are under way.

SS 110/10(20) Split 3 (Visoka) (calculated in 2018: HRK 4,999,993)

Preparatory activities were carried out to prepare the conceptual design for the reconstruction of the existing Split 3 (Visoka) substation, on the basis of which it was found that it was not necessary to obtain the location permit because the site for the reconstruction of the substation was owned by HOPS. The main project was prepared and the valid building permit obtained.

Manufacture of GIS 110 kV facility is under way and detailed plans are being prepared.

SS OSIJEK 2, REPLACEMENT OF 110 kV POWER TRANSFORMERS (calculated in 2018: HRK 9,365,581)

At the beginning of 2018, the procurement of power transformers was contracted for then replacement at the Osijek 2 substation. Due to their age and expired life cycle, it is necessary to replace the 110/35/10 kV transformer with 40 MVA rated output (TR 1 was manufactured in 1970, and TR 2 in 1971) with new transformers with s same rated output. The replacement will take place within the reconstruction of the entire Osijek 2 substation.

Office building of the Rijeka transmission area (calculated in 2018: HRK 35,534,711)

In 2016, after the public tendering procedure, a contract was signed with the best bidder for the construction of a new office building for the Rijeka Transmission Area on the site of the old one in Matulji. The supervision of the works was entrusted to external companies. The demolition works on the old building and the preparatory work for the new one began in November 2016 and were continued in 2017. RC works on the office and service buildings were finished in 2017, as well as some of the works on closing their openings. Trade works, mechanical works and electric installation works took place concomitantly with each phase of RC works in 2017. In 2018, all construction and trade works were completed, as well as equipping with furniture for the archives, for the staff and the new kitchen. In September 2018, the relocation of the staff from the office building in Opatija to the new location at Marinčićeva 3 in Matulji was completed. In October 2018, a valid occupancy permit was obtained, and all conditions were met for unimpeded operation at the new site.

SS Trogir – replacement of two 63 MVA transformers (calculated in 2018: HRK 13,316,092)

In May 2018, the works on the replacement of the TR2 power transformer were completed. The works included replacement of the coupling and suspension equipment and secondary cables in the transformer field. The works and commissioning of the power transformer is scheduled in April 2019.

SS Nerežišća - replacement of 40 MVA transformer (calculated in 2018: HRK 6,229,669)

In June 2018, works were completed on the replacement of the TR1 power transformer. The works included replacement of the coupling and suspension equipment and secondary cables in the transformer field.

SS Zadar – reconstruction (calculated in 2018: HRK 5,498,232)

Reconstruction of 110/35 kV SS Zadar were contracted towards the end of 2016. At the beginning of 2017, the preparation of the detailed plan and procurement of the equipment began. In July 2017, the works on the site began. The first phase of the reconstruction was completed in April 2018, and the second phase in November 2018. The reconstruction included the complete primary and secondary equipment, busbar system and auxiliary power supply system, new outdoor lighting and arranged facility plateau with all the auxiliary buildings. Also, the command building and the 35 kV facility building were reconstructed. The contract is scheduled until 22.03.2019. Final testing is under way, including test run and organization of technical inspection for obtaining the occupancy permit.

SS Koprivnica – replacement of primary and secondary equipment (calculated in 2018: HRK 7,726,105)

The reconstruction of the 110 kV facility of the 110/35 kV SS Koprivnica began in 2017. with the establishment of a provisional plant through cable connections from the existing 110 kV TL portals in the North-South direction: HPP Dubrava - Bjelovar and Ludbreg - Križevci. To the first one the 110kV Virje transmission line was connected by cable T-coupling. In addition, to each of the two connections one of the two existing 110 kV transformer fields were connected by T-coupling with power transformer to power 35 kV facilities of HEP ODS (-T1, -T2) and one each of the two existing 110 kV HŽ fields (HŽ „A“ and „B“). Such provisional connections enabled complete disconnection of the buses and all 110 kV switchyards, which was the necessary requirement for the intervention on the 110 kV facility.
When the provisional connections were set up, most of the existing 110 kV outdoor facility was dismantled and the construction works for the first phase were carried out, which included the construction of the foundations for the bus portals, device pedestals and cable ducts within the facility. This was followed by the installation of a double 110 kV bus system on both bus ranges.
In 2018, the installation of the primary and secondary equipment was completed for 10 fields of the 110 kV facility, including the newly-built coupling-measurement field, technical testing of the equipment installed and the functional testing of the facility.
In addition to the replacement of the primary and secondary equipment in 2018, other works were completed in 2018 as well, such as cable ducts, facility plateaus, outdoor lighting and

lightning conductors, site road with height limits etc. Facility earthing was renewed, the operating building of the substation was rebuilt and the fire-alarm installed.
In 2019, after a test run and technical inspection and the issuance of the occupancy permit, the facility will be commissioned.
The reconstructed 110 kV facility of SS 110/35 kV Koprivnica consists of two 110 kV bus system with 10 fields, of which five 110 kV TL fields (Bjelovar, Križevci, Virje, Ludbreg, HPP Dubrava), two transformer fields for powering the MV facility of HEP ODS (-T1, -T2), two HŽ fields (HŽ „A“ and „B“) and one switchyard.

Procurement and installation of network and security equipment and related software (calculated in 2018: HRK 7,077,000)

In 2018, HOPS continued with the modernization of the WAN communication platform between the management centres and EP facilities. The project of the modernization of the communication connections in remote-controlled EP facilities was continued, as well the segmentation of the process network with advanced firewalls, the implementation of the WAN communication infrastructure for the process network at EP facilities (about 80%). Cyber security was upgraded in 2018 by extending automated control mechanisms: web and mail traffic supervision tools and control systems were implemented plus internal process network firewalls at management centres, external process network firewalls, advanced solution at the juncture of the process and business networks, Proof of Concept of the SCADA firewall in EP facilities, central security SIEM system with control over the network and security equipment at management centres, firewalls began to be installed at EP facilities. The works under way include the projects of modernization and extension of data centres and virtualization platforms on HOPS networks and the internet output. HOPS follows requests for cyber security and the same requests coming from ENTSO-E bodies. Continuous harmonization with the NIS Directive of the EU and the national law/regulation is under way concerning cyber security of the key service operators and digital service providers, which is binding on HOPS. The Rules on HOPS IT system security are also being drafted as the basis for a possible future certification under ISO 27000.

HV SWITCHGEAR (calculated in 2018: HRK 5,371,960)

In mid-2016, a public tendering procedure was carried out and the supplier of HV switchgear was selected. The equipment was procured successively, concomitantly with the revitalization of the substations in the Osijek Transmission Area. In 2018, HV switchgear was purchased for the revitalization of the Osijek 2 substation that in now under way.

Purchase of power generators (calculated in 2018: HRK 13,071,898)

The purchase of the power generators for HOPS (in accordance with the framework agreement concluded towards the end of 2017) includes the manufacture and testing, transport to the site, installation, connection and commissioning of new power transformers.

In 2018, the Zagreb Transmission Area ordered three power transformers:

1) -T2, 220/110/10 kV, 150 MVA for SS 220/110/10 kV Mraclin,

2) -T1, 110/35 kV, 40 MVA for SS 110/35 kV Koprivnica,

3) -T2, 110/35 kV, 40 MVA for SS 110/35 kV Koprivnica.

In the first part of 2019, it is planned to transport and install the ordered power transformers and do on-site testing and commissioning. The existing power transformers will be removed, and the waste of the disassembled equipment will be disposed of in an environmentally-friendly way.

SS 110/20kV LOVRAN – replacement of primary and secondary 110kV equipment (calculated in 2018: HRK 7,497,128)

In 2017, a project for the replacement of the primary and secondary equipment of the 110 kV facility of SS Lovran was concluded. Towards the end of 2017, switches were replaced on all 110 kV fields. In 2018, construction works were carried out on the facilities to accommodate equipment and staff of HOPS. A new system of management, control, protection and measurement was realized. New 220 V DC, 48 V DC and 230 V AC subsystems were installed. The primary equipment was replaced on 110 kV fields (measuring transformers, surge conductors, disconnectors, insulator chains).

SS Melina - upgrade of the second busbar system, replacement of HV and secondary equipment of the 400 kV facility (calculated in 2018: HRK 7,339,494)

In 2016, the complex and comprehensive project was contracted for upgrading the second busbar system and the replacement of the remaining HV and secondary equipment of the 400 kV facility, and its completion is expected in 2019. In 2017, substantial construction works were carried out, a new system of busbars+W2 was erected and completely equipped with disconnectors and earthing switches, and it was connected to the old system of busbars+W1 through the main bay. The works on the replacement of the disconnectors of the busbars +W1 and auxiliary busbars +W7 were completed in 2018. to fulfil the contract, it is necessary to finish the western slope and install power transformers at neutral points AT1 and AT2, which is scheduled in 2019.

SS 110/35kV DOLINKA - 110/35kV 40MVA power transformer (calculated in 2018: HRK 5,010,363)

For the replacement of the power transformer of SS 110/35/10 kV Dolinka, in 2018, a 110/35/10 kV, 40 MVA three-phase oil regulated power transformer was ordered with related projects for the adjustment to connect the transformer to the existing primary an d secondary circuits.

SS OSIJEK 2, REVITALIZATION (calculated in 2018: HRK 12,679,204)

The project of revitalization of the Osijek substation was launched in 2014. The preparation of project documentation and obtaining the necessary permits was followed by the public tendering procedure at the beginning of 2018, with the conclusion of the works for the revitalisation of the entire substation. The revitalization of the Osijek 2 substation was necessary because its equipment (primary and secondary) was obsolete and unreliable, and the facility is of special importance because of its being directly next to TPSS Osijek.

SS 400/220/110 kV KONJSKO – reconstruction of secondary systems (calculated in 2018: HRK 4,414,465)

The reconstruction of the secondary systems at SS Konjsko includes the replacement of the obsolete equipment of the system of management, signalization or control, protection, measurement and regulation for the entire 220 kV switchyard, and for the 110 kV and 10 kV sides of the ATR1 and ATR2 power transformers. Also, the reconstruction includes the replacement of the entire auxiliary 220 V DC distribution and the auxiliary 400/230 V AC distribution equipment in all relay boxes of the 220 kV and 110 kV switchyard. In addition to the installation of new cabinets for management and control, relay protection, measurement and regulation, and the cabinet for the distribution of the auxiliary DC and AC power supply, the control cabinets will also be replaced for the facility, lighting system, as well as all related signal and power supply cables.

The reconstruction began when the contractor took over the site in December 2017. Prior to that, the necessary detailed project documentation was prepared. The completion of the works is scheduled in December 2019.

Revitalization of the 220 kV facility at the HPP Orlovac switchyard (calculated in 2018: HRK 6,075,211)

The project of the reconstruction of the 220 kV Orlovac switchyard began in 2014 with the preparation of the project brief and the main project. The building permit was obtained in May 2017. Documentation was prepared for the procurement and the public tendering procedure was conducted. The reconstruction contact was concluded towards the end of August 2018. The reconstruction includes: replacement of the primary and secondary equipment of the 220 kV facility 220 kV, inclusion in the remote-control (RC) system, construction of HOPS control building, new AC/DC distribution, electric installations, fire-alarm and video surveillance, new driveway, fence, outdoor lighting, construction works.

SS 110/35 kV Pračno – revitalization of the 110 kV facility (calculated in 2018: HRK 17,420,724)

For the reconstruction of the SS 110/35 kV Pračno, the building permit was obtained in July 2017. The public tendering procedure was conducted and in October 2017 the contract was concluded for the preparation of the detailed plan, supply of equipment and carrying out works. The reconstruction began in March 2018.

Provisory connections were made, the primary and secondary equipment was disassembled, old 110 kV wire buses. Steel structure of new buses was delivered and installed, and new bus wires were installed. Construction works were completed in 110 kV fields and the command building. The assembly of the steel structure for devices is under way for 110 kV fields, as well as the installation of the primary equipment.

SS 110/35 kV Ivanić Grad (calculated in 2018: HRK 15,105,324)

The building permit was obtained for the reconstruction and upgrade of the 110 kV facility at the Ivanić Grad substation, the public tendering procedure was conducted and the contracts concluded for the purchase of equipment, works, testing and commissioning. In October 2017, a contract was concluded for the preparation of a detailed plan and the works.

The works began in May 2018. Construction works were completed for two new switchyards and the 110 kV switchyard, steel structure for device pedestals and bus systems was installed as well as the AC and DC sub-switches, provisional powering of the substation, with the relocation of a 35 kV Šumećani-Ivanić transmission line column within the substation fence, cabling the connection range to the substation, and the reconstruction of the existing switchyards and bus systems began.

SS 110/10(20) kV Zamet (calculated in 2018: HRK 11,851,684)

The contract for the procurement and assembly of the primary equipment (GIS 110 kV) for the interior installation at SS 110/10(20) kV Zamet was signed on 4 May 2017, and it was scheduled to be completed within 18 months from the date of the Contractor taking over the works. The Contractor took over the works on 12 May 2017. GIS 110 kV facility was installed and tested.

The contract for the procurement of the secondary equipment including works and services at SS 110/10(20) kV Zamet was signed on 22 December 2017 and was scheduled to be fulfilled within 12 months from the date of the Contractor taking over the works. The secondary equipment was installed and all related works and services were completed, except testing from the Rijeka network centre that will be possible after the construction of the 2x110 kV cable connection for the 110/10(20) kV Zamet substation.

4.2 TERMS OF ELECTRIC POWER CONNECTION

Connection of Block C at TEPP Sisak (calculated in 2018: HRK 7,161,752)

In 2018, the works were completed on the construction of the 2x220 kV connecting transmission line from TEPP Sisak to the existing 220 kV Mraclin-Prijedor transmission line. When the construction was finished, there followed technical inspection, after which the occupancy permit was obtained. On 31.12.2018, the final reckoning was undertaken, and it is considered that all the requirements prescribed in the Connection Contract have been met.

Connection of wind farm Lukovac (calculated in 2018: HRK 11,356,612)

In February 2018, the Verfication Testing Paper was reviewed for WF Lukovac, and it was found that the conditions were met for permanent connection of WF Lukovac to the transmission network. Within the procedure for obtaining the occupancy permit for WF Lukovac, a technical inspection took place on 20 February 2018. The technical acceptance of the 30/110 kV substation Lukovac took place on 5 July 2018.

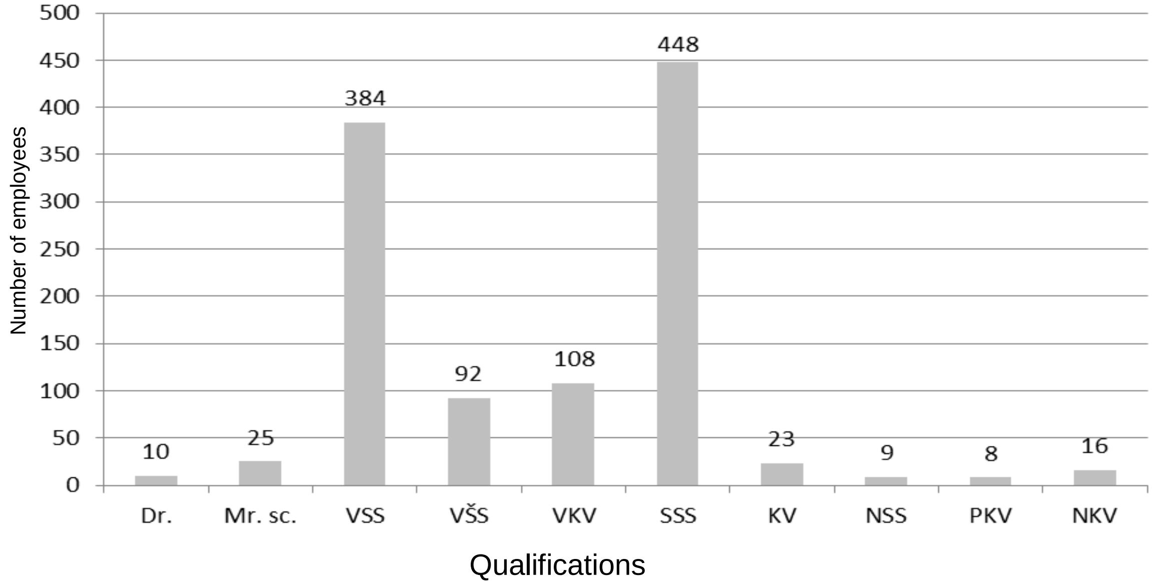
5. PERSONNEL

As of 31 December 2018, the Company had 1,123 employees, which is 18 employees more than on 31 December 2017.

The Board of the Company adopted the Employment Plan for 2018, which approved the employment of 45 new staff members. In 2018, 12 vacancies were filled that had been approved in the 2017 Employment Plan, and 8 vacancies were filled that were approved in the 2018 Employment Plan.

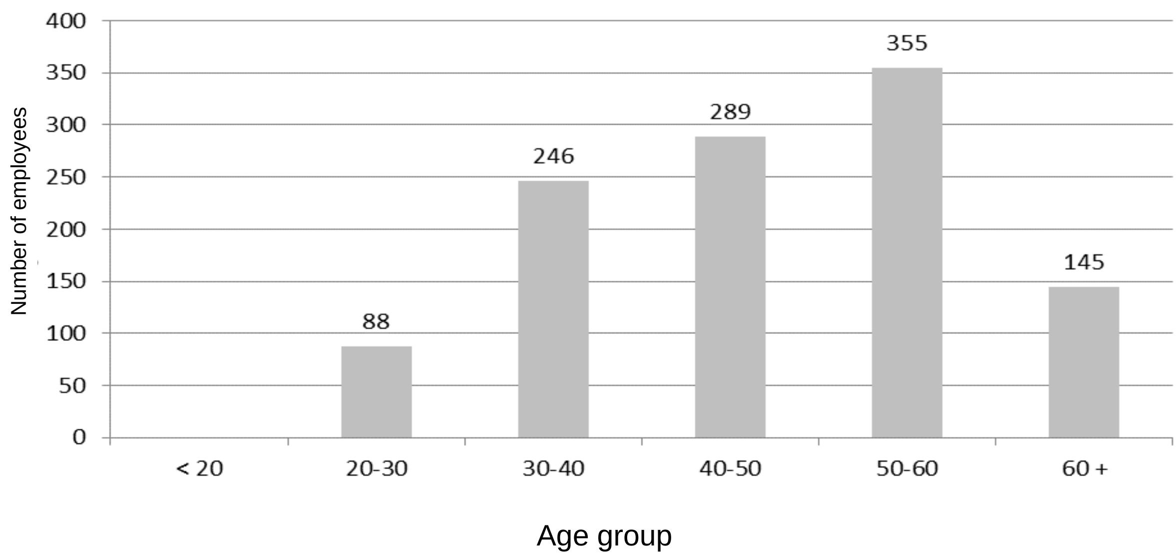
Pursuant to these plans, 20 staff members were hired, and in accordance with the Guidelines on Employment Procedure and the Process of Worker Movement Due to Unplanned Situations and Immediate Threat to EPS Function, 48 new staff members were hired outside the plan. In 2017, 50 staff members left the Company's employment.

Figure 9. Employee qualifications (as of 31 December 2018)



The average age of the employees of the Company as of 31 December 2018 as shown in Figure 10, was 46.7 years.

Figure 10. Employee age distribution (as of 31 December 2018)



6. HEALTH PROTECTION AND SAFETY AT WORK

In 2018, the following activities from the field of occupational safety were carried out:

- Training new workers in safety at work,
- Participation in occupational safety inspections,
- Introduction of external contractors to the work,
- Participation in technical inspections of new and reconstructed buildings,
- Regular inspections and testing of machines and devices with increased hazards,

- Medical check-ups of employees working under special conditions and with computers,
- Procurement of personal protection equipment
- Other activities to increase the safety of the employees and facilities.

In 2018, there were 8 injuries at work (6 at the workplace, 2 on the way to/from work), which was 2 injuries fewer than in 2017. These injuries in 2018 caused a loss of 2160 work hours or 270 work days, which was 5104 work hours or 638 work days less than in 2017.
In 2018, the following fire protection activities were undertaken:

- Inspections and functional testing of fixed fire alarms and fire extinguishing systems,
- Periodic inspections and control of fire extinguishers in all facilities of the Company,
- Multiple training courses for initial fire fighting,
- Fire alarms and fire extinguishing plans were developed for a number of facilities,
- Participation in fire protection inspections,
- Other activities related to fire protection.

Based on the Program of Activities for the implementation of special fire protection measures of interest to the Republic of Croatia in 2018, in the period from March to the end of 2018, additional fire protection measures were implemented in all transmission areas and inspections were carried out by the electric power inspectors and inspectors of the Ministry of the Interior of the Republic of Croatia.

7. ENVIRONMENTAL PROTECTION

Of particular importance to HOPS was the beginning of the preparation of the Environmental and Social Impact Assessment study to strengthen the main North-South energy axis in Croatia's power transmission system and establish a new interconnection between Croatia and Bosnia-Herzegovina (400 kV Lika – Banja Luka transmission line). The study is funded by the EBRD, and it will be prepared to the highest European standards in order to guarantee the optimum environmental protection.

In 2918, units of local self-government (counties and municipalities) prepared numerous development policies and programs, physical plans and amendments to the same. Strategic environmental impact i.e. the need for evaluation and audit of strategic environmental impact studies were assessed. The queries coming from the units of local self-government to HOPS can be categorized as follows:

- Queries to the competent authorities (HOPS) concerning the provision of data for preparing development policies and programs, physical plans and amendments to physical plans,

- Evaluation of the need for strategic assessment – opinion on the need for strategic assessment related to prepared strategic documents,

- Queries about opinion on the content of the study of the strategic environmental impact of the development policies and programs of units of local self-government, and concerning physical plans, when it is found necessary to make a strategic assessment of the environmental impact of an intervention,

- Review of completed development policies and programs, physical plans and strategic environmental impact studies carried out in regard of the mentioned documents, during the public procurement procedure.

HOPS responded to all queries in a timely fashion and with the utmost attention, and thus made the maximum contribution to the protection of environment and nature, simultaneously enabling the development and building of the transmission network in terms of security of customer supply.

Environmental and nature protection is an increasingly demanding area for HOPS due to the continuous development of and frequent changes in the legislative framework, in particular following the process of alignment with EU legislation, resulting in new commitments and expenses. HOPS has provided continuous monitoring and reporting on new regulations in the area of environmental and nature protection on a monthly basis, with special reference to the legal regulations and obligations to be met by HOPS.

In 2018, intensive activities took place in the realization of the goals and improvement of environmental protection, which resulted in the successfully implemented first monitoring audit of the system in accordance with ISO14001:2015. This way HOPS undoubtedly confirmed its commitment to the systematic care for the protection of the environment and nature.

Also, HOPS recognized energy efficiency as one of the most effective ways to achieve the goals of sustainable development, because it contributes to the reduction of greenhouse gas emissions into the environment and thus positively influences climate change. The implementation of energy efficiency measures is important in increasing the security of power supply, and it is the focus of the single energy policy of the EU that aims to reduce the overall power consumption by 20% until 2020 as compared to the base projection.

In 2018, intensive activities were being conducted to reach the goals and improve the power management system, which resulted in the successful first audit of the power management system, according to ISO 50001:2011. This way HOPS unequivocally confirmed its commitment to the systematic care of energy efficiency.

Owing to the active participation of all organizational units of HOPS, the obligations related to the Environment Pollution Register kept with the Croatian Agency for Environment and Nature have been fully realized. The Environment Pollution Register is a collection of data about the source, type, quantity, mode and location of release, transfer and disposal of pollutants and waste into the environment, and it is of the utmost importance that every company responsibly approaching the protection of environment and nature should fulfil all their obligations.

Since HOPS is registered in the "Register of Legal and Natural Persons/Tradesmen engaged in the import/export and marketing of controlled substances and/or fluorinated greenhouse gases, servicing, renewal and use of these substances", it has continued the successful servicing and maintenance of equipment containing the greenhouse gas of sulphur hexafluoride (SF_6). Pursuant to the Regulation on ozone-depleting substances and fluorinated greenhouse gases, HOPS prepared a report on the quantities of controlled substances and fluorinated greenhouse gases used, and submitted it to the Croatian Agency for Environment and Nature.

In 2018, HOPS submitted to the State Bureau of Statistics the form "IDU-OK Investment i Environmental Protection and Expenditures for Goods and Services in the Environment", specifying all its activities and financial expenditures for the protection of the environment and nature.

8. OPERATING RISKS

- **Risks of application and implementation of laws and bylaws**

Particular influences on the operation of the Company are exerted by:

- Decision of the Agency (Class: 310-03/18-25/10, Number: 371-06-18-2) of 13 December 2018 amending the fees for power transmission in 2019, reducing the planned income from power transmission in 2019 by HRK 38 million compared with the plan adopted by the bodies of the Company,

- Rules on the management of ECO BSG regulation the functioning of the ECO Balance-sheet Group, and the obligation to submit the data necessary for planning power generation by the members of ECO BSG, the transmission system operator and the distribution system operator, adopted by HROTE on 31 December 2018, and the beginning of the operation of ECO BSG from 1 January 2019,

- Amendments to the Transmission System Network Rules whose draft was offered for public consultations on the website of HOPS on 4 December 2018,

- Adoption of new and amendment of the existing by-laws with a view to harmonizing them with the provisions of the Guideline on Electricity Balancing (GLEB),

- Amendments to the methodology for establishing the fee for connecting new users to electric power network and increasing the connection power of the existing network users (adopted on 4 April 2018),

- Regulation on Issuing Power Approvals and Determining Terms and Conditions for Network Connection (entered into effect on 1 April 2018),

- Regulation of Network Connection (adopted on 26 April 2018).

The greatest risks for the Company brought about by stronger integration of winf farms in the EPS include:

- Substantial increase in operating costs,

- High dependence of the operating costs on the quality of forecasts concerning the generation of renewable energy conducted by HROTE,

- Uncertain cost (unit price) of the tertiary reserve for balancing,

- Limited possibilities to provide sufficient secondary and tertiary balancing reserves within the EPS of Croatia

- Investment in the necessary transmission network reinforcement.

In the future period, the role of the Agency, with its right to take measures in the event of inappropriate behaviour of energy subjects and to issue approvals to change tariff items, will be extremely important.

Important business decisions and activities of the Company, based on statutory authorization, will depend to a large extent on the Agency's approval.

- **External influences on operating the electric power system**

Operating the EPS in terms of direct impact on the increase in operating costs is influenced by the transit through the Croatian transmission network, which can cause additional losses in the transmission network. This also holds true for supporting services and for balancing electricity, particularly in regard to the problems with charging and collecting for deviations, and the insufficiently developed electricity balancing market. Pursuant to the Rules for

Electricity Balancing System, HOPS and HEP ODS forward the data on the performance of members of the Balance Group to the Croatian Energy Market Operator (HROTE). According to the data received, HROTE prepares the calculation of the deviation of the balance group leaders (hereinafter: BGL). In accordance with the deviation calculations submitted by HROTE, HOPS prepares and submits invoices to BGL. The integration of additional renewable energy sources into Croatian EPS can also significantly influence the increase in supporting service costs and system balancing.

- **Availability and prices of electricity on the European market and hydrological conditions (water inflow)**

Electricity prices are greatly affected by the supply and demand and the available generation capacities in relation to the growing demand for electricity. Availability of generation capacities has a significant impact on the revenues from market functions because it affects electricity flows and transit through the transmission network, and directly the costs of procurement of electricity for the Company's needs.

Hydrological conditions also have a significant impact on the flows, the import-export of electricity; extreme climatic conditions tend to result in an increase in demand and affect the availability of the electric power system, all of which have an impact on related system operating costs throughout the year.

- **Planning and procurement**

Timely adoption and funding of investment plans, and permanent monitoring and alignment of their realization are the basis for the efficient development and maintenance of the transmission system.

For the effective realization of all operating and development plans, the timely organization and conduct of the public procurement procedure play a key role, so this is where special attention is required. A significant risk in this includes appeal procedures, which cannot be anticipated, and which disrupt the planned realization schedule.

The entry into force of the 2016 Public Procurement Act made the procurement process very complex and multidisciplinary, requiring changes in the organization of work and number of allocated staff members in proportion to the scope and complexity of the planned procurements in the coming years. In 2018, the Procurement Department increased its staff numbers, and procurement departments were organised on Transmission Areas. At the beginning of 2019, it was also planned to amend the Company by-laws related to procurement. All this should improve and speed up the procurement process in the Company.

- **Risk of IT system downtime and compromising data security**

One substantial risk in the technological and commercial functioning of the Company lies in the protection of system security i.e. protection against third-party cyber attacks which could result in the unavailability and compromised integrity of the Company IT system, and great attention should be dedicated to this question.

- **Risk of delaying the realization of the SINCRO.GRID project**

The financing of the SINCRO.GRID project and the dynamic plan for its realization were approved for a period of four years. Project delays could cause funding problems, so they represent a risk that needs to be reduced with constant monitoring and control of the project, including corrective measures.

- **Risk of financing the project for the replacement of 110 kV underwater cables**

Considering the highly demanding project and the high level of the necessary investment (about HRK 490 mil.), the cable replacement project is a special challenge and financial burden on the Company. The Company plans to secure most of the funds for this investment (about 70%) as a grant from the EU funds, and failing to do so is a risk to the Company. In such a case, the Company would have to borrow from financial institutions.

- **Risk of increased demand for further connection of wind farms and solar farms to the transmission network**

In 2018, there was great interest in connecting wind farms and solar farms to both the transmission and distribution networks, particularly in the southern part of the electric power system. Due to limited transmission capacities in this area, to connect all of them it will be necessary to make substantial reinforcements and upgrades of the transmission network. With regard to the expected pressure from the investors and institutions and new projects, the Company should prepare multiple scenarios for the new projects in terms of acceptable dynamics of the integration of renewable sources of energy in the system and communication with the investors and the public. Within the mentioned activities, a study was commissioned into the possibilities of the integration of solar farms into the EPS of the Republic of Croatia considering the limitations in the transmission network, which will contribute to the process of integration of the renewable sources of energy into the system.

- **Risk of unsettled legal property relations**

The settlement of legal property relations is the key requirement for the realization of the investment plan. For many reasons, the procedures for their settlement are very complex and long. Since they have a considerable influence on the realization of the investment plan, the Company should dedicate special attention to their settlement.

- **Risk of non-harmonization with the General Data Protection Regulation *(„GDPR“)***

Throughout the EU area, Regulation 2016/679 of the European Parliament and Council on the protection of individuals in regard of personal data processing and free movement of data entered into force (General Data Protection Regulation, GDPR) has been applied since 25 May 2018.

The Company prepared the basic documents and procedures: General Policy for Personal Data Protection, Rules on Personal Data Protection, Rules on Video-surveillance, clauses on personal data protection implemented in contracts (related to public procurement, employment, labour relations, projects financed by the EU), staff education was conducted, all in order to reduce the risk of non-harmonization with the GDPR.

The fact is that very high fines are prescribed for the violation of the GDPR provisions (they can amount up to 4% of the annual global turnover or EUR 20 million, whichever is greater) and the violation of the same is a great financial and business risk for the Company.

The Company is regularly reviewing the existing measures for the protection and harmonization with the GDPR and improving them (staff education, improvement of business processes and IT systems that are in contact with personal data etc.), in order to minimize the risk of non-harmonization with the GDPR.

- **Risks of business environment and regulation**

The risk of the business environment is determined by the political, economic and social conditions in the state and region, which affect the operation and performance of domestic business entities. The energy sector, particularly the regulated activities that include the transmission of electricity, is subject to special regulations laying down the manner and terms of conducting the activity, which in that sense constitute a regulatory risk.

- **Financial risks**

The Management Board of the Company monitors and manages the financial risks (market risk, credit risk, liquidity risk and interest rate risk) related to the operation of the Company.

The situation on the financial markets globally and in Croatia may be a limiting factor in refinancing the existing and securing new credit arrangements to fund the planned investment projects.
The possible increase of EURIBOR may cause increase in the costs of interest on the loans without a contractually agreed fixed interest rate. With respect to new borrowing, the country's risk premium and the credit rating of HEP as a potential provider of funds for the Company's investment are also important, as they affect the margin that financial institutions demand above the reference interest rates.
Long-term and short-term loans are mostly tied to the EUR exchange rates. In the event of depreciation of the value of the Croatian currency (kuna), substantial negative exchange rate exposure is expected, which increases the expenditures and loan repayment increases cash outflow.

9. OBJECTIVES OF THE COMPANY IN THE COMING PERIOD

The Company's core objective is to ensure stable and secure operation of Croatia's EPS and the secure and reliable supply of electricity to customers. In the next ten years, it is realistic to expect a moderate increase in consumption and possible moderate increase in the fee for the usage of the transmission network, which substantially defines the income of the Company. In order to realize its basis tasks and maintain its investment potential, the Company will undertake measures to reduce the overall cost of operation with the emphasis on reducing the costs for auxiliary services, balancing and losses.

The secure and reliable operation of the system will be considerably contributed to by the SINCRO.GRID project as well, which will reduce the excessive voltages in the system and enable more efficient management of the system and further integration of renewable sources of energy.

Considering the economic and technical characteristics, optimal utilization of supporting services, intensive development of the market, the increasing number of market participants and transactions, participation in the electric power exchange with pending market coupling and foreseeable introduction of balancing electricity market let increasing challenges and risks occurr in the operation of the Company. In this sense it is necessary to consider the needs and increase the resources in a timely fashion (personnel, IT support) to be able to successfully rise to the new challenges and risks.

The Company plans activities related to opening the balancing electricity market and supporting services through securing new procurement mechanisms. In 2018, activities are continued in the pilot project of the consumption management with a view to promoting the participation of the network users with devices enabling them to offer supporting services. Also, several projects on the European level are under way to optimize the procurement of the balancing power procurement.

After the completion of the process of adoption of the EU regulations from the package "Clean Energy for All Europeans" that is expected in the spring of 2019, it is necessary to step up the activities to prepare for their implementation on the state, regional and EU levels, autonomously and in cooperation with the Agency and other relevant subjects in Croatia and the EU.

Significant improvements in the medium term, in terms of unification and optimization of the processes related to the operation of transmission system operators, are expected to be achieved through the adoption and application of EU network rules that are directly applicable in all Member States, which will ultimately result in increased supply security and integration of renewable energy resources and further development of the electricity market in the EU.

Procuring energy to cover the losses, in accordance with transparent, non-discriminatory and market-based principles, is one of the HOPS’ duties pursuant to Article 28 of the EMA, and HOPS will continue to systematically monitor, analyse and secure energy to cover the losses in the transmission network by combining long-term and short-term procurement.

For the purpose of an effective resolution of legal property law relations as a basic prerequisite to using the existing and to constructing new transmission network facilities, a special team at the Company level has been appointed systematically to address unresolved issues in this area and report regularly to the Board of the Company. The Company will also propose to the Ministry of Environmental Protection and Energy the necessary amendments to the relevant legislation aimed at systematically addressing this problem for all line infrastructure on the national level.

Following the successful completion of the project of coupling the Croatian and Western European Electricity Market (MRC) together, the activities will focus on selecting the next project for linking the market to some of the remaining neighbours.

The Company will initiate the formalization of SEE CAO integration initiatives with JAO or at least incorporate the remaining borders (Croatia-Bosnia and Herzegovina) into the JAO to optimize the Company's activities for long-term cross-border capacity allocation in accordance with the FCA.

The number of employees at the Company headquarters can be expected to grow, and in the next five years the Company will consider the possibility of building a new operating/office buildings for the Zagreb Transmission Area on the location of the Jarun substation in Zagreb. When the Zagreb Transmission Area is moved to the new location, the buildings at the headquarters of the Company will accommodate all other sectors, which will integrate the premises and processes.

In 2019, the process of restructuring the Company will continue in two phases. During the first phase, the Electricity Market Sector will be established through the process of amending the Rules on the Organization and Systematization of the Company (ROSC) while in the second phase the entire organization of the Company will be regulated in a different way.

Given the technological level of the existing business information system and the increasing needs and requirements regarding efficiency and speed of business processes, a project to replace the business information system is planned in the forthcoming period, which will ensure the optimum operating conditions and efficient and cost-effective business processes in the Company.

As vehicles are a prerequisite to successful performance of activities, the Company will continually renew its fleet with the aim of reducing total maintenance costs and increasing the safety of the Company's employees in traffic.

In the current ten-year network development plan for the period 2018-2027 (as well as the 10-year plan pending Agency's approval), it is important to emphasize several major projects.

This is primarily related to the continuation of the activities in the realization of the SINCRO.GRID project.

Most of this project includes the installation of the compensation facility at SS 400/220/110 kV Konjsko (SVC 250 MVAr), SS 400/220/110 kV Melina (VSR 200 MVAr) and SS 220/110 kV Mraclin (VSR 100 MVAr), with the connection to the 220 kV level for lower expected losses and investment compared to the connection to the 400 kV level. This will take care of the management and maintenance of the permitted voltage profile in the transmission network, specifically in the 400 and 220 kV networks, for a longer period. The project also envisages inclusion of wind farms in the regulation of system voltage via IT infrastructure in the form of a virtual cross-border control centre with the task of coordinated and centralized coordination of the operation of the source of reactive power in the Croatian and Slovenian electric power systems. Also, the system of dynamic thermal rating (DTR) of the lines will make possible, allowing for the weather conditions that directly affect the transmission capacity of the line, to optimally utilize the capacity of the lines and reduce the requirement to build new or replace the existing ones.

Through the construction of a 400 kV semi-ring around the Zagreb network (construction of the 2x400 kV Tumbri-Veleševec transmission line and re-connection to the existing 400 kV lines towards the Žerjavinec and Ernestinovo substations) in the next five-year period, the Company plans to settle the issue of possible overloads and unfavourable short-circuit conditions in the 110 kV transmission network in Zagreb due to possible outages of the 400 kV Tumbri–Žerjavinec transmission line on account of critical levels of transit that are already occurring on this line.

Replacement of the old 110 kV underwater cables between land and Central Dalmatian and Kvarner islands is a priority investment of the Company in the next five-year period. HOPS intends to secure most of the funding for this investment (about 70%) from an EU grant, with appropriate activities being conducted at this time with the competent ministries of the Government of the Republic of Croatia. The project of cable replacement, considering its complexity and investment value, is a special challenge and financial burden on the Company.

In the long-term renewal of the transmission network, great importance is still attached to the project of revitalization of a larger number of the existing 110 kV lines, consisting of the replacement of worn-out parts, particularly conductors, and the necessary increase in their transmission capacity by implementing new technologies.

An important part of the 10-year plan is also the construction of a great number of new substations (e.g. SS 220/110 kV Vodnjan) and the construction of several new 110/x kV substations jointly with HEP–ODS.

At the end of the period under scrutiny, in accordance with the long-term ENTSO-E regional plan for the development of the transmission network in South-East Europe (RG CSE), the beginning of the construction of SS 400/220 kV Lika at Brinje-Brlog is envisaged as a prerequisite to the connection of the planned generation facilities and the future 400 kV interconnection toward BiH (Banja Luka).

The project of the reinforcement of the existing 220 kV network and the construction of a new 400 kV Konjsko–Brinje (Lika)–Melina transmission line will largely depend on the plans for the connection of new generation facilities, particularly wind farms.

10. CONCLUSION

It is evident that in 2018, the Company successfully fulfilled its statutory tasks and obligations, its international obligations and objectives and tasks set out in the Work Program of the Management Board of the Company for the 2018-2022 period.

Electricity in the Croatian EPS is secured with the generation capacities of the Croatian EPS as well as with the import of electricity from neighbouring countries.
In 2018, comparing the available transmission capacities and available generation capacities with the mean hourly loads in the transmission system, the availability of sufficient generation and import capacities is apparent, and it can secure the required quantities of electricity for end-users. However, hydrological conditions at particular times of the year and unavailability and non-competitive prices of TEPPs caused high imports in the Croatian electric power system. In individual supply situations within the Croatia electric power system, the power

sufficiency requirement was not met. During the year, no significant operation events with major power outages were recorded.

Through the mechanisms of ENTSO/E, the Company participates in the analyses of sufficiency in the short-term, medium-term and long-term. Development plans are being continually adjusted to provide security of supply.

For the review of the operation, or for the implementation of the measures and activities based on the established operating objectives in 2018 and further development of the Company in the future, the following were the key activities and events during the year:

- Fulfilling the requirements within the deadlines prescribed in the Certificate Issuance Decision,
- High level of realization of business plans and investment,
- Significant changes in the area of balancing electric power system caused by the entry into force of bylaws,
- Preparing and adopting the 10-year plan (pending approval by the Agency)
- Regular and timely fulfilment of the international obligations of the Company,
- Beginning of the realization of the SINCRO.GRID project that is key to the more efficient operation and running of the electric power system and integration of renewable sources of energy, and
- Successful integration of Croatia's Day-Ahead Market into multi-regional interconnected market for electricity.

The Company's operation and development are being continually adjusted to the goals and tasks set in accordance with the network users' requirements, legislative and regulatory frameworks, and the regional and European settings.

In determining the optimal development of transmission infrastructure in the future period, the Company will continue to pay special attention to:

- Achieving satisfactory level of security of customer supply in the territory of the Republic of Croatia,
- Achieving satisfactory level of reliability, availability and adequacy of the Croatian transmission network for the smooth running of the activities of all participants on the electricity market (generators, retailers and suppliers, and other entities),
- Enabling the connection of new users to the transmission network under equal, transparent and non-discriminatory terms,
- Effecting controlled integration of renewable energy sources into the transmission system; and
- Defining the future transmission network configuration that will be sufficient and flexible enough to allow for the fulfilment of the above-mentioned requirements within the widest range of effects of uncertain influencing factors.

In order to continue to perform successfully, the Management Board of the Company will responsibly and systematically manage its operations and risks. Special attention is focused on maintaining a high level of reliability of the transmission network as national infrastructure of the highest importance to the Republic of Croatia and the high level of security of electricity supply throughout the Croatian transmission system, keeping the operating costs at a reasonable level, and ensuring the timely development of the transmission network through continuous investment.

Zlatko Visković	Mario Gudelj
Member of the Management Board	President of the Management Board

Zagreb, 17 April 2019

Statement of Management's Responsibilities

The Management Board of Croatian Transmission System Operator Ltd., Zagreb, Kupska 4, (hereinafter: "the Company") is responsible for ensuring that the annual financial statements are prepared in accordance with the applicable International Financial Reporting Standards as adopted by the European Union to give a true and fair view of the financial position, the results of operations, the changes in equity and the cash flows of the Company for that period.

The Company separately prepares and issues an annual report in accordance with legal and regulatory provisions.

The Board has a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Board has adopted the going concern basis in preparing the financial statements of the Company.

In preparing those financial statements, the responsibilities of the Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable financial reporting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless such assumption is not appropriate.

The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position and the results of operations of the Company and their compliance with the Croatian Accounting Law and the International Financial Reporting Standards as adopted by EU. The Board is also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Management Board is also responsible for the preparation and content of the Management Report in accordance with Article 21 of the Croatian Accounting Law. The management report presented on pages 1 to 40 and the financial statements were approved by the Management Board on April 17, 2019 for submission to the Supervisory Board.

Signed on behalf of the Management Board:

Zlatko Visković Member of the Management Board	Mario Gudelj President of the Management Board

Croatian Transmission System Operator Ltd.
Kupska 4
10000 Zagreb
Republic of Croatia
17 April 2019

AUDIT
REVIZIJSKE USLUGE, ZAGREB

MOORE STEPHENS
AUDIT ZAGREB

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INDEPENDENT AUDITORS' REPORT

To the owner of CROATIAN TRANSMISSION SYSTEM OPERATOR Ltd.

Report on the audit of the annual financial statements

Opinion

We have audited the annual financial statements of Croatian Transmission System Operator Ltd. ("the Company"), which comprise the statement of financial position of the Company as at 31 December 2018, the statement of comprehensive income, statement of the changes in equity, and statement of cash flows for the year then ended, and notes comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018 and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards as adopted by European Union and published in official gazette of EU ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Accounting Act, Auditing Act and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the annual consolidated financial statements section of our Independent Auditor's Report. We are independent of the Company and in accordance with the Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements of the current period and include identified most significant risks of material misstatement due to error or fraud with the highest impact on our audit strategy, on our resources available and the time spent by the engaged audit team. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<table>
<tr><th colspan="2">Application of IFRS 15 - Revenue from contracts with customers</th></tr>
<tr><td>Description</td><td>How we audited key audit matters</td></tr>
<tr><td>See Accounting policies, Note 2.4. Changes in accounting policies and disclosures, Note 3.1. Recognition of income and Note 31. Other long-term liabilities.

On 1 January 2018 started the application of the International Financial Reporting Standard 15 – Revenue from contract with customers which in the part related to contracts for the connection to the transmission grid replaces IFRIC 18 - Transfer of assets from the customer.
Pursuant to the provisions of IFRS 15, the grid connection is considered to be a non-refundable connection fee and consequently the revenue should be systematically allocated over the useful lifetime period of the built-in asset or the transferred asset used to provide a fixed service and the fees received from the customers has to be recorded as deferred revenue and recognized as the revenue simultaneously with the amortization of the related assets (connection).

Regard to the previous way of recognizing these revenues, on 1 January 2010 the Company adopted the Interpretation of IFRIC 18 "Transfer of Assets from Customers" and in accordance with its provisions, fees received from the customers for the grid connections as of 1 July 2009 were recognised as a revenue in the amount of money received from the customer at the time when the customer is connected to the grid or when it is possible to have a permanent access to the service delivery. In accordance with the transitional provisions of IFRS 15, the Company has adopted the approach to recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of as at 1 January 2018.

Consequently, the cumulative effects of first-time adoption of IFRS 15 are:
- increase in deferred income by the amount of HRK 316,450 thousand
- the increase of deferred tax assets by the amount of HRK 18,445 thousand and
- decrease in retained earnings in the amount of HRK 298,005 thousand

Considering the material impact and complexity of the new IFRS 15 Revenue from contract with customers, this issue was of particular importance for our audit.</td><td>Our audit procedures included, among others:
• communication with management regarding their understanding of the application of the new IFRS 15
• overview of customer contracts (connections) and assessment of the existence and completeness of the population subject to adjustment according to the IFRS 15, based on our knowledge of the Company and the experience of the industry in which it operates
• review of the cumulative effect of the adjustments on 1 January 2018 and the assessment of completeness and accuracy of the calculation
• process design assessment of the transactions calculations in accordance with the new standard and IT system in order to support the implementation of new requirements
• sample based analysis of the connection contracts, focusing on whether the transaction price includes a significant financing component
• review of the adequacy of presentation and disclosure in the annual financial statements.

Based on the above, we have been assured on the accuracy and completeness of the calculation and the presentation and the disclosure of the initial application of IFRS 15 in the annual financial statements for 2018</td></tr>
</table>

Assets under construction	
Description	How we audited key audit matters
See Accounting policies Note 3.5. Property, plant and equipment, Note 4. Key accounting judgements and estimates and Note 17. Property, plant and equipment. The Company has stated in the annual financial statements as at 31 December 2018 assets in preparation in the amount of HRK 494,204 thousand (31 December 2017 in the amount of HRK 502,597 thousand). One of the Company´s main mission is to develop, build and maintain a transmission grid for reliable and sufficient customer service. Investments in the transmission grid are based on the ten-year transmission grid development plan for the period 2018 - 2027. There are mainly multiannual, technically complex projects of high financial value whose completion in the planned time and financial framework depends, among other things, on compliance with the company HEP Operator of Distribution System Ltd. regarding the dynamics of construction and financing. This also affects the complexity of the assets activation and the start of depreciation. Considering the importance of investments in the Company's financial statements, this issue is of particular significance for our audit.	Our audit procedures included, among others: • analysis of the minutes of the Management Board and the Supervisory Board meetings regarding the information related to investment plans and investment project decisions • assessment of the compliance of property, plant and equipment recognition policies with relevant financial reporting standards; • review of the selected sample investment projects by checking contracts, invoices, delivery logs, etc. • analysis of expert sectors explanations on the current status and the anticipated completion of the ongoing investment projects • checking the required disclosures regarding the property, plant and equipment in the financial statements to determine that they are accurate and complete. By our audit procedures, we have been assured that the position of assets in preparation in all material aspects is recorded and disclosed in the the accordance with International Financial Reporting Standards

Litigations and potential liabilities	
Description	How we audited key audit matters
See Accounting policies Note 3.12. Provisions, note 4 Key accounting judgments and estimates and note 30. Provisions in annual financial statements. The Company has stated the provisions for the contingent liabilities due to court cases in which the Company is a defendant on 31 December 2018 in the amount of HRK 23,955 thousand (31 December 2017 in the amount of HRK 25,291 thousand). Due to its specific activity, the Company is exposed to a significant number of long-standing court disputes (eg expropriation compensations, compensation for fire damage, etc.) that require complex assessments with a high level of judgment and uncertainty, which can lead to a significant misstatement of the provision cost. The outcome of the court proceedings is outside the control of the Company, and accordingly the Management Board makes estimates on the outcome of court disputes based on the opinions of the internal legal service and external attorneys representing the Company. Given the significance of the amount and complexity of the outcome assessment process, the issue of court disputes and potential liabilities was of particular significance for our audit.	Our audit procedures included, among others: • compliance assessment of the provision recognition policy for the contingent legal disputes regarding the relevant financial reporting standards; • review of the purpose and nature of the material provisions • analysis of the attorney's response to our written inquiries and other supporting documentation prepared by the Company • review of the previously recorded provision amounts to estimate the accuracy of previous judgments and estimates • review of the required disclosures related to the provisions in the financial statements to determine whether they are accurate and complete. By our audit procedures, we have been assured that the provisions and the cut - off of expenses in all material aspects are recorded and disclosed in the accordance with International Financial Reporting Standards as disclosed in the financial statements.

Other Information

The Company's annual financial statements for the year ended 31 December 2017 were audited by the auditing company KPMG Croatia d.o.o., Zagreb, which in its Independent Auditor's Report of 12 April 2018 issued an unmodified opinion on these annual financial statements.

Other Information in the Annual Report

Management board of Company is responsible for the other presented information. Other information contains the information included in the Annual Report, but does not include the annual financial statements and our Independent Auditor’s Report on these statements.

Our opinion on the annual financial statements does not include other information, except to the extent explicitly stated in the part of our Independent Auditor's Report, entitled Report on Other Legal Requirements, and we do not express any kind of conclusion with assurance on them.

Related to our audit of the annual financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the annual financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstates. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Annual Financial Statements

The Management Board is responsible for the preparation of annual financial statements that give a true and fair view in accordance with IFRS and for such internal controls as the Management Board determines are necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Management Board of the Company is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management Board either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Annual Financial Statements

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Independent Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board of the Company.
- Conclude on the appropriateness of the Management's Board of the Company use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

If we conclude that a material uncertainty exists, we are required to draw attention in our Independent Auditor’s report to the related disclosures in the annual financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Independent Auditor’s report.

- However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with the Group governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal Requirements

Report based on the requirements of Regulation (EU) No. 537/2014

1. On 25 April 2018, the General Assembly of the Company appointed us, based on the proposal of the Supervisory Board, to carry out an audit of the annual financial statements for the year 2018.

2. As at the date of this report, we have been continuously engaged in carrying out the Company's statutory audits, from the audit of the Company's annual financial statements for the year 2018, which is a total of 1 year.

3. In addition to the matters we have included in our Independent Auditor's Report as Key Audit Matters within the subsection Report on the audit of annual financial statements, we have nothing to report in relation to point (c) of Article 10 of Regulation (EU) No. 537/2014.

4. By our statutory audit of the Company's annual financial statements for the year 2018, we are able to detect irregularities, including fraud in accordance with Section 225 Responding to Non-Compliance with Laws and Regulations of the IESBA Code, which requires us, in carrying out our audit engagement, to establish whether the Company complied with laws and regulations that are generally recognized to have a direct impact on the determination of significant amounts and their disclosures in annual financial statements, as well as other laws and regulations that do not have a direct effect on the determination of significant amounts and their disclosures in annual financial statements, but compliance with which may to be the key to the operational aspects of the Company's business, its ability to continue to operate as a going concern or to avoid significant penalties.

Unless we encounter, or find out about, non-compliance with any of the aforementioned laws or regulations that are apparently insignificant, according to our judgment of its content and its influence, financially or otherwise, for the Company, its shareholders and the wider public, we are obliged to inform the Company thereof and request to investigate this case and take appropriate measures to resolve the irregularity and to prevent the reappearance of these irregularities in the future. If the Company on the Balance Sheet date, does not correct irregularities based on which incorrect disclosures in the audited annual financial statements arise that are cumulatively equal to or greater than the amount of materiality to the annual financial statements as a whole, we are required to modify our opinion in the Independent auditor's report.

In the audit of the Company's annual financial statements for the year 2018, we determined the materiality for financial statements as a whole in the amount of HRK 30,850,000, representing approximately 1.8% of sales revenue, because these revenue represent a stable business indicator including key revenues from the activities the Company is engaged in, namely revenue from the transfer of electricity, revenue from the delivered balancing electricity, revenue from the sale of the transmission capacities on the auctions and revenue from the inter-compensation mechanisms.

5. Our audit opinion is consistent with the additional audit report prepared for the Company's Audit Committee in accordance with provisions of the Article 11 of Regulation (EU) No. 537/2014.

6. We have not provided to the Company prohibited non-audit services during the period between the initial date of the Company's audited annual financial statements for the year 2018 and the date of this report. In addition, we have not provided services for the design and implementation of internal control procedures or risk management related to the preparation and / or control of financial information or the design and implementation of technological systems for financial information in the preceding year. Therefore, we have remained independent of the Company in the performance of the audit.

Report based on the requirements of the Accounting Act

1. In our opinion, based on the work that we performed during the audit, the information in the Company's Management Report for 2018 are in accordance with the accompanying annual financial statements of the Company for the year 2018.

2. In our opinion, based on the work that we performed during the audit, the Company's Management Report for 2018, is prepared in accordance with the Accounting act.

3. Based on the knowledge and understanding of the Company and its environment obtained while performing the audit, we have not found that there are material misstatements in the Company's Management Report for 2018.

In Zagreb, 17 April 2019

Audit d.o.o.
Radnička cesta 54
10000 Zagreb

Darko Karić, director

Dubravka Tršinar, certified auditor

Croatian Transmission System Operator Ltd.

Statement of comprehensive income

For the year ended 31 December 2018

(in thousands of HRK)	**Notes**	**2018**	**2017**
Revenue from sales - related parties	*6,34*	1,465,987	1,548,808
Revenue from sales - third parties	*6*	249,151	283,671
Other income - related parties	*34*	843	5,450
Other income – third parties	*7*	39,535	16,350
		1,755,516	**1,854,279**
Materials and spare parts used	*8*	(16,485)	(18,734)
Service expenses	*9*	(178,354)	(177,447)
Personnel expenses	*10*	(184,890)	(180,350)
Depreciation and amortisation	*15,16*	(335,157)	(317,277)
Ancillary services	*11,34*	(294,390)	(310,562)
Transmission grid losses	*11,34*	(177,308)	(116,889)
Purchase of balancing energy	*11,34*	(177,284)	(218,200)
Other expenses – related parties	*34*	(48,201)	(47,449)
Other operating expenses	*12*	(112,115)	(88,868)
		(1,524,184)	**(1,475,776)**
Operating profit		**231,332**	**378,503**
Finance income	*13*	9,074	7,448
Finance costs	*14*	(24,321)	(32,323)
Net finance costs		**(15,247)**	**(24,875)**
Profit before tax		**216,085**	**353,628**
Income tax	*15*	(39,877)	(64,611)
Profit for the year		**176,208**	**289,017**
Other comprehensive income		**-**	**-**
Total comprehensive income for the year		**176,208**	**289,017**

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

(in thousands of HRK)	Notes	31 December 2018	31 December 2017
ASSETS			
Intangible assets	*16*	20,481	20.313
Property, plant and equipment	*17*	6,017,102	5.938.888
Prepayments for property, plant and equipment	*18*	3,617	4.577
Investment property	*19*	4,440	4.403
Investments in associates	*20*	591	-
Financial assets at fair value through other comprehensive income	*21*	40,157	40.157
Receivables from sale of apartments	*22*	1,282	1.893
Deferred tax assets	*15*	46,964	22.861
Total non-current assets		**6,134,634**	**6.033.092**
Inventories	*23*	10,515	11.527
Trade receivables	*24*	30,756	37.698
Receivables from related parties	*34*	314,306	343.986
Other current assets	*25*	36,134	15,911
Short-term financial assets	*26*	15,167	13.318
Cash and cash equivalents	*27*	156,881	144.502
Total current assets		**563,759**	**566.942**
TOTAL ASSETS		**6,698,393**	**6.600.034**
EQUITY AND LIABILITIES			
Subscribed capital	*28*	4,929,195	4.929.195
Reserves	*28*	5,523	5.523
Retained earnings		167,220	289.017
Total equity		**5,101,938**	**5.223.735**
Subloan from and liabilities to related parties	*29*	419,667	501.350
Provisions	*30*	70,457	71.277
Other long term liabilities	*31*	447,923	89.892
Total non-current liabilities		**938,047**	**662.519**
Subloan from related parties (current portion)	*29*	75,898	114.242
Provisions	*30*	1,853	3.983
Trade payables	*32*	241,769	206.933
Payables to related parties	*34*	236,060	308.409
Other current liabilities	*33*	102,828	80213
Total current liabilities		**658,408**	**713.780**
TOTAL EQUITY AND LIABILITIES		**6,698,393**	**6.600.034**

(in thousands of HRK)	**Subscribed capital**	**Reserves**	**Retained earnings**	**Total**
As at 31 December 2016	**4,364,392**	**5,523**	**271,673**	**4,641,588**
Dividend payment to HEP d.d.	-	-	(1)	(1)
Increase of subscribed capital by entering things	293,131	-	-	293,131
Transfer of reinvested profit to subscribed capital	271,672	-	(271,672)	-
Profit for the year	-	-	289,017	289,017
As at 31 December 2017	**4,929,195**	**5,523**	**289,017**	**5,223,735**
First Effect of IFRS 15 on January 1, 2018	-	-	(298,005)	(298,005)
Profit for the year	-	-	(298,005)	(298,005)
As at 31 December 2018	**4,929,195**	**5,523**	**167,220**	**5,101,938**

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

(in thousands of HRK)	**2018**	**2017**
Profit for the year	**176,208**	**289,017**
Adjusted for:		
Income tax	39,877	64,611
Depreciation and amortisation	335,157	317,277
Increase in provisions	(2,950)	8,312
Net finance expense	15,247	24,875
Net book value of assets disposed	9,172	5,885
Increase in provision for inventories	1,632	678
Asset surplus	-	(1,382)
Increase in provision for doubtful receivables, net	(895)	633
Impairment od financial asset	1,409	6,000
Change in fair value of investment property	(37)	6,321
Cash flows from operations before working capital changes	574,820	722,227
(Increase) / decrease in trade receivables	16,331	(21,146)
Decrease / (increase) in receivables from related parties	(162,696)	(190,653)
Decrease / (increase) in other receivables	(7,239)	(5,241)
Decrease in receivables for apartments sold	611	430
Decrease / (increase) in inventories	(831)	1,114
(Decrease) / increase in trade payables	33,120	(10,621)
(Decrease) / increase in liabilities to related parties	(22,553)	(24,471)
(Decrease) / increase in other liabilities	49,795	21,791
Cash flows from operating activities	**481,358**	**493,430**
Interest received	581	636
Income tax (paid)/ received	(44,118)	(1,728)
Increase in prepayments for tangible assets	960	(885)
Investment in associates	(2,000)	(118)
Deposits paid	(4,849)	(2,455)
Loans given	3,000	(3,000)
Purchases of property, plant, equipment and intangible assets	(422,500)	(443,465)
Cash used in investing activities	**(468,926)**	**(451,015)**
Dividends paid to the owner	-	(1)
Interest paid	(53)	(315)
Cash flows used in financing activities	**(53)**	**(1,280)**
Net increase in cash and cash equivalents	12,379	42,099
Cash and cash equivalents at beginning of year	144,502	102,403
Cash and cash equivalents at the end of year	**156,881**	**144,502**

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

1. GENERAL

Croatian Transmission System Operator Ltd., Zagreb (the "Company") is a limited liability company incorporated in the Republic of Croatia in 2005. The founder and sole owner of the Company is Hrvatska elektroprivreda d.d. (the ''Parent Company" or "HEP d.d."), a joint stock company owned by the Republic of Croatia. The Company is registered at the Commercial Court in Zagreb, Republic of Croatia under the registration No, 01924427. The Company had an average of 1,123 employees in 2018 *(2017: 1,105).*

The Company has certain business transactions with other members of the HEP Group, Related party transactions are set out in Note 34.

As at 31 December 2018 HEP Group consists of the following entities:

Members of the Group	**Country**	**Core business activity**
Hrvatska elektroprivreda d.d.	Croatia	Production and distribution of electricity and heat
HEP - Proizvodnja d.o.o.	Croatia	Electricity production
Hrvatski operator prijenosnog sustava d.o.o.	Croatia	Electricity transmission
HEP- Operator distribucijskog sustava d.o.o. (HEP-ODS)	Croatia	Electricity distribution
HEP Opskrba d.o.o.	Croatia	Electricity supply
HEP Elektra d.o.o.	Croatia	Electricity supply
HEP – Toplinarstvo d.o.o.	Croatia	Production and distribution of heat
HEP – Plin d.o.o.	Croatia	Gas distribution and supply
HEP ESCO d.o.o.	Croatia	Energy efficiency projects financing
Plomin Holding d.o.o.	Croatia	Energy production
CS Buško Blato d.o.o.	Bosnia and Herzegovina	Maintenance of hydropower plants
HEP – Upravljanje imovinom d.o.o.	Croatia	Leisure and Recreation services
HEP Telekomunikacije d.o.o.	Croatia	Telecom services
HEP NOC Velika	Croatia	Accommodation and education services
HEP – Obnovljivi izvori energije d.o.o.	Croatia	Electricity production
HEP –Trgovina d.o.o.	Croatia	Electricity trading
HEP – Energija d.o.o.	Slovenia	Electricity trading
HEP – Magyarorszag Energia KFT	Hungary	Electricity trading
HEP– Energija d.o.o. Mostar	BIH	Electricity trading
HEP– Energija d.o.o. Beograd	Serbia	Electricity trading
HEP Energija sh.p.k.	Kosovo	Electricity trading

1. GENERAL (CONTINUED)
Governance and management

General Assembly

The General Assembly consists of the founder`s representative:

Frane Barbarić	President	since January 1, 2018
Perica Jukić	President	from September 12, 2014 till December 31, 2017

Supervisory Board

Members of the Supervisory Board in 2018 and 2017:

Kažimir Vrankić	President	from April 4, 2016
Alina Kosek	Member	from April 4, 2016
Marijan Kalea	Member	from August 26, 2017
Ante Pavić	Member	from April 4, 2016
Sandro Abram	Member (employees representative)	from January 1, 2019
Denis Geto	Member (employees representative)	from May 21, 2014 till March 31, 2018
Dinko Andabaka	Member (employees representative)	from April 1, 2018 till December 31, 2018

Management Board in 2018 and 2017:

Mario Gudelj	President	from April 16, 2018
Zlatko Visković	Member	from April 16, 2018
Ivica Modrić	Member	from April 16, 2018 till April 11, 2019 (see Note 37)
Miroslav Mesić	President	from 2 September 2013 till April 15, 2018
Zdeslav Čerina	Member	from 2 September 2013 till April 15, 2018
Darko Belić	Member	from 2 September 2013 till April 15, 2018

2. BASIS OF PREPARATION

2.1. Statement on Compliance

The financial statements have been prepared in accordance with the Accounting Act and the International Financial Reporting Standards ('IFRS'), which have been adopted by the European Commission and published in the Official Journal of the European Union. The Company does not prepare consolidated financial statements since it uses the exemption in accordance with the International Accounting Standard ("IAS") 27 Consolidated and Separate Financial Statements, as the Company in total is a subsidiary of Hrvatska elektroprivreda d.d., a company incorporated in Zagreb, Croatia. HEP d.d. prepares financial statements that include consolidated financial statements prepared in accordance with International Financial Reporting Standards.

2.2. Basis of the preparation

Financial statements have been prepared by the application of basic accounting presumption of the business event inception upon which the effects of operations are recognised when arisen and are shown in the financial statements for the period to which they relate and with the basic accounting presumption of the going concern.

The financial statements are prepared on a historical cost basis, with the exception of investments in real estate at fair value. The methods used to measure fair value are explained in Note 5 with the annual financial statements.

2.3. Functional and reporting currency

The financial statements are prepared in the Croatian currency, kuna (kn), which is also a functional currency, rounded to the nearest thousand.

The Company's financial statements are prepared in Croatian kuna as the functional and reporting currency of the Company. The financial statements are presented in thousands of Croatian Kuna ('000 HRK'), which, since this is the currency in which most of the Company's business events are reported, is also the functional currency of the Company. At 31 December 2018 the exchange rate for 1 USD and 1 EUR was HRK 6.47 or HRK 7.42 (31 December 2017: HRK 6.27 or HRK 7.51).

2. BASIS OF PREPARATION (continued)

2.4. Changes in accounting policies and disclosures

For the first time, the Company applied the following standards and additions to the annual reporting period beginning on 1 January 2018:

- IFRS 9 Financial instruments
- IFRS 15 Revenues from contracts with customers
- Classification and measurement of share-based payment transactions - IFRS Additions 2
- Annual Improvements for the Reporting Cycle from 2014 to 2016
- Transfer to Real Estate Investment - Amendments to IAS 40
- Interpretation 22 Foreign currency transactions and prepayments

Following the adoption of IFRS 9 and IFRS 15, the Company had to change its accounting policies and implement certain retroactive adjustments. In addition to this, most of the other additions mentioned above did not have any impact on the amounts recognized in previous periods and are not expected to significantly affect current or future periods.

Adoption of IFRS 9 Financial Instruments

At the date of initial change, on 1 January 2018, the financial instruments were as follows:

Category of measurements			**Accounting amount**		
	Original	**New**	**Original**	**New**	**IFRS 9**
(in thousands of HRK)	**(IAS 39)**	**(IFRS 9)**	**(IAS 39)**	**(IFRS 9)**	**effect**
Long term assets					
Equity instruments	Available for sale	Fair value through other comprehensive income	40,157	40,157	-
Receivables from the sales of apartments	Amortised cost	Amortised costs	1,893	1,893	-
Current Assets					
Receivables from customers and other receivables	Amortised cost	Amortised cost	397,595	424,320	-
Bank's deposit	Amortised cost	Amortised cost	15,911	15,911	-
Cash and cash equivalents	Amortised cost	Amortised cost	144,502	144,502	-
Total					**-**

In July 2014, the International Accounting Standards Board issued the International Financial Reporting Standard (IFRS 9) "Financial Instruments". The application of the standard is mandatory for reporting periods beginning on or after 1 January 2018. The Standard introduces a new look at the classification and measurement of financial instruments and replaces IAS 39. The Company adopted the IFRS 9 Financial Instruments Standard as at 1 January 2018, and the first and continuous application of the Standard did not have any significant impact on the annual financial statements. Significant new accounting policies applied in the current period are disclosed in Note 3.13. and 3.14 to the annual financial statements and in Note 5. to the annual financial statements.

2. BASIS OF PREPARATION (continued)

2.4. Changes in accounting policies and disclosures (continued)

Adoption of IFRS 15 Revenues from contracts with customers

By adopting IFRS 15, there have been changes in accounting policies and adjustments of the annual financial statements related to the recognition of the revenue from grid connections. According to this standard, revenue arising from the payment of a network connection fee is linked to a future network usage agreement and electricity supply contract and should be systematically allocated over a period of useful life of the built-in or transferred asset used to provide permanent service, the remuneration received from the customers has to be recorded as deferred income and recognized as the income of the period at the same time as the depreciation of the assets to which it refers. Related to the current way of recognizing these revenues, on 1 January 2010, the Company adopted the Interpretation of IFRIC 18 "Transfer of Assets from Customers" and in accordance with its provisions, compensation received from customers for grid connection as of 1 July 2009 are recorded as income, in the amount of money received from the customer at the time the customer is connected to the grid or when it is possible to have a permanent access to the delivery of the service. Until the adoption of IFRIC 18 "Transfer of Assets from Customers", the connection fees, were allocated through the expected useful life of the asset, which is the policy that was continued to be applied after the adoption of IFRIC 18 "Transfer of Assets from Customers" for connection fees received before 1 January 2010.

Pursuant to the provisions of IFRS 15 due to the link between the connection agreement and a contract for the electricity supply, for the assets recognised in accordance with IFRIC 18 which has not yet been fully depreciated were carried out adjustments of the retained earnings for part of the revenue that is recognized at the time of connecting to the grid, which means connections recorded in the period from 1 July 2009 to 31 December 2017.

Applying point C3. (b) IFRS 15 related to the t retrospective application with cumulative effect on the initial application of Standard as at 01 January 2018, the Company has as at 31 December 2018 restated opening balances as at 1 January 2018 on following positions: deferred income was increased by HRK 316,450 thousand, deferred tax assets were increased by HRK 18,445 thousand and accumulated losses were recorded in the amount of HRK 298,005 thousand.

At the date of first application on 1 January 2018 to the Statement of the financial position / Balance sheet following adjustments were made:

	IAS 18/ IFRIC 18 Accounting amount	**IFRS 15 First application effects**	**IFRS 15 Accounting amount**
	31 December 2017		**1 January 2018**
	in thousands of HRK	in thousands of HRK	in thousands of HRK
Deferred tax assets	22,861	18,445	41,306
Other long-term liabilities (Deferred income for assets received free of charge)	70,093	316,450	386,543
Retained earnings	289,017	(298,005)	(8,988)

2. BASIS OF PREPARATION (continued)

2.4. Changes in accounting policies and disclosures (continued)

Adoption of IFRS 15 Revenues from Customer Contracts (continued)

The effects of adoption of the IFRS 15 in relation to the application of IAS 18 / IFRIC 18 on the Statement of the financial position / Balance sheet are presented in the following table:

	2018.	2018.	Difference
(in thousands of HRK)	IFRS 15	IAS 18/IFRIC 18	
Intangible assets	20,481	20,481	-
Property, Plant and Equipment	6,017,102	6,017,102	-
Advances for PP&E	3,617	3,617	-
Property investment	4,440	4,440	-
Investments in affiliated companies	591	591	-
Financial assets at fair value through other comprehensive income	40,157	40,157	-
Receivables from the sales of apartments	1,282	1,282	-
Deferred tax assets	46,964	28,519	18,445
Total non-current assets	**6,134,634**	**6,116,189**	**18,445**
Inventory	10,515	10,515	-
Accounts receivables	30,756	30,756	-
Receivables for affiliated companies	314,306	314,306	-
Receivables for corporate income tax	12,984	2,285	10,699
Other current assets	23,150	23,150	-
Given deposits and loans	15,167	15,167	-
Cash and cash equivalents	156,881	156,881	-
Total current assets	**563,759**	**553,060**	**10,699**
TOTAL ASSETS	**6,698,393**	**6,669,249**	**29,144**
Subscribed capital	4,929,195	4,929,195	0
Reserves	5,523	5,523	0
Retained earnings	167,220	513,958	(346,738)
Total capital	**5,101,938**	**5,448,676**	**(346,738)**
Loans to affiliated companies	419,667	419,667	0
Provisions	70,457	70,457	0
Other long-term liabilities	447,923	85,459	362,464
Total long-term liabilities	**938,047**	**575,583**	**362,464**
Loans to affiliated companies	75,898	75,898	0
Reservations	1,853	1,853	0
Accounts Payables	241,769	241,769	0
Liabilities to affiliated companies	236,060	236,060	0
Other short-term liabilities	102,828	89,410	13,418
Total short-term liabilities	**658,408**	**644,990**	**13,418**
TOTAL CAPITAL AND LIABILITIES	**6,698,393**	**6,669,249**	**29,144**

2. BASIS OF PREPARATION (continued)

2.4. Changes in accounting policies and disclosures (continued)

Adoption of IFRS 15 Revenues from contract with customers (continued)

The effects of adopting IFRS 15 in relation to the application of IAS 18 / IFRIC 18 on the Statement of comprehensive income are presented in the following table:

(in thousands of HRK)	2018 IFRS15	2018 IAS 18/IFRIC 18	Difference
Sales Revenues - Affiliated Companies	1,465,987	1,527,419	(61,432)
Sales Revenues - outside the Group	249,151	260,569	(11,418)
Other operating income - affiliated companies	843	843	0
Other operating income - outside the Group	39,535	26,117	13,418
	1,755,516	**1,814,947**	**(59,431)**
Used material and spare parts	(16,485)	(16,485)	-
Service Costs	(178,354)	(178,354)	-
Staff costs	(184,890)	(184,890)	-
Depreciation cost	(335,157)	(335,157)	-
Auxiliary service costs	(294,390)	(294,390)	-
Costs of Losses on transmission network	(177,308)	(177,308)	-
Costs of electricity supply	(177,284)	(177,284)	-
Other costs - affiliated companies	(48,201)	(48,201)	-
Other operating expenses	(112,115)	(112,115)	-
	(1,524,184)	**(1,524,184)**	-
Profit or loss for the year	**231,332**	**290,763**	**(59,431)**
Financial revenue	9,074	9,074	-
Financial expenses	(24,321)	(24,321)	-
Net loss from financial activities	**(15,247)**	**(15,247)**	-
Profit before taxation	**216,085**	**275,516**	**(59,431)**
Current tax	(39,877)	(50,575)	10,698
Profit for the current year	**176,208**	**224,941**	**(48,733)**
Other comprehensive profits	**-**	**-**	**-**
Total comprehensive profits	**176,208**	**224,941**	**(48,733)**

2. BASIS OF PREPARATION (continued)

2.4. Changes in accounting policies and disclosures (continued)

Adoption of IFRS 15 Revenues from Customer Contracts (continued)

Impact of IFRS 9 and IFRS 15 adoption on retained earnings of the Company as of 31 December 2017 and 1 January 2018 is as follows:

	in thousands of HRK
Retained earning as at 31 December 2017	**289,017**
Recognition of deferred income from the connection fee	(298,005)
Total efect of IFRS 15	(298,005)
Total efect of IFRS 9	-
Retained earning as at 1 January 2018	**(8,988)**

2.5 New standards and interpretations of published standards that have not yet been adopted

Several new standards and guidelines have been published that are not mandatory for reporting periods ending on 31 December 2018 and which the Company has not early adopted. These standards and interpretations are not expected to have a significant impact on the Company's financial statements.

- **IFRS 16 - Leases (effective for annual periods beginning on or after 1 January 2019)**

In January 2016, the Board for International Accounting Standards issued IFRS 16 "Leases". The standard is in effect for the first time for the annual periods beginning on or after 1 January 2019. IFRS 16 defines the rules for recognition, measurement, presentation and disclosure for the leases from the aspects of both parties, i.e. the buyer (the "lessee") and the supplier (the "lessor"). In accordance with the new standard, the lessees need to recognize most of the leases in their financial statements. A single accounting model will be applied to all leases, with certain exceptions. Accounting treatment of leases by the lessor will not be significantly altered. Management of the Company has decided not to apply new standard for leases retroactively completely but to use directive on exemption for lessee. During the transition to the new standard, the obligation to pay on the basis of existing operating leases will be discounted using appropriate incremental borrowing rate and will be recognized as a lease liability. The property with right of use will display the amount of the lease obligation adjusted for the amount prepaid or accrued payment for lease.

Management estimates that application of new standards as of 1 January 2019 will not have significant material effects on the Company's financial statements.

Most of the Company's leases refers to the lease of business premises and other real estates.

2. BASIS OF PREPARATION (continued)

2.5. New standards and interpretations of published standards that have not yet been adopted (continued)

• IFRS 17: Insurance contracts

The Standard is effective for annual periods beginning on or after 1 January 2021. Earlier application is permitted if IFRS 15 Revenues from Customer Agreement and IFRS 9 Financial Instruments have been applied. IFRS 17 Insurance contracts establish principles for recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The purpose of IFRS 17 is to ensure that the entity provides relevant information that faithfully represents such contracts. These data provide the basis for the users of the financial statements to assess the effect of the insurance contract on the financial position, financial result and the cash flows of the entity. This interpretation has not yet been adopted in the European Union.

• Prepayment features with negative compensation (Amendments to IFRS 9)

Amendments shall enter into force for annual periods commencing on or after 1 January 2019 with the prior consent being allowed. Existing requirements in IFRS 9 related to cancellation rights to allow measurement at amortized cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negligence.

• Long-term interests in associates and joint ventures (Amendments to IAS 28)

The Amendments shall be in effect for the annual periods beginning on or after January 1 2019, with earlier implementation permitted. The Amendment clarifies that an entity applies IFRS 9, including its impairment requirements, to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied. These amendments have not yet been adopted in the European Union.

2. BASIS OF PREPARATION (continued)

2.6. Use of estimates and judgments

The preparation of financial statements in accordance with IFRS requires Management to make judgments, estimates and assumptions that affect the applied policies and disclosed amount of assets and liabilities, revenue and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are considered to be reasonable in the circumstances, the results of which is starting point for estimating the carrying values of assets and liabilities that can not be obtained from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized 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.

Judgments made by Management in the application of IFRS that have significant effect on the financial statements and estimates with a high risk of materially significant corrections in the next periods are disclosed in Note 4.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied by the Company to all periods presented in these financial statements.

3.1. Revenue recognition

The main activity of the Company is the management of the power system and transmission system of the Republic of Croatia with interconnected transmission systems, ie the distribution system in the Republic of Croatia.

In accordance with the new IFRS 15, the Company applies a five-step model for recognizing a customer agreement:

1. Establish a contract with the buyer,
2. Determine delivery obligations in the contract,
3. Determine the transaction price
4. Assign the transaction price to the contract delivery obligations
5. Recognize revenue when (or how) a subject fulfils the obligation to deliver.

Revenue is recognized for each separate contract delivery obligation in the amount of the transaction price. The transaction price is the amount of contractual remuneration that the Company expects to be entitled to in return for the promise of the promised merchandise or customer service.

The new standard did not have a significant impact on the recognition of revenue from the fee for the use of the transmission network, ITC income, cross-border transmission capacity revenues and revenue from balancing or revenue recognition, at the same time as it was in force at IAS 18 Revenue. However, as explained below, it had a significant impact on the recognition of revenue from the connection due to substantially different revenue recognition treatment in relation to IFRIC 18 - Transfer of assets from the buyer that the Company applied to. January 1, 2018.

Revenue from use of transmission network fee

Since 2016, the Company's remuneration is based on energy sales data generated by customers, the Methodology for determining the tariff items for electricity transmission and the Decision on the amount of tariff items for the transmission of electricity by the Croatian Energy Regulatory Agency (HERA). In 2017 and 2018, the company recognizes revenue in the same way as in 2016. On December 13, 2018, HERA issued a Decision amending the tariff items for electricity transmission in 2019.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1. Revenue recognition (continued)

ITC Agreement Revenue

The Company, as a Transmission System Operator (TSO), signed an ITC Clearing and Settlement Agreement, under which it generates revenue as a compensation for losses incurred on transit of electric energy. Revenues generated by applying the ITC mechanism are determined on the basis of the methodology established by European Transmission System Operators (ETSO), pursuant to the Regulation (EC) No 1228/2003 of the European Parliament and of the Council on conditions for access to the network for cross-border exchanges in electricity.

Revenue from the cross-border transfer capacity

During 2017 and 2018, the bilateral and multilateral allocation of cross-border transmission capacities at the borders of the Republic of Croatia with adjacent transmission operators shall take place in accordance with the specific rules on allocation of cross-border transmission capacities, separately for one or more borders and in accordance with the rules on the use of cross-border transmission capacities regulating capacity utilization borders with neighboring system operators.

Revenue from sales of balancing energy

In the year 2015 the Company's revenue from balancing energy were realized through the sale of balancing energy to the entities responsible for the deviation in accordance with the applicable Rules on balancing the electric power grid, Methodology for determining the Balancing Electricity cost for the entities responsible for the deviation and Balancing electricity agreements concluded with the entities responsible for the deviation and in accordance with Annexes 1 to 5 of the Auxiliary Services Contract signed with HEP Proizvodnja d.o.o.

In the period till 1 September 2016, the Company recognized balancing energy revenues in the same way as in the year 2015, but due to changes in the bylaws since 1 September 1 2016, the Company generates revenues from balancing energy by selling balancing energy to the Balance Group Managers (BGM) in accordance with the applicable Rules on balancing the electric power grid, the Methodology for determining the price for the balancing energy calculation and Discontinuance Liability Contracts signed with the BGMs, and in accordance with Annexes 1 to 5 of the Auxiliary Services Contract signed with HEP Proizvodnja d.o.o.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1. Revenue recognition (continued)

From the 1 January 2017, the Company generates revenue from balancing and balancing energy services through the electricity sales to the Heads of Balance groups (VBGs) in accordance with the applicable Electricity Balancing Rules, the Methodology for determining the price for the balancing energy calculation, Discontinuance Liability Contracts signed with the Heads of Balance groups, and in accordance with a set of Auxiliary services contracts signed with HEP Proizvodnja d.o.o.

Revenues from connection fees - application of the new International Financial Reporting Standard 15 Revenue from contracts with customers

Until 1 January 2010 connection fees received from customers were deferred and recognized as revenue over the expected useful life of asset, i,e, connection fee. Such policy is still used for connection fees received before 1 January 2010.

The Company has adopted as of 1 January 2010 IFRIC 18 ''Transfers of Assets from Customers'' which is in accordance with Croatian regulations. IFRIC 18 clarifies the requirements of IFRS related to recognition of the contracts in which an entity receives an item of the property, plant and equipment from the customer or money for their construction that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. When the item of property, plant and equipment transferred from a customer meets the definition of an asset the Company must recognize the asset in its financial statements.

As a result, since 1 July 2009 the connection fees received from customers are recognized as revenue when the customer is connected to the network or is provided with ongoing access to a supply of services.

At 1 January 2018 the International Financial Reporting Standard 15 has come into force (furthermore IFRS 15) Revenues from contract with customers which replaces IFRIC 18 related to the contract for transmission network connections. In accordance with IFRS 15, the network connection is considered to be a non-refundable network connection fee which is linked to the future network usage agreement and the electricity supply contract. Consequently, the period of the revenue recognition from the connection fee is extended after the initial contractual period since the customer after the realization of the connection contract has acquired the right to use the transmission grid and electricity supply. Revenue should therefore be systematically allocated over the period of useful life of the constructed asset or transferred asset used for providing permanent services and the connection fees received from the customers recorded as deferred income and recognized as the income of the period at the same time as the depreciation of the assets (connection) to which it refers.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1. Revenue recognition (continued)

Since the mentioned provisions of the standard are a change of the current method of recognising the revenue from the connection fee and the return on revenue recognition before 2009 and the adoption of IFRIC 18, the standard requires retroactive application. Based on the above, as explained in Note 2.4. Company recognised the cumulative effect of the initial application of this Standard as a adjustments of the initial balance of the retained earnings, the deferred tax assets and the deferred income. Pursuant to the provisions of IFRS 15, given the inseparability between the connection contract and the electricity supply contract, for assets recognized under IFRIC 18 which have not yet been fully depreciated, retained earnings have been restated for the part of the revenue recognized at the time of the connection to the grid, which relates to the connections recorded in the period of 1 July 2009 till 31. December 2017.

For the period on 31 December 2018, Company revised the 1 January 2018 in the following positions: deferred income increased by HRK 316,450 thousand, deferred tax assets increased by HRK 18,445 thousand, the transferred loss was recorded in the amount of HRK 298,005 thousand.

The Company for the period ended ast at 31 December 2018 has restated opening balances as at 1 January 2018 for the following positions: deferred income was increased by HRK 316,450 thousand, deferred tax assets was increased by HRK 18,445 thousand, the accumulated losses stated in the amount of HRK 298,005 thousand.

Finance income

Finance income comprises interest income on funds invested, change of fair value on financial assets at fair value through profit and loss and foreign currency gains. Interest income is recognised on a time-proportion basis using the effective interest method. Dividend income is recognised when the right to receive payment is established.

3.2. Transactions and balances in foreign currency

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

Non-monetary assets and items that are measured based on historical cost in a foreign currency are not translated using new exchange rates. Non-monetary assets and liabilities that are measured based on a historical cost in a foreign currency are translated using the exchange rate at the date of transaction.

3.3. Leases

The Company does not have finance lease agreements with third parties. Leases where the significant portion of risks and rewards of ownership are not retained by the Company are classified as operating leases. Payments made under operating leases are charged to the Statement of the comprehensive income on a straight-line basis over the period of the lease.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4. Intangible assets

Non-current intangible assets include software and leasehold improvements regarding rights of usage and are capitalised to the extent that future economic benefits are probable and will flow to the Company. Subsequent expenditure on capitalised intangible assets is capitalised only if it is probable that it increases the future economic benefits embodied in the specific asset to which it relates and those benefits will flow to the Company. All other expenditure is recognised in the profit or loss as an expense as incurred.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets are amortised from the date on which they are available for use.
The estimated useful lives of intangible assets are as follows:

Software	5 years
Leasehold improvements regarding rights of usage	25 years

3, SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5. Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and any accumulated impairment losses. Cost includes the purchase price and directly associated cost of bringing the asset to a working condition for its intended use.

Assets under construction are not depreciated. Depreciation of buildings, plant and equipment is calculated using the straight-line method to allocate their cost over their estimated useful lives as follows:

Buildings (real estate and construction elements of buildings and facilities for the transmission of electricity)	10-40 years
Equipment (plant equipment and facilities for the transmission of electricity)	5-40 years
Other equipment (office equipment and data centers, furniture and motor vehicles)	5-20 years

The estimated useful life is reviewed at each reporting date and adjusted if appropriate. If the carrying amount of the asset exceeds the estimated recoverable amount, the difference is written off to the recoverable amount.

Gains and losses on disposals are determined as the difference between the income from the disposal and the carrying amounts of the asset disposed, and are recognised in profit or loss within other income/expenses.

Subsequent expenditure is included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the Statement of comprehensive income during the financial period in which they are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard performance, the expenditures are capitalised as an additional cost of property, plant and equipment. Costs eligible for capitalization include costs of periodic, pre-planned significant inspections and overhauls necessary for further operation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Impairment of non-financial assets

At each reporting date, the Company reviews the carrying amounts of its non-financial assets (apart from inventory and deferred tax assets which are separately reviewed) to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined net of depreciation or amortisation had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Investment property

Investment property comprises properties held to earn rentals or for capital appreciation, or both. Inbuilt equipment is considered part of the investment property. Cost includes all expenditure directly related to the acquisition of the asset. Investment property under construction is classified as non-current tangible assets until it is ready for use. Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is measured at fair value. Gains and losses arising from changes in the fair value of investment properties are included in profit or loss in the period in which they arise.

Subsequent expenditure for investment property is capitalised only if it is probable that it increases the future economic benefits embodied in the specific asset to which it relates and it can be reliably measured. Regular maintenance expenditure is recognised in income statement as an expense as incurred. Costs of replacing an item of property investment are recognized in the carrying amount of this asset if it is probable that the future economic benefits included in that item will flow to the Company and their value can be measured reliably. The costs of regular maintenance of real estate investments are recognized in the income statement as they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use as well as when no future economic benefits are expected from the disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

3.8. Investments in associates

(i)Subsidiaries

Subsidiaries are all companies (including special purpose companies) over which the Company has control over financial and business policies, which normally includes more than half of the voting rights. The existence and the effect of potential voting rights that can be used or replaced are considered when assessing whether the Company has control over another business entity. Investments in subsidiaries are initially recognized at cost and subsequently at cost less impairment. Testing of investments in subsidiaries for impairment is carried out on an annual basis (accounting policy 3.13).

(i) Associates

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for initially at cost and subsequently at cost less impairment losses, Investments in associates are tested annually for impairment (accounting policy 3.13),

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.9. Inventories

Inventories comprise mainly electro materials, spare parts for electro material and low value items and are carried at the lower of cost, determined using the weighted average price less allowance for obsolete inventories and the net realisable value. Cost comprises the invoiced amount as well as all other costs directly attributable to brining inventories to their present location and condition in which they are readily available for use. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

The Management adjusts the value of inventory based on a review of the overall ageing structure of inventories, as well as of individual significant amounts of inventories. Low value items and tools are expensed when put into use.

3.10. Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid instruments with original maturities of three months or less,

3.11. Employee benefits

(i) Pension obligations and post-employment benefits

In the normal course of business through salary deductions, the Company makes payments to the mandatory pension funds on behalf of its employees as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred. The Company is not obliged to provide any other post-employment benefits with respect to these pension schemes.

This obligation applies to all staff hired on the basis of employment contract. The contributions are paid at a certain percentage determined on the basis of gross salary. Contributions on behalf of the employees and the employer are accounted for as the expense for the period in which they arise (see Note 10),

	2018.	**2017**
Pension insurance contributions	20%	20%
Health insurance contributions	15%	15%
Employment Fund contribution	1.7%	1.7%
Occupational injury	0.5%	0.5%

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11. Employee benefits (continued)

(ii) Termination benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits as expenses when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(iii) Regular retirement benefits

Retirement benefits falling due more than 12 months after the reporting date are discounted to their present value based on the calculation performed at each reporting date by an independent actuary, using assumptions regarding the number of staff likely to earn regular retirement benefits, estimated benefit cost and the discount rate which is determined as average expected rate of return on investment in government bonds of the Republic of Croatia which are quoted on the market and their currency and maturity dates are in accordance with currency and estimated duration of liabilities for the benefit payment. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in profit or loss.

(iv) Regular retirement benefits

Under current Collective Agreement (effective from 1 January 2018), employees are entitled to a retirement benefit to the extent of 1/8 of the average gross monthly salary earned in the period of three months prior to the retirement for each completed year of continuous employment at the employer. This Collective Agreement was valid until 31 December 2019.

(v) Long-term employee benefits

The Company recognises a liability for long-term employee benefits (jubilee awards) evenly over the period the benefit is earned based on actual years of service. The long-service benefits range from HRK 1,500 to HRK 5,500 net and are provided for a discontinued tenure from 10 to 45 years. The long-term employee benefit liability is determined annually by an independent actuary, using assumptions regarding the likely number of staff to whom the benefits will be payable, estimated benefit cost and the discount rate which is determined as the average expected rate of return on investment in government bonds. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11. Employee benefits (continued)

(vi) Short-term employee benefits

The Company recognises a liability for employee bonuses where contractually obliged or where there is a past practice that has created a constructive obligation.

3.12. Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. Where the effect of discounting is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation, determined using the estimated risk free interest rate as the discount rate. Where discounting is used, the reversal of such discounting in each year is recognized as a financial expense and the carrying amount of the provision increases in each year to reflect the passage of time.

3.13. Financial assets

The Company has adopted IFRS 9 - Financial Instruments as at 1 January 2018 and its application has not had a significant impact on the Company's financial statements.

The Company recognizes financial assets in its financial statements when it becomes party to the contractual provisions of the instrument. Depending on the business model for asset management and contractual features of financial flows, the Company measures financial assets at amortized cost, fair value through other comprehensive income or fair value through profit or loss.

The Company classifies assets as shown below:

DESCRIPTION	Classification / Measurement
Non-current assets	
Financial assets through other comprehensive income	Equity instruments / The fair value through other comprehensive income
Loans given	Hold to collect / amortized cost
Current assets	
Cash and cash equivalents (deposits)	Hold to collect / amortized cost
Receivables from customers and others	Hold to collect / amortized cost

The Company's business models reflect the way in which the Company manages assets, with the aim to generate cash flows.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13. Financial assets (continued)

The business model reflects the way in which the Company manages assets to generate cash flows - whether the Company's objective is (i) solely the collection of contractual cash flows from assets ('holding due to contractual cash flows') or (ii) cash flows and cash flows arising from the sale of assets ('hold due to contractual cash flows and sales') and if none of the above items is applicable, financial assets are classified as part of another business model and are measured at fair value through profit or loss.

i) Financial assets through other comprehensive income

Initial Recognition

The Company recognize a financial asset or liability when and only when it becomes a party to the contractual provisions of the instrument. The Company initially recognizes financial assets at fair value plus transaction costs that can be attributed directly to the acquisition or issue of a financial asset. Equity instruments include strategic investments. Valuation of equity instruments is measured through other comprehensive income (FVOCI) without subsequent reclassification to the profit or loss. The reason for this is that in strategic investments, priority is not the short-term maximum increase in profits. Acquisition and sales of strategic investments are based on business policy considerations. Dividends are recognized in the profit or loss t if they do not represent repayment of principal.

Subsequent measurement

After initial recognition, the Company measures financial assets at fair value through other comprehensive income.

ii) Loans

Company loans are held within a business model whose purpose is to hold a financial asset in order to collect contractual cash flows. Contractual terms at a particular date are cash flows that represent only payments of principal and interest. At that, the principal is the fair value of the asset at initial recognition.

Based on the above, the given loans were measured at amortized cost.

Measurement at amortized cost implies the following;

- Interest revenue is calculated by using the effective interest method to the gross carrying amount of a financial asset.

iii) Accounts receivables

Receivables from customers that do not have a significant financial component at initial recognition have been measured in accordance with IFRS 15 at their transaction price.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13. Financial assets (continued)

i) Impairment

The Company recognizes a loss allowance for expected credit losses. At each reporting date, the Company measures expected credit losses and recognizes the same in the financial statements.

Expected credit losses from financial instruments are measured in a manner that reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes
- Time value of money
- Reasonable and supportable information about past events, current conditions and forecasts of future economic conditions

Regarding trade receivables, the Company applies a simplified approach allowed by IFRS 9 to measure expected credit losses by using expected provisions for credit losses.

To measure anticipated trade receivables losses, the Company has by analysing the age structure and historical data determined potential future losses

By analysing the age structure, it has been determined that the Company does not have significant due receivables, the most significant part of the receivables is not due for payment so the Company estimates that it will be fully collected. No significant credit losses have been identified.

Derecognition of the financial assets

The Company ceases to recognize financial assets when:

- the contractual rights to the cash flows from the financial asset expire
- it transfers the financial asset and the transfer qualifies for derecognition

The Company transfers a financial asset if, and only if, it either
(a) transfers the contractual rights to receive the cash flows of the financial asset, or
(b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement

When the Company transfers a financial asset, it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case when substantially all the risks and rewards of ownership of the financial asset are transferred, the Company derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.

If the Company neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, it has to determine whether it has retained control of the financial asset.

If the Company has not retained control, it derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13. Financial assets (continued)

If the Company has retained control, it continues to recognise the financial asset to the extent of its continuing involvement in the financial asset.

3.14. Financial liabilities

Initial recognition and measurement

Financial liabilities are classified as financial liabilities that are measured at amortized cost. All financial liabilities are initially recognized at fair value plus the associated transaction costs. The Company's financial liabilities include liabilities to suppliers and other liabilities, overdrafts and loans.

Subsequent measurement

After initial recognition, interest-bearing loans and loans are subsequently measured at amortized cost using the effective interest rate method.

Borrowing costs that can be directly linked to the acquisition, construction or production of a qualifying asset, that necessarily requires a considerable amount of time to be ready for intended use or sale, are attributed to the cost of purchasing that asset, until the asset is available to use or sale. Borrowings are classified as short-term liabilities, unless the Company has the unconditional right to postpone the obligation to pay at least 12 months after the reporting date. Short-term lending and supplier loans are shown on the original borrowed amount deducted for repayments. The interest expense is charged to the profit and loss account for the period to which the interest relates.

Derecognition

The Company ceases to recognize the liability in the financial statements when, and only when, it is extinguished. In case when existing financial liability is replaced with new financial liability with substantially different terms or a substantial modification of the terms of an existing financial liability it is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability and the difference between the carrying amounts is recognized in the profit and loss.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.15. Subscribed capital and capital reserves

Subscribed capital is stated in Croatian kuna at nominal value. Capital reserves are formed in accordance with the Companies Act and the Articles of association of the Company, based on cash payment and contribution in kind by the owner.

3.16. Dividends

Dividend distribution to the Company's owner is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's General Assembly.

3.17. Accounting presentation lease – Company as a lessee

Leases of assets where the Company accepts almost all benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the estimated present value of the related lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the balance outstanding. Corresponding obligation for rent, net of financial expenses is recorded within the long-term liabilities. The interest element of the finance costs is charged to profit or loss over the lease period. Assets acquired by a finance lease are depreciated over their useful lives. Leases of assets under which the benefits and risks of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the lease term. If an operating lease is terminated before the expiry of the lease, all payments to the lessor in the form of penalty is recognized as an expense in profit or loss in the period in which there has been a cancellation.

3.18. Taxation

(i) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.18. Taxation (continued)

(ii) Deferred tax assets and liabilities

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit and differences relating to investments in subsidiaries and jointly controlled companies when it is probable that their status will not change in the near future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

(iii) Tax exposures

In determining the amount of current and deferred tax, the Company takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgments about future events, New information may become available that causes the Company to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

(iv) Value added tax (VAT)

The Tax Authorities require the settlement of VAT on a net basis. VAT related to sales and purchases is recognised and disclosed in the statement of financial position on a net basis. Where a provision has been made for impairment of receivables, impairment loss is recorded for the gross amount receivable, including VAT.

4. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES

During the preparation of the Company's annual financial statements, the Management Board used certain estimates and assumptions that affect disclosed income, expense, assets and liabilities and disclosure of contingent liabilities during and on the reporting date. However, the uncertainty associated with these assumptions and estimates can result in significant changes in the carrying amount of the related assets or liability in future periods. Key assumptions related to the future and other key sources of uncertainty on the date of the Statement of financial position that bear significant risk of significant changes in the carrying amounts of assets and liabilities in the following financial year are as follows:

The preparation of financial statements in accordance with IFRS requires Management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses, Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis, Revisions to accounting estimates are recognized 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.

(i) Useful lives of property, plant and equipment

Determining the useful life of an asset is based on historical experience with similar assets as well as anticipated technological development. The suitability of the estimated useful life is considered annually, or whenever there are indications of significant changes in assumptions. We believe that this is an important accounting estimate, as it includes the assumptions about technological development and significantly depends on the Company's investment plans. Furthermore, given the significant share of a depreciable assets in total Company's assets. the impact of major changes in these assumptions could be significant for the financial position and results of the Company's business. During the 2018 there were no changes to estimated useful lives of property, plant and equipment, i.e., the depreciation rates.

(ii) Recognition of deferred tax assets

The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the Statement of financial position. Deferred tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgments and applies estimation based on previous years taxable profits and expectations of future income that are believed to be reasonable under the existing circumstances (Note 15). The carrying amounts of deferred tax assets at 31 December 2018 amounts to HRK 46.964 thousand *(31 December 2017: HRK 22,861 thousand),*

(iii) Recoverability of trade and other receivables

The recoverable amount of trade and other receivables is estimated at present value of future cash flows discounted at the market interest rate at the measurement date. Short-term receivables with no stated interest rate are measured by the amount of original invoice if the effect of discounting is not significant.

4. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

(iv) Valuation of inventories

The Company provides for the amount of unmarketable inventory materials according to the inventory ageing structure. During 2017 the Company recognised value adjustment of inventories in the amount of HRK 678 thousand. In 2018, the Company increased the value adjustment of inventories by 1,632 thousand charged to operating expenses (see Note 12 and 23),

(v) Actuarial estimates used in determining the retirement bonuses

The cost of defined benefits is determined using actuarial estimates. Actuarial estimates involve assumptions about discount rates, future salary increases and the mortality or fluctuation rates. Due to the long-term nature of those plans, these estimates contain an element of uncertainty. Provisions for jubilee awards and retirement bonuses amounted to HRK 48,355 thousand at 31 December 2018 (*31 December 2017: HRK* 50,327 *thousand*) (see Note 30),

(vi) Consequences of certain legal actions

There are a number of legal actions involving the Company, which have arisen from the regular course of operations. If there is a present obligation as a result of a past event (taking into account all available evidence, including the opinion of law experts) for which is probable that outflow of resources will be required to settle the obligation and if a reliable estimate can be made of the amount of the obligation, provisions are recorded (see Notes 12 and 30).

(vii) Ownership over land and buildings

The Company has acquired or is in the process of acquiring documentation of ownership over certain land and buildings. Restrictions on the ownership over land and buildings relate to properties that are not officially registered as the property of the Company. The Company is involved in several legal disputes regarding the ownership over certain real estates, however management believes that the outcome of these legal disputes will result in the Company obtaining all relevant documents relating to ownership over properties recorded in its accounts.

4. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

(viii) Expected loss model

With the application of IFRS 9, the model of expected loss (ECL) is introduced. The measurement of expected loss on impairment is based on reasonable and supporting information that is available without undue expense, and which includes information on past events, current and foreseeable future conditions and circumstances.

When estimating the expected future value of impairment, historical probabilities of non-fulfilment are usually used complementing future parameters relevant to credit risk.

The most significant part of the Company's financial assets relate to the receivables from related parties (HEP Distribution System Operator Ltd., Zagreb for the use of the transmission grid and the Hrvatska elektroprivreda d.d., Zagreb for balancing energy), trade receivables, investments in deposits and cash.

Accounts receivables are stated at the invoiced amount. The impairment of doubtful receivables is based on the best estimate of the Company's Management Board on the non-repayment. All receivables from bankruptcy entities as well as sued receivables are wholly written off. The Company's management performs impairment of the doubtful receivables based on an overview of the overall ageing structure of all receivables and on the basis of a review of significant individual amounts included in the receivables. Due to the likelihood that some receivables will not be collected over a longer period, the Company, on the basis of reasonable estimates and experience gained over a longer period, performs the value adjustment of uncollected receivables by reducing them in the following way:

Due	Impairment percentage
31 — 60 days	1,50%
61 — 90 days	3%
90 — 180 days	9%
181 — 365 days	30%
Over a year	90%

The general approach to the expected credit losses applies to the equity instruments measured through other comprehensive income. A simplified approach to expected credit losses applies to the trade receivables, which results in earlier recognition of impairment. By applying a simplified approach to financial assets and by reducing the value of the contract assets which is recognized as of 1 January 2018 in accordance with IFRS 9 (International Financial Reporting Standard 9), the impairment will have no significant impact on the Company's result.

4. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

(ix) Expected loss model (continued)

The analysis of receivables and related value adjustments has shown significant receivables in the coming years. Historically, these trends are stable and there are no known facts or indications that the trend will change in future periods. Historical data show that receivables from related companies are fully collectable and are not subject to impairment. During the reporting period there were no changes in the initial estimation methods or significant assumptions that were used. There were no significant changes in the carrying value of financial instruments during the reporting period, and thus no significant impact on the amount of value adjustment.

(x) Revenues from the ITC Agreement

The Company, as a Transmission System Operator, is a signatory to an ITC Clearing and Settlement Agreement based on which it generates revenue as a fee to cover expenses incurred through electricity transit. Revenues from the ITC mechanism are determined on the basis of the methodology established by ETSO (European Transmission System Operators) and in accordance with Regulation 1228/2003 of the European Parliament and of the Council on the conditions for access to the network for cross-border exchanges of electricity. The estimated revenues from the ITC mechanism relate to the Company's estimated revenue for the part of 2018 as they are not charged in the current year. The estimate is made as the medium value of historical data and data on the ratio of realized transit and import of electricity as well as revenues realized in the previous period of 2018 for which similar conditions were applicable.

5. DETERMINING FAIR VALUES

A number of the Company's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities,

The Company has an established control framework with respect to fair value measurement which assumes the overall responsibility of the Management Board and finance department in relation to the monitoring of all significant fair value measurements, consultation with external experts and the responsibility to report, with respect the above, to those charged with corporate governance,

Fair values are measured using information collected from third parties in which case the Board and the finance department assess whether the evidence collected from third parties support the conclusion that such valuations meet the requirements of IFRSs, including the level in the fair value hierarchy where such valuations should be classified,

All significant issues related to fair values estimates are reported to the Supervisory Board, Fair values are categorised into different level in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- *Level 1* - quoted prices (unadjusted) in active markets for identical assets or liabilities

- *Level 2* - inputs other than quoted prices included in level 1, that are observable for the asset or liability either directly (ie as prices) or indirectly (ie derived from prices)

- *Level 3* - input variables for assets or liabilities that are not based on observable market data (unobservable inputs)

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date, A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis,

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques, These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates, If one or more significant inputs are not based on observable market data, the fair value estimate is included in level 3,

In preparing these financial statements, the Company has made the following significant fair value estimates statements as further explained in detail in following notes:

- Note 19: Investment property

6. REVENUE FROM SALES

(in thousands of HRK)	**2018**	**2017**
Revenue from sales – related parties		
Electricity transmission income	1,338,804	1,333,681
Sales of balancing energy	38,160	41,309
Sales of balancing energy – imbalance settlement	66,756	148,228
Cross-border capacity income	-	162
Income from connection to transmission network	664	-
Other	21,603	25,428
	1,465,987	**1,548,808**

Revenue from sales – third parties		
Electricity transmission income	68,757	55,291
Cross-border transmission capacity - domestic	-	2,224
Cross-border transmission capacity - foreign	111,825	111,964
Sales of balancing energy	7,864	18,526
Sales of balancing energy - imbalance settlement	21,089	34,766
ITC revenue	37,140	5,513
Income from connection to transmission network	2,275	55,217
Sales from energy for transmission grid losses	201	-
	249,151	**283,671**

7. OTHER INCOME – THIRD PARTIES

(in thousands of HRK)	**2018**	**2017**
Reversal of litigation provisions	1,376	1,382
Reversal of retirement provisions	1,973	-
Reversal of unused vacation provisions	662	27
Consumption of own products and services	4,954	5,009
Income from assets received free of charge	2,930	2,941
Income from connection asset – IFRS 15	13,418	-
Nonstandard services income	383	861
Collection of written-off receivables income	2,139	236
Other services income	282	1,575
EBRD grant income	6,555	-
Other	4,863	4,319
	39,535	**16,350**

Income from consumption of own products and services refers to capitalized personnel expense connected to assets under construction (work of Company’s supervising engineers).

Other income refers to a sale of previously written of assets as a secondary raw material in the amount of HRK 1,913 thousand (*2017: HRK* 1,622 *thousand*), rent income HRK 426 thousand (*2017: HRK 416 thousand*), and other HRK 2,488 thousand (*2017: HRK 2,281 thousand*).

8. MATERIAL AND SPARE PARTS USED

(in thousands of HRK)	**2018**	**2017**
Maintenance material for power facilities	5,685	8,151
Energy	5,330	5,437
Maintenance material for other assets	945	1,310
Low value stock and safety clothes	1,669	1,542
Other	2,856	2,294
	16,485	**18,734**

9. SERVICE EXPENSES

in thousands of HRK)	**2018**	**2017**
Power facility maintenance services	97.190	81,265
Auctions for cross border transmission capacity	35.634	54,660
ITC mechanism costs	1.118	9,607
Security services	4.823	4,629
Maintenance services	7.353	7,025
Telecommunication services	1.571	1,459
Agency and research services	12.444	9,605
Reasrch and development cost	9,743	1,423
Other	8,478	7,774
	178,354	**177,447**

In 2018, part of the agency and scientific services costs related to the fees for the audit of the annual financial statements for 2017 in the amount of HRK 155 thousand, fees for other audit services in the amount of HRK 61 thousand, fees for tax and other consulting services in the amount HRK 238 thousand.

10. PERSONNEL EXPENSES

(in thousands of HRK)	**2018**	**2017**
Net salaries	111,679	109,157
Taxes and contributions from salaries	47,430	45,767
Contributions on salaries	25,781	25,426
	184,890	**180,350**

Total personnel costs were as follows:

Gross salaries	184,890	180,350
Reimbursement of costs to employees (Note 12)	17,335	16,279
Employee benefits (Note 12)	16,838	12,342
Additional health insurance costs (Note 12)	1,550	1,503
Provisions for retirement bonuses and other provisions (Note 12)	33,403	8,670
	254,016	**219,144**

As of 31 December 2018 the Company had 1,123 employees *(2017: 1,100 employees),* Reimbursement of costs to employees includes commutation allowances, daily allowances and travelling expenses, as well as other similar costs.

Employee benefit costs primarily include retirement bonuses, jubilee awards and other occasional bonuses, Early retirement bonuses in 2018 amounted to HRK 8,858 thousand *(2017: HRK 7,624 thousand),* and represent retirement bonuses for 46 employees.

Directors' and executive's remuneration:

(in thousands of HRK)	**2018**	**2017**
Gross salaries	4,695	4,827
Pension insurance contributions	1,055	1,074
Benefits in kind	863	577
	6,613	**6,478**
Number of directors and executives	18	13

11. ANCILLARY SERVICE COST, TRANSMISSION GRID LOSSES AND PURCHASE OF BALANCING ENERGY

(in thousands of HRK)	**2018**	**2017**
Ancillary services		
Ancillary services – related parties (Note 34)	293.859	310.562
Ancillary services – third parties	531	-
	294.390	**310.562**
Cost of transmission grid losses		
Cost of transmission grid losses – related parties (Note 34)	125.460	88.071
Cost of transmission grid losses – third parties	51.848	28.818
	177.308	**116.889**
Purchase of balancing energy		
Purchase of balancing energy – related parties HEP Proizvodnja d.o.o. (Note 34)	105.684	98.549
Purchase of balancing energy – imbalance settlement – related parties (Note 34)	27.861	70.643
Purchase of balancing energy – third parties	35.832	28.776
Purchase of balancing energy – imbalance settlement – third parties (Note 34)	7.908	20.232
	177.284	**218.200**

During 2017 and 2018, the Company purchased energy for Transmission Grid losses and for Balancing System on the Electricity Exchange, which began operating in February 2016,

12. OTHER OPERATING EXPENSES

(in thousands of HRK)	**2018**	**2017**
Employee benefits	16,838	12,342
Taxes, contributions and fees	20,167	19,826
Reimbursement of costs to employees	17,335	16,279
Impairment of inventories	1,632	678
Net book value of disposed tangible assets and inventories	9,123	6,350
Impairment of receivables	-	860
Additional health insurance costs	1,550	1,503
Affiliation fee for business associations	3,835	2,811
Insurance premiums	1,395	1,376
Provisions for retirement bonuses and other provisions for workers	33,403	8,670
Provisions for court cases	399	1,024
Change in fair value of investment properties	-	6,477
Fees damage to individuals	1,359	1,228
Impairment of financial assets	1,409	6,000
Other operating expense	3,670	3,444
	112,115	**88,868**

13. FINANCE INCOME

(in thousands of HRK)	**2018**	**2017**
Interest income	581	636
Foreign exchange gains	8,493	6,812
	9,074	**7,448**

14. FINANCE COSTS

(in thousands of HRK)	**2017**	**2016**
Sub-loan interest	21,677	29,227
Penalty interest	52	315
Foreign exchange losses	1,716	1,904
Amortized amount of the related discount cost	876	877
	24,321	**32,323**

15. CURRENT INCOME TAX

The Company is subject to income tax, according to the laws and regulations of the Republic of Croatia. The tax base is determined as the difference between income and expenses for the period, increased by tax non-deductible expenses. The income tax rate is 18% (2017: 18%),

(in thousands of HRK)	**2018**	**2017**
Current tax	45,535	69,389
Deferred tax	(5,658)	(4,778)
	39,877	**64,611**

(in thousands of HRK)	**2018**	**2017**
Profit before taxation	**216,085**	**353,628**
Income tax at the rate of 18%	38,895	63,653
Tax differences, non-deductible expenses	1,226	1,214
Tax differences, decreasable item	(244)	(256)
Tax cost	**39,877**	**64,611**
Effective tax rate (%)	**18,45%**	**18,27%**

Under tax regulations, the tax authorities may at any time inspect the books and records of the companies within three years from the expiry of the year for which the tax liability is declared, as well as impose additional tax liabilities and penalties. The management of the Company is not aware of any circumstances that could result in significant potential liabilities in this respect.

15. CURRENT INCOME TAX (continued)

The following table summarizes the movement in deferred tax assets during the year:

(in thousands of HRK)	**Provision for inventory**	**Provisions for jubilee and retirement benefits**	**Accrued expenses**	**Depreciation of large spare parts**	**Tax loss carried forward**	**First adoption of IFRS 15**	**Impairment of financial assets and investment property**	**Total**
At 1 January 2017	**3.051**	**7.977**	**215**	**5.499**	**1.341**	**-**	**-**	**18.083**
(Credited)/ debited to profit and loss	122	1.561	1.136	1.054	(1.341)	-	2.246	4.778
At 31 December 2017	**3.173**	**9.538**	**1.351**	**6.553**	**-**	**-**	**2.246**	**22.861**
First adoption – IFRS 15	-	-	-	-	-	18.445	-	18.445
(Credited)/ debited to profit and loss	294	(355)	5.205	993	-	(732)	253	5.658
At 31 December 2018	**3.467**	**9.183**	**6.556**	**7.546**	**-**	**17.713**	**2.499**	**46.964**

16. INTANGIBLE ASSETS

(in thousands of HRK)	**Software**	**Leasehold improvement regarding rights of usage**	**Total**
COST			
At 1 January 2017	**63,751**	**18,566**	**82,317**
Additions	4,730	-	4,730
Transfer from assets	104	-	104
Disposals and write-offs	(1,394)	-	(1,394)
At 31 December 2017	**67,191**	**18,566**	**85,757**
Additions	7,759	-	7,759
Transfer from assets	306	-	306
Disposals and write-offs	(209)	-	(209)
At 31 December 2018	**75,047**	**18,566**	**93,613**
ACCUMULATED			
At 1 January 2017	**44,325**	**15,233**	**59,558**
Charge for the year	6,533	741	7,274
Disposals and write-offs	(1,388)	-	(1,388)
At 31 December 2017	**49,470**	**15,974**	**65,444**
Charge for the year	7,148	741	7,889
Disposals and write-offs	(201)	-	(201)
At 31 December 2018	**56,417**	**16,715**	**73,132**
CARRYING AMOUNT			
At 31 December 2017	**17,721**	**2,592**	**20,313**
At 31 December 2018	**18,630**	**1,851**	**20,481**

17. PROPERTY, PLANT AND EQUIPMENT

(in thousands of HRK)	**Land**	**Buildings**	**Inventory and equipment**	**Assets under construction**	**Total**
COST					
At 1 January 2017	**153,696**	**4,358,920**	**8,164,216**	**393,284**	**13,070,116**
Additions	18	8,281	54,968	375,468	438,735
Transfer from assets under construction	-	50,044	215,285	(265,433)	(104)
Subscribed capital increase	-	123,827	240,761	-	364,588
Transfers and reclassifications	-	43	(43)	-	-
Surplus	1,144	-	238	-	1,382
Disposals	-	(18,994)	(79,598)	(722)	(99,314)
At 31 December 2017	**154,858**	**4,522,121**	**8,595,827**	**502,597**	**13,775,403**
Additions	-	183	48,604	365,954	414,741
Transfer from assets under construction	950	125,541	243,947	(370,744)	(306)
Transfers and reclassifications	-	151	(151)	-	-
Disposals	(308)	(6,915	(93,052)	(3,603)	(103,878)
At 31 December 2018	**155,500**	**4,641,081**	**8,795,175**	**494,204**	**14,085,960**
ACCUMULATED DEPRECIATION					
At 1 January 2017	**-**	**2.728.986**	**4.819.505**	**-**	**7.548.491**
Charge for the year	-	83,187	226,816	-	310,003
Transfer between related parties and reclassifications	-	3	(3)	-	-
Subscribed capital increase		17,736	53,721	-	71,457
Eliminated on disposal	-	(15,728)	(77,707)	-	(93,435)
At 31 December 2017	-	**2.814.184**	**5.022.332**	**-**	**7.836.516**
Charge for the year	-	85.344	241.924	-	327.268
Transfer and reclassifications	-	27	(27)	-	-
Eliminated on disposal	-	(6.534)	(88.392)	-	(94.926)
At 31 December 2018	-	**2.893.021**	**5.175.837**	**-**	**8.068.858**
CARRYING AMOUNT					
At 31 December 2017	**154,858**	**1,707,937**	**3,573,495**	**502,597**	**5,938,887**
At 31 December 2018	**155,500**	**1,748,060**	**3,619,338**	**494,204**	**6,017,102**

17. PROPERTY, PLANT AND EQUIPMENT (continued)

Assets under construction relate to investments in real estate, plant and equipment construction, The most significant investments in the period include the construction of TS Sesvete HRK 17,557 thousand (2017: HRK 17,219 thousand), reconstruction of TS Melina HRK 37,313 thousand, reconstruction of TS Pračno HRK 30,462 thousand, reconstruction of TS 110/20(10) kV Sućidar HRK 24,677 thousand, reconstruction of 110 kV powerline Slavonski Brod – Andrijevci HRK 22,508 thousand, revitalization of TS Osijek 2 HRK 14,620 thousand, reconstruction of TS Koprivnica HRK 15,505 thousand, construction of TS Zamet HRK 20,384 thousand. Contractual commitments related to investments in progress at the reporting date amount to HRK 298,514 thousand (2017: HRK 220,715 thousand), and the envisaged timing for implementation is in accordance with the deadlines of construction.

During 2018, the following significant investments were put into use: connection of C blok in TE Sisak in the amount of HRK 61,365 thousand, connection of VE Lukovac HRK 11,633 thousand, administrative building in Matulji HRK 60,504 thousand, reconstruction of TS Zadar HRK 14,815 thousand and reconstruction of TS Kutina HRK 71,569 thousand.

During 2018 and 2017, the Company did not capitalize on borrowing costs as they does not relate to the acquisition of a qualifying asset.

Ownership over land and buildings

With regard to land and buildings, the Company has acquired or is in the process of acquiring ownership documentation. Restrictions related to property ownership over land and buildings relate to properties that are not officially registered as property of the Company. In order to protect its interests, the Company conducts several judicial and / or administrative proceedings primarily related to the land that is partially registered with the Company and which have on that land parts of power stations and other facilities in the Company's function. It is not expected that the outcome of these procedures will have a significant impact on the Company's financial position or result.

18. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

(in thousands of HRK)	
As at 1 January 2017	**3,692**
Advances given	7,496
Utilised in current year	(6,610)
As at 31 December 2017	**4,578**
Advances given	2,874
Utilised in current year	(3,835)
As at 31 December 2018	**3,617**

19. INVESTMENT PROPERTY

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Fair value	4,403	10,724
Net change in fair value of investment property	37	(6,321)
Closing balance at fair value	**4,440**	**4,403**

Investment property relate to the non-business property (offices, apartments and garages) owned by the Company and leased for an indefinite time to employees of the Company and third parties.

Investment property is carried at fair value based on the valuation by an independent, expert appraiser based on the comparative method to market prices for similar real estate – 2nd level.

The Company generates revenue from the rental of apartments classified as investment property in the amount of HRK 262 thousand (*2017: HRK 253 thousand*), The Company recorded direct operating expenses (including maintenance fee) in the amount of HRK 19 thousand (*2017: HRK 18 thousand*).

The Company regularly tests the investment property for impairment analysing the price of comparable real estate. At the reporting date, was used to estimate the independent, expert appraisers made for the financial statements for 2018 and one part of the estimate of an independent expert estimator of 2017 as management believes that the market has not changed significantly. For investment property for which the management estimates that the Company can not realize the future economic benefit, an impairment loss of HRK 6,477 thousand was made in 2017. Changes in the fair value of investing in real estate are presented in note 12 "Other operating expenses".

20. INVESTMENTS IN ASSOCIATES

		31 December 2018		31 December 2017	
(in thousands of HRK)	Country	% ownership	Net book value	% ownership	Net book value
Hrvatska burza električne energije d.o.o.	Croatia	50,0%	8,000	50,0%	6,000
Value impairment			(7,409)		(6,000)
			591		**-**

The Company carries investment in associates at cost less impairment. In 2018, the Company increased subscribed capital of Hrvatska burza električne energije d.o.o. by HRK 2,000 thousand. Also in 2018, the Company made a decision by the management and based on the internal estimates it reduced the value of the investment in the company Hrvatska burza električne energije d.o.o. for HRK 1,409 thousand (2017: HRK 6,000 thousand). Impairment losses are disclosed in Note 12 "Other operating expense".

21. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

		31 December 2018		31 December 2017	
(in thousands of HRK)	Country	% ownership	Net book value	% ownership	Net book value
HEP Telekomunikacije d.o.o.	Croatia	13,7%	34,545	13,7%	34,545
JAO S.A.	Luxemburg	5%	2,578	5%	2,578
TSCNET Services GmbH	Germany	7,7%	2,728	7,7%	2,610
SEE CAO	Montenegro	12,5%	306	12,5%	306
			40,157		**46,039**

During 2013 the Company concluded the contract on incorporation of a new company HEP Telekomunikacije d.o.o with HEP d.d. and HEP Operator distribucijskog sustava d.o.o. whereby the Company has 13,73% share or HRK 34,545 thousand. Subscribed capital, in the extent invested by the Company, consists of optical and telecommunication assets.

The assemblies of companies CAO GmbH and CASC EU (two regional offices allocation for cross-border transmission of electricity capacity) approved in 2015 the merger agreement to create the office of the Joint Allocation Office (JAO). This merger has facilitated the internal electricity market in the European Union.

21. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (continued)

JAO S.A. is a joint service company where the owners are twenty transmission system operators (TSO) from seventeen countries.

SEE CAO is a joint company that provides an explicit cross-border transfer capacity between its shareholders, transmission system operators.

TSCNET as a regional security coordinator provides security service forecast for the Transmission System Operators and Power Flow Transmission through its transmission networks. These forecasts cover a one-year period up to the intraday phase of the working day.

22. RECEIVABLES FROM THE SALE OF APARTMENTS

Long-term receivables represent housing loans for apartments sold by HEP d.d. to its employees in the previous years, in accordance with the laws of the Republic of Croatia. Those receivables were transferred to the Company by its Parent Company on 1 July 2002. Receivables for apartments sold, which carry interest at a rate lower than the market rate, are repayable on a monthly basis over a period from 20 to 35 years. Management believes that the fair value of non-current receivables approximates their carrying values as to the effect of discounting was immaterial in view of the current low level of market interest rates for similar credit relations. Receivables are secured by mortgage on purchased flats.

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Total receivables for apartments sold	1,948	2,514
Current portion of long-term receivables	(666)	(621)
Non-current receivables	**1,282**	**1,893**

23. INVENTORIES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Electric units and other materials	3,755	4,540
Spare parts	6,640	6,873
Building materials	120	114
	10,515	**11,527**

Movement in the impairment allowance for inventories is as follows:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
At 1 January	**17,630**	**16,952**
Impairment loss recognised	1,632	678
At 31 December	**19,262**	**17,630**

Impairment loss on inventories amounts to HRK 1,632 thousand and is included within “Other operating expenses” in the statement of comprehensive income.

24. TRADE RECEIVABLES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Trade receivables	35,407	43,244
Impairment of receivables	(4,651)	(5,546)
Net receivables	**30,756**	**37,698**

Movements in impairment allowance were as follows:

(in thousands of HRK)	**2018**	**2017**
At 1 January	**5,546**	**9,329**
Impairment of receivables	-	860
Impairment cancellation	(860)	-
Collected receivables, previously provided for	(35)	(236)
Impairment	-	(4,407)
Change on receivables impairment	*(895)*	*(3,783)*
At 31 December	**4,651**	**5,546**

Management is confident that the fair value of the trade receivables at the reporting date approximates their carrying amount. The cost of trade receivables impairment is included within note “Other operating expenses”.

24. TRADE RECEIVABLES (continued)

Ageing analysis of receivables not impaired is as follows:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Not yet due	29,202	15,127
0 – 30 days	1,437	2,983
31 – 60	72	2
61 – 90 days	-	1
91 – 180	27	1,193
181 – 365 days	15	18,389
over 365 days	3	3
	30,756	**37,698**

Trade receivables are denominated in:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
HRK	17,028	34,793
EUR	13,728	2,905
	30,756	**37,698**

25. OTHER CURRENT ASSETS

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Income tax receivables	12,984	-
Prepaid expenses and accrued income	4,808	7,253
VAT receivables	16,273	-
Current portion of long-term receivables	666	723
Other receivables	1,403	957
	15,911	**15,911**

Prepaid expenses relate to additional health insurance premium and other expenses in the amount of HRK 670 thousand (in 2017: 1,019 thousand),

In 2018 accrued income in the amount of HRK 4,138 thousand comprise of ITC mechanism revenue thousand estimated by the Company's management for period November - December 2018 (2017: 2,109 thousand).

26. DEPOSITS AND LOANS

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Deposits – expropriation	15,167	10,318
Loans – Hrvatska burza električne energije d.o.o.	-	3,000
	15,167	**13,318**

Deposits – expropriation

The Company is obliged to deposit funds in particular expropriation proceedings during the construction of energy facilities that will be withdrawn after the conditions of Expropriation ACT are met. The deposits have maturity of one month to one year, or until the fulfilment of the conditions, in the Expropriation Act and carry interest rates ranging from 0,4% to 2%.

Loans – Hrvatska burza električne energije d.o.o.
In 2017, the Company according to decisions of the management borrowed the Hrvatska burza električne energije d.o.o. amount of HRK 3,000 thousand. Borrowers carry interest rates in the amount of interest between related companies (as per Article 14 Paragraph 3 of the Income Tax Law) for the year 2018 was equal to 4,55% (2017: 4,97%).

27. CASH AND CASH EQUIVALENTS

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Giro account – domestic	39,541	72,833
Giro account – foreign	105,025	27,831
Deposits up to 90 days	12,264	43,807
Cash in hands	51	31
	156,881	**144,502**

Cash in banks refers to cash accounts at the domestic banks with average yearly interest rate from 0,01% for foreign currency accounts and 0,2% for domestic currency account.

Interest rates on short-term deposits are fixed and in the range of 0,85 % (HRK deposits) to 0,35% (EUR deposits) per annum.

28. CAPITAL AND RESERVES

Subscribed capital

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Subscribed capital	**4,929,195**	**4,929,195**

During 2013, in accordance to Energy Market Act, Hrvatska elektroprivreda d.d. increased the Company`s subscribed capital by entering assets and rights into the share capital, so the share capital increased from the amount od HRK 20 thousand for the amount of HRK 3,366,901 thousand to the amount of HRK 3,366,921 thousand.

During 2017, the Company increased subscribed share capital by HRK 271,672 thousand (*2016: HRK* 189,680 *thousand*) from the profit of the previous year.

During 2017 HEP d.d. as the sole owner and founder of the Company, increased the Company`s subscribed capital by entering assets into the share capital in the total amount of HRK 293,131 thousand (2016: HRK 193,911 thousand).

As mentioned in Note 37 Events after the date of the Financial Position Report, on March 18, 2019, the Commercial Court in Zagreb issued a decision for the Company's share capital was increased by entering assets by HEP's d.d. in the amount of HRK 19,432 thousand and after that increase the share capital amounts HRK 4,948,627 thousand.

Reserves

Reserves were made when the subsidiaries were merged in 2005 in the amount of HRK 40 thousand and when entering real estate in equity during 2013 amounting to HRK 5,483 thousand.

29. SUBLOAN FROM AND LIABILITIES TO RELATED COMPANIES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Liabilities toward HEP d.d. for subloan	498,165	618,851
Transaction cost for subloan refinancing	(3,342)	(4,217)
Other non-current liabilities to related companies	742	958
	495,565	615,592
Current portion of long-term debt	(75,898)	(114,242)
Non-current portion	**419,667**	**501,350**

As at 31 December 2012, the lease of real estate, plant and equipment was terminated in accordance with the Electricity Market Act required for carrying out the activity. In 2013 the lease of real estate, plant and equipment was cancelled in total. Part of due obligations relating to terminated lease shall be paid on the basis of long-term sub loans concluded with HEP d.d. based on received loans by parent Company from commercial banks.

29. SUBLOAN FROM AND LIABILITIES TO RELATED COMPANIES (continued)

The maturity of loan liabilities at the reporting date is as follows:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Up to 6 months	37,949	57,121
6 – 12 months	37,949	57,121
1 – 2 years	-	76,888
2 - 5 years	422,267	427,721
	498,165	**618,851**

The maturity of other long-term liabilities at the reporting date is as follows:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Up to 6 months	100	108
6 – 12 months	100	108
1 – 2 years	200	216
2 - 5 years	342	526
	742	**958**

The carrying amount of borrowings approximates their fair value given that most has a variable interest rate or a fixed interest rate, which was the approximate current market interest rate at the time of contracting. The fair value is calculated using discounted cash flows.

The carrying amounts of the Company’s borrowings are denominated in the following currencies:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
HRK	-	-
EUR	419,667	501,350
	419,667	**501,350**

Loans amounting to HRK 419,667 thousand have fixed interest rates *(2017: HRK 532,017 thousand),* The interest rates for loans included in the table above are4,851% *(2017: from 4,851% to 6,53%).*

30. PROVISIONS

(in thousands of HRK)	Provision for jubilee awards	Provision for retirement benefits	Provision for court cases	Total
At 31 December 2017:				
Non-current	3,712	35,954	25,291	64,957
Current	518	1,473	-	1,991
	4,230	**37,427**	**25,291**	**66,948**
At 31 December 2018:				
Non-current	3,142	43,360	23,955	70,457
Current	502	1,351	-	1,853
	3,644	**44,711**	**23,955**	**72,310**

Movement in provisions was as follows:

(in thousands of HRK))	Provision for jubilee awards	Provision for retirement benefits	Provision for court cases	Total
At 1 January 2017	**4,230**	**37,427**	**25,291**	**66,948**
Increase	583	12,632	1,024	14,239
Reversal	-	-	(1,382)	(1,382)
Utilised	(509)	(4,036)	-	(4,545)
At 31 December 2017	**4,304**	**46,023**	**24,933**	**75,260**
At 1 January 2018	**4,304**	**46,023**	**24,933**	**75,260**
Increase	-	5,629	398	6,027
Reversal	(78)	-	(1,376)	(1,454)
Utilised	(582)	(6,941)	-	(7,523)
At 31 December 2018	**3,644**	**44,711**	**23,955**	**72,310**

30. PROVISIONS (continued)

Jubilee awards and retirement benefits

According to the Collective Agreement the Company has an obligation to pay jubilee awards, regular retirement benefits and other benefits to its employees, In accordance with the respective agreement, the employees are entitled to a regular retirement benefit of 1/8 of the average gross monthly salary earned in the period of three months prior to the retirement for each completed year of continuous employment at the employer. No other postretirement benefits are provided.

Provisions for both jubilee awards and regular retirement benefits are calculated by an independent actuary, using estimates derived on the basis of the following key assumptions:

	Estimate	
	2018	**2017**
Average staff turnover rate	2,95%	3,29%
Discount rate	1,90%	2,40%
Expected increase in salaries	2%	2%
Average expected retirement age (in years)	61-65	61-65

Set out below are movements in the present value of current obligations in respect of defined employee benefits:

(in thousands of HRK)	**Retirement benefits**	**Jubilee awards**	**Total**
At 1 January 2017	**37,427**	**4,230**	**41,657**
Service costs	1,957	283	2,240
Interest expense	1,036	95	1,131
Benefits paid	(4,036)	(509)	(4,545)
Actuarial losses	9,639	205	9,844
At 31 December 2017	**46,023**	**4,304**	**50,327**
At 1 January 2018	**46,023**	**4,304**	**50,327**
Service costs	7,605	239	7,844
Interest expense	795	63	858
Benefits paid	(6,941)	(582)	(7,523)
Actuarial losses / (gains)	(2,771)	(380)	(3,151)
At 31 December 2018	**44,711**	**3,644**	**48,355**

30. PROVISIONS (continued)

Court cases

A provision for court cases relates to all court cases for which an estimate was made that it is not probable of them being resolved in favour of the Company. Provision for court cases expense is included within ‘Other operating expenses in the statement of comprehensive income. The most significant court case for which is estimated that its solution is not probable in the favour of the Company relates to the complaint of an individual for the compensation of expropriated property, started at the State administration office in Split, in the amount of HRK 13,445 thousand. The Company has made provision in 2010 for the stated dispute.

Based on the expert opinion of legal advisors, management anticipates that the outcome of any disputes will not result in significant losses over the amount of a provision at 31 December 2018.

31. OTHER LONG-TERM LIABILTIES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Deferred income - assets received with no reimbursement appliance od IFRS 15	375.882	-
Deferred income - assets received with no reimbursement till 30 June 2009	67,114	70,093
Deferred income – cash received from the EU funds	19,719	20,844
Liabilities to state regarding apartments sold	1,258	1,603
Deferred income - cash received from others	297	297
	464,270	**92,837**
Current portion of other long-term liabilities	(16,347)	(2,945)
	447,923	**89,892**

Deferred income relates to fixed assets contributed by customers and others without charge and it is being recognised into income over the same periods as the related assets are amortised, which applies to contracts for connection to the network concluded by 30 June 2009. After 1 July 2009 the fee for connection is recognized as an income in the amount of funds received from the customer in the period when the customer is connected to the network or when permanent access to the delivery of the service is given.

31. OTHER LONG-TERM LIABILTIES (continued)

By applying IFRS 15 from January 1, 2018, the connection fee is recognized as deferred income, while the income is recognized at the same time as the depreciation of the tangible asset to which it relates. By applying IFRS 15, the Company acknowledged the cumulative effect of applying IFRS 15 to its initial state and recorded deferred income from the current value of assets financed from the connection fee in the period from 1 July 2009 to 31 December 2017 in the amount of HRK 316,450 thousand. Effects of first-time adoption of IFRS 15 Revenues under contract with customers are described in more detail in Notes 2.4. Changes in Accounting Policies and Disclosures and 3.1 Sales Revenues.

Deferred income for cash received from EU funds refers to the funds received for participation of the Company in the SINCRO.GRID project in the amount of HRK 18,122 thousand and to the CROSSBOW project in the amount of HRK 1,597 thousand. Received incentives will reduce the costs incurred in implementing these projects in future periods.

Other long-term liabilities relate to the obligation arising on the sale of housing units to employees under the Government program, which was discontinued in 1996. According to the law regulating housing sales, 65% of the proceeds from the sale of apartments to employees are payable to the state at such time as the proceeds are collected. According to the law, the Company has no liability to remit the funds until they are collected from the employee.

32. TRADE PAYABLES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Amounts due to suppliers of fixed assets	188,279	153,305
Amounts due to suppliers of current assets	53,490	53,628
	241,769	**206,933**

33. OTHER CURRENT LIABILITIES

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Liabilities for calculated incentive severance payments	33.403	-
Liabilities for received guarantees	9.251	7.560
Deferred income for cross-border transmission capacity	8.478	4.394
Net wages	8.386	7.958
Liabilities for unused vacation	7.145	7.807
Liabilities for taxes, contributions and other	5.104	4.289
Wages contributions	2.659	2.543
Wages taxes	1.316	1.193
Other liabilities to employees	2.730	1.566
Prepayments for connection fees	3.371	3.751
Balancing energy accrued expense – imbalance settlement	2.982	1.272
ITC mechanism accrued expense	-	5.909
Income tax	-	27.180
Current portion of long-term liabilities (Note 31)	16.347	2.945
Other	1.656	1.846
	102.828	**80.213**

Liabilities for calculated incentive severance indemnities in the amount of HRK 33,403 thousand refer to provisions for retirement of employees expected in 2019, which were executed in accordance with the Management decision from 18 December 2018 and the provisions of IAS 37 and are related to the restructuring process of the Company.

Deferred income relates to cross border transmission capacity revenue which is quoted on yearly and monthly auctions held in December 2018 and that are going to be used during January and February 2019.

Accrued expenses balancing energy – imbalance settlement refer to estimated cost of Final settlement for 2018 by Company due to the fact that they are not charged to the Company till the date of balance.

34. RELATED PARTY TRANSACTIONS

In the year 2015, recognized revenue to the extent of the fee received from the HEP ODS d.o.o. and fees received from customers directly connected to the transmission network. The fees are based on incurred sales to customers, under The Electricity Transmission Tariff Model, with no tariff item amounts and Decision of the Government of the Republic of Croatia on the Electricity Supply Tariff Model, with no tariff amounts which defines tariff model amounts are defined. In 2016, the basis for calculating the fee for the use of the transmission grid did not change compared to 2015, but there is a change in the Methodology which determines the amounts of tariff items for electricity transmission, so that in 2016 the Company's revenue recognition is based on energy Data on sales of electricity to customers, Methodology for determining tariff items for electricity transmission, and Decision on the amount of tariff items for the transmission of electricity by the Croatian Energy Regulatory Agency (HERA). In 2017 and 2018 the Company recognizes revenue in the same way as in 2016.

Costs of ancillary services in the total amount of HRK 293,859 thousand (2017: 310,562 thousand) were defined by the Ancillary Services contracts concluded by HOPS with HEP - Proizvodnja d.o.o. and all in accordance with the Price-Determination Methodology for providing auxiliary services.

As of 1 July 2013 the Company has been excluded from the Agreement on Mutual Relations by which balancing energy was provided by HEP d.d. and from that day mentioned services were provided in accordance to Annex 1 to 5 to the Agreement on providing ancillary services in order to ensure balancing service being rendered and valuation of power plant’s engagement in the balancing process. Since January 1, 2017, several Ancillary Services contracts are concluded.

From January 1, 2017, the Company generates revenue from balancing energy and balancing energy – imbalance settlement to the Balance Sheet Managers (BSM) in accordance with the applicable Electricity Balancing Rules, Methodology for determinating balancing energy prices, Responsibility Agreements for imbalance made with BGMs, and in accordance with a set of Ancillary Services contracts concluded with HEP Proizvodnja d.o.o.

34. RELATED PARTY TRANSACTIONS (continued)

Receivables, liabilities, income and expenses from the transactions with HEP d.d. and other related companies are presented in the table below:

(in thousands of HRK)	**2018**	**2017**
Income and expenses		
Sales income		
Electricity transmission fee income - HEP ODS d.o.o. and HEP Proizvodnja d.o.o.	1,338,804	1,333,681
Sales of balancing energy – Balance Sheet Managers – related parties	66,756	148,228
Sales of balancing energy - HEP Proizvodnja d.o.o.	37,160	41,309
Income from sale of cross-border transmission capacity HEP d.d.	-	162
Service income – HEP Telekomunikacije d.o.o.	18,073	21,378
Other sales income – related companies	4,194	4,050
	1,465,987	**1,548,808**
Other income		
Other income – related parties	**843**	**5,450**
Total related parties income	**1,466,830**	**1,554,258**
Finance income HEP d.d.	7,413	4,958
Expenses		
Other		
- Office space rental costs – HEP d.d.	625	1,190
- Telecommunication service cost – HEP Telekomunikacije d.o.o.	40,716	36,481
- Receivable impairment - HEP ODS	1,515	4,444
- Other expenses - related parties	5,345	5,334
	48,201	**47,449**
Transmission grid losses (Note 11)		
- Transmission grid losses – HEP d.d.	125,460	88,071
Purchase of regulating power (Note 11)		
Purchase of balancing energy – imbalance settlement – related parties BGMs	27,861	70,643
Purchase of balancing energy – HEP Proizvodnja	105,684	98,549
	133,545	**169,192**
Ancillary services– HEP Proizvodnja	293,859	310,562
Finance costs HEP d.d.	21,677	29,227

34. RELATED PARTY TRANSACTIONS (continued)

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Receivables and liabilities		
Receivables from HEP d.d. and other companies from HEP Group		
- Electricity transmission fee – HEP – ODS and HEP Proizvodnja	248,707	249,761
- for balancing energy from HEP Proizvodnja	7,770	9,167
- for balancing energy from BGMs- related parties	38,335	81,852
- connection fee from HEP Proizvodnja	16,783	-
- other	2,711	3,206
	314,306	**343,986**
Liabilities toward related parties		
Current liabilities		
- Amounts due according to lease contract – HEP d.d.	11,562	11,562
- Balancing energy – imbalance settlement – BGMs related parties	50,340	84,865
- Transmission grid losses – HEP d.d.	23,693	16,632
- deposits received HEP d.d. and HEP ODS	44,166	36,104
- other – HEP d.d.	19,268	32,068
- Accrued interest on subloan – HEP d.d.	3,926	4,212
- Prepayment for connection fee- HEP d.d.	8,126	3,615
- Other	5,899	5,688
	166,981	**194,746**
Liabilities to HEP Proizvodnja d.o.o. for ancillary services	68,484	65,579
Liabilities to HEP Proizvodnja d.o.o. for connection to the grid – prepayment	595	48,084
	69,079	**113,663**
Total short term liabilities to related parties	**236,060**	**308,409**
Non-current liabilities		
Subloan liabilities (Note 29) - HEP d.d.	494,823	614,634
Apartments sold (Note 29) - HEP d.d.	742	958
	495,565	**615,592**
Current portion (Note 29)	(75,898)	(114,242)
	419,667	**501,350**

During the year ending 31 December 2018, the Company has netted liabilities and interest on loans to related parties with receivables from affiliated companies in the amount of HRK 106,736 thousand relating to principal and HRK 27,973 thousand relating to interest (2017: HRK 211,750 thousand and HRK 33,238 thousand).

34. RELATED PARTY TRANSACTIONS (continued)

	Expenses		Sales revenue	
(in thousands of HRK)	**2018**	**2017**	**2018**	**2017**
State controlled entities				
Hrvatske željeznice d.o.o.	-	-	16,384	15,362
INA-Industrija nafte d.d.	4,778	4,450	-	-
Legislative. executive and other bodies of the Republic of Croatia	-	1,867	-	-
Petrokemija Kutina d.d.	-	-	5,633	2,772
Hrvatske šume d.o.o.	545	458	436	-
Croatia osiguranje d.d.	636	1,175	-	-
Narodne novine d.d.	316	276	-	-
Hrvatska radio televizija	536	467	-	-
Zdravstvene ustanove i organizacije	195	197	-	284
Hrvatske telekomunikacija d.d.	1,434	1,372	14	14
Sveučilišta i veleučilišta	172	72	-	-
Jadrolinija d.d.	113	86	-	-
Judicial institution	18	16	-	-
Other users	336	311	1	284
TOTAL	**9,079**	**10,747**	**22,468**	**18,716**

	Receivables		Liabilities	
(in thousands of HRK)	**31 December 2018**	**31 December 2017**	**31 December 2018**	**31 December 2017**
State controlled entities				
HŽ infrastruktura d.o.o.	1,830	1,650	-	-
Petrokemija Kutina d.d.	757	274	-	-
INA-Industrija nafte d.d.	-	-	431	425
Hrvatske telekom d.d.	-	-	190	205
Croatia osiguranje d.d.	-	-	112	167
Jadrolinija d.d.	-	-	4	1
Narodne novine d.d.	-	-	28	32
Other users	137	190	118	334
TOTAL	**2,724**	**2,114**	**883**	**1,164**

35. CONTINGENT LIABILITIES AND COMMITMENTS

Operating commitments

As at 31 December 2018 as part of its investing activities, the Company has concluded contracts under which the construction of a number of significant facilities and equipment has commenced but not completed. The contract value of incomplete work under most significant projects amounts to HRK 298,514 thousand *(31 December 2017: HRK* 220,715 *thousand).*

Environmental protection

The Company monitors and analyses the environmental impact of its business activities on an on-going basis, The key impact indicators comprise emissions of pollutants into air and the quantity of production waste which the Company reports to the competent institutions, local self-government units and public stakeholders on a regular and timely basis, Personnel engaged in environmental protection undergo training, seminars and workshops to receive information about the obligations and measures provided in the applicable environmental laws and regulations, There is an environmental expenditure monitoring system (RETZOK) at the Company which monitors all investments in environmental protection since 2004.

The Company is in the process of performing analyses with respect to compliance with the requirements imposed by EU legislation in terms of more stringent pollutant emission limits and reduced greenhouse gas emissions, the greenhouse gas emission trading scheme, integrated environmental permitting system, as well as the system of ecologically important areas and corridors (the National Ecological Network).

36. FINANCIAL INSTRUMENTS

Capital risk management

Net debt to equity ratio (Gearing ratio)

The Company manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimisation of the debt and equity balance.

Management reviews the capital structure on a semi-annual basis, As part of this review, management considers the cost of capital and the risks associated with each class of capital. The gearing ratio at the year-end can be presented as follows:

(in thousands of HRK)	**31 December 2018**	**31 December 2017**
Debt (long and short-term borrowings)	495,565	615,592
Current financial assets	(15,167)	(13,318)
Cash and cash equivalents	(156,881)	(144,502)
Net debt	323,517	457,772
Equity	5,101,938	5,223,735
Net debt to equity ratio	**6,34%**	**8,76%**

36. FINANCIAL INSTRUMENTS (continued)

Capital risk management (continued)

Debt is defined as long-term and short-term borrowings, and other long term liabilities. Equity includes all capital and reserves of the Company. Equity includes all capital and reserves.

Categories of financial instruments

(in thousands of HRK)	31 December 2018	31 December 2017
Financial assets		
Receivables for apartments sold	1,948	2,514
Trade receivables	30,756	37,698
Receivables from related parties	314,306	343,986
Other short-term assets	30,660	8,037
Current financial assets	15,167	13,318
Cash and cash equivalents	156,881	114,502
Total loans and receivables at amortised cost	**549,718**	**520,055**

((in thousands of HRK)	31 December 2018	31 December 2017
Financial liabilities		
Loan liabilities	495,565	615,592
Other non-current liabilities	1,554	2,199
Trade payables	241,769	206,933
Payables to related parties	236,060	308,409
Other short-term liabilities	102,827	80,213
Total financial liabilities at amortised cost	**1,077,775**	**1,213,346**

Fair value of financial instruments

The fair values of financial assets and financial liabilities are determined as follows:

- the fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments

Financial instruments held to maturity in the normal course of operations are carried at the lower of cost and the net amount less the portion repaid. Fair value is determined as the amount at which a financial instrument can be exchanged between willing and knowledgeable parties in an arm's-length transaction, except in the event of forced sale or liquidation. The fair value of financial instruments is the one quoted on the securities market or obtained using the discounted cash flow method.

36. FINANCIAL INSTRUMENTS (continued)

Fair value of financial instruments (continued)

Management believes that as at 31 December 2018, the carrying amounts of financial assets and liabilities and investment property approximate their fair value due to the short-term nature of those assets and liabilities.

Financial risk management objectives

The Company's Corporate Finance provides support services to the business operations, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Company through internal risk reports analysing exposures by degree and magnitude of risks. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk and liquidity risk.

The significant risks, together with the methods used to manage these risks, are described below.

Categories of financial instruments (continued)

Market risk

(i) *Price risk*

The Company operates with international customers and finances its operations using foreign currency denominated borrowings to a significant extent. As a result, the Company is exposed to the effect of exchange differences and changes in interest rates. In addition, due to credit terms extended to its customers, the Company is exposed to a risk of default.

(ii) *Foreign exchange risk management*

The Company undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise. The carrying amounts of the Company's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

(in thousands of HRK)	**Liabilities**	
	31 December 2018	**31 December 2017**
The European Union (EUR)	507,318	625,701

	Assets	
	31 December 2018	**31 December 2017**
The European Union (EUR)	118,755	68,305

As at 31 December the exchange rate of HRK was as follows:

	31 December 2018	**31 December 2017**
EUR	7,417575	7,513648

36. FINANCIAL INSTRUMENTS (continued)

Categories of financial instruments (continued)

Market risk (continued)

Foreign currency sensitivity analysis

The Company is mainly exposed to the fluctuations in the exchange rate of the Croatian Kuna to the Euro (EUR). The following table details the Company's sensitivity to a 10% decrease in 2018 in the Croatian Kuna against the relevant foreign currency (decrease of 10% in 2017). The sensitivity rates below are used when reporting foreign currency risk internally to key management personnel and represents management's assessment of a reasonably likely change in foreign exchange rate. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for percentage change in foreign currency rates. The sensitivity analysis includes monetary assets and monetary liabilities in foreign currencies. A negative number below indicates a decrease in profit and other equity where the Croatian Kuna changes by above mentioned percentage against the relevant currency. For a reverse proportional change of the Croatian Kuna against the relevant currency there would be an equal and opposite impact on profit and other equity.

(in thousands of HRK)	**2018**	**2017**
EUR change impact		
Decrease of net result	(38,856)	(55,740)

The exposure to the fluctuations in exchange rates is mainly attributable to the borrowings, trade payables, trade receivables and deposits denominated in Euros (EUR). The Company does not currently hedge currency risk with respect to the EUR as the local currency is pegged against the EUR.

(iii) *Interest rate risk management*

The Company is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates, Part of the Company's borrowings are at variable rates. The Company is exposed to interest rate risk to the extent of the interest rate risk exposure of its parent.

36. FINANCIAL INSTRUMENTS (continued)

Interest rate sensitivity analysis

The sensitivity analyses below has been determined based on the exposure to interest rates at the reporting date. For floating rate liabilities the analysis is prepared assuming the amount of liability outstanding at the reporting date was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of a reasonably likely change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Company's: result before tax for the reporting periods is as follows:

As at 31 December 2018	**Contractual cash flows**	Up to 12 months	From 1 year to 2 years	From 2 to 5 years	Over 5 years
At currently applicable interest rates	**607**	607	-	-	-
At currently applicable interest rates + 0,50%	**645**	645	-	-	-
Effect of increase of interest rate by 50 basis points	**-**	**-**	**-**	**-**	**-**

As at 31 December 2017	**Contractual cash flows**	Up to 12 months	From 1 year to 2 years	From 2 to 5 years	Over 5 years
At currently applicable interest rates	**102,346**	22,412	21,144	58,790	-
At currently applicable interest rates + 0,50%	**103,208**	23,082	21,336	58,790	-
Effect of increase of interest rate by 50 basis points	**(862)**	**(670)**	**(192)**	**-**	**-**

Credit risk management

Credit risk refers to the risk that counterparty will default on its contractual obligations resulting in financial loss to the Company.

The Company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The Company defines counterparties as having similar characteristics if they are related entities. The most significant customer is the associated company HEP-ODS and it makes more than 72% of receivables on 31 December 2018.

36. FINANCIAL INSTRUMENTS (continued)

Credit risk management (continued)

Except as detailed in the following table, the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Company's maximum exposure to credit risk without taking account of the value of any collateral obtained.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Company's Management Board, which has built an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate reserves and credit lines, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Liquidity and interest rate risk tables

The following tables detail the Company's remaining contractual maturity for its financial liabilities and financial assets presented in the statement of financial position at the each reporting period end. The tables have been drawn up based on the undiscounted cash flows until maturity and include cash flows from both interest and principal.

As at 31 December 2018	**Carrying amount**	**Contractual cash flows**	Up to 1 year	1 - 2 years	2 - 5 years	Over 5 years
			(in thousands of HRK)			
Non-interest bearing liabilities:						
Liabilities for apartments sold	**1,257**	**1,257**	433	433	391	-
Other long-term liabilities	**297**	**297**	-	297	-	-
Trade payables	**241,769**	**241,769**	241,769	-	-	-
Payables to related parties	**236,060**	**236,060**	236,060	-	-	-
Other short-term liabilities	**102,827**	**102,827**	102,827	-	-	-
	582,210	**582,210**	**581,089**	**730**	**391**	**-**
Interest bearing liabilities:						
Loan liabilities	**495,565**	**678,012**	97,145	20,485	560,382	-
	495,565	**678,012**	**97,145**	**20,485**	**560,382**	**-**
	1,077,775	**1,260,222**	**678,234**	**21,215**	**560,773**	**-**

36. FINANCIAL INSTRUMENTS (continued)

Liquidity and interest rate risk tables (continued)

As at 31 December 2017	**Carrying amount**	**Contractual cash flows**	Up to 1 year	1 - 2 years	2 - 5 years	Over 5 years
			(in thousands of HRK)			
Non-interest bearing liabilities:						
Liabilities for apartments sold	**1,604**	**1,604**	405	405	794	
Other long-term liabilities	**958**	**958**	216	216	526	-
Trade payables	**206,933**	**206,933**	206,933	-	-	-
Payables to related parties	**308,409**	**308,409**	308,409	-	-	-
Other short-term liabilities	**80,213**	**80,213**	80,213	-	-	-
	598,117	**598,117**	**596,176**	**621**	**1,320**	**-**
Interest bearing liabilities:						
Loan liabilities	**618,851**	**726,127**	137,737	98,402	489,988	-
	618,851	**726,127**	**137,737**	**98,402**	**489,988**	**-**
	1,216,968	**1,324,244**	**733,913**	**99,023**	**491,308**	**-**

36. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (continued)

As at 31 December 2018	**Carrying amount**	**Contractual cash flows**	Up to 1 year	1 - 2 years	2 - 5 years	Over 5 years
			(in thousands of HRK)			
Non-interest bearing assets:						
Non-current receivables	**1,948**	**1,948**	666	666	616	-
Trade receivables	**30,756**	**30,756**	30,756	-	-	-
Receivables from related parties	**314,306**	**314,306**	314,306	-	-	-
Short term financial assets	**30,660**	**30,660**	30,660	-	-	-
Other short-term assets	**8,037**	**8,037**	8,037	-	-	-
	385,707	**385,707**	**384,425**	**666**	**616**	**-**
Interest bearing assets:						
Current financial assets	**15,167**	**15,470**	15,470	-	-	-
Cash and cash equivalents	**156,881**	**160,018**	160,018	-	-	-
	172,048	**175,488**	**175,488**	**-**	**-**	**-**
	557,755	**561,195**	**559,913**	**666**	**616**	**-**

As at 31 December 2017	**Carrying amount**	**Contractual cash flows**	Up to 1 year	1 - 2 years	2 - 5 years	Over 5 years
			(in thousands of HRK)			
Non-interest bearing assets:						
Non-current receivables	**2,514**	**2,514**	617	617	1,280	-
Trade receivables	**37,698**	**37,698**	37,698	-	-	-
Receivables from related parties	**343,986**	**343,986**	343,986	-	-	-
Other short-term assets	**8,037**	**8,037**	8,037	-	-	-
	392,235	**392,235**	**390,338**	**617**	**1,280**	
Interest bearing assets:						
Current financial assets	**13,318**	**13,349**	13,349	-	-	-
Cash and cash equivalents	**114,502**	**114,731**	114,731	-	-	-
	127,820	**128,080**	**128,080**	**-**	**-**	**-**
	520,055	**520,315**	**518,418**	**617**	**1,280**	**-**

37. EVENTS AFTER THE DATE OF FINANCIAL POSITION STATEMENT

/i/ On March 18, 2019, the Commercial Court in Zagreb issued a decision by which the Company's share capital was increased by the entry of assets by HEP d.d. for HRK 19,432 thousand and is increased to the amount of HRK 4,948,627 thousand.

/ii/ Supervisory Board, at the meeting held on April 10, 2019, made a decision to revoke Mr Ivica Modrić from the post of Member of the Management Board of the Company.

/iii/ Supervisory Board, at the meeting held on April 4, 2019, made the proposal for dismission of Mr. Mario Gudelj from the position of the President of the Management Board. The proposal was submitted to the HERA in accordance with the provisions of the Electricity Market Act.

37. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board,

Signed on behalf of the Company on 17 April 2019 by:

Zlatko Visković

Member of the Management Board

Mario Gudelj

President of the Management Board