Hrvatski operator prijenosnog sustava d.o.o.

HRVATSKI OPERATOR PRIJENOSNOG SUSTAVA d.o.o., ZAGREB

Annual report for the year ended 31 December 2017

This version of the annual report and financial statements is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the annual report and financial statements takes precedence over this translation.

Contents

BASIC CHARACTERISTICS OF THE BUSINESS YEAR

In accordance with the current legislative and regulatory framework, Croatian Transmission System Operator Ltd. (hereinafter referred to as: Company, or HOPS), has regularly performed its basic tasks: operating the electric power system of the Republic of Croatia, electric power transmission, maintenance, development and construction of the transmission network, 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 referred to as: EU) and the Energy Community.
In line with the Company Board's Plan for the period 2013-2017, the set operating objectives were mostly realized in 2017.

- **Electric power indicators**

The business year 2017 was characterized by secure and reliable operation of the transmission network and the entire electric power system (hereinafter: EPS), without major disturbances and interruptions in electricity supply, and in this respect the Company fulfilled its statutory duties and tasks. An exception was the coastal area of Croatia that in 2017 was exposed to extreme weather conditions. Thus, towards the end of January 2017, after long spell of Bora on the islands of Krk, Lošinj, Rab and Pag, there was the worst salt sediment in several last decades, which caused occasional power outages due to failures on above-ground lines and planned disconnections for cleaning the facilities. In the summer, particularly in July 2017, there were several fires in the greater area of Split causing outages and planned disconnections for the sake of extinguishing the fire. In spite of substantial non-availability of the transmission network, there were no significant disruptions in the electric power supply.

In 2017, the total electricity demand in the transmission network of the Republic of Croatia was 17.32 TWh, which is 3.28% more than in 2016.

The peak load of the EPS of 3,079 MW was recorded on 4 August 2017 at 14.00 h.

In 2017, 22.10 TWh of electricity was transmitted, which was a decrease by 3.20 % over 2016.

Losses in the transmission network amounted to 417.1 GWh, or 1.89% of the total electricity transmitted, which was 0.35% less than in 2016. The losses in the transmission network in 2017 were at the level of losses of other transmission system operators in the EU.

- **Operating performance**

In 2017, the income totalled HRK 1,861.7 million, and expenditures were HRK 1,508.1 million. Pre-tax profit amounting to HRK 353.6 million was reduced by HRK 64.6 million corporate income taxes (the current tax amounting to HRK 69.389 million was reduced by the deferred tax assets amounting to HRK 4.778 million), so the profit for the period (2017) was HRK 289.0 million. The profit consists of the income from assets put to use pursuant to the provisions of IFRIC 18 i.e. the connection fee amounting to HRK 55.2 million, the balance between the revenues and expenditures from the allocation of cross-border transmission capacities amounting to HRK 59.7 million, and the balance of other revenues and expenditures amounting to HRK 238.7 million.

The after-tax profit in 2017 was HRK 17.3 million or 6.4% higher than in 2016. The greatest share in the revenue from operations was accounted for by the provision of the public service of electric power transmission, which in 2017 amounted to HRK 1,389.0 million or 74.6% of the total profit.

- **Certification of Independent Transmission Operator**

The decision on issuing the certificate (hereinafter: 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), network utilization agreements, auxiliary services, telecommunications separation, business premises), their fulfilment was a high priority for the Company, and this was carefully organized and supervised throughout the year and completed successfully.

In 2017, three certification requirements were met (including a number of related intermediate dates).

In early 2017, the Agency received the Independent Audit Report concerning the separation of the telecommunications (hereinafter TC) system of HOPS, thereby fulfilling entirely the certification requirement related to the independence and separation of the TC system of HOPS from the TC system of HEP Telekomunikacije d.o.o. (a company owned by HEP d.d.).

With the establishment of the intraday market on the electric power exchange with products suitable for balancing, on 26 April 2017 CROPEX successfully launched an organised Day Ahead Market for electricity in the Republic of Croatia in which HOPS also participates in accordance with the provisions of the Electricity Market Act (hereinafter EMA).

In accordance with the Certificate, in 2017, HOPS terminated the Lease Agreement with HEP d.d. for the office building of the Osijek Transmission Area (Cara Hadrijana 3, Osijek), which meant fulfilling another requirements of the Certificate. In regard of this, two related intermediary deadlines were priority fulfilled in 2017 (completion of tradesmen's works including the installation of the lift and equipping the new premises). The office building in Osijek, purchased in 2015, required thorough reconstruction. Based on the preliminary, main and detailed designs, the remodelling of the building began. In early 2016, demolition works and preparatory works for the thorough reconstruction of the building were carried out. After the public tendering procedure, the contract for the reconstruction of the building was signed with the best bidder. The works started in June and were completed in 2016, including the construction of a substation (SS 10(20)/0.4 kV) to supply the entire location with electricity, featuring 2x630 kVA transformers. The relocation of employees, equipment and vehicles to the fully refurbished building was carried out in April 2017, meaning that this requirement was fulfilled two months ahead of the schedule.

Also in 2017, activities were continued for the construction of the office complex in Matulji. The existing office building of Transmission Area Rijeka in Opatija, on the basis of the separation carried out and following the requirements of the certification as an independent transmission operator, needs to be vacated because the building has remained the property of HEP Plc. In order to make the operation simpler and more efficient, a solution that included the construction of a new office complex in Matulji was accepted, permitting the operation of most of Transmission Area Rijeka at a single location in keeping with today's conditions and standards. The completion of the construction and relocation of Transmission Area Rijeka to the new location is expected in the 3rd quarter of 2018. The total value of the investment project is estimated at HRK 45 million. Due to its complexity this requirement, in spite of the efforts of HOPS, was prolonged by 120 days due to the circumstances which HOPS could not influence, and the Agency was notified accordingly in a timely fashion. The deadline the fulfilment of the requirement was prolonged for several reasons such as e.g. complaints by the bidders and prolongation of the deadlines in the public tendering procedures of high value, inclement weather, increase in the excavation quantities and changes in the suspension of the Glass facade of the building. The remaining activity of the termination of the lease agreement for the office building in Opatija that is owned by HEP d.d. and used by the Rijeka Transmission Area, is the last requirement of the Certificate.

- **Integration of renewable energy sources**

In 2017, 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 2017, 4 agreements were concluded for the connection of 5 wind farms with 279 MW maximum total power. Simultaneously, activities were initiated to prepare network connection contracts for 5 additional wind power plants with investors who expressed an interest in signing the contracts.

- **Investment**

In 2017, the Company realized the Investment Plan worth HRK 44,47 mil., thus achieving 94.42% of planned realization for the year 2017. The high realization of the Investment Plan was a consequence of the raising of the quality of planning and periodic monitoring of the realization of the plan, including the adoption of corrective measures. The Investment Plan mostly involved replacement and reconstruction of the existing facilities, electric power requirements for connections, capital investment and revitalization of facilities and transmission network facilities.

In 2017, the construction of the new 110/20 kV Zamet substation began, for which HOPS contracted the supply and installation of the primary equipment (110 kV GIS facility), procurement of secondary equipment and related works and services. The construction of a 110 kV facility of the 110/20 kV Medulin substation in the Rijeka Transmission Area was also completed including the connection 2x110 kV transmission line, whose commissioning is scheduled after the completion of the construction of the 20 kV facility for which HEP-ODS is in charge, foreseeable towards the end of 2018. Also contracted was the manufacture and delivery of a 110 kV GIS facility and the detailed design for the reconstruction of the Sućidar 110/20(10) kV substation. The reconstruction of the 110 kV Slavonski Brod - Andrijevci transmission line was also begun, which is the continued replacement of the old and worn 110 kV Đakovo - Andrijevci – Slavonski Brod transmission line with a new double 110 kV transmission line.

New transformers were installed at the substations Osijek 2, Pehlin, Bilice, and 220/110 kV network transformers were replaced at the substation of Pehlin and the Plomin thermoelectric power plant.

In February 2017, the co-financing of the SINCRO.GRID project was approved, to be realized in cooperation between Croatian and Slovenian operators of the electric power transmission and distribution systems – HOPS, HEP-ODS, ELES and SODO, amounting to EUR 40.5 million, which is 51 percent of the project value, from the Connecting Europe Facility (CEF), a program of support in financing infrastructure projects. In June 2017, INEA (Innovation and Networks Executive Agency) remitted EUR 2.6 mil. advance payment to HOPS to continue the implementation of the SINCRO.GRID project, for which the donation agreement was concluded in May 2017. In the second half of 2017, the preparation of the main projects for then installation of compensation facilities at the 400/220/110 kV Melina substation (VSR 200 MVAr) and the 220/110 kV Mraclin substation (VSR 100 MVAr), and applications were filed with public authorities for building permits.

In 2017, HOPS issued 13 prior power consents, of which 9 for the facilities connected to the transmission network (wind farms Korlat, Kozjak, Oton, Zebar, Kavranica, combined co-generation power plant Slavonski Brod, hydroelectric power plant Kosinj, reversible hydroelectric power plant Vrdovo and Block L at the Zagreb Thermoelectric Heat and Power Plant) and 4 approvals of the prior power consents issued by HEP-ODS (wind farms Ljubač, Monalp Gospić I and II, Monalp Donji Lapac I and II and Monalp Sisak I and II). Two more prior power consents were issued for newly-built wind farms (ZD6P and ZD6 54 MW and Lukovac 48 MW).

The year 2017 saw the technical acceptance of the connection of the ZD6P (and VE ZD6) wind farm. The plant obtained the operational licence on 11 October 2017, and ZD 6P was put in permanent operation. The technical acceptance of the 33/110 kV Velika Popina substation took place on 28 November 2017.

The technical inspection of the Katuni wind farm took place on 20 March 2017, and the connection of the Katuni wind farm was commissioned on 3 July 2017, so that the 30/110 kV substation Katuni and the related 2x110 kV connection transmission line became property of HOPS.

For the Glunča wind farm, the connection – 20/110 kV Glunča substation and the related 110 kV transmission line was commissioned in 2017(Commissioning Protocol of 16 May 2017)

In 2017, in-house technical acceptance of the Lukovac wind farm was carried out, and on 21 August 2017, the 30/110 kV Lukovac substation was energized (trial run). The commissioning of the connection of the Lukovac wind farm and its permanent operation is expected in 2018.

Following the harmonization between the Company and the HEP-Distribution System Operator, the public consultation with the interested public, and the approval of the Agency, in January 2018, the 10-year transmission network development plan for the 2018-2027 period was published, with detailed elaboration for the initial three-year and one-year periods. The aforementioned development plan is in line with the current ten-year European Network Development Plan (ENTSO-E TYNDP) and the surrounding areas regarding the connection to the transmission network; it is a fundamental development document of the Company.

- **Activities of the Croatian Power Exchange (CROPEX)**

After the launched Day Ahead Market for electric power in the Republic of Croatia on 10 February 2016, procedures for contracting and implementation of a trading platform for intraday trade in electricity were initiated in late 2016 and early 2017. Having successfully tested the trading platform with the power exchange members, the organised intraday market for electricity was launched on 26 April 2017, for the first time in the Republic of Croatia, with the first 4 members of the exchange who first successfully completed the registration of their membership on the intra-day market.

After the launched procedures and processes for connecting the Croatian Day Ahead Market with the EU-connected MRC market across the Croatian-Slovenian border in 2016, CROPEX and HOPS formally joined the regional IBWT (Italian Borders Working Table) project in March 2017 and became full member of the IBWT project, which formally started the process of connecting the Croatian Day Ahead Market to the MRC electricity market.

In 2017, the schedule for the project with framework dates for the connection of the Croatian electricity market to the MRC market, expected in the second quarter of 2018, were defined and approved by the Management Board of the IBWT.

In January 2017, CROPEX and HOPS received the request of the 4M MC countries (operators of the transmission system and the electric power exchange of four interconnected Day Ahead Markets of Hungary, the Czech Republic, Slovakia and Romania) with the desire to connect the mentioned interrelated market with the MRC connected market across the Croatian-Hungarian border, including the potential merger of this project with the already started project to connect the Croatian market to the MRC market across the Croatian-Slovenian border. After consultations between HOPS and CROPEX, a joint response was sent to 4M MC parties, expressing the readiness of the Croatian side to begin with the project, with the additional emphasis on the need to separate the projects concerned. The HR-4M MC project was informally launched in 2017, and the „Analysis of the preconditions of the possibility of a 4M-HR coupling" was prepared as one of the documents on the basis of which to decide on the formal launching of the project of the extension of the MRC connected market (MRC Extension). Likewise, the joint document HR-4M MC High Level Roadmap was prepared to define the potential date for the connection of the mentioned markets in January 2019.

Considering the recognized and established risks of the project, which particularly relate to the overlap with the existing CORE FB MC project, the risks of the change of the time of closing the market in some of the 4M MC countries, the relation with the effective MRC agreements (MRC DAOA) and alike, the Croatian side in cooperation with the 4M MC parties sent a letter to all regulatory agencies of the 5 relevant countries on 19 September 2017, asking for support and further instructions concerning the formal initiation i.e. continuation of the HR-4M MC project for connecting the electricity market across the Croatian-Hungarian border.

Having acquired the observer status with the CORE FB project with a view to implementing the market connection by using the method of stream management for the calculation of cross-border capacities, in 2018, CROPEX cooperated with HOPS and initiated the procedures of formally joining the project, so that full membership is expected in early 2018.

In early 2016, CROPEX and HOPS formally joined the so-called accession stream project for cross-border connection of intraday electricity markets Cross Border Intraday Market Project (XBID). The main goal of the project is to set up cross-border intraday indirect continuous allocation of cross-border transfer capacities on the Pan-European level in a uniform manner, in accordance with EU CACM regulations. The implementation of the XBID project is organized through a number of different local implementation projects.

Considering that in April 2017, CROPEX successfully launched the local continuous intraday electricity market, HOPS and CROPEX began to analyse potential options for joining one of the existing European LIPs, and having made the analysis, in July 2017, they sent an official letter to the presiding company of the 15th LIP, Austrian Power Grid, with the request to admit HOPS and CROPEX with the Croatian Hungarian border to their LIP that is constituted of the transmission system operators and nominated electricity market operators of Germany, Austria, the Czech Republic, Romania and Hungary. The main goal of the involved parties is to start an intraday connected market through the XBID project in the so-called second wave of connection i.e. at the first possible moment after the connection of the first LIPs scheduled in the first quarter of 2018. On 22 August 2017, at the meeting of the Management Board of the 15th LIP the decision was reached to include HOPS and CROPEX as full members in this LIP, thereby formally including the Republic of Croatia into the local implementation cross-border project of intraday electricity market connection. LIP 15 is scheduled to go live in the first quarter of 2019.

- **International activities of the Company**

In accordance with its legal obligations, the Company cooperates on then 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. In 2017, this process was completed with the entry into force of the remaining three regulations (whose drafts were adopted by the EC and EU Member States at the meetings of the Cross-border Committee, in a long process of „comitology") – the System Operation Guideline (SOGL), the Guideline on Electricity Balancing (GLEB) and the Network Code on Emergency and Restoration (ER).

In the context of its numerous and extensive international activities and obligations, the Company continued to participate in the activities of the European Network of Transmission System Operators (hereinafter referred to as ENTSO-E), its working bodies (boards and groups) and its Assembly, thereby joining the current processes on the pan-European level. Of particular importance were the activities focused on the region of Southeast Europe primarily concerning the market where the representatives of HOP play a prominent role in the ENTSO-E contacts with the European Commission (hereinafter: EC) and the Energy Union (within their initiatives such as CESECe and WB6) and their support for the extension of the MRC to Southeast Europe, to which the sole active MRC extension project – the aforementioned connection of the Croatian market with the MRC across the Croatian-Slovenian border – is of special importance (LIPs).

Of particular importance were the activities pursuant to the proposals for new and revised EU energy regulations in the package titled "Clean Energy for All Europeans" i.e. the so-called "Winter Package", 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 reach the best possible legislative framework for the EU energy sector through extensive discussions and harmonization. The process of adoption of the EU energy regulations within the "Clean Energy for All Europeans" package is entering its final stage where even more intensive cooperation of the Company with other relevant subjects in the Republic of Croatia is required.

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, with discussions and decisions about proposed relevant documents (contracts, plans ...) .

In November 2017, the successful realization of the first extension of the scope of the Joint Allocation Office (hereinafter: JAO) from its foundation, involving JAO, HOPS and the Serbian EMS transmission system operator, the auctions of the cross-border transfer capacities on the Croatian-Serbian border are included in the auctions conducted by JAO. Thus, in accordance with its obligations under relevant regulations, HOPS included all its borders in the regional coordinated auctions and with the implementation of the Harmonised Allocation Rules (HAR) on all borders enabled further development of the cross-border electricity market of the EU and the Energy Union.

A prerequisite to this was also the implementation of HAR in SEE CAO (Southeast European Coordinated Auctions Office Ltd) that conducts the explicit coordinated auctions on the borders of its co-owners, SEE transmission systems operators (and among them HOPS), including the border between Croatia and Bosnia and Herzegovina. This was enabled through a new set of auction rules for SEE CAO to implement HAR as an early implementation of the Guidelines for the Forward Capacity Allocation (FCA GL) even before it became mandatory for the borders outside the EU, as initiated by HOPS.

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 European and Central European operators. In 2017, the Company continued to use TSC services even after the establishment of a joint office in Munich (Germany) and its transformation into a joint limited liability company under German law (TSCNET Services GmbH). In 2017, the Company re-joined the MRA Agreement (Multilateral Remedial Action, hereinafter: MRA) to jointly eliminate congestion in the network of TSC operators, and in October, the first activation took place in which power plants from the Croatian EES participated in the multilateral elimination of congestion.

Following the evaluation of the received binding bids for the preparation of the Feasibility Study (with environmental and social impact assessment) for the project of "Strengthening the main Croatian North-South transmission axis and enabling the development of new interconnections" (which in addition to internal lines also included the new Banja Luka–Lika 400 kV transmission line) in accordance with EBRD procedures (which will fund the preparation of the study with a grant of EU 1.1 million) the selected best bidder is the consortium of the Hrvoje Požar Energy institute, Dalekovod-Projekt d.o.o. and AF Consulting Ltd. After the completion of the negotiations with the selected bidder and the approval of the EBRD in March 2018 the EBRD Grant Agreement and the Consultancy Contract were signed with the mentioned consortium, and the realization of the project began.

In 2017, there were intensified and comprehensive activities in the implementation of the Commission Regulation (EU) 2015/1222 of 24 July 2015 on setting up the Guidelines on Capacity Allocation and Congestion Management (CACM) that are almost exclusively within the framework of the Core Capacity Calculation Region (Core CCR) extending from the Adriatic Sea to the Baltic Sea and from the North Sea to the Black Sea. The Core region encompasses the previous regions of Central West Europe (CWE) and Central East Europe (CEE), including the Croatian borders with Slovenia and Hungary. After the formal beginning of operation o the Core CCR level with the establishment of a number of working and management bodies, and the preparation of the documents necessary for its operation (particularly in regard of the allocation of expenses and methods of decision making), the drafting of the documents began (e.g. methodologies) that are to be offered for public debate and/or approval of the national regulators within Core CCR in accordance with the CACM requirements.

Regional co-operation of HOPS was continued in the Slovenia-Croatia-BiH control-regulation block, for which the new Agreement on Joint Sharing of Regulation Reserves was adopted and whose implementation was joined by NOS BiH. Through the mediation of HOPS between the partners in the SHB block (ELES and NOS BiH) activities were arranged that should enable a more transparent and efficient operation of the block and thus prevent its possible dissolution which would require a rapid increase in financial, personnel and technical resources of HOPS.

Activities with the neighbouring TSOs were also intensified in a series of topical meetings on different levels with Slovenian ELES and to a somewhat lesser extent with Hungarian MAVIR, Serbian EMS, and Bosnian-Herzegovinian NOS BiH and Elektroprenos-Elektroprijenos BiH, to discuss subjects of common interest.

In February 2017, HOPS became a member of the European Renewables Grid Initiative (RGI) that promotes cooperation between European non-governmental organizations (NGO) and the leading transmission system operators (TSO). Through its activities RGI promotes investment in transmission network projects whose substantial portion of income is earmarked for support to the projects of general benefit to society.

- **Personnel**

In 2017, the Company employed 45 new employees, while in the same period 35 employees left the Company. As of 31 December 2017, the Company had 1,105 employees or 10 more than on 31 December 2016. The increase in the number of employees is in accordance with the Management Operation Program, and it ensures the necessary number of operators to fulfil the Company's legal obligations.

- **Collection of payment**

The total net receivables from customers as of 31 December 2017, are HRK 37.7 million.

The receivables mostly refer 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 48 network users connected directly to the Company's transmission network, with 86 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 total HRK 11.4 mill., of which HRK 5.6 mill. is suspicious and debatable.

Suspicious and debatable receivables are related to the companies in bankruptcy (Adria Čelik d.o.o. HRK 4.6 mill.) and pre-bankruptcy settlement procedures (Adrial Plus d.o.o. HRK 996 thousand) i.e. debts claimed in legal action that are wholly corrected against the period when bankruptcy proceedings were initiated or the claim for debt recovery was filed with the court, or when the debt was filed in the pre-bankruptcy settlement procedure.

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 mill) of HRK 3.7 mill. total claims, whereas 30% (HRK 1.1 mill.) are to be paid without interest in 36 equal monthly instalments.
The bankruptcy proceedings of Adria Čelik d.o.o. in which the Company claims HRK 4.6 mill. have not been completed until the date of this report.
Receivables from the balance group leaders for balance energy as of 31 December 2017 total HRK 28.1 mill., of which HRK 6.3 mill. are unmatured receivables. The reason for the substantial increase in the receivables is invoicing the first calculation of the balance for December 2017, and implementation and invoicing a different calculation of the balance for 2017 that was introduced in February 2018.
The following activities are being undertaken for the collection of debts: continuous monitoring of collection, issuance of reminders, activation of payment security instruments, execution of enforcement procedures, continuous contact with the customers by telephone and electronic means.

- **Legal framework**

In 2017, the Company was intensively involved in drafting and amending of the by-laws that are key to the Company: Transmission System Network Rules, Rules for Balancing Electric Power System, Regulation on Network Connection, Methodology for Determining Charges for Connecting and Increasing the Connection Power.

Pursuant to the EMA and the Agency's approval, the Company adopted the Amendments to the Rules for Balancing Electric Power System in March 2017 (NN 135/2011), and the Transmission System Network Rules in July 2017 (NN 67/2017).

- **Research and development**

In 2017, 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 analysis of the effects of the development and construction of renewable sources of energy in the Republic of Croatia from 2007 to 2016, whose completion is planned for the first quarter of the year 2018.

In 2017, 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 Advanced Integration of Renewable Sources (SIREN). Activities were carried out in accordance with the schedule approved by the HRZZ. In line with the conclusions of the activities that have been carried out so far, papers were written and presented in international conferences and internationally recognized journals. The preparatory stage also includes the activities for filing applications for the Horizon 2020 project that is to gather a larger number of participants from the HEP Group and partners from scientific institutions and industry.

In January 2017, HOPS joined the international consortium of partners for the participation in the EU project CROSSBOW (framework Horizon 2020). In May 2017, the project was approved by the European Commission and a Grant Agreement was prepared and signed. The project started on 1 November 2017 and is scheduled to last four years. The company is to participate with 122 man-months with the approved funding grant of EUR 550,000. The participation of the Company in the project makes available the knowledge of new technologies, and the acquisition of a valuable reference for subsequent participation in similar EU projects. Furthermore, the participation in the CROSSBOW project makes visible the active role of the Company in dealing with the challenges of the integration of renewable energy sources and catching up with the EU goals for the implementation of clean technologies. The project plan envisages comprehensive involvement of the Company staff throughout the project, particularly in the project phase of „Demonstrations" where the Company is the guide and demonstrator.

- **Fleet renewal**

At the end of 2017, 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 launched a public procurement procedure for 64 new vehicles (passenger and four-wheel-drive) for the needs of all organizational units of the Company. The completion of the procedure, contracting for and procurement of new vehicles are scheduled in April 2018.
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.

1. DEVELOPMENT AND ORGANIZATION OF THE COMPANY

- **Background**

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 4,929,195,000.00.
The Company engages in the regulated activity of electricity transmission. The 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 of 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 above-mentioned activity 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:

1. Perica Jukić – Chairman until 31.12.2017; Frane Barbarić – Chairman since 01.01.2018

Supervisory Board:

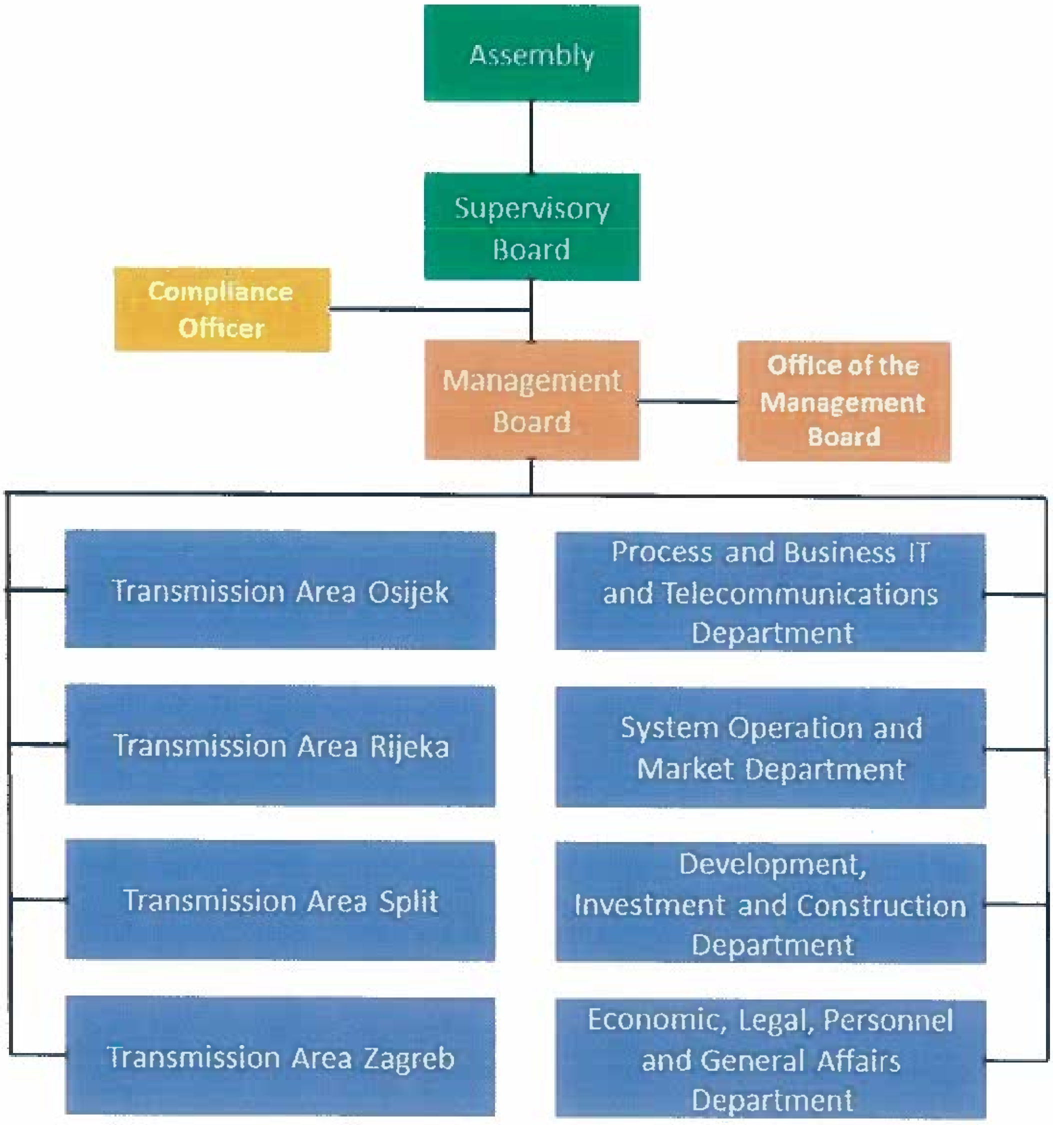
1. Kažimir Vrankić – Chairman
2. Alina Kosek - Vice-chairperson
3. Ante Pavić - Member
4. Denis Geto - Member – employee representative
5. Marijan Kalea - Independent member

Management Board:

1. Miroslav Mesić - Chairman
2. Zdeslav Čerina - Member
3. Darko Belić - Member

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 Organization of the Company



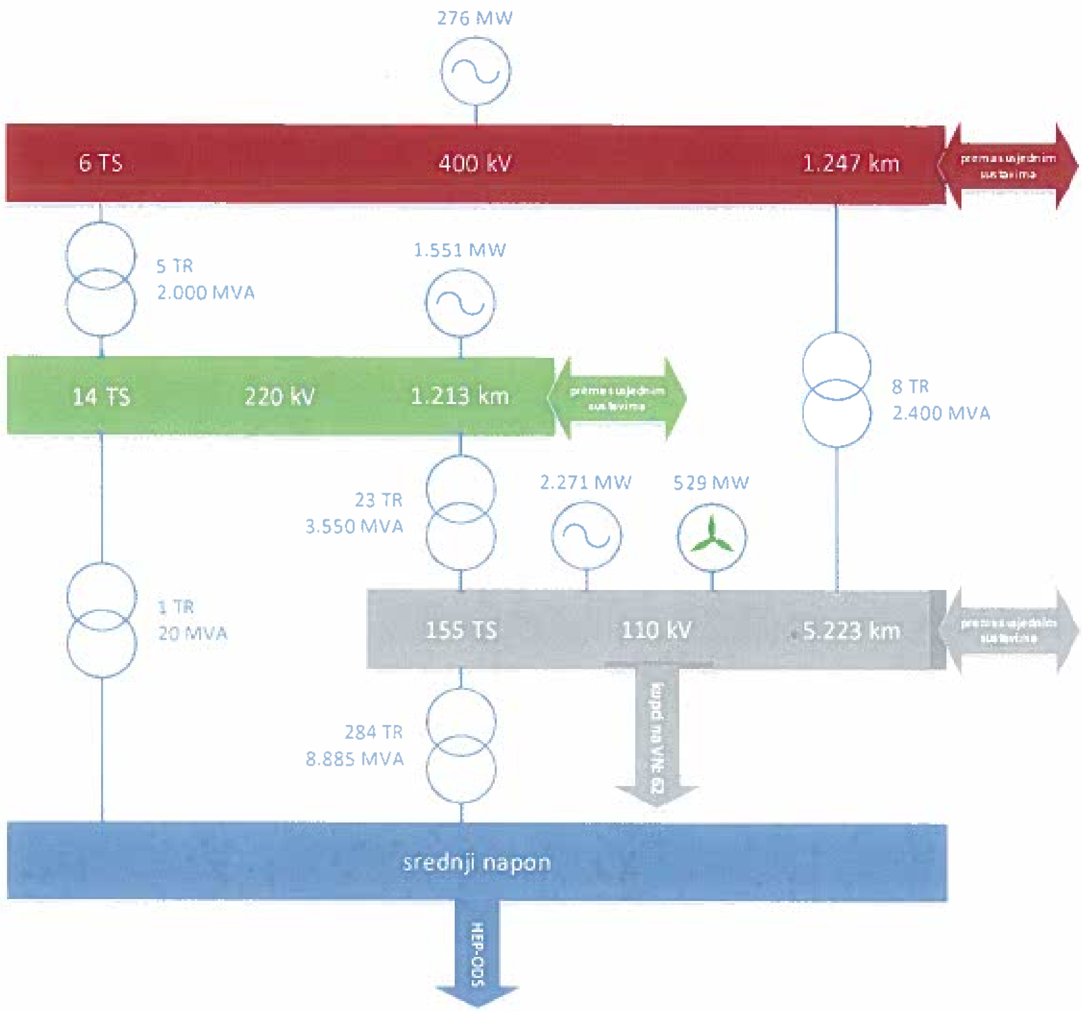
2. REPORT ON SUPPLY SECURITY IN THE ELECTRIC POWER SYSTEM OF CROATIA IN 2017

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 2017) is networked in six 400 kV substations, fourteen 220 kV substations and one hundred and fifty-five 110 kV switchyards 110/x kV substations.

Figure 2 Technical indicators of the EPS in Croatia by voltage – situation at the end of 2017



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.

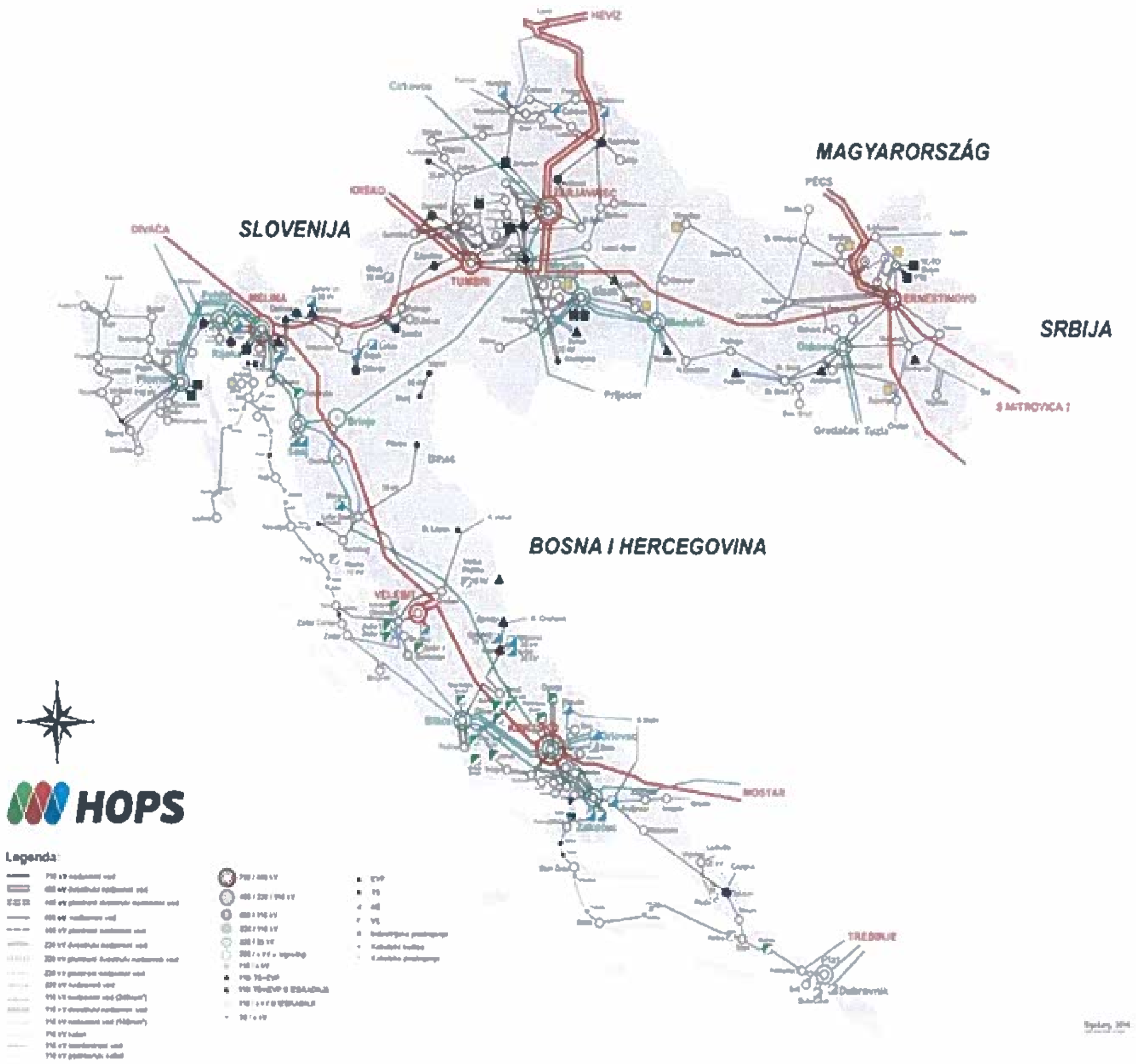
Of the generation facilities, only the Velebit reversible hydroelectric power plant is connected to the 400 kV network.

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 2017) HOPS owns 7,683 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 sufficient 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

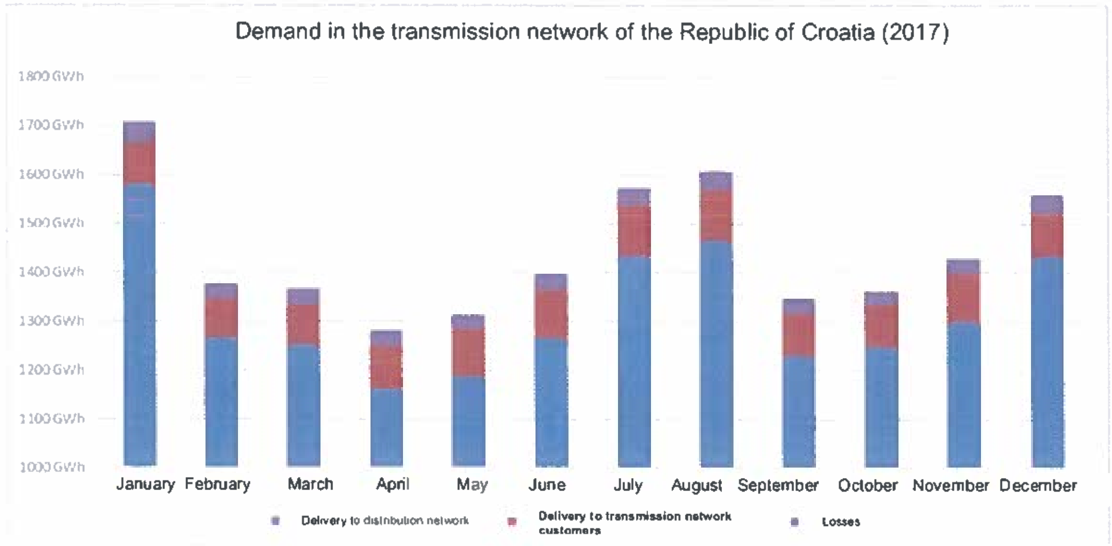
Figure 3. The 400-220-110 kV transmission network in the Republic of Croatia, situation at the end of 2017



2.2 SECURITY OF SUPPLY IN 2017

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 in 2017.
The peak hourly load in Croatia's EPS was recorded in summer, while the maximum total monthly electricity demand in the transmission network was recorded in January (1707 GWh).

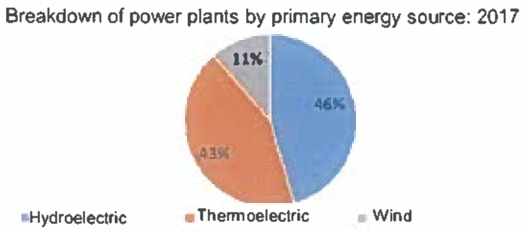
Figure 4. Demand in the transmission network of the Republic of Croatia in 2017



Available generation units presented according to the approved connection power broken down by the primary source of energy, solely the units connected to the transmission network, are shown in Figure 5.

Figure 5. Connection power of the power plants in the transmission network in the Republic of Croatia in 2017

Primary source	Connection power /MW/	/%/
Hydroelectric	2104	45.47%
Thermoelectric	1994	43.09%
Wind	529	11.43%
Σ	4627	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 that put the EPS of Croatia among the best-connected systems in Europe

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

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

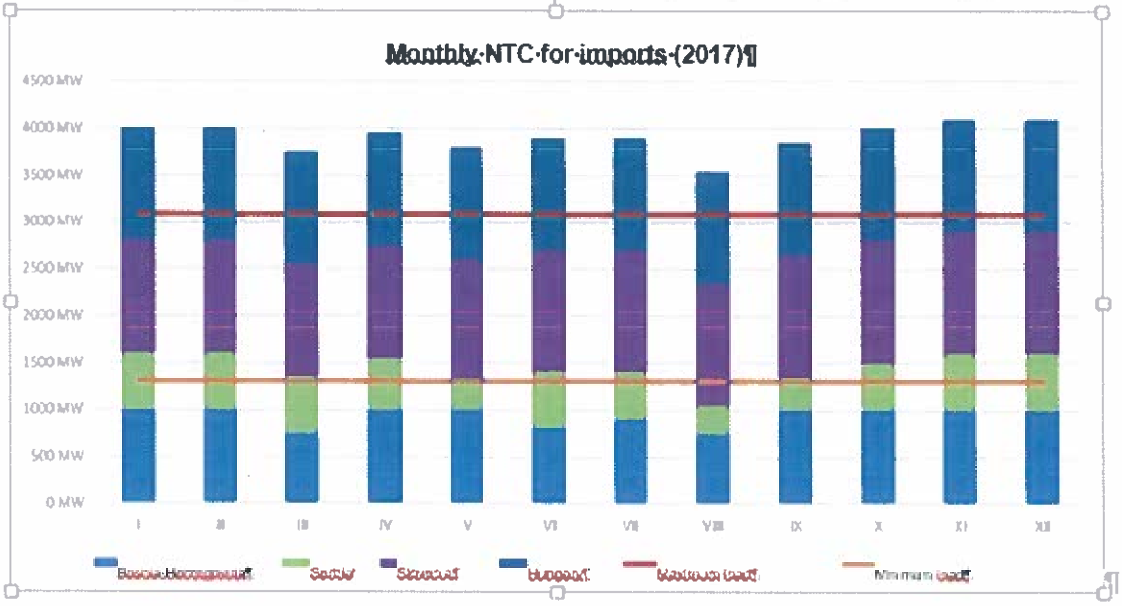
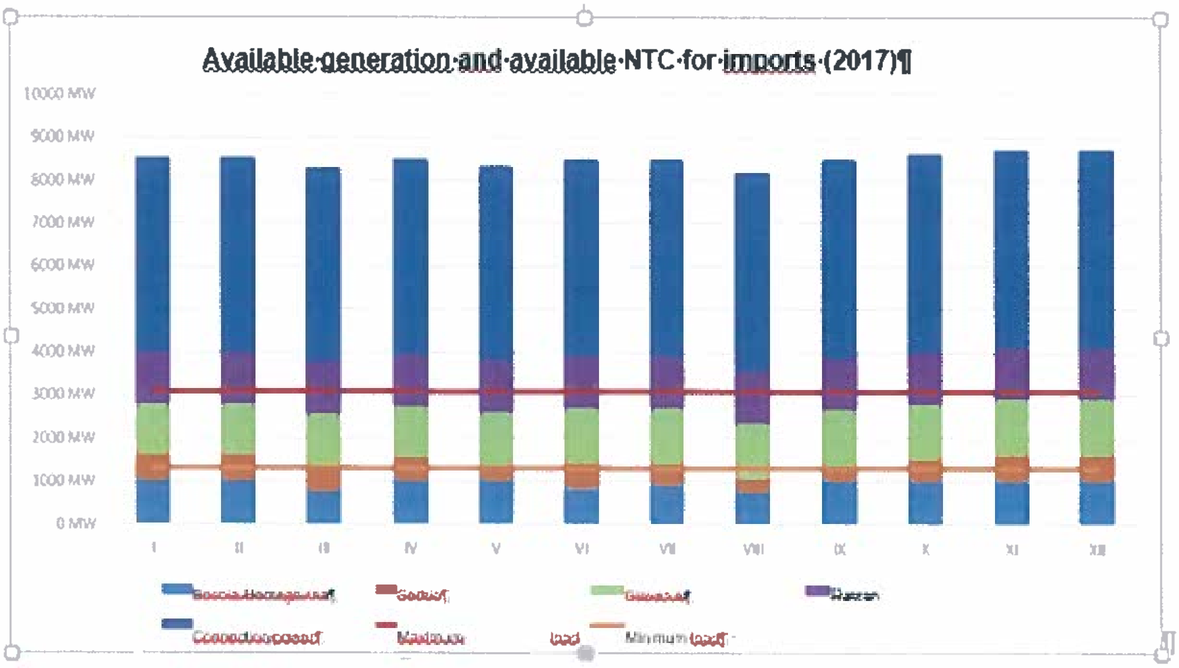


Figure 7. Available generation and available cross-border transfer capacities in relation to the minimum and maximum load in the transmission network



2.3 LOSSES IN THE TRANSMISSION NETWORK IN 2017

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 2017 totalling 417.1 GWh are shown n Figure 8

Figure 8. Total losses in 2017

In 2017, the total energy transmitted was lower than in the previous years, and accordingly, the total losses in the transmission network in 2017 were lower compared to previous years. The share of the losses in the energy transmitted was the lowest in the period under scrutiny from 2012 to 2017

In 2017, losses in the transmission network amounted to 1.89 % of the total energy transmitted and were lower for 0,35 % compared to the previous year.

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 contact means procurement through public tender for known amounts of electricity, the selection criterion being the lowest bid price that meets all bidding conditions.

Short-term procurement means the procurement of electricity to cover the losses on the Croatian Electricity Exchange (CROPEX).

3. OPERATING PERFORMANCE AND FINANCIAL POSITION OF THE COMPANY IN 2017

The Company's operating performance in 2017 is presented in the Comprehensive Income Statement for the period from 1 January 2017 to 31 December 2017, and the and the financial position in the Financial Position Statement as of 31 December 2017. Below are the above-mentioned statements featuring the most important items.

3.1 OPERATING PERFORMANCE

The Company finished the business year 2017 with pre-tax profit for the period of HRK 353.63 mil. Total realized profit consisted of income from assets put to use in accordance with IFRIC 18 provisions, i.e. the connection fee amounting to HRK 55.2 million, the balance of income and expenses related to the allocation of cross-border transfer capacity amounting to HRK 59.7 million and the balance of other income and expenditures amounting to HRK 238.7 million. In relation to the previous year, the realized profit was up 28.6% while the after-tax profit was up 6.4%.
The profit increase was mostly influenced by the growth of the income from the balancing electricity charges that in spite of the postponed beginning of the operation of EKO BG were several times higher than in the preceding year, the proceeds from the allocation of cross-border transfer capacities that were 70.8% higher than in the preceding year, and lower cost of the losses that were 19% lower than in the preceding year.

Total income consisted mostly of power transmission services (74.6%), revenues from charging balancing electricity (9.8%), sales of cross-border transfer capacities (6.1%), balancing energy sales (3.2%) and connection fees (3.0%). Other operating income refers to the income generated from the Inter-Transmission System Operator Compensation (ITC), sales of telecommunications services, income generated from the use of our own products and services, collected written-off receivables, income from property received free of charge, income from non-standard services, termination of provisions and other business and financial income.

The main items of total expenditures were depreciation expense (21.0%), staff expenses (14.0%), maintenance expenses (6.0%), and from other operating expenses, the supporting services expenses together with balancing electricity expenses (35.1%) and transmission network losses (7.8%).
Financial expenditures mainly related to interest and exchange rate exposure.

The corporation income tax in 2017 was HRK 64.6 million, considerably higher than in the previous year due to the amendments to the provisions of the Corporation Income Tax that for the year 2017 abolished the tax relief for re-investing profit over the year. In 2016, the Company used the tax relief for reinvesting the profit in capital investments amounting to HRK 271.7 million, which resulted in lower payment of the current corporation income tax amounting to HRK 54.3 million.

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	2017	2016	Difference	17/16
1	2	3	4 (2-3)	5 (2/3)
Revenues from sales and other business incomes	1,854.3	1,662.9	191.4	11.5%
Business expenditures	(1,475.8)	(1,366.0)	(109.8)	8.0%
PROFIT FROM BUSINESS ACTIVITIES	**378.5**	**296.9**	**81.6**	**27.5%**
Financial income	7.4	12.1	(4.7)	-38.8%
Financial expenditures	(32.3)	(34,1)	1.8	-5.3%
Net financial expenditures	**(24,9)**	**(22.0)**	**(2.9)**	**13.2%**
TOTAL INCOME	**1,861.7**	**1,675.0**	**186.7**	**11.1%**
TOTAL EXPENDITURES	**(1,508.1)**	**(1,400.1)**	**(108.0)**	**7.7%**
Pre-tax profit	353.6	274.9	78.7	28.6%
Income tax	(64.6)	(3.2)	(61.4)	1,918.8%
PROFIT FOR THE PERIOD	**289.0**	**271.7**	**17.3**	**6.4%**

Based on the above items, as shown in Table 2, earnings before net financial expenditures and current tax (EBIT) were HRK 378.50 million, which is 27.5% higher than 2016. EBITDA (EBIT excluding depreciation) was HRK 695.78 million, which is 16.9% higher than in 2016.

Table 2. Financial indicators (in HRK million)

Description	2017	2016
EBIT (pre-tax profit and net financial expenditures)	378.50	296.89
EBITDA (EBIT without the effect of amortization)	695.78	594.97
EBIT margin	20%	18%
EBITDA margin	38%	36%
Net profit margin	16%	16%

3.2 FINANCIAL POSITION

The financial position of the Company is presented in the Financial Position Statement as of 31 December 2017.
Table 3 shows the Financial Position Statement (Balance Sheet) with the most important items and a comparison with the previous year's performance.

Table 3. Extract from the Financial Position Statement of the Company (in HRK million)

Description	31 December 2017	% share	31 December 2016	% share	17/16
1	2	3	4	5	6 (2/4)
Long-term assets	6,033.1	91.4%	5,625.2	90.5%	7.3%
Short-term assets	566.9	8.6%	588.4	9.5%	-3.7%
Total assets	**6,600.0**	**100.0%**	**6,213.6**	**100.0%**	**6.2%**
Capital and reserves	5,223.7	79.1%	4,641.6	74.7%	12.5%
Long-term obligations	662.5	10.0%	755.8	12.2%	-12.3%
Short-term obligations	713.8	10.8%	816.2	13.1%	-12.5%
Total obligations and capital	**6,600.0**	**100.0%**	**6,213.6**	**100.0%**	**6.2%**

The total value of assets as of 31 December 2017 was HRK 6.600.0 million and compared to 31 December 2016 it was up HRK 386.4 million or 6.2 %.

As a result of investment in 2017, long-term assets increased by HRK 407.9 million and now amount to HRK 6,033.1 million. The share of fixed assets in total assets, compared to 2016 increased by 0.9 %.

Current assets amount to HRK 566.9 million and they decreased by HRK 21.5 million compared to the previous year, mainly due to the decrease in the receivables from related companies, which are down by HRK 54.3 million. The share of current assets in total assets decreased by 0.9%.The largest share of current assets as of 31 December 2017 related to unmatured receivables from HEP-ODS Ltd and HEP Generation Ltd. concerning the power transmission fee amounting to HRK 249.8 million.

Capital and reserves, which cover 79.1% of the total assets of the Company, increased by HRK 582.1 million due to the realized profit in 2017 and the increase of the share capital by bringing in assets worth HRK 293.1 million, so the share is 4.4% higher than in 2016.

The Company's share capital as of 31 December 2017 was HRK 4,929.2 million. In 2017, the Company increased its share capital by HRK 271.7 million from the realized and reinvested earnings of the previous year, whereas in 2017 and to date, the Company has increased the share capital by bringing in assets of HEP Plc amounting to HRK 293.1 million (properties along motorways and other energy assets).

Total liabilities amounted to HRK 1,376.3 million, which is down HRK 195.7 million from 2016, and their share in liabilities has decreased from 25.3% to 20.8%. Long-term liabilities account for 48.1% and short-term liabilities for 51.9% of total liabilities as of 31 December 2017.

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 repay 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 2017 was 2.27 years and it is lower than in the previous year by 0.49 years.

4. INVESTMENTS

In 2017, investments totalled HRK 443.47 million. The largest share consists of investments in replacement and reconstruction of existing transmission infrastructure, electrical power conditions for connection, and new capital facilities i.e. investment projects. The level of realized investment in 2017 was down 2.1% from the previous year, mostly due to lower investment activity co-financed by foreign investors.

Table 4. Investment in 2017 (HRK)

Type of investment	31 December 2017	% share	31 December 2016	% share	17/16
1	2	3	4	5	6 (2/4)
Preparation of investments	8,894,918	2.0%	12,638,231	2.8%	-29.6%
Replacement and reconstruction	159,636,145	36.0%	166,181,113	36.7%	-3.9%
Revitalization	72,452,618	16.3%	59,059,313	13.0%	22.7%
Repairs and renewal	-				
New facilities	86,046,461	19.4%	71,120,211	15.7%	21.0%
Other investments	55,289,373	12.5%	34,867,542	7.7%	58.6%
Electrical power conditions for connection	61,145,734	13.8%	109,312,752	24.1%	-44.1%
Total	**443,465,249**	**100.0%**	**453,179,163**	**100.0%**	**-2.1%**

4.1 THE MOST IMPORTANT INVESTMENTS

Listed below are the most important investments that were partly or entirely realized in 2017.

(1) SS 110/20 kV Sućidar (calculated in 2017: HRK 8,970,305)

The reconstruction includes building a new closed facility 110/20(10) kV in a building to be erected in part of the area of the existing corporate fleet of the Split Transmission Area, with 110 kV network cable connections. In 2017, the building permit was obtained for SS 110/20(10) kV Sućidar and 110 kV network connection, and the manufacture and supply of metal-shielded SF6 facility was contracted, plus the preparation of the detailed plan.

(2) TL 110 kV Sl. Brod - Andrijevci (calculated in 2017: HRK 13,871,354)

In mid-2017, the work were contracted and begun on the reconstruction of the 60-year old TL 110 kV Slavonski Brod – EVP Andrijevci, total length 21 km. This single-system line will be reconstructed in to a two-system line and connected to the recently reconstructed TL 110 kV Đakovo – EVP Andrijevci, which has been reconstructed similarly to a two-system line. In addition to the security of power supply, this will also substantially increase the transmission capacity of the 110 kV power link between Đakovo and Slavonski Brod as important consumer areas in Slavonija and Baranja. Works are under way, and by the end of 2017, they should be approx. 50% completed and continued in 2018, when in the middle of the year the occupancy permit should be obtained and the power connection commissioned between SS 110/35/10 kV Slavonski Brod and EVP Andrijevci.

(3) SS Valpovo, replacement of power transformers (calculated in 2017: HRK 3,969,561.

At SS Valpovo, due to its age, the power transformer 110/35 kV No. 1, 20 MVA was replaced by a new one of the same output.

(4) SS Osijek 2, replacement of power transformers 110 kV (calculated in 2017: HRK 9,167,344)

Under the framework agreement, two transformers 110/35 kV, 40 MVA were ordered and delivered. However, by the decision of a Board Member, one unit was urgently transported and installed at SS Pula Dolinka, whereas the other one was installed at SS Vinkovci as TR No.2, because of a great failure of the existing unit.

(5) HE-SS SENJ – replacement of the primary and secondary equipment (equipment and works) (calculated in 2017: HRK 6,206,301)

In 2016, works and equipment were contracted to replace part of the primary equipment and the entire secondary equipment. At the beginning of April 2017, works were begun on the replacement of the complete equipment for control, monitoring, protection and measuring. The works for the replacement of the secondary equipment were completed in November 2017. The works for the replacement of the bus system 110 kV bus +W1 and +W2 will take place when HEPP Senj is shut down, scheduled in August and September 2018.

(6) SS 220/110/35kV PEHLIN – power transformer with voltage regulation 220/110kV 150 MVA and power transformer 110/35kV 40 MVA (procurement and installation) (calculated in 2017: HRK 19,525,220)

In a joint procurement towards the end of 2015, a framework agreement was concluded for the procurement of power transformers for two-year needs of HOPS, on the basis of which the manufacture of the mentioned transformers was contracted for SS Pehlin. In 2017, the transformers were ordered and delivered, and they are ready for transport. The installation and commissioning is scheduled for January, February and March 2018.

(7) Administrative building of the Rijeka Transmission Area (calculated in 2017: HRK 24,926,300)

In 2016, after a public tendering procedure, a contract was signed with the best bidder for the construction of a completely new administrative building for the Rijeka Transmission Area in place of the old administrative building in Matulji. External companies were hired to supervise the works. The demolition works and the preparatory works for building began in November 2016 and were continued in 2017. RC works on the administrative and service building were completed in 2017, as well as part of the works to close the administrative and service buildings. The tradesmen's works, mechanical and electrical works took place following every stage of the RC works in 2017. The scheduled completion of the construction is June 2018, and moving in is scheduled in August 2018.

(8) SS Bilice – replacement of the second transformer 63 MVA (calculated in 2017: HRK 5,465,300)

At SS Bilice, a failed transformer was replaced by a new power transformer of the same technical characteristics, (110/30 kV, 63MVA).

(9) SS Kraljevac – revitalization (calculated in 2017: HRK 8,131,394)

The works on the reconstruction of SS 110/35 kV Kraljevac were contracted in late 2015 and begun in early 2016. The reconstruction is taking place in 5 stages, of which three were completed in 2016, and the remaining two were completed in 2017. The reconstruction is complete and the entire facility is undergoing a test run.

The reconstruction included the replacement of the complete primary and secondary equipment, bus system, auxiliary power system, and the disposition of the equipment in the external facility in accordance with new trends in making primary parts of facilities (new roads through the facility to enable unimpeded access to all devices).

(10) SS Zadar – reconstruction (calculated in 2017: HRK 6,736,759)

Works on the reconstruction of SS 110/35 kV Zadar were contracted in late 2016 and begun in early 2017. The reconstruction is taking place in two stages, of which the first one was completed in 2017, whereas the second one continues in 2018.

The reconstruction includes the replacement of the complete primary and secondary equipment, bus system, auxiliary power system, and the disposition of the equipment in the external facility in accordance with new trends in making primary parts of facilities (new roads through the facility to enable unimpeded access to all devices).

(11) SS Koprivnica – replacement of primary and secondary equipment (calculated in 2017: HRK 8,763,262)

In 2017, at SS 110/35 kV Koprivnica, a new provisional operation of the 110 kV facility was set up: from the existing TL portals within the facility connections were set up by means of cable connections, direction „North-South“: TL 110 kV HE Dubrava - Bjelovar and DV 110 kV Ludbreg - Križevci. To the first connection the TL 110 kV Virje was connected by cable in T-coupling. In addition, to either T-coupling connections one each of the two existing 110 kV transformer fields were connected with power transformer for powering 35 kV facilities of HEP ODS (-T1, -T2) and one each of the two existing HŽ 110 kV fields (A and B). Such a provisional solution enables complete shut down of the buses and all 110 kV switchyards, which was a prerequisite to undertaking the first stages of the envisaged intervention in the 110 kV facility. For newly-formed lines in the provisional connection the systems of relay protection in the neighbouring buildings were readjusted and the adjustment of the SCADA system took place at the Network Centre.

After the provisional solution was set up, most of the existing 110 kV facility was dismantled at SS 110/35 kV Koprivnica and the construction works of the first stage were completed, which included building the foundations for bus portals, device pedestals and cable canals within the facility.

Then, a double bus 110 kV system 110 kV was built in on both bus scopes, and in the fields of the other bus scope (from field =E6 to field =E10) the complete HV primary equipment was installed.

In 2018, further activities are planned to energize the field, including the completion of all envisaged works for the replacement of the primary and secondary equipment of the 110 kV facility.
The reconstructed 110 kV facility at SS 110/35 kV Koprivnica will consists of two 110 kV bus systems 110 kV with 10 fields, of which 5 TL fields, two transformer fields, two HŽ fields and one switchyard.

(12) SS Kutina 110 kV facility (calculated in 2017: HRK 19,548,435)

The reconstruction of the 110 kV facility at SS 110/10(20) kV Kutina was completed in 2017. The test run and technical acceptance were successful, and in the beginning of 2018, the occupancy permit was issued for the building. The warranty period of 36 months started with the signature of the Protocol on Final Calculation and Provisional Acceptance between the Client and the Supplier.
Of the HOPS portion of the investment, in 2017, HRK 19,431,501.44 was spent on equipment, works and services, and HRK 119,634.00 was spent on incidental expenditures such as supervisory services of a civil engineer and a mechanical engineer, safety at work coordinator at the stage of the execution of the work, and administrative fees and other administrative charges up to the issuance of the occupancy permit.
Technically, SS 110/10(20) kV Kutina saw a complete reconstruction of the old external 110 kV (AIS 110 kV) facility into a new metal-shielded and gas insulated SF6 110 kV facility (GIS 110 kV) that was built in the newly-erected operating building within the scope of the transformer station. In addition to GIS facilities and insertion and connection of the 110 kV cables, new secondary 110 kV systems were also placed in the operating building (control equipment, equipment for protection, measuring, regulation, signalization), telecommunications systems, auxiliary power supply systems (220 V DC, 0,4 kV AC and 230 V AC UPS), heating system, air-conditioning and ventilation, the system for the detection of the SF6 gas, fire alert system and other equipment necessary for the operation of the facility.
The reconstruction was successful and on time despite various aggravating circumstances such as limited possibility to shut down the old 110 kV facility during the execution of their works. During the works, the old 110 kV facility remained in operation to drive the power transformers of Petrokemija (because the manufacturing process at the factory could not be stopped) and the energy transformer of HEP ODS (supplying power to the industrial area of the town of Kutina). Owing to the good cooperation between of three investors in defining the terms, the designer involved in the preparation of project solutions, and other participants during the construction, the project of the reconstruction of the entire 110 kV facility at SS 110/10(20) kV Kutina was completed within the scheduled period. This AIS-to-GIS 110 kV facility reconstruction took three years from the selection of the preliminary design to the final realization.
The new 110 kV GIS facility at SS 110/10(20) kV Kutina consists of two bus systems with ten fields, of which three TL fields, six transformer fields and one switchyard, including a measurement field for measuring bus voltage. A possibility of addition of three more fields has been envisaged in case of need for the extension of the 110 kV GIS facility.

(13) Upgrade of the power management system (calculated in 2017: HRK 4,536,864)

Due to the introduction of new and the reconstruction of the existing electric power facilities, and in order to raise the quality of information exchange in accordance with ENTSO-E standards, continuous upgrades of the existing power system are necessary to maintain the functionality of the system. At the NDC and 4 MCs there is SCADA/AGC/EMS/OTS Network Manager system and the following real-time systems in use: smart alarm processing, system for planning works and processing of outages, system for locating atmospheric discharges, system for planning the operation of wind farms. In 2017, the following upgrades were made: implementation of the test QA (Quality Assurance) system, preparation of the preliminary design for the upgrade of the Network Manager system, preparation of the system for the statistical analysis of data models for EMS calculations, preparation of the systems for the statistical analysis of the event and alarm lists, introduction of remote control for new HOPS facilities and external network facilities, adjustment of the system at the controlling centres for the purpose of the modernization of related systems or introduction of new systems, inclusion of UPS at the NDC in the SCADA control system, upgrades for raising the information security of the system. In the coming years, continuous upgrade of the system of remote control for HOPS will be implemented.

(14) Procurement and installation of network and security equipment and software (calculated in 2017: HRK 8,955,849)

In 2017, HOPS completely modernized the WAN communication platform toward electric power facilities at the remaining two network centres. Thus, the project was completed at all control centres. The project of modernization of the communication connection at the electric power facilities in the remote control system was continued: in the Rijeka and Osijek transmission areas the project was completed and it was substantially realized in the Zagreb transmission area. Cyber security of HOPS was increased in 2017 with the extension of automatized control mechanisms. Projects of modernization and extension of data centres at HOPS networks and the Internet gateway began. HOPS follows the cyber security requirements and ENTSO-E requirements in this regard.

(15) Equipping the Rijeka MC (calculated in 2017: HRK 4,652,505)

In late 2016, there was a public tendering procedure and a contractor was selected for the supply and execution of the works. The delivery (of the equipment) and the execution of the works began in March 2017. The activities also included the installation of HVAC equipment purchased outside this contract. The Rijeka MC was finished in November 2017.

(16) SS 400/220/110 kV Melina – procurement and installation of 220 kV switches and other equipment (calculated in 2017: HRK 4,310,360)

Works were continued to replace disconnectors, circuit breakers and measuring transformers at a 110 kV facility; the completion of the works is expected in the second quarter of 2018.

(17) SS Melina – upgrade of the second busbar system, replacement of HV and secondary equipment of a 400 kV facility (calculated in 2017: HRK 14,100,058)

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 have continued in 2018.

(18) Reconstruction and replacement of tube busbar 400 kV at SS 400/110/30 kV Tumbri (calculated in 2017: HRK 5,350,467)

In 2017, the double main busbar system at SS 400/110/30 kV Tumbri was replaced, which included tube busbars, supporting isolators, the entire switchgear and adjustment of steel supports for the isolators. The works were carried out accordance with the harmonized schedule of the contractor and the possibilities of shutting down parts of the 400 kV facility (according to HOPS' annual plans for shut-downs in the 400 kV network).

In 2018, until the end of August 2018 and in accordance with the harmonized plan for shut-downs of the 400 kV network, it is planned to finish the replacement of auxiliary 400 kV busbars, which also includes new tube busbars, supporting isolators, the entire switchgear and adjustment of the isolator steel supports.

(19) SS 110/35 kV Pračno – revitalization of the 110 kV facility (calculated in 2017: HRK 12,877,432)

For the reconstruction of the SS 110/35 kV Pračno, the building permit was obtained in July 2017. Procurement documentation was prepared and the public tendering procedure conducted. There was agreement with all interested parties in the area of Sisak (HEP-ODS Elektra Sisak, INA Rafinerija Sisak, HŽ Infrastruktura) whose electric power facilities depend on the supply from SS Pračno, about the provisional operation during the reconstruction. The reconstruction contract for SS 110/35 kV Pračno was concluded at the beginning of October 2017, when the procurement of the equipment began (equipment for the switch cabinet for secondary equipment and switch cabinets, measuring transformers, 110 kV cable, cable jacks, signalling and control cables, ACSR 240/40 mm^2, ALR 300 mm^2, surge protectors, earthing equipment, low-ohm resistors).

(20) SV 110 kV Delnice-Moravice (calculated in 2017: HRK 5,787,896)

In 2016, the reconstruction of the entire line was completed, and in 2017, the system for secure climbing on poles was installed and legal property relations were being settled with a view to obtaining easements on the land plots in the corridor of the subject-matter transmission line.

(21) SS 110/20 kV Medulin (calculated in 2017: HRK 12,366,023)

The building contract for the 110 kV facility at SS 110/20 kV Medulin was signed on 23 December 2016, scheduled to be fulfilled within 12 months, counting from the date of the Contractor taking over the works. The Contractor took over the works on 16 January 2017. The construction of the 110 kV facility at the SS 110/20 kV Medulin ended in November 2017. The technical acceptance of the building and commissioning cannot be carried out until SS 110/20 kV Medulin has been completely finished i.e. until the 20 kV facility has been installed. The construction of the 20 kV facility is in the competence of HEP-ODS d.o.o.

(22) SS 110/10(20) kV Zamet (calculated in 2017: HRK 7,823,686)

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. The fulfilment of the contract is under way, the delivery of the facility is planned in April 2018, and the realization of the entire contract until October 2018.

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 Contractor took over the works on 25 January 2018. The fulfilment of the contract is under way and the completion of the contractual obligations is expected by the end of 2018.

(23) Reconstruction of the NDC building and Transmission in Zagreb (calculated in 2017: HRK 6,525,407)

The HOPS administrative buildings in the Kupska Street, Zagreb, were built in 1958 and 1982. Since their construction, the buildings have not undergone any major renovation, and they did not comply with the requirements of efficient energy management. External doors and windows were in poor shape, and among other things, there was the risk of breaking and falling out due to old age. Due to poor energy parameters of the building, the energy for heating and cooling was wasted.

In August 2016, works were contracted for the energy rehabilitation of buildings. In accordance with the project, they included rehabilitation and heat insulation of external walls, flat and sloping roofs, ceilings and floors toward non-heated areas, and the replacement of existing windows and doors with new PVC units. The project includes lining the facade with mineral wool 12 to 15 cm thick and new windows and doors made of aluminium sections with three sheets of thermal glass. In addition to the energy rehabilitation works, works were also carried out to achieve compliance with fire requirements, with fire-proof and smoke-proof doors and external fire evacuation staircase built in. All the works on the energy rehabilitation were finished in the 1st quarter of 2018.

4.2 TERMS OF ELECTRIC POWER CONNECTION

(1) Connection of Block C at TEPP Sisak (calculated in 2017: HRK 7,330,272)

In 2017, the works on the construction of the 2x220 kV connecting transmission line from TEPP Sisak to the existing 220 kV Mraclin-Prijedor transmission line continued. From January to April 2017, electric power assembly works were carried out, cutting forest, making access roads and building poles, and in September, electric power works were finished. At the end of November, after harmonization with the power utility organizations from the Republic of Bosnia and Herzegovina (Elektroprenos BiH and NOS BiH) concerning the plans for trial run, the works began on measuring electric parameters of the newly-created configuration TL 220 kV Mraclin-TEPP Sisak-SS Prijedor, and the works were carried out on the final connections at RP 220 kV TEPP Sisak and at the point of introduction of the connection TL 2x220 kV to the existing TL 220 kV Mraclin-Prijedor, which was successfully done on 14 December 2017, when the transmission line was trial run.
In November, an Annex to the Building Contract for TL 2x220 kV was concluded to extend the deadline, which included rehabilitation of the access roads, making good the shortcomings found by the in-house technical inspection, and additional control of the quality of the equipment for climbing the poles.

(2) Connection of wind farm Katuni (calculated in 2017: HRK 10,005,992)

Works were completed and trial run began in November 2016. Under the Connection Agreement the obligation of HOPS was the supervision of the construction of the connecting transmission line from SS Katuni to the existing 110 kV transmission line Kraljevac - Zagvozd the 110 kV facility and the secondary equipment of SS Katuni. The acceptance of the facility after obtaining the occupancy permit was carried out in July 2017.

(3) Connection of wind farm ZD 6P (calculated in 2017: HRK 29,665,959)

Works were finished and the occupancy permit obtained for connecting wind farm ZD 6P. Under the Connection Agreement and its Annex, the obligation of HOPS was to supervise the construction of the connecting 110 kV transmission line Velika Popina – Gračac, the 110 kV facility in RP 110 kV at SS x/110 kV Velika Popina with its secondary equipment, and the new 110 kV switchyard with its secondary equipment. The acceptance of the facility, after the occupancy permit was obtained, took place in November 2017.

(4) Connection of wind farm Glunča (calculated in 2017: HRK 13,918,772)

Works were finished and the occupancy permit obtained for connecting wind farm Glunča. Under the Connection Agreement with Annexes, the obligation of HOPS was to supervise the construction of the connecting transmission line from SS Glunča to the existing 110 kV transmission line Bilice - Trogir and the 110 kV facility and its secondary equipment at SS Glunča. The acceptance of the facility took place in May 2017.

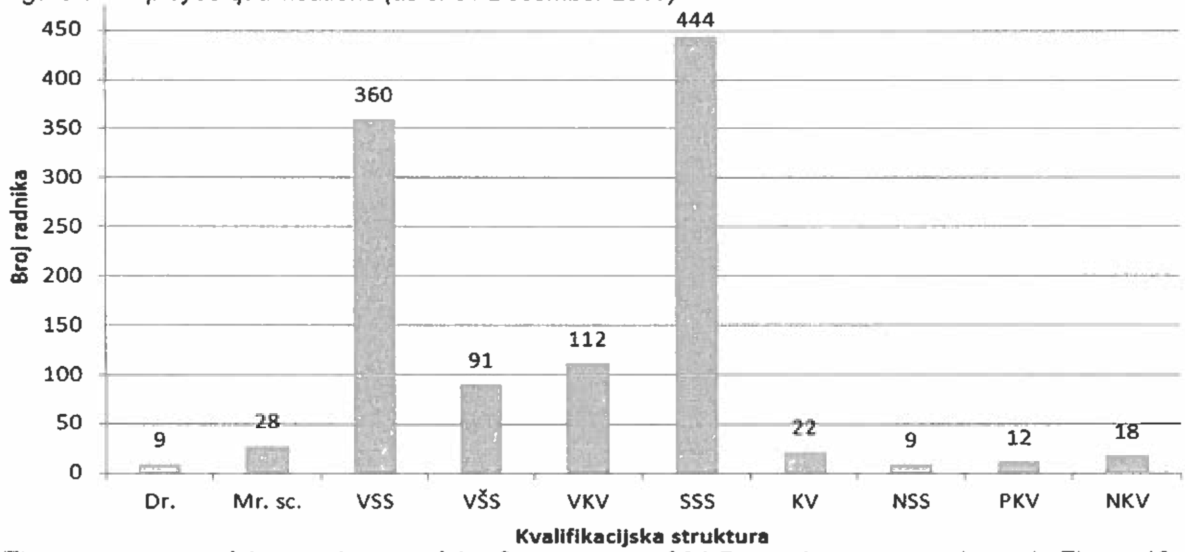
5. PERSONNEL

As of 31 December 2017, the Company had 1,105 employees, which is 10 employees more than on 31 December 2016.

The Board of the Company adopted the Employment Plan for 2017, which allowed for the employment of 33 staff members. In 2017, 10 vacancies were filled that had been allowed for in the 2016 Employment Plan, and 22 vacancies were filled that were allowed for in the 2017 Employment Plan.

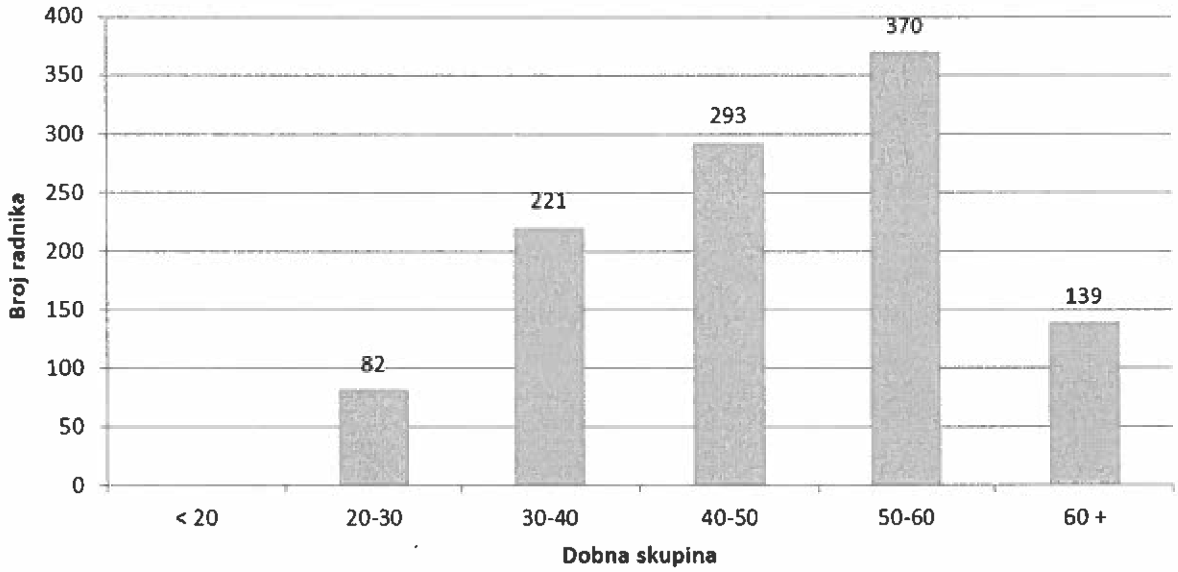
Pursuant to these plans, 42 staff members were hired, and in accordance with the Guidelines on Employment Procedure and the Process of Worker Movement Due to Unplanned Situations and Immediate Threat to EPS Function, 5 new staff members were hired outside the plan. In 2017, 35 staff members left the Company's employment.

Figure 9. Employee qualifications (as of 31 December 2017)



The average age of the employees of the Company as of 31 December 2017 as shown in Figure 10, was 47.8 years.

Figure 10. Employee age distribution (as of 31 December 2017)



6. HEALTH PROTECTION AND SAFETY AT WORK

In 2017, the following activities from the field of occupational safety were carried out:

- Training workers in safety at work,
- Participation in occupational safety inspections,
- Induction 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,
- Other activities to increase the safety of the employees and facilities.

In 2017, there were 9 injuries at work (8 at the workplace, 1 on the way to/from work), which was 2 injuries fewer than in 2016. These injuries in 2017 caused a loss of 7264 work hours, i.e. 908 work days, which was 1312 hours or 164 days more than in 2016.

In 2017, 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 2017, in the period from March to July 2017, 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

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 2017, 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 2017, all the necessary activities were being conducted to certify the HOPS energy management system in accordance with ISO 50001:2011. In December 2017, the authorized certification house carried out the main certification audit of the power management system, confirming that HOPS fulfilled all the requirements for obtaining the ISO 50001:2011 certificate.

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 (SF6). It has continued to implement appropriate training for HOPS employees for SF6 equipment servicing. 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.

The communication with the national and local authorities in charge was enhanced, in particular reporting on activities and investments in environmental and nature protection.

In 2017, 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.

8. OPERATING RISKS

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

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

- The Law on Renewable Energy Sources and Highly Effective Cogeneration, introducing renewable energy requirement for participation in the ECO Balance-Sheet Group (hereinafter: ECO BSG) managed by HROTE (implemented since 2016),
- Regulation amending the Law on Renewable Energy Sources and Highly Effective Cogeneration (issued on 28 December 2017) that postponed the start of ECO BSG for one year,
- Rules on balancing the electric power system (issued in March 2017),
- Network Regulations of the Croatian Electric Power System (issued in July 2017)
- 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 26 May 2017)
- Adoption of other bylaws regulating this area: Regulations Concerning Network Connection and Connection Rules, Regulations Concerning Fees for Electric Network Connection and Increase of Connection Power.

The greatest risks for the Company brought about by stronger integration of the wind-power plants in the EPS include:

- Substantial increase in operating costs,
- High dependence of the operating costs on the quality of forecasts concerning the production of renewable energy sources 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
- Investment in the necessary transmission network reinforcement.

A necessary prerequisite for the implementation of the operating plan in the future year(s) is the application of a pricing methodology for calculating the balancing electricity and implementing the Regulation on balancing the EPS in respect of the operation of ECO BSG.

The entry into force of the Regulation amending the Law on Renewable Energy Sources and Highly Effective Cogeneration (Official Gazette 131/17 of 28 December 2017) postponed the start of ECO BSG for one year. As a consequence, HOPS continues to cover the costs of balancing the system that are generated by members of the ECO BSG, which increases the costs of HOPS and reduces its profit and investment potential, which is unsustainable in the long run..

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 (hereinafter: 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 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.
Also, the entry into force of the new Public Procurement Act on 1 January 2017 has 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.

- **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**

As already mentioned in February 2017, the co-financing of the SINCRO.GRID project was approved (EUR 40.5 million from the CEF Fund of the EU, of which EUR 13.6 million for HOPS). Project funding and scheduling are 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 concluding new contracts on network usage with HEP-Proizvodnja d.o.o.**

Instead of the existing Network Utilization Agreements (NUA) for the power plants of HEP-Proizvodnja d.o.o. it is necessary to conclude new ones in accordance with the opinion of HERA of June 2017 in regard of the calculation measurement locations at the place where electric power is accepted from the transmission network for own consumption. Due to the positive effects of the mentioned agreements in the portion of the fee for the utilization of the transmission network, it is in the interest of the Company to conclude such agreements as soon as possible.

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

In 2017, 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, 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.

- **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")***

On 24 May 2016, 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), applicable as of 25 May 2018.

Bearing in mind the new concept of personal data protection, as defined in the mentioned Regulation, and the very rigorous financial sanctions for any violations of the Regulation, the Company is taking the necessary measures to prepare its staff, business processes and IT system in contact with personal data for the implementation of 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.

The entry into force of a number of (new or amended) Directive and Regulations of the European Union from the package of "Clean Energy for All Europeans" will affect (mainly in the medium term) the change of the purposes of HOPS and the relations with a number of actors (regulators, distribution system operators etc.) on the state, regional and EU levels.

- **Financial risks**

The 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 stagnation of economic growth with the increase in unemployment on the national level may affect the liquidity due to slowed-down collection from customers. 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 and USD 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.

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 intensive development of the market, the increasing number of participants and transactions, the participation in CROPEX with pending market coupling and foreseeable introduction of balancing electricity market represent the increasing challenges and risks 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.

In 2018, the Company plans activities related to opening the balancing electricity market and supporting services through securing new procurement mechanisms. The Company has launched a pilot project for consumption management with a view to encouraging participation in securing supporting services of network users who own facilities for providing supporting services. Also, there are several projects under way on the European level that aim to optimise the balancing electricity procurement.

Also, after the adoption of all the EU network rules (as the implementing regulations of the so-called Third Energy Package of the EU) that are directly applicable in all Member States, the implementation of their many provisions requires a number of activities of the Company on the state, regional and EU levels, to be carried out individually and in cooperation with the Agency and other relevant actors in the Republic of Croatia and the European Union.

The process of adoption of the energy legislation of the European Union is under way within the "Clean energy for all Europeans" package, and in this the participation of the Company, with that of other entities in the Republic of Croatia, is required.

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. Their application will ultimately result in increased supply security and integration of renewable energy resources and further development of the electricity market in the EU.

The long-term level of security of supply is connected to the adequacy of the EPS in a typical investment cycle of three to five years, and one of the Company's main goals in the future will be to maintain this adequacy by monitoring the market and investment risks arising from the regulatory framework and market models and considering the diversification of electric power generation. In this regard, the Company will submit a report to the competent Ministry, based on prior analysis and in accordance with its legal obligations, about the inadequacy of domestic power generation to cover the consumption in specific periods of the year

Securing 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 sort-term procurement.

For the purpose of an effective resolution legal property law relations as a basic prerequisite for the use of existing and the construction of 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.

As concerns further integration of renewable sources of energy in the electric power system, the Company needs to prepare for an acceptable scope and dynamics of the integration of renewable sources in the system and appropriate communication with the investors and the public.

As part of the long-term renewal of the transmission network, in 2017 the Company will carry out the first phase of anticorrosion protection of overhead lines and continue the projects of replacement of the traditional conductors with higher power transmission conductors.

The project of replacement of the 110 kV underwater cable in the Adriatic will be continued by setting up a team and speeding up all preparatory activities necessary for the implementation of the project. The replacement of old 110 kV underwater cables between land and Central Dalmatian and Kvarner islands is a priority investment in the next five year period. The project of cable replacement, given its complexity and cost, presents a special challenge and financial burden on the Company.

In 2018, the Company and CROPEX on Croatian side and ELES and BSP on Slovenian side are planning t complete the realization of then project to connect the Croatian and West European electricity markets under the name of „IBWT"(Engl. Italian border working table). The completion of the project is scheduled in the second quarter of 2018, after which the first positive effects of market coupling in Croatia are expected in the form of increased product offerings, more participants and greater liquidity of the exchange.

For the sake of effective implementation of the public procurement procedures, which is also important for the realization of the operating plans and investments, appropriate training and workshops will be organized for the individual organizational units of the Company.

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.

The existing Rules on the organization and systematization of the Company (hereinafter: ROSC) were adopted in 2013 in accordance with the then needs. In the meantime, many big changes have occurred in the international and domestic energy sector environment that urge to amend ROSC in accordance with the new conditions in most organizational units of the Company, respecting the principles of modern and rational management.

Since vehicles are a prerequisite to successful operation, the Company will continue to renovate the fleet in 2018 by procuring 64 new passenger and working vehicles. Renewing the fleet will reduce total vehicle maintenance costs and increase the safety of the Company's staff in traffic.

The completion of the project to connect the Croatian and Western European electricity markets by the Company and CROPEX from Croatian and ELES and BSP from Slovenian side, is scheduled in the second quarter of 2018, after which the first positive effects of market coupling in Croatia are expected in the form of increased product offerings, more participants and greater liquidity of the exchange..

In early 2018, a feasibility study for the new 400 kV interconnection project with BiH and the necessary transmission network interventions in the Konjsko-Lika section has been contracted, and this will be financed through an EBRD grant.

In 2018, the Company has to conduct the procedure for the renewal of the licence to engage in the electric power transmission. The current licence (from 2003) expires on 10. December 2018.

10. CONCLUSION

It is evident that in 2017 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 2013-2017 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 2017, 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, a dry spell for the most of the year and unavailability of TE 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, in spite of natural disasters such as fire and thunder, 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 2017 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,
- In December 2017, the authorized certification house conducted the main certification audit of the power management system confirming that HOPS fulfilled all the requirements of ISO 50001:2011,
- Elaboration and adoption of the 2017-2026 Ten-Year Transmission Network Development Plan with detailed elaboration for the initial three-year and one-year periods (approved by the Agency on 22 December 2017),
- 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
- Launching the project of electricity market coupling on the Croatian-Slovenian border.

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.

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.

Darko Belić MSc.	Zdeslav Čerina, B.S.E.E.	Miroslav Mesić, DSc., B.S.E.E
Board Member	Board Member	Chairman of the Management Board

HOPS
Hrvatski operator prijenosnog sustava d.o.o.
Kupska 4, Zagreb 1

Statement of Management's Responsibilities

The Management Board of Hrvatski operator prijenosnog sustava d.o.o., 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 36 and the financial statements were approved by the Management Board on April 12, 2018 for submission to the Supervisory Board.

Signed on behalf of the Management Board:

Darko Belić	Zdeslav Čerina	Miroslav Mesić
Member of the Management Board	Member of the Management Board	President of the Management Board

Hrvatski operator prijenosnog sustava d.o.o.
Kupska 4
10000 Zagreb
Republic of Croatia
12 April 2018

HOPS
Hrvatski operator prijenosnog sustava d.o.o.
Kupska 4, Zagreb
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KPMG

Independent Auditors' Report to the owner of Hrvatski operator prijenosnog sustava d.o.o.

Opinion

We have audited the financial statements of Hrvatski operator prijenosnog sustava d.o.o. ("the Company"), which comprise the statement of financial position of the Company as at 31 December 2017, and the statements of comprehensive income, cash flows and changes in equity of the Company for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2017 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ("EU IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in Croatia and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the Management Report included in the Annual Report of the Company, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Management Report, we also performed procedures required by the Accounting Act in Croatia ("Accounting Act"). Those procedures include considering whether the Management Report has been prepared in accordance with the requirements of Article 21 of the Accounting Act.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and procedures above, in our opinion:

- the information given in the Management Report for the financial year for which the financial statements are prepared, is consistent, in all material respects, with the financial statements;
- the Management Report has been prepared, in all material respects, in accordance with the requirements of Article 21 of the Accounting Act

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Management Report. We have nothing to report in this respect.

This version of our report is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Independent Auditors' Report to the owner of Hrvatski operator prijenosnog sustava d.o.o. *(continued)*

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

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

In preparing the financial statements, management 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 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.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 International Standards on Auditing 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 financial statements.

As part of an audit in accordance with International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the 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 controls.

- 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 controls.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

This version of our report is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

KPMG

Independent Auditors' Report to the owner of Hrvatski operator prijenosnog sustava d.o.o. *(continued)*

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

- Conclude on the appropriateness of management's 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 auditors' report to the related disclosures in the 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 auditors' 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 financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

KPMG Croatia d.o.o.

KPMG Croatia d.o.o. za reviziju
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

KPMG Croatia
d.o.o. za reviziju
Eurotower, 17. kat
Ivana Lučića 2a, 10000 Zagreb
5

12 April 2017

This version of our report is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

(in thousands of HRK)	**Notes**	**2017**	**2016**
Revenue from sales - related parties	*7,34*	1,548,808	1,461,502
Revenue from sales - third parties	*7*	277,331	170,576
Other income - related parties	*34*	5,450	4,112
Other income – third parties	*8*	22,690	26,699
		1,854,279	**1,662,889**
Materials and spare parts used	*9*	(18,734)	(20,067)
Service expenses	*10*	(179,958)	(141,452)
Personnel expenses	*11*	(180,350)	(177,060)
Depreciation and amortisation	*17,18*	(317,277)	(298,087)
Ancillary services	*34*	(310,562)	(341,512)
Transmission grid losses	*12*	(116,889)	(144,267)
Purchase of balancing energy	*12*	(215,689)	(127,024)
Other expenses – related parties	*34*	(47,449)	(49,686)
Other operating expenses	*13*	(88,868)	(66,848)
		(1,475,776)	**(1,366,003)**
Operating profit		**378,503**	**296,886**
Finance income	*14*	7,448	12,075
Finance costs	*15*	(32,323)	(34,054)
Net finance costs		**(24,875)**	**(21,979)**
Profit before tax		**353,628**	**274,907**
Income tax	*16*	(64,611)	(3,234)
Profit for the year		**289,017**	**271,673**
Other comprehensive income		-	-
Total comprehensive income for the year		**289,017**	**271,673**

The accompanying notes form an integral part of these financial statements

(in thousands of HRK)	Notes	31 December 2017	31 December 2016
ASSETS			
Intangible assets	*17*	20,313	22,759
Property, plant and equipment	*18*	5,938,888	5,521,626
Prepayments for property, plant and equipment	*19*	4,577	3,692
Investment property	*20*	4,403	10,724
Investments in associates	*21*	40,157	46,039
Receivables from sale of apartments	*22*	1,893	2,323
Deferred tax assets	*16*	22,861	18,083
Total non-current assets		**6,033,092**	**5,625,246**
Inventories	*23*	11,527	13,319
Trade receivables	*24*	37,698	15,329
Receivables from related parties	*34*	343,986	398,321
Income tax receivable		-	40,481
Other current assets	*25*	15,911	10,670
Short-term financial assets	*26*	13,318	7,863
Cash and cash equivalents	*27*	144,502	102,403
Total current assets		**566,942**	**588,386**
TOTAL ASSETS		**6,600,034**	**6,213,632**
EQUITY AND LIABILITIES			
Subscribed capital	*28*	4,929,195	4,364,392
Reserves	*28*	5,523	5,523
Retained earnings		289,017	271,673
Total equity		**5,223,735**	**4,641,588**
Subloan from and liabilities to related parties	*29*	501,350	618,612
Provisions	*30*	71,277	64,957
Other long term liabilities	*31*	89,892	72,288
Total non-current liabilities		**662,519**	**755,857**
Subloan from related parties (current portion)	*29*	114,242	216,681
Provisions	*30*	3,983	1,991
Trade payables	*32*	206,933	215,650
Payables to related parties	*34*	308,409	333,019
Income tax liability		27,180	-
Other current liabilities	*33*	53,033	48,846
Total current liabilities		**713,780**	**816,187**
TOTAL EQUITY AND LIABILITIES		**6,600,034**	**6,213,632**

(in thousands of HRK)	**Subscribed capital**	**Reserves**	**Retained earnings**	**Total**
As at 31 December 2015	**3,980,801**	**5,523**	**189,690**	**4,176,014**
Dividend payment to HEP d.d.	-	-	(10)	(10)
Increase of subscribed capital by entering things	193,911	-	-	193,911
Transfer of reinvested profit to subscribed capital	189,680	-	(189,680)	-
Profit for the year	-	-	271,673	271,673
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**

(in thousands of HRK)	**2017**	**2016**
Profit for the year	**289,017**	**271,673**
Adjusted for:		
Income tax	64,611	3,234
Depreciation and amortisation	317,277	298,087
Increase in provisions	8,312	3,486
Net finance expense	24,875	21,979
Net book value of assets disposed	5,885	3,425
Increase in provision for inventories	678	1,036
Asset surplus	(1,382)	-
Increase in provision for doubtful receivables, net	633	(7,148)
Impairment od financial asset	6,000	-
Change in fair value of investment property	6,321	23
Cash flows from operations before working capital changes	722,227	595,795
(Increase) / decrease in trade receivables	(21,146)	28,511
Decrease / (increase) in receivables from related parties	(190,653)	(285,764)
Decrease / (increase) in other receivables	(5,241)	16,555
Decrease in receivables for apartments sold	430	481
Decrease / (increase) in inventories	1,114	1,635
(Decrease) / increase in trade payables	(10,621)	24,374
(Decrease) / increase in liabilities to related parties	(24,471)	72,292
(Decrease) / increase in other liabilities	21,791	14,516
Cash flows from operating activities	**493,430**	**468,395**
Interest received	636	1,668
Income tax (paid)/ received	(1,728)	37,038
Increase in prepayments for tangible assets	(885)	1,679
Investment in associates	(118)	(4,286)
Deposits paid	(2,455)	-
Loans given	(3,000)	-
Purchases of property, plant, equipment and intangible assets	(443,465)	(453,179)
Cash used in investing activities	**(451,015)**	**(417,080)**
Decrease in other long term liabilities	-	(1,271)
Dividends paid to the owner	(1)	(9)
Interest paid	(315)	-
Cash flows used in financing activities	**(316)**	**(1,280)**
Net increase in cash and cash equivalents	42,099	50,035
Cash and cash equivalents at beginning of year	102,403	52,368
Cash and cash equivalents at the end of year	**144,502**	**102,403**

The accompanying notes form an integral part of these financial statements

1. GENERAL

Hrvatski operator prijenosnog sustava d.o.o., 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 1,100 employees in 2017 *(2016: 1,811)*.

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 2017 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 Opskrba plinom d.o.o.	Croatia	Gas supply
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
Program Sava d.o.o.	Croatia	Physical planning, design, construction and supervision

1. GENERAL (CONTINUED)
Governance and management

General Assembly

The General Assembly consists of the founder`s representative:

Perica Jukić	President	Member from 12 September 2014 till 31 December 2017

Supervisory Board

Members of the Supervisory Board in 2016 and 2017:

Kažimir Vrankić	President	From 1 October 2014
Alina Kosek	Member	From 1 October 2014
Ante Pavić	Member	From 1 October 2014
Denis Geto	Member (employees' representative)	From 21 May 2014 till 31 March 2018
Dinko Andabaka	Member (employees' representative)	From 1 April 2018
Marijan Kalea	Member	From 26 August 2013

Management Board in 2016 and 2017:

Miroslav Mesić	President	from 2 September 2013
Zdeslav Čerina	Member	from 2 September 2013
Darko Belić	Member	from 2 September 2013

The Management Board has a mandate until April 15, 2018.

2. BASIS OF PREPARATION

(i) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS"). The Company does not prepare consolidated financial statements due to exemption based on International Accounting Standard ("IAS") 27 Consolidated and separate financial statements as the Company is wholly owned subsidiary of Hrvatska elektroprivreda d,d,, registered in Zagreb, Croatia. HEP d.d. prepares financial statements comprising consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS").

These financial statements were authorized for issue by the Management Board on 12 April 2018.

(ii) Basis of measurement

These financial statements have been prepared on the historical cost basis, except for investment property which is stated at fair value. Methods used for fair value measurement are explained in Note 6.

The financial statements have been prepared under the going-concern assumption.

(iii) Functional and presentation currency

These financial statements are prepared in the Croatian kuna ("HRK"), which is also the functional currency, rounded to the nearest thousand.

(iv) Use of estimates and judgments

The preparation of financial statements in conformity 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. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent 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 IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustments in the next year are discussed in Note 5.

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

Revenue from use of transmission network fee

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, the company recognizes revenue in the same way as in 2016.

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 2016 and 2017, 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1. Revenue recognition (continued)

Revenue from sales of balancing energy

In 2015, the Company's revenue from balancing energy is realized through the sale of balancing energy to the entities responsible for the variation (SOZO) in accordance with the applicable Rules on balancing the electric power grid, Methodology for Determining the Costs for Balancing Electricity Balance for Entities Responsible for Deviation and Balancing Electricity Agreements concluded with SOZOs and in accordance with Annexes 1 to 5 of the Auxiliary Services Contract signed with HEP Proizvodnja d.o.o. In the period up to September 1, 2016, the Company recognizes balancing revenues in the same way as in 2015, but due to changes in by-laws of September 1, 2016, the Company generates revenues from balancing energy by selling balancing electricity to the Heads of Balance Groups (VBG) in accordance with the applicable Rules on balancing the electric power grid, the Balancing Electricity Balance Approach Methodology and Discontinuance Liability Contracts signed with Heads of Balance Groups, and in accordance with Annexes 1 to 5 of the Agreement for ancillary services signed with HEP Proizvodnja d.o.o.

From January 1, 2017, the Company generates revenue from balancing and balancing electricity balancing services to electricity sales to the Balance Sheet Managers (VBGs) in accordance with the applicable Electricity Balancing Rules, the Calculation Methodology for Balancing Electricity Balance, Responsibility Agreements for deviations made with VBG, and in accordance with a set of service contractual services contracts concluded with HEP Proizvodnja d.o.o.

Revenue from connection fees

Up 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.

As of 1 January 2010 Group has adopted IFRIC 18 "Transfers of Assets from Customers" which is in accordance with Croatian regulations, IFRIC 18 clarifies the requirements of IFRSs for agreements in which an entity receives an asset from customer (property, plant and equipment or cash) 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.1. Revenue recognition (continued)

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.

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 comprehensive income on a straight-line basis over the period of the lease.

3.4. Intangible assets

Intangible noncurrent 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 impairment losses. Equipment which has been installed is considered an integral component of investment property. 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:

	2017 and 2016
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 year end, with the effect of any change being accounted for based on the expectations, An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated 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, 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 deprecation 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, 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 course of construction is classified as non-current tangible assets in the course of construction 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.

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) 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 electromaterials, spare parts for electromaterial 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 provides for inventories 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 privately operated 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 11).

	2017	**2016**
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 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 October 2016), 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 2017.

(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

Financial assets are recognised and derecognised on the trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified as 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13. Financial assets (continued)

Loans and receivables (continued)

Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Management provides for doubtful receivables based on a review of the overall recoverability of receivables and a specific review of significant individual amounts receivable. As the collectability of certain receivables over a longer term is not certain, the Company will make an allowance for unrecoverable amounts, based on a reasonable estimate and past experience. Receivables and given loans are written-off as a cost of impairment of assets and in favor of impairment of short term receivables.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as a default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation; or
- the disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13. Financial assets (continued)

Impairment of financial assets (continued)

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account, Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

For financial assets measured at amortised cost, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognized.

Derecognition of financial assets

The Company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Company neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Company recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Company retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognise the financial asset and also recognises a collateralized borrowing for the proceeds received.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.14. Financial liabilities

Financial liabilities are classified as either financial liabilities at 'fair value through profit or loss' or 'other financial liabilities'. The Company has no financial liabilities designated as fair value through profit and loss.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date, Short-term borrowings and supplier loans are recorded at original amount granted less repayment, Interest expense is charged to income statement on an accrual basis.

Derecognition of financial liabilities

The Company derecognises financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.15. Subscribed capital and capital reserves

Subscribed capital is stated in HRK 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 leesee

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. NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

Certain standards, revisions and interpretations of existing standards that are applicable but not mandatory for the period ending 31 December 2017 and / or not adopted by the European Union have been published and as such have not been applied in the preparation of these financial statements. The review follows:

IFRS 15 Revenue Based on Customer Agreement

IFRS 15 establishes a comprehensive framework for determining the method and timing of recognition of revenue. It replaces existing revenue recognition guidelines, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programs. IFRS 15 will be effective for annual periods beginning on or after 1 January 2018, with prior approval.
The Company is currently conducting an assessment of the impact of the new standard on the financial statements, but it is not expected to have a significant impact on the Company's net result or net assets.

IFRS 9 Financial Instruments

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 Financial Instruments. IFRS 9 shall be effective for annual periods beginning on or after 1 January 2018 with permitted earlier application. The Company plans to apply IFRS 9 from 1 January 2018. The Company is currently conducting an assessment of the impact of the new standard on the financial statements, but it is not expected to have a significant impact on the Company's net result or net assets.

IFRS 16 Leases

IFRS 16 introduces a unique balance sheet model for lease accounting with lessees. The Lessee acknowledges the right to use the property which represents the right to use the property in question and the lease obligation that is the obligation to pay the rent. There is a possibility for short-term leases and rentals of small value items. The lessor's accountancy remains similar to the existing standard - that is, the lessees still classify the leases as finance or business leases.

The Standard shall be effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted for entities that apply IFRS 15 Customer Contract Revenues on or before the date of First Use of IFRS 16.

The Company is currently conducting an assessment of the impact of the new standard on the financial statements. Given that the Company has concluded certain lease agreements (operating leases) that could meet the criteria for recognition in the statement of financial position, the effects on the assets, liabilities, net assets and net result of the Company are possible. The Company does not expect these effects to have significant effects on the net assets and net result of the Company.

5. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES

Critical judgments and estimates in applying accounting policies

The preparation of financial statements in conformity 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

The Company reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period. During the year there were no changes to estimated useful lives of property, plant and equipment, i,e,, to 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 16). The carrying amounts of deferred tax assets at 31 December 2017 amounted to HRK 22,861 thousand *(31 December 2016: HRK 18,083 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.

5. KEY ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Critical judgments and estimates in applying accounting policies (continued)

(iv) Valuation of inventories

The Company provides for the amount of unmarketable inventory materials according to the inventory ageing structure, During 2016 the Company recognised value adjustment of inventories in the amount of HRK 1,036 thousand. In 2017, the Company increased the value adjustment of inventories by 678 thousand charged to operating expenses (see Note 13 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 50,327 thousand at 31 December 2017 (*31 December 2016: HRK 41,657 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 13 and 30). Management makes estimates of probable outcomes of the legal actions and recognizes provisions for liabilities arising from these actions on a consistent basis.

(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.

6. 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 20: Investment property

7. REVENUE FROM SALES

(in thousands of HRK)	**2017**	**2016**
Revenue from sales – related parties		
Electricity transmission income	1,333,681	1,288,521
Sales of balancing energy	41,309	31,664
Sales of balancing energy – imbalance settlement	148,228	33,962
Cross-border capacity income	162	445
Income from connection to transmission network	-	83,472
Other	25,428	23,438
	1,548,808	**1,461,502**

Revenue from sales – third parties		
Electricity transmission income	55,291	51,009
Cross-border transmission capacity - domestic	2,224	3,294
Cross-border transmission capacity - foreign	111,964	52,186
Sales of balancing energy	12,356	16,140
Sales of balancing energy - imbalance settlement	34,766	9,526
ITC revenue	5,513	22,570
Income from connection to transmission network	55,217	12,204
Sales from energy for transmission grid losses	-	3,647
	277,331	**170,576**

8. OTHER INCOME – THIRD PARTIES

(in thousands of HRK)	**2017**	**2016**
Reversal of litigation provisions	1,382	711
Consumption of own products and services	5,009	4,362
Income from assets received free of charge	2,941	2,945
Non standard services income	861	625
Collection of written-off receivables income	236	7,610
Other	7,745	3,575
	4,516	6,871
	22,690	**26,699**

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 1,622 thousand (*2016: HRK* 2,306 *thousand*), rent income HRK 416 thousand (*2016: HRK 454 thousand*), and other HRK 2,096 thousand (*2016: HRK 4,111 thousand*).

9. MATERIAL AND SPARE PARTS USED

(in thousands of HRK)	2017	2016
Maintenance material for power facilities	8,151	9,717
Energy	5,437	5,035
Maintenance material for other assets	1,310	1,416
Low value stock and safety clothes	1,542	1,746
Other	2,294	2,153
	18,734	**20,067**

10. SERVICE EXPENSES

(in thousands of HRK)	2017	2016
Power facility maintenance services	81,265	84,958
Auctions for cross border transmission capacity	54,660	20,979
ITC mechanism costs	9,607	4,506
Security services	4,629	5,017
Maintenance services	7,025	5,578
Telecommunication services	1,459	2,036
Agency and research services	9,605	8,260
MRA Settlement cost	-	427
INC Settlement cost	2,370	2,620
Other	9,338	7,071
	179,958	**141,452**

The cost of INC refers to the costs of the Imbalance netting settlement that HOPS concluded in 2016 with the Austrian and Slovenian transmission system operators.

The costs of agency and scientific services concerned fees for auditing annual financial statements, fees for other audit services, fees for tax consultancy services and fees for other consulting services.

11. PERSONNEL EXPENSES

(in thousands of HRK)	**2017**	**2016**
Net salaries	109,157	105,137
Taxes and contributions from salaries	45,767	46,679
Contributions on salaries	25,426	25,244
	180,350	**177,060**

Total personnel costs were as follows:

Gross salaries	180,350	177,935
Reimbursement of costs to employees (Note 13)	16,279	15,542
Employee benefits (Note 13)	12,342	7,367
Additional health insurance costs (Note 13)	1,503	1,487
Provisions for retirement bonuses and other provisions (Note 13)	8,670	5,034
Provision for unused vacation days (Note 13)	-	324
	219,144	**207,689**

As of 31 December 2017 the Company had 1,105 employees *(2016: 1,095 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 2017 amounted to HRK 7,624 thousand *(2016: HRK 2,371 thousand)*, and represent retirement bonuses for 50 employees.

Directors' and executives remuneration:

(in thousands of HRK)	**2017**	**2016**
Gross salaries	4,827	5,036
Pension insurance contributions	1,074	1,129
Benefits in kind	577	608
	6,478	**6,773**
Number of directors and executives	13	13

12. COSTS TRASMISSION GRID LOSSES AND PURCHASE OF BALANCING ENERGY

(in thousands of HRK)	**2017**	**2016**
Cost of transsmision grid losses		
Cost of transsmision grid losses – related parties (Note 34)	88,071	122,976
Cost of transsmision grid losses – third parties	28,818	21,291
	116,889	**144,267**
Purchase of balancing energy		
Purchase of balancing energy – related parties HEP Proizvodnja d.o.o. (Note 34)	98,549	90,800
Purchase of balancing energy – imbalance setllement – related parties (Note 34)	70,643	1,096
Purchase of balancing energy – third parties	26,265	32,966
Purchase of balancing energy – imbalance setllement – third parties (Note 34)	20,232	2,162
	215,689	**127,024**

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

13. OTHER OPERATING EXPENSES

(in thousands of HRK)	2017	2016
Employee benefits	12,342	7,367
Taxes, contributions and fees	19,826	19,904
Reimbursement of costs to employees	16,279	15,542
Impairment of inventories	678	1,036
Net book value of disposed tangible assets and inventories	6,350	3,591
Impairment of receivables	860	462
Additional health insurance costs	1,503	1,487
Affiliation fee for business associations	2,811	2,430
Insurance premiums	1,376	1,397
Provisions for retirement bonuses and other provisions for workers	8,670	5,034
Provisions for court cases	1,024	1,154
Change in fair value of investment properties	6,477	23
Fees damage to individuals	1,228	1,723
Provision for unused vacation days	-	324
Impairment of financial assets	6,000	-
Other operating expense	3,444	5,374
	88,868	**66,848**

14. FINANCE INCOME

(in thousands of HRK)	2017	2016
Interest income	636	1,668
Foreign exchange gains	6,812	10,407
	7,448	**12,075**

15. FINANCE COSTS

(in thousands of HRK)	2017	2016
Sub-loan interest	29,227	32,727
Penalty interest	315	46
Foreign exchange losses	1,904	402
Amortized amount of the related discount cost	877	879
	32,323	**34,054**

16. 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% (2016: 20%).

(in thousands of HRK)	2017	2016
Current tax	69,389	-
Deferred tax	(4,778)	3,234
	64,611	**3,234**

(in thousands of HRK)	2017	2016
Profit before taxation	**353,628**	**274,907**
Income tax at the rate of 18% (2016: 20%)	63,653	54,981
Tax deductible expense	1,214	725
Temporary differences for which no deferred tax asset is recognized	-	2,009
Incentives	(256)	(147)
Reinvested profit	-	(54,334)
	64,611	**3,234**
Effective tax rate (%)	**18.27%**	**1.18%**

As of 31 December 2017 Company does not have any unused tax loss to carry forward (2016: HRK 7,445 thousand, tax effect of HRK 1,341 thousand).

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.

16. 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**	**Impairment of trade receivables**	**Impairment of financial assets and investment property**	**Total**
At 1 January 2015	**3,183**	**7,856**	**1,537**	**5,275**	**3,242**	**222**	**-**	**21,315**
(Credited)/ debited to profit and loss	207	1,007	(1,298)	835	(1,752)	(222)	-	(1,223)
Effect of tax rate change	(339)	(886)	(24)	(611)	(149)	-	-	(2,009)
At 31 December 2016	**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**

Given that by modifying the provisions of the Profit Tax Act, the tax rate applied since 2017 has been reduced from 20% to 18%, deferred tax assets has been aligned for the mentioned impact of the tax rate change.

17. INTANGIBLE ASSETS

(in thousands of HRK)	**Software**	**Leasehold improvement regarding rights of usage**	**Total**
COST			
At 1 January 2016	**57,902**	**18,566**	**76,468**
Additions	6,287	-	6,287
Transfer from assets	253	-	253
Disposals and write-offs	(691)	-	(691)
At 31 December 2016	**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**
ACCUMULATED			
At 1 January 2016	**39,491**	**14,492**	**53,983**
Charge for the year	5,565	741	6,306
Disposals and write-offs	(691)	-	(691)
Transfers	(40)	-	(40)
At 31 December 2016	**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**
CARRYING AMOUNT			
At 31 December 2016	**19,426**	**3,333**	**22,759**
At 31 December 2017	**17,721**	**2,592**	**20,313**

18. PROPERTY, PLANT AND EQUIPMENT

(in thousands of HRK)	Land	Buildings	Inventory and equipment	Assets under construction	Total
COST					
At 1 January 2016	**153,696**	**4,085,228**	**7,847,099**	**409,789**	**12,495,812**
Additions	-	32,776	73,926	340,188	446,890
Transfer from assets under construction	-	98,538	256,313	(355,104)	(253)
Subscribed capital increase	-	107,307	86,605	-	193,912
Transfers and reclassifications	-	2,839	(2,837)	-	2
Surplus	-	-	24	-	24
Disposals	-	(19,041)	(116,525)	(1,589)	(137,155)
At 31 December 2016	**153,696**	**4,307,647**	**8,144,605**	**393,284**	**12,999,232**
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**	**4,470,848**	**8,576,216**	**502,597**	**13,704,519**
ACCUMULATED DEPRECIATION					
At 1 January 2016	-	**2,613,749**	**4,704,153**	-	**7,317,902**
Charge for the year	-	80,892	210,888	-	291,780
Transfer between related parties and reclassifications	-	1,854	(1,813)	-	41
Surplus		-	24	-	24
Eliminated on disposal	-	(18,779)	(113,362)	-	(132,141)
At 31 December 2016	-	**2,677,716**	**4,799,890**	-	**7,477,606**
Charge for the year	-	83,187	226,816	-	310,003
Transfer 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	-	**2,762,914**	**5,002,717**	-	**7,765,631**
CARRYING AMOUNT					
At 31 December 2016	**153,696**	**1,629,931**	**3,344,715**	**393,284**	**5,521,626**
At 31 December 2017	**154,858**	**1,707,934**	**3,573,499**	**502,597**	**5,938,888**

18. 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 17,219 thousand (2016: HRK 16,850 thousand),, construction of C terminal block for Sisak connection in the amount of HRK 54,028 thousand (2016: HRK 46,698 thousand), reconstruction of TS Kutina HRK 71,541 thousand (2016: HRK 71,541 thousand),, reconstruction of TS Melina HRK 30,642 thousand, construction of the connecting powerline 2x110kV of TS Medulin in the amount of 14,975 thousand HRK, construction of the connection line 2x110 kV TS Medulin in the amount of HRK 12,438 thousand, reconstruction of TS Pračno HRK 12,043 thousand, reconstruction of TS 110/20(10) kV Sućidar HRK 12,213 thousand, reconstruction of 110 kV powerline Slavonski Brod – Andrijevci HRK 14,100 thousand and the construction of the business permises in Matulji in the amount od HRK 26,643 thousand. Contractual commitments related to investments in progress at the reporting date amount to HRK 220,715 thousand (2016: HRK 262,378 thousand), and the envisaged timing for implementation is in accordance with the deadlines of construction.

During 2017, the following significant investments were made: control and management equipment in TS Melina for HRK 13,153 thousand, installation of 150 MWA autotransformers for TS Plomin in the amount of HRK 13,115 thousand, revitalization of TS 110/35 kV Osijek 1 in the amount of HRK 14,625 thousand, reconstruction of TS Dugi Rat 110/35 kV in the amount HRK 14,625 thousand, reconstruction of TS Kraljevac 110/35 kV in the amount of HRK 19,676 thousand, reconstruction of TS Međurić in the amount of HRK 10,857 thousand, connection of VE Katuni in the amount of HRK 10,406 thousand, connection of VE ZD6 in the amount of HRK 29,966 thousand and connection of VE Glunča in the amount of 14,052 thousand kuna.

During 2017 and 2016, the Company did not capitalize on borrowing costs as it 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 powerstations 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

.19. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

(in thousands of HRK)	
As at 1 Januarv 2016	**5.371**
Advances aiven	6.135
Utilised in current vear	(7.814)
As at 31 December 2016	**3,692**
Advances given	7,495
Utilised in current year	(6,610)
As at 31 December 2017	**4,577**

20. INVESTMENT PROPERTY

(in thousands of HRK)	**31 December 2017**	**31 December 2016**
Fair value	10,724	10,747
Net change in fair value of investment property	(6,321)	(23)
Closing balance at fair value	**4,403**	**10,724**

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 253 thousand (*2016: HRK 386 thousand*), The Company recorded direct operating expenses (including maintenance fee) in the amount of HRK 18 thousand (*2016: HRK 8 thousand*),

The Company regularly tests the investment property for impairment analyzing the price of comparable real estate. At the reporting date, was used to estimate the independent, expert appraisers from 2015 made for the financial statements for 2014 and one part of the estimate of an independent expert estimator of 2016 and 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. Changes in the fair value of investing in real estate are presented in note 13 "Other operating expenses".

21. INVESTMENTS IN ASSOCIATES

(in thousands of HRK)	31 December 2017	31 December 2016
Investment in subsidiaries	-	6,000
Other investments	40,157	40,039
	40,157	**46,039**

(in thousands of HRK)	Country	2017 % ownership	2017 Net book value	2016 % ownership	2016 Net book value
HEP Telekomunikacije d.o.o.	Croatia	13,7%	34,545	13,7%	34,545
Hrvatska burza električne energije d.o.o.	Croatia	50,0%	-	50,0%	6,000
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**

The Company carries investment in subsidiaries at cost less impairment. In 2017, 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 6,000 thousand. Impairment losses are disclosed in Note 13 "Other operating expense".

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

During 2017, the Company increased its share of affiliated company TSCNET Services GmbH, Germany in the amount of HRK 118 thousand.

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 2017**	**31 December 2016**
Total receivables for apartments sold	2,514	3,046
Current portion of long-term receivables	(621)	(723)
Non-current receivables	**1,893**	**2,323**

23. INVENTORIES

(in thousands of HRK)	**31 December 2017**	**31 December 2016**
Electric units and other materials	4,540	4,797
Spare parts	6,873	8,326
Building materials	114	141
Other	-	55
	11,527	**13,319**

Movement in the impairment allowance for inventories is as follows:

(in thousands of HRK)	**31 December 2017**	**31 December 2016**
At 1 January	**16,952**	**15,916**
Impairment loss recognised	678	1,036
At 31 December	**17,630**	**16,952**

Impairment loss on inventories amounts to HRK 678 thousand and is included within "Other operating expenses" in the statement of comprehensive income,

24. TRADE RECEIVABLES

(in thousands of HRK)	31 December 2017	31 December 2016
Trade receivables	43,244	24,658
Impairment of receivables	(5,546)	(9,329)
Net receivables	**37,698**	**15,329**

Movements in impairment allowance were as follows:

(in thousands of HRK)	2017	2016
At 1 January	**9,329**	**45,063**
Impairment of receivables	860	462
Impairment cancellation	-	(325)
Collected receivables, previously provided for	(236)	(7,285)
Impairment	(4,407)	(28,586)
Change on receivables impairment	*(3,783)*	*(35,734)*
At 31 December	**5,546**	**9,329**

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 2017	31 December 2016
Not yet due	15,127	14,006
0 – 30 days	2,983	964
31 - 60	2	-
61 – 90 days	1	349
91 – 180	1,193	1
181 – 365 days	18,389	6
over 365 days	3	3
	37,698	**15,329**

Trade receivables in the amount of HRK 19,582 thousand refer to receivables from the Balance Sheet Manager (BGM) for balancing energy – imbalance settlement from January and February 2017. Amounts are partially adjusted for value because most have been reimbursed up to the date of signature of these reports in accordance with the final settlement from February 2018.

Trade receivables are denominated in:

(in thousands of HRK)	31 December 2017	31 December 2016
HRK	34,793	9,567
EUR	2,905	5,762
	37,698	**15,329**

25. OTHER CURRENT ASSETS

(in thousands of HRK)	31 December 2017	31 December 2016
Prepaid expenses and accrued income	7,253	8,910
VAT recivables	7,080	-
Current portion of long-term receivables	621	723
Other receivables	957	1,037
	15,911	**10,670**

Prepaid expenses relate to additional health insurance premium and other expenses in the amount of HRK 1,019 thousand (in 2016: 493 thousand),

In 2017 accrued income in the amount of HRK 6,234 thousand comprise of ITC mechanism revenue in the amount of HRK 2,109 thousand estimated by the Company's management for period November - December 2017 (2016: 8,416 thousand), and cross-border capacity income for December 2017, in the amount od HRK 4,125 thousand (the same amount is billed in 2018).

26. DEPOSITS AND LOANS

(in thousands of HRK)	31 December 2017	31 December 2016
Loans – Hrvatska burza električne energije d.o.o.	3,000	-
Deposits – expropriation	10,318	7,863
	13,318	**7,863**

Loans – Hrvatska burza električne energije d.o.o. from which up to the amount of HRK 2,000 thousand was reimbursed to the date of signature of these reports.

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 od interest between related companies (as per Article 14 Paragraph 3 of the Income Tax Law) for the year 2017 was equal to 4.97%.

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%,

27. CASH AND CASH EQUIVALENTS

(in thousands of HRK)	31 December 2017	31 December 2016
Giro account - domestic	72,833	27,138
Giro account - foreign	27,831	28,739
Deposits up to 90 days	43,807	46,447
Cash in hands	31	79
	144,502	**102,403**

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

a) Subscribed capital

(in thousands of HRK)	31 December 2017	31 December 2016
Subscribed capital	**4,929,195**	**4,364,392**

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. The distribution of the above amounts in future periods may result in tax liability as it is based on tax benefits as explained further below. 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)..

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 2017	31 December 2016
Liabilities toward HEP d.d. for subloan	618,851	839,172
Transaction cost for subloan refinancing	(4,217)	(5,094)
Other non-current liabilities to related companies	958	1,215
	615,592	835,293
Current portion of long-term debt	(114,242)	(216,681)
Non-current portion	**501,350**	**618,612**

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,.

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

(in thousands of HRK)	31 December 2017	31 December 2016
Up to 6 months	57,121	65,459
6 – 12 months	57,121	151,222
1 – 2 years	76,888	114,913
2 - 5 years	427,721	77,332
Over 5 years	-	430,246
	618,851	**839,172**

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

(in thousands of HRK)	31 December 2017	31 December 2016
Up to 6 months	108	121
6 – 12 months	108	121
1 – 2 years	216	242
2 - 5 years	526	726
Over 5 years	-	5
	958	**1,215**

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

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 2017**	**31 December 2016**
HRK	-	-
EUR	501,350	618,612
	501,350	**618,612**

Loans amounting to HRK 191,122 thousand have variable interest rates *(2016: HRK 307,155 thousand)*. The variable interest rates for loans were in the range from 0.729% to 2.57% per annum *(2016: from 0.87% to 2.77% per annum)*,

Loans amounting to HRK 532,017 thousand have fixed interest rates *(2016: HRK 532,017 thousand)*. The fixed interest rates for loans included in the table above were in the range from 4.851% to 6.53% *(2016: 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 2016:				
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 2017:				
Non-current	3,688	42,656	24,933	71,277
Current	616	3,367	-	3,983
	4,304	**46,023**	**24,933**	**75,260**

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 2016	**3,887**	**32,736**	**24,848**	**61,471**
Increase	824	7,062	1,154	9,040
Reversal	-	-	(711)	(711)
Utilised	(481)	(2,371)	-	(2,852)
At 31 December 2016	**4,230**	**37,427**	**25,291**	**66,948**
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**

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 2017	2016
Average staff turnover rate	3.29%	3.34%
Discount rate	2.40%	2.80%
Expected increase in salaries	2%	0%
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 2016	**32,736**	**3,887**	**36,623**
Service costs	1,429	268	1,697
Interest expense	981	109	1,090
Benefits paid	(2,371)	(481)	(2,852)
Actuarial losses	4,652	447	5,099
At 31 December 2016	**37,427**	**4,230**	**41,657**
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**

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 favor 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 favor 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 2017.

31. OTHER LONG-TERM LIABILTIES

(in thousands of HRK)	**31 December 2017**	**31 December 2016**
Deferred income - assets received with no reimbursement	70,093	73,034
Deferred income - cash received from others	297	307
Liabilities to state regarding apartments sold	1,603	1,892
Deferred income – cash received from the EU funds	20,844	-
	92,837	**75,233**
Current portion of other long-term liabilities	(2,945)	(2,945)
	89,892	**72,288**

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.

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.

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 18,844 thousand and to the CROSSBOW project in the amount of HRK 2,000 thousand. Received incentives will reduce the costs incurred in implementing these projects in future periods.

32. TRADE PAYABLES

(in thousands of HRK)	31 December 2017	31 December 2016
Amounts due to suppliers of fixed assets	153,305	172,139
Amounts due to suppliers of current assets	53,628	43,511
	206,933	**215,650**

33. OTHER CURRENT LIABILITIES

(in thousands of HRK)	31 December 2017	31 December 2016
Deferred income	4,394	2,310
Accrued ITC mechanism cost	5,909	1,109
Accrued balancing energy- imbalance settlement cost	1,272	-
Other accrued costs	327	195
Advances received - connections to grid	3,751	2,665
Net salaries	7,958	8,068
VAT payable	-	5,481
Taxes, contributions and other duties payable	4,289	3,838
Liability for unused vacation days	7,807	7,833
Contributions from salaries	2,543	2,583
Received guaranties	7,560	7,846
Taxes from salaries	1,193	1,227
Other amounts due to employees	1,566	1,186
Current portion of long term liabilities (Note 30)	2,945	2,945
Other	1,519	1,560
	53,033	**48,846**

Deferred income relates to cross border transmission capacity revenue which is quoted on yearly and monthly auctions held in December 2017 and that are going to be used during January and February 2017.

Accrued ITC mechanism expenses relate to the estimated costs of the ITC mechanism by the Company`s management in 2017, as these expenses have yet been not charged by the other ITC Agreement signatories.

Accrued expenses balancing energy – imbalance settlement refer to estimated cost od Final settlment for 2017 by Company due to the fact that they are not charged to the Company till the date of balance. They are charged in 2018.

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, the Company recognizes revenue in the same way as in 2016.
Costs of auxiliary services in the total amount of HRK 310,562 thousand (2016: 341,512 thousand) were defined by the Auxiliary Services contracts concluded by HOPS with HEP - Proizvodnja d.o.o. and all in accordance with the Price-Determination Methodology for providing auxiliary servicesAs 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 Anciliary 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 Auxiliary 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)	**2017**	**2016**
Income and expenses		
Sales income		
Electricity transmission fee income - HEP ODS d.o.o. and HEP Proizvodnja d.o.o.	1,333,681	1,288,521
Sales of balancing energy - HEP Opskrba d.o.o. and HEP d.d.	148,228	33,962
Sales of balancing energy - HEP Proizvodnja d.o.o.	41,309	31,664
Income from sale of cross-border transmission capacity HEP d.d.	162	445
Connection to transmission network – HEP Proizvodnja d.o.o.	-	83,472
Service income – HEP Telekomunikacije d.o.o.	21,378	20,648
Other sales income – related companies	4,050	2,790
	1,548,808	**1,461,502**
Other income		
Other income – related parties	**5,450**	**4,112**
Total related parties income	**1,554,258**	**1,465,614**
Finance income HEP d.d.	4,958	9,736
Expenses		
Other		
- Office space rental costs – HEP d.d.	1,190	3,000
- Telecommunication service cost – HEP Telekomunikacije d.o.o.	36,481	35,693
- Receivable impairment - HEP ODS	4,444	5,805
- Other expenses - related parties	5,334	5,188
	47,449	**49,686**
Transmission grid losses (Note 12)		
- Transmission grid losses – HEP d.d.	80,071	122,976
Purchase of regulating power (Note 12)		
Purchase of balancing energy – imbalance settlement – related parties BGMs	70,643	1,096
Purchase of balancing energy – HEP Proizvodnja	98,549	90,800
	169,192	**91,896**
Ancillary services– HEP Proizvodnja d.o.o.	310,562	341,512
Finance costs HEP d.d.	29,227	32,727

34. RELATED PARTY TRANSACTIONS (continued)

(in thousands of HRK)	**31 December 2017**	**31 December 2015**
Receivables and liabilities		
Receivables from HEP d.d. and other companies from HEP Group		
- Electricity transmission fee – HEP – ODS and HEP Proizvodnja	249,761	282.229
- for balancing energy from HEP Proizvodnja	9,167	7,144
- for balancing energy from BGMs- related parties	81,852	10,627
- connection fee from HEP Proizvodnja	-	94,558
- other	3,206	3,763
	343,986	**398,321**
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	84,865	-
- Transmission grid losses – HEP d.d.	16,632	25,620
- deposits received HEP d.d. and HEP ODS	36,104	19,603
- other – HEP d.d.	32,068	31,357
- Accrued interest on subloan – HEP d.d.	4,212	5,321
- Other	9,303	9,438
	194,746	**102,901**
Liabilities to HEP Proizvodnja d.o.o. for ancillary services	65,579	91,454
Liabilities to HEP Proizvodnja d.o.o. for connection to the grid	-	94,558
Liabilities to HEP Proizvodnja d.o.o. for connection to the grid - prepayment	48,084	44,106
	113,663	**230,118**
Total short term liabilities to related parties	**308,409**	**333,019**
Non-current liabilities		
Subloan liabilities (Note 29) - HEP d.d.	614.634	834.078
Apartments sold (Note 29) - HEP d.d.	958	1.215
	615,592	**835,293**
Current portion (Note 29)	(114,242)	(216,681)
	501,350	**618,612**

During the year ending 31 December 2017, the Company has netted liabilities and interest on loans to related parties with receivables from affiliated companies in the amount of HRK 211,750 thousand relating to principal and HRK 33,238 thousand relating to interest (2016: HRK 131,074 thousand and HRK 32,772 thousand).

34. RELATED PARTY TRANSACTIONS (continued)

	Expenses		Sales revenue	
(in thousands of HRK)	**2017**	**2016**	**2017**	**2016**
State controlled entities				
INA-Industrija nafte d.d.	4,450	4,012	-	-
Legislative. executive and other bodies of the Republic of Croatia	1,867	2,244	-	-
Prirodni plin d.o.o.	-	-	-	-
Petrokemija Kutina d.d.	-	-	2,772	3,005
Hrvatske šume d.o.o.	458	455	-	358
Croatia osiguranje d.d.	1,175	1,400	-	-
Narodne novine d.d.	276	227	-	-
Croatia radio televizija	467	500	-	-
Zdravstvene ustanove i organizacije	197	106	284	292
Hrvatske telekomunikacija d.d.	1,372	2,013	14	-
Sveučilišta i veleučilišta	72	132	-	-
Jadrolinija d.d.	86	86	-	-
Judicial institution	16	16	-	-
Other users	311	269	284	-
Hrvatske željeznice d.o.o.	-	-	15,362	16,404
TOTAL	**10,747**	**11,460**	**18,716**	**20,059**

	Receivables		Liabilities	
(in thousands of HRK)	**31 December 2017**	**31 December 2016**	**31 December 2017**	**31 December 2016**
State controlled entities				
Hrvatske željeznice d.o.o.	1,650	1,808	-	-
Petrokemija Kutina d.d.	274	344	-	-
INA-Industrija nafte d.d.	-	-	425	418
Hrvatske telekomunikacije d.d.	-	-	205	322
Croatia osiguranje d.d.	-	-	167	288
Hrvatske šume d.o.o.	-	-	-	-
Jadrolinija d.d.	-	-	1	6
Narodne novine d.d.	-	-	32	24
Hrvatska radio televizija	-	-	-	9
Other users	190	139	334	179
TOTAL	**2,114**	**2,291**	**1,164**	**1,246**

35. CONTINGENT LIABILITIES AND COMMITMENTS

Operating commitments

As at 31 December 2017 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 220,715 thousand *(31 December 2016: HRK* 262,378 *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 2017**	**31 December 2016**
Debt (long and short-term borrowings)	615,592	**835,293**
Current financial assets	(13,318)	**(7,863)**
Cash and cash equivalents	(144,502)	**(102,403)**
Net debt	457,772	**725,027**
Equity	5,223,735	**4,641,588**
Net debt to equity ratio	**8.76%**	15.62%

Debt is defined as long-term and short-term borrowings. 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 2017**	**31 December 2016**
Financial assets		
Receivables for apartments sold	2,514	3,046
Trade receivables	37,698	15,329
Receivables from related parties	343,986	398,321
Other short-term assets	8,037	1,760
Current financial assets	13,318	7,863
Cash and cash equivalents	114,502	102,403
Total loans and receivables at amortised cost	**520,055**	**528,722**

36. FINANCIAL INSTRUMENTS (continued)

Categories of financial instruments (continued)

(in thousands of HRK)	**31 December 2017**	**31 December 2016**
Financial liabilities		
Loan liabilities	615,592	835,293
Other non-current liabilities	2,199	1,892
Trade payables	206,933	215,650
Payables to related parties	308,409	333,019
Other short-term liabilities	80,213	48,846
Total financial liabilities at amortised cost	**1,213,346**	**1,434,700**

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.

As at 31 December 2017, the carrying amounts of cash and cash equivalents, short-term deposits, receivables, short-term liabilities, short-term borrowings and other financial instruments approximate their fair value due to the short-term nature of those assets and liabilities.

Financial risk management objectives

The Company's Corporate Treasury 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.

36. FINANCIAL INSTRUMENTS (continued)

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 2017	**31 December 2016**
The European Union (EUR)	625,701	826,814
	Assets	
	31 December 2017	**31 December 2016**
The European Union (EUR)	68,305	45,081

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

	31 December 2017	**31 December 2016**
EUR	7,513648	7,557787

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 2017 in the Croatian Kuna against the relevant foreign currency (decrease of 10% in 2016). 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)	**2017**	**2016**
EUR change impact		
Decrease of net result	(55,740)	(78,173)

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 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)**	**-**	**-**

As at 31 December 2016	**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	**133,773**	30,278	22,845	63,257	17,393
At currently applicable interest rates + 0,50%	**136,236**	31,646	23,653	63,544	17,393
Effect of increase of interest rate by 50 basis points	**(2,463)**	**(1,368)**	**(808)**	**(287)**	**-**

36. FINANCIAL INSTRUMENTS (continued)

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 85% of receivables on 31 December 2017.

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.

36. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (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**	**-**

As at 31 December 2016	**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	**1,215**	**1,215**	242	242	726	5
Other long-term liabilities	**1,892**	**1,892**	462	462	968	-
Trade payables	**215,650**	**215,650**	215,650	-	-	-
Payables to related parties	**333,019**	**333,019**	333,019	-	-	-
Other short-term liabilities	**49,069**	**49,069**	49,069	-	-	-
	600,845	**600,845**	**598,442**	**704**	**1,694**	**5**
Interest bearing liabilities:						
Loan liabilities	**839,172**	**973,809**	243,015	138,687	143,485	448,622
	839,172	**973,809**	**243,015**	**138,687**	**143,485**	**448,622**
	1,440,017	**1,574,654**	**841,457**	**139,391**	**145,179**	**448,627**

36. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (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 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**	**-**

As at 31 December 2016	**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	**3,046**	**3,046**	821	821	1,404	-
Trade receivables	**15,329**	**15,329**	15,329	-	-	-
Receivables from related parties	**414,136**	**414,136**	414,136	-	-	-
Other short-term assets	**1,758**	**1,758**	1,758	-	-	-
	434,269	**434,269**	**432,044**	**821**	**1,404**	**-**
Interest bearing assets:						
Current financial assets	**6,768**	**6,836**	6,836	-	-	-
Cash and cash equivalents	**52,368**	**52,892**	52,892	-	-	-
	59,136	**59,728**	**59,728**	**-**	**-**	**-**
	493,405	**493,997**	**491,772**	**821**	**1,404**	**-**

37. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board.

Signed on behalf of the Company on 12 April 2018 by:

Darko Belić	Zdeslav Čerina	Miroslav Mesić
Member of the Management Board	Member of the Management Board	President of the Management Board

HOPS
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