Tradition. Knowledge. Responsibility.

Consolidated Annual Report Končar D&ST Group

2017

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2017

Končar D&ST Group

Kornati National Park, Croatia

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MANAGEMENT BOARD REPORT ON THE KONČAR D&ST GROUP POSITION IN 2017

1 Introductory Word by the Management Board

2017 - A YEAR OF NEW INVESTMENTS AND PROFIT GROWTH

The Končar D&ST Group consists of Končar D&ST Inc., Josipa Mokrovića 8, Zagreb, Croatia and Power Engineering Transformatory Sp. z o.o. (PET), Gdynska 83, Czerwonak, Poznan, Poland.

Končar D&ST Inc. has on 8th May 2017 signed a contract for acquiring majority ownhersip (74% of shares) of the company Power Engineering Transformatory Sp. z o.o. (PET) from Czerwonak, Poznan, Poland. The main activity of this company is design, production, placement and servicing medium power transformers up to 63 MVA and voltage up to 145 kV.

Total goods and services sales of the Končar D&ST Group in 2017 amounted to HRK 907 million (2016: HRK 853 million) which is an increase of 6% on an annual level. Export transactions amounted to HRK 761 million (2016: HRK 720 million) or 84% of sales and have increased by 6% compared to the preceding year.

The gross profit in 2017 reached HRK 45.9 million (net HRK 44.4 million) or 23% more than the gross profit for 2016 which amounted to HRK 37.3 million (net profit HRK 36 million).

The investment activities, mostly for purchase of new production, testing and IT equipment and improvement of working conditions in production in 2017 amounted to HRK 12.3 million (2016: HRK 19.6 million), and the investment in the company PET Poland with HRK 22.3 million which were intended for its modernisation through the purchase of new equipment. During the year, documents and decisions were adopted on the operational launch of a new investment cycle in the area of distribution transformers production.

On 31st December 2017, the number of employees in Končar D&ST Group was 601. The project of strengthening the technical and sales sector continued through the hiring of highly educated employees. Parallel to the hiring, significant funds were invested into advanced software development for product design and development and document management system.

In its operation the company adheres to internationally recognized standards and requirements of socially responsible operations.

In 2017, Končar D&ST ordinary and preferred shares were listed in the regular market quotation of the Zagreb Stock Exchange. At the beginning of the year, the ordinary Končar D&ST share price was around HRK 1,530 and at the end of the year it was HRK 1,640.

Considering the demanding conditions at the transformer market, the total operating results of Končar D&ST in 2017 are, in our opinion, successfully and the company is well prepared for future business challenges. Mutual trust and harmonized common interests of our shareholders, employees, business partners and banks have been of great importance for such good performance. The Management of Končar D&ST Inc. is grateful for the support and trust and is pleased to present this Annual Report for the Group for 2017.

For the Management Board of the Končar D&ST Inc.

Ivan Klapan
President of the Management Board

2 Major 2017 Figures for the Group and their Comparison with 2016

	2017	2016*	2017	2016*	17/16
	HRK ('000)		EUR ('000)		index
Sales					
Croatia	146,363	133,417	19,619	17,719	109.7
Exports	760,518	719,950	101,945	95,619	105.6
Total	906,881	853,367	121,564	113,338	106.3
Net profit	44,384	35,930	5,950	4,772	123.5
No. of employees					
as at 31/12	601	532			113.0

Note: average exchange rate 2016 1EUR = 7.5294 KN
2017 1EUR = 7.4601 KN

* For 2016 the data refers only to Končar D&ST Inc. because the Končar D&ST Group was established in 2017.

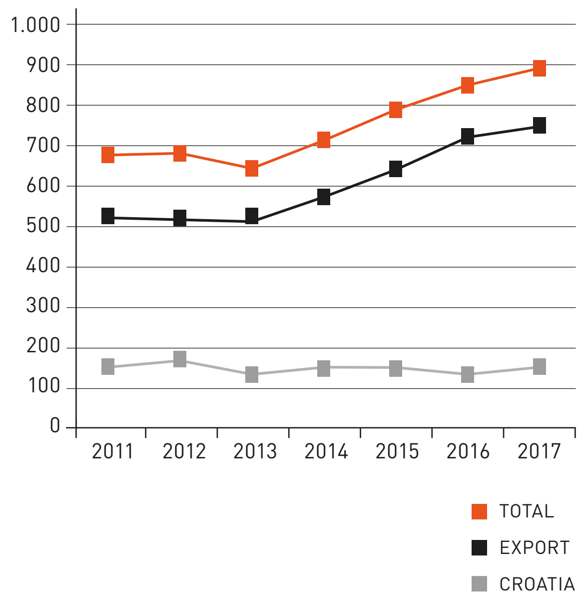
3 General position of the Group

Through successful organisational adjustment to high levels of sales and production - in the range of both distribution transformers and medium power transformers - the Company displayed the capacity to reach its business goals in demanding conditions.

Through prioritising sales and developmental activities, employing and systematically introducing young experts into the field, motivating employees, investing in product development and production modernization, the Company is prepared for the demands of complex market conditions which may be expected in the future as well. Investing into the company Power Engineering Transformatory Sp. Z.o.o. (PET) Poland, has opened another opportunity to access new markets.

Good business results in 2017 and in the previous years have strengthened the financial aspect of the Company which now has adequate financial stability and a good basis for further development of its operations.

SALES TRENDS (HRK mil.)



4 Group Organisation and Management in 2017

During 2017, Končar D&ST Inc. was managed by the Management Board, consisting of:

Ivan Klapan	President of the Management Board
Vanja Burul	Board Member, Director of the MPT Profit Centre
Martina Mikulić	Board Member, Director of the DT Profit Centre
Ivan Sitar	Board Member, Business Development Director
Petar Vlaić	Board Member, Director of Finance and Procurement

During 2017, the Supervisory Board of the Company Končar D&ST consisted of:

Darinko Bago	President of the Supervisory Board
Miroslav Poljak	Vice President of the Supervisory Board
Jozo Miloloža	Member of the Supervisory Board
Davor Mladina	Member of the Supervisory Board
Vlado Grund	Member of the Supervisory Board

After acquiring majority ownership of the company PET by Končar D&ST, the management of the company PET Sp. z o.o. was performed by:

Lukasz Farulevski	Director of the company PET Sp. z o.o.

Supervisory Board of the company PET Sp. z o.o.:

Ivan Klapan	President of the Supervisory Board
Miroslav Poljak	Vice President of the Supervisory Board
Petar Vlaić	Member of the Supervisory Board
Waldemar Organista	Member of the Supervisory Board
Grzegorz Kwiatkowski	Member of the Supervisory Board

The Končar D&ST Group performed its operations in 2017 in two locations. In the Republic of Croatia at the location Josipa Mokrovića 8, 10090 Zagreb, and in Poland at the location Czerwonak, Gdinjska 83.

In order to manage the transport and assembly of medium power transformers in Morocco, a branch office in Casablanca was operating under the name Koncar D&ST Succursale Maroc.

5 Corporate Governance Code Application

The Group implements most of the provisions of the Code of Corporate Governance, prepared by Zagreb Stock Exchange and HANFA and released on the official website of the Zagreb Stock Exchange (www.zse.hr). The only exceptions from this are certain provisions the Company considers non-applicable in the prescribed form, in particular:

- The Supervisory Board and Audit Committee consist mostly of non-independent members, which is deemed appropriate in the current Group position within the Končar Group;
- The Group has no long-term succession plan established but it does have sufficient number of high quality educated, experienced and qualified candidates within the Group for assuming all key positions where required
- No commission is established for appointments and rewards, but the appointment of new Management Board members and key management staff takes place in an organized manner and the rewarding is deemed adequate to the Group's position and its performance

The Group believes that the non-implementation of the respective Code provisions does not impair the high level of transparency of the Group's operations and will not have a significant impact on current and prospective investors in making their investment decisions.

A questionnaire with responses to 63 questions contains precise answers regarding the implemented and non-implemented provisions. The questionnaire is publicly available on the official website of the Zagreb Stock Exchange (www.zse.hr) and the Company's website (www.koncar-dst.hr).

Within its organizational model, in which the Group operates and in which all business processes take place, the Group has developed internal control systems at all important levels. These systems, among other things, allow for an objective and fair presentation of the financial and business reports.

Information on significant shareholders is available on daily basis on the official Central Depository & Clearing Company website at (www.skdd.hr), while its status on 31st December 2017 and 2016 was also published in the audit report. The shareholders are allowed the electronic voting with their presence at the General Assembly. Preferred shares of Končar D&ST do not provide any voting rights.

6 Market Position and Sales by Countries and Product Groups

After the stabilisation of demand growth on the transformer market in 2016, the trend has continued in 2017. Given the still steady growth of demand with increased capacity of existing competitors from Europe and Asia, the market is marked by strengthening presence of newly established competitors.

Continued market operation, improving relations with customers and stakeholders, monitoring product development trends and organisational change in terms of improving the market position resulted in steady growth in sales revenue.

In 2017, the sales of goods and services grew by 6.3% compared to 2016, and amounted to HRK 906.9 million. Per product groups, changes from the 2016 period were as follows:

U 2017. godini prodaja roba i usluga bilježi rast od 6,3% u odnosu na 2016. godinu i iznosila je 906,9 mil kuna, a po grupama proizvoda promjene u odnosu na 2016. su:
- distribution transformers: growth by 0.6%
- medium power transformers: growth by 9.0%
- dry and special transformers: growth by 21.8%
- other goods and services: drop by 0.8%

Sales by major markets were as follows:

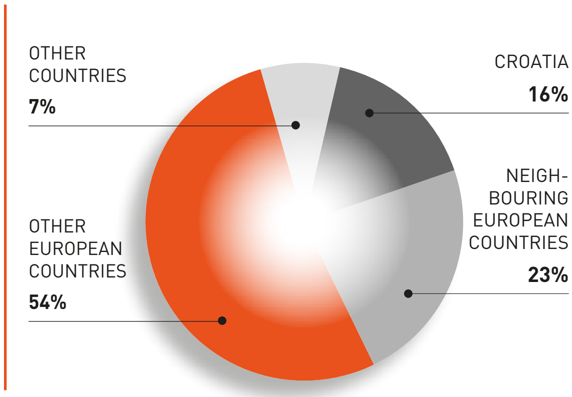
Croatia: in 2017, the sales reached HRK 146.4 million, which compared to HRK 133.4 million in 2016, is an increase of 9.7%

Neighbouring European Countries: Bosnia and Herzegovina, Slovenia, Macedonia, Montenegro, Austria, Italy, Czech Republic, Slovakia, Hungary, Kosovo, Serbia, Bulgaria, Romania, Albania - in 2017, the sales reached HRK 203.5 million, which compared to HRK 195 million in 2016, is an increase of 4.4%.

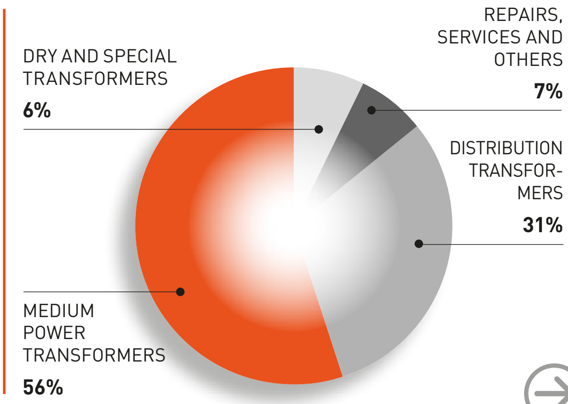
Other European countries: Sweden, Switzerland, Germany, Finland, Iceland, France, Great Britain, Ireland, Poland, Estonia, Latvia, Lithuania, Cyprus, Spain, Denmark, Norway, Malta - in 2017, the sales reached HRK 493.8 million, which compared to HRK 424 million in 2016, is an increase of 16.5%.

Other Asian, African and American countries: in 2017, we delivered HRK 63.2 million, which compared to HRK 102 million in 2016, constitutes a reduction by 38%.

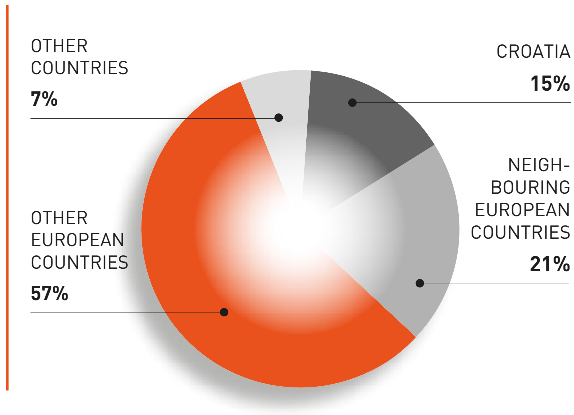
SALES STRUCTURE PER MARKETS (2017)



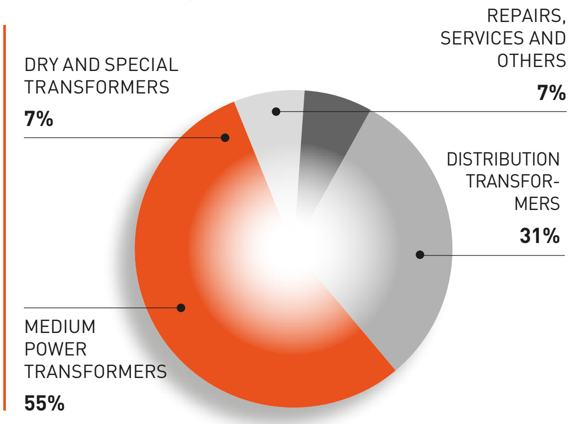
SALE STRUCTURE PER PRODUCTS (2017)



NEW CONTRACTS PER MARKETS (2017)



STRUCTURE OF NEW CONTRACTS PER PRODUCTS (2017)



7 Financial Position (Balance Sheet)

The total assets of the Group on 31st December 2017 amounted to HRK 667.5 million. Fixed assets make up 26% of the total assets and amount to HRK 176.5 million. Current assets amount to HRK 491 million or 74% of total assets.

Equity and reserves with a value of HRK 306.3 million amount to 46% of liabilities. Long-term liabilities as of the balance sheet date amount to HRK 44.9 million and the short-term liabilities amount to HRK 201.5 million.

8 Operating Results (Income Statement) and Share Price Trends

In 2017, the Končar D&ST Group reached HRK 930.8 million total revenue. Income from sales amounted to HRK 906.9 million, and their structure was dominated by income acquired outside of Croatia in the amount of HRK 760.5 million or 84%. In Croatia HRK 146.4 million of sales profit was realised.

In the financial activities domain, the income reached HRK 12.5 million with expenses of HRK 10.2 million. The profits from financial activities for 2017 amounts to HRK 2.3 million.

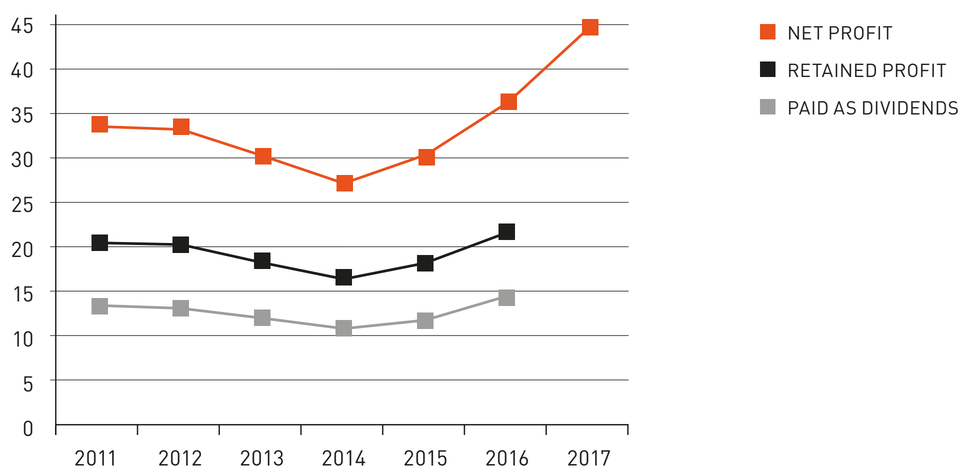
In 2017, the consolidated gross profit in the amount of HRK 45.9 million was reached, which makes 4.9% of the total Group profit. The effective corporate income tax rate amounts to 3.5% because of tax incentives granted to Končar D&ST due to realized investments and employments. The consolidated net profit after taxation amounts to HRK 44.4 million.

The year 2017 was marked with significantly lower trading dynamics at the Zagreb Stock Exchange compared to the preceding year. IN 2017, there were 2,641 stocks in trade as opposed to the year before when the number of stocks in trade was 7.623. The prices were within the range from HRK 1,420.00 to HRK 1,799.99 per share. The last transaction in 2016 with the preferred share was done at the price of HRK 1,550, and with the ordinary share at the price of HRK 1,640.

According to the ordinary share price, the P/E ratio on the last day of 2017 was 10.1. The market capitalisation as at 31st December 2017 amounted to HRK 413.7 million while on 31st December 2016 it was HRK 383.1 million.

In 2017, the parent company Končar D&ST did not acquire any treasury shares, and the subsidiary company PET, Poland did not acquire any parent company shares.

NET PROFIT TROUGH YEARS (HRK mil.)



9 Main Group Operating Risks

Market Risks. Demand for transformers on the target markets of the Končar D&ST Group is one of the main operating risk factors. Global demand for transformers as well as demand on target markets varied significantly in specific periods, depending on a number of factors. Periods of high demand (positive trends) are definitely periods of easier contracting. On the other hand, periods of global recession and economic crisis bring with them more difficult contracting of new works and the resulting decrease in profit margins. **Supply** of transformers by other producers - competition pressure - is another significant risk factor for operations of the Končar D&ST Group. Transformer market is generally in most target export markets close to the full competition pattern or a form of mild oligopoly, and the market pressure on majority of the target markets is very strong. The entire transformer industry has been through major changes in the recent 10-20 years with a number of restructurings, winding-ups of plants, opening of new plants, take-overs and mergers (consolidations) and the trends are continuing.

Procurement market risks. Prices of major raw materials and supplies for the production of transformers (copper, aluminium, transformer metal sheets, transformer oil, insulation, steel, etc.) have been volatile in the several recent years and sometimes with enormous growth or drop in a relatively short time period. Considering the available options, the Company protects itself from the risk of sudden changes in prices of strategic raw materials in several ways. As for copper, being a raw material listed on commodity exchange markets (London Metal Exchange), forward contracts are used to agree on quantities and prices for the forward period based on book of orders. As for steel, transformer metal sheets and some important transformer parts, semi-annual or annual contracts with suppliers are used to reduce this risk. Also, in some several-year contracts with customers, the rolling formula was based on the change of the price in materials.

Currency risk is highly expressed in our operations, considering a high percentage of exports and imports in our income and considering that majority of bank loans (both long-term and short-term ones) are expressed in EUR.

The Company protects itself from currency risk by forward contracts with banks as well as by internal methods for harmonisation of currency inflow and outflow.

Technology and development risks. At this moment, the Company has at its disposal state-of-the-art technology for the transformer production and appropriate technical solutions for the majority of products within its range. The Company is capable of following technical and technological development at an enviable level. In future, technical and technological lag behind the major competitors is not expected.

Credit risk and liquidity risk. Credit risk is observed as a risk that a certain debtor of the Group (e.g. customer to whom the delivery was made without any security) will not be able or willing to pay its dues to the Group in compliance with the agreed terms, and the Group will therefore incur losses by writing off or reducing such receivables.

Liquidity risk is observed as a risk that the Group will not be able to perform its liabilities to creditors in the agreed terms.

The Group protects itself from credit risk with collaterals (L/C, guarantees, etc.), and evaluation of customer solvency in cooperation with external solvency and credit rating agencies. Also, certain trade receivables in respect of specific customers are secured at specialized institutions.

The Group has contracts with commercial banks about credit facilities which make possible for the Company to surmount current need for liquid funds promptly and under familiar conditions. Also, receivables with relatively long maturity terms are most frequently collected by sale to financial institutions (factoring, forfeiting).

Management and personnel risk. Usual fluctuations and changes in the management and leading experts do not have significant effect on corporate operations while sudden or major fluctuations of such personnel categories might affect the Group's corporate performance. In addition to those specified above, design risks, production risks, political risks and other risk groups are also present to a certain extent.

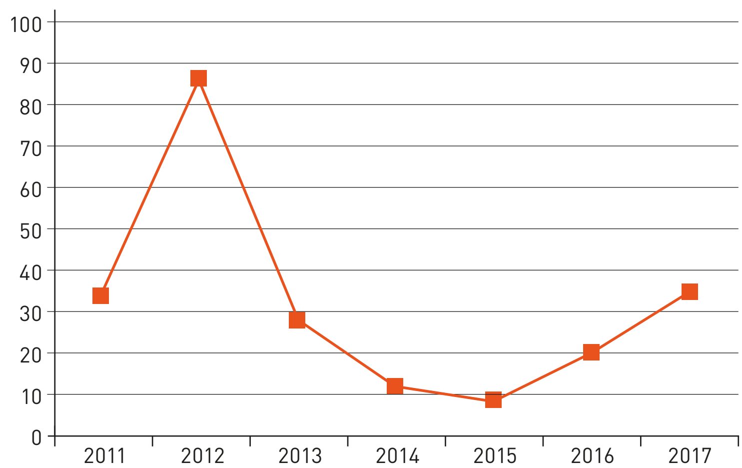
10 Investments and Technology Modernisation

HRK 22.3 milliion was invested in the company PET Poland in 2017 which were used to purchase new equipment, restructure and modernise the plant and human resources. In addition to the financial aspect, Končar D&ST, Inc. will invest its know-how and thus support the further development of a modern and competitive plant of medium power transformers in Poland with an expected return on investment through the medium term.

The Company makes targeted investments in the improvement and modernisation of processes which need to be raised to a higher technological level. Thus, in 2017, investments were made in the amount of HRK 12.3 million. Several specialised machines for the production process were purchased and modernized - several winding machines, various devices and logistics equipment - in compliance with the adopted plan. Significant investments were made in the infrastructure, new wardrobes, offices and especially IT equipment for the purposes of product research and development, drafting product documentation and communication technology.

Total investments in 2017 of the Končar D&ST Group amounted to HRK 34.6 million.

INVESTMENT TRENDS (HRK mil.)



11 Technical Development and Product Innovation

In the distribution transformer field, the focus was on creating a new software for stronger special and distribution transformer design. The rest of the assortment of distribution transformers were aimed at preventing noise and losses. In cooperation with the Faculty of Electrical Engineering and Computing, new bases for calculating load loss in oval distribution transformers were created, while new bases for core losses of rectangular distribution transformers were made in cooperation with the Institute for Electrical Engineering.

In the range of medium power transformers, the focus was on researching and applying new technological procedures and materials for decreasing core loses, noise and insulation distances. Bases for calculating transformer heating and cooling values have also been revised.

The cooperation with Končar Institute for Electrical Engineering, Faculty of Electrical Engineering and Computing and the Faculty of Mechanical Engineering and Naval Architecture in Zagreb and the Poznan University of Technology at Poznan, Poland has continued. There are several young professionals attending specialist and doctoral studies at the faculties of Zagreb and Poznan Universities.

Experts from the Technical Development Department and other departments actively participated in symposiums and seminars about transformers (CIRED in Glasgow, HRO CIGRE in Šibenik, EuroTechCon in Glasgow) and worked in the SO2 study committee for transformers and in the technical committee HZN/TO E14 Power Transformers.

12 Human Resources

On 31st December 2017 the number of employees at the Končar D&ST Group amounted to 601 employee (539 employees at Končar D&ST, Inc. and 62 employees at PET Sp. z o.o.).

In the area of employee training, continuous training is conducted at universities and polytechnics studies. The Company supports enrollment in postgraduate studies, the result of which is a growing number of employees educated at various faculties. A rewarding approach and promotion of professional and scientific training significantly enriches the know-how of the Group and its contacts with the relevant university institutions.

13 Quality Management, Environment Management and OHSAS Management

The Group recognizes the importance of a systematic approach to quality management, environmental management and occupational health and safety management.

In 2017, regular audits of all three certified management systems (ISO 9001, ISO 14001 and OHSAS 18001) were carried. The company PET Poland has a certified quality management system according to the ISO 9001 standard.

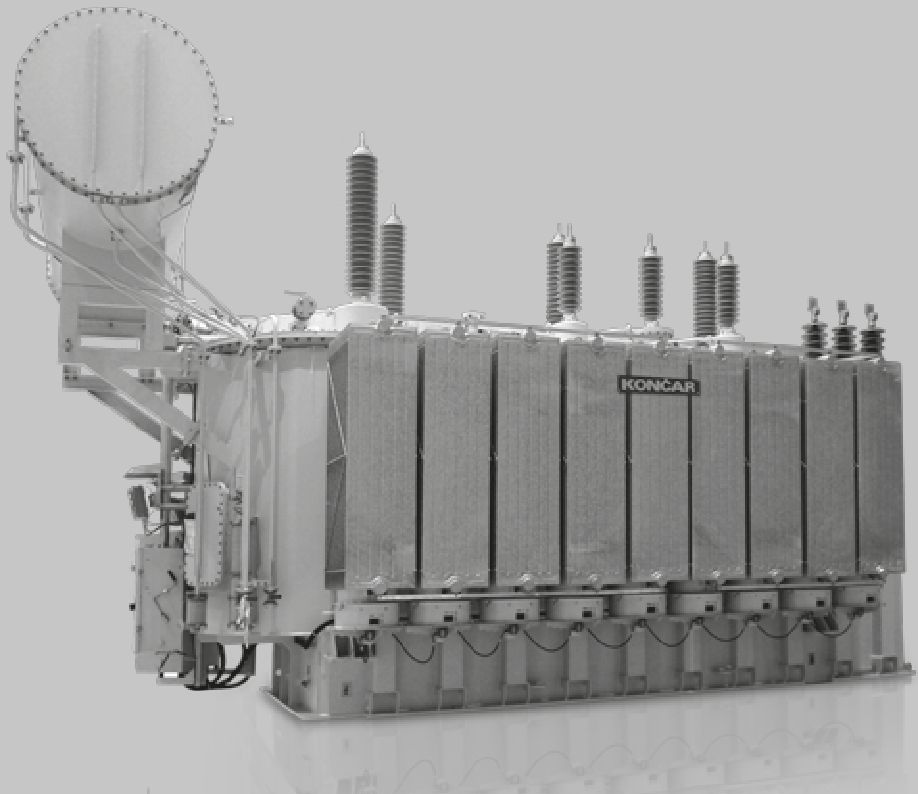
Through the established model of data collection and analysis for recognition of possible damages (property damages and personal injuries), the Končar D&ST Group promotes occupational health and safety and raises the awareness of the care for health and safety of each person in the Company.

14 Further Group Development Strategy

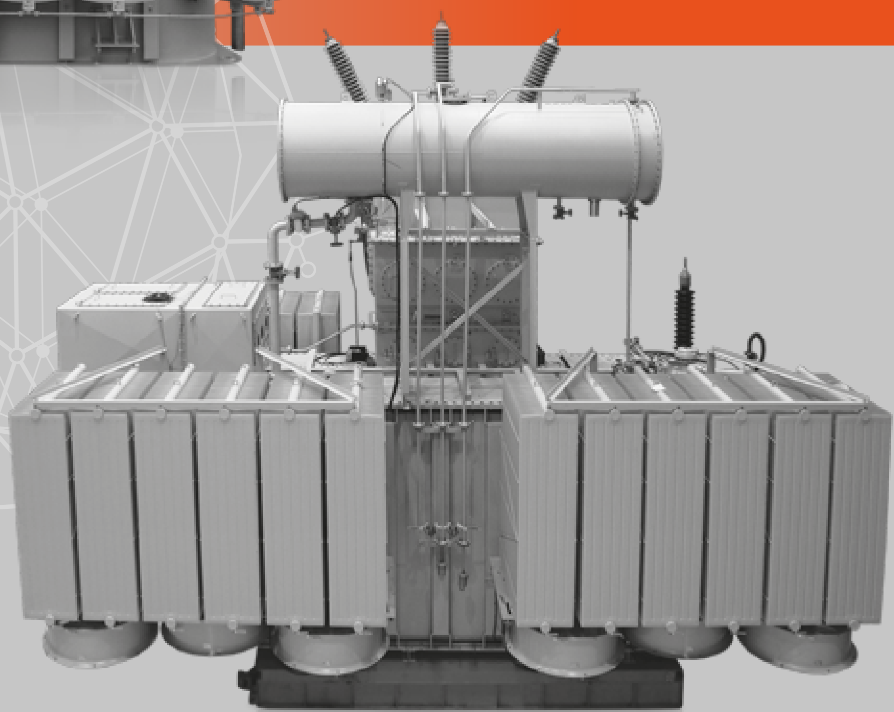
The core business activities of the Končar D&ST Group will continue to be development, sales and production of distribution oil transformers up to 8 MVA and 36 kV, special transformers, medium power transformers up to 100 MVA and 170 kV, as well as technology sales projects on selected markets.

Recognition and best fulfilment of the requirements of our target customers, commitment to the quality and sustainable development, technical and organisational development, training and incentives for our employees aimed to excellence and teamwork fostering, Končar D&ST shall provide high position among the leading European manufacturers of distribution, special and medium power transformers.

Remark: From the end of the year 2017 until the preparation of this report, there have been no unusual or significant events that could significantly change the view of the operations and position of the Group as presented in this report.



II DECISIONS PROVIDED BY LAW



Končar-Distribution and Special Transformers, Inc.
Zagreb, Josipa Mokrovića 8, PIN: 49214559889
(hereinafter: "the Company")

Pursuant to Articles 220 and 300d of the Croatian Act on Companies and Article 22 of the Articles of Association of KONČAR D&ST Inc., at the Supervisory Board meeting held on 28 March 2018, the Supervisory Board and the Management Board of the Company have adopted the following

DECISION
ON APPROVAL OF THE CONSOLIDATED
ANNUAL FINANCIAL STATEMENTS FOR 2017

The Supervisory Board and the Management Board of Končar-D&ST Inc. have jointly adopted the Consolidated Annual Financial Statements for 2017.

Explanation

The Management Board of the Company has submitted to the Supervisory Board for approval the Consolidated Financial Statements for 2017. The Supervisory Board has given approval to the Consolidated Financial Statements for 2017, whereby the Supervisory Board and the Management Board have jointly adopted the Consolidated Annual Financial Statements for 2017 as follows:

Total income	HRK	930,770,759
Total expenses	HRK	884,836,225
Profit before taxation	HRK	45,934,534
Corporate income tax	HRK	1,550,578
Profit after taxation	HRK	44,383,956
Total assets/liabilities	HRK	667,548,754

Darinko Bago
President of the Supervisory Board

Ivan Klapan
President of the Management Board

Zagreb, 28 March 2018

III INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS WITH NOTES

Responsibility for the Consolidated Annual Report

Pursuant to the Croatian Accounting Act, the Management Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards as adopted in the European Union, which give a true and fair view of the consolidated financial position and results of Končar - Distribution and Special Transformers Inc., Zagreb and its subsidiary (hereinafter: the Group) for that period.

The Management Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. Therefore, the Management Board continues to adopt the going concern basis in preparing the consolidated financial statements.

In preparing consolidated financial statements, the responsibilities of the Management Board include ensuring that:
- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- consolidated financial statements are prepared on a going concern basis unless this assumption is inappropriate.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group and their compliance with the Croatian Accounting Act. The Management Board is also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Moreover, in accordance with the Accounting Act, the Management Board is obliged to prepare a consolidated Annual Report comprising the consolidated financial statements, the consolidated Management Report and the Corporate Governance Statement. The consolidated Management Report was prepared in line with the requirements of Article 21 and 24 of the Accounting Act, and the Corporate Governance Statement in line with the requirements of Article 22 of the Accounting Act.

Ivan Klapan, President of the Management Board

Petar Vlaić, Member

Ivan Sitar, Member

Martina Mikulić, Member

Vanja Burul, Member

KONČAR
Distributivni i specijalni transformatori d.d.
Zagreb

Končar - Distribution and Special Transformers Inc.
Josipa Mokrovića 8
10 090 Zagreb
23 March 2018

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Independent Auditor's Report

To the Shareholders and Management Board of Končar – Distribution and Special Transformers Inc.

Report on the audit of the consolidated financial statements

Our opinion

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of Končar – Distribution and Special Transformers Inc. and its subsidiaries (the "Group") as at 31 December 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ("IFRS").

Our opinion is consistent with our additional report to the Audit Committee.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2017;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group and its subsidiaries are in accordance with the applicable law and regulations in the Republic of Croatia and that we have not provided non-audit services that are prohibited under Article 5(1) of Regulation (EU) No. 537/2014.

The non-audit services that we have provided in the period from 1 January 2017 to 31 December 2017, are disclosed in Note 1 to the consolidated financial statements.

PricewaterhouseCoopers d.o.o., Heinzelova 70, 10000 Zagreb, Croatia
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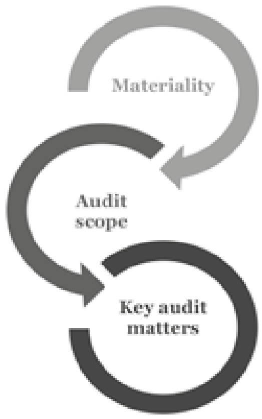
Our audit approach

Overview



Materiality

- Overall materiality for the consolidated financial statements as a whole: HRK 9,000 thousand, which is 1% of sales revenues

Audit scope

- We performed a full-scope audit of the parent company in Croatia (the company is subject to audit as stipulated by law).
- The audit of the subsidiary in Poland was performed by the component auditor.
- Our audit scope addressed 98% of the Group's revenues and 95% of the Group's profit.

Key audit matters

- Warranty provisions
- Impairment of inventories

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, if any, both individually and in aggregate on the consolidated financial statements as a whole.

Overall materiality for the financial statements as a whole	HRK 9,000 thousand
How we determined it	1% of sales revenues
Rationale for the materiality benchmark applied	We chose sales revenues as the key metric, because we consider it to be the benchmark which best reflects the Group's performance in the period under review. We chose 1%, which is within the range of commonly acceptable quantitative materiality thresholds in this sector.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	How our audit addressed the key audit matter
Warranty provisions *See Note 2 to the financial statements under the headings "Provisions, contingent assets and liabilities", Note 3 (Critical accounting judgements and estimates) and Notes 12, 30 and 39* Provisions for servicing during warranty periods relate to estimated costs of possible repairs (rectifications or replacement of faulty products) of the Group's products (special and distribution transformers). The Group provides warranties for its products for a period of 2 to 5 years in accordance with signed contracts. In the year ended 31 December 2017, the Group recognised a warranty provision amounting to HRK 6,665 thousand. Movements in provisions in the current period are disclosed in Notes 30 and 39. Provisions include general and specific provisions. General provisions are calculated using estimations (2% of the value of sold goods under warranty) based on the Company's past experience and on the experience of other manufacturers of similar energy equipment, taking into account specific design and performance requirements. Specific provisions relate to possible quality problems in relation to the equipment sold to certain customers (the Group estimates total costs which may be incurred for resolving quality problems for a particular customer). We focused on this area because Management made provisions that require significant judgements in relation to the amount of current and potential future claims from customers for losses or damages incurred within the warranty period.	In the view of the significant judgements involved in the calculation of warranty provisions, we examined the most material provisions in detail and sought relevant supporting evidence and analyses made by management. We made inquiries with Management in order to obtain an understanding as to the Management's viewpoint and underlying assumptions and inspected a sample of significant sales agreements with a focus on contractual terms related to warranty periods and warranty terms. In relation to general provisions where Management applied 2% as the appropriate percentage for its deliveries, we compared the used percentage with the percentage used by manufacturers of similar energy equipment in order to assess whether the assumption used in the provision calculation was appropriate. We have not identified any significant deviations. In respect of specific provisions related to possible quality problems of equipment sold to certain customers, we reviewed the matrix defined by the Company involving the probabilities of small, medium and big errors in order to assess whether the provided amount was appropriate. We have found the calculations to be reasonable. As set out in the Note 3 to the consolidated financial statements, because Management's assumptions concern future events, the calculations of the provisions are inherently uncertain. We verified the mathematical accuracy of the calculations and agreed the data used in the calculations with the Group's records. We also reviewed the sensitivity analysis in the consolidated financial statements disclosing the effect of change in percentage used for general provisions and found no issues. Based on the evidence obtained, while noting the inherent uncertainty related to such provisions, we determined the level of warranty provisioning at 31 December 2017 to be consistent with previous periods and in accordance with the information currently available to the Group.

Key audit matters	How our audit addressed the key audit matter
Impairment of inventories *See Note 2 to the consolidated financial statements under the heading "Inventories" (accounting policies), Note 3 (Critical accounting judgements and estimates) and Notes 11 and 23* As disclosed in Note 2 to the consolidated financial statements, inventory write-downs are recognised in case when Management assesses there is a need to reduce inventory from cost to net realisable value based on the predetermined criteria. The calculation of net realisable value takes into account the intended use of the inventory (e.g. inventories held to satisfy a particular service maintenance contract are based on the contract price). In case when Management assesses that the decline in the price of materials indicates that the cost of finished goods will exceed their net realisable value, materials are written down and in such case the replacement cost is the best available measure of their net realisable value. The write-down of inventories to net realisable value is calculated by applying Management judgement to the period-end inventory levels, with this judgement being affected by the inventory ageing structure as well as Management's view of the current inventory profile and age. The write-down expense recognised in the current period amounted to HRK 5,850 thousand (2016: HRK 9,511 thousand). We focused our attention to the valuation of inventories because of the significance of the inventory balance and the nature of judgements made by Management when assessing the carrying value of inventories.	At year-end, we attended the inventory count, primarily at the Group's manufacturing locations. On a sample basis, we checked the correctness of counting inventory quantities by the Group, and we also assessed the effectiveness of count controls at each location. We compared the inventory count results as determined by Management at year-end with the data in the accounting records in order to determine the level of count variances. We performed a test of details involving a comparison of the net realisable value with cost on the selected sample of finished goods, noting no significant variances. We checked the accuracy of the inventory ageing structure report used by Management when determining the inventory write-down by performing a detailed test on a selected sample of inventory items and we did not find any errors. We reviewed the Management's decisions on the inventory write-down based on its analysis and found no inconsistencies. We held discussions with Management in order to obtain an understanding as to the basis of Management's views and related assumptions. Based on the audit procedures performed, we accept the reasonableness of Management's assumptions used in determining the inventory write-down expense.

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How we tailored our Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

In establishing the overall approach to the group audit, we determined the type of work that needed to be performed by us, as the group engagement team, and component auditors. Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at that component to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group's consolidated financial statements as a whole.

For the parent company, a full-scope audit was performed, while for the not significant component audited by the component auditor, no additional audit procedures were performed by the group engagement team.

The audit work performed at the parent company and by the group engagement team enabled us to get 97% coverage of the Group's total assets, 98% coverage of the Group's revenue and 95% coverage of the absolute value of the Group's underlying profit.

By performing the procedures at all the significant components combined with additional procedures at the Group level, we obtained sufficient and appropriate audit evidence regarding the financial information of the Group as a whole to provide a basis for our opinion on the consolidated financial statements.

Reporting on other information including the Management Report and Corporate Governance Statement

Management is responsible for the other information. The other information comprises the Group's Annual Report, which includes the Management Report and Corporate Governance Statement, but does not include the consolidated financial statements and our independent auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information, including the Management Report and Corporate Governance Statement.

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

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia. Those procedures include considering whether the Management Report includes the disclosures required by Article 21 and 24 of the Accounting Act, and whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

Based on the work undertaken in the course of our audit, in our opinion:

- the information given in the Management Report and the Corporate Governance Statement for the financial year for which the consolidated financial statements are prepared is consistent, in all material respects, with the consolidated financial statements;
- the Management Report has been prepared in accordance with the requirements of Article 21 and 24 of the Accounting Act, and
- whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

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In addition, in light of the knowledge and understanding of the Group 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 and the Corporate Governance Statement. We have nothing to report in this respect.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted in the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group'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 Group or to cease operations, or has no realistic alternative but to do so.

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

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- 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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our independent auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our independent auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

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- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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 control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate and consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our independent auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

Appointment

We were first appointed as auditors of the Group on 23 May 2014. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 4 years.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
Heinzelova 70, Zagreb
23 March 2018

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2017

	Note	2017	2016
		HRK	*HRK*
Revenue	4	906,880,947	853,366,620
Other operating income	5	2,236,005	4,454,364
Operating income		**909,116,952**	**857,820,984**
Increase/(decrease) in inventories of work in progress and finished goods		(22,914,105)	37,939,218
Cost of materials and energy	6	(544,284,973)	(572,841,114)
Cost of goods sold		(30,880,077)	(29,302,376)
Service costs	7	(77,186,664)	(73,011,763)
Staff costs	8	(127,930,496)	(117,023,507)
Depreciation and amortisation	9	(19,617,469)	(19,031,584)
Other expenses	10	(23,889,373)	(23,246,253)
Impairment of current assets	11	(6,399,420)	(11,720,416)
Provisions	12	(20,868,565)	(9,248,529)
Other operating expenses		(671,139)	(3,165,712)
Operating expenses		**(874,642,281)**	**(820,652,036)**
Operating profit		**34,474,671**	**37,168,948**
Gain on bargain purchase	**42**	**8,903,103**	**-**
Finance income	13	12,445,652	11,110,237
Finance costs	14	(10,193,944)	(11,178,566)
Net finance result		**2,251,708**	**(68,329)**
Total income		**930,465,707**	**868,931,221**
Total expenses		**(884,836,225)**	**(831,830,602)**
Share in profit of investments accounted for using the equity method	**15**	305,052	309,912
Profit before tax		**45,934,534**	**37,410,531**
Income tax	16	(1,550,578)	(1,370,462)
PROFIT FOR THE YEAR		**44,383,956**	**36,040,069**
Other comprehensive income			
Items that may be subsequently reclassified to profit or loss			
Exchange differences on translation of foreign operations		245,487	-
Other comprehensive income/(loss)		**245,487**	**-**
COMPREHENSIVE INCOME FOR THE YEAR		**44,629,443**	**36,040,069**
Earnings per share (basic and diluted) in HRK	17	173.64	140.99

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

Consolidated Statement of Financial Position

as at 31 December 2017

	Note	31 December 2017	31 December 2016
		HRK	*HRK*
ASSETS			
Non-current assets			
Intangible assets	18	2,396,559	2,935,724
Property, plant and equipment	19	163,121,053	145,810,830
Investment property	20	3,500,000	-
Investments accounted for using the equity method	21	4,389,052	4,284,000
Financial assets	22	2,862,110	2,843,285
Deferred tax assets	16	264,224	327,071
		176,532,998	**156,200,910**
Current assets			
Inventories	23	200,445,554	227,172,100
Receivables from related parties	24	42,906,848	15,256,027
Trade receivables	25	113,415,938	110,914,829
Other receivables	26	2,732,851	7,158,889
Financial assets	27	882,706	241,611
Cash and cash equivalents	28	130,043,399	71,450,771
Prepaid expenses		588,460	259,517
		491,015,756	**432,453,744**
Non-current assets held for sale		**-**	**4,000,000**
TOTAL ASSETS		**667,548,754**	**592,654,654**
EQUITY AND LIABILITIES			
Share capital	29	**76,684,800**	**76,684,800**
Legal reserves	29	3,839,641	3,839,641
Statutory reserves	29	153,369,600	145,672,503
Other reserves	29	25,231,495	11,371,723
Translation reserves		245,487	-
Retained earnings		**2,551,542**	**2,441,630**
Profit for the year		**44,383,956**	**36,040,069**
EQUITY		**306,306,521**	**276,050,366**
Warranty provisions		99,624,792	95,836,420
Provisions for pensions, termination benefits and similar liabilities		15,224,434	2,255,022
Provisions	30	**114,849,226**	**98,091,442**
Liabilities from purchase of shares	31	8,001,769	-
Bank borrowings	32	36,895,965	21,253,771
Non-current liabilities		**44,897,734**	**21,253,771**
Liabilities to related parties	33	6,696,470	6,297,259
Bank borrowings	34	9,614,576	8,501,508
Trade payables	35	69,350,738	57,547,949
Advances received	36	45,943,641	62,461,555
Other liabilities	37	16,061,778	15,074,253
Accrued expenses and deferred income	38	9,056,240	6,299,416
Current provisions	39	44,771,830	41,077,135
Current liabilities		**201,495,273**	**197,259,075**
Total liabilities		**361,242,233**	**316,604,288**
TOTAL EQUITY AND LIABILITIES		**667,548,754**	**592,654,654**

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

Consolidated Statement of Cash Flows

for the Year Ended 31 December 2017

	Note	2017	2016
		HRK	*HRK*
Cash flows from operating activities			
Cash proceeds from trade receivables		868,954,831	883,453,423
Cash proceeds from insurance compensations		15,797	126,963
Cash proceeds from tax returns		43,096,205	45,198,584
Cash paid to suppliers		(678,686,691)	(717,461,734)
Cash paid to employees		(121,409,235)	(112,431,290)
Taxes paid		(21,379,893)	(19,881,146)
Cash expenses for insurance reimbursements		(1,648,753)	(1,901,787)
Other cash proceeds and payments		(16,186,723)	(15,869,177)
Cash from operations		**72,755,538**	**61,233,836**
Interest paid		(1,066,257)	(2,105,441)
Net cash flows from operating activities		**71,689,281**	**59,128,395**
Cash flows from investing activities			
Proceeds from sale of non-current tangible and intangible assets		338,798	2,040,264
Dividends received		2,113,086	1,928,202
Interest received		33,315	73,291
Purchase of non-current tangible and intangible assets		(14,946,000)	(17,909,628)
Net cash used in investing activities		**(12,460,801)**	**(13,867,871)**
Cash flows from financing activities			
Proceeds from borrowings	32.34	23,352,783	105,688,042
Repayment of borrowings	34	(9,017,784)	(112,848,794)
Dividends paid		(14,373,288)	(12,028,542)
Finance lease payments	34	(597,135)	-
Other cash proceeds and payments		(428)	43,889
Net cash used in financing activities		**(635,852)**	**(19,145,405)**
Net increase in cash and cash equivalents		**58,592,628**	**26,115,119**
Cash and cash equivalents at the beginning of the year		71,450,771	45,335,652
Cash and cash equivalents at the end of the year	28	**130,043,399**	**71,450,771**

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

Consolidated Statement of Changes in Equity

for the Year Ended 31 December 2017

	Share capital	Legal reserves	Statutory reserves	Other reserves	Retained earnings	Profit for the year	Total equity
	HRK	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
At 1 January 2016	**76,684,800**	**3,839,641**	**127,634,716**	**11,371,723**	**2,441,630**	**30,064,520**	**252,037,030**
Profit for the year	-	-	-	-	-	36,040,069	**36,040,069**
Total comprehensive income	-	-	-	-	-	*36,040,069*	*36,040,069*
Transactions with owners:							
Transfer to reserves as per annual schedule	-	-	18,037,787	-	-	(18,037,787)	-
Dividends paid	-	-	-	-	-	(12,026,733)	**(12,026,733)**
	-	-	*18,037,787*	-	-	*(30,064,520)*	**(12,026,733)**
At 31 December 2016	**76,684,800**	**3,839,641**	**145,672,503**	**11,371,723**	**2,441,630**	**36,040,069**	**276,050,366**
Profit for the year						44,383,956	**44,383,956**
Other comprehensive income:							
Exchange differences on translation of foreign operations	-	-	-	-	-	245,487	245,487
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**44,629,443**	**44,629,443**
Transactions with owners:							
Transfer to reserves as per annual schedule	-	-	7,697,097	13,859,772	109,912	(21,666,781)	-
Dividends paid	-	-	-	-	-	(14,373,288)	**(14,373,288)**
	-	-	*7,697,097*	*13,859,772*	*109,912*	*(36,040,069)*	*(14,373,288)*
At 31 December 2017	**76,684,800**	**3,839,641**	**153,369,600**	**25,231,495**	**2,551,542**	**44,629,443**	**306,306,521**

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

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

1. General information on the Group

The principal activities of the Končar Group - Distribution and Special Transformers Inc. are the design, production, placement and servicing of distribution, special and medium power transformers up to 100 MVA and voltage up to 170 kV.

The Group consists of the parent company Končar - Distribution and Special Transformers Inc. and the subsidiary Power Engineering Transformatory Sp. z.o.o. On 8 May 2017, a contract was signed on the acquisition of the majority ownership share (74% share) in Power Engineering Transformatory Sp. z o.o. (PET) from Czerwonak, Poznan, Poland. The principal activity of the stated company is the design, production, placement and servicing of medium power transformers up to 63 MVA and voltage up to 145 kV. The consideration paid for the acquisition of the 74% share will be used to purchase new equipment and modernise the factory.

Shares in ownership and voting rights as at 31 December were as follows:

	31 December 2017		31 December 2016	
	Ownership share (%)	*Voting rights share (%)*	*Ownership share (%)*	*Voting rights share (%)*
Power Engineering Transformatory (PET)	74	74	-	-

The Company also has the associate Elkakon Ltd. with an ownership share of 50%. As at 31 December 2017, the Group had 601 employees, while as at 31 December 2016 the Group had 532 employees. The Group has a subsidiary in Morocco (which is not a legal entity), and its financial information is included in the Group's financial statements.

The employee structure is as follows:

	31 December 2017	31 December 2016
University degree, Master's degree and PhD	213	183
College	27	27
Secondary school qualifications	281	264
Skilled workers	49	31
Primary school + training on the job	31	27
Total	**601**	**532**

Members of the Supervisory Board

- Darinko Bago, President
- Miroslav Poljak, Deputy
- Jozo Miloloža, Member
- Davor Mladina, Member
- Vlado Grund, Member

Members of the Management Board

- Ivan Klapan, President
- Petar Vlaić, Member
- Ivan Sitar, Member
- Martina Mikulić, Member
- Vanja Burul, Member

Compensations paid to members of the Management Board and Supervisory Board of the Group are disclosed in Notes 8 and 10 to the financial statements.

In 2017, non-audit services provided to the Group amounted to HRK 27,180 net.

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

2. Summary of significant accounting policies

The significant accounting policies used for the preparation of these consolidated financial statements are presented below. These accounting policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The Group's consolidated financial statements have been prepared in accordance with the applicable laws in the Republic of Croatia and International Financial Reporting Standards adopted in the European Union.

The consolidated financial statements have been prepared using the historical cost convention, except for available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss and liabilities which are stated at fair value. The consolidated financial statements have been prepared under the accrual principle on a going concern basis.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the Management Board to exercise its judgement in the process of applying the Group's accounting policies. The areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3.

The comparative figures in these consolidated financial statements (as at 31 December 2016 and for the year then ended) refer to the results of the parent company and associate accounted for using the equity method, since the subsidiary was acquired during 2017 and the Group has been established since then.

The Group's financial statements are presented in Croatian kuna (HRK) as the functional and presentation currency of the Group. As at 31 December 2017, the exchange rate for USD 1 and EUR 1 was HRK 6.27 and HRK 7.51 (31 December 2016: HRK 7.17 and HRK 7.56). All amounts disclosed in these consolidated financial statements are expressed in HRK unless otherwise stated.

New and amended standards adopted and effective

The Group has adopted the following new and amended standards for their annual reporting period commencing 1 January 2017 which were endorsed by the European Union and which are relevant for the Group's financial statements:

- Disclosure Initiative - IAS 7
- Recognition of Deferred Tax Assets for Unrealised Losses - IAS 12

The adoption of these improvements did not have any impact on the current period or any prior period and is not likely to affect future periods.

New standards and interpretations not yet adopted

Certain new standards and interpretations have been published that are not mandatory for 31 December 2017 reporting periods and have not been early adopted by the Group. None of these is expected to have a significant effect on the Group's financial statements, except for the following standards:

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

IFRS 15 Revenue from contracts with customers and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

The IASB has issued a new standard for the recognition of revenue. This will replace IAS 18 which covers contracts for goods and services and IAS 11 which covers construction contracts.

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer, so the notion of control replaces the existing notion of risks and rewards.

Key changes to current practice are:

- Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements.
- Revenue may be recognised earlier than under current standards if the consideration varies for any reasons (such as for incentives, rebates, performance fees, royalties, success of an outcome, etc.) - minimum amounts must be recognised if they are not at a significant risk of reversal.
- The point at which revenue is able to be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa.
- There are new specific rules on licenses, warranties, non-refundable upfront fees and, consignment arrangements, to name a few; and, as with any new standard, there are also increased disclosures.
- As with any standard, there are also increased disclosures.

The Group chose prospective application with additional disclosures.

Management has assessed the effects of applying the new standard on the Group's financial statements and established the following areas that will be affected:

- During 2017, the Group has made a preliminary assessment and calculation of effects of applying IFRS 15 as of 1 January 2018 for unfinished contracted projects and the application of new rules would increase contracted assets by the amount of HRK 9 HRK thousand, contracted liabilities by the amount of HRK 347 thousand and decrease retained earnings of the Company by HRK 338 thousand.

This standard is mandatory for financial years commencing on or after 1 January 2018. The Group intends to adopt the standard by prospective application with additional disclosures.

IFRS 9 Financial instruments and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting and a new model for impairment of financial assets.

The majority of the Group's debt instruments that are currently classified as available-for-sale will satisfy the conditions for classification as at fair value through other comprehensive income (FVOCI) and hence there will be no change to the accounting for these assets.

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

Other financial assets held by the Group include:
- equity instruments currently classified as AFS for which a FVOCI election is available
- equity investments currently measured at fair value through profit or loss (FVPL) which will continue to be measured on the same basis under IFRS 9, and
- debt instruments currently classified as held-to-maturity and measured at amortised cost which meet the conditions for classification at amortised cost under IFRS 9.

Accordingly, the Group does not expect the new guidance to affect the classification and measurement of these financial assets. However, gains or losses realised on the sale of financial assets at FVOCI will no longer be transferred to profit or loss on sale, but instead reclassified below the line from the FVOCI reserve to retained earnings. During financial year 2017, the Group did not have any such gains.

There will be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities. The derecognition rules have been transferred from IAS 39 Financial Instruments: Recognition and Measurement have not been changed.

The new hedge accounting rules will align the accounting for hedging instruments more closely with the Group's risk management practices. As a general rule, more hedge relationships might be eligible for hedge accounting, as the standard introduces a more principles-based approach. Upon the adoption of IFRS 9, the Group will qualify the current hedge relationships as continuing hedges. In addition, the Group intends to designate the intrinsic value of foreign currency option contracts as hedging instruments going forward. These are currently accounted as held-for-trading derivatives at FVPL. Changes in the fair value of foreign exchange forward contracts attributable to forward points, and in the time value of the option contracts, will in future be deferred in new costs of hedging reserve within equity. The deferred amounts will be recognised against the related hedged transaction when it occurs.

The new impairment model requires the recognition of impairment provisions based on expected credit losses (ECL) rather than only incurred credit losses as is the case under IAS 39. It applies to financial assets classified at amortised cost, debt instruments measured at FVOCI, contract assets under IFRS 15 Revenue from Contracts with Customers, lease receivables, loan commitments and certain financial guarantee contracts. Based on the assessments undertaken to date, the Group expects a small increase in the impairment loss of financial assets by approximately HRK 318 HRK thousand.

The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

This standard is mandatory for financial years commencing on or after 1 January 2018. The Group will apply the new rules prospectively from 1 January 2018, and comparatives for 2017 will not be restated.

IFRS 16 Leases (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019)
- IFRS 16 will affect primarily lessee accounting and will result in the recognition of almost all leases on the balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.

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- The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.
- Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.
- Lessor accounting will not change significantly. Some differences may arise as a result of the new guidance on the definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The standard will affect primarily the accounting for the Group's operating leases. As at the reporting date, the Group has non-cancellable operating lease commitments of HRK 1.024 thousand, see Note 7. At this stage, the Group is not able to estimate the total impact of the new standard on the Group's financial statements, it will make more detailed assessments of the impact over the next twelve months. The Group plans to adopt this standard on its effective date. The Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption.

Clarifications to IFRS 15 Revenue from Contracts with Customers (issued in April 2016 and effective for annual periods beginning on or after 1 January 2018)

The amendments clarify how companies:
- Identify a performance obligation - the promise to transfer a good or service to a customer is distinct within the context of a contract
- Identify whether the company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good service to be provided)
- Determine whether the revenue from granting a licence should be recognised at a point in time or over time.

In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard.

The Group will apply the new rules prospectively from 1 January 2018, with the practical expedients permitted under the standard.

Standards, interpretations and amendments issued by the IASB, which have not been adopted by the EU:

IFRIC 22 Foreign Currency Transactions and Advance Consideration was issued in December 2016 and is effective for annual periods beginning on or after 1 January 2018. IFRIC 22 clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. The Interpretation covers foreign currency transactions when the Group recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the Group recognises the related asset, expense or income.

For a single payment or receipt, the date of the transaction should be the date on which the Group initially recognises the non-monetary asset or liability arising from the advance consideration (the prepayment or deferred income/ contract liability).

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If there are multiple payments or receipts for one item, a date of transaction should be determined as above for each payment or receipt.

The Group can choose to apply the interpretation:

- retrospectively for each period presented
- prospectively to items that are initially recognised on or after the beginning of the reporting period in which the Interpretation is first applied, or
- prospectively from the beginning of a prior reporting period presented as comparative information.

The Group assesses the potential effect of the amendments on its financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

IFRIC 23 - Uncertainty over Income Tax Treatments was issued in June 2016 and is effective for annual periods beginning on or after 1 January 2019.

The Interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. The Group should determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. The Group should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. If the Group concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the effect of uncertainty will be reflected in determining the related taxable profit or loss, tax bases, unused tax losses, unused tax credits or tax rates, by using either the most likely amount or the expected value, depending on which method the Group expects to better predict the resolution of the uncertainty. The Group will reflect the effect of a change in facts and circumstances or of new information that affects the judgements or estimates required by the interpretation as an change in accounting estimate. Examples of changes in facts and circumstances or new information that can result in the reassessment of a judgment or estimate include, but are not limited to, examinations or actions by a taxation authority, changes in rules established by a taxation authority or the expiry of a taxation authority's right to examine or re-examine a tax treatment. The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in fact and circumstances or new information that affects the judgments and estimates required by the interpretation.

The Management Board anticipates that the adoption of the amendments will not have a material effect on the Group's financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

Annual improvements 2014 -2016 cycle, issued in December 2016:

- IFRS 1 - First-time Adoption of International Financial Reporting Standards - deleted short-term exemptions covering transition provisions of IFRS 7, IAS 19 and IFRS 10 which are no longer relevant.

- IAS 28 - Investments in Associates and Joint Ventures - clarifies that the election by venture capital organisations, mutual funds, unit trusts and similar entities to measure investments in associates or joint ventures at fair value through profit or loss should be made separately for each associate or joint venture at initial recognition.

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The Management Board anticipates that the adoption of the amendments will not have a material effect on the Group's financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

Transfers of Investment Property - Amendments to IAS 40, issued in December 2016 and effective for annual periods beginning on or after 1 January 2018. The amendments clarify when the Group should transfer assets, including assets under construction or in progress, to or from investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and if this is supported by evidence. The list of evidence for a change of use in the standard was re-characterised as a non-exhaustive list of examples to help illustrate the principle. A change in the Management Board's intentions alone on the use of a property does not provide sufficient evidence of a change in the use of the property.

The Board provided two options for transition:

- prospectively, with any impact from the reclassification recognised as adjustment to opening retained earnings as at the date of initial recognition, or
- retrospectively - only permitted without the use of hindsight.

Additional disclosures are required if the Group adopts the requirements prospectively.

The Group assesses the potential effect of the amendments on its financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

Amendments to IAS 28 Interests in Associates and Joint Ventures were issued in October 2017 and effective for annual periods beginning on or after 1 January 2019. The amendments clarify that reporting entities should apply IFRS 9 to long-term loans, preference shares and similar instruments that form part of a net investment in an equity method investee before they can reduce such carrying value by a share of loss of the investee that exceeds the amount of investor's interest in ordinary shares.

The Management Board anticipates that the adoption of the amendments will not have a material effect on the Group's financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

Annual improvements 2015 - 2017 cycle were issued in December 2017 and are effective for annual periods beginning on or after 1 January 2019, and they include clarifications to the following standards:

- IFRS 3 Business Combinations - the Group remeasures its previously held interest in joint operations when it obtains control.
- IFRS 11 Joint Arrangements - the Group does not remeasure its previously held interest in joint operations when it obtains control.
- IAS 12 Income Taxes - the Group recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, e.g. in profit or loss or in other comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits.

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- IAS 23 Borrowing Costs - explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowing costs eligible for capitalization only until the specific asset is substantially complete.

The Group will apply the amendments on their effective date and when endorsed by the European Union.

Amendments to IFRS 10 and IAS 28 Investments in Associates and Joint Ventures - In December, the IASB decided to defer the application date of this amendment until such time as the IASB has finalised its research project on the equity method. The amendments clarify the accounting treatment for sales or contribution of assets between an investor and its associates or joint ventures. They confirm that the accounting treatment depends on whether the non-monetary assets sold or contributed to an associate or joint venture constitute a 'business' (as defined in IFRS 3 Business Combinations).

Where the non-monetary assets constitute a business, the investor will recognise the full gain or loss on the sale or contribution of assets. However, any gain or loss (as a result of a sale or non-operational asset) is recognised only to the amount invested by another investor in an associate or a joint venture. The amendments apply prospectively. The Management Board anticipates that the adoption of the amendments will not have a material effect on the Company's financial statements and plans to adopt the amendments as of their effective date and after being adopted by the European Union.

a) Basis for consolidation

The consolidated financial statements of the Group include the financial statements of the Parent company and the financial statements of the companies controlled by the Parent company (subsidiaries). The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions among the Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Changes in ownership interests in subsidiaries without change of control

Transactions with non-controlling interests that do not result in a loss of control are accounted for as equity transactions - that is, as transactions with the owners in their capacity as owners. For purchases from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

Sale/loss of control over subsidiary

When the Group ceases to have control, any retained interest in the entity is remeasured to its fair value at the date that control ceases, with the change in carrying amount recognised in the income statement. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to the income statement.

b) Investments in associates

Associates are all entities over which the Group has between 20% and 50% of voting rights and in which the Group has significant influence, but not control. In the consolidated financial statements investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The Group's investment in associates includes goodwill identified on acquisition. Dividends received or receivable from associates are deducted from the carrying value of the investment.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

The Group's share of post-acquisition profit or loss is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to 'share of profit/(loss) of associates' in the income statement.

Profits and losses resulting from upstream and downstream transactions between the group and its associate are recognised in the group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group. Dilution gains and losses arising in investments in associates are recognised in the income statement.

c) Business combinations

Business combinations are accounted for by applying the acquisition method. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquire and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

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Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquire over the fair value of the identifiable net assets acquired.

If the total of consideration transferred, non-controlling interest recognised and previously held interest measured at fair value is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the CGUs, or groups of CGUs, that is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs of disposal.

Any impairment is recognised immediately as an expense and is not subsequently reversed.

d) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value added tax, excise tax, estimated returns, rebates and discounts.

Sales of goods and products

Revenue from the sale of goods and own products is recognised when all the following conditions have been met:
- the Group has transferred all significant risks and benefits arising from the ownership of the goods or products to the buyer;
- the Group does not retain constant involvement in the control of the assets sold up to a point usually related with ownership nor does it have control over the sale of goods;
- the amount of income can be measured reliably;
- it is probable that the economic benefits associated with the transactions will flow to the Group; and
- the costs incurred or to be incurred on those transactions can be measured reliably.

Income from services is recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

e) Finance income and costs

Finance income and costs comprise interest on loans calculated using the effective interest rate method, receivables for interest on investments, revenues from dividends, foreign exchange gains and losses, gains and losses from financial assets at fair value through profit and loss.

Interest income is recognised in the income statement on an accrual basis using the effective interest method. In-

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come from dividends or shares in profit is recognised in the income statement at the date when the Group's right to receive payment is established.

Finance costs comprise interest on loans, changes of fair value of financial assets at fair value through profit or loss, impairment losses of financial assets and foreign exchange losses.

f) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised during the period indispensable for the finalisation and preparation of the asset for its intended use or sale. Other borrowing costs are recognised in profit or loss using the effective interest method.

g) Taxes

The Parent company calculates taxes in accordance with Croatian law. Income tax for the year comprises current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates in effect at the balance sheet date.

Deferred taxes arise from temporary differences between the amounts of assets and liabilities in the financial statements and the values presented for the purposes of determining the income tax base. A deferred tax asset for the carry-forward of unused tax losses and unused tax credits is recognized to the extent that it is probable that future taxable profit will be realised on the basis of which the deferred tax assets will be utilised. Deferred tax assets and liabilities are calculated using the tax rate applicable to the taxable profit in the years in which these assets or liabilities will be realised.

Current and deferred tax are recognised as income or expense in the income statement; except when they relate to items credited or debited in other comprehensive income or directly in equity, in which case tax is also recognised in other comprehensive income or directly in equity.

h) Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Management/Supervisory Board that makes strategic decisions.

The Group's Management Board monitors operations as a single operating segment, while sales revenues are monitored as two operating segments: Medium power transformers and Distribution transformers as presented in Note 4.

i) Earnings per share

The Group presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share are calculated by dividing the profit or loss attributable to ordinary and preference shareholders by the weighted average number of ordinary shares outstanding during the period decreased by potential shares arising from realised options.

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j) Dividend distribution

Dividends are recognised in the statement of changes in equity and recorded as liabilities in the period in which they are approved by the Group's shareholders.

k) Foreign currency transactions

Foreign currency transactions are initially converted into Croatian kuna by applying the exchange rates prevailing on the transaction date. Cash, receivables and liabilities denominated in foreign currencies are re-translated at the rates prevailing on the balance sheet date. Gains and losses arising on translation are included in the income statement for the current year. Foreign exchange losses and gains arising on translation are included in profit or loss for the current year and are presented in Notes 13 and 14 in gross amounts (the stated amounts include foreign exchange differences from principal activities as well as foreign exchange differences on borrowings).

During the consolidation, assets and liabilities of Group's foreign operations are translated into the Group presentation currency at the exchange rates ruling at the reporting date. Revenues and expenses are translated at the foreign exchange rates ruling at the dates of the transactions and the exchange differences are recognized in other comprehensive income. All foreign exchange gains and losses are recognized in the period when the transaction occurred.

l) Non-current tangible and intangible assets

Non-current intangible and tangible assets are initially carried at cost, which includes the purchase price, including import duties and non-refundable tax after deducting trade discounts and rebates, as well as all other costs directly attributable to bringing the assets to their working condition for their intended use.

Non-current intangible and tangible assets are recognised if it is probable that future economic benefits associated with the item will flow to the Group and if the cost of the asset can be reliably measured.

After initial recognition, assets are measured at cost less accumulated amortisation and depreciation and any accumulated impairment losses.

Maintenance and repairs, replacements and minor-scale improvements are expensed when incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in future economic benefits expected to be obtained from the use of an asset beyond its originally assessed standard performance, the expenditures are capitalised i.e. included in the carrying value of the asset. Gains or losses on the retirement or disposal of assets are included in the income statement in the period when incurred.

The amortisation and depreciation of assets commence when the assets are ready for use, i.e. when the assets are at the required location and the conditions necessary for use have been met. The amortisation and depreciation of assets cease when the assets are fully amortised or depreciated and expensed or classified as held for sale. Amortisation and depreciation are charged so as to write off the cost of each asset, other than land and non-current intangible and tangible assets under construction, over their estimated useful lives, using the straight line method.

	Amortisation and depreciation rates (from - to)
Concessions, patents, licences, software etc.	25%
Buildings	3% - 5%
Plant and equipment	5% -25%
Tools	5% - 25%

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Impairment of property, plant and equipment

At each balance sheet date, the Group reviews the present value of its property, plant and equipment to determine whether there is any indication of impairment of such assets. 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 the individual asset, the Group estimated 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's cash-generating units for which a reasonable and consistent allocation basis can be identified.

The 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 present value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is 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 as an expense in the income statement.

m) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are initially recognised in the lessee's balance sheet as assets or liabilities at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation.

Lease payments are apportioned between finance costs and a reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly to profit or loss.

Operating lease payments are recognised in profit or loss as an expense on a straight-line basis over the lease term.

n) Financial assets and financial liabilities

Financial assets

Investments are recognised and derecognised on the trade date where the purchase or sale of a financial asset is under a contract whose terms require the delivery of the asset within the time frame 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 into the following categories:

- **'Financial assets at fair value through profit or loss (FVTPL)'**

Financial assets are classified as FVTPL where the financial asset is either held for trading or it is designated as FVTPL. Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. All derivative financial instruments are included in this category, except if designated and effective as hedging instruments in which case hedge accounting is applied.

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• **'Held-to-maturity investments'**

Bills of exchange and promissory notes with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are carried at amortised cost using the effective interest method less any impairment, with revenue recognised on an effective yield basis.

• **'Available-for-sale financial assets'**

Financial assets available for sale are non-derivative financial assets which are designated as such or they cannot be included in any of the above mentioned categories. These assets are stated at fair value. Gains and losses arising from changes in fair value are recognised in other comprehensive income in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in other comprehensive income in the investments revaluation reserve is included in profit or loss for the period.

• **'Loans and receivables'**

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for current receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired if there is objective evidence of impairment resulting from one or more events that occurred after the initial recognition of an asset when the event affects the estimated future cash flows from the financial asset.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 60 days, as well as observable changes in national or local economic conditions that correlate with default on receivables.

Derecognition of financial assets

The Group 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.

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Financial liabilities and equity instruments issued by the Group

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

Share capital

a. Ordinary shares

Share capital represents the nominal value of shares issued.

The share premium includes the premium at the issuance of shares. Transactions costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity.

b. Share capital repurchase

The consideration paid for the repurchase of the Company's equity share capital, including any directly attributable incremental costs related to the repurchase, is deducted from equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- the amount of the obligation under the contract, as determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and
- the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies (dividend and interest income).

Financial liabilities at fair value through profit or loss

Financial liabilities are classified as "at fair value through profit or loss" where the financial liability is either held for trading or designated by the Group as "at fair value through profit or loss".

Financial liabilities at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in the income statement includes any interest paid on the financial liability.

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.

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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.

Derecognition of financial liabilities

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

Financial risk management and disclosures in accordance with IFRS 7 are set out in Note 40 to these financial statements.

o) Inventories

Inventories are stated at the lower of cost or net realisable value. The cost of inventories comprises all purchase costs, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average cost method.

Costs of conversion comprise costs that are specifically attributable to units of production such as direct labour and similar. They also comprise a systematic allocation of fixed and variable production overheads incurred in converting raw materials into finished goods. Fixed production overheads are indirect costs of production that remain relatively constant r regardless of the level of production, such as depreciation, maintenance of factory buildings, the costs of factory management and similar. Variable production overheads are those that vary directly with the volume of production such as indirect materials and indirect labour.

The allocation of fixed production overheads is based on the normal level of productive capacity. The normal level of capacity is the average production expected to be achieved over a number of periods in normal circumstances, taking into account a production loss due to planned maintenance. Unallocated overheads are expensed in the period in which they are incurred.

Slow moving and obsolete inventories are written off to their net realisable value by using value adjustment account for these inventories. Net realisable value is the estimated net selling price in the normal course of business decreased by estimated cost of completion and estimated costs needed to complete the sale.

Small inventories, packaging and car tyres are fully written-off when put into use.

p) Receivables

Receivables are initially measured at fair value. At each balance sheet date, receivables, whose collection is expected within a period of more than one year, are stated at amortised cost using the effective interest method, less any impairment loss. Current receivables are initially recognised at their nominal value less corresponding allowances for estimated uncollectible amounts and impairment losses.

The value of receivables is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of an asset when this event affects estimated future cash flows from receivables which can be reliably estimated. Receivables are assessed at each balance sheet date whether there is objective evidence of their impairment. If there is objective evidence of impairment, the impairment loss is measured as the difference between the carrying amount and estimated future cash flows. The carrying value of receivables is reduced either directly or by using a separate allowance account. The loss amount is charged to the income statement for the current year.

q) Cash and cash equivalents

Cash consists of bank deposits, cash on hand, demand deposits and securities or collectible within 3 months.

r) Borrowings

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.

Borrowings are classified as current liabilities, unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

s) Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are reviewed at each balance sheet date and adjusted to reflect the best current estimate.

Provisions are determined for costs of repairs within warranty periods, awards to employees for long-term employment and retirement (regular jubilee awards and termination benefits).

Provisions for warranties are recognized at the moment the underlying products are sold. Provisions are made based on estimates and experiences of the Group and other manufacturers of energy transformers within the Group and the estimate of possible solutions in accordance with their probabilities.

Provisions for employee benefits for the number of years of service and retirement (regular jubilee awards and termination benefits) are determined as the present value of future cash outflows using a discount rate equal to the interest rate on government bonds.

t) Employee benefits

(i) Defined pension fund contributions

In the normal course of business through salary deductions, the Group makes payments to 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 Group does not have any other pension scheme and, consequently, has no other obligations in respect of employee pensions.

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(ii) Long-term employee benefits

The Group has post-employment benefits to be paid to the employees at the end of their employment in the Group (either upon retirement, termination or voluntary departure). The Group recognises a liability for these long-term employee benefits evenly over the period the benefit is earned based on actual years of service. The long-term employee benefit liability is determined using assumptions regarding the likely number of staff to whom the benefit will be payable, estimated benefit cost and the discount rate.

(iii) Short-term employee benefits - bonuses

A liability for employee benefits is recognised in provisions based on the Group's formal plan and when past practice has created a valid expectation by the Management Board/key employees that the bonus will be paid and the amount can be determined before the time of issuing the financial statements. Liabilities for bonus plans are expected to be settled within 12 months of the balance sheet date and are recognised at the amounts expected to be paid when they are settled.

u) Contingent assets and liabilities

Contingent liabilities are not recognised in the financial statements. They are only disclosed in the notes to the financial statements, unless the likelihood of an outflow is small.

Contingent assets are not recognised in the Group's consolidated financial statements, except in case where the realisation of income is certain and the assets in question are not contingent assets and their recognition is appropriate.

v) Events after the balance sheet date (subsequent events)

Events after the balance sheet date, which provide additional information on the Group's position at the balance sheet date (adjusting events), are reflected in the financial statements. Events that are not adjusting events are disclosed in the notes to the financial statements, if material.

3. Critical accounting estimates

Estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under existing circumstances. The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

a) Impairment of inventories

The Group performs an impairment of inventories for all inventories whose carrying amount exceeds the market value, i.e. realisable value. The estimate is based on the observable prices which can be achieved on the market involving this kind of industry (for example, prices of cuprum declined in 2016, and the Group recognised a provision for impairment for cuprum items on stock).

b) Warranty provisions

The Group provides warranties for its products for an average period of 3-5 years. The Management Board estimates a provision for future warranty fees based on historical information. Factors that could impact the estimated claim information include the success of the Group's quality initiatives, as well as spare parts and labour costs. If the required level of general provisions made had increased by 1% in relation to performed deliverables in the past three years, provisions would have increased by HRK 24 million (2016: HRK 22 million).

4. Revenue

	2017	2015
	HRK	*HRK*
Foreign sales of goods	760,517,828	719,950,239
Domestic sales of goods	146,363,119	133,416,381
	906,880,947	**853,366,620**

Domestic and foreign sales include revenue from the sale to related parties as presented in Note 43.

Sales by operating segments in 2017:

	Medium Power Transformers	Distribution Transformers	Total
	HRK	*HRK*	*HRK*
Sales to unrelated parties	480,729,694	332,680,682	**813,410,376**
Sales to related parties	51,350,340	42,120,231	**93,470,571**
	532,080,034	**374,800,913**	**906,880,947**

Sales by operating segments in 2016:

	Medium Power Transformers	Distribution Transformers	Total
	HRK	*HRK*	*HRK*
Sales to unrelated parties	470,994,217	315,229,152	**786,223,369**
Sales to related parties	24,822,888	42,320,363	**67,143,251**
	495,817,105	**357,549,515**	**853,366,620**

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5. Other operating income

	2017	2016
	HRK	*HRK*
Net gain on sale of non-current assets	511,098	1,666,912
Income from collected receivables previously impaired	259,490	1,154,888
Inventory surpluses	227,187	151,472
Income from collected penalties, awards, etc.	59,452	97,115
Income from approved discounts, rebates, etc.	45,798	39,928
Insurance compensation claims	15,797	11,103
Other income	1,117,183	1,332,946
	2,236,005	**4,454,364**

6. Cost of materials and energy

	2017	2016
	HRK	*HRK*
Cost of raw materials and supplies	537,798,757	566,730,157
Energy cost	5,742,852	5,600,679
Cost of small inventory	743,364	510,278
	544,284,973	**572,841,114**

7. Service costs

	2017	2016
	HRK	*HRK*
Transportation costs	21,231,089	19,099,379
External product design and selling services	15,510,605	14,254,891
Agency commission costs	9,666,394	12,030,858
Maintenance services (servicing)	9,644,868	7,596,127
Compensation for the usage of company name and trade mark - Končar Inc.	5,284,643	4,814,258
Entertainment	2,813,551	3,930,183
Intellectual and similar services	2,317,046	1,539,500
Outsourcing of employees	1,902,430	2,033,612
Telephone, post, etc.	1,555,795	1,509,951
Costs of advertising and fairs	1,133,812	936,657
Rent services and leases	1,024,425	1,022,800
Utility services	892,329	808,670
Audit costs	62,568	62,568
Other external costs	4,147,109	3,372,309
	77,186,664	**73,011,763**

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8. Staff costs

	2017	2016
	HRK	*HRK*
Net salaries and wages	71,799,735	63,923,184
Taxes and contributions	37,311,549	35,998,169
Contributions on salaries	18,819,212	17,102,154
	127,930,496	**117,023,507**

Net salaries in the amount of HRK 71,799,735 (2016: HRK 63,923,184) include compensations to members of the Management Board, comprising the Management Board's salaries amounting to HRK 3,416,298 (2016: HRK 2,704,318) and accrued bonuses to the Management Board in the amount of HRK 1,400,000 (2016: HRK 1,300,000), and are an integral part of staff costs.

In 2017, pension fund contributions amounted to HRK 20,220,250 (2016: HRK 18,786,737).

Employee benefits (such as transportation to and from work, termination benefits and jubilee awards, business travel expenses) in the amount of HRK 9,933,057 (2016: HRK 9,065,239) are recorded in Note 10.

9. Depreciation and amortisation

	2017	2016
	HRK	*HRK*
Depreciation of property, plant and equipment (Note 18)	18,589,247	18,365,860
Amortisation of intangible assets (Note 17)	1,028,222	665,724
	19,617,469	**19,031,584**

10. Other expenses

	2017	2016
	HRK	*HRK*
Bank charges and commissions	3,019,319	3,765,965
Employee transportation costs (Note 8)	3,821,184	3,370,561
Daily allowances for business trips and travel expenses (Note 8)	3,402,259	2,626,931
Compensations to employees, gifts and grants (Note 8)	2,709,614	3,067,747
Insurance premiums	2,122,060	1,863,338
Voluntary pension fund premiums and fees	1,991,210	-
Compensations to members of the Supervisory Board	471,193	539,051
Contributions, membership fees and similar charges	277,978	271,315
Cost of unused vacation days	156,880	3,062,752
Other	5,917,676	4,678,593
	23,889,373	**23,246,253**

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11. Impairment losses

	2017	2016
	HRK	*HRK*
Impairment of inventories	5,849,804	9,511,122
Impairment of non-current assets held for sale	500,000	1,960,000
Impairment of trade receivables	49,616	249,294
	6,399,420	**11,720,416**

12. Provisions

	2017	2016
	HRK	*HRK*
Provisions for termination benefits and jubilee awards	12,959,405	9,224,863
Provisions for costs within warranty period	6,665,398	23,666
Provisions for penalties	1,243,762	-
	20,868,565	**9,248,529**

The movement in provisions by categories is presented in Note 30.

13. Finance income

	2017	2016
	HRK	*HRK*
From relations with related parties		
Foreign exchange gains	97,745	100,434
	97,745	**100,434**
From relations with unrelated parties		
Foreign exchange gains	10,111,705	9,205,571
Income from dividends and shares in profit of associate	1,913,086	1,728,202
Interest income on deposits	-	3,312
Other interest income	323,116	72,718
	12,347,907	**11,009,803**
	12,445,652	**11,110,237**

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14. Finance costs

	2017	2016
	HRK	*HRK*
From relations with related parties		
Foreign exchange losses	159,526	40,348
	159,526	**40,348**
From relations with unrelated parties		
Interest expense on borrowings and other forms of financing	1,016,480	1,817,135
Foreign exchange losses	8,294,649	7,891,625
Foreign exchange losses arising from forward contracts	723,289	1,429,458
	10,034,418	**11,138,218**
	10,193,944	**11,178,566**

15. Share in profit of associate

The share in profit of the associate in the amount of HRK 305,052 (2016: HRK 309,912) relates to the share in profit of the company Elkakon Ltd. in which the Group owns a share of 50%.

During 2017, the stated company realised a total net profit of HRK 610,104 (2016: HRK 619,823).

16. Income tax

The Parent company calculates income tax at a preferential rate obtained when reducing the income tax rate by 85%, as the Parent company is the beneficiary of incentive measures in accordance with the Investment Promotion Act for a project entitled "High-Voltage Laboratory - Laboratory development and extension of production capacities". On 3 September 2010, the Ministry of Economy, Labour and Entrepreneurship issued a certificate confirming that these investments meet the requirements of the Act and that the Parent company may use the incentive measures. The maximum amount of the granted incentive is HRK 37,327,421.

On 6 October 2014, the Ministry of Economy issued an Approval for the revision of the maximum amount of the granted incentive for the "High-Voltage Laboratory" project due to increased invested financial funds and an increased number of newly created jobs in relation to the planned ones. The new maximum amount of the granted investment incentive amounts to HRK 46,678,233, and the cumulative amount used to date is HRK 42,627,302. The remaining incentive amount is HRK 3,950,931, and the Company may use it until 2020.

	2017	2016
	HRK	*HRK*
Current tax	1,779,573	1,697,533
Deferred tax	(228,995)	(327,071)
Income tax expense	**1,550,578**	**1,370,462**

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The Group's current income differs from the theoretical amount that would arise using the actual tax rate applicable to profits of the Group as follows:

	2017	2016
	HRK	*HRK*
Consolidated profit before tax	45,934,534	37,610,531
Income tax at 18% (2016: 20%)	8,268,216	7,522,106
Adjustments by tax effects of:		
Consolidation adjustments	(517,759)	(21,982)
Tax non-deductible expenses	4,651,814	4,339,593
Tax deductions	(538,450)	(482,831)
Investment incentives (2017: 85%; 2016: 85%)	(10,084,248)	(9,619,353)
Current income tax charge	**1,779,573**	**1,697,533**
Effective tax rate	3.87%	4.55%
Advances paid	766,264	859,766
Income tax payable	1,013,309	837,767

17. Earnings per share

Basic earnings per share:

	2017	2016
	HRK	*HRK*
Net profit	44,383,956	36,040,069
Weighted average number of shares (preference and ordinary shares)	255,616	255,616
Earnings per share	**173.64**	**140.99**

In previous years, distributed dividends for ordinary and preference shares were the same. The Group does not hold any treasury shares.

Diluted earnings per share

Diluted earnings per share for 2017 and 2016 are the same as basic earnings per share, since the Group did not have any convertible instruments or share options during either period.

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18. Non-current intangible assets

	Concessions, patents, licences, software and other rights	Assets under construction	Total
	HRK	*HRK*	*HRK*
Cost			
At 1 January 2016	**8,023,336**	**586,541**	**8,609,877**
Additions	-	1,871,431	**1,871,431**
Transfer	2,457,972	(2,457,972)	**-**
Disposals	(45,068)	-	**(45,068)**
At 31 December 2016	**10,436,240**	**-**	**10,436,240**
Acquisition of subsidiary	42,057	-	**42,057**
Additions	-	447,000	**447,000**
Transfer	447,000	(447,000)	**-**
Disposals	(2,780)	-	**(2,780)**
At 31 December 2017	**10,922,517**	**-**	**10,922,517**
Accumulated amortisation			
At 1 January 2016	**6,879,860**	**-**	**6,879,860**
Amortisation charge	665,724	-	**665,724**
Disposals	(45,068)	-	**(45,068)**
At 31 December 2016	**7,500,516**	**-**	**7,500,516**
Amortisation charge	1,028,222	-	**1,028,222**
Disposals	(2,780)	-	**(2,780)**
At 31 December 2017	**8,525,958**	**-**	**8,525,958**
Net book amount			
31 December 2016	2,935,724	-	**2,935,724**
31 December 2017	**2,396,559**	**-**	**2,396,559**

The cost of fully amortised intangible assets still in use as at 31 December 2017 amounts to HRK 5,113,167 (31 December 2016: HRK 5,853,261).

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19. Property, plant and equipment

	Land	Buildings	Plant and equipment	Tools and office sup-plies	Advances	Assets under construction	Total
Cost	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
At 1 January 2016	**9,012,529**	**122,815,590**	**190,147,217**	**25,636,015**	**14,466**	**386,871**	**348,012,688**
Additions	-	-	-	-	581,088	17,596,534	**18,177,622**
Transfer from assets under construction	-	2,052,180	8,137,263	3,404,135	-	(13,593,578)	**-**
Disposals	-	-	(7,760,867)	(1,023,953)	-	-	**(8,784,820)**
At 31 December 2016	**9,012,529**	**124,867,770**	**190,523,613**	**28,016,197**	**595,554**	**4,389,827**	**357,405,490**
Acquisition of subsidiary	2,105,083	15,745,105	3,552,215	702,863	-	1,439,801	**23,545,067**
Additions	-	2,609,683	-	-	3,589,005	9,253,802	**15,452,490**
Transfer from assets under construction	-	2,962,288	7,796,162	2,805,855	-	(13,564,305)	**-**
Disposals	-	-	(1,756,803)	(2,367,373)	(3,428,951)	-	**(7,553,127)**
At 31 December 2017	**11,117,612**	**146,184,846**	**200,115,187**	**29,157,542**	**755,608**	**1,519,125**	**388,849,920**
Accumulated depreciation							
At 1 January 2016	**-**	**63,890,572**	**120,301,122**	**17,642,735**	**-**	**-**	**201,834,429**
Depreciation charge	-	5,070,877	11,230,258	2,064,725	-	-	**18,365,860**
Disposals	-	-	(7,743,910)	(861,719)	-	-	**(8,605,629)**
At 31 December 2016	**-**	**68,961,449**	**123,787,470**	**18,845,741**	**-**	**-**	**211,594,660**
Acquisition of subsidiary	-	(399,823)	-	-	-	-	**(399,823)**
Depreciation charge	18,532	5,737,128	10,078,971	2,754,616	-	-	**18,589,247**
Disposals	-	-	(1,687,844)	(2,367,373)	-	-	**(4,455,040)**
At 31 December 2017	**18,532**	**74,298,754**	**132,178,597**	**19,232,984**	**-**	**-**	**225,728,867**
Net book amount							
31 December 2016	9,012,529	55,906,321	66,736,143	9,170,456	595,554	4,389,827	145,810,830
31 December 2017	**11,099,080**	**71,886,092**	**67,936,590**	**9,924,558**	**755,608**	**1,519,125**	**163,121,053**

As at 31 December 2017, the net book amount of mortgaged property amounts to HRK 66,538,481 (31 December 2016: HRK 63,168,073). Mortgages have been registered over these properties in the total amount of EUR 40 million, and there is a pledge on movable assets (net carrying amount of HRK 19.1 million) in the amount of EUR 25 million (31 December 2016: EUR 25 million) (Note 30).

The cost of fully depreciated tangible assets still in use as at 31 December 2017 amounts to HRK 90,042,028 (31 December 2016: HRK 110,613,056).

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20. Investment property

Investment property in the amount of HRK 3,500,000 relates to the property acquired in exchange for the unpaid receivable from Elektromaterijal d.o.o. in bankruptcy. The stated property in 2017, based on the Management Board's decision, has been reclassified from non-current assets held for sale to investment property including an impairment by HRK 500,000 (Note 11).

21. Investments accounted for using the equity method

	31 December 2017	31 December 2016
	HRK	*HRK*
Investment in associate		
Elkakon Ltd., Zagreb (50% share)	4,389,052	4,284,000
Total	**4,389,052**	**4,284,000**

The company Elkakon produces industrial conductors and is primarily the strategic partner to the subsidiary Končar D&ST d.d.

	Elkakon Ltd.	
	2017	2016
	HRK'000	*HRK'000*
Income	67,173	64,175
Expenses	66,429	(63,400)
Profit before tax	744	775
Income tax	(134)	(155)
Profit after tax	**610**	**620**
Non-current assets	5,691	5,366
Current assets	16,035	13,367
Total assets	**21,726**	**18,733**
Total liabilities	**12,948**	**10,153**

Movements in investments in associates during the year were as follows:

	Elkakon Ltd.
	HRK
1 January 2016	**4,174,088**
Profit of associate (Note 15)	309,912
Dividend payment by associate	(200,000)
31 December 2016	**4,284,000**
Profit of associate (Note 15)	305,052
Dividend payment by associate	(200,000)
31 December 2017	**4,389,052**

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22. Non-current financial assets

	31 December 2017	31 December 2016
	HRK	*HRK*
Other financial assets - financial assets available for sale		
Shares in companies up to 20% of the share capital		
Ferokotao Ltd., Donji Kraljevec (16% share)	1,048,128	1,048,128
Novi Feromont Ltd., Donji Kraljevec (18.9% share)	1,717,200	1,717,200
	2,765,328	**2,765,328**
Investments in shares		
Shares of Zagrebačka banka d.d., Zagreb	**39,000**	**39,000**
Other financial assets		
Derivative instruments - FX forward contracts	**57,782**	**38,957**
	2,862,110	**2,843,285**

23. Inventories

	31 December 2017	31 December 2016
	HRK	*HRK*
Raw materials and supplies	74,351,756	73,129,850
Work in progress	72,479,376	74,970,911
Unfinished and semi-finished goods	7,342,814	7,399,759
Finished goods	54,160,924	75,403,890
Less: Impairment of raw materials and supplies	(4,082,390)	(3,811,481)
Less: Impairment of finished goods	(5,680,741)	(561,795)
	198,571,739	**226,531,134**
Advances given	1,873,815	640,966
	200,445,554	**227,172,100**

In 2017, the cost of own goods sold amounted to HRK 644,581,545 (2016: HRK 615,972,317).

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24. Receivables from related parties

	31 December 2017	31 December 2016
	HRK	*HRK*
Sister companies within the Končar Group:		
Končar - Power Plant and Electric Traction Engineering Inc. Zagreb	28,469,694	7,619,836
Končar - Switchgears Inc., Zagreb (from 29 December 2017 Končar - Apparatus and Switchgear Inc.)	687,802	1,037,865
Končar - Instrument Transformers Inc., Zagreb	750	15,262
Končar - Electronics and Informatics Inc., Zagreb	-	7,322
	29,158,246	**8,680,285**
Associates:		
Elkakon Ltd., Zagreb	6,791,986	6,095,354
Končar - Power Tranformers Ltd., Zagreb	6,956,616	480,388
	13,748,602	**6,575,742**
	42,906,848	**15,256,027**

As at 31 December, the ageing structure of receivables from the Group's related parties was as follows:

	Total	Not past due	Past due but collectible				
			< 60 days	60-90 days	90-180 days	180-365 days	> 365 days
	HRK	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
2017	**42,906,848**	41,921,544	629,300	-	257,852	98,152	-
2016	**15,256,027**	14,168,984	1,042,591	-	-	44,452	-

25. Trade receivables

	31 December 2017	31 December 2016
	HRK	*HRK*
Domestic trade receivables	29,905,883	25,453,260
Less: Impairment	(3,648,697)	(3,908,187)
	26,257,186	**21,545,073**
Foreign trade receivables	88,547,476	90,808,863
Less: Impairment	(1,388,724)	(1,439,107)
	87,168,717	**89,369,756**
	113,415,938	**110,914,829**

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As at 31 December, the ageing structure of the Group's trade receivables was as follows:

	Total	Not past due	Past due but collectible				
			< 60 days	60-90 days	90-180 days	180-365 days	> 365 days
	HRK	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
2017	**113,415,938**	86,761,025	18,584,669	647,451	1,648,534	5,720,088	54,171
2016	**110,914,829**	94,008,995	15,532,069	-	1,260,398	45,347	68,020

There was no significant change in the credit quality of receivables past due which have not been impaired and they are considered recoverable.

The maximum exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above.

The movement in the impairment of the Group's trade receivables was as follows:

	2017	2016
	HRK	*HRK*
At 1 January	5,347,294	6,845,939
Acquisition	9,701	-
Collected during the year	(259,490)	(1,154,888)
Written off during the year	(51,983)	(381,560)
Written off during the year (foreign exchange difference)	(8,101)	37,803
At 31 December	**5,037,421**	**5,347,294**

26. Other receivables

	31 December 2017	31 December 2016
	HRK	*HRK*
VAT receivable	1,451,780	6,687,004
Other receivables	1,281,071	471,885
	2,732,851	**7,158,889**

27. Current financial assets

	31 December 2017	31 December 2016
	HRK	*HRK*
Other current financial assets		
Derivative instruments - FX forward contracts	882,706	241,611
	882,706	**241,611**

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28. Cash and cash equivalents

	31 December 2017	31 December 2016
	HRK	*HRK*
Foreign currency accounts	119,999,504	56,533,695
HRK accounts	9,991,902	10,886,425
Cash on hand - foreign currencies	35,857	12,852
Cash on hand - HRK	16,136	40,968
Term deposits up to 3 months	-	3,976,831
	130,043,399	**71,450,771**

The Group mainly deposits its cash at financial institutions that are part of international banking groups with an A/A-1 credit rating by Standard & Poor's.

29. Equity

Share capital is determined in the nominal amount of HRK 76,684,800 (31 December 2016: HRK 76,684,800) and comprises 255,616 ordinary shares with a nominal value of HRK 300 per share.

The ownership structure of the Parent company is as follows:

	31 December 2017		31 December 2016	
Shareholder	*Number of shares*	*Ownership share %*	*Number of shares*	*Ownership share %*
Končar - Electrical Industry Inc.	134,798	52.73	134,798	52.73
AZ OMF B category	13,550	5.3	13,550	5.3
Floričić Kristijan	9,916	3.88	9,916	3.88
Knežević Nikola	7,852	3.07	7,158	2.8
Radić Antun	3,943	1.54	3,834	1.5
AZ OMF A category	3,628	1.42	3,287	1.29
SZAIF Inc.	2,800	1.1	-	-
Primorska banka Inc., Rijeka	-	-	2,800	1.1
Other	79,129	30.96	80,273	31.4
	255,616	**100.00**	**255,616**	**100.00**

As at 31 December 2017 and 31 December 2016, the Parent company's share capital consists of 194,188 ordinary shares and 61,428 preference shares.

The dividend per share paid to the Parent company's shareholders in 2017 amounted to HRK 56.23 per share (2016: HRK 47.05 per share).

Statutory, legal and other reserves were formed on the basis of profit distribution compliant with the decisions of the General Assembly, in accordance with the provisions of the Companies Act (statutory and other reserves are eligible for distribution pursuant to the provisions of the above Act and the Company's Articles of Association).

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30. Provisions

	Warranty provisions	Jubilee awards and termination benefits	Total
	HRK	*HRK*	*HRK*
1 January 2016	**88,281,301**	**2,231,356**	**90,512,657**
Additional provisions	9,224,863	23,666	9,248,529
Transfer to current provisions	(1,669,744)	-	(1,669,744)
31 December 2016	**95,836,420**	**2,255,022**	**98,091,442**
Additional provisions	6,665,398	12,959,405	19,624,803
Acquisition	817,669	-	817,669
Foreign exchange differences	-	10,007	10,007
Transfer to current provisions	(3,694,695)	-	(3,694,695)
31 December 2017	**99,624,792**	**15,224,434**	**114,849,226**

Warranty provisions

Warranty provisions are determined on the basis of Management's best estimate and include general and specific provisions. General provisions are based on estimates and experience of other similar producers of transformers. The Group regularly issues warranties for a minimum of 3 years for each sold transformer. Management assesses and recognises a provision representing 2% of the value of sold products under warranty obligation (2016: 2%). Specific provisions refer to potential quality issues with regard to sold transformers to individual customers in the total amount of HRK 96 million (2016: HRK 92 million).

Provisions for long-term employee benefits (termination benefits and jubilee awards)

The non-current portion of termination benefits and jubilee awards in the amount of HRK 15,224,434 (2016: HRK 2,255,022) relates to the estimated amount of termination benefits and jubilee awards in line with the Collective Agreement, to which Company employees are entitled at the end of their employment (either upon retirement, termination or voluntary departure, meeting the conditions for obtaining jubilee awards). The present value calculation of these provisions is based on the number of employees, average gross salary, number of years of service at the Company and the statistics of paid termination benefits in the past 4 years at the balance sheet date and the discount rate of 2% (2016: 3.5%).

31. Non-current liabilities arising from purchase of shares

Non-current liabilities in the amount of HRK 8,001,769 relate to liabilities arising from the put/call option contracted at acquisition (Note 42), whereby the Group has the option of purchasing shares of the subsidiary PET currently held by the seller.

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32. Non-current liabilities

	31 December 2017	31 December 2016
	HRK	*HRK*
Lease liabilities	1,677,234	-
	1,677,234	**-**
Bank borrowings		
Raiffeisenbank Austria d.d., Zagreb	22,540,944	-
Raiffeisenbank Austria d.d., Zagreb	21,129,645	29,755,279
Less: Current portion	(8,451,858)	(8,501,508)
	35,218,731	**21,253,771**
	36,895,965	**21,253,771**

Non-current liabilities to banks relate to two foreign currency borrowings from Raiffeisenbank Austria d.d.

The borrowing amounting to EUR 3,000,000.00 was granted in June 2017, with a fixed interest rate of 2.05% used to finance the 74% share in the company Power Engineering Transformatory Sp. z.o.o., Poland. Security instruments are 2 blank bills of exchange with a bill of exchange statement, 1 general debenture of EUR 3,000,000.00, a pledge over the Company's property and movables based on the Insurance Agreement amounting to EUR 25,000,000.00.

The second borrowing was granted in December 2017 in the amount of EUR 3,093,385.39 with a fixed interest rate of 1.85% p.a. used to refinance the long-term foreign currency borrowing at RBA d.d. granted in August 2016 in the amount of EUR 4,499,469.64, which was used to refinance the borrowing from HBOR's lending programme for the development of economic activities for financing the investment called High-Voltage Laboratory. Security instruments are 4 blank bills of exchange with a bill of exchange statement, 1 general debenture of EUR 4,500,000.00, a pledge over the Company's property and movables based on the Insurance Agreement amounting to EUR 25,000,000.00.

Furthermore, the Company contracted certain covenants for these borrowings, the most important of which are as follows:

- direct 60% of all domestic currency payment and a minimum of EUR 10,000,000.00 foreign currency payments through RBA accounts
- enable the bank to continuously monitor the use of pledged properties.
- The bank has a right to cancel the loan and to call it as due in the following cases:
  - late payment of any cash obligation under the contract
  - misuse of the borrowing or part of the borrowing
  - in the event that it does not partially or fully meet or partially violates any of the special contracted terms
  - in the event of material adverse change in the business, assets, liabilities or financial position of the Company
  - in the event that security instruments are no longer sufficient for the bank for any reason, and the Company does not offer another security instrument, suitable for the bank

Notes to the Consolidated Financial Statements

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Movements in bank borrowings during the year can be summarised as follows:

	HRK
1 January 2016	**31,490,857**
Repayment of borrowings	(30,833,822)
New borrowing	29,472,415
Foreign exchange differences	(374,171)
Less: Current portion	(8,501,508)
31 December 2016	**21,253,771**
1 January 2017	**21,253,771**
New borrowing	22,213,581
Foreign exchange differences	203,237
Less: Current portion	(8,451,858)
31 December 2017	**35,218,731**

Non-current liabilities mature as follows:

	31 December 2017	**31 December 2016**
	HRK	*HRK*
From 1 to 2 years	10,627,834	8,501,508
From 2 to 3 years	7,619,678	8,501,508
From 3 to 4 years	3,151,554	4,250,755
From 4 to 5 years	2,817,618	-
Over 5 years	12,679,281	-
	36,895,965	**21,253,771**

Notes to the Consolidated Financial Statements

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33. Liabilities to related parties

	31 December 2017	31 December 2016
	HRK	*HRK*
Končar Group companies:		
Končar - Electrical Industry Inc., Zagreb	1,277,422	1,449,189
Končar - Infrastructure and Services Ltd., Zagreb	868,297	906,317
Končar - Electrical Engineering Institute Inc., Zagreb	593,033	305,144
Končar - Electronics and Informatics Inc., Zagreb	129,983	38,821
Končar - Small Electrical Machines Inc., Zagreb	124,315	3,575
Končar - Instrument Transformers Inc., Zagreb	62,696	120,463
Končar - Power Plant and Electric Traction Engineering, Zagreb	35,784	39,230
Končar - Apparatus and Switchgear Inc. (previously: Končar - Medium Voltage Apparatus Inc., Zagreb)	2,125	-
Končar - Switchgears Inc., Sesvetski Kraljevec (now: Končar - Apparatus and Switchgear Inc.)	-	148,885
Končar - Low Voltage Switches and Circuit Brakers Ltd., Zagreb	-	113,641
	3,093,655	**3,125,265**
Associates:		
Elkakon Ltd., Zagreb	3,582,824	3,118,994
Končar - Power Transformers, Ltd., Zagreb	19,991	53,000
	3,602,815	**3,171,994**
	6,696,470	**6,297,259**

As at 31 December, the ageing structure of liabilities to related parties was as follows:

	Total	Not past due	Past due				
			< 60 days	60-90 days	90-180 days	180-365 days	> 365 days
	HRK	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
2017	**6,696,470**	6,443,567	252,903	-	-	-	-
2016	**6,297,259**	5,909,612	387,647	-	-	-	-

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for the Year Ended 31 December 2017

34. Current liabilities

	31 December 2017	31 December 2016
	HRK	*HRK*
Short-term borrowings		
Current portion of long-term borrowing (Note 29)	8,451,858	8,501,508
Acquisition - borrowing from the company UTECH	551,193	-
	9,003,051	**8,501,508**
Acquisition - lease liabilities	611,525	-
	611,525	**-**
	9,614,576	**8,501,508**

Movements in liabilities during the year are as follows:

	HRK
1 January 2016	**5,725,610**
Repayment of borrowings	(82,016,017)
New borrowing	76,215,627
Foreign exchange differences	74,780
Plus: Current portion	8,501,508
31 December 2016	**8,501,508**
Repayment of lease	(597,135)
Repayment of borrowings	(9,017,784)
New borrowing	1,139,202
Foreign exchange differences	(25,791)
Plus: Current portion	9,614,576
31 December 2017	**9,614,576**

The fair value of current borrowings does not differ significantly from its carrying value due to the short-term nature of these liabilities.

35. Trade payables

	31 December 2017	31 December 2016
	HRK	*HRK*
Domestic trade payables	18,190,700	16,624,539
Foreign trade payables	51,160,038	40,923,410
	69,350,738	**57,547,949**

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As at 31 December, the ageing structure of trade payables was as follows:

	Total	Not past due	Past due				
			< 60 days	60-90 days	90-180 days	180-365 days	> 365 days
	HRK	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*	*HRK*
2017	**69,350,738**	68,318,806	1,005,843	2,350	19,808	3,931	-
2016	**57,547,949**	56,501,686	979,337	-	15,468	51,458	-

36. Advances received

	31 December 2017	31 December 2016
	HRK	*HRK*
Advances received		
From foreign customers	45,270,619	61,123,429
From domestic customers	555,030	1,102,142
Related parties		
Končar - Power Plant and Electric Traction Engineering Inc., Zagreb	117,992	235,984
	45,943,641	**62,461,555**

37. Other current liabilities

	31 December 2017	31 December 2016
	HRK	*HRK*
Liabilities to employees		
Liabilities for net salaries	6,436,037	6,514,829
	6,436,037	**6,514,829**
Taxes, contributions and similar charges		
Contributions, taxes and surtaxes payable	7,980,570	7,755,307
Income tax payable	686,238	272,340
VAT payable	336,786	92,361
	9,003,594	**8,120,008**
Other liabilities		
Liabilities for sick leave and similar	83,487	74,955
Interest payable	131,251	183,648
Other liabilities	305,793	85,856
	520,531	**344,459**
Liabilities for distribution of profit	**101,616**	**94,957**
	16,061,778	**15,074,253**

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38. Accrued expenses and deferred income

Accrued expenses and deferred income in the amount of HRK 9,056,240 (31 December 2016: HRK 6,299,416) relate to accrued unused vacation days in the amount of HRK 3,219,632, estimated uninvoiced agent commissions and installation in the amount of HRK 4,595,564, and deferred income amounting to HRK 1,241,044 refers to the right of use of land in Poland, where the majority of land is owned by the state (usufruct).

39. Current provisions

Current-term provisions in the amount of HRK 44,771,830 (31 December 2016: HRK 41,077,135) relate to the current portion of long-term provisions for costs within warranty periods (Note 30).

40. Commitments

The Group's contractual commitments on the basis of sales contracts as at 31 December 2017 amounted to HRK 558 million (31 December 2016: HRK 623 million).

41. Off-balance-sheet items

As at 31 December, the Group has the following off-balance sheet items:

	31 December 2017	31 December 2016
	HRK	*HRK*
Guarantees		
- in foreign currency	190,967,153	171,613,696
- in HRK	6,182,794	3,182,794
	197,149,947	**174,796,490**

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42. Business combinations

In May 2017, the Group acquired a 74% share in the company Power Engineering Transformatory Sp. z.o.o. (PET) from Czerwonak, Poznan, Poland. Since for the remaining 26% share there is a symmetric call and put option in effect in the period from 8 May 2020 until 31 December 2037, which can be used at the prices defined in the contract, this acquisition by the Group was accounted for as if it had immediately acquired the 100% share, and it recognised the amount payable as per the put/call option as deferred and paid at the redemption price.

The fair value of identifiable assets and liabilities of the subsidiary Power Engineering Transformatory Sp. z.o.o. (PET) as at the acquisition date, 8 May 2017, was as follows:

	8 May 2017
	HRK
Non-current intangible assets	8,581
Non-current tangible assets	22,070,850
Non-current receivables	62,645
Inventories	2,793,477
Current receivables	378,109
Cash	646,822
Prepaid expenses	74,648
Provisions	(677,972)
Non-current liabilities	(2,199,350)
Current liabilities	(4,999,888)
Accrued expenses and deferred income	(1,253,050)
Total identifiable assets	**16,904,872**
Non-current liabilities related to share purchase	(8,001,769)
Gain on bargain purchase	**8,903,103**

Notes to the Consolidated Financial Statements

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43. Related party transactions

Parties are considered to be related if one party has the ability to control the other party, is under common control or exercises significant influence over the other party in making financial or operational decisions. The Group's principal activity includes performing related party activities, including the purchase and sale of goods and services. The nature of services with related parties is based on usual commercial terms. In addition to companies within the Končar Group and associates, the Group's related parties are the Group's Management and Supervisory Board.

During 2017, the Group engaged in transactions with related parties and realised revenues and expenses based on the trade of products and services, which can be analysed as follows:

2017	**Operating activities**				
	Receivables	Liabilities	Advances received	Revenues	Expenses
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*	*HRK'000*
Končar Group companies:					
Končar - Electrical Industry Inc.	-	1,278	-	-	6,101
Končar - Power Plant and Electric Traction Engineering Inc.	28,469	36	118	54,608	-
Končar - Infrastructure and Services Inc.	-	868	-	129	1,908
Končar - Electrical Engineering Institute Inc.	-	593	-	-	1,818
Končar - Electronics and Informatics Inc.	-	130	-	6	543
Končar - Small Electrical Machines Inc.	-	124	-	-	2,096
Končar - Instrument Transformers Inc.	1	63	-	17	1,282
Končar - Apparatus and Switchgear Inc. (previously: Končar - Medium Voltage Apparatus Inc., Zagreb)	-	2	-	-	10
Končar - Electric Vehicles Inc.	-	-	-	450	-
Končar - Switchgears Inc. (from 29 December 2017 Končar - Apparatus and Switchgear Inc.)	688	-	-	1,442	429
Končar - Generators and Motors Inc.	-	-	-	8	29
Končar - Low Voltage Switches and Circuit Breakers Ltd.	-	-	-	-	131
Končar - Engineering Co. for Plant Installation & Commissioning Inc.	-	-	-	51	-
Končar - Steel Structures Inc.	-	-	-	-	171
	29,158	**3,094**	**118**	**56,711**	**14,518**
Associates:					
Elkakon Ltd., Zagreb	6,792	3,583	-	30,837	36,682
Končar - Power Transformers Ltd.	6,957	20	-	5,924	586
	13,749	**3,603**	**-**	**36,761**	**37,268**
	42,907	**6,697**	**118**	**93,472**	**51,786**

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During 2016, the Group engaged in transactions with related parties and realised revenues and expenses based on the trade of products and services, which can be analysed as follows:

2016	**Operating activities**				
Društvo	Receivables	Liabilities	Advances received	Revenues	Expenses
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*	*HRK'000*
Končar Group companies:					
Končar - Electrical Industry Inc.	-	1,449	-	-	5,557
Končar - Power Plant and Electric Traction Engineering Inc.	7,620	39	236	27,285	-
Končar - Infrastructure and Services Inc.	-	906	-	1	1,964
Končar - Electrical Engineering Institute Inc.	-	305	-	19	2,173
Končar - Electronics and Informatics Inc.	7	39	-	11	1,487
Končar - Small Electrical Machines Inc.	-	4	-	-	2,383
Končar - Generators and Motors Inc.	-	-	-	-	43
Končar - Instrument Transformers Inc.	15	120	-	67	981
Končar - Medium Voltage Apparatus Inc.	-	-	-	-	69
Končar - Electric Vehicles Inc.	-	-	-	6,000	-
Končar - Switchgears Inc.	1,038	149	-	2,153	1,074
Končar - Low Voltage Switches and Circuit Breakers Ltd.	-	114	-	-	238
Končar - Engineering Co. for Plant Installation & Commissioning Inc.	-	-	-	6	1
	8,680	**3,125**	**236**	**35,540**	**15,970**
Associates:					
Elkakon Ltd., Zagreb	6,095	3,119	-	30,607	39,357
Končar - Power Transformers Ltd.	480	53	-	996	582
	6,575	**3,172**	**-**	**31,603**	**39,939**
	15,255	**6,297**	**236**	**67,143**	**55,909**

44. Financial instruments

In this note the following information will be disclosed:

A) The significance of financial instruments for the financial position and performance of the Group, and

B) The types and the nature of risks arising from financial instruments to which the Group is exposed at the end of the reporting period, and the method used by the Group in order to manage those risks.

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

A) The significance of financial instruments for the financial position and performance of the Group

The significance of financial instruments for the financial position and performance of the Group is presented in the following tables:

31 December 2017	Loans and receivables	Assets at fair value through P&L	Available-for-sale assets	**Assets classified under**
	IAS 39	*HRK'000*	*HRK'000*	*HRK'000*
Derivative financial assets - non-current	-	58	-	**58**
Available-for-sale financial assets	-	-	2,804	**2,804**
Derivative financial assets - current	-	883	-	**883**
Trade receivables	113,416	-	-	**113,416**
Receivables from related customers	42,907	-	-	**42,907**
Cash	130,043	-	-	**130,043**
	286,366	**941**	**2,804**	**290,111**

31 December 2016	Loans and receivables	Assets at fair value through P&L	Available-for-sale assets	**Assets classified under**
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*
Derivative financial assets - non-current	-	39	-	**39**
Available-for-sale financial assets	-	-	2,804	**2,804**
Derivative financial assets - current	-	242	-	**242**
Trade receivables	110,915	-	-	**110,915**
Receivables from related customers	15,256	-	-	**15,256**
Cash	71,451	-	-	**71,451**
	197,622	**281**	**2,804**	**200,707**

All the Group's liabilities have been classified as "At amortised cost", except for derivative financial instruments as explained in this note.

The Group manages its capital to ensure its ability to continue as a going concern while enabling an increased return to shareholders through the optimisation of the debt to equity balance.

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	31 December 2017	31 December 2016
	HRK	*HRK*
Debt (interest-bearing)	**46,510,541**	**29,755,279**
Long-term borrowings	36,895,965	21,253,771
Short-term borrowings (including current portion of long-term borrowings)	9,614,576	8,501,508
Less: Cash and cash equivalents	**(130,043,399)**	**(71,450,771)**
Net debt	**(83,532,858)**	**(41,695,492)**
Total equity	306,306,521	276,050,366
Equity and net debt	**222,773,663**	**234,354,874**
Net debt-to-equity ratio	**-**	**-**

Fair value of financial assets and liabilities

The fair value of a financial instrument is the amount at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The Group uses the following hierarchy for determining the fair value of financial instruments:

- level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
- level 3: techniques which use inputs which have a significant effect on the recorded fair value, which are not based on observable market data

31 December 2017				
	Level 1	**Level 2**	**Level 3**	**Total**
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*
Listed shares	39	-	-	39
Fair value of derivative financial instruments	-	904	-	904
Available-for-sale financial assets (Note 19)	-	-	2,765	2,765
	39	**904**	**2,765**	**3,708**
31 December 2016				
Listed shares	39	-	-	39
Fair value of derivative financial instruments	-	281	-	281
Available-for-sale financial assets (Note 19)	-	-	2,765	2,765
	39	**281**	**2,765**	**3,085**

The fair value of the Group's financial assets and liabilities approximates the carrying amounts of the Group's assets and liabilities.

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Investments in equity instruments

Of all the Group's financial assets, only the shares of Zagrebačka banka d.d. are listed on the active market. The carrying value of these shares amounts to HRK 39,000 and the fair value (according to the closing price at the Zagreb Stock Exchange) amounts to HRK 120,156 (2016: HRK 123,120).

Other investments in equity instruments (shares in Ferokotao Ltd. and Novi Feromont Ltd.) are investments not listed on the active market; therefore, those investments are measured at cost under IAS 39, since the fair value of those instruments cannot be measured reliably and included in level 3.

Derivative financial instruments

The fair value of financial instruments that are not traded in an active market included in level 2, is determined by using valuation techniques. Valuation techniques maximise the use of observable market data, where available, and rely as little as possible on entity-specific estimates.

In addition to investments in equity instruments, the Group used the following methods and assumptions in estimating the fair value of financial instruments:

Receivables and bank deposits

For assets that mature within 3 months, the carrying value approximates their fair value due to the short maturities of these instruments. For longer-term assets, the contracted interest rates do not deviate significantly from the current market rates and, consequently, the fair value approximates the carrying value.

Borrowings

The fair value of current liabilities approximates their carrying value due to the short maturities of these instruments. The Management Board believes that their fair value is not materially different from their carrying value.

Other financial instruments

The Group's financial instruments not carried at fair value are trade receivables, other receivables, trade payables and other current liabilities. The historical carrying value of receivables and liabilities, including provisions that are in line with the usual terms of business is approximately equal to their fair value.

b) Risks arising from financial instruments

The Group's operations are exposed to the following financial risks: market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk.

1. Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risks.

There were no significant changes to the Group's exposure to market risk or the manner in which it manages and measures the risk.

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a) Foreign currency risk management and hedge accounting

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Group is exposed to this risk through sales, purchase and loans stated in foreign currency which is not the Group's functional currency. Foreign currencies to which the Group is primarily exposed are EUR, USD, SEK, MAD, CZK, CHF, NOK, PLN, RON, GBP and HUF.

The Group is, therefore, exposed to the risk that movements in exchange rates will affect both its net income and financial position, as expressed in HRK.

The Group exposes itself to foreign currency risk through sales, purchasing, borrowings and depositing of funds denominated in foreign currencies. EUR is not considered a currency of significant risk and the Group does not hedge against it, as opposed to all other currencies where the Group hedges through forward contracts on the trade of currencies with banks.

The Group's foreign currency exposure arises from:
- highly probable forecast transactions (sales/purchases) denominated in foreign currencies;
- firm commitments denominated in foreign currencies; and
- monetary items (mainly trade receivables, trade payables and borrowings) denominated in foreign currencies.

The Group's policy is to hedge all material foreign exchange risk associated with highly probable forecast transactions, firm commitments and monetary items denominated in foreign currencies.

The Group's policy is to hedge the risk of changes in the relevant spot exchange rate.

Hedging instruments

The Group mainly uses forward contracts as well as swap foreign exchange contracts to hedge foreign exchange risk. All derivatives must be entered into with counterparties with a credit rating of A or A negative.

Extracts of effectiveness testing policies for currency risk

Strategy: Cash flow hedges of foreign currency exposure in highly probable forecast transactions.

Effectiveness testing policy for currency risk

Prospective effectiveness testing for cash flow hedges

Prospective effectiveness testing is performed at the inception of the hedge and at each reporting date. The hedge relationship is highly effective if the changes in fair value or cash flow of the hedged item that are attributable to the hedged risk are expected to be offset by the changes in fair value or cash flows of the hedging instrument.

Prospective effectiveness testing is performed by comparing the numerical effects of a shift in the exchange rate (for example, EUR/USD rate) on: the fair value of the hedged cash flows measured using a hypothetical derivative; and the fair value of the hedging instrument. Consistent with the Group's risk management policy, the hedged risk is defined as the risk of changes in the spot exchange rate. Changes in interest rates are excluded from the hedge relationship (for both the hedging instrument and the hedged forecast transaction) and do not affect the calculations of effectiveness. Only the spot component of the forward contract is included in the hedge relationship (that is, the forward points are excluded). At least three scenarios should be assessed, unless the critical terms of the hedging instrument perfectly match the critical terms of the hedged item, in which case one scenario is sufficient.

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Retrospective effectiveness testing for cash flow hedges

Retrospective effectiveness testing is performed at each reporting date using the dollar offset method on a cumulative basis. The hedge is demonstrated to be effective by comparing the cumulative change in the fair value of the hedged cash flows measured using a hypothetical derivative, and the fair value of the hedging instrument. A hedge is considered to be highly effective if the results of the retrospective effectiveness tests are within the range 80% -125%.

$$\textbf{Effectiveness} = \frac{\textbf{Cumulative change in fair value of hedging instrument}}{\textbf{Cumulative change in fair value of hedged item (hypothetical derivative)}}$$

The change in the fair value of the spot component of the hedging instrument (the forward contract) is the difference between the fair value of the spot component at the inception of the hedge and at the end of the testing period. The difference is derived based on translating the foreign exchange leg of the forward contract at the current spot rate and discounting the net cash flows on the derivative using the zero-coupon rates curve derived from the swap yield curve.

The change in the fair value of the hedged cash flows of the hedged item (hypothetical derivative) is the difference between the value of the hypothetical derivative at the inception of the hedge and at the end of the testing period. The difference is derived based on translating the foreign exchange leg of the hypothetical derivative at the current spot rate and discounting the net cash flows on the hypothetical derivative using the zero-coupon rates curve derived from the swap yield curve.

The Group's exposure to currency risk as at the balance sheet date is as follows:

31 December 2017												
(in thousands of HRK)	EUR	USD	MAD	SEK	CZK	CHF	GBP	PLN	HUF	Total foreign currencies	HRK	Total
Trade receivables and receivables from related parties	87,055	85	91	7,959	-	245	-	4,161	-	99,596	56,727	156,323
Derivative instruments	940	-	-	-	-	-	-	-	-	940	-	940
Cash and cash equivalents	105,981	764	256	6,028	2,957	1,857	3	2,190	1	120,037	10,008	130,045
Total assets	**193,976**	**849**	**347**	**13,987**	**2,957**	**2,102**	**3**	**6,351**	**1**	**220,573**	**66,735**	**287,308**
Trade and other payables	47,275	708	8	2,326	-	171	-	672	-	51,160	24,887	76,047
Financial liabilities	51,672	-	-	-	-	-	-	2,840	-	54,512	-	54,512
Total liabilities	**98,929**	**708**	**8**	**2,326**	**-**	**171**	**-**	**3,512**	**-**	**105,672**	**24,887**	**130,559**

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31 December 2016											
(in thousands of HRK)	EUR	USD	MAD	SEK	CHF	GBP	NOK	HUF	Total foreign currencies	HRK	Total
Trade receivables and receivables from related parties	80,889	1,295	114	2,453	1,160	-	3,853	-	89,764	36,407	126,171
Derivative instruments	281	-	-	-	-	-	-	-	281	-	281
Cash and cash equivalents	46,762	9	75	6,402	1,580	27	5,667	1	60,523	10,927	71,450
Total assets	**127,932**	**1,304**	**189**	**8,855**	**2,740**	**27**	**9,520**	**1**	**150,568**	**47,334**	**197,902**
Trade and other payables	38,546	374	8	1,926	-	-	68	-	40,922	22,922	63,844
Financial liabilities	29,755	-	-	-	-	-	-	-	29,755	-	29,755
Total liabilities	**68,301**	**374**	**8**	**1,926**	**-**	**-**	**68**	**-**	**70,677**	**22,922**	**93,599**

Sensitivity analysis

A (weakening)/strengthening of the HRK exchange rate in relation to the following currencies by the presented percentages at the reporting date would increase/(decrease) profit before tax by the following amounts:

			2017	2016
	% Change 2017	% Change 2016	Effect on profit before tax HRK'000	Effect on profit before tax HRK'000
EUR	(1)%	(1)%	(548)	(602)
USD	(13)%	3%	(18)	23
SEK	(3)%	(5)%	(371)	(363)
CZK	5%	(1)%	149	-
CHF	(9)%	0%	(166)	(8)
NOK	(8)%	4%	-	381
Other currencies			(17)	(8)

This analysis assumes that all other variables, interest rates especially, remain unchanged. The percentages of changes in exchange rates are determined on the average change in these currencies over the past 12 months.

A reverse proportional change of the HRK against the above currencies by the presented percentage changes at the reporting date would have had the equal but opposite effect on the profit before tax, provided that all other variables are held constant.

b) Interest rate risk

The Group is not exposed to interest rate risks because all loans are contracted with a fixed interest rate, there are no variable interest rates, while most of the assets are not interest bearing.

c) Other price risk

The Group is not exposed to other price risks related to financial instruments.

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2) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the other party. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss form defaults. The Group only transacts with entities with good credibility. The Group uses publicly available information on entities' financial positions, reports on creditworthiness by independent credit rating agencies and its own trading records to rate its major customers. The Group's exposure and the credit ratings of its counterparties are continuously monitored and measured and the aggregate value of contracts concluded is spread amongst creditworthy counterparties.

A significant part of credit risk arises from trade receivables.

Trade and other receivables

The Group's exposure to credit risk is mainly affected by the individual characteristics of each customer.

The demographics of the customer base, including the default risk of the industry and country, in which customers operate, has less of an influence on credit risk. The Group has established a credit policy under which each new customer is analysed individually for creditworthiness before standard payment and delivery terms and conditions are offered. From customers with low creditworthiness the Company requires common payment collaterals, such as letters of credit, bank collaterals, mortgages, debentures, bills of exchange etc. The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of receivables.

The Group has not used derivative instruments to hedge these risks.

The ageing structure of trade receivables (related and unrelated) which are past due but are considered collectable are presented in Notes 24 and 25.

Credit quality of financial assets

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates. As at 31 December 2017, financial assets not past due classified in the category 'Trade receivables' and Receivables from related companies amounted to HRK 124,552 thousand (2016: HRK 108,178 thousand). All receivables relate to outstanding loans, deposits, receivables from government institutions, interest receivables and to customers who typically pay within 60 days from the maturity date.

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

	31 December 2017	31 December 2017
	HRK	*HRK*
Trade receivables		
Counterparties with credit rating (Standard and Poor's)		
BBB and higher	20,211,416	26,620,212
Counterparties without credit rating*		
Group 2	64,033,834	50,062,930
Group 3	29,170,688	34,231,687
	113,415,938	**110,914,829**
Receivables from related parties	**42,906,848**	**15,256,027**

Notes to the Consolidated Financial Statements

for the Year Ended 31 December 2017

	31 December 2017	31 December 2017
	HRK	*HRK*
Cash and short-term deposits		
BB/Stable (Standard & Poor's)		
A	7,495,126	795,983
BBB+	101,991,048	51,945,237
BBB	644,098	9,817,944
BBB-	6,462,038	8,197,803
BB	13,399,097	636,702
Cash in hand and at other banks	51,993	57,103
	130,043,399	**71,450,771**

Classification of counterparties without credit rating:

- Group 1 - new customers (less than 6 months)
- Group 2 - existing customers (more than 6 months) with no defaults in the past
- Group 3 - existing customers (more than 6 months) with defaults in the past; all default payments have been fully collected.

**Although some amounts of receivables from related parties are past due, they were not impaired because historically repayments have been regular and accordingly the risk of non-collectibility of these receivables is immaterial.

***The Group has procedures in place for assessing the reasonableness of non-recurring transactions with third parties, including mandatory verification of customer creditworthiness.

3) Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due, or that they will face difficulties in meeting these obligations. Liquidity risk management is the responsibility of the Management Board, which has built a quality frame for monitoring short-, mid- and long-term financing and all liquidity risk requirements. The Group manages this risk by constantly monitoring estimated and actual cash flow and comparing it with the maturity of financial assets and liabilities.

The following table presents the maturity of the Group's financial liabilities as at 31 December 2017 in accordance with contracted undiscounted payments:

31 December 2017	Contracted cash flows	Less than 1 months	1 - 3 months	3 - 12 months	2 - 5 years	Over 5 years
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*	*HRK'000*	*HRK'000*
Liabilities						
Current liabilities to related parties	6,697	5,874	823	-	-	-
Current trade and other payables	69,453	31,143	37,313	987	-	-
Long-term borrowings	46,907	-	-	475	32,660	13,772
Short-term borrowings	10,532	131	2,323	8,078	-	-
Total liabilities	**133,579**	**37,148**	**40,459**	**9,540**	**32,660**	**13,772**

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The following table presents the maturity of the Group's financial liabilities as at 31 December 2016 in accordance with contracted undiscounted payments:

31 December 2016	Contracted cash flows	Less than 1 months	1 - 3 months	3 - 12 months	1 - 5 years
	HRK'000	*HRK'000*	*HRK'000*	*HRK'000*	*HRK'000*
Liabilities					
Current liabilities to related parties	6,298	5,355	943	-	-
Current trade payables	57,549	31,984	22,985	2,520	60
Long-term borrowings	21,925	-	-	-	21,925
Short-term borrowings	9,112	-	2,294	6,818	-
Total liabilities	**94,884**	**37,339**	**26,222**	**9,338**	**21,985**

45. Events after the balance sheet date (subsequent events)

After the reporting date and until the approval date of these financial statements, there were no events that could significantly affect the annual financial statements of the Group for 2017, and that should, consequently, be disclosed.

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Tradition. Knowledge. Responsibility.

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