KONČAR D&ST

Inspired by challenge

Consolidated Annual Report

2022

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2022

Končar – Distribution and Special Transformers Inc.

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MANAGEMENT REPORT

2022 – A year of significant growth in demand for transformers, with continued overall business growth

1. Introductory Word by the Management Board

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

The highly complex and dynamic market trends continued through 2022. With the already present circumstances concerning the global COVID-19 pandemic, further instability was caused by supply chain disturbances, continued rising prices of the main raw and other materials, the war in Ukraine and its impacts on the European and global markets. Sanctions imposed on Russia and the sudden and significant spike in energy prices (natural gas, oil, electricity) and the effects of inflation left their mark on the business year. Despite this, in 2022 the Group continued its series of successful business years.

The total sale of goods and services in 2022 amounted to HRK 1,914 million (up from HRK 1,424 million in 2021), which is a 34% increase at the annual level. Exports accounted for 90% of sales at HRK 1,719 million (compared to HRK 1,244 million in 2021), up 34% from the year before.

Profit before tax in 2022 was HRK 185.9 million (net HRK 174.4 million), which was 55% higher than the profit before tax in 2021 at HRK 119.6 million (net HRK 99.3 million).

The significant increase in demand for transformers is a consequence of green transition and a greater focus on sustainability, our strong market position on demanding foreign markets, and recognising sales opportunities, resulting in a record number of contracts. At the end of 2022, total contract value was HRK 2,170 million, which is up 56% over the year before at HRK 1,394 million.

During 2022, a total of HRK 57.6 million (as opposed to HRK 20.8 million in 2021) was invested. The majority share of investments (HRK 37.6 million) was for the purchase of the second half of the production hall and cutting centre. Through the investment project "Sustainable SETup for the development of socially and environmentally responsible production" (Sustainable SETup), this space will be primarily used to normalise the existing level of production and to increase warehouse space, enabling an optimisation of business processes and ensuring more appropriate flow of materials, raw materials, equipment and finished products. The remaining part of the investment was used for the procurement of new production, testing and IT equipment, and to improve working conditions. During 2022, we also completed the installation of a 1.1 MW photovoltaic plant on the rooftops of our production halls. This solar plant will cover about 35% of the electricity needs of Končar D&ST Inc.

In 2022, Končar D&ST Inc. secured additional resources to provide active support to the company PET, Poland, to further improve overall operations.

On 31 December 2022, the number of employees in the Končar D&ST Group was 815, with 744 at the Zagreb location and 71 at PET Poland. The engineering departments, support services, and production all received new workers. A number of organisational changes was made to more effectively manage the Group's growth and the growth in production volume.

In its operations, the Group operates in compliance with the internationally recognised standards and requirements of corporate social responsibility.

Given the above, we can consider the total business results of the Končar D&ST Group in 2022 to be successful, and the company is stronger and well prepared for future business challenges. The alignment of interests of all stakeholders – owners, management, employees, customers, suppliers and banks, and our mutual trust, have been of the utmost importance in achieved these good business results. The Končar D&ST Management Board expresses its gratitude for this support and confidence, and we are pleased to present this Report on the Position of the Group for 2022.

For the Končar D&ST Inc. Management Board

Vanja Burul

Board President

2. Major 2022 figures Compared to 2021, 2020 and 2019

	2022 HRK ('000)	2021 HRK ('000)	2020 HRK ('000)	2019 HRK ('000)	2022 EUR ('000)	2021 EUR ('000)	22/21 Index
Sales							
Croatia	194,776	180,446	153,149	128,210	25,861	23,924	107.9
Exports	1,719,365	1,243,905	1,011,453	941,051	228,287	165,261	138.2
Total	**1,914,141**	**1,424,351**	**1,164,602**	**1,069,261**	**254,148**	**189,185**	**134.4**
EBITDA	**206,473**	**149,646**	**116,785**	**80,737**	**27,414**	**19,889**	**138.0**
Net profit	**174,405**	**99,342**	**102,052**	**57,998**	**23,156**	**13,203**	**175.6**
Number of employees							
on 31 Dec	815	750	718	683			108.7

Note:
Average exchange rate: 2019 1 EUR = 7.4136 kn; 2020 1 EUR = 7.5331 kn; 2021 1 EUR = 7.5242 kn; 2022 1 EUR = 7.5316 kn

3. General Position of the Group

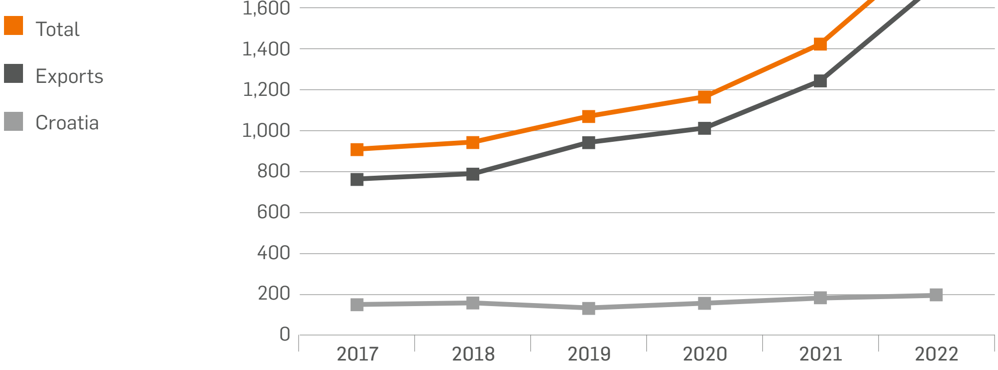
Good business results in 2022 and in the years preceding gave an additional financial boost to the Group, ensuring appropriate financial stability and a strong foundation for further business development.

As a result of ongoing organisational adjustments to new external and internal conditions, both in terms of its line of distribution transformers and its line of medium power transformers, the Group has improved its competitive edge on the market in these challenging times.

By identifying sales and development activities as its priorities, along with employment and systematised training of young experts, employee motivation, investments in IT, product development and production modernisation, the Group is prepared to meet the demands of the complex market conditions that can also be expected in the future.

By following the guidelines and requirements for a sustainable and circular economy the digitalisation of internal processes and its own business operations, the Group will continue to actively contribute to and participate in the energy transition and decarbonisation processes.

Sales trends (million HRK)



4. Group Organisation and Management in 2022

During 2022, the company Končar D&ST was managed by the Management Board in the following composition:
Vanja Burul, *Board President*
Petar Bobek, *Board Member, MPT Profit Centre Director*
Martina Mikulić, *DT Profit Centre Director*
Dominik Trstoglavec, *Board Member, Technical and Business Development Director*
Petar Vlaić, *Finance, Procurement and HR Director*

During 2022, the members of the company Končar D&ST Supervisory Board were:
Gordan Kolak, *President*
Ivan Bahun, *Member*
Josip Ljulj, *Member*
Miki Huljić, *Member*
Ana-Marija Markoč, *Member*

The company PET Sp. z o.o. was managed by the Management Board in the following composition:
Ivor Grubišić, *Board President*
Maciej Malolepszy, *Board Member*
Boleszlaw Brodka, *Board Member*

The Supervisory Board of the company PET Sp. z o.o.:
Vanja Burul, *President*
Petar Vlaić, *Member*
Mate Biloš, *Member*

In 2022, the Končar D&ST Group performed its activities at two locations: in the Republic of Croatia at the location Josipa Mokrovića 8, 10090 Zagreb, and in Poland at the location Czerwonak, Gdynska 83

5. Implementation of the Corporate Governance Code

The parent company of the Group is listed on the Zagreb Stock Exchange, and implements the Corporate Governance Code in compliance with the rules of the Zagreb Stock Exchange.

Končar D&ST implements most of the provisions of the Corporate Governance Code drafted by the Zagreb Stock Exchange and HANFA, and published on the website of the Zagreb Stock Exchange (www.zse.hr). The only exceptions are certain provisions that Končar D&ST holds do not have to be implemented in the prescribed form, in particular:

- the Supervisory Board and the Review Committee consist primarily of members who are not independent, which is considered to be appropriate in this situation of the Company within the Končar Group.

The Company holds that the fact it does not implement some of the provisions of the Code does not undermine the high level of transparency of Company operations and that this will not substantially influence either current or potential investors in making investment decisions.

The compliance questionnaire includes precise answers to any questions as to which provisions of the Code the Company implements and which it does not, and this is publicly available on the official website of the Zagreb Stock Exchange (www.zse.hr) and the Company website (www.koncar-dst.hr).

As part of its organisational model, which serves as the basis for its operation and all business processes, Končar D&ST Inc. has developed internal control systems at all important levels. These systems also enable objective and correct presentation of financial and business reports.

Data on significant shareholders are available at all times on the official website of the Central Depository and Clearing Company (www.skdd.hr) and are also published in the auditor's report as on 31 December 2022 and 2021. Shareholders can vote electronically with attendance at the Shareholders' Assembly. Preferred shares of Končar D&ST Inc. do not carry the right to vote.

6. Market Position and Sales by Country and Group of Products

The stabilisation of operations at the end of 2021 after a year of turbulence caused by the COVID-19 virus was very short-lived. Already in the second half of February 2022, the Russian aggression against the Ukraine caused gradual disturbances in all business segments, starting with logistics challenges followed by a dramatic spike in the price of materials and raw materials, which resulted in inflation that was unprecedented for many years before this. Such an altered situation indicated the inadequacy of the tender and contracted models, particularly in the commercial sense. Accordingly, it was necessary to renegotiated the contract models with customers to track the prices of materials and raw materials and inflation.

Parallelly, considering the goal of European countries to meet green transition targets and achieve energy independence as soon as possible, the demand for transformers increased significantly. This high demand further drove up the price of equipment, materials and raw materials needed for operations in the transformer industry, resulting in a lengthening of delivery periods for transformers. In this sense, it proved exceptionally important to develop strong partnerships with strategic buyers throughout Europe, as the main factors in these processes.

The Group invested extraordinary efforts throughout the year on virtually all markets, with a fair business and partnership approach towards buyers, and reliability and quality of supply to strengthen its market position. This resulted in exceptional business results in 2022.

In 2022, sales recorded growth of 34% over 2021, and totalled HRK 1,914 million (EUR 254 million).

Changes by product groups in 2022 in comparison to 2021 were:

Distribution transformers: **36% growth**

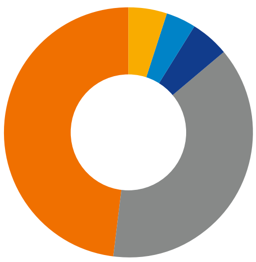
Medium power transformers: **27% growth**

Dry and special transformers: **15% decline**

Other goods and services: **74% growth**

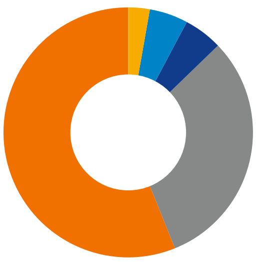
Sales structure by product type in 2022

Medium power transformers	48%
Distribution transformers	38%
Services	5%
Dry and special transformers	4%
Supplies	5%



Structure of new contracts by product type in 2022

Medium power transformers	56%
Distribution transformers	31%
Services	5%
Dry and special transformers	5%
Supplies	3%



Sales by main markets was as follows:

Croatia: In 2022, deliveries were valued at HRK 195 million (EUR 26 million), or **8% growth** compared to 2021 (HRK 180 million, EUR 24 million).

Neighbouring European countries: BiH, Slovenia, North Macedonia, Montenegro, Austria, Italy, Czech Republic, Slovakia, Hungary, Serbia, Romania - In 2022, deliveries were valued at HRK 319 million (EUR 42 million), or **22% growth** compared to 2021 (HRK 262 million, EUR 35 million).

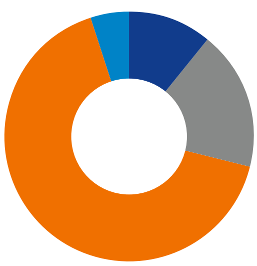
Other European countries: Sweden, Switzerland, Germany, Finland, Iceland, France, Great Britain, Ireland, Poland, Estonia, Latvia, Lithuania, Cyprus, Spain, Denmark, Norway, Malta, The Netherlands, Belgium, Greece - In 2022, deliveries were valued at HRK 1,298 million (EUR 172 million), which is a **43% rise** compared to 2021 (HRK 905 million, EUR 120 million).

Asia, Africa, and the Americas: In 2022, deliveries were valued at HRK 101.7 million (EUR 13.5 million), which is **31% growth** compared to 2021 (HRK 77 million, EUR 10 million).

In 2022, total contract value was HRK 2,663 million (EUR 353 million), which is 37% more than in 2021.
The state of transactions contracted at the end of the year was worth HRK 2,170 million, up 56% over the end of 2021.

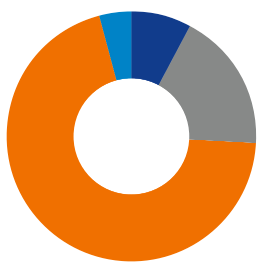
Sales structure by market in 2022

Other European countries	66%
Neighbouring European countries	18%
Croatia	11%
Asia, Africa, and the Americas	5%



New contracts by market in 2022

Other European countries	70%
Neighbouring European countries	18%
Croatia	8%
Asia, Africa, and the Americas	4%



7. Financial Position (Balance Sheet)

On 31 December 2022, assets of the Končar D&ST Group were HRK 1,445 million, which was HRK 424 million or 42% higher than the year before. Long-term assets account for 21% while short-term assets account for 79% of the total assets.

The dominant item in the non-current assets is property, plants and equipment, accounting for 89% of this group of assets. The long-term assets were increased by HRK 36 million or 14% over one year before, and totalled HRK 299 million. This increase in value is the consequence of the purchase of the second half of the commercial building that forms a functional whole with the previously purchased part of that structure. The purchased half-building has an area of approx.. 4700 m2 and will be turned into additional production, warehouse and administrative space. This is part of the new investment cycle in the period 2022 to 2024 as part of the project “Sustainable SET-up”.

On 31 December 2022, current assets amounted to HRK 1,146 million, up HRK 388 million (or 51%) from one year earlier. Within this class, the greatest growth was seen in inventory, up 66% to HRK 723 million, followed by accounts receivable at HRK 352 million (up 78%), while cash and cash equivalents was down by 48% in relation to one year earlier at HRK 65 million.

This growth in assets and changes to its structure where the less liquid assets (primarily inventory and current receivables, and then property and equipment) grew significantly, while money in accounts declined, giving rise to the need for additional liquidity.

Funds to finance these additional needs were primarily obtained from lines of credit the company has in commercial banks, and from loans from the parent company Končar - Electroindustry.

On 31 December 2022, total liabilities of the Group towards current borrowings loans totalled HRK 130.9 million (EUR 17.4 million), while short-term borrowing on 31 December 2022 totalled HRK 5 million (EUR 663,600).

Current liabilities towards suppliers also had a positive influence on liquidity, and on 31 December 2022 totalled HRK 202 million, which was 57% higher than the total at the end of 2021 when they amounted to HRK 128 million.

Advances from customers continue to be a significant source of company financing, and on the final day of the period totalled HRK 200 million, which is a 14% share in the total sources of financing.

All current sources of funding amounted to HRK 645 million, and on 31 December 2022 accounted for 45% of equity and liabilities. In relation to the previous year, this was nearly twice as high, i.e., by HRK 309 million or 89%.

The described trends of assets and liabilities led to a worsening of general liquidity ratios. On 31 December 2022, the current ratio was 1.75 (as opposed to 2.20 at the end of the previous year), and quick ratio by 0.65 (as opposed to 0.94 one year earlier).

The business reasons behind this erosion of liquidity can be found in the general business environment affecting the year. The instability spilling over from 2021 was only further aggravated by the war in Ukraine and high inflationary pressures.

Unlike the current liabilities, non-current liabilities were reduced from HRK 131 million on 31 December 2021 to HRK 108 million on 31 December 2022, which is a share of 7% of the total liabilities.

Own sources of funding, i.e., capital with reserves and retained profits, totalled HRK 684 million on 31 December 2022, accounting for 47% of liabilities. This was HRK 139 million (26%) higher than one year earlier, which is a consequence of retaining a part of the net profits from 2021 in the amount of HRK 53 million, and the remainder pertains to an increase in net profit in the reference period of both Group members in comparison with the year before.

With a 13% share of interest-bearing debt in the total source of financing, it can be concluded that the Group has low indebtedness and is financially stable (financial stability indicator of 2.6).

8. Operating Result (Income Statement)

The 2022 business year was marked by a significant increase in revenues. Sales revenues were HRK 1,914 million, with an increase of HRK 490 million or 34% in relation to 2021 when they were HRK 1,424 million. In the consolidated sales revenues, Končar D&ST contributed with HRK 1,809 (95%) while the contribution of PET was HRK 105 million (5%).

Sales achieved in exports totalled HRK 1,719 million, and accounted for 90% of all sales revenue. Exports grew by HRK 475 million or 38% in comparison to 2021, and represent the main driver of growth of Group operations.

The high rate of inflation that began during 2021 continued into 2022. Inflationary trends significantly affected a spike in input costs. During the year, major efforts were invested to successfully transfer the inflationary pressures on the value of open contracts and in the conclusion of new contracts. The growth in sales revenues is largely a consequence of those activities.

During the year, the price of strategic materials increased sharply (electromagnetic transformer steel sheets, copper, aluminium, transformer oil, cold rolled steel), and for all other materials used in production.

In addition to rising prices of strategic materials that account for a significant share of product cost, nearly all other costs also rose, and in terms of their importance, it is necessary to highly the costs of transport and logistics, costs of energy (especially natural gas), costs of auxiliary materials and services in production, maintenance, compensation to the parent company for the use of the name and trademark, etc.

Personnel costs rose by 16%, which is the result of salary increases and an increase in the number of employees. At the end of 2021 there were 750 employees, and at the end of 2022 there were 65 more (9%), for a total of 815.

One-off items pertaining to reservations in the warrantee period and reservations for an onerous contracts with the parent company also had an effect on the result. The net effect of change on the line items of these reservations was had in their cancellation in the amount of HRK 17 million, which was recorded as a reduction of costs.

The result of financial operations was a profit of HRK 8 million, which stems from the unrealised profits concerning the evaluation of forward currency exchange contracts concluded with the commercial banks for the purpose of protection from currency exchange risks. On the other hand, the weakening of the value of the PLN against the EUR had a negative impact on financial operations.

The profit before taxation of the Group for 2022 was HRK 185.9 million, accounting for 9.7% of sales revenues. The same indicator was 8.4% one year earlier. PET ended the year with a positive result (HRK 5.1 million), thus ending its previous trend of losses.

In line with the new Extra Profit Tax, Končar D&ST is subject to the Act and pursuant to its provisions, was required to pay the amount of HRK 21.1 million. Together with the regular profit tax paid, in the amount of HRK 27.5 million, the total tax obligation was HRK 48.6 million, or effectively 27% of the total profits.

Since the Company received tax subsidies for the investment entitled “Sustainable SETup for the development of socially and environmentally responsible manufacturing” in the amount of HRK 41.2 million, the majority of the received subsidy, in the amount of HRK 36.4 million (75% of the calculated tax obligation) will be used to reduce the payment of tax obligations for 2022.

Comprehensive income in 2022 totalled HRK 174.5 million, which is HRK 75 million or 75% higher than the net profits in the year before.

9. Group Main Operating Risks

In 2022, the parent company of the Group, Končar D&ST revised its Rulebook Ordinance on Risk Management and its Risk Management Policy, which are in compliance with standard ISO 31000:2018 (Risk Management - Guidelines) and with the ERM (Enterprise Risk Management) principles. In accordance with this policy, risk management in the Group is:

- integrated in all business processes and decision-making processes in the Group. It is structured and comprehensive, taking into consideration both the external and internal context in which the Group, and is based on the best information available;
- inclusive, and it encompasses a wide circle of persons starting with the Management Board and the Supervisory Board, sector and field directors, managers and heads of departments and workshops, and finally all employees and external stakeholders;
- dynamic because new risks may appear, change, or disappear in line with changes to the internal or external context;
- based on continued improvements to management that is founded on learning and acquisition of new experiences.

In full acknowledgement of the business strategy and business goals, the Group determines that there is a moderate (average) propensity to take risks.

The lowest propensity for risk-taking is in the field of goals related to safety and compliance, including employee health and safety. A slightly greater propensity to take risks is in the field of strategic and operative goals. This means that reducing risk arising from our systems, equipment, products, and work settings to reasonable and feasible levels and compliance with our legal obligations will have priority over other business goals.

The Risk Catalogue, revised in late 2022, was drawn up in line with the defined risk management methodology. It identifies, analyses, and evaluates the main strategic, operative, and financial risks and specific risk reduction measures, as well as the persons responsible for risk management (risk owners). Risks have been identified in all organisational units of the Group.

The prices of main raw materials and other materials (copper, aluminium, transformer sheet, transformer oil, steel) began to rise substantially in the first quarter of 2021, and this trend continued through most of 2022.

The 2022 business year was marked by the start of the Russian aggression against the Ukraine, with numerous consequences for the European and global economies. The war led to shortages and price spikes of energy prices, particularly natural gas, as well as electricity and other energy sources, with high uncertainty as to the further development of the situation on the market. The Group responded adequately to these risks, mitigated them with the available measures and actions, and the 2022 business year ended without significant negative impacts on Group operating results.

DEMAND of transformers on Group target markets is one of the main risk factors for the operation of the Group. The business year 2022 was characterised by an increased demand for transformers for a number of reasons, of which the most significant were investments into renewable energy sources and electro-mobility in the EU, the forecasts of further growth of prices of energy, raw and other materials, and uncertainty in view of supply chain disturbances.

SUPPLY of transformers by other manufacturers — competitive pressure — is another very important risk factor for Group operations. The behavioural patterns of existing competitors and entry of new ones (particularly from Turkey, but other countries also) onto target markets of the Končar D&ST Group create a very strong competitive pressure on most target markets. The entire transformer industry has experienced considerable changes in recent years, with numerous restructurings, spin-offs and/or sales of the energy business segment in large corporations, closures or bankruptcies of existing factories, opening of new ones, takeovers, and consolidations, and these trends will continue.

RISKS ON THE PROCUREMENT MARKET were also pronounced in the business year 2022. The main challenges involved shortages and the rising prices of energy due to the war in the Ukraine. The prices of main raw and other materials used in transformer manufacture (copper, aluminium, transformer sheet, transformer oil, insulation, steel, etc.) are volatile, with significant growth in relatively short periods. In view of the options available, the Group protects itself against the risks of sudden changes to the prices of strategic raw materials in several ways. The most important manner in the past two years has been the introduction of sliding formulas for materials in sales contracts with customers. In the case of copper, the risk mitigation policy for contracts in which there is not a sliding formula is such that, since it is a raw material listed on commodity exchanges (London Metal Exchange), quantities and prices are negotiated with copper suppliers by forward contracts for future periods according to contract status and estimates. In terms of transformer sheet and other important procurement parts, semi-annual contracts with suppliers attempt to mitigate this risk and secure the required quantities. Changing prices for materials are included in calculations when drafting new product offers.

TECHNOLOGICAL AND DEVELOPMENTAL RISKS. The Group currently uses modern technologies in the manufacture of transformers and offers appropriate technical solutions for most products in its programme, and therefore is able to keep up with technical and technological development at an enviable level. In the future, it is not expected that the company will lag behind its main competitors in terms of technical and technological development.

STRATEGIC INVESTMENT AND ACQUISITION RISKS. In 2022, work in Končar D&ST Inc. intensified on the strategic investment project "Sustainable SETup for the development of environmentally and socially responsible production", and intensive support continued for the development of the company PET, Poland. This group of risks is mitigated through appropriate analyses and evaluation of potential risks, taking adequate measures to mitigate risks, and active involvement of the management board and key managers and employees in the process.

IN TERMS OF FINANCIAL RISKS, THE MOST PRONOUNCED ARE THE FOREIGN EXCHANGE RISK, CREDIT RISK, AND LIQUIDITY RISK.

FOREIGN EXCHANGE RISK is quite pronounced in the Group operations in view of the high percentage of exports and import in revenues and in view of the fact that certain monetary asset and liability items are denominated in foreign currencies. The Group protects itself from foreign exchange risk through forward contracts with banks and internal incoming and outgoing currency adjustment techniques, as well as the alignment of the state of monetary items in foreign currencies in the balance sheet.

CREDIT RISK arises as the danger that a particular debtor of the Group (e.g., customer to whom delivery is made without sufficient payment security) will not be able or willing to make payments towards the Group in accordance with the contract and that the Group will therefore have losses in write-off or diminished accounts receivable. The Group protects itself from credit risks through payment security instruments (letters of credit, guarantees, promissory notes, etc.) and an assessment of customer solvency in co-operation with external agencies that assess solvency and creditworthiness. Further, it also seeks security for accounts receivable from certain customers to be issued by specialised institutions.

LIQUIDITY RISK arises as the danger that the Group will not be able to perform its obligations towards creditors within the agreed terms. The Group has a contractual relationship with commercial banks for framework loans, which enables it to quickly overcome the current need for liquid funds, subject to known terms. Further, it collects claims with relatively long maturity periods by selling them to financial institutions (factoring, forfeiting).

MANAGEMENT AND PERSONNEL RISKS. The usual fluctuations and changes in management, leading experts, and employees do not affect significantly the operation of the Group, while sudden and more extensive fluctuations in the management, key and other employees might affect the Group's business results. The Group manages these risks actively.

In addition to the foregoing, there are also IT risks, design-construction risks, production risks, political risks, and other risk groups.

10. Investments and Technology Modernisation

During 2022, a total of HRK 57.6 million (up from HRK 20.8 million in 2021) was invested. The majority share of these funds (HRK 37.6 million) was invested in the purchase of the second half of the production hall with cutting centre. The purchased half of the hall, having an area of 4700 m2, will be set up as additional warehouse, production and administrative space, as part of the investment project "Sustainable SETup for the development of socially and environmentally responsible production" (Sustainable SETup). The Sustainable SETup project is implemented in the period from 2022 – 2024, and the aim is to normalise the existing level of project by increasing warehouse, production and administrative space, so as to achieve better flow of materials and finished projects and more efficient organisation of production processes.

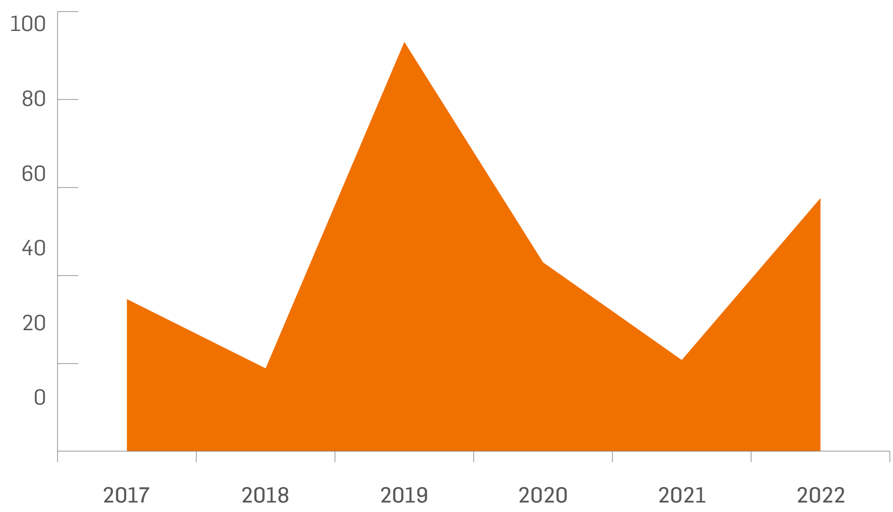
A significant investment in 2022 was the installation and commissioning of the photovoltaic plant at the end of 2022 at Končar D&ST Inc. The plant has an installation strength of 1.1 MW and is fully operational, and it is expected that it will generate one-third of the company's annual electricity demand.

In 2022, various types of special production machinery were modernised and procured.

A new machine for lateral cutting of transformer sheet was contracted for the distribution transformer product line, and its delivery is expected at the start of the Q3 2023. The installation and commissioning of this new machine will enable more stable production of distribution transformer cores, and will improve the working conditions in the Cutting centre.

Parallel with investments into production equipment, investments were made to upgrade IT equipment and to modernise computer equipment, thereby increasing the efficacy of administering the business processes and ensuring better support to the technical offices. Employee training was also implemented to raise awareness about cybernetic safety, which will contribute to raising the overall information security of the company.

Investments (HRK mil.)



11. Technical Development and Product Innovation

The technical development departments (Product Development and Production Development) employ more than 20 highly-educated experts having multidisciplinary profiles (electrical engineering, civil engineering, computer science), of whom two hold a doctoral degree, and several experts are enrolled in specialist and doctoral studies at different faculties of the University of Zagreb.

The most important development steps taken in 2022 involve the development of solutions and creation of a prototype of a transformer with improved, direct cooling, and significant progress in the area of transients, i.e., resizing insulation with regard to the peak charge load. Further, research is ongoing to seek out new solutions for noise reduction, research on biodegradable insulation fluids, and development of a programme for the design of special distribution transformers. Improvements are also being made to the existing programme for transformer design, and investments made into additional commercial programmes for the calculation of mechanical and thermal variables in transformers.

Experts in technical development and from other departments took active part in expert symposia on transformers (CIGRE Paris – large electrical energy systems, ISMA/ISAC Leuven – noise and vibration), in the work of the study committee SO A2 for transformers, and in the work of the technical committees HZN/TO E15 Rigid electrical and technical insulating materials, HZN/TO E36 Insulators, HZN/TO E55 Winding wires, HZN/TO E112 Assessment and characteristics of insulating materials and systems, and HZN/TO E10 Fluids for use in electrical engineering.

Co-operation with institutes and faculties continues (Končar — Electrical Engineering Institute Ltd.; Faculty of Electrical Engineering and Computing, University of Zagreb; Faculty of Mechanical Engineering and Naval Architecture, University of Zagreb; Technical Faculty of Poznan University of Technology in Poznan, Poland).

12. Human Resources in the Končar D&ST Group

The number of employees in the Group on 31 December 2022 was 815 (up from 750 on 31 December 2021). Among the total employees, 744 are employed at Končar D&ST Inc., and 71 at PET, Poland.

The Group systematically plans and continuously implements employee training and professional development, including university and college studies. The Group supports enrolment in graduate, postgraduate and doctoral studies, and the result is a growing number of employees studying in different faculty programmes. The approach to rewarding and promoting professional and scientific development significantly enrich Group knowledge, and strengthen ties with relevant university institutions.

13. Quality Management, Environment Management, and OH&S Management

For the purpose of maintaining its strong market position and successfully meeting its business targets, the Končar D&ST Group remains dedicated to quality, environmental protection, and the protection of occupational health and safety.

In 2022, the quality management system based on the standard ISO 9001:2015 in the company Končar D&ST was recertified, while supervisory audits were conducted of the remaining two management systems (ISO 14001:2015 and ISO 45001:2018).

In the company PET, Poland, the quality management system according to ISO 9001:2015 and the environmental protection management system according to the standard ISO 14001:20015 were audited.

14. Corporate Sustainable Responsibility

Corporate social responsibility of the Končar D&ST Group is based on a set of measures and policies and the Code of Business Conduct, aimed at achieving the mission and vision of Končar D&ST, while respecting and implementing our proclaimed values.

Within the sphere of its influence, the Group supports and implements the obligations and measures prescribed by the laws and internationally recognised standards in effect in the fields of environmental protection, business ethics, employee rights, and the protection of health and safety.

In 2022, Končar D&ST issued its second Report on Corporate Social Responsibility and Sustainability in accordance with the GRI Reporting Guidelines, within which it conducted a detailed analysis of its products and general business activities in light of the economic activities defined under the legal framework "Regulation on EU Taxonomy".

The Group plans to proceed with its reporting practice concerning sustainability and socially responsible business since decarbonisation, mitigating the consequences of climate change, and transition to a circular economy feature as the goals and strategy embraced by the Group. For that purpose, in 2022, the Group implemented several projects to calculate the carbon footprint of its products. Also, at the end of 2022, it successfully installed and commissioned the 1.1 MW photovoltaic power plant at Končar D&ST.

The special values by which the Končar D&ST Group is guided in its work are:

Quality,
Minimising its environmental impact,
Occupational safety,
Honesty and accountability for upholding its commitments,
Compliance with laws, standards, and best practices in operations,
Creating above-average business results,
Care for its employees and continued investments in their professional development,
Respect of diversity amongst employees through openness, trust and involvement in teamwork, and
Good business relations with customers and suppliers.

The Group continuously engages in initiatives to create positive changes and invests in development, professional training, minimisation of environmental impact, and community care. The Group conducts numerous activities that illustrate its dedication to corporate social responsibility and takes an active part in the life of the community in which it operates.

As an example of our ongoing green initiatives, we would like to single out our second annual cleaning effort in green areas in the eastern part of Zagreb in co-operation with the volunteer association Čisteći medvjedići ("Cleaning Teddy Bears").

In 2022, the Group supported a number of corporate social responsibility initiatives and projects. Many are just an extension of our long-standing practices, such as donations to the SOS Children's Village Croatia and Caritas, numerous rehabilitation associations and organisations for assistance and support to children with special needs and children with disabilities. In view of our sensitivity to children's needs, we have continued our cooperation with the MALI ZMAJ ("Little Dragon") Society for improving the quality of life of poor children and children without adequate parental care, which is active throughout Croatia.

Donations have also been made to support a substantial number of various associations and organisations, such as soup kitchens, sports clubs, seniors' associations, veterans' associations and student associations.

In its operation and everyday activities, the Group and its employees respect the principles of the Code of Business Conduct and the manual Corporate Culture and Communication, and practice zero tolerance towards corruption and other impermissible business practices. Members of the Management Board, employees, and business partners are aware of our zero tolerance towards corruption and they respect the said principle in their operation and activities.

15. Further Group Development Strategy

The principal business activities of the Group will continue to be development, sales, and production of distribution oil transformers up to 8 MVA and 36 kV, special transformers, and medium power transformers up to 160 MVA and 170 kV.

In the period from 2022 to 2024, the investment project "Sustainable SETup for the development of socially and environmentally responsible production" ("Sustainable SETup") is implemented at Končar D&ST. This project is aimed primarily at normalising the existing level of production and increasing warehouse space, so as to enable optimisation of several business processes and a more adequate flow of materials, raw materials, equipment and finished products.

The Končar D&ST Group will secure a high place amongst the top-ranking European producers of distribution, special, and medium power transformers by recognising and fulfilling the needs of its target buyers, partner relations with its suppliers, commitment to quality and sustainable development, technical and organisational development, and training and motivating its employees to achieve business excellence through teamwork.

Final remark: Even after the end of the 2022 business year, and to the drafting of this report, the COVID-19 pandemic has still not been formally ended, and there is a probability that in the case of unfavourable trends, this could have negative implications on future operations. Further, negative implications are possible due to the continuation and/or escalation of the war in the Ukraine, and due to supply chain disturbances, the high cost of energy, and the shortage of certain key materials on global markets. Other than the above, there were no other unusual or important business events that would significantly alter the overall operations and State of the Group as outlined 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 04 April 2023, the Supervisory Board and the Management Board of the Company have adopted the following

DECISION
ON APPROVAL OF THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR 2022

The Supervisory Board and the Management Board of Končar-D&ST Inc. have jointly adopted the Consolidated Annual Financial Statements for 2022.

Explanation

The Management Board of the Company has submitted to the Supervisory Board for approval the Consolidated Financial Statements for 2022.
The Supervisory Board has given approval to the Consolidated Financial Statements for 2022, whereby the Supervisory Board and the Management Board have jointly adopted the Consolidated Annual Financial Statements for 2022 as follows:

	000 HRK
Total income	1.933.143
Total expenses	1.747.293
Profit before taxation	185.850
Corporate income tax	11.446
Profit after taxation	174.404
Total assets	1.445.324

Gordan Kolak
President of the Supervisory Board

Vanja Burul
President of the Management Board

Zagreb, 04 April 2023

III

INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS WITH NOTES

KONČAR D&ST

Končar - Distribution and Special Transformers Inc.

Statement of Management's Responsibilities

The Management Board of the company Končar — Distribution and Special Transformers Inc. (Company) is responsible for preparing financial statements for each business year with a true and accurate presentation of the financial standing of the Company and its affiliates (together, the Group), their business results, and cash flows, in conformity with the accounting standards in effect and, at all times, it must also duly maintain accounting records required for drawing up financial statements. The Management Board holds the general responsibility for taking any and all available measures to preserve assets of the Group and to prevent and identify fraud and other irregularities.

The Management Board is responsible for:

- selecting appropriate accounting policies in accordance with the accounting standards in effect and for their consistent application,
- adopting reasonable and prudent decisions and assessments, and
- drawing up unconsolidated financial statements based on the going concern principle, unless the assumption that the Group will continue in business is inappropriate.

Having conducted research activities, the Management Board reasonably expects the Group to be in possession of adequate means to continue in business in the foreseeable future. Therefore, the Management Board continues to accepts the going concern principle in drawing up its financial statements.

The Management Board is also responsible for the preparation and content of the Report of the Management Board and the Corporate Governance Code Statement, in accordance with the Croatian Accountancy Act, and for the preparation and publication of financial statements in electronic form, drawn up in accordance with the ESEF Regulation (ESEF Financial Statements).

The Report of the Management Board, Corporate Governance Code Statement, unconsolidated ESEF Financial Statements, and the attached unconsolidated financial statements comprise the Annual Report of the Group; they were approved and signed by the Management Board on 19 April 2023 for submission to the Supervisory Board.

Vanja Burul, Management Board President

Petar Vlaić, Member

Petar Bobek, Member

Martina Mikulić, Member

Dominik Trstoglavec, Member

Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc.

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of Končar – Distribution and Special Transformers Inc. ("the Company") and its subsidiaries (together referred to as "the Group"), which comprise the consolidated statement of financial position of the Group as at 31 December 2022, and the consolidated statements of comprehensive income, cash flows and changes in equity of the Group for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

In our opinion, the accompanying financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2022 and of 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 ("EU IFRS").

Basis for Opinion

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

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Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters

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

<table>
<tr><th colspan="2">Revenue recognition</th></tr>
<tr><td colspan="2">Revenue from customer contracts for the sale of transformers recognized in profit or loss in 2021 amounts to HRK 1,914,141 thousand (2021.: HRK 1,424,351 thousand). Please refer to the notes: Significant accounting policies 2e) Revenue recognition, Key accounting estimates 3a) Revenue recognition and note 4 Revenue in the financial statements.</td></tr>
<tr><th>Key audit matter</th><th>How we addressed the matter</th></tr>
<tr><td>The Group's core activities include manufacturing and sales of distribution and special transformers.

The applicable financial reporting standard governing the accounting for revenues, IFRS 15 Revenue from Contracts with Customers, requires management to exercise judgement identifying all goods or services provided to customers and determine whether to account for each such good or service as a separate performance obligation. Given the nature of contracts with customers, this also entails consideration of whether there is a significant financing component or a separate performance obligation such as an extended warranty included in the contract.

As discussed in note 2 e), revenue is recognised at a point in time when the performance obligation relevant to the contract is executed and when control over the products and transfers to the customer which is typically upon delivery to the customer. In addition, in relation to its contracts with customers, the Group typically receives advance payments which it accounts for as contract liabilities.

Due to the above factors, accounting for revenues requires management to exercise significant judgment and making complex estimates. The area required our increased attention in the audit and was considered by us to be a key audit matter.</td><td>Our procedures performed in this area included:

• Evaluating the design and implementation of selected controls over the revenue cycle and evaluating the controls within the information technology (IT) systems that support the recording of revenue;
• Assessing the Group's policy for recognizing revenue, including considering whether the policy is in accordance with the five-step approach required by the revenue standard;
• For a sample of contracts or contract equivalents with key customers in force during the reporting period:
- challenging the Group's identification of performance obligations included therein;
- critically assessing the Group's determination of revenue recognition pattern (point-in-time vs over time) for identified performance obligations by reference to the provisions of the contracts and our understanding of the resulting pattern of satisfying related performance obligations;
- based on the results of the above procedures, critically evaluating the revenue amounts recognized by, among other things, inspecting contracts and supporting documents with particular attention paid to cut-off procedures over amounts recognised at or around the reporting date;
• For a sample of customers, obtaining external confirmations of amounts due as at the reporting date, and inquiring as to the reasons for any significant differences between the amounts confirmed and the Group's accounting records, and inspecting the underlying documentation;
• Inspecting journal entries posted to revenue accounts focusing on unusual and irregular items.
• Assessing the adequacy of disclosures regarding estimation uncertainty involved in the accounting for customer contracts.</td></tr>
</table>

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Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on the Audit of the Financial Statements *(continued)*

Key Audit Matters (continued)

Warranty provisions

Warranty provisions related to customer contracts recognised in the statement of financial position as at 31 December 2022 amounted to HRK 81,832 thousand (31 December 2021.: HRK 95,189 thousand). Please refer to the notes: Significant accounting policies 2s) Provisions, Key accounting estimates 3b) Warranty provisions and note 23 Provisions in the financial statements.

Key audit matter	How we addressed the matter
The Group's customer arrangements include product warranties given to customers granted for a period ranging from 3 to 5 years from the delivery of transformers. The product warranties primarily cover expected costs to repair or replace components with defects or functional and/or serial errors as well as financial losses suffered by the Group's customers in connection with unplanned suspension of operations. As stated in note 3b), the Group estimates general provisions for product warranties by reference to: historical costs related to product warranties; industry statistics of transformer failure incidence levels; and market experience from other transformer manufacturers. In addition, where applicable, specific risks attributable to individual customer contracts and related products (as explained in note 3b)) are taken into account when assessing the need for additional specific warranty provisions for such individual cases. The completeness and valuation of the expected outcome of warranty provisions requires a high degree of Management judgement and the use of estimates giving rise to inherent uncertainty in the amounts recorded in the financial statements. As a result, this area required our increased attention in the audit and was considered by us to be a key audit matter.	Our procedures performed in this area included: • Testing the selected controls regarding completeness of warranty provisions and how Management assesses valuation of provisions. • Challenging the assumptions underlying the valuation of provisions by reference to relevant information from customer contracts (such as warranty duration and expiry), available industry information and historical information on costs related to product warranties. • Where specific warranty provisions were recognised in relation to individual customer contracts and related products, assessing the reasonableness of warranty provisions at year-end by: - obtaining an understanding of the nature of the specific provision through interviews with management and project managers; - inspecting relevant customer contracts and warranty terms as well as source documentation such as relevant warranty claims; - inspecting correspondence with customers, where applicable; • Assessing the adequacy of disclosures regarding estimation uncertainty involved in the accounting for warranty provisions related to customer contracts.

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Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on the Audit of the Financial Statements (continued)

Other Information

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

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

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

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia ("Accounting Act"). Those procedures include considering whether:

- the Management Report has been prepared in accordance with the requirements of Articles 21 and 24 of the Accounting Act,
- the Corporate Governance Statement includes the information specified in Article 22of the Accounting Act.

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

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

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

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

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

In preparing the financial statements, management is responsible for assessing the 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.

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Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on the Audit of the Financial Statements (continued)

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal controls.
- 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 auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- 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.

Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on the Audit of the Financial Statements (continued)

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

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' 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

We were appointed by those charged with governance on 24 May 2022 to audit the consolidated financial statements of Končar – Distribution and Special Transformers Inc. for the year ended 31 December 2022. Our total uninterrupted period of engagement is three years, covering the years ending 31 December 2022, 31 December 2021 and 31 December 2020.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Company dated 4 April 2023;
- for the period to which our statutory audit relates, we have not provided any non-audit services (NASs), hence we have not provided any prohibited non-audit services referred to in Article 44 of the Audit Act. We also remained independent of the audited entity in conducting the audit.

The engagement partner on the audit resulting in this independent auditors' report is Igor Gošek.

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Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on Other Legal and Regulatory Requirements (continued)

Report on Compliance with the ESEF Regulation

In accordance with the requirements of Article 462 paragraph 5 of Capital Market Act, we are required to express an opinion on compliance of the consolidated financial statements of the Group as at and for the year ended 31 December 2022, as included in the attached electronic file "549300DOZHZICNEMG593-2022-12-31-hr.zip", with the requirements of the Commission Delegated Regulation (EU) 2019/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format (the "RTS on ESEF").

Responsibilities of Management and Those Charged with Governance

Management is responsible for the preparation of the consolidated financial statements in a digital format that complies with the RTS on ESEF. This responsibility includes:

- the preparation of the consolidated financial statements in the applicable xHTML format and their publication;
- the selection and application of appropriate iXBRL tags, using judgment where necessary;
- ensuring consistency between digitised information and the consolidated financial statements presented in human-readable format; and
- the design, implementation and maintenance of internal control relevant to the application of the RTS on ESEF.

Those charged with governance are responsible for overseeing the Group's ESEF reporting, as a part of the financial reporting process.

Auditors' Responsibilities

Our responsibility is to express a conclusion, based on evidence obtained, as to whether the consolidated financial statements comply, in all material respects, with the RTS on ESEF. We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* (ISAE 3000) issued by the International Auditing and Assurance Standards Board.

Independent Auditor's Report to the Shareholders of KONČAR – DISTRIBUTION AND SPECIAL TRANSFORMERS Inc. *(continued)*

Report on Other Legal and Regulatory Requirements (continued)

Report on Compliance with the ESEF Regulation (continued)

Work performed

A reasonable assurance engagement in accordance with ISAE 3000 involves performing procedures to obtain evidence about compliance with the RTS on ESEF. The nature, timing and extent of procedures selected depend on the auditor's judgment, including the assessment of the risks of material departures from the requirements of set out in the RTS on ESEF, whether due to fraud or error. Reasonable assurance is a high degree of assurance. However, it does not guarantee that the scope of procedures will identify all significant (material) non-compliance with the RTS on ESEF.

In respect of the subject matter, we have performed the following procedures:

- obtaining an understanding of the tagging process;
- evaluating the design and implementation of relevant controls over the tagging process;
- tracing the tagged data to the consolidated financial statements of the Group presented in human-readable format;
- evaluating the completeness of the Group's tagging of the consolidated financial statements;
- evaluating the appropriateness of the use of iXBRL elements selected from the ESEF taxonomy used and creation of extension elements where no suitable element in the ESEF taxonomy has been identified;
- evaluating the use of anchoring in relation to the extension elements; and
- evaluating the appropriateness of the format of the consolidated financial statements.

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

Conclusion

In our opinion, based on the procedures performed and evidence obtained, the consolidated financial statements of the Group as at and for the year ended 31 December 2022 presented in ESEF format and contained in the aforementioned attached electronic file, have been prepared, in all material respects, in accordance with the requirements of the RTS on ESEF.

Our conclusion does not represent an opinion on the true and fair view of the financial statements as this is included in our Report on the Audit of the Financial Statements.

KPMG Croatia d.o.o. za reviziju **19 April 2023**
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2022

	Note	2022 HRK'000	2021 HRK'000
Revenue	4	1,914,141	1,424,351
Other operating income	5	6,344	2,867
Operating income		**1,920,485**	**1,427,218**
Change in inventories of work in progress and finished goods		72,001	36,629
Materials, consumables, goods and services used	6	(1,532,206)	(1,104,391)
Personnel costs	7	(206,280)	(178,269)
Depreciation and amortisation		(30,653)	(29,749)
Other operating expenses	8	(47,528)	(31,541)
Operating expenses		**(1,744,666)**	**(1,307,321)**
Operating profit		**175,819**	**119,897**
Financial income	9	11,003	309
Financial expenses	9	(2,627)	(1,735)
Net financial result		**8,376**	**(1,426)**
Share of profit from equity accounted investee		**1,655**	**1,178**
Profit before tax		**185,850**	**119,649**
Corporate income tax	10	(11,446)	(20,307)
PROFIT FOR THE YEAR		**174,404**	**99,342**
Foreign operations – foreign currency differences		81	245
Other comprehensive income		**81**	**245**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**174,485**	**99,587**
Earnings per share (basic and diluted) in HRK	11	**341.14**	**194.32**

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

Consolidated Statement of Financial Position

for the year ended 31 December 2022

	Note	31.12.2022 HRK'000	31.12.2021 HRK'000
ASSETS			
Non-current assets			
Intangible assets	12	3,118	2,344
Property, plant and equipment	13	267,466	237,095
Right-of-use assets	14	6,286	5,876
Investment property	15	2,640	2,815
Investments in subsidiary	16	8,135	6,730
Receivables		102	24
Financial assets at FVOCI	17	2,804	2,804
Financial assets at FVTPL	25	2,886	543
Deferred tax assets		5,913	4,908
		299,350	**263,139**
Current assets			
Inventories	18	722,819	435,460
Trade and other receivables	19	352,081	197,372
Financial assets at FVTPL	25	6,397	-
Cash and cash equivalents	21	64,677	125,189
		1,145,974	**758,021**
TOTAL ASSETS		**1,445,324**	**1,021,160**
EQUITY AND LIABILITIES			
Share capital	22	153,370	153,370
Legal reserves		7,668	7,668
Statutory reserves		230,825	177,765
Other reserves		45,983	45,983
Reserves from exchange rate recalculation		(136)	(217)
Retained earnings		246,246	160,278
- from which profit for the year		*174,404*	*99,342*
EQUITY AND RESERVES		**683,956**	**544,847**
Borrowings	24	41,742	49,232
Provisions for warranty repairs	23	60,974	76,470
Other reservations	23	5,093	5,636
Non-current liabilities		**107,809**	**131,338**
Borrowings	24	139,807	13,643
Financial liabilities at FVTPL	25	-	2,054
Income tax liability		7,710	2,415
Trade and other payables	26	278,660	185,247
Contract liabilities	20	199,524	112,172
Provisions for warranty repairs	23	20,858	18,719
Provisions for onerous contracts	23	7,000	10,725
Current liabilities		**653,559**	**344,975**
Total liabilities		**761,368**	**476,313**
TOTAL EQUITY AND LIABILITIES		**1,445,324**	**1,021,160**

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

Consolidated Statement of Cash Flow

for the year ended 31 December 2022

	Note	2022 HRK'000	2021 HRK'000
Cash flows from operating activities			
Cash proceeds from trade receivables		1,840,502	1,413,107
Cash proceeds from insurance reimbursements		104	164
Cash proceeds from tax returns		66,934	37,883
Cash paid to suppliers		(1,756,934)	(1,191,634)
Cash paid to employees		(191,753)	(167,932)
Taxes paid		(25,197)	(17,930)
Cash paid for insurance related to reimbursements		(1,729)	(1,850)
Other cash proceeds and payments		(15,899)	(13,849)
Cash from operations		**(83,972)**	**57,959**
Interest paid		(1,489)	(1,121)
Net cash flows from operating activities		**(85,461)**	**56,838**
Cash flows from investment activities			
Cash proceeds from sale of non-current tangible and intangible assets		612	153
Cash proceeds from dividend		2,185	573
Cash expenses for purchase of non-current tangible and intangible assets		(57,841)	(14,751)
Net cash used in investing activities		**(55,044)**	**(14,025)**
Cash flows from financing activities			
Cash proceeds from principal portion of loans and borrowings	24	170,923	5,078
Repayment of principal portion of loans and borrowings	24	(52,718)	(5,626)
Principal portion of lease payments	24	(1,360)	(843)
Dividends paid		(35,383)	(26,274)
Other cash proceeds and payments		(1,469)	(1,543)
Net cash used in financing activities		**79,993**	**(29,208)**
Net increase/(decrease) in cash and cash equivalents		**(60,512)**	**13,605**
Cash and cash equivalents at the beginning of the period		125,189	111,584
Cash and cash equivalents at the end of the period	**21**	**64,677**	**125,189**

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

Consolidated Statement of Changes in Equity

for the year ended 31 December 2022

	Share capital HRK'000	Legal reserves HRK'000	Statutory reserves HRK'000	Other reserves HRK'000	Reserves from exchange rate recalculation HRK'000	Retained earnings HRK'000	Total HRK'000
As at 1 January 2021	**153,370**	**7,668**	**130,515**	**45,983**	**(462)**	**134,282**	**471,356**
Profit for the year	-	-	-	-	-	99,342	**99,342**
Other comprehensive income							
Reserves from exchange rate recalculation	-	-	-	-	245	-	**245**
Total comprehensive income	**-**	**-**	**-**	**-**	**245**	**99,342**	**99,587**
Transfers	-	-	47,250	-	-	(47,069)	**181**
Dividend	-	-	-	-	-	(26,277)	**(26,277)**
Total transactions with owners	**-**	**-**	**47,250**	**-**	**-**	**(73,346)**	**(26,096)**
As at 31 December 2021	**153,370**	**7,668**	**177,765**	**45,983**	**(217)**	**160,278**	**544,847**
Profit for the year	-	-	-	-	-	174,404	**174,404**
Other comprehensive income							
Reserves from exchange rate recalculation	-	-	-	-	81	-	**81**
Total comprehensive income	**-**	**-**	**-**	**-**	**81**	**174,404**	**174,485**
Transfers	-	-	53,060	-	-	(53,060)	**-**
Dividend	-	-	-	-	-	(35,376)	**(35,376)**
Total transactions with owners	**-**	**-**	**53,060**	**-**	**-**	**(88,436)**	**(35,376)**
As at 31 December 2022	**153,370**	**7,668**	**230,825**	**45,983**	**(136)**	**246,246**	**683,956**

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

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

1. General Information about the Company

Končar – Distribution and Special Transformers, Inc., Zagreb, Josipa Mokrovića 8, ("the Company") is a subsidiary of the Končar – Electrical Industry Group („the Group") where the ultimate parent company and the ultimate owner is Končar – Electrical Industry Inc., Zagreb, Fallerovo šetalište 22, and is engaged in design, production, sale and servicing of distribution, special and medium power transformers up to 160 MVA power rating and up to 170 kV voltage.

The Group consists of the Company and its wholly owned subsidiary Power Engineering Transformatory Sp. z.o.o. The principal activity of the subsidiary is the design, production, placement and servicing of medium power transformers up to 63 MVA and voltage up to 145 kV.

The Company also has a 50% interest in Elkakon d.o.o., its equity accounted investee.
As at 31 December 2022, the Group had 815 employees, while as at 31 December 2021, there had been 750 employees in the Group.

Members of the Supervisory Board

- **Gordan Kolak**, President
- **Ivan Bahun**, Member
- **Miki Huljić**, Member
- **Josip Ljulj**, Member
- **Ana-Marija Markoč**, Employee representative

Members of the Management Board

- **Vanja Burul**, President since 1 April 2021, Member until 31 March 2021
- **Ivan Klapan**, President until 31 March 2021
- **Petar Vlaić**, Member
- **Martina Mikulić**, Member
- **Petar Bobek**, Member
- **Dominik Trstoglavec**, Member from 1 April 2021

Remunerations payable to members of the Management Board and Supervisory Board are presented in Notes 8 and 28 to the financial statements.
The consolidated financial statements are expressed in thousands of kuna (HRK '000). The stated amounts are rounded to the nearest thousand HRK.

2. Significant accounting policies

The basic accounting policies used for the preparation of these financial statements are those of the Company and are explained below. These accounting policies have been consistently applied to all the years presented by all Group entities, unless stated otherwise.

BASIS OF PREPARATION

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

The financial statements have been prepared using the historical cost convention, except where otherwise stated. The financial statements have been prepared under the accrual principle on a going concern basis.

The preparation of financial statements in conformity with the International Financial Reporting Standards (IFRS) requires the use of certain critical accounting estimates. It also requires the Management Board to exercise its judgment 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 financial statements are denominated in Croatian Kuna (HRK) as the Group's functional and reporting currency.

The Group has prepared these consolidated financial statements in accordance with the Croatian laws. The Company has also prepared separate financial statements in accordance with IFRS, which were approved by the Management Board simultaneously with these consolidated financial statements.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Certain new accounting standards and interpretations have been published that are not mandatory for the reporting periods ending 31 December 2022 and that have not been early adopted by the Group in the preparation of these financial statements. Management does not expect any of these standards to have a significant impact on the financial statements of the Group.

A) BASIS FOR CONSOLIDATION

The consolidated financial statements of the Group include the financial statements of the Company and the financial statements of the companies controlled by the 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 over the entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

All intra-group transactions, balances and unrealised gains on transactions 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

The Group applies a policy of treating transactions with non-controlling interests that do not result in loss of control as equity transactions – that is, as transactions with the owners in their capacity as owners. For purchases from minority shareholders, 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..

Disposal of subsidiaries/loss of control over subsidiaries

When the Group ceases to have control, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. 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

Associate companies are companies in which the Group has between 20% and 50% of voting power 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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

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 in 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 associate. 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 value of the assets transferred, the liabilities incurred to the former owners of the acquiree 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 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.

D) 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 previously held equity interest in the acquiree 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 Group's CGUs, or groups of CGUs, that are 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 goodwill is compared to the recoverable amount, which is the higher of the value in use d the fair value less costs to sell.

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

E) REVENUE RECOGNITION

The Group recognises revenue from:

- Sales of distribution transformers
- Sales of medium power transformers
- Sales of services

The Group recognises revenue when control over particular goods or services is transferred to a customer, i.e. when a customer acquires the right to manage the transferred goods or services provided that there is an agreement that creates enforceable rights and obligations and, among other things, where collection of the consideration is probable, taking into account the credit rating of the Group's customers. The revenue is recognised in the amount of transaction price the Group expects in return for the transfer of the promised goods or services to customers.

The promised consideration includes fixed amounts

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

Sales of services: Revenue is recognised over time on a straight-line basis or as services are provided, i.e. according to the measurement of expenses incurred up to a certain date in relation to the total expected costs required for the performance of the contract obligations as described in the previous section.

Sales of goods: Revenue is recognised at a time when control of goods passes to the buyer, usually after the delivery of the goods. Invoices are issued at that time and are usually paid within the deadlines defined by the contractual provisions.

When a party to a contract with a customer meets its obligation, contracts with customers are presented as a contract liability, contract asset or receivable in the statement of financial position, depending on the relationship between the Group's performance and the customer's payment. Contract assets and liabilities are presented as short-term because they arose within the usual operating period.

Contract assets and liabilities

A contract liability is presented when a customer has paid the consideration and the Group has not transferred goods or services to the customer.

If the Group has transferred goods or services to a customer before the customer pays consideration and the Group's right to consideration is only subject to the passage of time before payment of the consideration is due, the trade receivable is recognised.

Contract assets are recognised if the right to consideration is subject to a condition (for example, performance of another obligation).

F) FINANCIAL INCOME AND EXPENSES

Finance income and expenses comprise interest on loans and borrowings calculated using the effective interest method, receivables for interest on investments, dividend income, foreign exchange gains and losses, gains and losses from financial assets at fair value through profit or loss.

Interest income is recognised in the income statement on an accrual basis using the effective interest method. Dividend income and income from share in profit is recognised in the income statement at the date when the Group's right to receive payment is established.

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

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 Group accounts for taxes in accordance with applicable law. Income tax for the year comprises current and deferred tax.

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

Deferred taxes arise from temporary differences between the carrying amounts of assets and liabilities in the financial statements and the values expressed for determination of income tax base. A deferred tax asset for unused tax losses and unused tax benefits is recognised 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.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

Tax benefit for investments

Tax benefits for investments are considered to be benefits derived from state incentive measures that enable the Company to reduce the tax liability of income tax or other specified taxes in future periods, and are related to the construction or acquisition of certain assets and/or the implementation of certain activities and/or the satisfaction of certain specific conditions prescribed by the relevant regulation for investment incentives by competent authorities. Tax benefits for investments are initially recognized as deferred tax assets and tax income/benefit in the amount lower than the maximum allowed amount of the benefit and the amount of benefit that the Group is estimated to be able to achieve during the period of the related incentive measure. Deferred tax assets recognized as a result of the tax credit for investments are cancelled during the period of the incentive measure, that is, until the end of the credit (if specified) in accordance with the availability of tax liabilities in the following years that can be reduced as a result of using the benefit.

H) SEGMENT INFORMATION

Segment represents a separable part of the Group either as a part engaged in providing products or services (business segment) or as a part engaged in providing products or services within a particular economic environment (geographical segment) that is subject to risk and benefits that differ from those of other segments. The Group does not report segment information in terms of the requirement of IFRS 8 Operating segments as internal reporting is not based on segmental information other than revenues per type product and geography as disclosed within note 4 to the financial statements.

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 of the year attributable to ordinary shareholders by weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share are calculated by dividing the profit or loss of the year 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.

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 Note 9 in net amounts (the stated amounts include foreign exchange differences from principal activities as well as foreign exchange differences on borrowings).

L) NON-CURRENT INTANGIBLE AND TANGIBLE ASSETS (PROPERTY, PLANT AND EQUIPMENT)

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 location and into the working condition for their intended use.

Non-current intangible and tangible assets are recognised if it is probable that future economic benefits attributable to 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 any accumulated impairment losses.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

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 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 in the conditions necessary for use have been met. The amortisation and depreciation of assets cease when the assets are fully amortised or depreciated 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 in preparation, over their estimated useful lives, using the straight-line method.

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

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 that those assets should be impaired. 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 estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest 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 an 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) FINANCIAL ASSETS AND LIABILITIES

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

Classification and measurement of financial assets

Financial assets are classified into three categories, depending on the selected business model for managing financial assets and the cash flow characteristics:

- financial assets carried at amortised cost,
- financial assets at fair value through other comprehensive income, and
- financial assets at fair value through profit or loss.

The business model for managing financial assets depends on how a company manages its financial assets for the purpose of generating cash flows. A reclassification of debt instruments is only possible if the business model changes. Business models for managing financial assets include:

- amortised cost model - business model the whose objective is achieved by holding financial assets in order to collect contractual cash flows (principal and interest),

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

- model of fair value through other comprehensive income - business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and
- model of fair value through profit or loss - business model whose objective is to hold financial assets for trading or for managing the financial asset on a fair value basis.

Derecognition of financial assets

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

On derecognition of financial assets at fair value through profit or loss, all gains or losses arising from the derecognition of such assets are recognised in profit or loss. On derecognition of financial assets carried at fair value through other comprehensive income (other than equity instruments classified in this category), cumulative gains or losses previously recognised in other comprehensive income are reclassified and transferred from equity to profit or loss.

On derecognition of equity instruments classified as financial assets at fair value through other comprehensive income, amounts previously recognised in other comprehensive income are not reclassified to profit or loss.

On derecognition of financial assets at amortised cost, all gains or losses arising from the derecognition are recognised in profit or loss.

Impairment of financial assets

At each reporting date, the Group recognises impairment allowances for financial assets (except at fair value through the profit or loss) using the expected credit loss model.

The expected credit losses are estimated on an individual or a portfolio level in a way that reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes, time value of money, and
- all reasonable and substantiated information that is available (without undue cost and effort) about past events, current conditions and forecasts of future conditions and circumstances.

Provisions for the impairment of trade receivables and contract assets are measured in the amount of lifetime expected credit loss allowance, i.e. by applying a simplified approach to expected credit losses.

In measuring the expected credit losses, the Group uses historical observations (over a minimum period of 3 years) on days past due with regard to the collection of receivables adjusted for estimated future expectations relating to the collection of receivables. Trade receivables are divided into portfolios depending on the rating of the customer's domicile country and age structure.

In addition to the above assets to which a simplified approach is applied, at subsequent measurement of financial assets, when determining the credit loss assessment, a general impairment approach is applied consisting of three stages: Stage 1, Stage 2 and Stage 3.

- Stage 1 - when determining the impairment of financial assets, a 12-month expected credit loss model is applied. This model applies if there is no significant increase in credit risk.
- Stage 2 - when determining the impairment of financial assets, a lifetime ECL model applies. This model applies if there is a significant increase in credit risk.
- Stage 3 - when determining the impairment of financial assets, a lifetime ECL model applies. This model applies if there is a significant increase in credit risk and there is objective evidence of impairment at the reporting date.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

For the amount of expected credit losses, the value of the financial asset is impaired and the gain or loss on the impairment is recognised in profit or loss, except for debt instruments where credit losses are recognised in profit or loss but the carrying amount is not impaired, instead revaluation reserves are recognised.

Objective evidence of impairment of financial assets for expected credit losses includes:

- significant financial difficulties of the issuer or debtor and/or
- breach of contract, such as a default or delinquency in interest or principal payments; and/or
- probability that the borrower will enter bankruptcy or financial restructuring.

The past due presumption itself is not an absolute indicator that credit risk has increased after initial recognition. The presumption that there has been a significant increase in credit risk after initial recognition due to default may be rebutted by the Group if there is reasonable and supportable information that there has been no significant increase in credit risk, but this may be an indicator of an increase in credit risk unless there is other information available.

Financial liabilities and equity instruments

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

An equity instrument is any contract that evidences a residual interest in the company's assets 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

Ordinary shares

Share capital represents the nominal value of shares issued.

Share premium includes premium at the issuance of shares. Any transaction costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity.

Reserves are stated at nominal amounts defined in the allocation from net earnings, with legal reserves, statutory reserves and other reserves stated separately.

Share capital repurchase

The consideration paid for the repurchase of the Group's equity share capital, including any directly attributable costs, is deducted from equity and reserves. Repurchased shares are classified as treasury shares and presented as a deduction from total equity and reserves. The purchase of treasury shares is recorded at cost, and the sale of treasury shares at the negotiated prices. The gain or loss from the sale of treasury shares is recognised directly in equity and reserves.

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

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate exactly discounts estimated future cash payments over the expected life of the financial instrument, or, where appropriate, a shorter period, to the gross carrying amount of the financial assets or to the amortised cost of financial liability, except for the credit loss impaired financial assets.

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

They are measured at fair value and the associated profit or loss is recognised through profit or loss, except for the changes in the fair value of the liabilities resulting from the changes in the Group's own credit risk which are recognised in other comprehensive income. The net gain or loss recognised in the income statement includes any interest paid on the financial liability.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

Derecognition of financial liabilities

A financial liability is derecognised when, and only when, it is discharged, cancelled or expires.

N) INVENTORIES

Inventories are stated at the lower of cost or net realisable value. The cost of inventories comprises all purchase costs, cost of conversion and other costs that have been 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 products 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 regardless of the level of production, such as depreciation, maintenance of factory buildings, and 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 or seasons in normal circumstances, taking into account planned maintenance. Unallocated fixed 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 for these inventories due to their aging. 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 (100%) written off when put into use.

O) RECEIVABLES

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

P) CASH AND CASH EQUIVALENTS

Cash consists of bank demand deposits, cash on hand and deposits and securities payable on demand or at the latest within a period of three months.

Q) 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.

R) LEASES

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.

Leases are recognized as right-of-use assets and corresponding liabilities as from the date from which the leased assets are available for use by the Group.

The right-of-use assets are presented separately in the statement of financial position.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

At the commencement date, lease liabilities are measured at an amount equal to the present value of the following lease payments for the underlying right-of-use assets during the lease term:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the Group under residual value guarantees;
- exercise price of a purchase option if the Group is reasonably certain to exercise that option;
- payments of penalties for terminating the lease, if the lease term reflects the Group exercising that option.

The lease payments are discounted using the interest rate implicit in the lease, if that rate can be readily determined, or using the Group's incremental borrowing rate.

Each lease payment is allocated between the liability and the finance cost. Lease liabilities are subsequently measured using the effective interest method. The carrying amount of liability is remeasured to reflect any reassessment, lease modification or revised in-substance fixed payments.

The lease term is a non-cancellable period of a lease; periods covered by options to extend and terminate the lease are included in the lease term only if it is reasonably certain that the lease will be extended or not terminated.

Right-of-use assets are measured initially at cost comprising the following:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs;
- restoration costs.

Subsequently, the right-of-use assets are measured at cost less accumulated depreciation and any accumulated impairment losses and adjusted for remeasurement of the lease liability due to reassessment or lease modifications.

The right-of-use assets are depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. The amortization periods for the right-of-use assets are as follows:

- right of use for land 3 years
- right of use for commercial buildings 5 years
- right of use for vehicles 5 years

For a contract that contains a lease component and one or more additional non-lease components, the consideration in the contract is allocated to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components. The stand-alone price shall be determined on the basis of the price the lessor, or a similar supplier, would separately charge for that component, or a similar component. Non-lease components are accounted for applying other applicable accounting policies.

Payments associated with all short-term leases and certain leases of overall low-value assets are recognized on a straight-line basis as an expense in profit or loss. The Group applies the exemption for low-value assets on a lease-by-lease basis i.e. for the leases where the asset is sub-leased, a right-of-use asset is recognized with the corresponding lease liability; for all other leases of low value asset, the lease payments associated with those leases will be recognized on a straight-line basis over the lease term.

Short-term leases are leases with a lease term of 12 months or less.

Low-value assets comprise printers.

The weighted average incremental borrowing rate applied to measure lease liabilities is 2% for buildings and 2.5% for vehicles.

Lease activities

The Group leases various properties (building (power plant), warehouse), means of transport, other small equipment (e.g. printers). Leases are negotiated on an individual basis and contain a wide range of different terms and conditions

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(including termination and renewal rights). The main lease features are summarized below

- The land is leased for a fixed period of 3 years with an option to renew the contract. The lease payments are fixed
- The building is leased for a fixed period of 5 years with an option to renew the contract. The lease payments are fixed.
- The means of transport are leased for a fixed period of 5 years.

The lease agreements do not impose any covenants, but leased assets may not be used as security for borrowing purposes.

There are no future cash outflows which the Group is potentially exposed to that are not reflected in the measurement of the lease liability. The Group does not provide any residual value guarantees.

S) PROVISIONS

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

T) EMPLOYEE BENEFITS

i. Pension obligations and post-employment benefits

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

ii. Termination benefits

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

iii. Regular retirement benefits

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

iv. Long-term employee benefits

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

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v. Short-term employee benefits

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

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 probability of an outflow is insignificant. Contingent assets are not recognised in the Group's financial statements, unless the realisation of income is certain and these assets are not contingent assets and can be recognised.

V) GOVERNMENT GRANTS

Government grants are not recognised until there is reasonable assurance that the Company will comply with the conditions attaching to them and that the grants will be received.

Government grants whose primary condition is that the Company should purchase, construct or otherwise acquire non-current assets, are recognised as deferred income in the balance sheet and released in the income statement on a systematic and appropriate basis in accordance with the useful life of that asset. Government grants are recognised as income over the periods necessary to match them with the costs (for which they are intended to compensate), on a systematic basis.

Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Company with no future related costs are recognized in profit or loss in the period in which they become receivable.

W) EVENTS AFTER THE BALANCE SHEET DATE

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. Key accounting estimates and judgments

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) Revenue recognition

The Group recognises revenue at a point in time for delivery of goods since the asset created has an alternative use because it can be sold in the area of the same or similar energy network. Revenue is recognised when a customer obtains control of specific goods, usually when the goods are delivered, when the buyer has full discretionary powers over the goods and when there are no unsatisfied performance obligations that might affect the buyer's acceptance of the goods. Delivery usually occurs when the goods are delivered to the agreed location and the risk of loss is transferred to the buyer and the buyer accepted the goods in accordance with the contractual provisions, or the terms of acceptance of the goods expired or if the Group has objective evidence that all acceptance criteria have been met.

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- *Extended warranties*

As part of its customer arrangements, the Group typically provides warranties for its products/projects performed for a period of 3 – 5 years. However, certain customer arrangements may include warranty periods which exceed those typically granted by the Group which is primarily related to contracts with customers in geographies where longer warranty periods are standard market practice. The Group nevertheless analyses contracts in which a warranty period significantly exceeds the typical warranty duration and assesses whether such warranties represent a separate performance obligation. As a result of its assessment, the Group did not identify significant contracts with extended warranties.

- *Significant financing component*

In certain contracts, the Group may agree to sell the equipment whose production may last longer than one year after the signing of the contract. Given the fact that the Group typically receives advances from customers, the period between payment by the customer and the transfer of the products to the customer may be longer than one year. In such cases, which are considered outliers, the amount received as an advance is considered a discounted transaction price. The Group analysed its contracts with customers and noted that the performance obligation in a majority of the Group's customer contracts is satisfied within one year. As a result, the Group did not identify contracts with a significant financing component..

b) Warranty provisions

The Group provides warranties for its products for an average period of 3 - 5 years. In certain cases where warranties extend past this range, the Group analysed and concluded that such contracts did not include significant non-standard guarantees which could be considered a separate performance obligation. Management estimates a general provision for warranty repairs based on historical information and industry statistics of transformer failures, specifically incidence of major transformer failure. Additionally, where circumstances are identified which carry increased risk of defects and failures, warranty provisions for such contracts are individually assessed based on those specific circumstances. Provisions are then based on current and future estimated costs of rectification of defects and/or replacement of transformers as a result of technical analyses and correspondence with customers. Factors which affect these individual provisions include information as to the success of product quality initiatives and rectifications thus far, likelihood of product replacement, as well as cost of spare parts and labour costs.

c) Provisions for onerous contracts

During the first quarter of 2021, an accelerated rise in prices is recorded in the world market for all strategic materials used in the production of transformers. This growth continued throughout entire 2022. The growth is caused by the imbalances in the world economy after the Covid-19 pandemic, the green transition policy, especially in the EU, which further stimulates demand, and the increase in demand in China. Additional complications were triggered by disorder in supply chains, which hampered the supply of inputs in production and further affected the growth of raw material prices. High inflation continued through 2022, and was further boosted by Russia's aggression against Ukraine. In order to amortize the negative consequences of these inflationary trends, the Group initiated appropriate activities towards customers. However, a number of contracts with customers signed in earlier periods remained, which did not have a built-in mechanisms for anticipating significant fluctuations in the prices of strategic raw materials through the, so-called, sliding formulas. In some of these contracts, the consent to participate in covering the cost of material growth by the customer was either not obtained or the adjustment achieved was insufficient to make the contracted revenue higher than the projected cost of fulfilling the contract. Recognition of the adverse effects of these contracts as required by IAS 37 is presented in Note 8.

d) Critical judgments in determining the lease term

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not to exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (extension option) or not terminated (termination option). The assessment of whether the Group is reasonably certain to

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exercise an extension option, or not to exercise a termination option is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and is within the control of the Group.

The lease period of a separate warehouse is classified as a short-term lease as alternative assets are easily available.

4. Revenue

	2022 HRK'000	2021 HRK'000
Type of goods or services		
Sales of distribution transformers	784,228	595,604
Sales of medium power transformers	975,164	731,095
Sales of services	154,749	97,652
Total revenue from contracts with customers	**1,914,141**	**1,424,351**
Geographic areas		
Croatia	194,776	180,009
EU member states	1,457,343	1,077,915
Bosnia & Herzegovina, Macedonia, Serbia, Montenegro	14,310	15,480
Other European countries	145,937	83,617
Africa	14,726	18,442
Asia	84,054	43,557
Other countries worldwide	2,995	5,331
Total revenue from contracts with customers	**1,914,141**	**1,424,351**
Revenue recognition time:		
At a point in time	1,914,141	1,424,351
Over time	-	-
Total revenue from contracts with customers	**1,914,141**	**1,424,351**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

5. Other operating income

	2022 HRK'000	2021 HRK'000
Rental income	2,086	208
Net profit from the sale of fixed assets	575	122
Discounts, rebates and similar	373	689
Inventory surplus	136	231
Insurance recoveries	104	164
Other income	3,070	1,453
	6,344	**2,867**

6. Materials, consumables, goods and services used

	2022 HRK'000	2021 HRK'000
Raw materials and consumables	1,317,907	945,724
Cost of goods sold	63,997	42,570
Transport services	53,315	42,781
External production related services	20,141	19,939
Maintenance and servicing	12,085	9,874
Other costs	64,761	43,503
	1,532,206	**1,104,391**

7. Personnel costs

	2022 HRK'000	2021 HRK'000
Net salaries and wages	121,464	105,126
Taxes and contributions from salaries	50,903	43,677
Contributions on salaries	26,883	24,168
Reimbursement of employee expenses, gifts and grants	7,030	5,298
	206,280	**178,269**

In 2022, pension fund contributions amounted to HRK 33,197 thousand (2021: HRK 26,262 thousand).
Personnel costs include HRK 734 thousand of retirement and termination benefits (2021. HRK 851 thousand).
The average number of employees during 2022 was 799 employees (2021: 731 employees).

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8. Other costs

	2022 HRK'000	2021 HRK'000
Staff transportation costs	5,351	4,878
Bank charges and commissions	3,657	3,531
Entertainment	3,489	2,391
Insurance	2,787	2,557
Daily allowances and business trip related costs	2,725	1,541
Premiums and benefits for voluntary pension pillar	2,094	1,957
Professional training costs	1,982	1,050
Intellectual services	1,218	1,205
Accrued expenses	712	199
Fees payable to Supervisory board members	103	85
Increase/(decrease) in provisions for jubilee awards and severance payments	(1,186)	-
Provisions for onerous contracts	(3,726)	10,725
Increase/(decrease) in provisions for warranty repairs	(851)	(15,945)
Impairment costs	13,315	1,151
Other non-production related costs	8,190	9,412
Other operating costs	7,668	6,804
	47,528	**31,541**

For details in regards with provisions for onerous contracts, please see Notes 3c) and 23 within these financial statements.

9. Net financial result

	2022 HRK'000	2021 HRK'000
Dividends and share in profits	1,935	173
Interest and similar income	-	1
Positive exchange rate differences	9,065	-
Other financial income	3	135
Total financial income	**11,003**	**309**

	2022 HRK'000	2021 HRK'000
Interest and similar expenses	2,627	1,312
Negative exchange rate differences	-	423
Total financial expenses	**2,627**	**1,735**

Net financial result	**8,376**	**(1,426)**

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10. Corporate income tax

	2022 HRK'000	2021 HRK'000
Current tax	6,885	5,064
Additional tax	5,262	-
Deferred tax	(701)	15,243
Income tax expense	**11,446**	**20,307**

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

	2022 HRK'000	2021 HRK'000
Accounting profit (before tax)	185,850	119,650
Tax at 18%	33,453	21,537
Adjustments for:		
Non-taxable income	405	407
Non-deductible expenses	(641)	(217)
Temporary differences for which no deferred tax assets were recognizes	(6,090)	338
Change in recognized deferred taxes	5,756	205
Investment tax credit utilization	(20,656)	-
Effect of tax rates in foreign jurisdictions	(1,016)	(1,751)
Share of profit of equity accounted investee	(298)	(212)
Recognition of deferred tax asset on investment tax credit	(4,729)	-
Additional tax	5,262	-
Income tax expense	**11,446**	**20,307**
Effective tax rate	6.16%	16.97%

Investment incentives

On December 23, 2021, an application was submitted to obtain the status of an incentive holder for a new project under the abbreviated name “Sustainable SETup” and on March 2, 2023, the Ministry of Economy and Sustainable Development (MINGO) issued a decision by which the Group became the holder of incentives for this project in the amount of HRK 41,171 thousand, for which the company has the possibility of reducing future income tax liabilities for the years ending December 24, 2031. Based on the assessment of the utilization of tax relief by the Management Board, the financial statements for 2022 recognized the entire approved amount of tax relief as deferred tax assets and tax income, of which HRK 36,442 thousand has already been utilised to reduce the tax liability for the current year.

The Group has not recognized deferred tax assets in the amount of approximately HRK 11.1 million (31 December 2021: HRK 11.1 million) for part of the temporary differences, as it does not expect to realize them in the foreseeable future.

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11. Earnings per share

Basic and diluted earnings per share:

	2022 HRK'000	2021 HRK'000
Net result in HRK thousands	174,404	99,342
Total and weighted average number of shares	511,232	511,232
Earnings per share	**341.14**	**194.32**

In previous years, declared dividends for ordinary and preference shares were the same. The Group does not hold any treasury shares. Diluted earnings per share for 2022 and 2021 are equal to basic earnings per share, since the Group did not have any convertible instruments or share options outstanding during either period.

12. Non-current intangible assets

	Licenses, software and other rights HRK'000	Assets under construction HRK'000	Total HRK'000
Cost			
At 1 January 2021	**14,204**	**30**	**14,234**
Additions	-	1,483	**1,483**
Transfer	1,513	(1,513)	-
Disposals and write offs	-	-	-
As at 31 December 2021	**15,717**	**-**	**15,717**
Additions	21	1,762	**1,783**
Transfer	1,139	(1,139)	**-**
Disposals and write offs	(393)	-	**(393)**
As at 31 December 2022	**16,484**	**623**	**17,107**
Accumulated amortization			
At 1 January 2021	**12,577**	**-**	**12,577**
Charge for the year	796	-	796
Disposal and write offs	-	-	-
As at 31 December 2021	**13,373**	**-**	**13,373**
Charge for the year	1,009	-	1,009
Disposals and write offs	(393)	-	(393)
As at 31 December 2022	**13,989**	**-**	**13,989**
Carrying amount			
As at 31 December 2021	2,344	-	2,344
As at 31 December 2022	**2,495**	**623**	**3,118**

The cost of intangible assets fully amortised and still in use as at 31 December 2022 amounts to HRK 10,922 thousand (31 December 2021: HRK 8,678 thousand).

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13. Property, plant and equipment

Cost	Land HRK'000	Buildings HRK'000	Plant and equipment HRK'000	Tools and furniture HRK'000	Assets under construction and advances HRK'000	Total HRK'000
At 1 January 2021	**18,836**	**212,975**	**256,946**	**35,368**	**11,341**	**535,466**
Additions	-	-	30	51	12,896	**12,977**
Transfers	-	3,178	15,370	758	(19,306)	-
Disposals and write offs	-	-	(2,553)	(638)	(593)	**(3,784)**
Exchange rate difference	(52)	69	176	(280)	(35)	(122)
As at 31 December 2021	**18,784**	**216,222**	**269,969**	**35,259**	**4,303**	**544,537**
Additions	-	-	290	-	58,858	**59,148**
Transfers	9,777	30,055	14,453	711	(54,996)	-
Disposals and write offs	-	-	(3,123)	(1,292)	-	**(4,415)**
Exchange rate difference	(29)	(206)	(41)	(6)	(43)	**(325)**
As at 31 December 2022	**28,532**	**246,071**	**281,548**	**34,672**	**8,122**	**598,945**
Accumulated depreciation						
At 1 January 2021	**36**	**94,030**	**163,438**	**24,517**	**-**	**282,021**
Charge for the year	-	8,883	16,257	2,776	-	**27,916**
Disposals and write offs	-	-	(1,859)	(636)	-	**(2,495)**
As at 31 December 2021	**36**	**102,913**	**177,836**	**26,657**	**-**	**307,442**
Charge for the year	17	9,925	16,070	2,355	-	**28,367**
Disposals and write offs	-	-	(3,038)	(1,292)	-	**(4,330)**
As at 31 December 2022	**53**	**112,838**	**190,868**	**27,720**	**-**	**331,479**
Carrying amount						
As at 31 December 2021	18,748	113,309	92,133	8,602	4,303	237,095
As at 31 December 2022	**28,479**	**133,233**	**90,680**	**6,952**	**8,122**	**267,466**

As at 31 December 2022, the net book amount of mortgaged properties amounts to HRK 113,116 thousand (31 December 2021: HRK 119,416 thousand). Mortgages have been registered over these properties in the total amount of EUR 42 million, and there is a pledge of EUR 8 million on movable assets with a net carrying amount of HRK 14,8 million (note 24).

The cost of fully depreciated tangible assets still in use as at 31 December 2021 amounts to HRK 135,665 thousand (31 December 2021: HRK 149,593 thousand). As at 31 December 2022 total advances for property, plant and equipment amounted to HRK 3,646 thousand (31 December 2021: HRK 1 thousand).

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14. Right-of-use assets

Right-of-use assets relate to the following:

	31.12.2022 HRK'000	31.12.2021 HRK'000
Plant and equipment	2,151	2,309
Buildings	1,887	2,323
Transport vehicles	1,800	1,244
Land	448	-
	6,286	**5,876**

The movement during the year is shown below:

	2022 HRK'000	2021 HRK'000
As at 1 January	5,876	5,898
Increase - new leases	1,588	1,056
Decrease – termination of leases	-	(119)
Depreciation	(1,102)	(863)
Exchange rate difference	(76)	(96)
As at 31 December	**6,286**	**5,876**

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15. Investment property

	Total HRK'000
Cost	
At 1 January 2021	**3,500**
Additions	-
As at 31 December 2021	**3,500**
Additions	-
As at 31 December 2022	**3,500**
Accumulated depreciation	
At 1 January 2021	**510**
Charge for the year	175
As at 31 December 2021	**685**
Charge for the year	175
As at 31 December 2022	**860**
As at 31 December 2021	**2,815**
As at 31 December 2022	**2,640**

The Group owns certain business premises for which the market value is estimated at around HRK 3.5 – 4.5 million.

16. Investments in associates (equity-accounted investees)

	31.12.2022 HRK'000	31.12.2021 HRK'000
Equity accounted investment		
Elkakon d.o.o., Zagreb (50% share)	8,135	6,730
	8,135	**6,730**

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The Group holds a 50% ownership share in Elkakon d.o.o., company engaged in the production of industrial conductors and a strategic and associate of the Company. The relevant financial information with respect to the equity-accounted investee is as follows:

	Elkakon d.o.o.	
	2022 HRK'000	2021 HRK'000
Income	115,634	104,898
Expenses	(111,571)	(102,004)
Profit before tax	4,063	2,894
Corporate income tax	(752)	(537)
Profit after tax	**3,311**	**2,357**
Non-current assets	10,573	8,265
Current assets	19,776	16,329
Total assets	**30,349**	**24,594**
Total liabilities	**14,079**	**11,135**

Changes in the investment in the equity-accounted investee during the year were as follows:

	Elkakon d.o.o. HRK'000
1 January 2021	**5,956**
Profit of the associate (50% share)	1,179
Profit correction	(5)
Dividend payment by the associate	(400)
31 December 2021	**6,730**
Profit of the associate (50% share)	1,655
Profit correction	-
Dividend payment by the associate	(250)
31 December 2022	**8,135**

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17. Financial assets at FVOCI

	31.12.2022 HRK'000	31.12.2021 HRK'000
Unqouted equity instruments	2,765	2,765
Other financial assets at FVOCI	39	39
	2,804	**2,804**

Fair value measurement

The fair value of investments in shares of unquoted equity instruments are measured at cost because they do not have an active market price and the fair value cannot be reliably measures. However, the Group compares the cost of these investments with a high-level valuation model based on comparable multiples to assess whether indication exist that the fair value could materially differ from cost. At the reporting date, there were no such indications.

18. Inventories

	31.12.2022 HRK'000	31.12.2021 HRK'000
Raw materials and consumables	362,214	159,459
Production work-in-progress	171,426	192,356
Finished products	160,156	67,191
Merchandise	16	386
Advances and similar	29,007	16,068
	722,819	**435,460**

19. Trade and other receivables

	31.12.2022 HRK'000	31.12.2021 HRK'000
Receivables from foreign customers	291,333	159,113
Receivables from domestic customers	39,323	18,501
Other receivables	485	785
VAT receivable	16,898	12,618
Prepayments	4,042	6,355
	352,081	**197,372**

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

	31.12.2022 HRK'000	31.12.2021 HRK'000
Not yet due	306,017	151,868
< 60 days	24,216	25,009
60-90 days	45	55
90-180 days	378	498
180-365 days	-	13
> 365 days	-	171
	330,656	**177,614**

Maximum exposure to credit risk at the balance sheet date is the carrying value of each class of receivables mentioned above. The following table explains the changes in the expected credit loss for trade receivables between the beginning and the end of the period:

	2022 HRK'000	2021 HRK'000
As at 1 January	309	495
Net change in ECLs	(2)	10
Written-off	63	(193)
Effect of change in foreign exchange rate	(2)	(3)
As at 31 December	**368**	**309**

20. Contract liabilities

	31.12.2022 HRK'000	31.12.2021 HRK'000
Contract liabilities – advances received from customers	199,524	112,172
Total contract liabilities	**199,524**	**112,172**

The recognized income in the reporting period, which was included in the balance of contractual obligations at the beginning of the period, amounts to HRK 529,957 thousand (2021: HRK 316,776 thousand).

Contractual obligations on the reporting date refer to contracts with customers with a total value of HRK 808,153 thousand (December 31, 2021: HRK 548,371 thousand), and regarding which performance obligations should be fulfilled in the next reporting period.

Advances received from customers relate to contracts with customers totalling HRK 1,003,273 thousand (31 December 2021: HRK 569,022 thousand) to be fulfilled in the following reporting period.

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21. Cash and cash equivalents

	31.12.2022 HRK'000	31.12.2021 HRK'000
Cash in bank	64,677	125,189
	64,677	**125,189**

Interest rate on the Group's cash in bank and deposits up to 3 months is from 0% - 0.001% (2021.:0% - 0.001%) . Disclosures related to credit risk are presented in Note 29 – Risk management.

22. Equity and reserves

Share capital is determined in the nominal amount of HRK 153,370 thousand (31 December 2021: HRK 153,370 thousand). The ownership structure of the Company was as follows:

	31 December 2022		31 December 2021	
Shareholder	**No of shares**	**Ownership share %**	**No of shares**	**Ownership share %**
Končar – Elektroindustrija Inc.	269,596	52.73	269,596	52.73
AZ OMF class B	28,249	5.53	27,100	5.30
Floričić Kristijan	19,832	3.88	19,832	3.88
Knežević Nikola	16,004	3.13	16,004	3.13
Berkopić Dražen	12,000	2.35	10,263	1.83
Levačić Juraj	8,255	1.61	8,255	1.61
Radić Antun	7,886	1.54	7,886	1.54
ADRIATIC OSIGURANJE Inc.	5,270	1.03	5,270	1.03
Other	144,140	28.2	147,026	28.95
	511,232	**100**	**511,232**	**100**

As at 31 December 2022 and 2021, the Company's share capital consists of 388,376 ordinary shares and 122,856 preference shares comprising a total of 511,232 shares with the nominal value of HRK 300 per share. Dividend per share paid to the Company's shareholders in 2022 amounted to HRK 69.20 (2021: HRK 51.40 per share) and totalled HRK 35,377 thousand (2021: HRK 26,277 thousand).

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

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

23. Provisions

	Warranty repairs HRK'000	Jubilee awards and retirement benefits HRK'000	Provisions for onerous contracts HRK'000	Other provisions HRK'000	Total HRK'000
As at 1 January 2021	**112,730**	**5,901**	-	-	**118,631**
Increase	12,691	62	10,725	88	23,566
Release	(29,950)	(420)	-	-	(30,370)
Exchange rate fluctuations	1	5	-	-	6
Used throughout the year	(283)	-	-	-	(283)
As at 31 December 2021	**95,189**	**5,548**	**10,725**	**88**	**111,550**
Increase	28,229	124	4,657	635	33,645
Release	(28,920)	(1,210)	(8,382)	-	(38,512)
Exchange rate fluctuations	(8)	(4)	-	(1)	(13)
Used throughout the year	(12,658)	-	-	(87)	(12,745)
As at 31 December 2022	**81,832**	**4,458**	**7,000**	**635**	**93,925**
of which:					
- non-current	60,974	4,458	-	635	**66,067**
- current	20,858	-	7,000	-	**27,858**

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 the Group and other transformer producers. The Group generally issues warranties for a period of 3 to 5 years for each transformer sold. Based on historical data regarding expenses for warranty repairs and industry statistics on transformer failure incidence rates, Management assesses and recognises a general provision for warranty repairs. The value of general provisions amounts to HRK 81.35 million (2021: HRK 65.8 million) and they increased as a result of increase in revenues and in the number of transformers delivered to customers during 2022.

In previous periods, the Group created individual reservations related to specific contracts with customers and the products. The provisions were related to several contracts for sales of products in geographies where the Group identified specific risks arising from atypical defects related to extreme climate exposures and technical complexities which are considered non-standard. The Group has formed this provision based on the expected cost of rectification of these defects and/or replacement of transformers. For two contracts where individual reservations were created, and which were active on December 31, 2021, the warranty periods expired during 2022, and they did not result in significant expenses for repairs. Consequently, the Group released all individual provisions in the total amount of HRK 28.9 million.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

Provisions for onerous contracts

Significant inflationary trends that started in 2021 resulted in provisions for onerous contracts on 31 December 2021 in the amount of HRK 10.7 million. High inflation rates continued through 2022. Part of the contracts that were identified and recognized as onerous in 2021 were realized during 2022 and provisions were released for these contracts. For the rest of the contract, the delivery of which was transferred to 2023, a reassessment of profitability was made, which resulted in the amount of HRK 7 million of unavoidable costs above the expected economic benefits.

Provisions for long-term employee benefits

The long-term portion of the provisions for termination benefits and jubilee awards in the amount of HRK 4,458 thousand (2021: HRK 5,507 thousand) relates to the estimated amount of termination benefits and jubilee awards in line with the Collective Agreement, to which Group employees are entitled at the end of their employment (either upon retirement or meeting the conditions for obtaining jubilee awards). The present value of these provisions is calculated based on the number of employees, number of years of service at the Group and the statistics of paid termination benefits and the discount rate of 3.2% (2021: 0,7%).

24. Borrowings

	31.12.2022 HRK'000	31.12.2021 HRK'000
Non-current borrowings		
Leases	2,186	2,250
Bank loans	39,556	46,982
	41,742	**49,232**
Current borrowings		
Leases	1,415	1,087
Bank loans	78,116	12,556
Other borrowings	60,276	-
	139,807	**13,643**
Total borrowings	**181,549**	**62,875**

Long term bank borrowings relate to a loan granted in April 2019 in the amount of EUR 8,000,000 with a fixed interest rate of 1.85% p.a. to finance the purchase of a property in Jankomir, procurement of new equipment and reconstruction of the property within the scope of the "Distribution Transformer Production Capacity Increase" project. Security instruments are 2 blank bills of exchange with related B/E statement, 1 ordinary debenture of EUR 8,000,000, pledge over Company property and movables based on the Security Agreement amounting to EUR 30,000,000 and EUR 8,000,000 respectively.

Short-term liabilities to banks and financial institutions refer to one loan received from Raiffeisenbank Austria Inc. in the amount of 3,000,000 euros with an interest rate of 1M euribor + 1.1%, approved in March 2022 and one loan from Zagrebačka banka Inc. in the amount of HRK 37,500,000 with a fixed interest rate of 1.95% per year approved in November 2022.

Short-term liabilities for received loans refer to two loans from Končar – Electrical Industry Inc. The first loan in the amount of EUR 3,000,000 was approved on July 19, 2022 with a fixed interest rate of 0.75% per year. On October 6, 2022, a second loan in the amount of EUR 5,000,000 was approved, also with a fixed interest rate of 0.75% per annum.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

Changes in liabilities to banks during the year are as follows:

	Loans HRK'000	Leases HRK'000	Other borrowings HRK'000	Total HRK'000
As at 1 January 2021	**60,296**	**3,524**	**988**	**64,808**
Cash receipts (borrowed)	5,078	-	-	5,078
Cash outflows (repaid)	(5,626)	(843)	-	(6,469)
Other non-monetary transactions	-	721	(988)	(267)
Foreign exchange rate changes	(210)	(65)		(275)
As at 31 December 2021	**59,538**	**3,337**	**-**	**62,875**
Cash receipts (borrowed)	65,641	-	105,282	170,923
Cash outflows (repaid)	(7,542)	(1,360)	(45,176)	(54,078)
Other non-monetary transactions	-	1,588	-	1,588
Foreign exchange rate changes	35	36	170	241
As at 31 December 2022	**117,672**	**3,601**	**60,276**	**181,549**

Non-current liabilities to banks mature as follows:

	31.12.2022 HRK'000	31.12.2021 HRK'000
up to 1 year	78,116	12,556
1 - 2 years	7,535	7,517
2 - 3 years	7,535	7,517
3 - 4 years	7,535	7,517
4 - 5 years	7,535	7,517
over 5 years	9,416	16,914
	117,672	**59,538**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

25. Financial instruments at FVTPL

	31.12.2022 HRK'000	31.12.2021 HRK'000
Derivative instruments - currency forwards	9,283	543
Financial assets at FVTPL	**9,283**	**543**
of which:		
- non-current	2,886	-
- current	6,397	-
Derivative instruments - currency forwards	-	2,054
Derivative instruments - currency forwards	**-**	**2,054**
Financial liabilities at FVTPL		
of which:	-	-
- non-current	-	2,054
- current		

During the year, the Group used forward contracts entered into with commercial banks with the intention of managing the fluctuations of foreign currencies (SEK primarily). The nominal value of currency forwards as at the reporting date amounted to HRK 300,890 thousand, with the contracts maturing in the period from 2023 to 2025. Gains and losses recognized as changes in the market value of the currency forward contracts are recorded in the statement of comprehensive income within 'Net financial result'.

26. Trade payables

	31.12.2022 HRK'000	31.12.2021 HRK'000
Payables to domestic suppliers	42,548	29,676
Payables to foreign suppliers	159,032	98,402
Payables to employees	8,120	6,421
Other taxes, contributions and fees payable	9,522	4,989
Deferred income	8,783	6,677
Unused holiday	5,509	4,869
Interest payable	372	263
Liabilities for share in profits	163	140
Other accrued costs	36,806	26,773
Other liabilities	7,805	7,037
	278,660	**185,247**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

27. Off-balance-sheet items

Off-balance sheet items as of December 31, 2022 include the following: joint guarantees issued on behalf of the PET subsidiary to banks and clients in the amount of HRK 58,516 thousand and guarantees issued on behalf of related parties in the amount of HRK 125,502 thousand. In total, the Company issued insurance instruments to related companies and third parties in the amount of HRK 1,230,568 thousand, while related companies and third parties issued insurance instruments to the Company in the amount of HRK 129,380 thousand.

Balance of the Group's transactions concluded (order book) based on active projects as of 31 December 2021 amounts to HRK 2,170 million (31 December 2021: HRK 1,316 million).

28. 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's operations. 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 arm's length conditions. In addition to sister companies within the Končar Group and the associates, the Group's related parties are the Company's Management Board and Supervisory Board.

During 2022, the Group engaged in transactions with its related parties and realised revenues and expenses based on the trade of products and services, which can be analysed as follows.

2022					**Operating activities**
Related party:	**Receivables** HRK'000	**Liabilities** HRK'000	**Advances received** HRK'000	**Revenue** HRK'000	**Expenses** HRK'000
Končar Group companies:	24,286	2,928	6,243	66,436	27,842
Končar – Electrical Industry, Inc.	-	8,111	-	13	59,378
Associates	3,559	752	-	64,028	73,295
	27,845	**11,791**	**6,243**	**130,477**	**160,515**

During 2021, 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:

2021					**Operating activities**
Related party:	**Receivables** HRK'000	**Liabilities** HRK'000	**Advances received** HRK'000	**Revenue** HRK'000	**Expenses** HRK'000
Končar Group companies:	10,570	2,686	830	31,856	19,855
Končar – Electrical Industry, Inc.	-	1,972	-	-	8,443
Associates	2,999	-	-	42,488	55,342
	13,569	**4,658**	**830**	**74,344**	**83,640**

Končar – Electrical Industry, Inc. is the ultimate parent and controlling entity of the Company.

Key management renumerations

During 2022 total remuneration of HRK 6,268 thousand (fixed and variable) was paid to Management Board of the Group (31 December 2021: HRK 6,839 thousand) which include HRK 3,175 thousand of variable remuneration for

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

2021 (in 2021 a total of HRK 2,951 thousand of variable consideration was paid relating to 2020). Accrued variable Management remuneration as at the reporting date amounts to 3,100 thousand (31 December 2021: HRK 3,500 thousand). Management Board has five members (2021.: 5 members). During 2022 Management Board of subsidiary Power Engineering Transformatory Sp. z.o.o. received total remuneration of HRK 545 thousand (2021: HRK 567 thousand). Management Board of subsidiary has three members (2021: 3 members).

29. Risk management

Capital risk management

Financial leverage ratio

	31.12.2022 HRK'000	31.12.2021 HRK'000
Debt (current and non-current) = D	(181,549)	(62,875)
Cash and cash equivalents	64,677	125,189
Net cash / (debt)	(116,872)	62,314
Equity = E	(683,956)	(544,847)
Financial leverage ratio = D/(D+E)	**20.98%**	**10.35%**

Financial risk management

The Group operates with international customers and finances its operations to an extent using foreign currency denominated borrowings. The Group's operations are therefore exposed to the following financial risks: market risk (including currency risk, interest rate risk and other price risks), credit risk and liquidity risk. Categories of financial instruments and method for measuring fair values are as follows:

	FV hierarchy	31.12.2022 HRK'000	31.12.2021 HRK'000
Equity instruments at FVOCI	Level 3	2,765	2,765
Other financial assets at FVOCI	Level 3	39	39
Total financial assets at FVOCI		**2,804**	**2,804**
Derivative instruments	Level 2	9,283	543
Total financial assets at FVTPL		**9,283**	**543**
Trade receivables	n/a	330,656	177,614
Cash and cash equivalents	n/a	64,677	125,189
Total financial assets at amortised cost		**395,333**	**302,803**
Total financial assets		**407,420**	**306,150**
Leases payable	n/a	3,601	3,337
Bank loans payable	n/a	117,672	59,538
Other loans	n/a	60,276	-
Trade payables	n/a	201,580	128,078
Total financial liabilities at amortised cost		**383,129**	**190,953**
Derivative instruments	Level 2	-	2,054
Total financial liabilities at FVTPL		**-**	**2,054**
Total financial liabilities		**383,129**	**193,007**

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

A) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value of a financial instrument is the amount at which it could be exchanged, or a liability settled, between knowledgeable and 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 such assets or liabilities
- level 2: other techniques where all inputs which have a significant effect on the fair value are observable on the market, directly or indirectly
- level 3: techniques where all inputs which have a significant effect on the fair value are not based on the observable market data.

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

Derivative financial instruments

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

In addition to investing 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

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 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) FINANCIAL INSTRUMENT RISKS

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

1. Market risk

Market risk is the fluctuation risk of fair value or future cash flows of financial instruments resulting from changes in market prices. Market risk comprises three types of risk: foreign exchange 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 measures and manages the risk.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

a) Foreign currency risk and cash flow 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 a foreign currency which is not the Group's functional currency. Foreign currencies primarily exposed to such risks are EUR and SEK. 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 hedges against currency risk through forward contracts with commercial banks with respect to all foreign currencies apart from EUR which is not considered a currency of significant risk due to the domestic monetary policy of pegging the HRK exchange rate to the EUR.

The relevant exchange rate for EUR and SEK were as follows:

	Spot exchange rate		Spot exchange rate	
	31.12.2022 HRK	31.12.2021 HRK	2022 HRK	2021 HRK
EUR	7,53450	7,51717	7,53159	7,52418
SEK	0,67745	0,73219	0,70924	0,74160

The Group's exposure to the currency risk of the specified currencies as of the reporting date is shown below. Also, an analysis of the effect of changes in relevant exchange rates on the net result was presented, except for the euro currency, considering the introduction of the euro as a functional currency on January 1, 2023.

	Denominated in EUR		Denominated in SEK	
	31.12.2022 HRK'000	31.12.2021 HRK'000	31.12.2022 HRK'000	31.12.2021 HRK'000
Trade receivable	230,526	126,272	1,496	14,579
Cash and cash equivalents	35,963	93,095	-	1,571
Leases payable	(915)	(184)	14,093	-
Bank loans payable	(69,694)	(54,499)	-	-
Other loans	(60,276)	-	-	-
Trade payables	(153,610)	(86,373)	-	(2,468)
Derivatives	9,283	(2,273)	-	-
	(8,723)	**76,038**	**15,589**	**13,682**
Effect of 1% change in exchange rates on profit	**-**	**-**	**156**	**137**

The sensitivity analysis includes outstanding balances of monetary assets and liabilities in foreign currencies recalculated at the reporting date by applying a percentage change in foreign exchange rates. A negative number indicates a decrease in profit where Croatian kuna increases against the relevant currency for the percentage specified above. For a weakening of Croatian kuna against the relevant currency in the same percentage, there would be an equal and opposite impact.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

b) Interest rate risk

The Group is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The variable interest rates currently applicable on the carrying values of floating rate debt as at the reporting dates are based on the following:

	31.12.2022 HRK'000	31.12.2021 HRK'000
Bank and other loans based on fixed interest rates	95,069	59,538
Bank and other loans based on variable interest rates	22,603	-
Leases based on fixed interest rates	60,276	-
Leases based on variable interest rates	3,601	3,337
	181,549	**62,875**

The Group analyses the exposure to interest rates at the reporting date by taking into account the effect of a reasonably possible increase in interest rates on floating rate debt on the expected contractual cash flows of such debt compared to those calculated using the interest rates applicable at the current reporting period end date. A 50 basis point increase/decrease is deemed a reasonably possible change in interest rates. The estimated effect of the reasonably possible change in variable interest rates on the result before tax is not material. The Group does not hedge against interest rate risk.

2) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group's exposure to credit risk is influenced mainly 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.

Credit risk for the Group arises primarily from trade receivables as well as other receivables and investments.

Total exposure to credit risk at the reporting date is as follows is set out in note 29 to the financial statements. The Group does not have a significant credit exposure that is not covered by security instruments, or not reflected in the estimates of indications of impairment as at the reporting dates.

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 it 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-, middle- and long-term financing and all liquidity risk requirements. The Group manages liquidity risk by continuously monitoring the anticipated and actual cash flow comparing it with the maturity of financial assets and liabilities.

Notes to the Consolidated Financial Statements

for the year ended 31 December 2022

The following table presents the maturity of financial liabilities of the Group as at 31 December 2022 in accordance with contracted undiscounted payments:

as at 31 December 2022	Net book value HRK'000	Contractual cash flows HRK'000	up to 1 year HRK'000	1 - 2 years HRK'000	2 - 5 years HRK'000	over 5 years HRK'000
Non interest bearing liabilities:						
Trade payables	**201,580**	**201,580**	201,580	-	-	-
	201,580	**201,580**	**201,580**	-	-	-
Interest bearing liabilities:						
Leases payable	**3,601**	**3,708**	1,459	1,138	1,111	-
Bank loans payable	**117,672**	**121,733**	80,142	8,223	23,818	9,550
Other loans	**60,276**	**60,383**	60,383	-	-	-
	181,549	**185,824**	**141,984**	**9,361**	**24,929**	**9,550**
	383,129	**387,404**	**343,564**	**9,361**	**24,929**	**9,550**

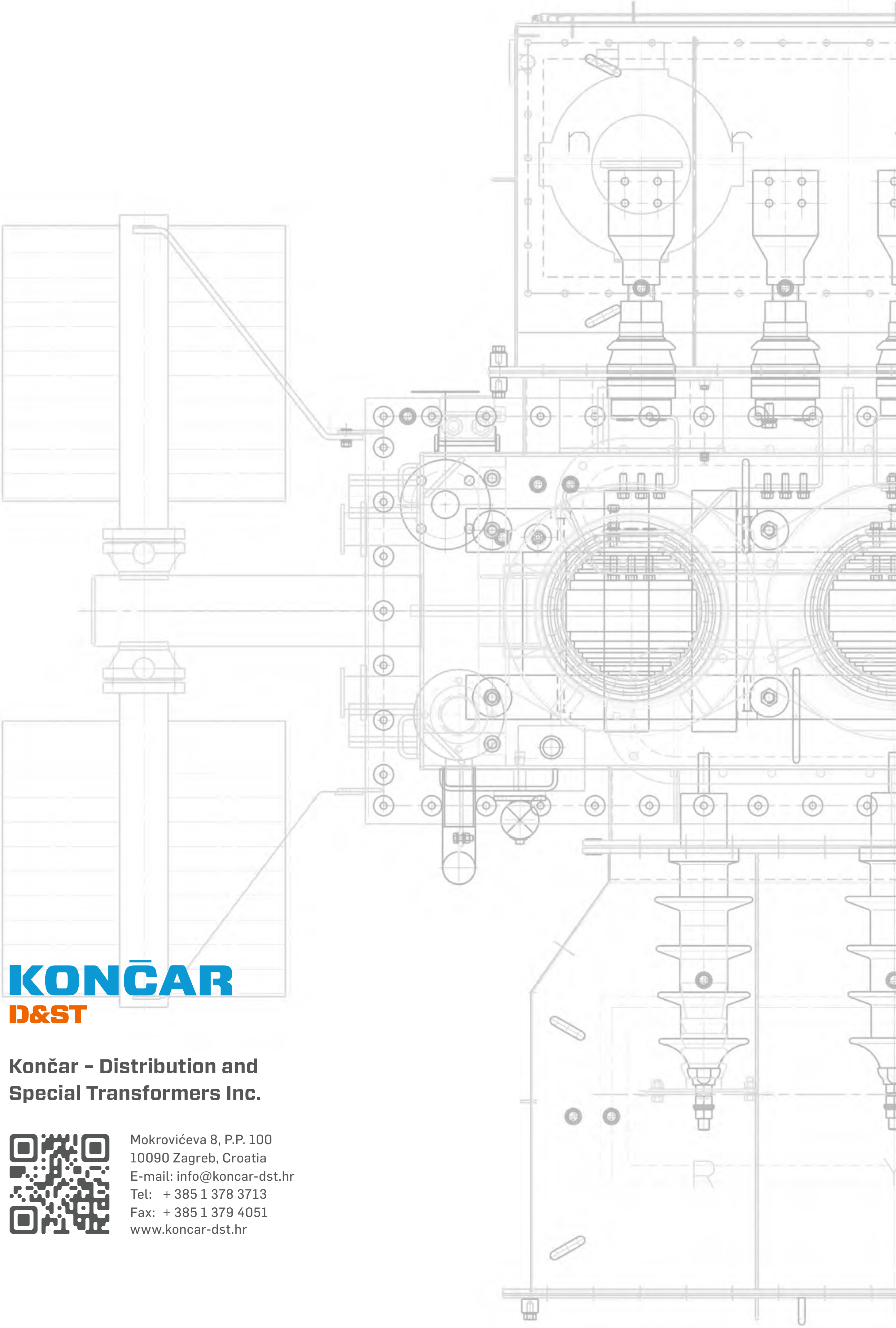
The following table presents the maturity of financial liabilities of the Group as at 31 December 2021 in accordance with contracted undiscounted payments:

as at 31 December 2021	Net book value HRK'000	Contractual cash flows HRK'000	up to 1 year HRK'000	1 - 2 years HRK'000	2 - 5 years HRK'000	over 5 years HRK'000
Non interest bearing liabilities:						
Trade payables	**128,078**	**128,078**	128,078	-	-	-
	128,078	**128,078**	**128,078**	-	-	-
Interest bearing liabilities:						
Leases payable	**3,337**	**3,421**	1,106	1,842	473	-
Loans payable	**59,538**	**63,626**	13,788	8,343	24,187	17,308
	62,875	**67,047**	**14,894**	**10,185**	**24,660**	**17,308**
	190,953	**195,125**	**142,972**	**10,185**	**24,660**	**17,308**

30. Subsequent events

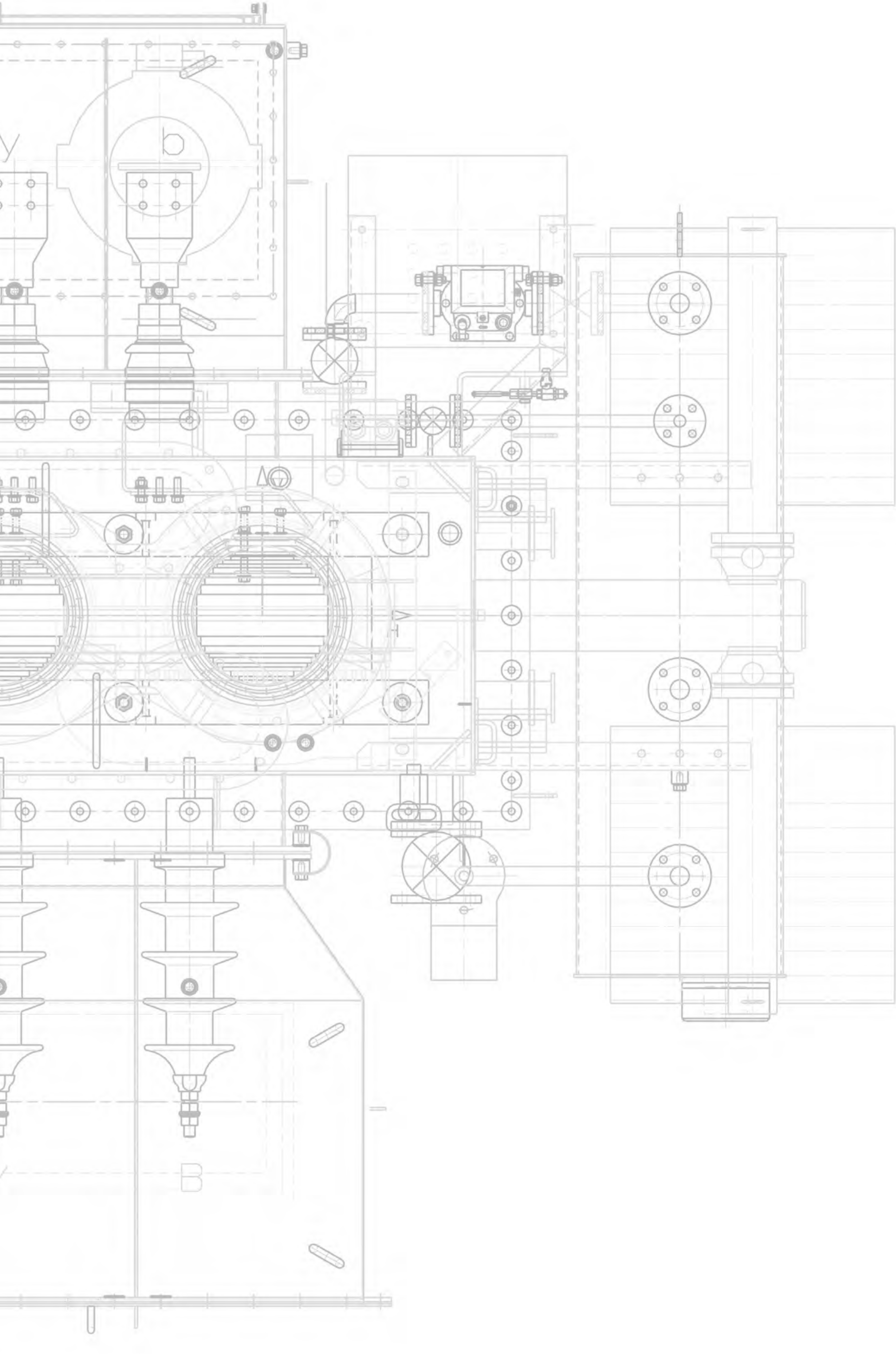
The Government of the Republic of Croatia adopted the Decision on the announcement of the introduction of the euro as the official currency in the Republic of Croatia (published in "Official Gazette" No. 85/22). With the aforementioned decision, the euro becomes the official monetary unit and legal currency in the Republic of Croatia on 1 January 2023. The fixed conversion rate is set at HRK 7.53450 for one euro. The introduction of the euro as the official currency in the Republic of Croatia represents a change in the functional currency that will be calculated prospectively and does not represent an adjusting subsequent event.

After the reporting date, until the date of approval of these financial statements, there were no other events that would have a significant impact on the Company annual accounts for 2022, which should therefore be disclosed.



Končar – Distribution and Special Transformers Inc.

Mokrovićeva 8, P.P. 100
10090 Zagreb, Croatia
E-mail: info@koncar-dst.hr
Tel: + 385 1 378 3713
Fax: + 385 1 379 4051
www.koncar-dst.hr



KONČAR
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Končar – Distribution and Special Transformers Inc.

Mokrovićeva 8, P.P. 100
10090 Zagreb, Croatia
E-mail: info@koncar-dst.hr
Tel: + 385 1 378 3713
Fax: + 385 1 379 4051
www.koncar-dst.hr

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