**ULJANIK d.d., Pula**

# CONSOLIDATED ANNUAL REPORT
# 31 DECEMBER 2016

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ULJANIK d.d.

## Responsibility for the consolidated financial statements

Pursuant to the Accounting Act of the Republic of Croatia, the Management Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards as adopted in the European Union (IFRS) and as published by the International Accounting Standards Board, which present fairly the financial position and results of ULJANIK d.d. and its subsidiaries (hereinafter: the "Group").

After making enquiries, the Management Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

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

- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

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

Signed on behalf of the Management Board:

Gianni Rossanda, Board president

Veljko Grbac, Board member

Marinko Brgić, Board member

**ULJANIK d.d.**
Flaciusova 1
Pula
Republic of Croatia

Pula, 24 April 2017

# *Independent auditor's report*

## To the shareholders and Management Board of Uljanik d.d.

## *Our qualified opinion*

In our opinion, except for the possible effects of the matters 1, 2 and 3 described in the Basis for qualified opinion section of our report, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Uljanik d.d. and its subsidiaries (the Group) as at December 31, 2016, 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 in the European Union.

**What we have audited**

Uljanik d.d. consolidated financial statements comprise:

- the consolidated statement of financial position as at December 31, 2016;
- the consolidated statement of profit or loss and other comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory notes.

## *Basis for qualified opinion*

1. As described in notes 6 and 23, the Group recognised receivables in relation to government grants amounting to HRK (Croatian kuna) 134 million (2015: HRK 170 million) at the balance sheet date and income from government grants amounting to HRK 141 million for the year ended 31 December 2016 and to HRK 136 million for the year ended 31 December 2015. In accordance with IAS 20 "Accounting for government grants and disclosure of government assistance", government grants shall not be recognised until there is reasonable assurance that the entity will comply with the conditions attached to them and the grants will be received. In the absence of the required information to enable us to assess the amount of government grants to be recognised, we were unable to satisfy ourselves as to the carrying amount of government grants receivable recognised as at 31 December 2016 and 31 December 2015, and government grants income for the years then ended.

2. Included in Trade and other receivables as at 31 December 2016 are receivables due from Government ministries and other customers amounting to HRK 53 million (2015: HRK 73 million) which are overdue for more than 120 days. Management has carried out an impairment review of these assets as at the balance sheet date to determine whether any impairment write down should be applied and has assessed these assets as recoverable. However, based on our audit procedures performed and due to existing uncertainties regarding the timely collection and expected cash flows related to these assets, we were unable to satisfy ourselves as to whether these assets are impaired, and therefore their carrying amounts as at 31 December 2016 and 31 December 2015.

3. Included in Property, plant and equipment as at 31 December 2016 are two vessels (bulk carriers) in total amount of HRK 367 million stated at the balance sheet date. The Management has carried out an internal review of these assets to determine whether the assets impaired and has assessed these assets as recoverable. However, based on our audit procedures performed and due to existing uncertainties regarding the prices which could be achieved at current market for these types of vessels, we were unable to satisfy ourselves as to whether these assets are impaired, and therefore their carrying amounts as at 31 December 2016.

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

We believe that the audit evidence, except for the matters described in 1,2 and 3 above, we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

**Independence**

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

## *Our audit approach*

**Overview**

**Materiality**

- Overall Group materiality: HRK 11.4 million, which represents 5% of Average Result before tax for the last three years (Average RBT).

**Audit scope**

- We conducted full scope audit work at 10 reporting units: (Croatian companies subject to statutory audit) in a single country.
- At Group level, we also performed specified procedures and overall analytics for 3 subsidiaries and 4 associates.
- Our audit scope addressed 95% of the Group's revenues and 90% of the Group's absolute value of underlying result.

**Key audit matters**

- Revenue recognition for ship buildings and provisions for expected losses
- Stock valuation
- Valuation and impairment of vessels (property, plant and equipment)

## How we designed audit scope

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

## Materiality

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

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

| | |
|---|---|
| ***Overall group materiality*** | HRK 11.4 million |
| ***How we determined it*** | 5% of Average result before tax (RBT), (average of last three years) |
| ***Rationale for the materiality benchmark applied*** | We chose average RBT as the benchmark because, in our view, it is a most appropriate measure for assessing the performance of the Group taking into consideration significant fluctuations in revenues, expenses and results due to long construction process, and is a generally accepted benchmark. We selected 5% based on our professional judgement, noting that it is also within the range of commonly acceptable quantitative materiality thresholds in auditing standards. |

**How we tailored our group audit scope**

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

Considering our ultimate responsibility for the opinion on the Group's consolidated financial statements we are responsible for the direction, supervision and performance of the group audit. In this context, we have determined the nature and extent of the audit procedures for components of the Group to ensure that we performed enough work to be able to give an opinion on the consolidated financial statements as a whole.

Determining factors were the geographical structure of the Group, the financial significance and/or risk profile of the Group entities and activities, the accounting processes and controls, and the industry in which the Group operates. On this basis, we selected Group entities for which an audit of financial information or specific balances was considered necessary.

In establishing our overall approach to audit the Group, we considered the significance of the components to the Group financial statements, our assessment of risk within each component, the overall coverage across the Group achieved by our procedures, as well as the risk associated with less significant components not brought into the full scope of our audit. We determined the type of work for each component that needed to be performed by us in relation to activity within Croatia where the work was performed by another firm, we determined the level of involvement we needed to have in their audit work to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole. We conducted full scope audit work at 10 reporting units: (Croatian companies subject to statutory audit) in a single country. At Group level, we also performed specified procedures for 3 components and 4 associates.

Our audit scope addressed 95% of the Group's revenues and 90% of the Group's absolute value of underlying profit.

**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 consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matters described in the Basis for qualified opinion section, we have determined the matters described below as the key audit matters to be communicated in our report.

| Key audit matter | How our audit addressed the Key audit matter |
|---|---|
| *Revenue recognition for ship buildings and provisions for expected losses*<br>*Refer to note 2.23 of the financial statements under heading "Ship construction contracts" and note 2.21 "Provisions" (accounting policies), note 4 (Critical accounting estimates) and notes 5, 23, 28 and 30*<br>We focused on recognition of revenue because there are large commercial contracts for building sophisticated and complex ships which are a significant part of the business. We also focused on this area due to significant level of estimations made by the Group's | We assessed the consistency of the application of the revenue recognition policy of the Group's revenues. Where effective and efficient, we tested the design and operating effectiveness of the controls over revenue systems across the Group to determine the extent of additional substantive testing required. We found no material misstatements nor control deficiencies from our testing.<br>In addition we have performed detailed test of major new contracts which include testing the relevant supporting documentation (Shipbuilding |

management in assessing margins and possible contract losses.

The Group is currently involved in 20 ship buildings. For 13 buildings the Management assessed that the outcome (margin) cannot be estimated reliably (due to sophisticated technical requirements) and therefore the contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. For the rest of the ship buildings revenues are recognized on the basis of stage of completion.

The customer payment milestones set in the contracts usually do not follow revenue recognition criteria in accordance with IAS 11 and involve significant amounts of advances.

As a result in the financial statements the Company presents gross amounts due from/to customers for all active projects at the balance sheet date on the basis of stage of completion.

*As disclosed in Note 23 gross amount due from customers (net) amounts to HRK 575 million thousand at the balance sheet date.*

Further, the Management assessed the level of provisions needed for expected losses on contracts as the difference between expected costs of each contact and the contracted selling price. For certain buildings, the management assessed that there are currently no indications that the contract costs will exceed contract revenues and therefore assessed that provision for losses is not needed at the balance sheet date.

*The total provision for expected losses under IAS 11 amounts to HRK 87.5 million at the balance sheet date.*

contracts, approved estimations of total contract costs, actual costs summaries, sample of invoices and timecards, analytics and similar)in relation to significant projects in the current year.

We checked that revenue had been recognised in accordance with the requirements of IAS 11 by testing a sample of transactions and comparing the timing of revenue recognition to stage of completion based on the proportion of contract costs incurred for work performed to date to estimated total contract costs. No exceptions were noted from our testing which would be reported.

In relation to provision for expected losses recognized in the current year, on the basis of provided documentation and explanation in course of our audit we found the management assessment acceptable.

Our work also included testing a sample of manual journals which did not identify any items that could not be substantiated.

We found disclosures in the financial statements in relation to the accounting for revenues, provisions for expected losses and amounts due/from customers for work performed appropriate.

*Stock valuation*

*Refer to note 2.15 of the consolidated financial statements under heading “Inventories” (accounting policies), note 4 (Critical accounting estimates) and note 22*

The valuation of stock was in focus because of the nature of the judgements made by the management when assessing the level of write downs required.

As disclosed in notes 2.15 and 4 to the consolidated financial statements, write downs are recognized in case when the management assess there is a need to reduce inventory from cost to net realisable value based on the predetermined criteria.

The Management applies a judgement to the period-end stock level in order to determine the appropriate level of write down allowance, taking into consideration the stock ageing structure, the current stock profile and need for certain materials in relation to current Orderbook (containing all contracted ship buildings).

We have obtained stock ageing structure and detailed stock analysis at the balance sheet date for the most significant stock types prepared by the Group explaining the needs and specifics for certain materials/group of materials, expectations of future consumption in relation to current Orderbook and assessment of net realisable value

| | |
|---|---|
| The calculation of net realisable value takes into account the intended use of the inventory (most inventories are used in ship buildings where production cycle lasts on average 2 to 3 years).<br>The cumulative write down account amounts to HRK 20.5 million at the balance sheet date. | at the balance sheet date.<br>We assessed this provision by testing the accuracy of the stock ageing structure on the sample basis, reviewing the detailed stock analysis and the explanations provided by management on the current profile, noting no significant issues. |
| *Valuation and impairment of vessels (property, plant and equipment)*<br>*Refer to note 2.6 of the consolidated financial statements (accounting policies) and note 15*<br>We focused on this area due to significant level of estimations made by the Group's management in assessing recoverable values of vessels.<br>The Group has two vessels (bulk carriers) with aggregate carrying values of HRK 367 million as at 31 December 2016. Following a review of the business and the outlook for the industry, management has assessed these carrying values. The Management concluded that the recoverable amount was higher than their carrying values such that no impairment provision is required.<br>These conclusions are dependent upon significant management judgement, including estimated resale value, utilisation and disposal value.<br>The Management made internal analysis of second-hand market for bulk carriers (vessels of similar type and age) and concluded that the impairment loss is not needed at the balance sheet date. | Our procedures in relation to management's impairment assessment of vessels included:<br>• Reviewing the results of subsidiaries managing the vessels<br>• Reviewing the internal analysis prepared by the Management<br>• Challenging the management related to their assessment that no impairment is needed<br>• Asking for independent appraisal for vessels, which was not obtained.<br>Since we have not been able to obtain sufficient audit evidence that the value of these vessels is not impaired at the balance sheet date the matter is qualified in our auditors' report for the year ended 31 December 2016.<br>We found the disclosures in the notes to the consolidated financial statements to be appropriate. |

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

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the [consolidated] financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's 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 consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

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The certified auditor engaged as partner on the audit resulting in this independent auditor's report is Kristina Dimitrov.

PricewaterhouseCoopers d.o.o.

Zagreb, 24 April 2017

John M Gasparac

President of the Management Board

Kristina Dimitrov

Certified auditor

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

## Consolidated statement of comprehensive income

For the year ended 31 December 2016

*(all amounts expressed in thousands of HRK)*

| | Note | 2016 | 2015 |
|---|---|---|---|
| Sales | 5 | 1,930,765 | 1,328,176 |
| Change in provisions for expected losses on new buildings and warranties | 28 | 83,989 | 181,060 |
| Government grants | 6 | 141,733 | 137,198 |
| Other income | 7 | 55,894 | 51,799 |
| Change in value of work in progress | | 19,326 | 6,182 |
| Cost of materials and services | 8 | (1,509,363) | (977,312) |
| Staff costs | 9 | (578,301) | (526,174) |
| Amortisation and depreciation | 14, 15, 16 | (65,150) | (61,062) |
| Other operating expenses | 10 | (148,558) | (121,940) |
| Other gains – net | 11 | 5,105 | 18,840 |
| **Operating (loss)/profit** | | **(64,560)** | **36,767** |
| Finance income | | 78,848 | 49,503 |
| Finance costs | | (163,064) | (153,438) |
| **Finance costs - net** | 12 | **(84,216)** | **(103,935)** |
| **Share in (loss)/profit of associates** | | **(10,723)** | **96** |
| **Loss before tax** | | **(159,499)** | **(67,072)** |
| Income tax | 13 | (13,529) | (3,509) |
| **Loss for the year** | | **(173,028)** | **(70,581)** |
| ***Other comprehensive income*** | | | |
| *Items that may be reclassified to profit or loss:* | | | |
| Exchange differences on translation of foreign operations | | 26,747 | 11,123 |
| *Items that will not be reclassified to profit or loss:* | | | |
| Gain on revaluation of equipment | | 42,521 | - |
| Income tax related to this item | | (7,654) | - |
| **Other comprehensive income, net of tax** | | **61,614** | **11,123** |
| **Total comprehensive loss** | | **(111,414)** | **(59,458)** |
| Net loss attributable to: | | | |
| The Company's owners | | (176,959) | (91,501) |
| The non-controlling interest | | 3,931 | 20,920 |
| Comprehensive loss attributable to: | | | |
| The Company's owners | | (115,345) | (80,378) |
| The non-controlling interest | | 3,931 | 20,920 |
| Loss per share (in HRK) – basic and diluted | 33 | **(54.42)** | **(28.14)** |

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

ULJANIK d.d.

Consolidated statement of financial position

As at 31 December 2016

*(all amounts expressed in thousands of HRK)*

| ASSETS | Note | 31/12/2016 | 31/12/2015 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 14 | 185,665 | 188,623 |
| Goodwill | 34 | 21,512 | - |
| Property, plant and equipment | 15 | 749,344 | 430,576 |
| Investment property | 16 | 88,719 | 89,664 |
| Investments in subsidiaries | 18 | 28 | 29 |
| Investments in associates | 18 | 254,722 | 246,094 |
| Other non-current receivables | 19 | 24,971 | 33,747 |
| Deposits and loans receivable | 20 | 362,735 | 191,437 |
| Other financial assets | | 337 | 322 |
| Financial assets at fair value through profit or loss | 21 | 1,236 | 1,113 |
| | | **1,689,269** | **1,181,605** |
| **Current assets** | | | |
| Inventories | 22 | 856,282 | 292,640 |
| Trade and other receivables | 23 | 1,418,967 | 1,094,462 |
| Deposits and loans receivable | 20 | 17,246 | 122,693 |
| Cash and cash equivalents | 24 | 103,781 | 281,678 |
| | | **2,396,276** | **1,791,473** |
| **Total assets** | | **4,085,545** | **2,973,078** |
| **EQUITY** | | | |
| Share capital | 25 | 100,688 | 100,688 |
| Capital reserves | 25 | 216,566 | 216,566 |
| Treasury shares | 25 | (4,697) | (4,697) |
| Reserves for treasury shares | | 4,700 | 4,700 |
| Other reserves | | 23,475 | 10,342 |
| Currency translation reserves | | 66,384 | 39,637 |
| Revaluation reserves | | 34,867 | - |
| Accumulated losses | | (550,510) | (371,037) |
| | | *(108,527)* | *(3,801)* |
| Non-controlling interest | 26 | 128,691 | 124,759 |
| **Total equity** | | **20,164** | **120,958** |
| **LIABILITIES** | | | |
| **Non-current liabilities** | | | |
| Trade payables | | 17,586 | - |
| Deferred tax liability | 13 | 19,537 | - |
| Borrowings | 27 | 686,603 | 651,220 |
| Provisions | 28 | 18,506 | 58,853 |
| | | 742,232 | 710,073 |
| **Current liabilities** | | | |
| Trade and other payables | 29 | 669,157 | 433,844 |
| Advances received | 30 | 1,340,963 | 873,494 |
| Borrowings | 27 | 1,220,722 | 660,495 |
| Provisions | 28 | 92,307 | 174,214 |
| | | 3,323,149 | 2,142,047 |
| **Total liabilities** | | **4,065,381** | **2,852,120** |
| **Total equity and liabilities** | | **4,085,545** | **2,973,078** |

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

ULJANIK d.d.

Consolidated statement of changes in equity

For the year ended 31 December 2016

*(all amounts expressed in thousands of HRK)*

| | Share capital | Capital reserves | Res. for treasury shares | Other reserves | Revaluation reserves | Currency trans.res. | Treasury shares | Accumulated losses | Owners' equity | Non-controlling interest | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Balance as at 1 January 2015 | 302,063 | 15,191 | 4,700 | 5 | - | 28,514 | (4,697) | (286,470) | 59,306 | 109,921 | 169,227 |
| *Loss for the year* | - | - | - | - | - | - | - | *(91,501)* | *(91,501)* | *20,920* | *(70,581)* |
| *Other comprehensive income* | | | | | | | | | | | |
| Exchange differences on translation of foreign operations | - | - | - | - | - | 11,123 | - | - | 11,123 | - | 11,123 |
| *Total comprehensive loss* | - | - | - | - | - | **11,123** | - | **(91,501)** | **(80,378)** | **20,920** | **(59,458)** |
| *Transactions with owners* | | | | | | | | | | | |
| Decrease of share capital | (201,375) | 201,375 | - | - | - | - | - | - | - | - | - |
| Transfer to reserves | - | - | - | 10,337 | - | - | - | (10,337) | - | - | - |
| Correction of error | - | - | - | - | - | - | - | 16,026 | 16,026 | - | 16,026 |
| Merger | - | - | - | - | - | - | - | (3,698) | (3,698) | - | (3,698) |
| Transactions with non-controlling interest | - | - | - | - | - | - | - | 4,942 | 4,942 | (6,081) | (1,139) |
| | *(201,375)* | *201,375* | - | *10,337* | - | - | - | *6,933* | *17,270* | *(6,081)* | *11,189* |
| **Balance as at 31 December 2015** | **100,688** | **216,566** | **4,700** | **10,342** | - | **39,637** | **(4,697)** | **(371,038)** | **(3,802)** | **124,760** | **120,958** |
| *Loss for the year* | - | - | - | - | - | - | - | *(176,959)* | *(176,959)* | *3,931* | *(173,028)* |
| *Other comprehensive income* | | | | | | | | | | | |
| Exchange differences on translation of foreign operations | - | - | - | - | - | 26,747 | - | - | 26,747 | - | 26,747 |
| Revaluation - gross | - | - | - | - | 42,671 | - | - | - | 42,671 | - | 42,671 |
| Deferred tax | - | - | - | - | (7,681) | - | - | - | (7,681) | - | (7,681) |
| Depreciation transfer - gross | - | - | - | - | (150) | - | - | - | (150) | - | (150) |
| Deferred tax | - | - | - | - | 27 | - | - | - | 27 | - | 27 |
| *Total comprehensive loss* | - | - | - | - | *34,867* | *26,747* | - | *(176,959)* | *(115,345)* | *3,931* | *(111,414)* |
| *Transactions with owners* | | | | | | | | | | | |
| Impairment reversal of receivables from subsidiares | - | - | - | - | - | - | - | 10,620 | 10,620 | - | 10,620 |
| Transfer to reserves | - | - | - | 13,133 | - | - | - | (13,133) | - | - | - |
| | - | - | - | *13,133* | - | - | - | *(2,513)* | *10,620* | - | *10,620* |
| **Balance as at 31 December 2016** | **100,688** | **216,566** | **4,700** | **23,475** | **34,867** | **66,384** | **(4,697)** | **(550,510)** | **(108,527)** | **128,691** | **20,164** |

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

| | Note | 2016 | 2015 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Loss before tax | | (159,499) | (67,072) |
| *Adjustments for:* | | | |
| Amortisation and depreciation | 14,15,16 | 65,150 | 61,062 |
| Write-off of tangible and intangible assets | | 827 | 233 |
| Impairment of receivables and loans | | - | 371 |
| Net movement in provisions | 28 | (122,254) | (221,435) |
| Fair value adjustments - receivables | | (2,897) | (5,968) |
| Fair value adjustments - shares | | (123) | 243 |
| Dividend income | | (9) | (58) |
| Interest income | | (23,598) | (2,438) |
| Interest expense | | 104,713 | 78,161 |
| Deferred taxes, exchange differences and other adjustments | | (57,128) | 5,534 |
| *Operating result before changes in working capital* | | *(194,818)* | *(151,367)* |
| Increase in trade receivables, other receivables and construction contracts | | (521,642) | (112,315) |
| Increase in inventories | | (563,642) | (4,678) |
| Decrease in trade payables, advances payable and other liabilities | | 710,182 | 469,398 |
| Cash generated from operations | | (569,920) | 201,038 |
| Interest paid | | (104,713) | (78,161) |
| Income tax paid | | (3,343) | (3,509) |
| ***Net cash (used in)/from operating activities*** | | ***(677,976)*** | ***119,368*** |
| **Cash flow from investing activities** | | | |
| Purchase of property, plant and equipment | 15 | (55,047) | (7,406) |
| Purchase of intangible assets | 14 | (5,691) | (4,601) |
| Dividend received | | 9 | 58 |
| Net movement in investments | | - | 150 |
| Loans granted | | (1,798) | (15,585) |
| Repayment of loans granted | | 2,884 | 4,125 |
| Repayment of deposit | | 232,605 | 407,086 |
| Term deposits | | (292,091) | (522,196) |
| Interest received | | 23,598 | 2,438 |
| **Net cash used in investing activities** | | ***(95,531)*** | ***(135,931)*** |
| **Cash flow from financing activities** | | | |
| Transactions with non-controlling interests | | - | (1,138) |
| Proceeds from borrowings | | 898,567 | 755,154 |
| Repayments of borrowings | | (302,957) | (566,456) |
| **Cash generated from financing activities** | | ***595,610*** | **187,560** |
| **Net increase/(decrease) in cash and cash equivalents** | | **(177,897)** | **170,997** |
| Cash and cash equivalents at beginning of year | | 281,678 | 110,681 |
| **Cash and cash equivalents at end of year** | 24 | **103,781** | **281,678** |

## NOTE 1 – GENERAL INFORMATION

The company ULJANIK d.d. was established in 1992 and is registered at the Commercial Court in Rijeka. The Company's registered office is in Pula, Flaciusova 1, Croatia. The Company's principal activities are related party management and the provision of procurement, sales, project design and financial services to subsidiaries. The Group's principal activities are building ships of a high degree of complexity and marine engines, as well as manufacturing other metal structures.

The ULJANIK Group comprises the parent company ULJANIK d.d., Pula and 11 subsidiaries. In June 2015 the parent Company purchased 230,823 ordinary shares of the company 3. MAJ Motori i dizalice d.d. representing 100% share for the consideration of 1 kuna. As of 30 November 2016 this company was merged with ULJANIK Strojogradnja d.d. into newly established company ULJANIK Strojogradnja Diesel d.d., with the effective date as of 1 December 2016.

*Supervisory and Management Board*

Supervisory Board:

Renata Kašnjar-Putar, President
Đino Šverko, Deputy president
Andrija Hren, Member
Rajko Kutlača, Member
Marko Pokrajac, Member

Management Board:

Gianni Rossanda, President of the Management Board
Veljko Grbac, Member of the Management Board
Marinko Brgić, Member of the Management Board

The Company is the parent company of the Uljanik Group (the Group) which consists of the following entities (consolidated subsidiaries):

| | **Ownership %** | |
|---|---|---|
| Name of subsidiary | **2016** | **2015** |
| ULJANIK Brodogradilište d.d., Pula | 100% | 100% |
| 3.MAJ Brodogradilište d.d., Rijeka | 85,46% | 85,46% |
| ULJANIK Strojogradnja Diesel d.d., Pula | 100% | 100% |
| ULJANIK Proizvodnja opreme d.d., Vodnjan | 100% | 100% |
| ULJANIK Poslovno informacijski sustavi d.o.o., Pula | 100% | 100% |
| ULJAIK Brodograđevni projekti d.o.o., Pula | 100% | 100% |
| ULJANIK Financije d.o.o., Pula | 100% | 100% |
| ULJANIK Standard d.o.o., Pula | 100% | 100% |
| USCS d.o.o., Pula | 100% | 100% |
| MARITIME TRANSPORT PULA THREE INC, Liberia | 100% | 100% |
| MARITIME TRANSPORT PULA FOUR INC, Liberia | 100% | - |

**NOTE 1 – GENERAL INFORMATION (CONTINUED)**

The following subsidiaries are immaterial and are not consolidated at the Group level:

| | Ownership % | |
|---|---|---|
| Name of subsidiary | **2016** | **2015** |
| 3. MAJ Motori i dizalice d.d., Rijeka | - | 100% |
| BRODO OPUS d.o.o., Pula | 100% | 100% |
| Maritime Transport Pula One Inc., Liberia | 100% | 100% |
| Maritime Transport Pula Two Inc., Liberia | 100% | 100% |
| United Shipping Services Sixteen Inc., Liberia | - | 100% |

The company 3. MAJ Motori i dizalice d.d., Rijeka has been merged with the company ULJANIK Strojogradnja Diesel d.d in accordance with the Commercial court resolution as of 30 November 2016. 3. MAJ Motori i dizalice d.d. is no longer classified as subsidiary held for disposal and has been consolidated within Uljanik group from that date. The company United Shipping Services Sixteen Inc., Liberia has been renamed into MARITIME TRANSPORT PULA FOUR INC, Liberia. In 2016 this subsidiary started with its activities and has been included in consolidated accounts.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

**2.1 Basis of preparation**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted in the EU. The financial statements have been prepared under the historical cost convention, except for financial assets at fair value through profit or loss, which are carried at fair value, as disclosed in the accounting policies.

The preparation of financial statements in conformity with International Financial Reporting Standards (IFRS) as adopted in the EU requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

These financial statements have been prepared under the assumption that the Group will be able to continue as a going concern (Note 35).

The global shipbuilding industry crisis, which has been lasting for years, is coming to an end, and 2016 and 2015 saw an increased contracting of work with particular focus on specialised sectors of the new constructions where the ULJANIK Group sees its future. The strategic orientation of the ULJANIK Group is directed towards offshore markets and the special-purpose ship markets where considerably higher revenues would be achieved, while optimising costs and achieving full employment in both shipyards which will ensure better business results from 2017 onwards.

*(a) New and amended standards, amendments and interpretations adopted by the Group*

The Group has adopted new and amended standards for their annual reporting period commencing 1 January 2016 which were endorsed by the European Union and which are relevant for the Group's financial statements:

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.1 Basis of preparation (continued)

- *Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38.*
- *Annual Improvements to IFRSs 2012-2014 Cycle comprising changes to four standards (IFRS 5, IFRS 7, IFRS 19, IAS 34).*

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

*(b) Standards, amendments and interpretations issued but not yet effective*

Certain new standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Group. None of these is expected to have significant effect on the Group's financial statements, except for the following standards:

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

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

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

Key changes to current practice are:

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

Entities will have a choice of full retrospective application, or prospective application with additional disclosures.

Management is currently assessing the impact of the new rules of IFRS 15 and has identified the following areas that are likely to be affected:

- The point of revenue recognition in the case of contracting projects without margin
- Extended warranties, which will need to be accounted for as separate performance obligations, which will delay the recognition of a portion of the revenue.

At this stage, the Group is not able to estimate the impact of the new rules on the Group's financial statements, it will make more detailed assessments of the impact over the next twelve months. The Management plans to adopt the standard on its effective date.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### 2.1 Basis of preparation (continued)

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

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting. In December 2014, the IASB made further changes to the classification and measurement rules and also introduced a new impairment model. With these amendments, IFRS 9 is now compete.

The Management of the Group assessed the impact of the new standard IFRS 9 on its financial statements as follows:

- Following the changes approved by the IASB in July 2014, the Group no longer expects any impact from the new classification, measurement and derecognition rules on the Group's financial assets and financial liabilities.
- While the Group has yet to undertake a detailed assessment of the debt instruments currently classified as available-for-sale financial assets, it would appear that they would satisfy the conditions for classification as at fair value through other comprehensive income (FVOCI) based on their current business model for these assets. Hence there will be no change to the accounting for these assets.
- There will also be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities.
- The new hedging rules align hedge accounting more closely with the Group's risk management practices. As a general rule it will be easier to apply hedge accounting going forward as the standard introduces a more principles-based approach. The new standard also introduces expanded disclosure requirements and changes in presentation.
- The new impairment model is an expected credit loss (ECL) model which may result in the earlier recognition of credit losses.
- The Group has not yet assessed how its own hedging arrangements and impairment provisions would be affected by the new rules.

The Management plans to adopt the standard on its effective date.

*IFRS 16 "Leases" (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019)*

- IFRS 16 will affect primarily lessee accounting and will result in the recognition of almost all leases on the balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.
- The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.
- Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**2.1 Basis of preparation (continued)**

- Lessor accounting will not change significantly. Some differences may arise as a result of the new guidance on the definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

At this stage, the Group is not able to estimate the impact of the new standard on the Group's financial statements, it will make more detailed assessments of the impact over the next twelve months. The Management plans to adopt the standard on its effective date and when endorsed by the European Union.

**2.2 Business combinations and goodwill**

Subsidiaries are all entities controlled by the Group. The Group controls the entity when the Group is exposed or is entitle to variable returns from its association with the entity and has the ability to influence those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the 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 on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest’s proportionate share of the recognized amounts of acquiree’s identifiable net assets. Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer’s previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through comprehensive income.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either as income or expense or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the difference between the consideration transferred and the amount of non-controlling interest in the acquiree in relation to the fair value of identified net assets acquired. If this consideration is lower than the fair value of the net assets acquired, the difference is recognized in the statement of comprehensive income.

Intercompany transactions, balances, income and expenses from transactions with Group entities are eliminated. Gains and losses from intercompany transactions recognised in assets are also eliminated. The accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**2.3 Investments in associates**

In the Group's financial statements, investments in an associate (generally a shareholding of between 20% and 50% of voting rights) where significant influence is exercised by the Group, is accounted for using the equity method less any impairment in assets. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased by the share in profit or loss after the date of acquisition. An assessment of the investment in an associate is performed when there is an indication that the asset has been impaired or that the impairment losses recognised in previous years no longer exist.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognise further losses, unless there is a legal or constructive obligation or it made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

**2.4 Segment reporting**

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

When identifying operating segments, Management primarily monitors sales of goods or the provision of services in accordance with the particular Group activities, and has identified the following operating segments: shipbuilding, engineering, manufacturing of equipment and other. Each of these operating segments are separately managed since they are determined on the basis of specific market needs. Policies of valuation/measurement used by the Group for segment reporting are the same as those used during the preparation of the financial statements. Furthermore, assets which cannot be directly attributable to certain business segments remain unallocated.

There were no changes in the valuation methods used when determining the profit/loss of an operating segment compared to the previous periods.

**2.5 Foreign currencies**

*(a) Functional and presentation currency*

Items included in the financial statements of the Group are measured using the currency of the primary economic environment in which the Group operates ('the functional currency'). The financial statements are presented in Croatian kuna (HRK), which is the Group's functional currency and presentation currency. At 31 December 2016, the exchange rate for USD 1 and EUR 1 was 7.17 HRK and 7.557 HRK, respectively (31 December 2015: HRK 6.992 and HRK 7.635 respectively). Foreign exchange gains and losses from borrowings and cash equivalents are presented within in finance costs, while all other exchange differences are recorded within Other gains/(losses) - net.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**2.5 Foreign currencies**

*(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income.

**2.6 Property, plant and equipment**

Property, plant and equipment is included in the balance sheet at historical cost less accumulated depreciation and impairment losses, where required, except for specific equipment of motor construction which is revalued starting from 1 December 2016. Revaluation model includes assessment whether specific equipment differs significantly from its fair value, and in case it does, it is adjusted to its fair value. Revaluation gain is recognized within other comprehensive income. Further losses for revalued assets are recognized in other comprehensive income up to the amount of revaluation reserve. Losses exceeding the amount of revaluation reserve are recognized in profit or loss. Historical cost includes the cost that is directly attributable to the acquisition of assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The cost of replacement of larger items of property, plant and equipment is capitalised, and the carrying amount of the replaced part is written off.

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

| | |
|---|---|
| Buildings | 10 - 40 years |
| Machinery and equipment | 4 - 20 years |
| Specific equipment for motor construction | 24 years |
| Vessels | 20 years |
| Furniture, tools and other equipment | 4 - 10 years |

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'Other gains – net' in the statement of comprehensive income.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.7 Concession on maritime domain**

For the purpose of its operations, on its location in Pula the Group uses land (326,471m2) and sea (340,400m2) areas for which it has obtained a concession from the Republic of Croatia for a period of 30 years starting from 18 January 2011.
For the purpose of its operations, on its location in Rijeka the Group uses land (303,649m2) and sea (209,165m2) areas for which it has obtained a concession from the Republic of Croatia for a period of 32 years starting from 16 September 1999.
The concessions on maritime domain are governed by the following regulations: the Maritime Code, the Seaports Act, the Decisions of the Croatian Government on the concession on maritime domain for the purpose of commercial use of special-purpose ports and the Agreement concluded between the concession grantor and the concessionaire. Under the Maritime Code, after the expiry of the concession, the concessionaire is not entitled to indemnity.
If the concessionaire has built any new objects on the maritime domain based on the concession, the concessionaire is entitled to retain any new facilities and buildings that he has built, if possible, by the nature of things and without significant damage to the maritime domain. If this is not possible, any facilities and buildings will be considered part of the maritime domain; however, the grantor may request from the concessionaire to remove any such facilities and buildings at his cost in part or in full and to restore the maritime domain to its previous condition. Buildings on the maritime domain are depreciated in line with the concession period. The Group is obliged to pay an annual fee to the concession grantor, namely the Croatian Government. The fee is charged to the statement of comprehensive income in the accounting period to which it relates. The annual fee payable by the concessionaire consists of two elements:

- a fixed element set at HRK 3.00 / m2
- a variable element set at 1% of the total revenue.

**2.8 Intangible assets**

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of up to 5 years. Intangible assets comprise leasehold improvements and are carried at cost. These costs are amortised over their estimated useful lives from 5 to 20 years.

**2.9 Investment property**

Investment property includes property held either to earn rental income or for capital appreciation or both. Investment property is initially carried at cost. The cost of investment property includes the purchase cost and all other direct costs. Investment property under construction is classified as property, plant and equipment until the construction is complete, except for land which is immediately recognised as investment property. After initial recognition, investment property is measured at cost (determined at fair value at the time of acquisition) less depreciation.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

### 2.10 Impairment of non-financial assets

At each balance sheet date, the Group reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of any impairment loss. Where it is not possible to estimate the recoverable amount of an 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 company of 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 time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately as an expense in the statement of comprehensive income.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately as income in the statement of comprehensive income.

### 2.11 Financial assets

Investments are recognised and derecognised on the trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the time frame established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through the statement of comprehensive income, which are initially measured at fair value.

Financial assets are classified into the following categories: financial assets ‘at fair value through profit or loss’, financial assets ‘available for sale’ and ‘loans and receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

*Effective interest method*

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

Income is recognised on an effective interest basis for debt instruments other than those financial assets designated as at FVTPL.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.11 Financial assets

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

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset. Fair value is determined in the manner described in Note 3.3.

*b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. The Group's loans and receivables comprise "trade and other receivables", "deposits" and "cash and cash equivalents" in the balance sheet.

Loans and receivables are carried at amortised cost using the effective interest method.

*Impairment of financial assets*

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions and references to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired.

A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivables are impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision and subsequent recoveries of amounts previously written off are recognised in the income statement within 'other operating expenses'.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 2.11 Financial assets (continued)

*Derecognition of financial assets*

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

If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Company continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

### 2.12 Leases

Leases where the significant portion of risks and rewards of ownership are not retained by the Group are classified as operating leases. Assets leased out under operating leases are included in the balance sheet under ‘investment property’. Lease income is recognised in the statement of comprehensive income on a straight-line basis over the period of the lease.

### 2.13 Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivables are impaired. The amount of the provision is the difference between the asset’s carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision less subsequent recoveries of amounts previously written off is recorded in the statement of comprehensive income within 'other operating expenses'.

### 2.14 Cash and cash equivalents

Cash comprises cash held at banks and on hand. Cash equivalents include demand deposits and term deposits with original maturities up to three months.

### 2.15 Inventories

Inventories of materials and spare parts are stated at the lower of cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Cost is determined using the weighted average cost method. Small inventory and tools are stated at cost less impairment. Slow-moving stock is expensed on the basis of the Management's estimate.

The cost of finished goods and work in progress comprises raw materials, direct labour, subcontracting, other cost of material and those attributable to manufacturing, borrowing costs and the corresponding production overheads. Borrowing costs that are directly attributable to the construction or production of an asset are included in the cost of that asset. Borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

### 2.16 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are stated net of transaction costs incurred.

### 2.17 Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the regular operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

### 2.18 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.

Borrowing costs directly attributable to the acquisition or construction of qualifying assets are capitalised during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are charged to the statement of comprehensive income. The Group capitalises interest costs in inventory.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

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 balance sheet date.

### 2.19 Current and deferred income tax

*Current tax*

The current tax liability is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company’s liability for current tax is calculated using tax rates that have been enacted by the balance sheet date.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.19 Current and deferred income tax (continued)**

*Deferred tax*

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method.

Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised

Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the amount at which the Company expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

*Current and deferred tax for the period*

Deferred tax is recognised as an expense or income in profit or loss, except when it relates to items credited directly to other comprehensive income, in which case the deferred tax is also recognised in other comprehensive income, or where they arise from the initial accounting for a business combination.

In the case of a business combination, the tax effect is taken into account in calculating goodwill or in determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

**2.20 Employee benefits**

*(a) Pension obligations and post-employment benefits*

In the normal course of business through salary deductions, the Group makes payments to mandatory pension funds on behalf of its employees as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred. The Group does not have any other pension scheme and consequently, has no other obligations in respect of employee pensions.

*(b) Long-term employee benefits*

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

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.20 Employee benefits (continued)**

*(c) Short-term employee benefits*

The Group recognises a liability for bonuses where contractually obliged or where there is a past practice that has created a constructive obligation. In addition, the Group recognises a liability for accumulated compensated absences based on unused vacation days at the balance sheet date.

**2.21 Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense. This increase is stated under "other operating expenses".

**2.22 Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown, net of value-added tax, estimated returns, rebates and discounts. The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below.

*(a) Sales of products and services*

*Sales of goods/products*

Sales of goods/products are recognised when the Group has delivered the products to the end customer, and there is no unfulfilled obligation that could affect the customer's acceptance of the products.

*Sales of services*

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. The stage of completion is measured on the basis of realised costs until the end of the reporting period as a percentage of total estimated costs separately for each contract, i.e. project. The typical duration of services provision is up to one month.

If circumstances arise that may change the original estimate of revenues, costs or extent of progress toward completion estimates are revised.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.22 Revenue recognition (continued)**

These revisions may result in an increase or decrease in estimated revenues or costs and are reflected in income in the period in which the circumstances that give rise to revision become known to management.

Revenue recognition for long-term ship and engine construction contracts is discussed in accounting policy 2.23 – Ship construction contracts.

*(b) Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method.

**2.23 Ship construction contracts**

Ship construction contract costs are recognised when incurred.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. The Group accounts for such expected losses within "Provisions".

The Group uses the percentage of completion method to determine the appropriate amount of revenues and costs to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract.

Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories (as work in progress), prepayments or other assets, depending on their nature. Contract work in progress is stated at actual cost. Actual cost includes both direct and indirect costs of production. Indirect costs of production, such as depreciation, maintenance cost, energy and administrative costs of production lines are allocated to contract work in progress in proportion to actual labour hours.

The Group presents as an asset (amounts due from customer for contract work) the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses, but excluding provisions for expected losses which are accounted for within “Provisions”) exceed progress billings.

The Group presents as a liability (amounts due to customer for contract work) the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses, but excluding provisions for expected losses which are accounted for within “Provisions”).

**2.24 Government grants**

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

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 Group with no future related costs are recognized in profit or loss in the period in which they become receivable.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**2.24 Government grants (continued)**

The Group recognises revenue from government grants for restructuring in the period in which the grant was received and which can be demonstrated to have appropriately implemented the restructuring measures for which the grant was given.

**2.25 Mutual cancellations and other non-cash settlements**

A portion of receivables and liabilities are settled by mutual cancellations and other non-cash settlements including debt instruments such as promissory notes and bills of exchange. Sales and purchases that are expected to be settled as stated are performed at fair value.

**2.26 Value added tax**

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

**2.27 Earnings/(loss) per share**

The Group presents basic and diluted earnings/(loss) per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period decreased by treasury shares. Diluted earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period decreased by treasury shares and potential shares arising from realised options.

**NOTE 3 – FINANCIAL RISK MANAGEMENT**

**3.1 Financial risk factors**

The Group's activities expose them to a variety of financial risks: market risk (including currency risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Group does not have a written risk management programme, but overall risk management in respect of these risks is carried out by the Group's Management/Finance department.

*(a) Market risk*

*(i)Foreign exchange risk*

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar (USD) and the Euro (EUR) and due to its foreign currency balance sheet gap. About 22% of assets (2015: 24%) and 49% of liabilities (2015: 45%) are denominated in foreign currencies. Movements in exchange rates between the US dollar, EUR and Croatian kuna (HRK), therefore, have an impact on operating results. The Group does not actively hedge its exposure to foreign exchange risk.

**NOTE 3 – FINANCIAL RISK MANAGEMENT**

**3.1 Financial risk factors (continued)**

At 31 December 2016, if the EURO had weakened/strengthened by 1% against the HRK (2015: 1%), with all other variables held constant, the profit/loss for the reporting period would have been HRK 11,973 thousand (2015: HRK 6,674 thousand) higher/(lower), mainly as a result of foreign exchange gains/(losses) on translation of EURO-denominated borrowings, trade receivables, amounts due from customers for construction contracts, trade and other payables and foreign cash funds.

At 31 December 2016, if the USD had weakened/strengthened by 5% (2015: 5%) against the HRK, with all other variables held constant, the profit/(loss) for the reporting period would have been HRK 5,503 thousand (2015: HRK 4,809 thousand) higher/(lower), mainly as a result of foreign exchange gains/(losses) on translation of USD-denominated borrowings, trade receivables, amounts due from customers for construction contracts, trade and other payables and foreign cash funds.

(ii) Cash flow and fair value interest rate risk

The Group’s interest rate risk arises from long-term borrowings (Note 27). Borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group does not use derivative instruments to actively hedge cash flow and fair value interest rate risk exposure.

At 31 December 2016, if interest rates on currency-denominated borrowings had been 1% higher/lower (2015: 1%), with all other variables held constant, the result for the year would have been HRK 14,623 thousand (2015: HRK 11,379 thousand) lower/higher, mainly as a result of higher/lower interest expense on variable-rate borrowings.

(iii) Commodity price risk

The Group is exposed to the risk of changes in steel prices on the global market because it uses various steel profiles and steel products in the construction of ships.

At 31 December 2016 and 2015, if the steel prices would have increased/decreased by 5% (2015: 5%), with all other variables held constant, the result for the year would have been HRK 11,447 thousand (2015: HRK 7,872 thousand) lower/higher as a result of increased/decreased costs of materials in ferrous metallurgy.

*(b) Credit risk*

The Group’s assets subject to credit risk, primarily include cash, trade and other receivables. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history, within previously defined credit limits. Credit risk with respect to loan receivables is limited due to the fact that most loans are granted to employees. Provisions for impairment of trade and other receivables have been made based on credit risk assessment. Management monitors the collectability of receivables through monthly reports on individual balances of receivables. The amount of all trade and other receivables has been written down to their recoverable amount. Credit risk with respect to loan receivables is minimal. The Group has policies that limit the amount of credit exposure to any financial institution. A detailed analysis and maximum exposure to credit risk are shown in Note 17. Furthermore, estimates and assumptions related to credit risk and impairment of loans and receivables are set out in detail in Note 4.

**NOTE 3 – FINANCIAL RISK MANAGEMENT**

### 3.1 Financial risk factors (continued)

*(c) Liquidity risk*

The table below analyses the Company's financial liabilities at the reporting date according to contracted maturities. The amounts disclosed in the table are the contractual undiscounted cash flows.

| | Up to 1 year | 1-2 years | 2-5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| **At 31 December 2016** | | | | | |
| Trade and other payables | 451,732 | - | - | - | 451,732 |
| Borrowings | 1,313,380 | 733,921 | 718 | - | 2,048,019 |
| **At 31 December 2015** | | | | | |
| Trade and other payables | 236,638 | - | - | - | 236,638 |
| Borrowings | 722,283 | 667,692 | 7,256 | - | 1,397,231 |

### 3.2 Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend paid to the shareholders, return capital to the shareholders, issue new shares or sell assets to reduce debt.

The calculation of the gearing ratio at the reporting date is shown in the table below:

| | 31 December 2016 |
|---|---|
| Borrowings | 1,907,325 |
| Less: Cash and cash equivalents | (103,781) |
| Net debt | **1,803,544** |
| Equity | (108,527) |
| Capital and net debt | 1,695,017 |
| **Gearing ratio** | **106.40** |

| | 31 December 2015 |
|---|---|
| Borrowings | 1,311,715 |
| Less: Cash and cash equivalents | (281,678) |
| Net debt | **1,030,037** |
| Equity | (3,801) |
| Capital and net debt | 1,026,236 |
| **Gearing ratio** | **100.37** |

**NOTE 3 – FINANCIAL RISK MANAGEMENT**

**3.3 Fair value estimation**

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. Quoted market prices for similar instruments are used for long-term debt. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

The disclosure of fair value measurements was performed by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The table below present the Group's assets at fair value as at 31 December 2016 and 2015:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **At 31 December 2016** | | | | |
| Listed companies | 1,236 | - | - | 1,236 |
| **Total** | **1,236** | **-** | **-** | **1,236** |
| **At 31 December 2015** | | | | |
| Listed companies | 1,113 | - | - | 1,113 |
| **Total** | **1,113** | **-** | **-** | **1,113** |

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

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

**NOTE 4 – CRITICAL ACCOUNTING ESTIMATES**

Estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the 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.

## NOTE 4 – CRITICAL ACCOUNTING ESTIMATES (CONTINUED)

*a) Impairment of receivables and loans*

The Group reviews on a yearly basis its loans and receivables portfolio to assess impairment. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable impairment in the estimated future cash flows from a portfolio of loans and receivables before the impairment can be identified with an individual loan or receivable in that portfolio.

*b) Recognition of revenue from construction*

The Group uses the percentage-of-completion method to determine the appropriate amount of income from construction contracts for a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. If the stage of completion had increased by 10%, the Group's revenues for 2016 would have increased by HRK 73,062 thousand (2015: HRK 50,692 thousand), whereas if the stage of completion would have decreased by 10%, the Group's revenues would have decreased by HRK 79,121 thousand (2015: HRK 70,269 thousand).

*c) Expected losses on new-buildings*

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Expected losses represent the difference between the estimated expected cost of each contract and the selling price. In 2016, Management estimated expected losses both for contracts on which work has started and those on which it has not yet started in the amount of HRK 29,063 thousand.

If the level of planned expenses had increased by 10%, the Group's expected losses for 2016 would have increased by HRK 10,991 thousand (2015: HRK 111,698 thousand), whereas if planned expenses had decreased by 10%, the Group's expected losses would have decreased by HRK 10,991 thousand (2015: HRK 111,698 thousand).

*d) Legal claims and disputes*

Provisions for legal claims and disputes are recorded based on Management's best estimate of probable losses after consultation with legal counsel.

**NOTE 5 – SEGMENT INFORMATION AND SALES**

The segment information for the year ended 31 December 2016 is as follows:

| | Shipbuilding | Engineering | Manufacturing of equipment | Other | Intra-group transactions | Total Group |
|---|---|---|---|---|---|---|
| Sales | 2,242,308 | 106,513 | 50,021 | 76,828 | (544,905) | 1,930,765 |
| Operating loss | (115,496) | (15,357) | (459) | (18,952) | 85,704 | (64,560) |
| Net finance income/(costs) | (75,936) | 2,555 | (148) | (8,229) | (2,458) | (84,216) |
| Losses of associates - net | - | - | - | - | (10,723) | (10,723) |
| Result before taxation | (191,433) | (12,802) | (607) | (27,181) | 72,524 | (159,499) |
| Income tax | (13,481) | - | - | (48) | - | (13,529) |
| Net loss | (204,914) | (12,802) | (607) | (27,229) | 72,524 | (173,028) |

The segment information for the year ended 31 December 2015 is as follows:

| | Shipbuilding | Engineering | Manufacturing of equipment | Other | Intra-group transactions | Total Group |
|---|---|---|---|---|---|---|
| Sales | 1,447,200 | 52,524 | 36,678 | 60,720 | (268,946) | 1,328,176 |
| Operating income | 39,851 | (17,654) | (1,470) | (15,081) | 31,121 | 36,767 |
| Net finance income/(costs) | (126,616) | (532) | (345) | (5,292) | 28,850 | (103,935) |
| Losses of associates | - | - | - | - | 96 | 96 |
| Result before taxation | (86,765) | (18,186) | (1,815) | (20,373) | 60,067 | (67,072) |
| Income tax | (3,421) | - | - | (88) | - | (3,509) |
| Net loss | (90,186) | (18,186) | (1,815) | (20,461) | 60,067 | (70,581) |

The balance of assets and liabilities at 31 December 2016 by business segments is as follows:

| | Shipbuilding | Engineering | Manufacturing of equipment | Other | Intra-group transactions | **Total Group** |
|---|---|---|---|---|---|---|
| Total assets | 6,008,030 | 218,132 | 123,536 | 584,019 | (2,848,172) | 4,085,545 |
| Total liabilities | 5,753,665 | 255,513 | 34,163 | 403,763 | (2,381,723) | 4,065,381 |

The balance of assets and liabilities at 31 December 2015 by business segments is as follows:

| | Shipbuilding | Engineering | Manufacturing of equipment | Other | Intra-group transactions | **Total Group** |
|---|---|---|---|---|---|---|
| Total assets | 4,254,246 | 72,166 | 106,885 | 380,859 | (1,841,078) | 2,973,078 |
| Total liabilities | 3,829,968 | 127,528 | 16,905 | 263,996 | (1,386,277) | 2,852,120 |

An overview of revenue realised with external customers on the domestic and foreign markets is presented below:

| | **2016** | **2015** |
|---|---|---|
| Foreign sales | 1,895,379 | 1,289,536 |
| Domestic sales | 35,386 | 38,640 |
| | **1,930,765** | **1,328,176** |

Sales mostly relates to contraction contract revenues recognized in accordance with stage of completion, in 2016 these revenues amounted to HRK 1,861,304 thousand (2015: HRK 1,246,916 thousand).

Service revenues in 2016 amounted to HRK 27,303 thousand (2015: HRK 41,768 thousand).

**NOTE 6 – GOVERNMENT GRANTS**

| | **2016** | **2015** |
|---|---|---|
| Recognised grants from the Croatian Ministry of Economy for restructuring | 141,245 | 136,192 |
| Other subsidies | 488 | 1,006 |
| | **141,733** | **137,198** |

Recognised grants in the amount of HRK 141,245 thousand (2015: HRK 136,192 thousand) refer to recognition of adequate proportion for grants for restructuring costs pursuant to the Agreement on the sale and transfer of shares of Brodograđevna industrija 3. Maj d.d., Rijeka (hereinafter: the "Agreement") and the Restructuring programme of Brodograđevna industrija 3. Maj d.d., Rijeka (hereinafter: the "Restructuring programme"). Based on fulfilling the conditions stipulated in the Agreement for the receipt of grants, and in accordance with the intended use of support in line with the Restructuring programme and investment dynamics, the Group recognized the stated amount of income relating to the contribution of the Republic of Croatia in restructuring the Group. In 2014, the Group recorded a correction of retained earnings in the amount of HRK 176,372 thousand on the basis of state subsidies aimed at covering losses from 2010 and 2011. In 2015, HRK 198,557 thousand was collected, of which HRK 62,365 thousand relates to coverage of losses decreasing the receivable from the State, and the remaining HRK 136,192 thousand was recognized in profit and loss.

In 2016, HRK 177,632 thousand was collected on the basis of the Restructuring programme, of which HRK 141,245 thousand was recognized in profit or loss, and the remaining HRK 36,387 thousand related to coverage of losses decreased the receivable from the State.

**NOTE 7 – OTHER INCOME**

| | 2016 | 2015 |
|---|---|---|
| Release of provisions - net (Note 28) | 41,189 | 40,219 |
| Insurance claims recovered | 1,424 | 1,305 |
| Collected receivables written off | 123 | 122 |
| Inventory surpluses | 780 | 246 |
| Other | 12,378 | 9,907 |
| | **55,894** | **51,799** |

**NOTE 8 – COST OF MATERIALS AND SERVICES**

| | 2016 | 2015 |
|---|---|---|
| **Raw materials and supplies** | | |
| Raw materials and supplies used | 1,116,070 | 747,800 |
| Energy and water used | 31,425 | 25,322 |
| Cost of goods sold | 1,033 | 729 |
| | 1,148,528 | 773,851 |
| **External services** | | |
| Product development services | 255,782 | 120,142 |
| Intellectual services | 6,338 | 19,101 |
| Rentals | 4,322 | 5,685 |
| Utility services | 12,031 | 12,190 |
| Transportation services | 2,352 | 2,235 |
| Intermediation | 19,652 | 11,178 |
| Licences | 6,897 | 4,814 |
| Protection clothes | 9,628 | 6,817 |
| Maintenance services | 6,551 | 5,691 |
| Other | 37,282 | 15,608 |
| | 360,835 | 203,461 |
| | **1,509,363** | **977,312** |

**NOTE 9 – STAFF COSTS**

| | 2016 | 2015 |
|---|---|---|
| Net salaries | 325,422 | 296,279 |
| Taxes and contributions from and on salaries | 211,631 | 191,740 |
| | 537,053 | 488,019 |
| Other employee benefits | 39,030 | 38,991 |
| Release of provisions – net (Note 28) | 2,218 | (836) |
| | **578,301** | **526,174** |
| Number of employees | **4,369** | **4,011** |

In 2016, pension fund contributions amounted to HRK 83,848 thousand (2015: HRK 80,031 thousand).

**NOTE 10 – OTHER OPERATING EXPENSES**

| | **2016** | **2015** |
|---|---|---|
| Bank charges (commissions and fees) | 68,058 | 62,926 |
| Concession | 17,173 | 10,847 |
| Insurance | 11,367 | 9,631 |
| Fines, penalties and compensation for damages | 9,383 | 3,019 |
| Donations | 3,667 | 988 |
| Taxes, contributions and other charges irrespective of business result | 2,179 | 10,038 |
| Entertainment expenses | 752 | 731 |
| Supervisory Board fees | 756 | 782 |
| Impairment of receivables | 1,029 | 371 |
| Memberships, contributions and similar | 1,546 | 1,208 |
| Other | 32,648 | 21,399 |
| | **148,558** | **121,940** |

**NOTE 11 – OTHER GAINS – NET**

| | **2016** | **2015** |
|---|---|---|
| Foreign exchange losses from operations | (214,816) | (100,681) |
| Foreign exchange gains from operations | 219,798 | 119,635 |
| Gains on change in fair value of financial assets | 123 | (114) |
| | **5,105** | **18,840** |

**NOTE 12 – FINANCE COSTS AND INCOME**

| | **2016** | **2015** |
|---|---|---|
| **Finance costs** | | |
| Interest | (104,713) | (78,161) |
| Foreign exchange losses | (58,189) | (65,476) |
| Other | (162) | (9,801) |
| | (163,064) | (153,438) |
| **Finance income** | | |
| Foreign exchange gains | 47,959 | 41,019 |
| Interest income | 23,598 | 2,438 |
| Fair valuation of receivables | 2,897 | 5,968 |
| Other | 4,394 | 78 |
| | 78,848 | 49,503 |
| **Finance costs - net** | **(84,216)** | **(103,935)** |

**NOTE 13 – INCOME TAX**

The following table presents the reconciliation of income tax expense from the statement of comprehensive income and the amount of income tax calculated at the statutory income tax rate:

| | 2016 | 2015 |
|---|---|---|
| Loss before tax | (159,499) | (67,072) |
| Income tax at 20% | (31,900) | (13,414) |
| Tax effects arising from: | | |
| Consolidation adjustments | (2,056) | (8,357) |
| Income not subject to tax and deductions | (23,782) | (37,304) |
| Expenses not deductible for tax purposes | 7,161 | 3,722 |
| Utilisation of previously unrecognized tax losses | - | (2) |
| Tax losses for which no deferred income tax asset was recognized | 64,106 | 58,864 |
| **Income tax** | **13,529** | **3,509** |

The Croatian Income Tax Act is subject to varying interpretations and changes in respect of expenses which decrease the tax base. The Management Board's interpretation of such legislation as applied to the transactions and activities of the Company may be challenged by the relevant authorities. The Tax Administration may be taking a different position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. The Tax Administration may start performing an inspection within three years following the year in which the tax liability is reported for a specific financial period.

The subsidiary 3. MAJ Brodogradilište d.d. has a right not to record an income tax liability even when realising tax profit based on the Act on Governing the Rights and Obligations of Shipyards in the Process of Restructuring (Official Gazette 66/2011) and in accordance with Article 11 of the Agreement on the sale and transfer of shares of Brodograđevna industrija 3. MAJ d.d. Rijeka. The established tax debt incurred due to implementing the shipyard restructuring process is offset against the tax loss, and the remaining debt is written off.

The total tax loss carry forward on the Group level is as follows:

| Year | 2016 | 2015 |
|---|---|---|
| 2016 | - | 129,104 |
| 2017 | 107,142 | 107,142 |
| 2018 | 448,908 | 449,854 |
| 2019 | 322,073 | 301,575 |
| 2020 | 308,061 | 308,132 |
| 2021 | 335,181 | - |
| | **1,521,365** | **1,295,807** |

*Deferred tax assets*

Deferred tax assets arising from tax losses are recognised only to the extent that it is likely that the related tax relief will be realised. Tax losses have not been recognised in the Group's financial statements due to the uncertainty of their utilisation in the future. As at 31 December 2016, deferred tax assets not recognised in these financial statements amounted to HRK 273,846 thousand (2015: HRK 259,161 thousand). Deferred tax asset has been calculated on the basis of 18% tax rate in accordance with changes in tax regulations (2015: 20%).

**NOTE 13 – INCOME TAX (continued)**

*Deferred tax liability*

The Group recognized deferred tax liability in the amount of HRK 19,537 thousand on the basis of revaluation gain of specific equipment for motor construction and on the basis of differences between fair value of acquired assets of 3. MAJ Motori i dizalice d.d. and their tax basis.

| | 2016 | 2015 |
|---|---|---|
| Non-current portion | 18,723 | - |
| Current portion | 814 | - |
| **Total** | **19,537** | **-** |

**NOTE 14 – INTANGIBLE ASSETS**

| | Development expenditure | Concessions, patents, licences, software and other rights | Assets under construction | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| **1 January 2015** | **18,557** | **327,829** | **1,135** | **347,521** |
| Additions | - | - | 4,601 | **4,601** |
| Transfer from tangible assets | - | - | 402 | **402** |
| Transfer | 3,696 | 976 | (4,672) | **-** |
| Disposals | - | (8) | - | **(8)** |
| **31 December 2015** | **22,253** | **328,797** | **1,466** | **352,516** |
| Additions | - | - | 5,691 | **5,691** |
| Transfer from tangible assets | - | - | 10 | **10** |
| Transfer | 335 | 1,814 | (2,149) | **-** |
| Revaluation | 62 | (545) | - | **(483)** |
| Acquisition of subsidiary | 2,456 | 3,077 | - | **5,533** |
| **31 December 2016** | **25,106** | **333,143** | **5,018** | **363,267** |
| **Accumulated amortisation** | | | | |
| **1 January 2015** | **320** | **150,156** | **-** | **150,476** |
| Amortisation charge for the year | 4,050 | 9,375 | **-** | **13,425** |
| Disposals | - | (8) | **-** | **(8)** |
| **31 December 2015** | **4,370** | **159,523** | **-** | **163,893** |
| Amortisation charge for the year | 4,428 | 9,281 | - | **13,709** |
| **31 December 2016** | **8,798** | **168,804** | **-** | **177,602** |
| **Net book amount** | | | | |
| 31 December 2015 | 17,883 | 169,274 | 1,466 | 188,623 |
| **31 December 2016** | **16,308** | **164,339** | **5,018** | **185,665** |

**NOTE 15 – PROPERTY, PLANT AND EQUIPMENT**

| | Land and buildings | Plant and equipment | Tools, plant inventory and transport vehicles | Assets under construction and advances | Other | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **1 January 2015** | **192,264** | **1,232,504** | **432,688** | **34,613** | **782** | **1,892,851** |
| Additions | - | - | - | 7,060 | - | **7,060** |
| Exchange differences | - | - | 19,452 | - | - | 19,452 |
| Transfer to use | 1,011 | 1,729 | 4,329 | (7,069) | - | - |
| Transfer from intangibles | - | - | - | (402) | - | (402) |
| Disposals | (8) | (3,496) | (3,399) | - | - | (6,903) |
| Merger effect | 3,228 | 1,239 | - | (103) | - | 4,364 |
| **31 December 2015** | **196,495** | **1,231,976** | **453,070** | **34,099** | **782** | **1,916,422** |
| Additions | - | - | | 55,047 | - | 55,047 |
| Subsidiary inclusion | - | - | 189,265 | - | - | 189,265 |
| Exchange differences | - | - | 15,384 | - | - | 15,384 |
| Transfer to use | 2,907 | 12,220 | 16,266 | (31,393) | - | - |
| Acquisition of subsidiary | - | 65,495 | 1,350 | - | - | 66,845 |
| Revaluation surplus | 6 | 27,695 | 15,853 | 6 | | 43,560 |
| Transfer to intangibles | - | - | - | (10) | - | (10) |
| Disposals | (8) | (2,218) | (3,519) | (804) | - | (6,549) |
| **31 December 2016** | **199,400** | **1,335,168** | **687,669** | **56,945** | **782** | **2,279,964** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| **1 January 2015** | **120,060** | **1,075,872** | **244,551** | **-** | **-** | **1,440,483** |
| Merger effect | 2,779 | 1,239 | - | - | - | **4,018** |
| Exchange differences | - | - | 1,323 | | | **1,323** |
| Depreciation charge | 2,397 | 27,837 | 16,458 | - | - | **46,692** |
| Disposals | (8) | (3,453) | (3,209) | - | - | **(6,670)** |
| **31 December 2015** | **125,228** | **1,101,495** | **259,123** | **-** | **-** | **1,485,846** |
| Depreciation charge | 2,420 | 24,914 | 23,162 | - | - | 50,496 |
| Disposals | (8) | (2,211) | (3,503) | - | - | (5,722) |
| **31 December 2016** | **127,640** | **1,124,198** | **278,782** | **-** | **-** | **1,530,620** |
| | | | | | | |
| **Net book amount** | | | | | | |
| 31 December 2015 | 71,267 | 130,481 | 193,947 | 34,099 | 782 | 430,576 |
| **31 December 2016** | **71,760** | **210,970** | **408,887** | **56,945** | **782** | **749,344** |

**NOTE 15 – PROPERTY, PLANT AND EQUIPMENT (continued)**

For the purpose of its operations, the Group uses land (630,120 m2) and sea (549,565 m2) areas for which it has obtained a concession from the Republic of Croatia over a period of 32 years starting from 16 September 1999.

The carrying value of pledged property and equipment as at 31 December 2016 amounted to HRK 53,835 thousand (31 December 2015: HRK 48,262 thousand) (Note 27).

**NOTE 16 – INVESTMENT PROPERTY**

| | Land | Buildings | Total |
|---|---|---|---|
| ***Cost/fair value*** | | | |
| **At 1 January 2015** | **55,333** | **57,988** | **113,321** |
| Additions/(disposals) | - | - | - |
| **At 31 December 2015** | **55,333** | **57,988** | **113,321** |
| Additions/(disposals) | - | - | - |
| **At 31 December 2016** | **55,333** | **57,988** | **113,321** |
| ***Accumulated depreciation*** | | | |
| **At 1 January 2015** | **-** | **22,712** | **22,712** |
| Depreciation charge for the year | - | 945 | 945 |
| **At 31 December 2015** | **-** | **23,657** | **23,657** |
| Depreciation charge for the year | - | 945 | 945 |
| **At 31 December 2016** | **-** | **24,602** | **24,602** |
| **Net book amount** | | | |
| 31 December 2015 | 55,333 | 34,331 | 89,664 |
| **31 December 2016** | **55,333** | **33,386** | **88,719** |

**Fair value of land and buildings**

The following table analyses non-financial assets carried at fair value, in accordance with the valuation method. Different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

| | Fair value measurement as at 31 December 2016 and 2015 | | |
|---|---|---|---|
| | **Level 2** | **Level 3** | **Total** |
| Land | - | 55,333 | **55,333** |
| Buildings | - | 33,386 | **33,386** |
| | | **88,719** | **88,719** |

The fair value of land and buildings at level 3 was determined by internal assessment of the Management Board that approximates its carrying value.

## NOTE 17a – FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items below:

| | 2016 | 2015 |
|---|---|---|
| **Assets at the reporting date** | | |
| Recoverable amount of contraction contracts (note 23) | 575,339 | 370,318 |
| Trade receivables (note 23) | 50,516 | 69,796 |
| Interest receivable (note 23) | 2,335 | 933 |
| Due from state (note 23) | 160,719 | 362,764 |
| Deposits and loans receivable (note 20) | 379,981 | 314,130 |
| Financial assets at fair value through profit or loss (note 21) | 1,236 | 1,113 |
| Cash and cash equivalents (note 24) | 103,781 | 281,678 |
| | **1,273,907** | **1,400,732** |

Trade and other receivables do not include receivables from employees, receivables for taxes and similar charges and advances receivable.

The above amounts of loans and receivables represents the maximum exposure to credit risk at the reporting date. The carrying amounts of loans and receivables approximate their fair values.

| | 2016 | 2015 |
|---|---|---|
| **Liabilities at the balance sheet date – *at amortised cost*** | | |
| Trade and other payables | 508,582 | 296,136 |
| Borrowings (note 27) | 1,907,325 | 1,311,715 |
| | **2,415,907** | **1,607,851** |

Trade and other payables do not include tax liabilities, liabilities to employees, taxes and contributions and advances.

## NOTE 17b – CREDIT QUALITY OF FINANCIAL ASSETS

The credit quality of financial assets that is neither past due nor impaired:

| | 2016 | 2015 |
|---|---|---|
| **Trade and other receivables** | | |
| Key customers | 25,743 | 40,099 |
| Other customers | 1,315 | 903 |
| | **27,058** | **41,002** |

The key customers group consists of customers with an amount exceeding HRK 100 thousand.

**NOTE 17b – CREDIT QUALITY OF FINANCIAL ASSETS**

Cash at bank according to Standard&Poor's ratings:

| | 2016 | 2015 |
|---|---|---|
| **Cash at bank** | | |
| BB | 5,468 | 3,662 |
| BBB- | 47,841 | 171,547 |
| BBB + | 646 | 355 |
| B+ | - | 10 |
| BB+ | 241 | - |
| Without credit rating | 49,585 | 106,104 |
| | **103,781** | **281,678** |

**NOTE 18 – INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES**

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | **Share** | **Amount** | **Share** | **Amount** |
| **Investments in subsidiaries:** | | | | |
| BRODO OPUS d.o.o. | 100% | 20 | 100% | 20 |
| United Shipping Services Sixteen Inc., Liberia | - | - | 100% | 1 |
| Maritime Transport Pula One Inc. Liberia | 100% | 4 | 100% | 4 |
| Maritime Transport Pula Two Inc. Liberia | 100% | 4 | 100% | 4 |
| **Total** | | **28** | | **29** |
| **Investments in associates:** | | | | |
| United Shipping Services Twelve Inc., Liberia | 45.00% | 83,056 | 45.00% | 80,743 |
| United Shipping Services Thirteen Inc., Liberia | 45.00% | 84,242 | 45.00% | 78,620 |
| Fratarski d.o.o. | 49.00% | 157 | 49.00% | 157 |
| Adriadiesel d.d., Karlovac | 28.15% | 10,611 | 28.15% | 10,422 |
| Viktor Lenac d.d., Rijeka | 34.67% | 76,656 | 34.67% | 76,152 |
| **Total** | | **254,722** | | **246,094** |
| | | **254,750** | | **246,123** |

*a) Investments in subsidiaries*

Summary of subsidiaries which are part of the Group and included in the consolidated financial statements is presented in note 1. The subsidiary that has material non-controlling interest is solely 3. MAJ Brodogradilište d.d. The summary information of the this subsidiary is as follows:

**NOTE 18 – INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES (continued)**

| | 2016 | 2015 |
|---|---|---|
| ***Statement of comprehensive income*** | | |
| Income | 887,439 | 886,170 |
| Expenses | (860,402) | (742,288) |
| Loss before tax | 27,037 | 143,882 |
| Income tax | - | - |
| **Loss after tax** | **27,037** | **143,882** |
| ***Statement of financial position*** | | |
| Non-current assets | 398,157 | 248,761 |
| Current assets | 1,285,987 | 1,298,233 |
| **Total assets** | **1,684,144** | **1,546,994** |
| **Total liabilities** | **764,064** | **688,951** |
| ***Cash flow*** | | |
| Cash flow from operating activities | (93,316) | 51,647 |
| Cash flow from investing activities | (302,575) | (60,499) |
| Cash flows from financing activities | 251,768 | 144,418 |

*b) Investments in associates*

The companies United Shipping Services Twelve and Thirteen Inc. are engaged in international maritime transport. In accordance with the signed agreement, majority ownership guarantees for the repayment of loan liabilities for each of the associate and all the financial costs are born exclusively by the majority owner.

The company Adriadiesel is engaged in the production of diesel engines and spare parts for diesel engines, other power plants and providing repair services, machining and heat treatment. Shipyard Viktor Lenac provides services of overhaul and modification of ships and the construction and repair of offshore platforms.

| | 2016 | 2015 |
|---|---|---|
| **At 1 January** | **246,094** | **243,627** |
| Share in (loss)/profit of associates (Profit or loss) | (10,723) | 96 |
| Foreign exchange differences and other adjustments (Other comprehensive income) | 19,351 | 2,371 |
| **At 31 December** | **254,722** | **246,094** |

The summary information of associates is presented in the table below:

| | Assets | Liabilities | Income | Result |
|---|---|---|---|---|
| **2016** | | | | |
| Viktor Lenac d.d. | 421,453 | 212,500 | 276,917 | 1,451 |
| Adriadiesel d.d. | 125,809 | 88,015 | 74,536 | 676 |
| United Shipping Services Twelve Inc., Liberia | 188,041 | 147,373 | 11,452 | (16,756) |
| United Shipping Services Thirteen Inc., Liberia | 185,566 | 150,858 | 8,751 | (21,505) |

**NOTE 18 – INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES (continued)**

| | Assets | Liabilities | Income | Result |
|---|---|---|---|---|
| **2015** | | | | |
| Viktor Lenac d.d. | 396,695 | 177,029 | 535,709 | 26,201 |
| Adriadiesel d.d. | 108,233 | 71,232 | 38,794 | 539 |
| United Shipping Services Twelve Inc., Liberia | 187,469 | 130,590 | 13,716 | (15,434) |
| United Shipping Services Thirteen Inc., Liberia | 192,774 | 147,475 | 14,760 | (17,410) |

In accordance with Shareholders agreement signed with Uljanik plovidba d.d. financial liabilities and finance costs of associates United Shipping Services Twelve and United Shipping Services Thirteen are entirely born by that company and are not included in Group's share of its results.

**NOTE 19 – NON-CURRENT RECEIVABLES**

| | 2016 | 2015 |
|---|---|---|
| Receivables for apartments sold /i/ | 26,391 | 31,445 |
| Provision for receivables for sold apartments | (5,495) | (6,275) |
| Other | 6,075 | 9,718 |
| Provision for other receivables | (2,000) | (1,141) |
| | **24,971** | **33,747** |

/i/ Loans for the purchase of apartments were given to former employees for a period up to 32 years, with an interest rate of 1% p.a. These flats were sold under the provisions of the Act on the Sale of Flats with Tenancy Rights.

The carrying value of non-current receivables approximates their fair value.

**NOTE 20 –DEPOSITS AND LOANS RECEIVABLE**

| | 2016 | 2015 |
|---|---|---|
| **Short-term** | | |
| Loans receivable | 7,318 | 63,374 |
| Provision for impairment of loans | - | (10,836) |
| Loans receivable - net | 7,318 | 52,538 |
| Deposits | 9,928 | 74,799 |
| Less: current portion | - | (4,644) |
| **Total short-term loans** | **17,246** | **122,693** |
| **Long-term** | | |
| Loans receivable | 51,585 | 4,644 |
| Deposits | 311,150 | 186,793 |
| **Total long-term loans** | **362,735** | **191,437** |

**NOTE 20 –DEPOSITS AND LOANS RECEIVABLE (continued)**

Loans bear interest rate of 3% to 7% per annum, and are secured by pledge over the movables or debentures and blank bills of exchange. Long-term portion matures within next two to five years.

The carrying amount of deposits and loans receivable is denominated in the following currencies:

| | **2016** | **2015** |
|---|---|---|
| EUR | 303,056 | 245,199 |
| USD | 17,933 | 16,403 |
| HRK | 58,992 | 52,528 |
| | **379,981** | **314,130** |

**NOTE 21 – OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS**

| | **2016** | **2015** |
|---|---|---|
| Listed shares (PBZ, Croatia osiguranje, ULJANIK Plovidba d.d.) | 1,236 | 1,113 |
| | **1,236** | **1,113** |

**NOTE 22 – INVENTORIES**

| | **2016** | **2015** |
|---|---|---|
| Raw materials and supplies | 763,660 | 226,225 |
| Work in progress | 68,582 | 43,642 |
| Trade goods and finished products | 46 | 33 |
| Advances for inventories | 43,648 | 42,909 |
| Non-current assets held for sale | 854 | 643 |
| Impairment of slow-moving inventories | (20,508) | (20,812) |
| | **856,282** | **292,640** |

In 2016, the cost of goods sold amounted to HRK 2,563,161 thousand (2015: HRK 1,613,258 thousand).

**NOTE 23 – TRADE AND OTHER RECEIVABLES**

| | 2016 | 2015 |
|---|---|---|
| Amounts due from customers for construction work /i/ | **575,339** | **370,318** |
| Domestic trade receivables | 19,477 | 29,518 |
| Foreign trade receivables | 36,284 | 55,225 |
| Provision for impairment of trade receivables | (5,245) | (14,947) |
| Trade receivables – net | 50,516 | 69,796 |
| Interest receivable | 2,335 | 933 |
| | 52,851 | 70,729 |
| VAT receivable | 68,785 | 43,431 |
| Government grants receivable (Note 6) | 133,589 | 169,977 |
| Receivables from the Ministry of Maritime Affairs, Transport and Infrastructure | - | 21,961 |
| Receivables from the Ministry of Economy | - | 144,365 |
| Receivables from the Ministry of Finance /ii/ | 27,130 | 26,461 |
| Advances | 507,349 | 227,826 |
| Other receivables | 53,924 | 19,394 |
| | 790,777 | 653,415 |
| | **843,628** | **724,144** |
| | **1,418,967** | **1,094,462** |

/i/ Amounts due from customers for construction work

| | 2016 | 2015 |
|---|---|---|
| At beginning of year | 370,318 | 237,091 |
| Contract costs incurred during the year plus recognised gains, minus recognised losses | 1,898,750 | 1,369,798 |
| Invoiced amounts | (1,693,729) | (1,236,571) |
| Amounts due from customers for construction work | **575,339** | **370,318** |

The carrying value of the amounts due from customers for construction work is denominated as follows:

| | 2016 | 2015 |
|---|---|---|
| EUR | 174,188 | - |
| USD | 351,798 | 340,226 |
| HRK | 49,353 | 30,092 |
| | **575,339** | **370,318** |

**NOTE 23 – TRADE AND OTHER RECEIVABLES (continued)**

/ii/ Receivables from the Ministry of Finance in the amount of HRK 27,130 thousand (2015: HRK 26,461 thousand) relates to receivables from the amounts paid as a result of the Arbitration proceeding regarding terminated construction contract.

Trade receivables

| | Not past due | Past due | | | | | Total |
|---|---|---|---|---|---|---|---|
| | | < than 30 days | 30-60 days | 60-90 days | 90-120 days | > than 120 days | |
| **2016** | **27,058** | **751** | **4,713** | **663** | **909** | **16,422** | **50,516** |
| 2015 | **41,002** | **12,112** | **954** | **842** | **1,467** | **13,419** | **69,796** |

**Movements in the provision for impairment of trade receivables are as follows:**

| | **2016** | **2015** |
|---|---|---|
| At 1 January | 14,947 | 30,776 |
| Provision for impairment during the year | 417 | 542 |
| Release of provisions | (10,119) | (16,371) |
| **At 31 December** | **5,245** | **14,947** |

| | **2016** | **2015** |
|---|---|---|
| Neither past due nor impaired | 27,058 | 41,002 |
| Past due, but not impaired | 23,458 | 28,794 |
| Past due and impaired | 5,244 | 14,947 |
| | **55,760** | **84,743** |

**NOTE 24 – CASH AND CASH EQUIVALENTS**

| | 2016 | 2015 |
|---|---:|---:|
| Giro account and cash in hand | 40,514 | 180,634 |
| Foreign currency account | 63,186 | 98,042 |
| Time deposits up to 90 days | 17 | 17 |
| Foreign currency letters of credit | 62 | 2,985 |
| Other | 2 | - |
| | **103,781** | **281,678** |

The Group has giro accounts with Privredna banka d.d., Zagreb, Zagrebačka banka d.d., Zagreb , Erste &Steiermärkische Bank d.d., Rijeka , Veneto banka d.d., Zagreb, OTP banka Hrvatska d.d., Zadar, Istarska kreditna banka Umag d.d., Umag, Hrvatska poštanska banka d.d.,Zagreb, Primorska banka d.d., Rijeka, Addiko Bank d.d., Zagreb, Imex banka d.d., Split, Sberbank d.d., Zagreb.

The carrying amount of the Group's cash and cash equivalents is denominated in the following currencies:

| | 2016 | 2015 |
|---|---:|---:|
| HRK | 40,532 | 180,651 |
| EUR | 32,991 | 47,866 |
| USD | 30,256 | 53,159 |
| Other | 2 | 2 |
| | **103,781** | **281,678** |

**NOTE 25 – EQUITY**

The authorised and registered share capital of the parent company amounting to HRK 100,688 thousand consists of 3,356,250 shares (2015: 3,356,250 shares). The nominal value per share is HRK 30 (2015: HRK 30 per share). The shareholders are entitled to dividend and one vote per share at the annual and extraordinary meetings. The latest change in the share capital of the Company was registered at the Commercial Court in Rijeka on 23 October 2015 by which the share capital was decreased (by the simplified decrease procedure) from the amount of HRK 302,063 thousand by the amount of HRK 201,375 thousand to HRK 100,688 thousand (nominal value per share decreased from HRK 90 per share to HRK 30 per share).

Reserves include capital reserves formed in accordance with the provisions of Company's Act in the amount of HRK 216,566 thousand (2015: HRK 216,566 thousand) formed during the share capital decrease as described above (non-distributable).

In previous periods, the parent company purchased treasury shares and as at 31 December 2016 it owned 104,375 treasury shares or 3.1099% of the share capital.

By the General Assembly's Decision from 21 July 2016 the profit of the parent earned in 2015 of HRK 13,133 thousand has been allocated to other reserves.

**NOTE 25 – EQUITY (continued)**

The ownership structure as at 31 December was as follows:

| Shareholder | 2016<br>% | 2015<br>% |
|---|---|---|
| Croatia osiguranje d.d. | 9.93 | 9.93 |
| CERP/ HZMO - Croatian Pension Insurance Institute | 7.74 | 7.74 |
| Hrvatska poštanska banka d.d. / Kapitalni fond d.d. | 6.62 | 6.62 |
| Hrvatska poštanska banka d.d. / Fund for Financing the Decommissioning of the Krško Nuclear Power Plant | 4.97 | 4.97 |
| Hypo Alpe - Adria - Bank d.d. / PBZ Croatia osiguranje obvezni mirovinski fond | 3.97 | 3.97 |
| HZZO - Croatian Health Insurance Fund | 3.88 | 3.88 |
| Societe generale - Splitska banka d.d. / Erste plavi obvezni mirovinski fond | 3.31 | 3.31 |
| Treasury shares | 3.11 | 3.11 |
| Adris grupa d.d. | 2.47 | 2.47 |
| CERP / State Agency for Deposit Insurance and Bank Resolution | 2.38 | 2.38 |
| Domestic private individuals | 46.22 | 46.21 |
| Foreign private individuals | 0.10 | 0.10 |
| Other shareholders | 5.30 | 5.31 |
| **Total** | **100.00** | **100.00** |

**NOTE 26 – NON-CONTROLLING INTEREST**

The non-controlling interest in the amount of HRK 128,691 thousand (2015: HRK 124,759 thousand) entirely relates to the non-controlling interest in the company 3. MAJ Brodogradilište d.d. acquired in 2013 (summarised financial information of this subsidiary is presented in note 18).

**NOTE 27 – BORROWINGS**

| | **2016** | **2015** |
|---|---|---|
| **Long-term** | | |
| Long-term bank borrowings | 1,871,158 | 1,099,889 |
| Finance lease liabilities | 4,882 | 5,791 |
| Long-term other borrowings | 6,951 | - |
| Current portion of long-term bank borrowings | (1,192,238) | (453.040) |
| Current portion of finance lease | (1,579) | (1.420) |
| Current portion of long term other borrowings | (2,571) | - |
| | 686,603 | 651,220 |
| Liabilities for issued bills of exchange | - | 44,971 |
| Current portions | - | (44,971) |
| **Total non-current portions** | **686,603** | **651,220** |
| **Short-term** | | |
| Short-term bank borrowings | 23,894 | 161,064 |
| Current portion of long-term bank borrowings | 1,192,238 | 453,040 |
| Current portion of long-term other borrowings | 440 | - |
| Current portion of finance lease | 1,579 | 1,420 |
| Current portion of long term other borrowings | 2,571 | - |
| | 1,220,722 | 615,524 |
| Current portion of issued bills of exchange | - | 44,971 |
| Total current portions | **1,220,722** | **660,495** |
| **TOTAL BORROWINGS** | **1,907,325** | **1,311,715** |

Finance lease liabilities as at 31 December 2016 relate to the liability for financing purchase of equipment for the welding and pre-assembly of sections and for a sheet metal folder. Finance lease liabilities are primarily secured by debentures.

Borrowings from commercial banks are primarily secured by debentures and a state guarantee in the amount of 80% of loan amount, HBOR insurance policy, pledge over the share in Maritime Transport Pula Four Inc (MTP4), pledge over the ships in MTP's ownership and ships currently built, term deposit of HRK 5 million and term deposit of EUR 3 million. Borrowings from foreign bank are contacted with the significant number of covenants. Finance liabilities towards commercial banks are mostly used for financing current production.

In 2016, the average effective interest rate on the above stated borrowings ranged from 4.4 – 6.8% (2015: 4 – 8.9%).

Maturities of long-term borrowings (current portions included) are as follows:

| | **2016** | **2015** |
|---|---|---|
| 1 - 2 years | 685,948 | 644,113 |
| 2 - 5 years | 655 | 7,107 |
| | **686,603** | **651,220** |

The carrying amounts of short-term borrowings approximate their fair value.

**NOTE 28 – PROVISIONS**

| | Provisions for expected losses on contracts /i/ | Unused vacation days /ii/ | Warranty provisions /iii/ | Legal disputes /iv/ | Termination benefits and jubilee awards /v/ | Contingent liabilities (acquisition) /vi/ | Total |
|---|---|---|---|---|---|---|---|
| **At 1 January 2015** | **348,416** | **2,926** | **4,890** | **24,213** | **6,186** | **67,871** | **454,502** |
| Additional provisions | - | 1,875 | 69 | 2,952 | 381 | - | 5,277 |
| Released | (100,719) | (2,926) | (4,201) | (9,194) | (166) | (31,109) | (148,315) |
| Foreign currency difference | - | - | | 680 | | | 680 |
| Used during the year | (76,209) | - | | (2,868) | - | - | (79,077) |
| **At 31 December 2015** | **171,488** | **1,875** | **758** | **15,783** | **6,401** | **36,762** | **233,067** |
| Additional provisions | 29,063 | 3,936 | - | 716 | 156 | - | 33,871 |
| Released | - | (1,875) | - | (5,142) | - | (36,762) | (43,779) |
| Subsidiary | - | - | 20 | 686 | - | - | 706 |
| Used during the year | (113,052) | - | - | - | - | - | (113,052) |
| **At 31 December 2016** | **87,499** | **3,936** | **778** | **12,043** | **6,557** | **-** | **110,813** |
| Up to 12 months | 87,499 | 3,936 | 778 | - | 94 | - | **92,307** |
| After 12 months | - | - | - | 12,043 | 6,463 | - | **18,506** |

/i/ Provisions for expected losses comprise losses calculated under IAS 11, chargeable to new projects until their final delivery. Expected losses represent the difference between the estimated expected cost of each contract and the selling price. Expected losses have been estimated both for the contracts on which work has started and those on which it has not been started yet.

/ii/ Provisions for works within the warranty period have been made for any additional costs expected to be incurred on delivered ships.

/iii/ Provisions for unused vacation days have been made based on the number of unused vacation days for 2016, while at the same time provisions made in the previous period were reversed.

/iv/ As at 31 December 2016, these are provisions for pending legal disputes initiated against the Group by legal entities, present and former employees, as confirmed by the legal department. According to the estimates of the legal department, it is likely that the Group will be obliged to pay indemnity for these claims (Note 32).

/v/ Provisions for termination benefits and jubilee awards relate to the estimated amount of termination benefits and jubilee awards for certain Group companies to which the employees are entitled when retiring. The provision amounts are discounted to the present value using a discount rate of 3.5% (2015: 4.85%).

/vi/ Provisions in the amount of HRK 36,762 thousand in 2015 related to contingent liabilities arising under the Agreement on the sale and transfer of shares of Brodograđevna industrija 3. Maj d.d., Rijeka and the Restructuring programme of Brodograđevna industrija 3. Maj d.d. Rijeka, which have been recorded in the consolidated financial statements when determining the fair value of assets and liabilities of the company 3. Maj Brodogradilište d.d.

**NOTE 29 – TRADE AND OTHER PAYABLES**

| | **2016** | **2015** |
|---|---|---|
| Domestic trade payables | 254,054 | 191,147 |
| Foreign trade payables | 184,843 | 41,030 |
| Liabilities towards SCAC Delmas (SDV) /i/ | 56,850 | 59,498 |
| Interest and fees payable | 12,835 | 4,461 |
| | 508,582 | 296,136 |
| Due to employees and members of the Supervisory Board | 32,482 | 27,704 |
| Taxes and contributions payable | 44,756 | 45,371 |
| Other liabilities | 83,337 | 64,633 |
| | **669,157** | **433,844** |

/i/ The liability to the company Bollore Delmas from France, a buyer who withdrew from the construction of 2 ships, are based on a lost court/arbitration proceedings which has been in progress for several years. In 2008, the Commercial Court in Rijeka issued a decision on approving the arbitration decision, and the company's Management adopted the Decision on recording and disclosing liabilities in line with the aforementioned decision, which as at 31 December 2016 comprise the principal in the amount of HRK 13,287 thousand (2015: HRK 13,423 thousand), interest calculated at a rate of 8% and amounting to HRK 34,205 thousand (2015: HRK 35,077 thousand) and arbitration costs of HRK 9,358 thousand (2015: HRK 10,998 thousand).

The carrying amounts of trade and other payables are denominated in the following currencies:

| | **2016** | **2015** |
|---|---|---|
| HRK | 262,848 | 126,857 |
| USD | 21,815 | 16,449 |
| EUR | 197,830 | 96,798 |
| GBP | 24,386 | 55,736 |
| NOK | 200 | 262 |
| Other | 1,503 | 34 |
| | **508,582** | **296,136** |

**NOTE 30 – ADVANCES RECEIVED**

| | **2016** | **2015** |
|---|---|---|
| Liabilities from construction contracts | 1,340,498 | 872,411 |
| Other advances received | 465 | 1,083 |
| | **1,340,963** | **873,494** |

**NOTE 31 – RELATED PARTY TRANSACTIONS**

Related party transactions are as follows:

| **Associates** | **2016** | **2015** |
|---|---|---|
| **Operating income** | | |
| Sales | 629 | 6,063 |
| | 629 | 6,063 |
| **Operating expenses** | | |
| External services costs | 6,639 | 299 |
| | 6,639 | 299 |
| **Finance income** | | |
| Interest income | - | 8 |
| | - | 8 |
| **Finance costs** | | |
| Interest charge | - | 5 |
| | - | 5 |
| **Loans, trade and other receivables** | | |
| Loans receivable | - | 358 |
| Trade receivables | 343 | 841 |
| Advances | 17,163 | 3,506 |
| | 17,506 | 4,705 |
| **Liabilities** | | |
| Trade payables | 1,788 | 224 |
| | 1,788 | 224 |

**Key management compensation**

During 2016, total gross salaries paid to the Company's Management Board as well as Supervisory Board compensation amounted to HRK 32,757 thousand (2015: HRK 25,740 thousand). Key personnel comprises 85 Company’s employees (2015: 62 employees).

## NOTE 32 – CONTINGENCIES AND COMMITMENTS

### Legal disputes

Legal disputes in which the Group is the defendant are mostly labour related, i.e. compensations of damages to workers due to work-related injuries, and disputes of compensations of damages caused by fatalities, consequences arising from asbestosis or injuries at work.

As at 31 December 2016, the Group made a provision for contingencies from legal disputes and the stated arbitration in the amount of HRK 12,043 thousand (2015: 15,783 thousand) (see Note 28).

**Commitments.** As at 31 December 2016, the Group had concluded contracts under which works have not yet started in the total value of HRK 9 billion (2015: HRK 9.3 billion). Also, the Group committed to fulfil all restructuring measures in accordance with an Agreement on the sale and transfer of shares of Brodograđevna industrija 3. Maj d.d., Rijeka and adopted Restructuring programme.

## NOTE 33 – LOSS PER SHARE

### Basic loss per share

Basic loss per share is calculated by dividing the loss attributable to shareholders of the parent Company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the parent company and held as treasury shares.

| | **2016** | **2015** |
|---|---|---|
| Loss attributable to owners of the parent *(in thousands of HRK)* | (176,959) | (91,501) |
| Weighted average number of ordinary shares (basic) | 3,251,875 | 3,251,875 |
| **Loss per share *(in HRK)*** | **(54.42)** | **(28.14)** |

### Diluted loss per share

Diluted loss per share for 2016 and 2015 is equal to basic loss per share, since the Group did not have any convertible instruments or share options outstanding during either 2015 or 2016.

## NOTE 34 – ACQUISITION

In 2015 the parent company acquired the company 3. MAJ MOTORI I DIZALICE d.d., purchase consideration amounted to HRK 1. The investment was classified as a subsidiary held for disposal until 30 November 2016 when the Management's intention to sell the subsidiary outside the Group changed (the company 3. MAJ MOTORI I DIZALICE d.d. was merged with the subsidiary within the Group – ULJANIK Strojogradnja d.d.).

Details of purchase consideration, the net assets acquired and goodwill are presented below.

The assets and liabilities recognized as a result of the acquisition and the related goodwill are as follows:

| | **Fair value** |
|---|---|
| Cash and cash equivalents | 49 |
| Trade and other receivables | 6,171 |
| Inventory | 9,397 |
| Intangibles | 5,533 |
| Property, plant and equipment | 66,845 |
| Trade and other payables | (66,619) |
| Borrowings | (30,320) |
| Provisions | (685) |
| Deferred tax liability | (11,883) |
| | |
| Less: non-controlling interest | - |
| Goodwill | 21, 512 |
| Net assets acquired | **(21,512)** |

Purchase consideration and cash acquired

| | **2016.** |
|---|---|
| Outflow of cash to acquire subsidiary, net of cash acquired | |
| Cash consideration (HRK 1) | - |
| Less: balances acquired | 49 |
| Net outflow of cash – investing activities | **(49)** |

**NOTE 35 – GOING CONCERN**

The Group realised operating loss in 2016 of HRK 64 million (2015: profit of HRK 36 million) and current liabilities exceed current assets by the amount of HRK 927 million (2015: HRK 350 million) which indicate the existence of certain uncertainties regarding going concern.

Due to the new contracted work and the status of the Order book which currently includes orders in the amount of HRK 9 billion at the Uljanik Group level, the primary restructuring objective of the entire Uljanik Group has been achieved including re-launching of the production process. Consequently, commencing from 2017, adequate utilisation of the production capacity will be secured as well as realising a positive operating result on the Group level. With the support of the Government and its grants and guarantees, the Group plans to provide adequate funds for the timely repayment of short-term borrowings and the normal functioning of the production process at the Group level.

Given all of the above, Management is of opinion that the use of the going concern assumption in the preparation of these consolidated financial statements is adequate.

**NOTE 36 – POST-BALANCE-SHEET EVENTS**

After the balance sheet date, there were no events that could significantly affect the consolidated financial statements of the Group as of 31 December 2016 or for the year then ended, which should be disclosed.

**NOTE 37 – APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS**

The consolidated financial statements set out on the previous pages were prepared and approved by the Company's Management Board on 24 April 2017.

Signed on behalf of the Management Board:

Gianni Rossanda,
*President of the Board*

Veljko Grbac,
*Member of the Board*

Marinko Grbić,
*Member of the Board*