

Petrokemija d.d.

Annual report
on the Group
for the year ended
31 December 2016

Petrokemija d.d.
Annual report on the Group

Contents

Management report on the Group for the year ended 31 December 2016	1 – 12
Statement of implementation of the corporate governance code	13-15
Statement of Management's responsibilities	16
Independent Auditors' Report to the Shareholders of Petrokemija d.d.	17 – 24
Consolidated statement of comprehensive income	25
Consolidated statement of financial position	26
Consolidated statement of changes in equity	27
Consolidated statement of cash flows	28
Notes (<i>forming part of the financial statements</i>)	29 - 63

Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016

Key indicators for Petrokemija Group for 2016

- Actual total revenues of Petrokemija Group: HRK 1,940.7 million, 24.9% down than the previous year,
- Loss from operating activities HRK 49.2 million, loss from financial activities HRK 38.4 million, total loss HRK 87.6 million,
- EBITDA for Petrokemija Group: HRK 33.9 million,
- Actual production of fertilizers – 1,069 thousand tons, 11.7% less than in 2015,
- Compared to 2015, production of NPK fertilizers decreased by 30.9%, production of Urea decreased by 12.1%, whereas the production of CAN was 4.6% higher,
- Utilization of currently installed production capacity of the facilities - 86.4% (taking into account the month of overhaul in July and part of August),
- Actual sales of fertilizers – 1,086 thousand tons, down 5.8% on last year,
- Share of fertilizer sales in the domestic market – 27 %,
- Domestic sales - 288 thousand tons, while 798 thousand tons of mineral fertilizers sold in export,
- Capital and reserves on 31.12.2016 for Petrokemija Group – HRK 45.5 million,
- Invested in Petrokemija, d.d. – HRK 138.9 million,
- Employed on 31.12.2016.: Petrokemija, d.d. – 1,595; Petrokemija Group – 1,733.

Management's analysis of Group operations for the year ended 31 December 2016

- In January – December 2016, Petrokemija Group had total income of HRK 1,940.7 million and total expense of HRK 2,028.30 million. The Company reported loss of HRK 87.9 million or 4.5% of the total revenues.
- After high growth of USD in 2015, in the reporting period there were no significant deviations, rise or fall of the USD and EUR compared to the previous year or to the planned values. Exchange rate of USD was 0.8% lower than in 2015.
- In procurement of natural gas, the share of volumes in prices set in USD was 45%, and in those set in EUR 55% with a trend of lower dependence on the USD exchange rate, which was an individually most significant financial risk in the operations of Petrokemija, d.d. in the previous period.
- In the structure of income, domestic sales amounted to 31.8% or HRK 588.8 million, 16.8% lower when compared to 2015, while export accounted for 68.3% or HRK 1,264.6 million, 30.1% lower than 2015.
- Lower sales volumes by 5.8% and lower average sales by 22.4% compared to the same period of 2015.
- In assortment, compared to 2015, higher sales in 2016 of CAN by 19.1%, lower realization of NPK fertilizer sales by 33.6% (market reasons; lower consumption caused the imbalance of phosphorus and potassium prices in relation to the NPK fertilizers), and Urea by 5.1%.
- Domestic sales 0.7% higher in volume than in 2015;
- Export sales volumes 7.9% lower than in 2015;
- Sales volumes of clay-based products and liquid fertilizers 13.6% higher than in 2015.
- Fall of fertilizer prices in the world market was transferred to a significant extent to the EU and the region, which resulted in increased imports of cheaper fertilizers;
- Lower domestic sales were caused by the customers' liquidity problems (Petrokemija, d.d. has no sources of funding deferred payments, and banks refuse to support the long production process in agriculture), delay in payment of state incentives to domestic market and the increasingly common principle of buying last minute before application with direct manipulation in the field (partly due to the delay of the spring sowing season and application of fertilizers, because of precipitation and low temperatures);
- Exceptionally low price of cereals and other agricultural products have resulted in the reduction of land sown with these crops, and consequently the use of mineral fertilizers per hectare, so even the largest buyers are reducing purchase of mineral fertilizers;
- Liquidity indicators are below recommended value, but significantly improved from last year (on 31.12.2016, negative working capital was HRK 38 million; on 31.12.2015 it was HRK 161 million);
- Short-term assets decreased by 10.68% compared to end 2015, and short-term liabilities increased by 3.19% (the effect of HBOR loan and debt rescheduling for natural gas);

Petrokemija d.d.

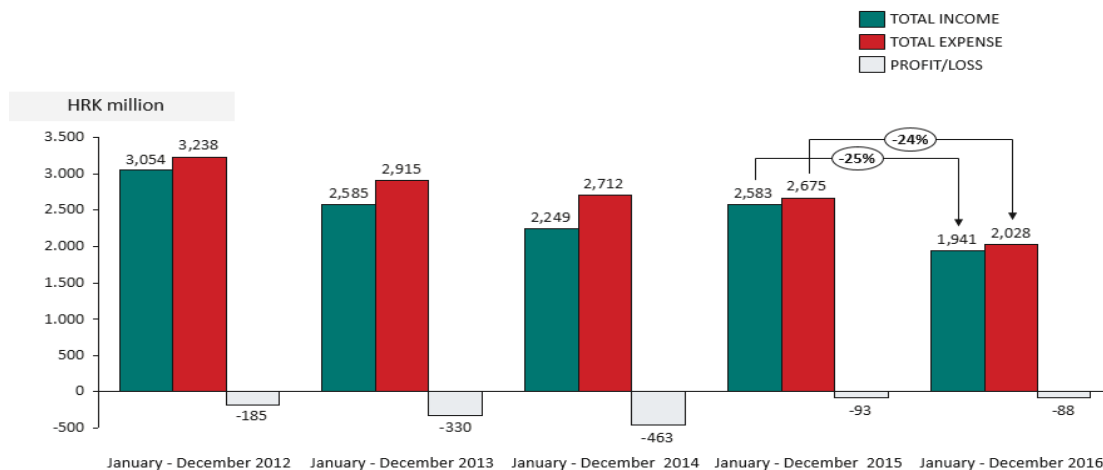
Management report on the Group for the year ended 31 December 2016 (continued)

Management's analysis of Group operations for the year ended 31 December 2016 (continued)

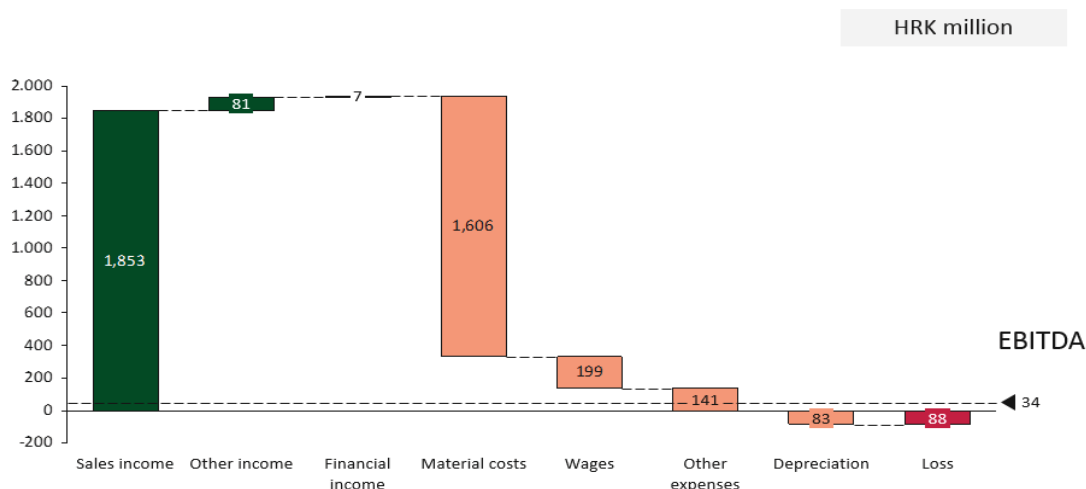
- Indicator of financial stability as well as indicators of indebtedness and own funding are below recommended values;
- Average realized natural gas price (without transport costs) was 34.7% lower in HRK and 33.87% lower in USD than in 2015, while transport costs of natural gas were 21.3% higher;
- Total number of employees of Petrokemija Group is 1,733, a reduction of 29 or 1.7% as compared to 31.12.2015.;
- Achieved level of investment was HRK 138.9 million, an increase of HRK 85.6 million as compared to 2015.

Profit and Loss 2016

- Total income: HRK 1,940.7 million,
- Total expenses: HRK 2,028.3 million,
- Loss before tax: HRK 87.6 million,
- **EBITDA: HRK 33.9 million**



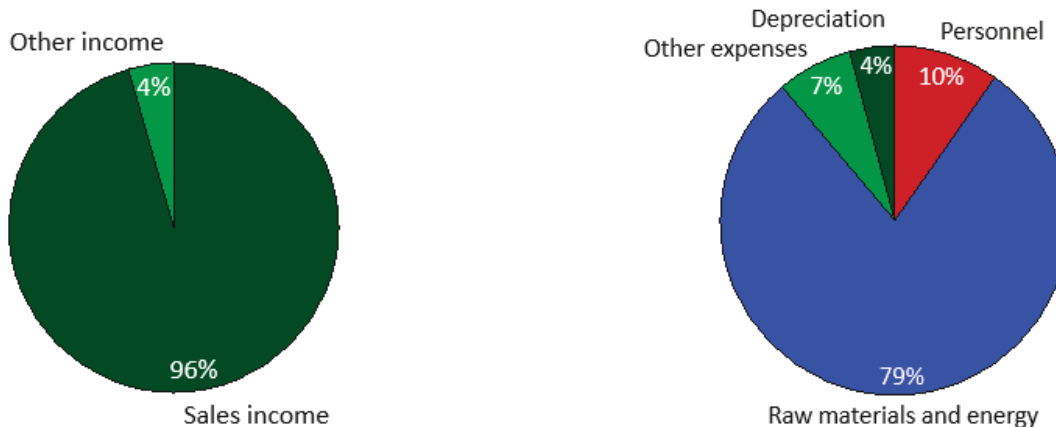
Structure of income and expenses in 2016



In 2016, Petrokemija d.d. achieved 30% of income from domestic market, 65% income from export, and financial and other income account for 5% of total income. Out of total, 96% of Petrokemija Group income is from sales of products and services and 4% is other income. In the structure of total expenses of Petrokemija Group, the dominant 79% account for raw materials and energy; personnel costs for 10%, while all other costs make 11%.

Petrokemija d.d.
Management report on the Group for the year ended 31 December 2016
(continued)

Structure of income and expenses in 2016 (continued)

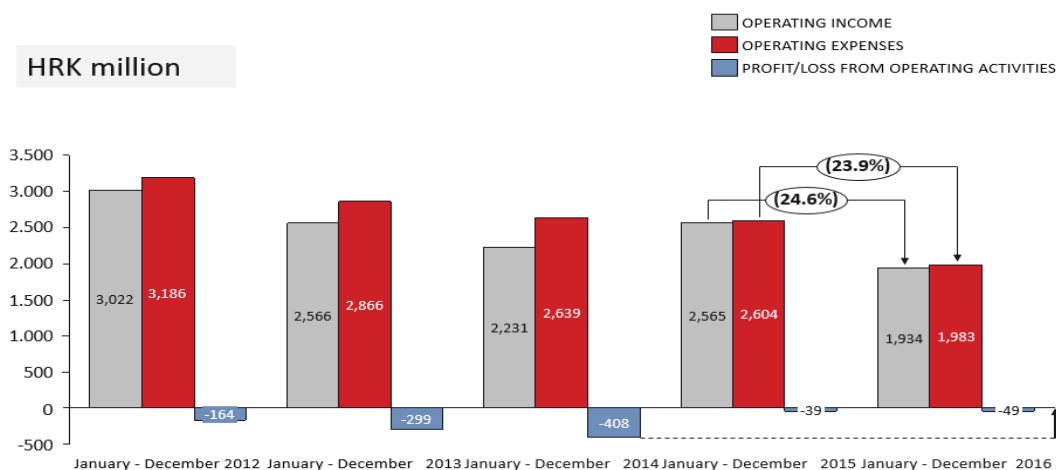


Key financial indicators for 2016:

(HRK 000)

	January – December 2016	January – December 2015	Difference	% change
Operating income	1,933,698	2,565,246	(631,548)	(24.62%)
Operating expense	1,982,855	2,604,117	(621,262)	(23.86%)
EBITDA *	33,927	54,217	(20,290)	(37.42%)
Amortization	83,084	93,088	(10,004)	(10.75%)
Net financial income / (expenses)	(38,454)	(53,978)	(15,524)	(28.76%)
Net extraordinary income / (expenses)	-	-	-	-
Profit / loss / before taxation	(87,611)	(92,849)	5,238	(5.64%)
	31.12.2016	31.12.2015		
Fixed assets	685,498	632,599	52,899	8.36%
Current assets	539,216	603,661	(64,445)	(10.68%)
Capital and reserves	45,501	133,189	(87,688)	(65.84%)
Long-term liabilities + provisions	187,125	141,633	45,492	32.12%
Current liabilities + provisions	992,088	961,438	30,650	3.19%

Operating profit or loss for Petrokemija Group in the period 2012-2016



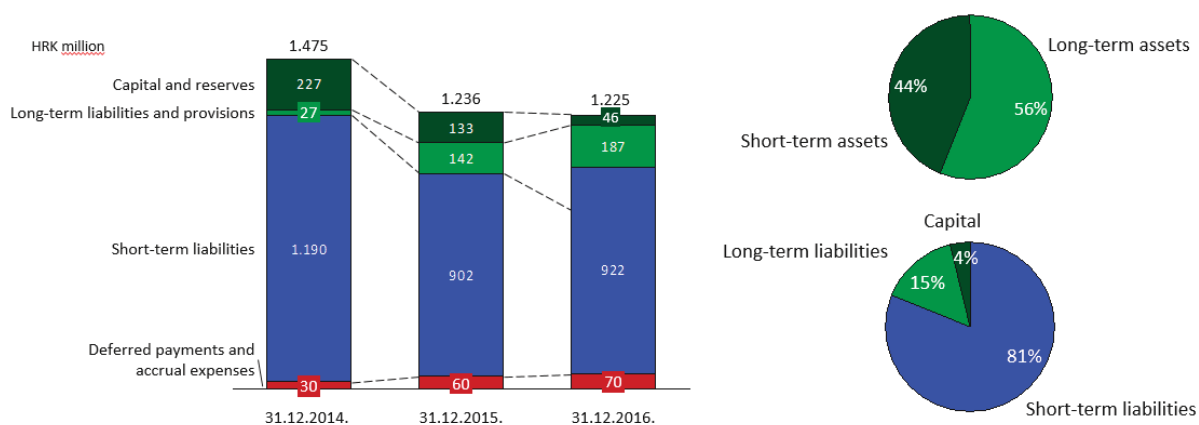
Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016 (continued)

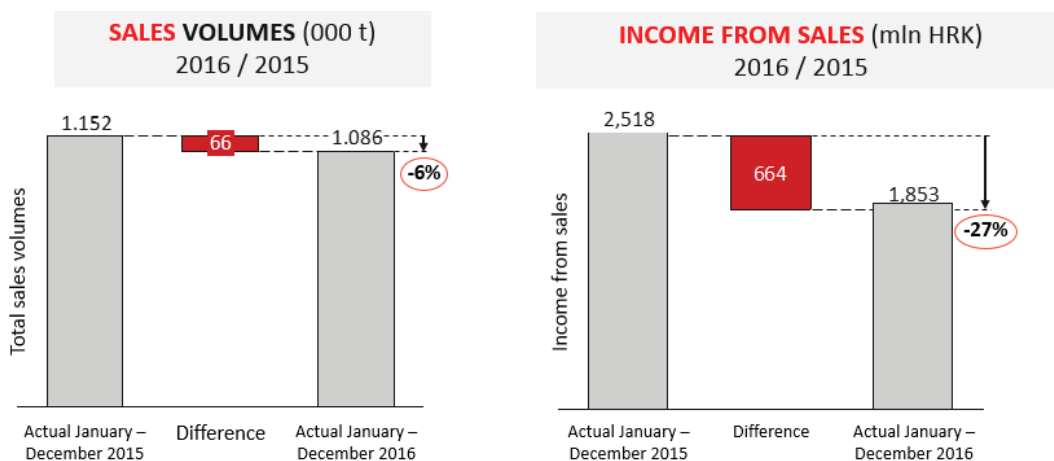
Structure of assets and liabilities at 31 December 2016

As at 31 December 2016, Petrokemija Group had 44% in value of short-term and 56% in long-term assets, which can be attributed to relatively high depreciation and the age of production and auxiliary facilities.

The level of capital reflects the impairment for losses reported for 2014 and 2015. In the structure of debt during the third quarter there was a change in the structure and approximate equalization of long- and short-term sources, as a result of rescheduling debt for gas from the previous period and approval of HRK 200 million long-term loan from HBOR. At the end of the reporting period on 31.12.2016, a part of long-term liabilities falling due in 2017 was transferred to short-term liabilities thus making short-term liabilities in excess of short term assets of HRK 453 million.



Total fertilizer sales

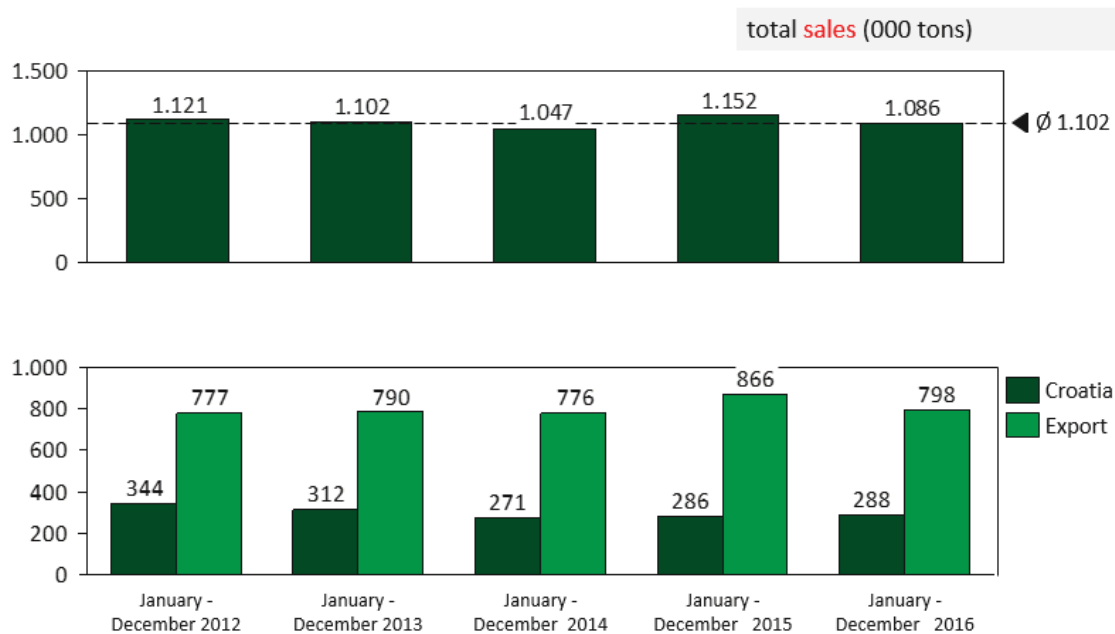


Actual fall in sales volumes of fertilizers of 6% and fall in income from sales of fertilizers of 27%, which indicates a significant decrease in average selling prices.

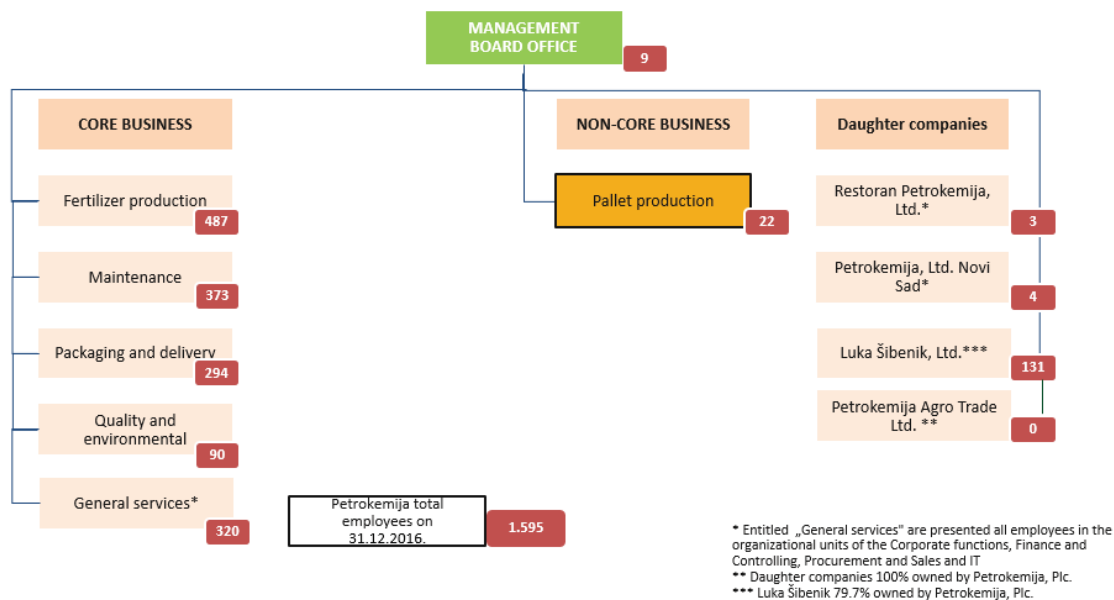
Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016 (continued)

Actual fertilizer sales in the period 2012-2016

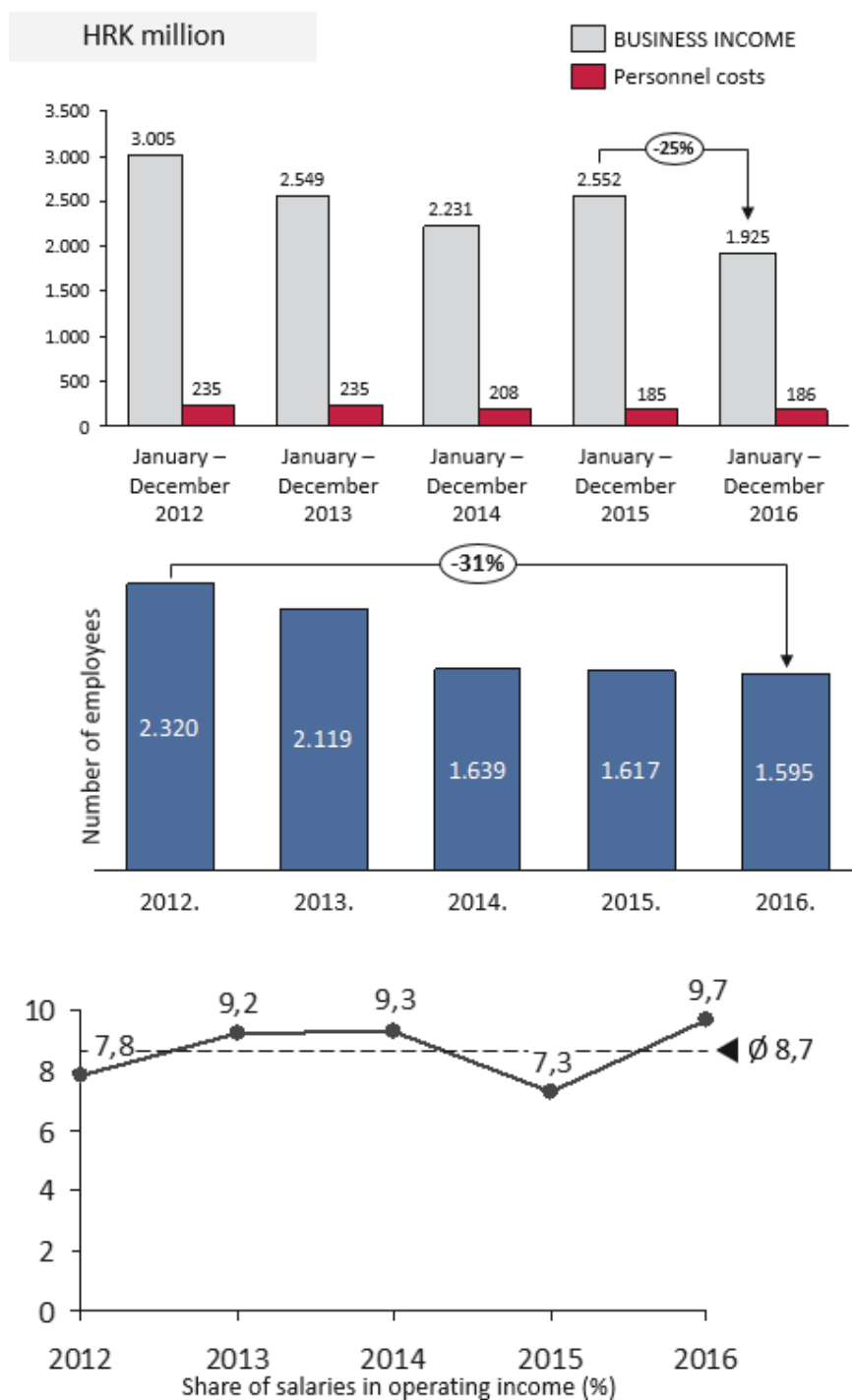


Organization chart of Petrokemija d.d. and Petrokemija Group



Petrokemija d.d.
Management report on the Group for the year ended 31 December 2016
(continued)

Operational income, personnel costs, number of employees



As at 31 December 2016 Petrokemija d.d. had 1,595 employees, and its subsidiaries - members of Petrokemija Group 138, which is a total of 1,733 employees.

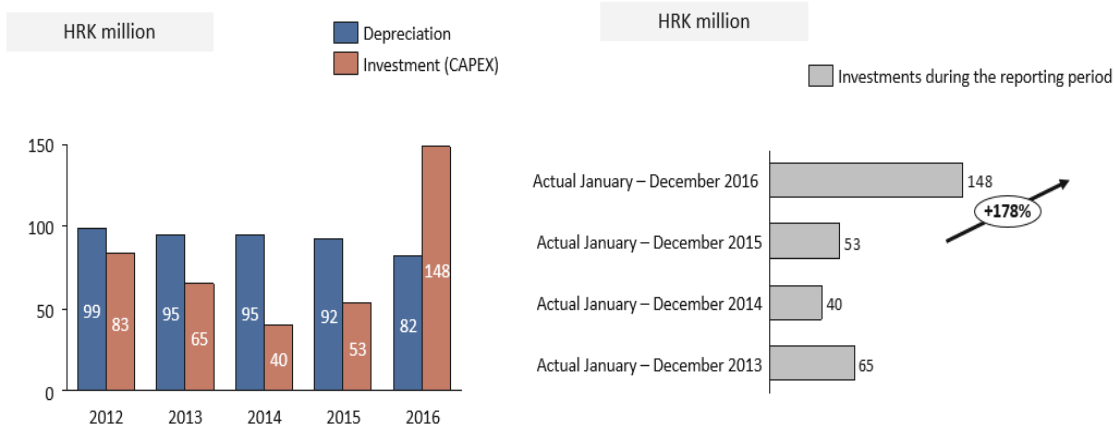
Personnel costs share in operating revenues was 9.7%.

Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016 (continued)

Realized investment

Investment realized in reporting period amounted to HRK 138.9 million. Compared to the same period of 2015, it is an increase of HRK 85.6 million or 178%. The realization of planned level of investment of HRK 173 million on an annual basis is not completely realized (index 79.9), due to limited funding opportunities, or lack of support for banks.



Air quality in the Kutina area for January to December 2016 period at local monitoring station (K1, K2, K3, K5, K6 i K7) and the state monitoring station (DMP)



Clean or slightly polluted air	Polluted air	Pollutants
1 st category C<LV	2 nd category C>LV	
K2, K7, DMP		Sulphur dioxide (SO ₂)
K1, K2, K3, K6, K7		sediment
K1, K2, K3, K5, K6, K7, DMP		Ammonia (NH ₃)
K1, K2, K3, K5, K6, K7, DMP		Nitrogen dioxide (NO ₂)
K2, K7, DMP		Hydrogen sulphide (H ₂ S)
	DMP	PM10

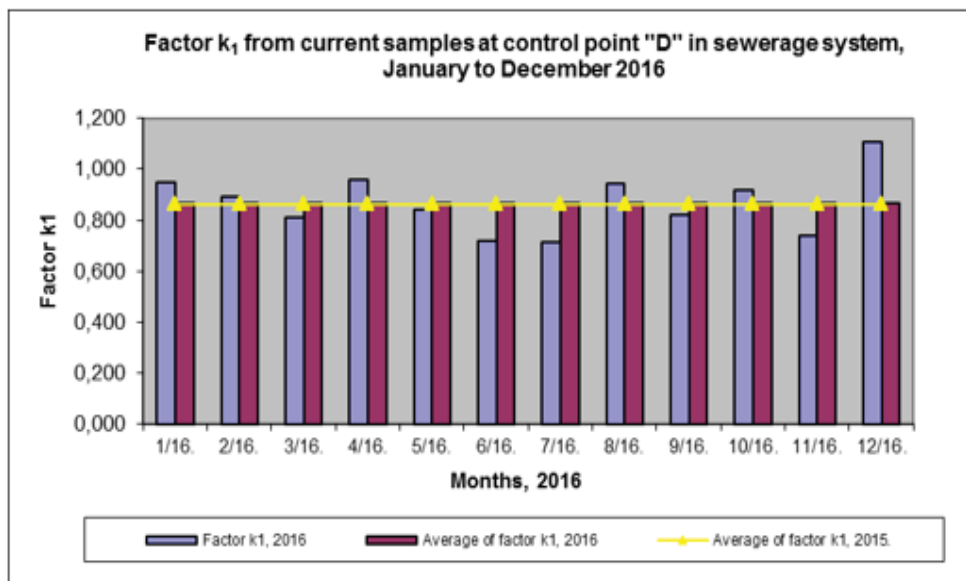
Note: The categorization of air quality at DMP can be changed after validation of data that has not been made by the competent institution.

Petrokemija d.d.
Management report on the Group for the year ended 31 December 2016
(continued)

Ambient air limit value (LV) exceedance of AMMONIA in the January to December 2016 period (local network)

Monitoring station	The number of limit value (LV) exceedances in the January to December 2016 period/ permitted exceedance number
K 1 - Dom zdravlja	32 / 7
K 2 - Vatrogasni dom	25 / 7
K 6 - Husain	6 / 7
K 7 - Krč	3 / 7
TOTAL	66

Water management



In the period from January to December 2016, the average value of k₁ factor is on the same level than average value in the same period of 2015.

In the period from January to December 2016, monthly average consumption of raw water is lower than average value in the same period of 2015.

Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016

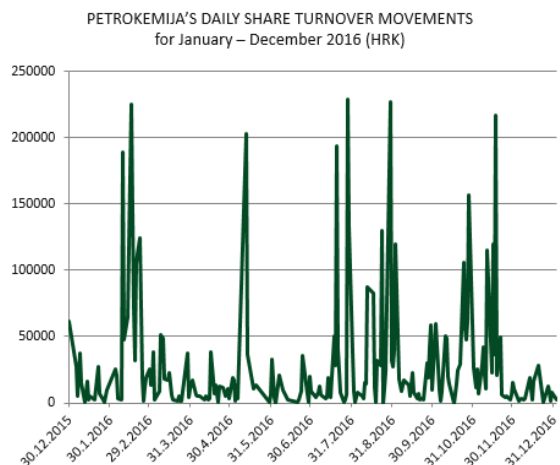
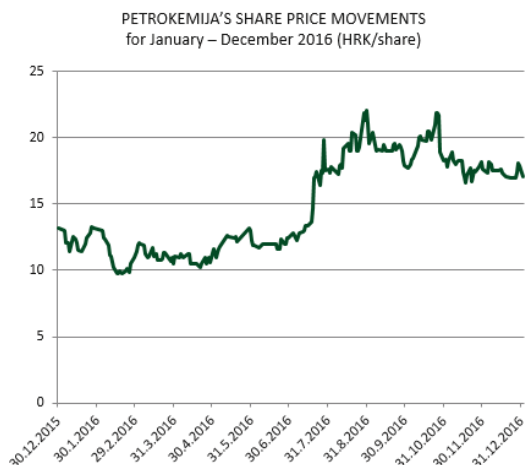
(continued)

Company share capital, market value of the share, changes in Supervisory Board

After the conducted increase in 2015, the Company share capital amounts to HRK 386,135,400.00 and is divided into 12,871,180 ordinary shares marked PTKM-R-A, with a nominal amount of HRK 30.00.

On 30 December 2015, the average share value was HRK 13.14, and on 30 December 2016 it was HRK 17.90 (increase of 36.22%).

Petrokemija d.d. share price and daily turnover movements



Changes in Supervisory Board

Tomislav Pokaz resigned as President and member of the Supervisory Board of Petrokemija effective as of 8 February 2016, for reasons of a new position that is incompatible with membership in the Supervisory Board.

At the meeting of 19 February 2016, Branimir Fleković was appointed President and Sonja Ivoš Vice President of the Supervisory Board.

General Meeting of Petrokemija, d.d. was held on 11 May 2016. A new Supervisory Board was appointed, consisting of Ladislav Turčinović, Marijan Kuprešak, Mladen Novak and Mijo Šepak. Željko Klaus remained appointed member of the Supervisory Board as workers' representative.

At the Supervisory Board meeting of 12 May 2016, Marijan Kuprešak was elected President and Željko Klaus Vice President of the Board.

Supervisory Board member, Mladen Novak, resigned from membership in the Supervisory Board of Petrokemija, effective as of 31 July 2016.

At the meeting of 6 February 2017, Mijo Šepak was elected President of the Supervisory Board.

At its meeting of 6 February 2017, the Supervisory Board passed a decision establishing the mandate termination as on that day of the President of the Management Board Nenad Zečević and members of the Board Antonija Perošević Galović, Tamara Pernar and Vladimir Fresl. The Supervisory Board appointed Đuro Popijač from Zagreb as President and Nenad Zečević member of the Management Board. The mandate of the appointed members of the Board began on 7 February 2017 and runs until 6 February 2021.

An Extraordinary General Assembly Meeting was held on 23 March 2017 where Robert Blažinović was appointed as new member of the the Supervisory Board.

Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016

(continued)

Key events in 2016

- In October 2015, following the Decision of the Croatian Government of 24 September 2015 on granting authorization to the General Meeting to adopt the decision on conducting the capital increase in cash, assets and rights of Petrokemija d.d. Fertilizer Company, Kutina, a public call to submit indication of interest to subscribe for new ordinary shares of Petrokemija was published. After the conducted due diligence, one binding offer of a potential investor was received, which was not realized by 31. December 2016. At the time of these financial report, the Company Board has no precise knowledge of the intentions of the majority owner or potential investors.
- Due to the partial failure to achieve the assumptions of the Program of Restructuring and Financial Consolidation for the period 2015 -2019, in the first quarter of 2016, a revised Program, i.e. Business Plan for 2016 -2020 was made, which includes changes in the assumptions with regard to the change of product range and the current level of input-output prices, the new recapitalization and debt rescheduling as well as the reduction of the amount of investment.
- At the session held on 11 May 2016, the Croatian Government adopted the Decision on amending the Decision on establishing the list of companies and other legal entities of strategic and special interest for the Republic of Croatia. Petrokemija, d.d., Kutina was removed from the list of companies of special interest in which the Republic of Croatia has a majority share. Following the above mentioned Decision, on 6 July 2016, a transfer of shares of Petrokemija d.d. was made, from the State Office for State Property Management (DUUDI) to the Centre for restructuring and sale (CERP), as a legal entity with public authority which specializes in the management of shares and interests in companies whose owner is the Republic of Croatia and which are not defined as companies of strategic and special interest for the Republic of Croatia.
- Through continuous and long negotiations with two natural gas suppliers, INA d.d. Zagreb and Prvo plinarsko društvo d.o.o. Vukovar, Petrokemija, d.d. managed to revise the existing terms of natural gas supplies for gas year 2015/2016. Moreover, the Company contracted certain volumes of natural gas under new terms for the gas year 2016/2017.
- Upon an international tender, the Company concluded a new contract for supply of natural gas in the gas year 2016/2017 for the remainder of the necessary volumes. The contract was concluded with Prvo plinarsko društvo Ltd. Vukovar, as the most favorable supplier. With this contract, Petrokemija secured sufficient volumes of natural gas for a stable planned production in the gas year 2016/2017. The contracted terms of natural gas supply are one of the preconditions for further restructuring and financial consolidation of the Company.
- According to Plans on Overhaul Works in 2016, overhauling of fertilizer production facilities was conducted in July and the first half of August. By the scope of work, it was one of the largest in the past decade. The total investment was about HRK 139 million, out of which, next to the co-financing by the Croatian Bank for Reconstruction and Development from the Loan Program for Financing Projects of Environmental Protection, Energy Efficiency and Renewable Energy Resources, 38 million kuna was invested in the construction of a new high-pressure gas pipeline, which now supplies natural gas to all production facilities of the Company. During the overhaul, Measure M7 investment was realized at Urea Plant, which will help achieve a significant improvement in environmental standards in terms of reducing pollution of waste water.
- At its 38th session held on 31 August 2016, the Croatian Government adopted the Decision on granting approval to Petrokemija, d.d., to take a loan of HRK 200 million from Croatian Bank for Reconstruction and Development for the implementation of the Company restructuring and financial consolidation and the Decision on granting state guarantee for the benefit of Croatian Bank for Reconstruction and Development for the loan. Details on the website of the Croatian Government: <https://vlada.gov.hr/sjednice/38-sjednica-vlade-republike-hrvatske-19380/19380>
- Following the Government Decision on granting approval to Petrokemija, d.d., for a loan of HRK 200 million, Petrokemija and the Croatian Bank for Reconstruction and Development signed a loan agreement. The loan was used for settling the due liabilities for natural gas and the implementation of the Company restructuring and financial consolidation in accordance with the Government's decisions.

Petrokemija d.d.

Management report on the Group for the year ended 31 December 2016

(continued)

Key events in 2016 (continued)

- The Supervisory Board of Petrokemija d.d. approved the selection of consultant for the development of the Company Restructuring Program in accordance with the prescribed activities from the Government Decision on approval for a loan of HRK 200 million from the Croatian Bank for Reconstruction and Development. Activities on the Restructuring Program began on 15 September 2016; by the end of reporting period the first draft was made. At the date of signing the audited financial statements the management in cooperation with consultants has developed a proposed Concept of restructuring that has been sent to relevant institutions for consideration.
- Petrokemija, d.d. and HEP-ESCO d.o.o. signed the Contract on the implementation of energy efficiency project Modernization of Electric Drive Systems at Water-2 Plant, Power Plant and Pakra Pumping Station and Modernization of Part of the System of Outdoor Lighting. These investments in energy efficiency measures will achieve electricity savings of around 3.4 GWh on an annual basis, with the intended return on investment within two years. HEP-ESCO will finance and manage the project, and the investment will be returned through savings.
- On 10 November 2016, a contract was signed on the merger of the company Restoran Petrokemija, Ltd. (Transferor company) and Petrokemija, d.d. (Transferee company). The merger agreement was received on 11 November 2016 by the Commercial Court in Zagreb under number: R3-16464 / 16. In 2017 Restoran has continued its regular activities as one of the organizational units within Petrokemija, d.d.

Significant financial risks in 2017

The overall business position of Petrokemija, d.d. in 2017 depends on a number of factors, whose impact is very difficult to estimate. The contracted new terms of natural gas procurement and rescheduling of outstanding debt for natural gas have reduced a part of the risk transferred from the previous period.

However, according to the current market situation, it is estimated that in 2017 there will continue to be a pronounced influence of variable levels of fertilizer prices in the world market and the relatively high level of natural gas price in Europe and Croatia. Extremely high financial burden on the business of Petrokemija, d.d. is exceptionally high price of natural gas transport, which is up to three times higher than in other EU countries. Furthermore, the level of financial expenditure and operational business management will be significantly affected by the Company's insufficient liquidity and high cost of financing. The final financial result for the business year 2017 is likely to depend on the pace and scope of potential measures for restructuring of the Company and Petrokemija Group. In addition to the above, caution is still suggested due to the following risks:

- Petrokemija d.d. is highly dependent on the movements of fertilizers and their raw materials price in the global market, the exchange rate of the HRK against USD and EUR and their interrelationship. After the high growth rate of USD of on average 19.4% in 2015, in 2016 the USD exchange rate did not cause significant additional negative impacts on the business of Petrokemija, d.d. and Petrokemija Group,
- Natural gas as the most important raw material is still procured on the domestic market, according to contracts concluded with two suppliers – INA, d.d. Zagreb and Prvo plinarsko društvo d.o.o Vukovar. The price of natural gas in 2017 is linked to the EUR exchange rate and the movement of natural gas prices on the European spot market,
- The sales prices of fertilizers in the global market have grown in late 2016 and early 2017, but are still very low (short-term also influenced by cyclical and seasonal changes) and the price of nitrogen fertilizer Urea has been at a very low level for a long time now; so in case of a more pronounced growth of natural gas price on the European spot market, profitability of production may come in question at certain time intervals,
- Lower VAT in 2017 should have positive effects on mineral fertilizer sales in the domestic market.
- Purchasing prices of most primary raw materials are lower than in the previous period, but fluctuations in raw material prices on the world market, which have so far been present, will continue to have impact on material costs in the next period,
- High costs of working capital – because of insufficient own working capital, financing costs were reduced, but will continue to be significant in the next period,

Petrokemija d.d.
Management report on the Group for the year ended 31 December 2016
(continued)

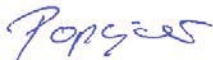
Significant financial risks in 2017 (continued)

- In 2016, an extensive overhaul was conducted, whose implementation was partly financed from long-term sources. However, the risks in terms of providing the remaining long-term financing sources are still present in 2017, and it is very difficult to finance the continuation of the investment process from operative business. Deadlines for implementation of part of the so-called 'environmental investment' by 31. December 2017, in accordance with the Decision of Integrated Environmental Requirements, will be very difficult to meet, and some investments are likely to be transferred to 2018 due to difficulties in financing.
- By settling the debt for natural gas supplied in the previous periods and approval of loan by HBOR of 200 million HRK in the third quarter of 2016, the risk of blockade and delays in the delivery of natural gas, and consequently production, was avoided. However, the price movements of natural gas on the European spot market calls for caution,
- As mentioned earlier, funding of investment is still not covered by long-term funding sources and will depend on the key decisions of the majority owner in view of the continuing process of restructuring, recapitalization and/or finding a strategic partner.
- Higher level of realized loss in the fourth quarter of 2016, compared to the earlier part of the year, suggests caution in predicting financial and operating results in 2017. A part of this negative impact will already be transferred to the result of the first quarter of 2017, due to the liabilities for delivery of fertilizers for received advance payments from the fourth quarter of 2016.

Other information

The Group does not have significant research and development activities. Furthermore, as the Company comprises a large majority of the assets, liabilities, equity, income and expenses of the Group, management analysis is primarily based on the results of operations and the financial position of the Company and does not discuss individual operations of the Company's subsidiaries.

Đuro Popijač
President of the Management Board



Nenad Zečević
Member of the Management Board



13 April 2017
Aleja Vukovar 4
Kutina
Croatia



Petrokemija d.d.

Statement of implementation of the corporate governance code

General information

The Company and its subsidiaries adhere to the objectives and guidelines of the corporate governance code and the principles contained therein in accordance with regulations and directives of Republic of Croatia, Zagreb Stock Exchange Rules and national best practices. The aim of such corporate governance is to ensure effective and transparent distribution of the roles and responsibilities of its corporate Bodies, proper balance of strategic supervision, management and control functions with emphasis on risk management, protection of assets of the Company and its reputation. The business strategy, corporate policy, key corporate regulations and business practice are all geared towards creating a transparent and efficient business operation while forging solid bonds with the local community.

The Company is listed on the Official market of the Zagreb Stock Exchange, and has complied with the Zagreb Stock Exchange Governance Code. The Company respects and implements the prescribed corporate governance measures (as reported in detail in the prescribed annual questionnaire and published as prescribed on the Zagreb Stock Exchange). The major direct shareholders according to the Central Depository and Clearing Company data are listed in the table for structure of ownership in the *Share Capital* note to the financial statements.

The Companies Act and the Company's Articles of Association define the General Assembly's authority and prescribe how it meets and works. The meeting invitation, proposals and the adopted resolutions are made public according to the provisions of the Companies Act, the Capital Market Act and the Zagreb Stock Exchange Rules. There is a time limit related to the voting right at the General Assembly: according to the provisions of the Croatian Companies Act, shareholders are required to register their participation within the prescribed time limit in order to attend the General Assembly. Under no circumstances can the financial right arising from securities be separated from holding the securities. There are no securities with special control rights nor are there any limitations to voting rights in the Company (one share, one vote).

The Company's Articles of Association comply with the Croatian Companies Act and they define the procedure of appointing and recalling members of the Management Board and Supervisory Board. There are no limitations based on gender, age, education and profession or similar. The Companies Act determines any amendments to the Company's Articles of Association, without any additional limitations. The Management Board members' authority fully complies with the regulations prescribed by the Companies Act.

Corporate governance structure

In accordance with the Companies Act and the Company's Articles of Association, the bodies of the Company are the General Assembly, the Supervisory Board, and the Management Board. The mentioned also acts regulate their duties and responsibilities.

General Assembly of the Company

The General Assembly decides on issues stipulated by law and by the Articles of Association and, among other, it adopts the Articles of Association, decides on the allocation of profits, decides on an increase and a reduction of the share capital, appoints and relieves of duty members of the Supervisory Board, grants the approval of action to members of the Management Board and of the Supervisory Board of the Company, appoints the external auditor of the Bank, and also performs other tasks in compliance with the law and the Company's Articles of Association.

In 2016, a regular Annual General Assembly Meeting was held on 11 May 2016, while an Extraordinary General Assembly Meeting was held on 23 March 2017.

Petrokemija d.d.

Statement of implementation of the corporate governance code

(continued)

Supervisory Board

The Supervisory Board of the Company supervises the conduct of business affairs in the Company. With this end in view, it goes through and examines the Company's business accounts and documentation. The Supervisory Board submits to the General Assembly a written report on the supervision exercised with respect to the conduct of business affairs in the Company. As at the date of this annual report, the Supervisory Board consists of four members. As a general rule, regular Supervisory Board meetings are held quarterly. The Supervisory Board may decide on important and urgent matters in meetings held by letter.

Members of the Supervisory Board as at the date of this annual report and during the reporting period are as follows:

Mijo Šepak	Member until 5 February 2017, President from 6 February 2017
Marijan Kuprešak	Member until 11 May 2016, President until 6 May 2017 and Member after that date
Branimir Fleković	Vice president until 19 February 2016, President from 19 February 2016
Tomislav Pokaz	President, until 8 February 2016
Sonja Ivoš	Member until 19 February 2016, Vice president until 11 May 2016
Željko Klaus	Member until 11 May 2016, from 11 May 2016 Vice President
Krešimir Huljev	Member until 11 May 2016
Ladislav Turčinović	Member from 11 May 2016
Mladen Novak	Member from 11 May 2016 until 31 July 2016
Robert Blažinović	Member until 23 March 2017

Audit Committee

Pursuant to its Articles of Association, the Supervisory Board of the Company established the Audit Committee whose work is governed by the Audit Committee Charter.

The Audit Committee, appointed in accordance with the law, consists of four members during the previous year, all of whom were also members of the Supervisory Board. During 2016, five meetings of the Audit Committee were held, discussing the issues within the competence of the Supervisory Board. The Audit Committee helped the Supervisory Board in carrying out its duties related to the supervision of the financial reporting process, the audit process (including the recommendation of the General Meeting for the election of the external auditor), as well as compliance with laws, regulations, rules and the code of ethics.

The Supervisory Board, with the help of the Audit Committee, monitored the adequacy of the internal control system, which is achieved through three independent control functions (internal audit, risk control, compliance), and in order to establish such a system of internal controls that will enable early detection and monitoring of all risks to which the Company is exposed in its operations. The Audit Committee as at the date of this Annual report is composed of:

Marijan Kuprešak	President
Mijo Šepak	Member
Željko Klaus	Member
Ladislav Turčinović	Member
Robert Blažinović	Member

Management Board

The Management Board conducts business operations of the Company. The number of Board members varies and the Board currently has two members. Board members are generally appointed in up to four-year terms of office and entrusted with a specific area of responsibility. The Management Board regularly meets to reach management decisions. Members of the Management Board as at the date of this annual report and during the reporting period are as follows:

Đuro Popijač	President from 6 February 2017
Nenad Zečević	Member, President until 6 February 2017
Antonija Perošević Galović	Member until 6 February 2017
Tamara Pernar	Member until 6 February 2017
Vladimir Fresl	Member until 6 February 2017

Petrokemija d.d.

Statement of implementation of the corporate governance code

(continued)

Key elements of the systems of internal controls and risk management relating to financial reporting for the Company and the Group

The Company's and the Group's overall control systems include:

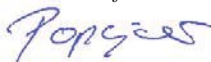
- appropriate organizational structure at all levels with segregation of duties and defined authority limits and reporting mechanisms to higher levels of management
- internal controls integrated into business processes and activities
- accounting and administrative policies and procedures within the scope of the control functions relating to key risks
- corporate governance model consists of a Supervisory Board and a Management Board
- Management Board members with responsibility for core business areas
- reconciliation of data, consolidated into the Group's financial statements, giving a true and fair view of the financial position of the Company and the Group. A review of the consolidated data is undertaken by Management Board to ensure that the financial statements have been prepared in accordance with required legislation and approved accounting policies
- a Code of Conduct establishing the basic standards of conduct of the members of the Management Board and supervisory bodies, as well as employees and external collaborators who are, within their roles, obliged to perform their duties in the interest of the Company and the Group, and their shareholders in a diligent, proper, just and professional manner

The basis of the Company's and the Group's internal control system is to contribute to proper corporate governance and business transparency ensuring safe and stable operations in accordance with regulatory requirements. The main features are as follows:

- a comprehensive set of accounting policies and procedures relating to the preparation of the annual financial statements in line with EU IFRS
- the Company's Internal Audit that oversees the overall operations in order to assess the adequacy of the established system of internal controls
- Department for finance and accounting ensuring the reliability of accounting and financial reporting, controlling and protecting system of internal controls for the preparation of financial information
- the Annual Report is subject to detailed review and approval through a structured governance process involving senior and executive finance personnel.

The Company defined the process of preparing and disclosing financial reports in a detailed internal document. With this, the financial reporting procedure is set within a system of internal review and risk management. Moreover, in order to monitor and mitigate the said risk, the Company uses the measures described in the *Risk Management* note to the financial statements.

Đuro Popijač
President of the Management Board



Nenad Zečević
Member of the Management Board



13 April 2017
Aleja Vukovar 4
Kutina
Croatia



Petrokemija d.d.

Statement of Management Board's Responsibilities

The Management Board of Petrokemija d.d. ("the Group") is required to prepare the consolidated financial statements for each financial year which give a true and fair view of the financial position of the Group and of the results of its operations and its cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the consolidated financial statements on a going concern basis unless it is inappropriate to presume that the Group will continue in business.

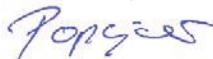
Management acknowledges that uncertainty remains over the Group's ability to meet its funding requirements and to refinance or repay its liabilities as they fall due. However, as described in detail in note 2.4, management has a reasonable expectation that the Group will ensure adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the consolidated financial statements.

If for any reason the Group is unable to continue as a going concern, then this could have an impact on the Group's ability to realise assets at their recognised values and to extinguish liabilities in the normal course of business at the amounts stated in the consolidated financial statements. These financial statements do not include the possible effects which would result from the Group's inability to continue operating as a going concern.

The Management is also responsible for the preparation and content of the Management Report and the Statement on the implementation of corporate governance code, as required by the Croatian Accounting Act. The Management Report set out on pages 1 to 12 and the Statement of implementation of the corporate governance code set out on pages 13 to 15, as well as the accompanying consolidated financial statements were authorised and signed by the Management Board on 13 April 2017 for issue to the Supervisory Board. The Supervisory Board is required to approve the annual consolidated financial statements for submission to the General Assembly of Shareholders for adoption.

The unconsolidated financial statements of the Company and the Annual report on the Company are published separately and issued simultaneously with this Annual report and the consolidated financial statements.

Duro Popijač
President of the Management Board



Nenad Zečević
Member of the Management Board



13 April 2017
Aleja Vukovar 4
Kutina
Croatia





Independent Auditors' Report to the Shareholders of Petrokemija d.d.

Qualified Opinion

We have audited the consolidated financial statements of Petrokemija d.d. ("the Company") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, except for the effects of the matters described in the *Basis for Qualified Opinion* section of our report, the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union ("EU IFRS").

Basis for Qualified Opinion

As described in note 29, the Group has a legal obligation to restore its landfill site in Kutina to its original condition. In accordance with IAS 37 *Provisions, contingent liabilities and contingent assets*, the Group is required to recognize a provision for the costs of land restoration and site closure. No such provision was recognized in the consolidated financial statements as at 31 December 2016 and 31 December 2015. Had this provision been recognised in accordance with IAS 37, adjustments would have been made to increase non-current liabilities and decrease equity by HRK 155,356 thousand as at 31 December 2016 (31 December 2015: HRK 148,520 thousand) and decrease the net result for the year then ended by HRK 6,836 thousand (2015: HRK 6,541 thousand). Our opinion on the consolidated financial statements for the preceding period was also qualified in respect of this matter.

As described in note 18, as at 31 December 2016, inventory of spare parts stated at HRK 95,024 thousand (31 December 2015: HRK 93,662 thousand) includes items relating to major spare parts and stand-by equipment which the Group expects to use during more than one period. IAS 16 *Property, plant and equipment*, requires that such items are classified as part of property, plant and equipment and depreciated accordingly. We have requested the Group to prepare an assessment quantifying the adjustments with respect to this matter. No such assessment was performed.

As described in note 14, as at 31 December 2016, the Group's property, plant and equipment and related spare parts and materials include items stated at HRK 14,567 thousand and HRK 20,140 thousand, respectively (31 December 2015: HRK 16,483 thousand and 20,174 thousand), for which indications exist that their carrying amounts may not be recovered. Pursuant to IAS 16 *Property, plant and equipment* and IAS 2 *Inventories*, the Group is therefore required to assess, respectively, the recoverable amounts and net realisable values of the above assets. No such assessment was performed.

It was not practicable for us to quantify the effects of the departures from EU IFRS discussed in the preceding two paragraphs on the stated amounts of property plant and equipment, inventories and accumulated losses as at 31 December 2016 and 31 December 2015 as well as on the stated amounts of depreciation, impairment losses and net result for the years then ended. Our opinion on the consolidated financial statements for the preceding period was also qualified in respect of these matters.

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



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

Material Uncertainty Related to Going Concern

Without further qualifying our opinion, we draw attention to note 2.4 to the consolidated financial statements, which indicates that the Group incurred net losses of, respectively, HRK 87,945 thousand and HRK 93,198 thousand, for the years ended 31 December 2016 and 31 December 2015. As at 31 December 2016, the Group's current liabilities exceeded its current assets by HRK 452,872 thousand. Furthermore, the Group breached financial covenants on a loan in the amount of HRK 191,610 thousand and has other liabilities maturing within twelve months of the reporting date in the total amount of HRK 314,582 thousand that it does not expect to have the ability to repay. In addition, capital expenditure in the amount of HRK 250,000 thousand is required by the end of 2018 for the Group to maintain a competitive level of production costs and meet various environmental requirements. As stated in note 2.4, these events and conditions, along with other matters as set forth in note 2.4, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matters described in the *Basis for Qualified Opinion* and in the *Material Uncertainty Related to Going Concern* sections, we have determined the matters described below to be the key audit matters to be communicated in our report.

Carrying amount of property, plant and equipment

The carrying amount of property, plant and equipment (PPE) as at 31 December 2016 is HRK 677,243 thousand with related depreciation charge for the year of HRK 81,425 thousand.

Refer to accounting policy 3.5 and note 14 to the consolidated financial statements.

Key audit matter	How we addressed the matter
<p>The Group's reported property, plant and equipment with a total carrying amount of HRK 677 million comprises mostly the Company's main production facility in Kutina.</p> <p>During the year ended 31 December 2016, additions to PPE of HRK 137 million included HRK 37 million relating to capitalized own costs. Identification of such costs and their amount as well as the determination of whether they satisfy the capitalization criteria generally involves more complex assumptions.</p> <p>Depending on its nature, expenditure relating to fixed assets may be capitalised as PPE or expensed as incurred. In making this decision management have to consider inter alia whether the expenditure will generate future economic benefits which necessarily involves judgment, for example in determining whether activities or items are adding value or maintaining existing assets.</p> <p>Useful lives of PPE are reviewed annually and judgement is applied primarily taking into consideration technical factors which may affect the useful life expectancy of assets.</p>	<p>With respect to capitalisation of PPE, we have performed the following procedures, amongst others:</p> <ul style="list-style-type: none">▪ Assessed the Group's capitalisation policies for compliance with relevant accounting standards▪ On a sample of items, we traced capitalised amount to underlying supporting documentation (e.g. invoices).▪ Assessed the reasonableness of useful lives applied by the Group by reference to useful lives applied by companies in the same industry, as well as through inquiries with relevant technical personnel.▪ Inspected a sample of transactions for disposal of PPE in order to assess whether significant gains or losses on disposal were recognised and whether such gains or losses are indicative of the depreciation rates not reflecting the actual useful lives of those assets.▪ Challenged the amounts of own costs capitalised by reference to budgeted figures and our understanding of the nature of the work performed.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

Key Audit Matters (continued)

Carrying amount of property, plant and equipment (continued)

Key audit matter	How we addressed the matter
<p>Furthermore, the continued deterioration in the Group's performance as a result of adverse market conditions due to decreasing market prices of fertilizers and inadequate access to market supply of natural gas (primary production input) represents indicators of potential impairment of the Company's property, plant and equipment.</p> <p>As required by relevant financial reporting standards, individual items of property, plant and equipment or cash generating units (CGUs) for which impairment indicators exist are required to be tested by the Group for potential impairment. Any such impairment would be recognised in the amount by which the carrying amount of the asset (or a related CGU) exceeds its recoverable amount.</p> <p>The estimation of the recoverable amount of these assets, which is generally considered to be their value in use (based on discounted cash flow models) or, in some cases fair value less costs to sell, relies on significant judgments and assumptions about the future, including: future profitability growth, capital expenditure, working capital, inflation and the most appropriate discount rate. These projections are exposed to significant variability due to changing market conditions.</p> <p>Therefore, the assessment of fair values and impairment testing of property, plant and equipment is determined to be a key audit matter.</p>	<p>With respect to impairment risk, we have performed the following procedures, amongst others:</p> <ul style="list-style-type: none">▪ Reviewed the Group's controls over the identification of impairment triggers;▪ Assessed the appropriateness of the Group's judgments regarding identification of assets or CGUs which may be impaired;▪ Assessed the appropriateness of allocation of assets to CGUs;▪ Critically assessed the Group's assumptions and estimates used to determine the recoverable amounts of property, plant and equipment and any impairment losses recognised, using our own valuations specialists. This included:<ul style="list-style-type: none">- challenging management's assessment of the projected financial performance by comparing actual results to the prior periods' budgeted figures as well as to forecasts for future periods;- testing the integrity of the model, including its mathematical accuracy, and evaluating the key assumptions applied (such as forecast sales volumes, market prices of fertilizers and natural gas in the forthcoming period) for reasonableness compared to both externally derived data and historical financial performance;- compared management's key assumptions with respect to expected capital expenditure included in the model with the existing capital commitments and historical capital expenditure levels;▪ Assessed the Group's analysis of the sensitivity of the impairment tests' results, in particular in respect of the assumptions with the greatest potential effect on the test results, e.g. those related to discount rates;▪ Evaluated the adequacy and completeness of disclosures in respect of impairment.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

Key Audit Matters (continued)

Valuation of finished products

Inventory of finished products as at 31 December amounts to HRK 164,943 thousand.

Refer to accounting policy 3.7, and note 18 to the consolidated financial statements.

Key audit matter

The Group is primarily engaged in the production and distribution of fertilizers to customers in Croatia, and other countries both within and outside of the European Union. Market prices of fertilizers are significantly influenced by volatility of demand for agricultural products which may not necessarily correlate to changes in market prices of natural gas, which is the Group's key production input and the most significant component of finished goods inventory costing. Accordingly, there is a risk that market prices of fertilizers at a specific point in time may fall below their production cost.

At each reporting date, as required by relevant accounting standards, the Group determines whether the carrying amount of its inventory exceeds its net realizable value. The Group's inventory of finished products is tested for potential decline of their expected selling prices below production cost.

We focused on this area as arriving at the carrying amount of inventory requires significant management judgment, which relies on the assumptions such as, primarily, the market prices of fertilizers achievable in the future as well as the expected levels of market demand for fertilizers. Changes to these assumptions could result in a material change in the carrying value of inventory and the associated effect on the results of operations.

How we addressed the matter

We have performed the following procedures, amongst others:

- Testing internal controls over inventory valuation and the estimation of net realisable value;
- Analysing gross profit margins by product to identify inventory sold at low or negative margins prior to the reporting date to give an indication of any items in the year-end balance that might be impaired;
- On a sample basis, considering whether the write-down to net realizable value applicable to individual items of inventory is reasonable by reference to their selling prices and estimated costs to sell after the reporting date;
- Assessing the adequacy of disclosures about the degree of estimation involved in arriving at the net realizable value of inventory and any related write-down.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

Other Information

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

Our opinion on the consolidated financial statements does not cover the other information.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work that we have performed, we conclude that there is a material misstatement of this other information, then we are required to report that fact. Except for the misstatements of the other information with respect to items where departures from EU IFRS have been identified, as described in the *Basis for Qualified Opinion* section, we have nothing to report in this respect.

With respect to the Management Report and the Statement of implementation of corporate governance code, we have also performed the procedures required by Article 20 of the Croatian Accounting Act. These procedures include considering whether the Management Report and the Statement of implementation of corporate governance code include the disclosures required by Articles 21, 24 and 22 of the Croatian Accounting Act and obtaining evidence regarding specified information provided in the Statement of implementation of corporate governance code.

Based solely on the work required to be undertaken in the course of the audit of the consolidated financial statements and the procedures above, in our opinion, and taking into account the fact that our audit opinion on the consolidated financial statements is qualified:

- the information given in the Management Report and the parts of the Statement of implementation of corporate governance code, containing the information referred to in Article 22, paragraph 1, items 3 and 4 of the Croatian Accounting Act and Article 24 paragraph 2 (hereinafter, "extracts of Statement of implementation of corporate governance code) for the financial year for which the consolidated financial statements are prepared, is consistent, in all material respects, with the consolidated financial statements on which we have issued a qualified audit opinion; and
- the Management Report and the extracts of the Statement of implementation of corporate governance have been prepared, in all material respects, in accordance with the applicable legal requirements of the Croatian Accounting Act.
- the Statement on implementation of corporate governance code includes information required by Article 22 paragraph 1, items 2,5, 6 and 7 of the Croatian Accounting Act.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)

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

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with EU IFRS and for such internal control as management determines is necessary to enable the preparation of 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.

Auditors' 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 auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with 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 controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the 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 auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the 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.



Independent Auditors' Report to the Shareholders of Petrokemija d.d. (continued)


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


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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, 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 auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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


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


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

13 April 2017

Petrokemija d.d.

Consolidated statement of comprehensive income

as at 31 December 2016

<i>(in thousands of HRK)</i>	<i>Note</i>	2016	2015
Revenue from sales	7	1,853,436	2,517,890
Other income	8	80,262	47,356
Total operating income		1,933,698	2,565,246
Change in inventory of finished goods and work in progress		(94,926)	31,676
Raw materials, consumables and services used	9	(1,510,801)	(2,243,083)
Staff costs	10	(204,442)	(203,738)
Depreciation and amortisation	14, 15	(83,084)	(93,088)
Other operating expenses	11	(89,602)	(95,884)
Total operating expenses		(1,982,855)	(2,604,117)
Operating loss		(49,157)	(38,871)
Finance income	12	7,037	17,273
Finance expenses	12	(45,491)	(71,251)
Net finance costs		(38,454)	(53,978)
Loss before tax		(87,611)	(92,849)
Income tax	13	(334)	(349)
Loss for the period		(87,945)	(93,198)
Other comprehensive income:			
Exchange differences on translation of foreign operations		257	(66)
Total comprehensive loss		(87,688)	(93,264)
Loss attributable to:			
Equity holders of the parent		(87,806)	(93,341)
Non-controlling interests		(139)	143
Total comprehensive loss attributable to:			
Equity holders of the parent		(87,549)	(93,407)
Non-controlling interests		(139)	143
Loss per share (in HRK):			
- Basic and diluted	22	(6.82)	(7.25)

The accompanying notes form an integral part of these financial statements

Petrokemija d.d.

Consolidated statement of financial position

as at 31 December 2016

<i>(in thousands of HRK)</i>	<i>Note</i>	31.12.2016	31.12.2015
ASSETS			
Non-current assets			
Property, plant and equipment	14	677,243	624,444
Intangible assets	15	8,104	7,767
Deferred tax assets		143	380
Non-current financial assets	17	8	8
		685,498	632,599
Current assets			
Inventories	18	401,668	487,394
Trade and other receivables	19	79,454	76,676
Current financial assets	17	33,632	30,167
Cash and cash equivalents	20	24,462	9,424
		539,216	603,661
Total assets		1,224,714	1,236,260
EQUITY AND LIABILITIES			
Equity			
Share capital	21	386,135	386,135
Reserves		(200)	(200)
Accumulated losses		(344,104)	(256,555)
Attributable to owners of the Company		41,831	129,380
Non-controlling interest		3,670	3,809
		45,501	133,189
Non-current liabilities			
Loans and borrowings	23	174,106	130,094
Provisions	24	13,019	11,539
		187,125	141,633
Current liabilities			
Trade and other payables	25	518,740	725,260
Loans and borrowings	23	473,348	236,178
		992,088	961,438
Total equity and liabilities		1,224,714	1,236,260

The accompanying notes form an integral part of these financial statements

Petrokemija d.d.

Consolidated statement of changes in equity for the year ended 31 December 2016

(in thousands of HRK)

	Share capital	Other reserves	Accumulated losses	Attributable to owners of the Company	Non-controlling interest	Total equity
As at 1 January 2015	386,135	301,447	(464,051)	223,531	3,666	227,197
<i>Comprehensive income</i>						
Loss for the period	-	-	(93,341)	(93,341)	143	(93,198)
Other comprehensive income	-	-	(66)	(66)	-	(66)
Total comprehensive income	-	-	(93,407)	(93,407)	143	(93,264)
Transfers to cover accumulated losses (note 21)	-	(300,903)	300,903	-	-	-
<i>Transactions with owners recognised directly in equity</i>						
Paid share capital registration costs (note 21)	-	(744)	-	(744)	-	(744)
Total transactions with owners recognised directly in equity	-	(744)	-	(744)	-	(744)
As at 31 December 2015	386,135	(200)	(256,555)	129,380	3,809	133,189

(in thousands of HRK)

	Share capital	Other reserves	Accumulated losses	Attributable to owners of the Company	Non-controlling interest	Total equity
As at 1 January 2016	386,135	(200)	(256,555)	129,380	3,809	133,189
<i>Comprehensive income</i>						
Loss for the period	-	-	(87,806)	(87,806)	(139)	(87,945)
Other comprehensive income	-	-	257	257	-	257
Total comprehensive income	-	-	(87,549)	(87,549)	(139)	(87,688)
As at 31 December 2016	386,135	(200)	(344,104)	41,831	3,670	45,501

The accompanying notes form an integral part of these financial statements

Petrokemija d.d.

Consolidated statement of cash flows

for the year ended 31 December 2016

(in thousands of HRK)

	<i>Note</i>	2016	2015
Loss before tax		(87,611)	(92,849)
Depreciation and amortization	14, 15	83,084	93,088
Impairment losses on trade receivables	11	18	922
Interest income	12	(265)	(1,169)
Interest expense	12	31,946	45,408
Net increase/(reversal) of provisions		4,614	2,265
(Profit)/loss on disposal of property, plant and equipment		(3,863)	456
Own consumption		(37,499)	(17,381)
Foreign exchange differences - net		257	(66)
Changes in working capital:		(9,319)	30,674
Decrease in inventories		85,726	36,023
Decrease/(increase) in trade and other receivables		(2,893)	145,550
Increase in trade and other payables		156,978	203,062
Ddecrease in provisions		(3,134)	(952)
Cash generated from operations		227,358	414,357
Income tax paid		-	(416)
Interest paid		(29,216)	(45,679)
Net cash from operating activities		198,142	368,262
Cash flows from investing activities			
Purchase of property, plant, equipment and intangibles	14, 15	(138,919)	(59,435)
Interest received		265	1,169
Net inflows/(outflows) from bank deposits and money market funds		(6,075)	16,548
Proceeds from sale of property, plant, equipment		6,562	-
Net inflows from other non-current financial assets		-	133
Net cash from investing activities		(138,167)	(41,585)
Cash flows from financing activities			
Proceeds from borrowings		30,394	3,694
Repayment of borrowings		(77,941)	(335,495)
Transaction costs for share capital increase		-	(744)
Net cash from financing activities		(47,547)	(332,545)
Net increase /(decrease) of cash and cash equivalents		12,428	(5,868)
Cash and cash equivalents at beginning of year		13,045	18,913
Cash and cash equivalents at the end of year	20	25,473	13,045

The accompanying notes form an integral part of these financial statements

Petrokemija d.d.

Notes (forming part of the financial statements)

1 General information

The company Petrokemija d.d. Fertilizers factory (hereinafter "the Company") was founded in 1965, although the beginning of the sooth production dates back to 1926. Today the Company is registered at the Commercial Court in Zagreb under registration number 080004355 and personal identification number 24503685008.

As at 31 December 2016 the share capital amounts to HRK 386,135 thousand and it is divided into 12,871,180 non-materialized ordinary shares at a nominal value of HRK 30 each. The Company's shares are listed on the official market of the Zagreb Stock Exchange. The shareholder structure is shown in note 21.

Pursuant to the national classification of activities and along with the basic activity of manufacturing mineral fertilizers registered at the Commercial Court Register in Zagreb, the Company's main activities are: production of food additives for animals, production of chemicals and chemical products, production of other rubber products, metal products, supply of electricity, gas, steam and hot water, collecting, purifying and distributing water, research and development in natural, technical and technological sciences.

The Company and its subsidiaries as disclosed in note 16 together form the Group. The principal activities of the subsidiaries relate to hospitality services (Restoran Petrokemija d.o.o.), port related services (Luka Šibenik d.o.o.) and sale of fertilizers (Petrokemija Novi Sad d.o.o.).

As at 31 December 2016, the Group employed 1,733 employees (31 December 2015: 1,762 employees).

Company bodies

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

Management Board

Member of the Management Board during the reporting period and up to the date of approval of these financial statements were:

Đuro Popijač	President from 6 February 2017
Nenad Zečević	Member, President until 6 February 2017
Antonija Perošević Galović	Member until 6 February 2017
Tamara Pernar	Member until 6 February 2017
Vladimir Fresl	Member until 6 February 2017

Supervisory Board

Members of the Supervisory Board are:

Mijo Šepak	Member until 5 February 2017, President from 6 February 2017
Marijan Kuprešak	Member until 11 May 2016, President until 6 May 2017 and Member after that date
Branimir Fleković	Vice president until 19 February 2016, President from 19 February 2016
Tomislav Pokaz	President, until 8 February 2016
Sonja Ivoš	Member until 19 February 2016, Vice president until 11 May 2016
Željko Klaus	Member until 11 May 2016, from 11 May 2016 Vice President
Krešimir Huljev	Member until 11 May 2016
Ladislav Turčinović	Member from 11 May 2016
Mladen Novak	Member from 11 May 2016 until 31 July 2016
Robert Blažinović	Member until 23 March 2017

General Assembly

The General Assembly is the Company Body in which shareholders realize their rights in the Company's operations unless regulated differently under the law or the Constitution. The General Assembly members are shareholders with voting rights.

Petrokemija d.d.

Notes (*continued*)

2 Basis of preparation

2.1 Basis of accounting

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards adopted by the European Union (“EU IFRS”).

These consolidated financial statements are presented for the Group. The financial statements of the Group comprise the consolidated financial statements of the Company and its subsidiaries. The unconsolidated financial statements of the Company, which the Company has also prepared in accordance with EU IFRS, are published separately and issued simultaneously with these consolidated financial statements.

These financial statements were authorised for issue by the Management Board on 13 April 2017.

2.2 Basis of measurement

The financial statements are prepared on the historical cost basis except where otherwise stated.

2.3 Functional and presentation currency

The financial statements are presented in the Croatian currency Kuna (“HRK”), which is the Group’s functional currency. All financial information presented is rounded to the nearest thousand.

2.4 Going concern

In the year ended 31 December 2016, the Group incurred a net loss of HRK 87,945 thousand (*31 December 2015: HRK 93,198 thousand*). Furthermore, as at 31 December 2016, the Group’s current liabilities exceeded its current assets by HRK 452,872 thousand (*31 December 2015: HRK 357,777 thousand*).

The Group manages its liquidity through receivables financing and other working capital measures. At the present market prices of fertilizers, the Group is unable to service its existing financial indebtedness. The continuing low fertilizer price environment has placed significant pressure on the Group’s liquidity position and its solvency, with resulting in a negative working capital of approximately HRK 38 million as at 31 December 2016 and financial indebtedness of approximately HRK 647 million.

Since 2013, the Group has been continually carrying out a comprehensive set of measures of operational and financial restructuring in the context of a wider restructuring plan approved by the Supervisory Board. The restructuring plan, which was updated on several occasions, is based on the completion of the following set of measures primarily aimed at long-term stabilisation of the Group:

- optimization of procurement costs, especially cost of natural gas
- refocusing of production activities,
- optimization of workforce structure,
- divestment or repurposing of non-operational and non-core assets and
- measures of debt refinancing and recapitalization

In this respect, the Group has thus far completed several phases of the restructuring plan including the stabilization of its financial indebtedness in 2014 whereby its share capital was increased on two occasions by a total amount of HRK 253,042 thousand by issuing new shares. Furthermore, during 2014 the Group executed a workforce restructuring program whereby severances were paid to 492 employees totalling HRK 100,340 thousand, resulting in annual savings in employee expenses in the following years of some HRK 45 to 50 million.

Petrokemija d.d.

Notes (continued)

2 Basis of preparation (continued)

2.4 Going concern (continued)

During 2015, the Group was primarily focused on optimizing procurement costs in the context of which management was successful in lowering the purchase price of natural gas. In addition, following two years of continued operations, a major overhaul of production facilities was executed significantly utilizing available own resources and thus decreasing the cash outflows for the purpose of the overhaul. The overhaul, alongside general cost savings measures, contributed to the optimization of production costs. Furthermore, management also refocused part of its production process and launched a new product - granular ammonium sulphate (AS) which has had positive effects on both revenue and gross margin and which the Group expects will contribute to its efforts to move away from products with a less favourable pricing structure.

In addition to the measures implemented thus far and as described above, the Group initiated a process to introduce a strategic investor that would recapitalize the Group and enable sufficient liquidity to finalize the restructuring process and stabilize operations of the Group for the long term. This process has undergone several phases with several investors expressing interest and executing a due diligence of the Group. Ultimately, the latest round of negotiations with potential strategic investors, which took place in the first half of 2016, resulted in two binding offers being received. However, parliamentary elections in Croatia which were held twice in the last two years resulted in several changes of the Croatian Government, being the governing body of the majority shareholder (the State). As a result of the politically volatile environment, the process was significantly prolonged ultimately resulting in the expiration of the binding offers from interested strategic investors as at 31 December 2016.

The prolonged restructuring process, especially with respect to the expected recapitalization of the Group, has stressed the Group's liquidity position resulting in increased debt. The liquidity burden of the amassed debt toward suppliers of natural gas and banks further increased due to external competitive pressures and the trend of reducing market prices of fertilizers. In an urgent need to refinance its working capital, the Company secured a loan facility of HRK 200 million from the Croatian Bank for Restructuring and Development (HBOR) with the Government of Croatia as a guarantor for the loan. Upon granting of the loan, the Government of Croatia as the guarantor instructed the Group to prepare an updated restructuring plan which would include an overview of options available to the stakeholders. The HBOR loan was used mainly to refinance short term liabilities toward natural gas suppliers, fund required capital investments and to continue with the workforce restructuring. The HBOR loan includes financial covenants the Group is required to adhere to on a quarterly basis in order for the contractual maturity to remain valid. However, based on the financial position of the Group and the results of its operations, and the compliance testing done on the basis of the previous twelve months of 2016, the Group did not meet these debt requirements as at 31 December 2016 and, based on estimated quarterly financial results, is not expected to meet them at 31 March 2017, whereby the loan could become immediately repayable either by the Group or the guarantor. The Group is in regular contact with HBOR and although recent communications indicate that the lender is inclined to continue applying the initial contractual maturity and has, with this in mind, granted a waiver from penalising the Group for not adhering to debt covenants as at 31 December 2016, there is no guarantee that such a waiver will be provided in the following quarterly periods in 2017, or until the agreed financial indicators show the effects of the restructuring program of the Group which is being prepared.

Further, management recognizes that the Group has significant debt repayments scheduled in 2017 which it will, in all likelihood, not be able to meet in absence of a wider restructuring of its operations. The current projections of the Group's financial performance indicate that, without executing additional restructuring measures, the Group will be cash flow negative and will require refinancing and recapitalization. As instructed by the majority shareholder, the Group drafted a restructuring plan which includes projections of financial performance and is based on the assumptions that the Company will be re-capitalised during 2017. Negotiations with key stakeholders, the Croatian Government and natural gas suppliers, regarding the options for restructuring of the operations and funding of the Company are in progress.

Petrokemija d.d.

Notes (*continued*)

2 Basis of preparation (*continued*)

2.4 *Going concern (continued)*

All stakeholders recognise that the Group's current debt structure is unsustainable and that all stakeholders (i.e. financial creditors, shareholders, government and suppliers) need to contribute to achieve a consensual restructuring solution. The restructuring options considered thus far include the possibility of a privatisation of the Company through a structured tendering process to interested strategic investors or the financial restructuring of the Company which may include extension of contractual debt maturities, conversion of existing debts into equity and a financial injection. Consequently, based on discussions held to date, management expects the ongoing negotiations to focus on restructuring involving all or a combination of extension of debt maturities, debt-to-equity swap and/or additional cash injection, together with contributions from operational stakeholders in the form of discounts/cost reductions.

Based on these steps and their assessment of the degree of commitment of the various parties to successfully negotiate and implement the restructuring plan, management is reasonably confident that an agreement will be reached by all relevant stakeholders for the restructuring of the Group that will allow the Group to meet its liabilities as they fall due over the next twelve months. However, there can be no guarantee that these negotiations will result in an agreement being reached with all relevant stakeholders in the available time (if at all) to secure the objectives described above and, even if an agreement is ultimately reached, there is no guarantee it will take the form of any terms which may currently be under discussion. Management recognises that these circumstances represent a material uncertainty that may cast significant doubt as to the Group's ability to continue as a going concern and that it may be unable to realise all of its assets and discharge all of its liabilities in the normal course of business. Nevertheless, management is confident that agreements can be reached and accordingly the financial statements have been prepared on a going concern basis and do not include the adjustments that would result if the Group were unable to continue as a going concern.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies

The accounting policies set out below are the accounting policies of the Company and have been applied by the Company and all its subsidiaries consistently to all periods presented in these financial statements.

3.1 *Basis of consolidation*

The consolidated financial statements comprise the Company and its subsidiaries (together “the Group”).

Business combinations

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment. Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if related to the issue of debt or equity securities. The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss. If share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree’s employees (acquiree’s awards), then all or a portion of the amount of the acquirer’s replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based measure of the replacement awards compared with the market-based measure of the acquiree’s awards and the extent to which the replacement awards relate to pre-combination service.

Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

In its separate financial statements, the Company accounts for its investments in subsidiaries at cost less any impairment.

Non-controlling interests

Non-controlling interests are measured at their proportionate share of the acquiree’s identifiable net assets at the date of acquisition. Changes in the Group’s interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

Non-controlling interests in subsidiaries are included in the total equity of the Group.

Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interests and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group’s interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies (*continued*)

3.2 Goodwill

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business, less accumulated impairment loss, if any. For the purposes of impairment testing, goodwill is allocated to each cash-generating unit (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods. On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

3.3 Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currency at the balance sheet date are translated into the functional currency at the foreign exchange rate ruling at that date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

Non-monetary assets and items that are measured in terms of historical cost of a foreign currency are retranslated using the exchange rate at the date of the transaction.

Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into the functional currency at foreign exchange rates ruling at the dates the fair values were determined.

Group companies

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency").

Income and expense items and cash flows of foreign operations that have a functional currency different from the presentation currency are translated into the Group's presentation currency at rates approximating the foreign exchange rates ruling at the dates of transactions (average exchange rates for the month) and their assets and liabilities are translated at the exchange rates ruling at the year end. All resulting exchange differences are recognised in equity.

Net investment in Group companies

Exchange differences arising from the translation of the net investment in foreign operations are taken to equity. When a foreign operation is sold, such exchange differences are released in profit or loss as part of the gain or loss on sale.

Petrokemija d.d.

Notes (continued)

3 Significant accounting policies (continued)

3.4 Intangible assets

(i) Software licences and project documentation

Licences and project documentation are amortised over their estimated useful lives. Estimated useful lives are reviewed annually and impairment reviews are undertaken if events occur which call into question the carrying values of the assets.

(ii) Subsequent expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only if it is probable that it increases the future economic benefits embodied in the specific asset to which it relates and those benefits will flow to the Company. All other expenditure is recognised in the profit or loss as an expense as incurred.

(iii) Amortisation

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

Software and project documentation	3- 5 years
------------------------------------	------------

3.5 Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Cost includes all costs directly attributable to bringing the asset to working condition for its intended use, including the proportion of the related borrowing costs for plant and equipment incurred during the period of their construction.

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of plant and equipment and those benefits will flow to the Group. All other expenditure is recognised in profit or loss as an expense as incurred.

Depreciation is charged to profit or loss on a straight-line basis over the estimated useful lives of each part of an item of plant and equipment. Land and assets in the course of construction are not depreciated. The estimated useful lives are as follows:

Buildings	6 - 50 years
Plant and equipment	5 - 25 years
Tools and fittings	5 - 25 years

Depreciation methods and useful lives, as well as residual values, are reassessed annually.

(ii) Assets under the concession arrangement

The subsidiary Luka Šibenik d.o.o. has a long-term service concession arrangement for the provision of port related services which generate the majority of its revenue. The concession arrangement in place involves the transfer of operating rights over the port of Šibenik for a limited period, under the control of the local port authority, using dedicated assets (port infrastructure) either built by the subsidiary during the term of the concession arrangement or made available to it for a fee or nil consideration.

This arrangement defines "public service obligations" of the subsidiary in return for remuneration. The remuneration is based on operating conditions, continuity of service, price rules and obligations with respect to the maintenance/replacement of port infrastructure. The contract determines the conditions for the transfer of port infrastructure to the local port authority or a successor at its expiry.

Maintenance expenditure

Maintenance of assets which are part of the concession arrangement is recognised as an expense when incurred within profit or loss and presented within cost of materials and services used.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies (*continued*)

3.5 Property, plant and equipment (*continued*)

Capital expenditure into the concession area

Capital expenditure into port infrastructure made in accordance with the terms of the concession arrangement is recognised as an asset within the appropriate class of property, plant and equipment and carried at cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes expenditure that is directly attributable to the acquisition of the items.

In cases where these assets relate to items which are transferred to the local port authority (“Grantor”) at the expiry of the concession arrangement, the depreciation of such assets is calculated using the straight-line method to allocate their cost less any residual value over the shorter of their estimated useful lives and the remaining term of the concession arrangement.

In cases where these assets are not transferred to the Grantor, the depreciation of such assets is calculated in accordance with the depreciation policy applicable to the category property, plant and equipment to which the asset is classified in accordance with accounting policy 3.5 (i).

Assets transferred to the Group by the concession Grantor

As part of the concession arrangement, the local port authority (the Grantor) transferred the operational rights over a number of assets comprising the port infrastructure to the subsidiary which is entitled to use these assets in the course of providing the services defined in the concession arrangement. Such assets are not recognised by the Group and are instead kept off balance sheet.

3.6 Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments comprise investments, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group’s contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group’s obligations specified in the contract expire or are discharged or cancelled.

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Accounting for financial income and expense is discussed in a separate note within significant accounting policies.

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses for financial assets.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and bills of exchange. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management as well as bank deposits with original maturity up to three months are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies (*continued*)

3.7 Inventories

Inventories of raw materials and finished products are stated at the lower of cost, determined using the weighted average cost method, and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

The cost of work-in-process and finished goods comprise raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity).

Trading goods are carried at the lower of purchase cost and selling price (less applicable taxes and margins). Low valued inventory and tools are expensed when put into use.

Spare parts which are considered strategic are held as inventory until the date of installation when they are recognised as subsequent expenditure relating to respective items of plant and equipment and depreciated over their estimated useful life.

3.8 Impairment

(i) Financial assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in companies that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in other comprehensive income is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised in other comprehensive income.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable group of assets that generates cash flows that largely are independent from other assets and groups of assets.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. 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.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognised.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies (*continued*)

3.9 Employee benefits

(i) Defined pension fund contributions

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

(ii) Long-term employee benefits

The Group recognises a liability for long-term employee benefits (jubilee awards and regular retirement benefits) evenly over the period the benefit is earned based on actual years of service. The long-term employee benefit liability is determined annually by an independent actuary, using assumptions regarding the likely number of staff to whom the benefits will be payable, estimated benefit cost and the discount rate which is determined as the average expected rate of return on investment in government bonds.

(iii) Bonus plans

A liability for employee benefits is recognised in provisions based on the Group's formal plan and when past practice has created a valid expectation by the Management Board that they will receive a bonus and the amount can be determined before the time of issuing the financial statements.

Liabilities for bonus plans are expected to be settled within 12 months of the balance sheet date and are measured at the amounts expected to be paid when they are settled.

3.10 Provisions

A provision is recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

3.11 Revenue

Revenue from the sale of goods is recognised in profit or loss when the significant risks and rewards of ownership are transferred to the buyer. Revenues are stated net of taxes, discounts, and volume rebates. Provisions for rebates to customers are recognised in the same period that the related sales are recorded, based on contract terms.

Revenue from services is recognised in the period in which services are provided in proportion to the stage of completion of the transaction at the reporting date.

3.12 Financial income and expenses

Financial income comprises interest income on funds invested, changes in the fair value of financial assets at fair value through profit or loss and foreign currency gains.

Interest income is recognised as it accrues, using the effective interest method.

Financial expenses comprise interest expense on borrowings, foreign currency losses, changes in the fair value of financial assets at fair value through profit or loss and impairment losses recognised on financial assets.

Petrokemija d.d.

Notes (*continued*)

3 Significant accounting policies (*continued*)

3.13 Accounting for leases – where the Group is the lessee

Leases of property, plant and equipment where the Group assume substantially all the benefits and risks of ownership are classified as finance leases. Finance leases are capitalised at the estimated present value of the underlying lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance charge is charged to profit or loss over the lease period. The property, plant and equipment acquired under finance leasing contracts are depreciated over the useful life of the asset.

Leases of assets under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

3.14 Share capital

Share capital consists of ordinary shares. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Share issue costs incurred directly in connection with a business combination are included in the cost of acquisition.

3.15 Dividends

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

3.16 Segment information

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

The Group does not report segment information as internal reporting is not based on segmental information other than revenues per geographic market.

Petrokemija d.d.

Notes *(continued)*

3 Significant accounting policies *(continued)*

3.17 Taxation

(i) Income tax

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

(ii) Deferred tax assets and liabilities

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences arising from the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

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

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

(iii) Tax exposures

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

(iv) Value added tax (VAT)

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

4 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations have been released and are effective but not mandatory for the year ended 31 December 2016 and/or are not yet adopted by the European Union and as such have not been applied in preparing these financial statements. Overview:

- IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue* and IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. It is not expected that this standard will have a significant effect on the consolidated financial statements of the Group.

Petrokemija d.d.

Notes (*continued*)

4 New standards and interpretations not yet adopted

- *IFRS 9 Financial Instruments*

In July 2014, the International Accounting Standards Board issued the final version of IFRS 9 *Financial Instruments*. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group currently plans to apply IFRS 9 initially on 1 January 2018. This new standard is not expected to have a significant effect on the consolidated financial statements of the Group.

- *IFRS 16 Leases*

IFRS 16 introduces a single, on-balance lease sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are optional exemptions for short-term leases and leases of low value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases. The standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted for entities that apply IFRS 15 Revenue from Contracts with Customers at or before the date of initial application of IFRS 16. So far, the most significant impact identified is that the Group will recognise new assets and liabilities for its operating leases.

- *Disclosure Initiative (Amendments to IAS 7)*

The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. The amendments are effective for annual periods beginning on or after 1 January 2017, with early adoption permitted. This amendments are not expected to have a significant effect on the consolidated financial statements of the Group.

Petrokemija d.d.

Notes (*continued*)

5 Key accounting judgements and estimates

Critical judgements in applying accounting policies

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Judgements made by management in the application of accounting policies that have significant effect on the amounts recognised in the financial statements are discussed in a separate note. Key assumptions concerning the future on which significant estimates are based, and other key sources of estimation uncertainty, which involve a significant risk of causing a material adjustment to the carrying value of assets and liabilities within the next financial year, are disclosed below.

(i) Deferred income tax assets recognition

The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded in the statement of financial position. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgements and applies estimation based on previous years taxable profits and expectations of future income that are believed to be reasonable under the existing circumstances (see accounting policy 3.17 and note 13).

(ii) Actuarial estimates used in determining obligations for employee benefits

The cost of defined benefits is determined using actuarial estimates. Actuarial estimates involve assumptions about discount rates, future salary increases and the mortality or fluctuation rates. Due to the long-term nature of those plans, these estimates contain an element of uncertainty (see accounting policy 3.9 and note 24).

(iii) Consequences of certain legal actions

There are a number of legal actions which have arisen from the regular course of operations. Management makes estimates of probable outcomes of the legal actions and recognises provisions for the liabilities that may arise to the Group in respect of claims.

The Group recognises a provision in the total expected amount of outflows of economic benefits as a result of the court case, which is generally the claim amount plus the estimated related legal costs and penalty interest (if applicable), if it is more likely than not, based on the opinion of management after consultation with legal advisers, that the outcome of the court case will be unfavourable for the Group. The Group does not recognise provisions for court cases or the expected related legal costs and penalty interest (if applicable) in cases where management estimates that an unfavourable outcome of the court case is less likely than a favourable outcome for the Group.

Where indications exist of a possible settlement in relation to a particular court case, a provision is recognised, based on the best estimate of management made in consultation with its legal advisers, in the amount of the expected settlement less any existing amounts already provided for in relation to that particular court case.

Where the Group is a plaintiff in a particular court case, any economic benefits expected to flow to the Group as a result are recognised only when virtually certain which is generally as at the date of inflow of these economic benefits.

Provisions for the Group's obligations arising legal actions are recognised on a consistent basis and estimated on a case by case principle (see note 3.10 and 24).

Petrokemija d.d.

Notes (*continued*)

5 Key accounting judgments and estimates (*continued*)

Critical judgements in applying accounting policies (continued)

(iv) *Trade receivables - impairment*

The recoverable amount of trade and other receivables is estimated at present value of future cash flows discounted at the market interest rate at the measurement date.

Short-term receivables with no stated interest rate are measured by the amount of original invoice if the effect of discounting is not significant.

The Group regularly reviews the ageing structure of trade receivables and monitors the average collection period. In cases where debtors with extended payment periods (generally above 120 days) are identified, the Group reduces the related credit limits and payment days for future transactions and, in cases where it deems it necessary, imposes restrictions on future transactions until the outstanding balance is repaid either entirely or in part.

In the process of regulating the collection of overdue debts, the Group actively negotiates with the respective debtors taking into account expectations of future business relations, significance of exposure to an individual debtor, possibilities of compensation, exercise of instruments of security (if any) or seizure of assets etc.

Each customer is valued separately based on its status (i.e. customer is blocked and is cash only customer, legal procedure have been commenced), the ageing of the amount due, stage of legal case and security of payment (e.g. bill of exchange).

(v) *Impairment of non-financial assets*

The Group annually reviews non-financial assets for potential indicators of impairment. Where such indicators exist, the Group performs impairment tests in order to assess whether the carrying amount of respective assets is recoverable. For the purposes of performing impairment tests, the Group has identified one cash generating unit (CGUs) which comprises the main production facility in Kutina.

For the main production, the calculation of the recoverable amount is based on a three year projection of financial performance with the primary assumption being that the Group will continue as a going concern. The calculation of the recoverable amount implies a terminal growth rate for cash flows after the projected three year period of 2%. Cash flows are discounted using the discount rate which reflects the risk of the underlying asset, and which has been approximated for the purposes of the impairment test as the weighted average cost of capital for the relevant industry segment and amounts to 12%. Apart from the discount rate, key variables used in the value in use model relate to expected fertilizer prices and natural gas prices obtained from relevant external sources.

Apart from the main production facility, the Group also has two side facilities which are either temporarily non-operational or at a minimal level of capacity utilisation and where the Group is in the process of considering the feasibility of production continuation/increase which ultimately depends on the long-term strategy and is ultimately dependent on the outcome of the restructuring process, especially with respect to entry of strategic investors. The Group does not perform impairment tests on these assets.

During 2016 and 2015, the Group has not recorded any impairments with respect to property, plant and equipment. Management considers that the carrying amount of non-financial assets is recoverable taking into account its conclusions on the use of the going concern assumption (see note 2.4.).

(vi) *Accounting for the concession arrangement*

A significant part of the registered activity of the subsidiary Luka Šibenik d.o.o. is performed on an area under concession over maritime domain. According to the Maritime Domain and Seaports Act, the maritime domain is managed by the Port Authority of Šibenik, who is the concession Grantor while the subsidiary is the Operator or the concessionaire. Given that the Group is majority owned by the State and, consequently, the subsidiary itself is in majority State ownership, the Group does not apply the interpretation IFRIC 12 *Service Concession Arrangements* in accounting for the concession arrangement of the subsidiary since the above interpretation is not mandatory for application to concession arrangements between two parties whereby the party who awards the contract (the Grantor) and the party which is the concessionaire (the Operator) are both from the public sector.

Petrokemija d.d.

Notes (*continued*)

6 Determination of fair value

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

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

All significant issues related to fair values estimates are reported to the Supervisory Board and the Audit Committee.

Fair values are categorised into different level in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

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

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

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques 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 significant inputs are not based on observable market data, the fair value estimate is included in level 3.

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

- Note 17: Financial assets

Petrokemija d.d.

Notes (continued)

7 Revenue from sales

	2016 HRK '000	2015 HRK '000
Revenue from sale of products and merchandise	1,849,652	2,514,376
Revenue from services	3,784	3,514
	1,853,436	2,517,890

An overview of revenue per market is given below:

	2016 HRK '000	2015 HRK '000
Croatia	584,777	707,915
Slovenia	205,837	174,017
Bosnia and Herzegovina	131,255	110,315
Serbia and Montenegro	147,851	166,395
Macedonia	20,137	21,117
Other countries	763,579	1,338,131
	1,853,436	2,517,890

8 Other income

	2016 HRK '000	2015 HRK '000
Sale of raw materials	1,256	2,947
Manufacture of spare parts	385	635
Own consumption	37,499	17,381
Insurance reimbursements	10,067	5,054
Sale of manufactured packaging	4,923	6,003
Inventory surplus	3,035	843
Reversal of provisions	3,693	-
Sale of plant and equipment	3,863	23
Other income	15,541	14,470
	80,262	47,356

9 Raw materials, consumables and services used

	2016 HRK '000	2015 HRK '000
Raw materials and consumables used	1,442,557	2,158,619
Cost of wholesale and retail goods sold	3,792	13,750
Cost of production services	64,452	70,714
	1,510,801	2,243,083

Petrokemija d.d.

Notes (continued)

10 Staff costs

	2016	2015
	HRK '000	HRK '000
Salaries	126,976	128,443
Contributions on salaries	28,949	28,852
Other staff costs	48,517	46,443
	<u>204,442</u>	<u>203,738</u>

The number of employees of the Group as at 31 December 2016 was 1,733 (2015: 1,762).

During 2016, the Group continued to restructure its workforce in the course of which it incurred expenses of HRK 5.6 million relating to termination benefits which are included in other staff costs.

11 Other operating expenses

	2016	2015
	HRK '000	HRK '000
Impairment of inventories	143	81
Other fees and taxes	30,972	51,428
Other employee costs	13,853	14,138
Insurance	10,015	10,274
Increase in provision	8,307	2,265
Bank charges	4,376	1,797
Inventory loss	2,517	3,048
Impairment of trade receivables	18	922
Intellectual services	591	995
Travel expenses	413	487
Other	18,397	10,449
	<u>89,602</u>	<u>95,884</u>

Other fees and taxes include HRK 10,425 thousand (2015: HRK 28,739 thousand) of fees for greenhouse gas emissions. After the Croatian accession to the European Union, Petrokemija d.d. as a plant operator is subject to obligation to purchase emission allowances.

12 Finance income and finance expenses

	2016	2015
	HRK '000	HRK '000
Interest income	265	1,169
Foreign exchange differences	6,697	6,984
Other finance income	75	9,120
Total finance income	<u>7,037</u>	<u>17,273</u>
Unrealised losses on financial assets	-	(315)
Interest expense	(31,946)	(45,408)
Foreign exchange losses	(13,545)	(25,528)
Total finance costs	<u>(45,491)</u>	<u>(71,251)</u>
Net finance costs	<u>(38,454)</u>	<u>(53,978)</u>

Petrokemija d.d.

Notes (continued)

13 Income tax

Recognised in profit or loss:

	2016 HRK '000	2015 HRK '000
Current income tax	97	416
Deferred tax, net	237	(67)
	<u>334</u>	<u>349</u>

Effective tax rate reconciliation

A reconciliation of tax expense per the statement of comprehensive income and taxation at the statutory rate is detailed in the table below:

	2016 HRK '000	2015 HRK '000
Loss before taxation	(87,611)	(92,849)
Tax calculated at 20% (2015: 20%)	(17,522)	(18,570)
Non-deductible expenses and non-taxable income	735	325
Temporary differences and tax losses not recognised as deferred tax assets	308	653
Utilisation of temporary differences previously not recognised as deferred tax assets	(664)	(547)
Tax losses not recognised as deferred tax assets	15,735	17,769
Effect of change in future tax rates from 20% to 18% on unrecognised temporary differences	1,758	-
Effect of different tax rates	(16)	719
Tax expense recognised in the statement of comprehensive income	<u>334</u>	<u>349</u>
Effective tax rate	0%	0%

At the reporting date, carry forward tax losses of the Group amounting to HRK 1,042,457 thousand (31 December 2015: HRK 955,040 thousand) have not been recognised as a deferred tax asset as management believes it is not probable that future taxable profits will be available to utilise the unused tax losses.

Tax rate for future taxable profits for periods ending after 31 December 2016 has changed from 20% to 18%.

Tax value of tax losses available in future periods is as follows:

	2016 HRK '000	2015 HRK '000
Tax loss from 2012 - expires on 31 December 2017	32,028	35,843
Tax loss from 2013 - expires on 31 December 2018	58,703	65,225
Tax loss from 2014 - expires on 31 December 2019	64,954	72,171
Tax loss from 2015 - expires on 31 December 2020	15,992	17,769
Tax loss from 2016 - expires on 31 December 2021	15,735	-
	<u>187,412</u>	<u>191,008</u>

Petrokemija d.d.

Notes (continued)

14 Property, plant and equipment

(in thousands of HRK)

Cost	Land	Buildings	Plant and equipment	Equipment and fittings	Assets under construction	Prepayments	Total
At 1 January 2015	49,482	580,028	1,202,618	70,539	49,380	8,482	1,960,529
Additions	-	-	999	-	51,739	5,289	58,027
Transfers	-	1,167	38,479	331	(39,977)	-	-
Disposals	-	-	(1,651)	(564)	(17)	-	(2,232)
At 31 December 2015	49,482	581,195	1,240,445	70,306	61,125	13,771	2,016,324
Accumulated depreciation							
At 1 January 2015	-	323,594	931,787	47,063	-	-	1,302,444
Charge for the year	-	19,282	67,269	4,661	-	-	91,212
Disposals	-	-	(1,215)	(561)	-	-	(1,776)
At 31 December 2015	-	342,876	997,841	51,163	-	-	1,391,880
Carrying amount							
As at 31 December 2015	49,482	238,319	242,604	19,143	61,125	13,771	624,444
Cost							
At 1 January 2016	49,482	581,195	1,240,445	70,306	61,125	13,771	2,016,324
Additions	-	-	1,817	28	135,078	-	136,923
Transfers	-	6,745	167,978	738	(161,789)	(13,672)	-
Disposals	(975)	(2,334)	(5,647)	(438)	-	-	(9,394)
At 31 December 2016	48,507	585,606	1,404,593	70,634	34,414	99	2,143,853
Accumulated depreciation							
At 1 January 2016	-	342,876	997,841	51,163	-	-	1,391,880
Charge for the period	-	18,708	58,768	3,949	-	-	81,425
Disposals	-	(779)	(5,480)	(436)	-	-	(6,695)
At 31 December 2016	-	360,805	1,051,129	54,676	-	-	1,466,610
Carrying amount							
At 31 December 2016	48,507	224,801	353,464	15,958	34,414	99	677,243

Assets under construction relate primarily to equipment for reconstruction and overhaul of production facilities.

The Group's property amounting to HRK 84,450 thousand (2015: HRK 75,770 thousand) is mortgaged as security for loans and borrowings. Property, plant and equipment of the Group include non-operational assets with a carrying value amounting to HRK 14,567 thousand (2015: HRK 16,483 thousand) which relates to plant for the production of phosphoric acid and a soot plant. The Group is currently in the process of considering the feasibility of continuing production in these plants which ultimately depends on the long-term strategy of the Group. The Group has not been able to make adequate impairment tests and assess the recoverable value of these non-operational assets.

Petrokemija d.d.

Notes (continued)

15 Intangible assets

<i>(in thousands of HRK)</i>	Assets under construction	Software and project documentation	Total
Cost			
At 1 January 2015	3,933	23,542	27,475
Additions	1,566	15	1,581
Transfers	(3,784)	3,784	-
Disposals	-	(12)	(12)
At 31 December 2015	1,715	27,329	29,044
Accumulated amortisation			
At 1 January 2015	-	19,413	19,413
Charge for the year	-	1,876	1,876
Disposals	-	(12)	(12)
At 31 December 2015	-	21,277	21,277
Carrying amount			
As at 31 December 2015	1,715	6,052	7,767
Cost			
At 1 January 2016	1,715	27,329	29,044
Additions	1,815	181	1,996
Transfers	(10)	10	-
Disposals	-	(59)	(59)
At 31 December 2016	3,520	27,461	30,981
Accumulated amortisation			
At 1 January 2016	-	21,277	21,277
Charge for the period	-	1,659	1,659
Disposals	-	(59)	(59)
At 31 December 2016	-	22,877	22,877
Carrying amount			
At 31 December 2016	3,520	4,584	8,104

Intangible assets under construction primarily relate to project documentation. Project documentation relates to the study on decrease of ammonia emissions at the UREA plant and the study on absorption of gases at the NPK 1 plant.

16 Subsidiaries

As at the reporting date the Company holds ownership interests in its subsidiaries as follows:

Name of subsidiary	Ownership interest in %	
	31.12.2016	31.12.2015
Petrokemija d.o.o., Novi Sad	100%	100%
Restoran Petrokemija d.o.o., Kutina	100%	100%
Petrokemija Agro Trade d.o.o.	100%	100%
Luka Šibenik d.o.o.	80%	80%

Petrokemija d.d.

Notes (continued)

17 Financial assets

	31.12.2016 HRK '000	31.12.2015 HRK '000
Non-current financial assets		
Investments in other equity instruments	8	8
Current financial assets		
Deposits	1,011	3,621
Financial assets held for trading	32,621	26,546
	<u>33,632</u>	<u>30,167</u>

Financial assets held for trading relate to investments in cash funds. Investment in other equity securities relates to a minority share in TV Moslavina, Kutina. Deposits relate to deposits in banks with original maturity less than 3 months.

Fair value measurement

The fair value of investments in cash funds is based on market prices at the balance sheet date. In accordance with the input variables used, the assessment is categorized in the fair value hierarchy as level 1 (see note 6). Investments in other equity instruments where there is no active market are carried at cost and tested for impairment regularly.

18 Inventories

	31.12.2016 HRK '000	31.12.2015 HRK '000
Raw materials and supplies	109,987	111,597
Work in progress	20,229	23,266
Finished goods	164,943	257,109
Trade goods	864	1,160
Spare parts	95,024	93,662
Prepayments	10,621	600
	<u>401,668</u>	<u>487,394</u>

Spare parts include items relating to stand-by equipment and spare parts that can only be used in connection with specific items of plant and equipment, and should thus be classified as plant and equipment. The Group is currently in the process of determining the value of spare parts which need to be re-classified from current to non-current assets as part of plant and equipment.

19 Trade and other receivables

	31.12.2016 HRK '000	31.12.2015 HRK '000
Current receivables		
Trade receivables	124,244	116,992
Trade receivables in factoring	-	2,300
Less: Provisions for impairment	(106,198)	(106,276)
Net trade receivables	<u>18,046</u>	<u>13,016</u>
Prepaid expenses	298	30
Receivables for taxes and contributions	35,589	63,170
Bills of exchange received	-	215
Receivables from employees	7	13
Other receivables	25,514	232
	<u>79,454</u>	<u>76,676</u>

Petrokemija d.d.

Notes (continued)

19 Trade and other receivables (continued)

Movement in the impairment allowance for trade receivables during the year was as follows:

	2016 HRK '000	2015 HRK '000
At 1 January	106,276	109,389
Increase	18	922
Amounts collected	(37)	(149)
Written off as uncollectible	(59)	(3,886)
At 31 December	106,198	106,276

Impairment losses on trade receivables are included in note 'Other operating expenses'. Ageing analysis of trade receivables (including factoring) as at the reporting date is as follows:

	2016 HRK '000	2015 HRK '000
Not yet due	10,958	10,194
Overdue 0-120 days	5,874	1,730
Overdue 121-180 days	136	249
Overdue 181-360 days	355	1,769
Overdue over 1 year	106,921	105,350
	124,244	119,292

Trade receivables (including factoring) are denominated in following currencies:

	2016 HRK '000	2015 HRK '000
Croatia (HRK)	114,956	110,651
European Union (EUR)	7,100	5,263
USA (USD)	2,188	3,378
	124,244	119,292

20 Cash and cash equivalents

	31.12.2016 HRK '000	31.12.2015 HRK '000
Cash with banks	24,455	9,419
Cash in hand	7	5
Cash and cash equivalents in the statement of financial position	24,462	9,424
Deposits	1,011	3,621
Cash and cash equivalents as presented in the statement of cash flows	25,473	13,045

Cash with banks relates to cash accounts with commercial banks and bears an average interest rate ranging from 0.01% to 0.1% per annum. Deposits relate to deposits in banks with original maturity less than 3 months.

Petrokemija d.d.

Notes (continued)

21 Share capital

	31.12.2016 HRK '000	31.12.2015 HRK '000
Share capital	386,135	386,135

The ownership structure as at the reporting date was as follows:

Structure of ownership	31.12.2016		31.12.2015	
	Number of shares	% of ownership	Number of shares	% of ownership
CERP/RH	10,277,975	79.85%	10,277,975	79.85%
Societe Generale-Splitska banka d.d./AZ OMF	399,932	3.11%	399,932	3.11%
Addiko bank d.d./PBZ Croatia osiguranje d.d. OMF	366,431	2.85%	366,431	2.85%
Societe Generale-Splitska banka d.d./Erste Plavi OMF	332,883	2.59%	332,883	2.59%
HPB d.d./Kapitalni fond d.d.	126,713	0.98%	126,713	0.98%
PBZ d.d./State street client account	121,585	0.94%	125,804	0.98%
HPB d.d./Fond za financiranje razgradnje NEK	97,200	0.76%	97,200	0.76%
Zagrebačka banka d.d./AZ profit dobrovoljni mirovinski fond	-	0.00%	45,638	0.35%
Zagrebačka banka d.d./State street bank and trust company	34,030	0.26%	43,425	0.34%
OTP banka d.d.	31,250	0.24%	-	0.00%
PBZ d.d./Skrbnički zbirni račun klijenta	30,616	0.24%	42,062	0.33%
Other shareholders	1,052,565	8.18%	1,013,117	7.87%
Total	12,871,180	100.00%	12,871,180	100.00%
Paid but unregistered shares	-		-	
Total share capital	12,871,180		12,871,180	

Share capital comprises 12,871,180 ordinary shares (31 December 2015: 12,871,180 shares) of a nominal value of HRK 30 (31 December 2015: HRK 30) per share.

Subsequent to the reduction of share capital performed during 2014, the Company increased its share capital on two occasions in the amount of HRK 253,042 thousand by issuing 8,434,733 ordinary shares with a nominal value of HRK 30 per share. Simultaneously, the Company's other reserves decreased by HRK 240 thousand with respect to the cost of issue of ordinary shares. This increase in share capital was not registered at the Commercial Court as at 31 December 2014 and related mostly to a re-capitalization from the state. As at 18 February 2015 the increase in share capital was registered at the Commercial Court and the transaction costs of registering the shares was recognised in other reserves in the amount of HRK 744 thousand.

22 Earnings/(loss) per share

Basic earnings/(loss) per share

Basic earnings per share are determined by dividing the Group's consolidated net earnings or losses with the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Group and held as treasury shares.

	31.12.2016	31.12.2015
Loss attributable to equity holders of the parent (in thousands of HRK)	(87,806)	(93,341)
Weighted average number of registered shares	12,871,180	12,871,180
Basic and diluted loss per share in HRK	(6.82)	(7.25)

Petrokemija d.d.

Notes (continued)

23 Loans and borrowings

	31.12.2016 HRK '000	31.12.2015 HRK '000
Non-current borrowings		
Banks	78,273	34,261
Other loans	95,833	95,833
	174,106	130,094
Current borrowings		
Banks	244,274	91,295
Factoring liabilities	3,910	2,300
Other loans	225,164	142,583
	473,348	236,178
Total borrowings	647,454	366,272

Maturity of borrowings as at the reporting date was as follows:

	31.12.2016 HRK '000	31.12.2015 HRK '000
Up to 1 year	473,348	236,178
Between 1 and 2 years	73,977	81,663
Between 2 and 5 years	76,730	48,431
Over 5 years	23,399	-
	647,454	366,272

Bank loans

Bank loans amounting to HRK 93,426 thousand (2015: HRK 108,889 thousand) have variable interest rates. The variable interest rates for bank loans included in the table above were in the range from 4.58% to 5.65%.

Bank loans amounting to HRK 227,709 thousand (2015: HRK 15,833 thousand) have fixed interest rates. The fixed interest rates for bank loans included in the table above were in the range from 5.40% to 8.00%.

The majority of bank loans was used to settle overdue supplier loans in the amount of HRK 170,000 thousand as well as overdue trade payables in the amount of HRK 31,268 thousand. These transactions were done by direct cash transfer from banks to suppliers and represent non-cash transactions from the Group's perspective.

Security

Loans and borrowings are secured by mortgages over the Group's property amounting to HRK 84,450 thousand and inventories of finished products amounting to HRK 134,431 thousand as well as with bills of exchange and debentures.

Factoring liabilities

Factoring liabilities relate to short-term financing of operational cash flows relating to trade receivables. The factoring agreements entered into by the Group are with recourse and the risk of collection of trade receivables ultimately lies with the Group. Finance costs relating to factoring liabilities are entirely borne by the customer.

Other loans and borrowings

Other loans and borrowings relate to a loan from an insurance company in the amount of HRK 18,000 thousand (2015: HRK 2,055 thousand) carrying a fixed interest rate of 6% and loans from suppliers. As an instrument for managing current liquidity, during the year the Group reprogrammed and reclassified a part of its trade payables in the amount HRK 298,725 thousand (2015: HRK 108,525 thousand) to short-term loans by signing loan agreements with suppliers bearing an average interest rate ranging from 6% to 9% per annum. Additionally, during the year, a total of HRK 170,000 thousand of bank loans was used to settle supplier loans by direct cash transfers from banks to suppliers.

As at reporting date, the Group has loans towards suppliers in the amount of HRK 302,997 thousand (2015: HRK 236,361 thousand).

Petrokemija d.d.

Notes (*continued*)

23 Loans and borrowings (*continued*)

Debt covenants

In June 2016 the Group secured a loan facility of HRK 200 million from the Croatian Bank for Restructuring and Development (HBOR) with the Government of Croatia as a guarantor for the loan. Interest on the loan is fixed and the loan is denominated in EUR and is repayable in quarterly instalments beginning from 30 April 2019.

According to the loan agreement with HBOR, the Group is obligated to maintain a “Debt service cover ratio” (DSCR) at a minimum of 1.1. DSCR representing the ratio of consolidated net operating revenues to the aggregate amount of debt repayment including both principal and interest. Also, the Group is obligated to maintain a ratio of consolidated Net Debt / EBITDA at a maximum of 6.0.

Based on the financial position of the Group and the results of its operations, and the compliance testing done on the basis of the previous twelve months of 2016, the Group did not meet these debt requirements as at 31 December 2016 and, based on estimated quarterly financial results, is not expected to meet them at 31 March 2017, whereby the loan could become immediately repayable either by the Group or the guarantor. The Group is in regular contact with HBOR and recent communications indicates that the lender is inclined to continue applying the initial contractual maturity and has, with this in mind, granted a waiver from penalising the Group for not adhering to debt covenants as at 31 December 2016. However, as there is no guarantee that such a waiver will be provided in the following quarterly periods during 2017 or further until the effects of the restructuring program of the Group, which is still in progress, become evident. Accordingly, the entire loan is classified as short term in the financial statements.

Petrokemija d.d.

Notes (continued)

24 Provisions

<i>(in thousands of HRK)</i>	Jubilee awards	Retirement benefits	Court cases	Total
At 31 December 2015				
Non-current	7,421	3,152	966	11,539
At 1 January 2016	7,421	3,152	966	11,539
Increase	2,083	360	-	2,443
Utilised	(778)	(8)	(177)	(963)
At 31 December 2016	8,726	3,504	789	13,019
At 31 December 2016				
Non-current	8,726	3,504	789	13,019

Court cases

There are a number of legal proceedings initiated against the Group for minor amounts as well as those initiated by the Group against others. A provision amounting to HRK 385 thousand was recognised in relation to legal proceedings. Management believes that no significant costs exceeding those provided for at the reporting date will occur as a result of ongoing legal proceedings.

Jubilee awards and regular retirement benefits

According to the Collective Labour Agreement, the Group has an obligation to pay jubilee awards, retirement and other benefits to employees. In accordance with the respective agreement, employees are entitled to a regular retirement benefit in the net amount of HRK 8 thousand. No other post-retirement benefits are provided.

The liability for these long-term employee benefits is determined annually by an independent actuary, using assumptions regarding the likely number of staff to whom the benefits will be payable, estimated benefit cost and the discount rate which is determined as the average expected rate of return on investment in government bonds. Input variables for actuarial calculation of provisions for jubilee awards and retirement benefits:

	<i>Estimate</i>	
	31/12/16	31.12.2015
Discount rate	3.0%	4.0%
Fluctuation rate	3.4%	3.7%

25 Trade and other payables

	31.12.2016 HRK '000	31.12.2015 HRK '000
Trade payables	289,059	512,987
Salaries and other benefits to employees	22,872	17,247
Accrued interest	3,065	335
Taxes, contributions and other duties	6,749	7,616
Advances received	136,969	127,349
Other	60,026	59,726
	518,740	725,260

During the year, as part of its liquidity management, the Group reprogrammed and reclassified a part of its trade payables in the amount HRK 298,725 thousand (2015: HRK 108,525 thousand) to short-term loans by signing loan agreements with suppliers of natural gas. Other payables contain the liability for the purchase of emission unites in the amount of HRK 57,851 thousand (2015: HRK 53,443 thousand).

Petrokemija d.d.

Notes (continued)

26 Risk management

Financial risk management

Categories of financial instruments are as follows:

	2016 HRK '000	2015 HRK '000
Short-term financial assets	33,632	30,167
Trade receivables	18,046	13,016
Bills of exchange	-	215
Cash and cash equivalents	24,462	9,424
Total loans and receivables	76,140	52,822
Total financial assets	76,140	52,822
Loan liabilities	647,454	366,272
Trade payables	289,059	512,987
Total financial liabilities at amortised cost	936,513	879,259
Total financial liabilities	936,513	879,259

Fair value of financial instruments

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

- the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices;
- the fair value of other financial assets and financial liabilities (excluding derivative instruments) is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.

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

As at 31 December 2016, the carrying amounts of cash and cash equivalents, short-term deposits, receivables, short-term liabilities, accrued expenses, short-term borrowings and other financial instruments approximate their fair value due to the short-term nature of those assets and liabilities and due to the fact that a majority of short term assets and liabilities are at variable interest rates.

As at the reporting dates, the carrying amounts of borrowings arising from bank and other loans approximate their fair values as the majority of these borrowings bear variable interest rates or fixed interest rate approximating current market interest rates or are payable on demand (in case of covenant breach as described earlier).

Petrokemija d.d.

Notes (continued)

26 Risk management (continued)

Financial risk management (continued)

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Management board which manages the Group's short, medium and long-term funding and liquidity requirements. The Group manages liquidity risk by monitoring the net current asset position and addressing any expected current liquidity deficits. As part of its loan arrangements, the Group also monitors required debt covenants.

Liquidity risk analysis

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

as at 31 December 2016	Carrying amount	Contractual cash flows				over 5 years
		up to 1 year	1 - 2 years	2 - 5 years	years	
<i>Non-interest bearing assets:</i>						
Trade receivables	18,046	18,046	18,046	-	-	-
	18,046	18,046	18,046	-	-	-
<i>Interest bearing assets:</i>						
Current financial assets	33,632	33,800	33,800	-	-	-
Cash and cash equivalents	24,462	24,584	24,584	-	-	-
	58,094	58,384	58,384	-	-	-
	76,140	76,430	76,430	-	-	-

as at 31 December 2016	Carrying amount	Contractual cash flows				over 5 years
		up to 1 year	1 - 2 years	2 - 5 years	years	
<i>Non-interest bearing liabilities:</i>						
Loans and borrowings	3,910	3,910	3,910	-	-	-
Trade payables	289,059	289,059	289,059	-	-	-
	292,969	292,969	292,969	-	-	-
<i>Interest bearing liabilities:</i>						
Loans and borrowings	643,544	730,679	506,192	89,433	108,204	26,850
	643,544	730,679	506,192	89,433	108,204	26,850
	936,513	1,023,648	799,161	89,433	108,204	26,850

Generally, the Group's objective is to ensure sufficient liquidity through the use of bank and supplier funding, receivables factoring and advance payments with the aim of meeting its obligations when they become due.

The continuing low fertiliser price environment coupled with external competitive pressures has placed significant pressure on the Group's liquidity position and its solvency. The Group has significant debt repayments scheduled in 2017 which it will, in all likelihood, not be able to meet in absence of a wider restructuring of its operations. The Group drafted a restructuring plan and is in negotiations with key stakeholders (the Croatian Government and natural gas suppliers) in order to restructure its operations and secure sufficient liquidity for sustainable operations. See note 2.4 for further details.

Petrokemija d.d.

Notes (continued)

26 Risk management (continued)

Financial risk management (continued)

Interest rate risk management

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

<i>(in thousands of HRK)</i>	2016	2015
	HRK '000	HRK '000
Ministry of finance's Treasury bills based bank loans	93,426	108,889
	93,426	108,889

Interest rate sensitivity analysis

The sensitivity analyses below have been determined based on the exposure to interest rates at the reporting date. For floating rate liabilities, the analysis is prepared by calculating the effect of a reasonably possible increase in interest rates on floating rate debt on the expected contractual cash flows of such debt compared to those calculated using the interest rates applicable at the current reporting period end date. A 100 basis point increase/decrease is used when reporting interest rate risk internally to key management personnel and represents the management's assessment of the reasonably possible change in interest rates.

The estimated effect of the reasonably possible change in variable interest rates on the Group's result before tax for the reporting periods is as follows:

<i>as at 31 December 2016</i>	Contractual cash flows	up to 6 months	from 6 to 12 months	from 1 to 2 years	from 2 to 5 years	over 5 years
	<i>(in thousands of HRK)</i>					
At currently applicable int. rates	100,743	28,519	21,917	22,846	27,461	-
At currently applicable int. rates + 100 basis points	102,170	28,920	22,201	23,206	27,843	-
Effect of increase of int. rates by 100 basis points	(1,427)	(401)	(284)	(360)	(382)	-

The Group does not hedge interest rate risk as the estimate of possible effect of interest rate changes on the result of operations is not deemed significant.

Petrokemija d.d.

Notes (continued)

26 Risk management (continued)

Financial risk management (continued)

Currency risk management

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

	Assets	
	2016 HRK '000	2015 HRK '000
European Union (EUR)	8,208	19,221
USA (USD)	2,602	3,381
	10,810	22,602
	Liabilities	
	2016 HRK '000	2015 HRK '000
European Union (EUR)	103,972	103,899
USA (USD)	148,319	90,203
	252,291	194,102

Foreign currency sensitivity analysis

The Group is mainly exposed to the fluctuations in the exchange rate of Croatian kuna to Euro and US dollar, since the most of the transactions with international customers are in Euro and US dollar. Borrowings are denominated in Croatian kuna and the Company is not exposed to currency in this respect. The following table shows the applicable exchange rates of HRK against EUR and USD during the reporting period:

	Spot FX rate		Average FX rate	
	31.12.2016	31.12.2015	2016	2015
EUR	7.557787	7.635047	7.529383	7.609601
USD	7.168536	6.991801	6.803718	6.862262

The following table details the Group's sensitivity to a 1% increase in Croatian kuna against the EUR and a 10% increase against the USD as the estimated reasonably possible change in the exchange rate of the respective currencies. The sensitivity analysis includes monetary assets and monetary liabilities in foreign currencies. A negative number below indicates a decrease in profit and other equity where Croatian kuna increases against the relevant currency for the percentage specified above. The weakening of the Croatian kuna against the relevant currency in the same percentage, would result in an equal and opposite impact on net result.

	EUR exposure	
	2016 HRK '000	2015 HRK '000
Increase/(decrease) of net result	(958)	(847)
	USD exposure	
	2016 HRK '000	2015 HRK '000
Increase/(decrease) of net result	(14,572)	(8,682)

The Group does not currently hedge currency risk with respect to the EUR as the local currency is loosely pegged against the EUR but is assessing the need for hedging against the USD given the recent volatility of this currency and the exposure to it arising from USD denominated natural gas prices which are determined in USD.

Petrokemija d.d.

Notes (continued)

26 Risk management (continued)

Financial risk management (continued)

Credit risk management

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

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, has less of an influence on credit risk.

The Group has established a credit policy under which each new customer is analysed individually for creditworthiness before standard payment and delivery terms and conditions are offered. The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments.

Total exposure to credit risk at the reporting date is as follows:

	31.12.2016	31.12.2015
Not yet due	10,958	10,194
Overdue 0-120 days, but not impaired	5,874	1,730
Overdue more than 120 days, but not impaired	1,214	1,092
Total trade receivables	18,046	13,016
Cash in banks (including deposits)	25,466	13,040
Total exposure to credit risk	43,512	26,056

Overdue receivables more than 120 days include HRK 723 thousand of receivables overdue for more than 360 days which have not been impaired and which Management considers recoverable.

Operational risk management

Sales concentration risk management

The Group generates approximately 32% (2015: 31%) of its revenue from domestic customers, whereas around 68% (2015: 69%) of sales are generated from international customers (based on geographical location of customer). The Group determines the selling prices in accordance with the macroeconomic conditions prevailing in each of the markets where the customers are located.

The Group has significant customer concentration whereby approximately 45-50% of revenue is generated by top five customers. Consequently, the Group's capacity for revenue generation is highly dependent on the quality of its relationships with its key customers, their financial stability or the probability of customers switching suppliers in lieu of increased competitive pressures and inability of the Group to provide competitive pricing terms due to its stressed liquidity position.

The Group manages this risk through active and frequent communication with key customers, acquisitions of new customers, and through monitoring of relevant competitors and market conditions both locally and internationally.

Price risk

The supply of the Company's primary production input, natural gas, is dependent on two major suppliers who are also the Group's largest creditors accounting for 33% of its total liabilities. In lieu of prolonged payments to suppliers due to the stressed liquidity position, access to supplies of natural gas at market prices is limited and exerts additional pressure on product margins.

The Group aims to manage this risk by defining long-term relationships with strategic suppliers and is in the process of negotiations for reduction of gas prices as a prerequisite for creating conditions for sustainable operations.

The Group also has investments in money market funds which are subject to price risk. A change in market prices of shares in money market funds of 1% would decrease profit or loss by HRK 326 thousand (2015: HRK 265 thousand).

Petrokemija d.d.

Notes (continued)

27 Contractual and capital commitments

Procurement of natural gas

The Group has a contractual commitment for purchase of natural gas from the suppliers INA d.d. in which the Republic of Croatia has an ownership stake of 44.8% and from Prvo plinarsko društvo d.o.o., Vukovar. As per the contracts currently in force, the Group has an obligation to buy the total amount of natural gas required in its production cycle from these suppliers of which a part will be purchased based on a combination of the “oil index formula” and the spot price of gas while a part will be paid at a fixed price. These contractual commitments expire on 1 October 2017. At a minimum, until the contract expires the Group is required to procure at least 465.8 million m3 of natural gas which, based on spot market price as at 31 December 2016, amounts to approximately HRK 640 million.

Capital commitments

The Group plans significant capital investments in the production process which include legislative requirements regarding environmental protection as well as technical upgrades to key production processes (upgrade of ammonium production). In this respect, the Group is required to secure capital investments of HRK 190 million until the end of 2018 in relation to improvements of ecological efficiency of the plant as prescribed by the Resolution of combined requirements of environmental protection. In addition to this, the Group expects that further capital expenditure of HRK 60 million will be required to maintain a competitive level of production costs.

Agreement on priority concession

Based on the annexes of the Agreement on priority concession, concessionaire of Luka Šibenik d.o.o. has an obligation to invest in modernization and capacity of port activities in the total amount of HRK 115,725 thousand as a prerequisite for holding the concession. Dynamics and amounts of contractual obligations are as follows:

	31.12.2016 HRK '000
2012.-2017.	30,100
2017.-2020.	32,745
2020.-2025.	35,780
2025.-2026.	6,000
2026.-2029.	11,100
	<u>115,725</u>

28 Related party transactions

The most significant shareholder of Petrokemija d.d. is the Republic of Croatia which holds 79.85% of share capital and voting rights of the Company through the Restructuring and sale center (“RSCE”) and has significant influence over the operations of the Company.

The Group considers that it has an immediate related party relationship with its key shareholders (see note 21) and entities under their control or influence (subsidiaries and associates); key management personnel (see below); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definitions contained in International Accounting Standard 24 *Related Party Disclosures* (“IAS 24”).

Furthermore, the Group has a related party relationship with State institutions and companies where the State is the majority owner or where the State has a significant influence.

Petrokemija d.d.

Notes (continued)

28 Related party transactions (continued)

Transactions with State related parties

Given that the Group's majority owner is the State, the Group is also in a related party relationship with state institutions and other companies in which the State is a majority owner or has a significant influence. For the purposes of related party disclosures, the Group does not consider routine transactions (such as taxes, levies etc.) with various communal entities (directly or indirectly owned by the State) or with other State bodies to be related party transactions.

Significant transactions of the Group with such entities relate to purchase of gas which is the primary raw material used in the Group's production cycle, freight rail transport services and supply of electricity. The Group is also in part financed by a bank where the majority owner is the State. During 2016, the Group had the following transactions with State related entities:

	2016 HRK '000	2015 HRK '000
Lučka uprava Šibenik		
Concession fee	225	971
Liabilities as at 31 December	-	366
HBOR		
Loans and borrowings payable at 31 December	222,701	-
Interest expense	3,098	-
INA d.d.		
Purchase of gas, other raw materials and services	487,475	704,579
Liabilities as at 31 December	53	172,390
Loans and borrowings payable at 31 December	152,510	107,195
Interest expense	13,848	13,848
HŽ Cargo d.o.o.		
Purchase of transport services	64,494	81,278
Liabilities as at 31 December	6,278	8,530
HEP Opskrba d.o.o.		
Purchase of electricity	17,765	21,937
Liabilities as at 31 December	2,812	3,425
HPB d.d.		
Loans and borrowings payable at 31 December	-	-
Interest expense	-	6,119

Transactions with key management and Supervisory Board

Management Board remuneration relates to regular monthly payments for salaries and other benefits in kind. During 2016, remuneration paid to key management amounted to HRK 3,291 thousand (2015: HRK 3,506 thousand) and related to 4 persons (2015: 4 persons).

Furthermore, during 2016, a total of HRK 485 thousand (2015: HRK 204 thousand) was paid to the members of the Supervisory Board.

Petrokemija d.d.

Notes (*continued*)

29 Contingencies

Environmental provisions

Over a number of years, the Group formed a landfill of phosphogypsum which is a by-product of a part of the Group's production cycle and for which the Group has a legal obligation for land restoration and closure in accordance with a restoration plan. Currently, the Group does not have a detailed restoration plan but has indicatively estimated the potential cost of restoration and closure of the landfill based on a study performed by a relevant specialist. However, the legislative framework is unclear and does not prescribe an exact period over which the restoration is to be performed nor does it prescribe the required method of restoration.

Additionally, as described further, the landfill itself has potential, albeit limited, for commercialization through use as a raw material in construction and the possibility for prolonging the timing of the restoration is also being considered. Accordingly, apart from the preliminary assessment of potential cost of restoration done by a specialist, the Group has not prepared a detailed plan of restoration and has not recognized any provisions in this respect.

Limitations with respect to estimating the cost of restoration and closure

According to current legislation on waste, phosphogypsum falls into the category of non-hazardous waste for which the Group has a disposal license issued by the Ministry of Environmental Protection. With respect to the type of waste, there are currently three models, or options, available for restoration and closure, the choice of which ultimately depends on the decisions of the relevant ministries, which in the end determines the amount of restoration costs:

- *Option 1*

This option has been applied to certain landfills in Europe and worldwide, and is more demanding in terms of larger amounts of clay and substrate foil to be placed on the landfill and in terms of required funding.

- *Option 2*

This option is developed on the basis of scientific research presented in the report "Gradual greening of phosphogypsum waste" and is more favourable as it does not require placement of foil and substantial amounts of clay and substrate.

- *Option 3*

This option does not predict the closure of the landfill but the use of phosphogypsum as a raw material in road building, construction, agriculture and other sectors, while the costs of land restoration would be significantly less.

Management considers that at this moment, given the ambiguity of related regulations, option 3 is the most likely option. Estimated costs of land restoration in this scenario would amount to HRK 155 million (including effects of discounting).

Court cases

There are a number of legal proceedings initiated against the Group for minor amounts as well as those initiated by the Group against others. Management believes that no significant costs exceeding those provided for at the reporting date will occur as a result of ongoing legal proceedings as presented in note 24.