



# ANNUAL REPORT 2016



**SHIPYARD**

**VIKTOR LENAC**

*Delivering Top Quality, In a Safe Way, On Time*

April 2017

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## Foreword

The Management Board of the Viktor Lenac Shipyard j.s.c. presents its Annual Report for 2016 to all its shareholders, clients, employees, business partners and the entire public.

The Annual Report 2016 is the review of the Company's business and financial performance for the year. In a separate enclosure to the Report, the Corporate Governance rules applied by the Company are described.

## Annual Report in Croatian and English

The Viktor Lenac Shipyard's Annual Report 2016 has been issued both in Croatian and English. The Annual Report is submitted to the Company's shareholders at the General Assembly and is published on the Company's website.

## Legal Form

According to the Companies Act, Article 250.a and Article 250.b, the annual financial statements and report on the Company's business performance for 2016 shall be submitted to the General Assembly as an integral part of the Annual Report 2016, whereas the Supervisory Board's Report shall be submitted to the General Assembly as a separate document.

The annual financial statements, both consolidated and non-consolidated, have been made in accordance with the Law on Accounting and International Financial Reporting Standards and have been revised according to the International Standards on Auditing.

The Annual Report 2016 has been made in accordance with the Law on Accounting, Article 21 and Companies Act, Article 250.a and Article 250.b to give an objective assessment of the Company's business and financial performance and development plan, as well as other crucial information for the Company.

## Subsidiary Company, Consolidated Financial Statements

A limited liability company *Viktor Servisi, Rijeka* is a wholly owned subsidiary of the Viktor Lenac Shipyard. The consolidated and non-consolidated financial statements form an integral part of the Report. The difference between the consolidated and non-consolidated financial statements is not significant in material terms, as the subsidiary's revenues and assets participate with less than 1% in the Group's revenues and assets. The Report focuses on business result of the mother company - Viktor Lenac Shipyard.

## Abbreviations

In the Annual Report, Viktor Lenac Shipyard j.s.c. is referred to as the "Shipyard" or "Viktor Lenac" or "Company". Viktor Lenac Shipyard j.s.c. and its subsidiary Viktor Servisi Ltd. hereinafter are referred to as the "Group".

## Foreign Exchange Rates

Assets, liabilities and equity amounts have been converted to foreign currency (EUR) at the midpoint exchange rate of the Croatian National Bank as at 31 December of the reference year. The items from the income statement have been converted at the average of midpoint exchange rates of the Croatian National Bank determined on the last day of the month for the reference year.

For year	Exchange Rate as of 31 Dec	Average Exchange Rate
2016	7,5578	7,5271
2015	7,6350	7,6173
2014	7,6615	7,6344
2013	7,6376	7,5755
2012	7,5456	7,5265

## PRESIDENT'S ADDRESS TO SHAREHOLDERS



Dear Shareholders, Clients, Employees, Business Partners and everyone reading the Report,

The business year 2016 proved to be full of challenges just as it was announced. Continued recession of the shipping market has further intensified competition among ship repair yards in the wider Mediterranean, causing the drop in ship repair prices and consequently falling revenues and profitability. Despite such a challenging environment and significant loss generated in the first half of the year, we managed to achieve a positive result at the end of the year and our goal was accomplished. We have succeeded to maintain continuity of positive result which is crucial to the future of the Shipyard.

Our core activity – ship repair generated over 80% of operating revenue, whereas the rest of the revenue was generated from other activity involving a small scope conversion of the fishing vessel *Navigator* for an Island's client and the first stage of works carried out on board the US Navy's 6th Fleet Flagship *USS Mount Whitney*. A

total of 84 different projects were realized, which shows that the volume of work was held at the same level as in the previous year. Of major projects, it is worth mentioning the installation of Ballast Water Treatment System (BWTS) on three tankers for Russia's SCF Group, in addition to docking and overhaul, which resulted in the conclusion of Fleet Agreement 2017-2018 and enabled us to firmly position on the global map of shipyards that can perform BWTS projects.

In September, the Shipyard was awarded the 4th contract in a row for extensive upgrade and modernisation of the US Navy's *USS Mount Whitney*, which is a clear indication that Viktor Lenac is at the very top of the world's ship repair yards. Given that the project execution began at the end of the year, a more significant impact on revenue will be felt in 2017. Total income is expected to amount to USD 30m, of which USD 2.5m was realized in 2016.

Due to the ongoing offshore market crisis, consequently a lack of revenues from the offshore activity, the Shipyard has been looking for different projects to activate its offshore resources, such as the Ship-to-Shore Container Crane Assembly Project for Italy's TMI Group and the project of construction and testing of special anchors for the renowned company Saipem, which have brought us additional revenue. We intend to continue with such a practice until recovery of the offshore market or opting for other strategic opportunity.

In the second half of the year, significant personnel and organizational changes have been made, which will continue in 2017. The aim is to create a new shipbuilding culture that will be based on open communication, respect for hard work, proactive and more accountable approach for the result at all levels. The ultimate outcome of such reorganization will be increased efficiency and productivity, which I consider to be a fundamental precondition for ensuring financial stability and sustainable growth of the Shipyard. To accelerate this process, several management training courses have been launched and a plan for key investment in production means and modern technologies in 2017 has been adopted.



A chronic shortfall in skilled workers, involving main shipbuilding crafts, is one of the biggest challenges we will continue to face in the coming years. Our subcontractors have also been facing challenges of skilled migration across foreign countries, particularly young workers, which is reflected in decreased quality of work. On the other hand, subcontractors' prices have not been reduced, which emerged as a double burden for the Shipyard. For this reason, we were forced to import workers from Ukraine, who proved to be good and hardworking, so we intend to continue this practice in 2017.

Although no significant recovery of the shipping market is expected in 2017, nor the competition will be reduced, the award of the project for upgrade and modernization of the US Navy's 6th Fleet Flagship *USS Mount Whitney* and several projects for installation of Ballast Water Treatment System, on top of normal ship repair activity, made it possible to expect a very good business result in terms of a significant increase in revenue and profit. We, therefore, look forward with optimism to 2017 and intend to make the most use of it to be prepared for 2018.

President of the Management Board & CEO

Aljoša Pavelin





## KEY FINANCIAL FIGURES

### Consolidated Financial Figures

	thousand HRK			thousand EUR *		
	2016	2015	Index	2016	2015	Index
Total Revenues	303.613	536.543	0,57	40.336	70.437	0,57
Total Expenses	301.498	509.065	0,59	40.055	66.830	0,60
Operating Revenues	303.257	536.205	0,57	40.289	70.393	0,57
Operating Expenses	296.503	504.589	0,59	39.391	66.243	0,59
Operating Profit (or Loss)	6.754	31.615	0,21	897	4.150	0,22
Profit and Loss before Tax	2.115	27.478	0,08	281	3.607	0,08
Net Profit and Loss	1.473	26.143	0,06	196	3.432	0,06
Total Assets	423.466	398.581	1,06	56.030	52.204	1,07
Equity	212.124	222.507	0,95	28.067	29.143	0,96

### Non-consolidated Financial Figures

	thousand HRK			thousands EUR *		
	2016	2015	Index	2016	2015	Index
Total Revenues	302.991	535.938	0,57	40.253	70.358	0,57
Total Expenses	300.908	508.707	0,59	39.977	67.177	0,60
Operating Revenues	302.648	535.619	0,57	40.208	70.316	0,57
Operating Expenses	295.924	504.238	0,59	39.315	66.196	0,59
Operating Profit (or Loss)	6.724	31.380	0,21	893	4.120	0,22
Profit and Loss before Tax	2.083	27.231	0,08	277	3.575	0,08
Net Profit and Loss	1.453	25.924	0,06	193	3.403	0,06
Total Assets	421.558	396.609	1,06	55.778	51.946	1,07
Equity	208.955	219.389	0,95	27.648	28.735	0,96

\* All amounts expressed in Croatian Kuna, except for assets, share capital and reserves, have been converted into euros according to the average midpoint exchange rate by the Croatian National Bank for 2016 respectively 2015. Assets, share capital and reserves have been converted into euros according to the midpoint exchange rate by the Croatian National Bank on 31st December 2016 respectively 31st December 2015 as listed on page 3 of the Report.

The consolidated profit and loss statement and other financial statements include Viktor Lenac's wholly owned subsidiary company Viktor Servisi Ltd. Rijeka, which, during 2016, generated revenues from its normal business activity consisting in providing specialized and licensed services in shipbuilding.

In 2016, Viktor Lenac and Viktor Servisi generated together total revenues in the amount of 303.6 million Croatian Kuna and total expenses in the amount of 301.5 million Croatian Kuna, after annulment of their reciprocal transactions and after balancing positive and negative exchange rate differences.

Comparing the consolidated financial statements with the non-consolidated ones, it can be concluded that the influence of Viktor Lenac's subsidiary company is irrelevant. Viktor Lenac's subsidiary company generated a net profit in the amount of 20,000 Croatian Kuna. Revenues and expenses of the Mother Company make more than 99% of revenues respectively expenses of the Group. Likewise, the assets of the Mother Company make 99% of the Group's assets. The Annual Report 2016, therefore, reports on the financial result and the balance sheet of the Mother Company.



## BUSINESS ENVIRONMENT

The shipping market has been under recession that lasts a few years and it is not expected to stabilise during the current year given the fact that the market continues to offer a greater supply than the demand for ship space, along with an additional increase in the global fleet of about 4%, according to Lloyd's List. On the other hand, no significant ship demolition can be expected, which means that the demand for ship space will not exceed the current supply. For that reason, shipping companies will continue to cut down on fleet costs and only take the necessary repair and maintenance works to meet the requirements of the classification societies. The market is not likely to see the first wave of Ballast Water Treatment System installation projects in 2017, as shipping companies are able to take advantage of a 5-year postponement, so a considerable number of such installation projects is expected in 2019. Until then, BWTS projects will be sporadic. This will keep the ship repair market conditions like those that marked business in 2016.

This means that global competition among shipyards will be further intensified and could have a negative impact on revenue and profit through further pressure to reduce prices. The situation in the Mediterranean will not be different and an even greater pressure from competition from the eastern Mediterranean and Black Sea is expected. Turkish, but also some Mediterranean and Black Sea shipyards have already lowered their service prices through high discounts in 2016. To maintain competitiveness in such a market, Viktor Lenac will also have to offer discounts on its prices, which will reduce the average revenue per project, with intense pressure on the profit margin. However, this reduction in average revenue per project is intended to compensate for a larger number of projects, which, in addition to high revenues from the US Navy's 6th Fleet Flagship project, will still result in significantly higher income and profit in 2017 compared to 2016. Efforts to increase efficiency and productivity have been intensified since mid-2016 and we expect to be able to maintain a healthy operating profit margin.

Most conversion projects currently involve construction of offshore wind farms in the North Sea. Despite of our unfavourable geographic position it is expected that an intensified direct sales activity could result in at least one conversion project of such kind in 2017. Besides, two or three projects for the installation of Ballast Water Treatment System can be expected.



The Shipyard has been continuing its good cooperation with the US Navy and there is a real possibility, in addition to the 6th Fleet Flagship *USS Mount Whitney* project that will bring us a significant revenue, to contract another US Navy's project of smaller scope in the fourth quarter of 2017.

A major challenge is the chronic skilled labour shortage in main shipbuilding crafts - welders, cutters and fitters and this is not likely to change



without structural changes in society. Domestic subcontractors have the same problem that is reflected in a noticeable drop in quality and productivity because skilled workers go to more developed Western European countries where they are better paid. On the other hand, more highly skilled workers demand higher pay. One solution for getting out of this unfavourable situation was to import skilled workers from Ukraine. This approach has the disadvantage of low flexibility in managing costs, but has a key advantage of high productivity and quality of work, and a more accountable approach for the result.

It is certain that the offshore industry will not recover in 2017, so no revenue from that segment of activity is expected. The Company has been looking intensively for different projects to activate its offshore resources, such as Ship-to-Shore Container Crane assembly or construction and testing of special anchors for oil platforms, which may provide additional income and profit to Viktor Lenac until recovery of the offshore market or opting for other strategic opportunity.

Despite all these challenges, Viktor Lenac expects a very good and successful year.

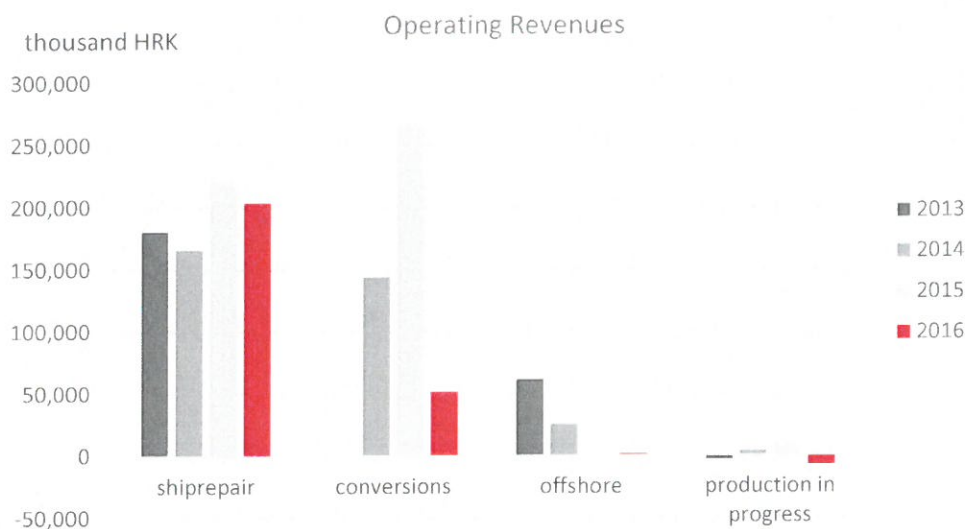




## BUSINESS ACTIVITIES

### SALES

#### Realized Revenues



In 2016, Viktor Lenac generated a total of EUR 34.2 million of revenues from its core activity, of which EUR 1 million related to work that was in progress at the end of the previous year. Compared to 2015, the operating revenues are significantly lower, primarily due to lack of a major conversion or extensive ship repair project, such as the projects that were realized in 2015. In particular, compared to 2015 where a total of EUR 35 million of revenues were generated from an extensive

conversion and renovation of the US Navy's 6th fleet Flagship *USS Mount Whitney*, in 2016, revenues from conversion amounted to only EUR 6.8 million. It is expected that the current year will again record high revenues, primarily due to a large scope project executed on the same US Navy's vessel, which began in December 2016 and will last until July 2017. The accounted value of the preparatory works and the works carried out in December 2016, which made up part of the reported conversion revenue totals EUR 2.3 million. The remaining EUR 4.5 million of the conversion revenues refers to a smaller scope project of conversion of the fishing vessel *Navigator* and to the installation of Ballast Water Treatment System on board *NS Power* and *NS Stream* for Russia's SCF Group.

A total of EUR 27.3 million was generated from the ship repair activity deriving from 76 repairs projects including revenues that were generated from two contracts which involved the mooring of vessel. Five projects were under progress at the end of the year, one of them being the third ship of the SCF Group's fleet that involved BTWS installation. The average value of repair job amounted to EUR 355,000, which is slightly more than the average value of repair job realized in the previous year.

During 2016, several major repair contracts were executed having an individual value of over EUR 1 million, such as *Johann Jacob* and *Sloman Themis* in the first part of the year, and *Nautical Tide* and *Sloman Thetis* in the second part of the year.

During the period between the two extensive contracts executed on board the US Navy's *USS Mount Whitney* – the one started in 2015 and the second one started in December 2016, a few small scope contracts were executed on board the same vessel during March and April, totalling nearly EUR 1.3 million. All the works are part of the 3rd stage of its scheduled life-cycle maintenance to extend the life of this 1970s-era command ship till 2039, which started in 2011. The current *USS Mount Whitney* project is the fourth contract in a row that has been awarded to Viktor Lenac.

	thousand HRK			thousand EUR		
	2014	2015	2016	2014	2015	2016
Shiprepair	165.820.853	221.012.950	203.644.939	21.817.778	28.870.299	27.250.311
Conversions	143.793.961	267.504.399	51.168.459	18.810.720	35.029.536	6.796.883
Offshore	25.334.411	334.404	1.094.173	3.318.440	43.727	145.365
Realized revenues	334.949.226	488.851.753	255.907.571	43.946.938	63.943.561	34.192.558
Production in progress	3.376.577	10.235.775	-7.676.652	440.722	1.340.630	-1.015.727
Realized scope of works	338.325.802	499.087.528	248.230.919	44.387.660	65.284.191	33.176.831

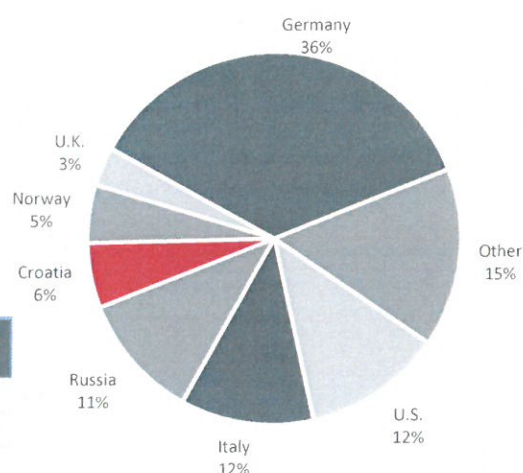
The offshore activity recorded only a few thousands of euros involving minor maintenance works carried out on board gas exploitation platforms in the North Adriatic, and most of the recorded revenue referred to assistance provided for testing of equipment for closure of oil wells for a renowned Italian client.

## Market Analysis

Put in perspective of market structure, even 94% of total revenue generated from core activities derived from foreign markets involving 22 different countries. A total of 21 different repair projects, having an average value of over half a million euros, were executed for the German market which dominated by 36%.

Market	Revenue in EUR	Number of projects
Germany	12.184.796	22
Italy	4.139.403	10
U.S.	4.112.671	4
Russia	3.740.148	4
Croatia	1.908.481	21
Norway	1.742.258	3
U.K.	1.126.860	3
Other	5.237.941	17
<b>Total</b>	<b>34.192.558</b>	<b>84</b>

Realized revenues per market



The Italian clients ranked second with a 12% share resulting from a total of 10 repair projects, the same as the US market on the account of the two USS MTW contracts realized during 2016. The Russian market took a share of 11% involving 2 repair contracts and 2 BTWS installation projects including the third one which was still in progress at the end of the business year.

In domestic market, the Shipyard completed a few small scope projects for docking of newbuilding for domestic shipyards as well as other ships for domestic shipping companies, achieving approximately 2 million euros that makes just 6% of the market revenue structure.

## Sales

During 2016 Viktor Lenac received 350 inquiries from shipowners for various shiprepair works. Due to unavailability of dry dock / repair facilities in the requested period, 40 inquiries were not processed. A total of 85 contracts resulted out of 310 quotations. A large number of inquiries was the result of intense market competition and the fact that shipowners have been increasingly looking for new shipyards to find cheaper ship repair services.



The Shipyard's selective sales approach is aimed at focusing on jobs that are more certain to be realized and increasing the effectiveness of the inquiry response process, which should result in the growing trend of contracting rate and achieving the target revenue with reduced number of projects. Unfortunately, this is less likely to happen in near future because the shipping market is still under recession which is reflected in a decreased scope of ship repair works and the reduction of sales prices at global level.

According to customer feedback, the main reason for not accepting a repair offer involved deviation from the voyage due to the Shipyard's geographic location (60%) that implies additional costs and a longer period time, whereas in about 25% of cases the reason was the price mainly when put in relation to Turkish or Black Sea competitors. Other reasons for not concluding a repair offer included non-availability of ship repair facilities in the requested period or changes in shipowner's plans.

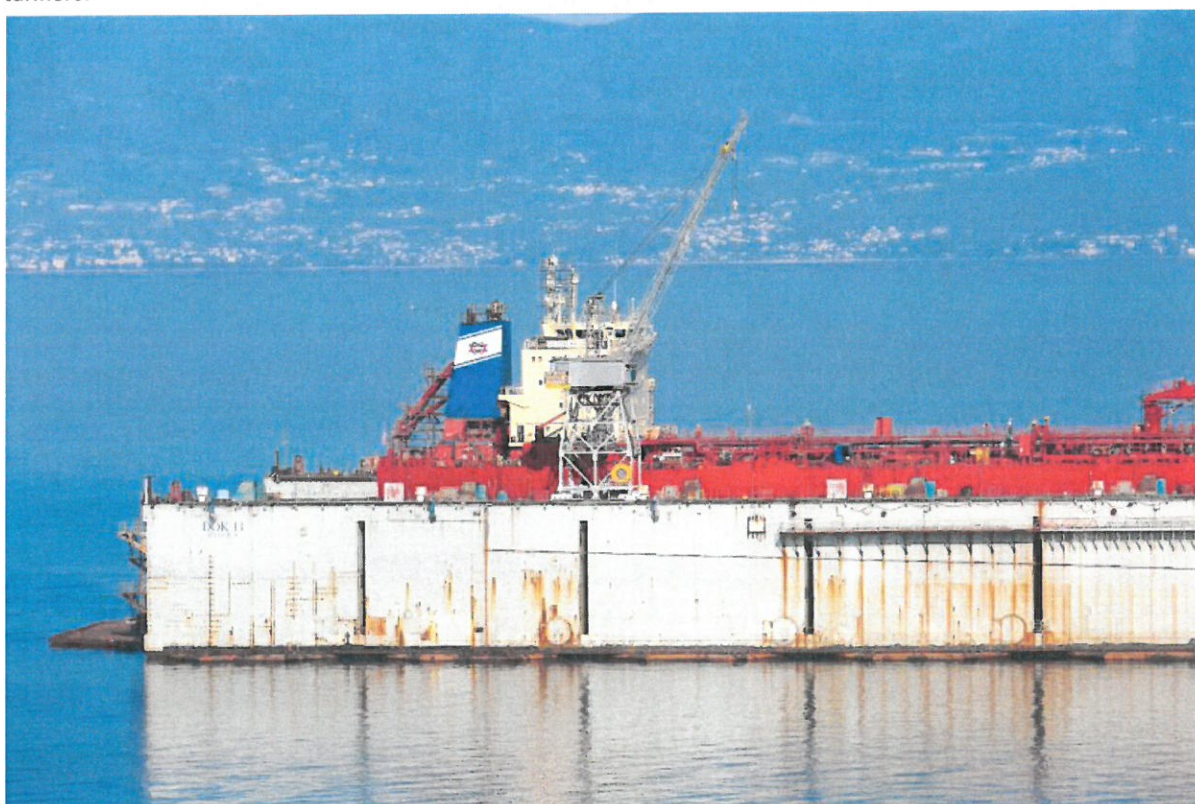
## Contracts concluded to quotations issued

	2012	2013	2014	2015	2016
Number of inquiries received	330	312	347	401	350
Number of quotations created	308	295	317	317	310
Number of contracts concluded	58	62	77	86	85
Contracting rate	19%	21%	24%	27%	27%

Viktor Lenac implements two basic sales strategies: direct and indirect. Recently it has been increasingly using its own sales force (direct selling) especially on the markets where it does not use sales agents. Of total revenues generated from core activities in 2016, about 40% of total contracts were made in direct selling, whereas in ship repair works the share is 30%.

Lower demand for ship repair in 2016, especially in relation to the previous year, and a lack of major ship conversion projects, necessarily implied lowering prices for some services and granting additional discounts to maintain competitiveness and neutralize the impact of unfavourable geographic position.

As a result of continuously strengthening cooperation with its steady clients, in 2016 the Shipyard was awarded a contract for repair of a series of four, respectively six vessels for two German clients and a contract for repair of a series of four vessels for a shipowner from Greece. The Shipyard has been continuing its good cooperation with its traditional Italian clients and a considerable progress has also been made in the Russian market where, after many years, cooperation with the SCF Group has been restored, involving BTSW installation on their two tankers.





The major success that marked 2016 was the award of the contract for repair and conversion of the US Navy 6th Fleet Flagship *USS Mount Whitney*, in competition of several European shipyards. The contract worth 20.9 million US Dollars was concluded in September 2016. The works commenced in December when the ship arrived at the Shipyard. The project involves the 3rd stage of its scheduled life-cycle maintenance to extend the life of this 1970s-era command ship till 2039. The contracted duration of the works is 6 months, and the contract also provides for the option of carrying out additional works, which will substantially increase the preliminary contracted value and thus the total revenue for 2017. This will partially compensate for a decrease in revenues from ship repair activity, which happened when the Shipyard reduced prices to remain competitive.





## PRODUCTION

### Production Activity

During 2016 Viktor Lenac completed 84 various projects including 5 projects that were under progress at the end of the year. The projects included the following types of vessel:

- ✓ 22 tankers (oil tankers, chemical tankers, LPG tankers)
- ✓ 11 container ships
- ✓ 11 passenger ships/ferry boats
- ✓ 8 general cargo ships
- ✓ 6 bulk carriers
- ✓ barges, tug boats, offshore platforms, suppliers and military ships.

Of the total number of ships, there were 5 newbuilding dockings for domestic shipyards.

Major technically demanding projects involved three projects of Ballast Water Treatment System installation of which two were realized during the year and the last one was under progress at the end of the year. Each project was realized within about 5 weeks with additional time of about one month for the preparation of steel pipes and deck houses. In addition to installing special BWTS equipment, each project involved about 50 tons of steel renewal and about 10 kilometres of new cables with main and control boards for a three-position control system. These projects also involved installation of special Glass Reinforced Epoxy pipes that required additional training of the Shipyard's workers to work with these specific pipes. According to feedback received from the client, the systems installed at Viktor Lenac did not show any problems in work. At the client's request, on two of the vessels the GRE pipes were mounted with heaters for sailing in cold water. Such projects are relatively new in the shipbuilding market, so the project team was facing a few challenges such as incomplete technical documentation, extensive additional works and improvised solutions. Nonetheless the works have been completed in excellent quality, timely and in a safe way. Viktor Lenac has been now firmly positioned in the BWTS market segment and is therefore expecting further business in the future especially in the period from 2019 to 2021.

The lack of major conversion projects has resulted in a lower scope of production activities and significant oscillations of the capacity utilization rate. Therefore, periods of low capacity utilisation were used to carry out extensive steel renewal works on the floating docks 5, 11 and RI-38 to increase their value and extend their lifetime in compliance with the requirements of the Croatian Ship Registry.

Production works carried out in other projects were mainly of standard type – mostly steel renewal works and anti-corrosion treatment representing, together with steel renewal carried out on the floating docks, half of the total productions works carried out during 2016.

A total of 690 tonnes of steel was renewed in total ship repair projects, which is almost the same level as compared to the previous year. Individually, major steel works involved *Johann Jacob* (177 tonnes) and *Sloman Thetis* (123 tonnes). The most extensive steel works were carried out on the floating docks, of which 311 tonnes of steel was renewed on the Dock 11 and 204 tonnes of steel was renewed on the Dock 5.

Anti-corrosion works refer to different technologies of ship surface treatment for coating including high water pressure jet, degreasing, brushing and sandblasting. During the last couple of years Viktor Lenac has been introducing modern, ecologically friendly technologies such as UHPW using water as an alternative to traditional sandblasting. New, clean technology has been currently used in Dock 11. A total of 20,000 sqm of ship hull was treated in this way in 2016. Full coat was applied on over 770,000 sqm including spot coating applied on a total of more than 170,000 sqm.





## Labour Capacity and Production Cost

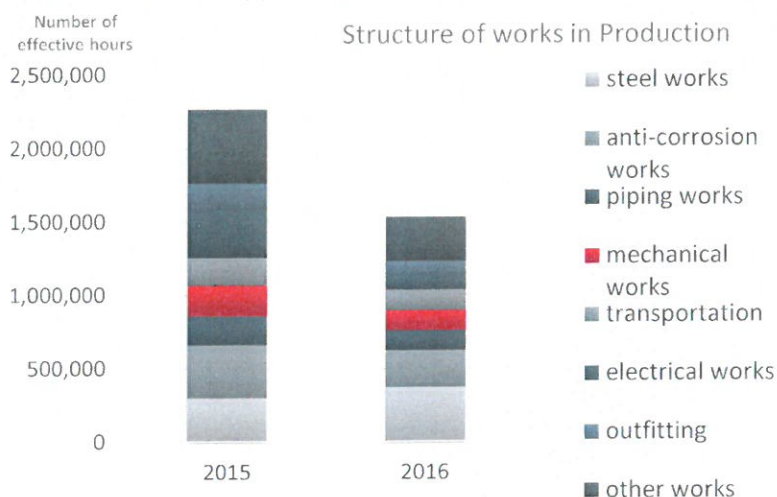
The annual production capacity is measured in the number of effective hours in core activity, maintenance segment and own investment activity aimed at extending the lifetime of own property and meeting the requirements of the Croatian Register of Shipping.

A total of 1.53 million effective hours were produced in core activity in 2016, down by 32.4% compared to the previous year as a direct consequence of lower capacity utilisation and the lack of major conversion projects. Due to steel renewal works carried out on own floating docks, the total scope of steel works increased compared to the previous year. Other works decreased following a decrease in capacity utilisation. The largest decrease was recorded in electrical works. In general, volume of electrical works increases in conversion projects.

	2015	2016	share '15	share '16	2016/2015
Steel works	299.367	370.012	13,2%	24,2%	123,6%
Anti-corrosion works	361.095	252.704	16,0%	16,5%	70,0%
Piping works	196.693	137.909	8,7%	9,0%	70,1%
Transportation works	210.671	136.789	9,3%	8,9%	64,9%
Mechanical works	186.824	135.829	8,3%	8,9%	72,7%
Electrical works	324.399	104.574	14,3%	6,8%	32,2%
Outfitting	182.977	92.380	8,1%	6,0%	50,5%
Other works	501.754	300.556	22,2%	19,6%	59,9%
	2.263.780	1.530.753	100,0%	100,0%	67,6%



Apart from its own permanent production workers, depending on needs, Viktor Lenac uses subcontractors for all its production activities, which is a general global practice. Subcontractors are mainly contracted on turn-key base, and in lesser scope per hour, noticeably during periods of oscillations where own labour is not sufficient. Lower capacity utilisation rate recorded in 2016 as compared to the previous year decreased needs for some crafts and trades in shipbuilding. However, in the second half of the year, when ship repair works intensified, considering steel renewal of own floating docks, the Shipyard needed additional workforce for steel works especially fitters and welders. When speaking of ship repair activity, due to oscillations of the capacity utilisation rate, the Shipyard is often faced with a challenge of shortage or surplus in shipbuilding crafts.



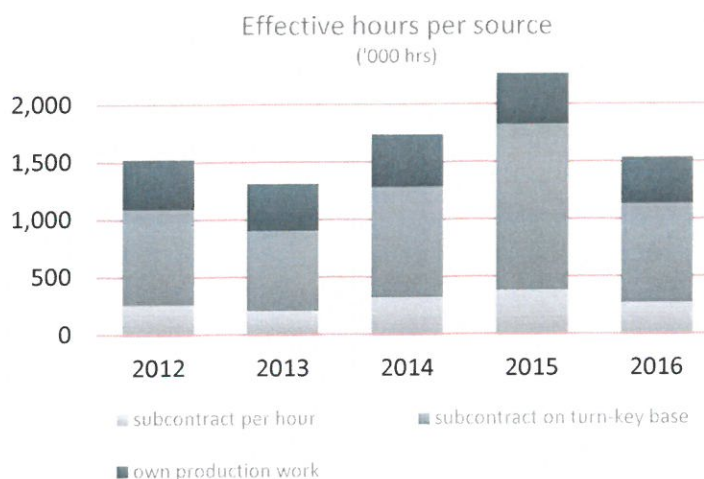
The growing need for shipbuilding workers involving all shipyards in the area, labour mobility and skilled workers migration across the EU countries, has put a challenge ahead of the Shipyard to find additional workforce in the wider environment. As a result, about 50 Ukrainian workers have already been recruited within the approved import quota.

Own production workers as fixed production capacity provide an average of about 420,000 effective hours. In 2016, the

Shipyard's workers produced a total of 402,000 effective hours, which accounted for only 26% of the total realized 1.53 million effective hours realized in direct production involving core activity and own investment. Compared with the previous year, the share of own production capacity increased by 6.7%. The remaining hours were produced by subcontractors, mainly those contracted on regular basis, but also some new considering the growing need for additional workforce.

In figures, the total cost of production work incorporated in working orders relating to core activity and own investment amounted to 101.5 million Croatian Kuna, down by almost 50 million Croatian Kuna compared to the previous year as a direct consequence of a decrease in subcontractor cost concerning that own workers imply fixed production capacity.

Apart from own production, Viktor Lenac also uses external services such as sub-licensing involving manufacture and provision of services in core activity, but are mainly carried out outside the location of the Shipyard or using subcontractors' means of work. Examples of such services are custom made manufacture, finishing, processing, tug and port services as well as waste disposal.



## Dock and Berth Utilisation Rate

Viktor Lenac disposes of three floating docks (Dock 5, Dock 11 and Dock RI-38) allowing for flexibility required in shiprepair industry.

Given the oscillations and the lower level of income achieved in 2016, dock utilisation rate was favourable but still considerably lower than in the previous year. This was especially the case for Dock 5, which in 2015 recorded an utilisation rate of over 90%. A very low utilisation rate involving all three docks was recorded from May to July (Dock 5 = 73 days lost, Dock 11 - 32 days lost and Dock RI-38 - 55 days lost). Ship repair works intensified in July which resulted in a high utilisation rate recorded in the second half of the year. During the periods of high utilisation, Dock 5 recorded two cases of co-dry-docking, while Dock 11 recorded four cases of co-dry-docking when docking two ships at the same time.

Dock	Dock utilisation rate		Number of vessels docked
	number of days	in percentage	
Dock 5	291	79,7%	20
Dock 11	321	87,9%	31
Dock RI 38	285	78,1%	26

The Shipyard's main operative berths - 1, 2 and 3 are located in the immediate vicinity of the shipyard's plants, workshops and warehouses. The operative berths 8 and 9 are of special purpose and are used when main operative berths are not sufficient to fulfil operating needs. During the last few years the operative berths 4, 5 and 6 have been accommodating vessels for mooring only; however, these berths have been increasingly used for core ship repair activities due to an increase in the number of ships undergoing repairs, and the necessity to execute works on several ships at the same time.

Dock and berth utilisation rate is a measure of utilisation of the Shipyard's shiprepair facilities. The average utilisation rate of the main operational berths - 1, 2, 3, 8 and 9 recorded 62% in 2016, down by 15% compared to 2105.





## Raw Material and Energy

The cost of raw material and energy in the Shipyard's core activity generally participates with 20-30%, depending on structure of works, put in relation to total operating revenues. In general, the share of raw material and built-in equipment is larger in conversion and offshore projects with respect to standard ship repair projects. In other words, the share of value of raw material and built-in equipment in 2014 recorded a high rate (30%) put in relation to the value of completed projects that was due to a large scope of raw material and built-in equipment in the *Cable Enterprise* project. In 2016, the share was only 18%, which involved normal ship repair works with an elevated share of labour.

In 2016, a total of 36.2 million Croatian Kuna was spent for various raw material and built-in equipment in production projects, out of inventories, including a total of EUR 2.3 million of energy, twice as much as less compared to the previous year. Considering steel renewal on the Shipyard's floating docks, only an increase in sheets was recorded compared to the previous year, while in all other types of material a significant decrease was recorded. The biggest fall in costs was recorded in dedicated materials and equipment, cables and electric material, otherwise typical for large-scope conversion projects. The beginning stage of the *USS Mount Whitney* project, which started in December 2016, did not have a significant impact on raw material quantity as procurement of raw material and equipment for this project was just under way.

Structure of raw material varies depending on the structure of works. The most important groups of raw materials that are built-in on board vessels under repairs or used in technological processes are ferrous materials (sheets, profiles and tubes), grit or sand for blasting in anti-corrosion treatment, technical gases and fuel.

A total of 1,900 tonnes of sheets, 316 tonnes of profiles and 145 tonnes of pipes was used for steel works, outfitting and piping works in core activity, maintenance and own investment. A total of 4,240 tonnes of grit was used for surface treatment, down by 5,000 tonnes compared to the previous year.

Viktor Lenac uses significant amounts of energy such as electric power, fresh water, technological water and gas.

Part of electric energy and fresh water represent fixed costs, while part is calculated as variable production cost that depends on scope of production activity. Technological water which is not used for drinking and technological gas such as liquid oxygen and acetylene are variable costs, which depend in whole on scope of production activity.

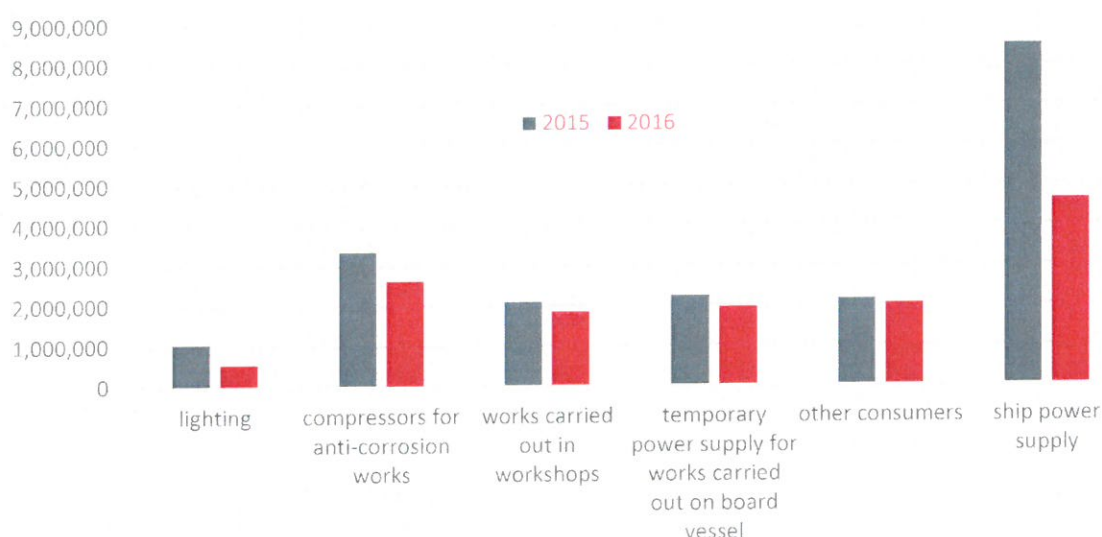
Technological water is used in washing and high pressure jetting, steel cutting and assembly. Liquid oxygen and acetylene are used in steel cutting and machining.



Energy cost has been decreased compared to previous years because of a decrease in production activity and continuing implementation of cost reduction measures in energy management.

Energy consumption	Unit of measurement	2012	2013	2014	2015	2016	2016/2015
Electric power	thousand kWh	13.907	10.868	11.806	19.339	13.560	70,1%
Fresh water	thousand m <sup>3</sup>	80	61	65	93	63	67,3%
Technological water	Thousand m <sup>3</sup>	178	185	199	265	262	98,8%
Oxygen and acetylene	t	565	602	590	672	558	82,9%
Light fuel	t	545	523	450	485	331	68,3%

Electric power cost structure



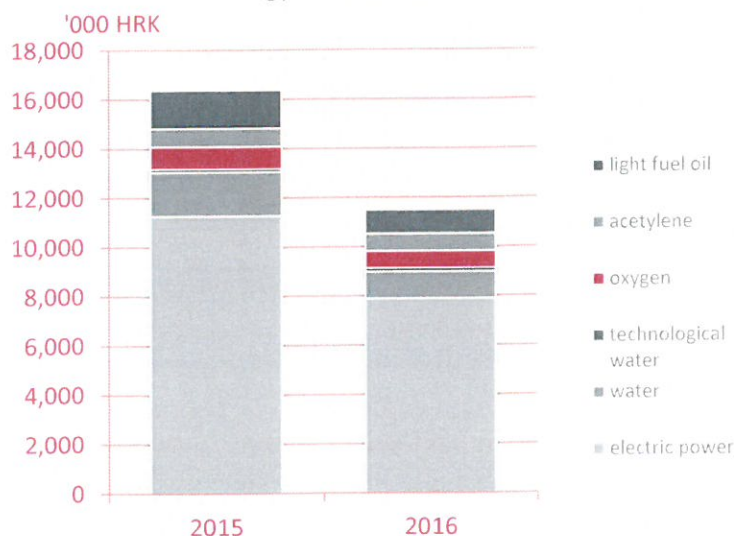
Besides production activities, a large amount of electricity is used for ship power supply, which was particularly pronounced in 2015 due to an extended period of power supply on board the vessel *USS Mount Whitney*. A decrease in ship repair activity in 2016 resulted in a decrease in electricity consumption by around 30%, but

there is still a considerable cost of ship power supply due to a substantial number of vessels that underwent repairs.

Consumption of electricity for indoor and outdoor lighting compared to 2015 has been reduced by 40%, which is a direct consequence of replacing old lighting with new, fluorescence and LED sources under the recent energy efficiency project implemented in cooperation with HEP ESCO Ltd. Additional savings in electricity are achieved through planning and monitoring in accordance with power supply market trends.

Considerable savings have also been achieved in consumption of medium and extra light fuel (fixed cost) used for space

Energy cost structure





and water heating, down by nearly one third compared to the previous year. Such substantial savings have been achieved because of the newly installed hot-water heating system using compressor heat.

Total energy cost in 2016 decreased by nearly 5 million Croatian Kuna or 30% compared to the previous year. Almost 70% of total energy cost, having a value of 11.5 million Croatian Kuna, referred to electricity.



An adequate water resource management involves prompt elimination of any leaks and water consumption monitoring. The existing technological water distribution system enables the use of technological water instead of more expensive water from the public water supply. More reduction will be achieved by installing additional technological water pipelines aimed at using technological water at larger scope.

Compared to the previous year, total consumption of technical gases (oxygen and acetylene) was also reduced, although there was an increase in steel works where these gases are normally used.



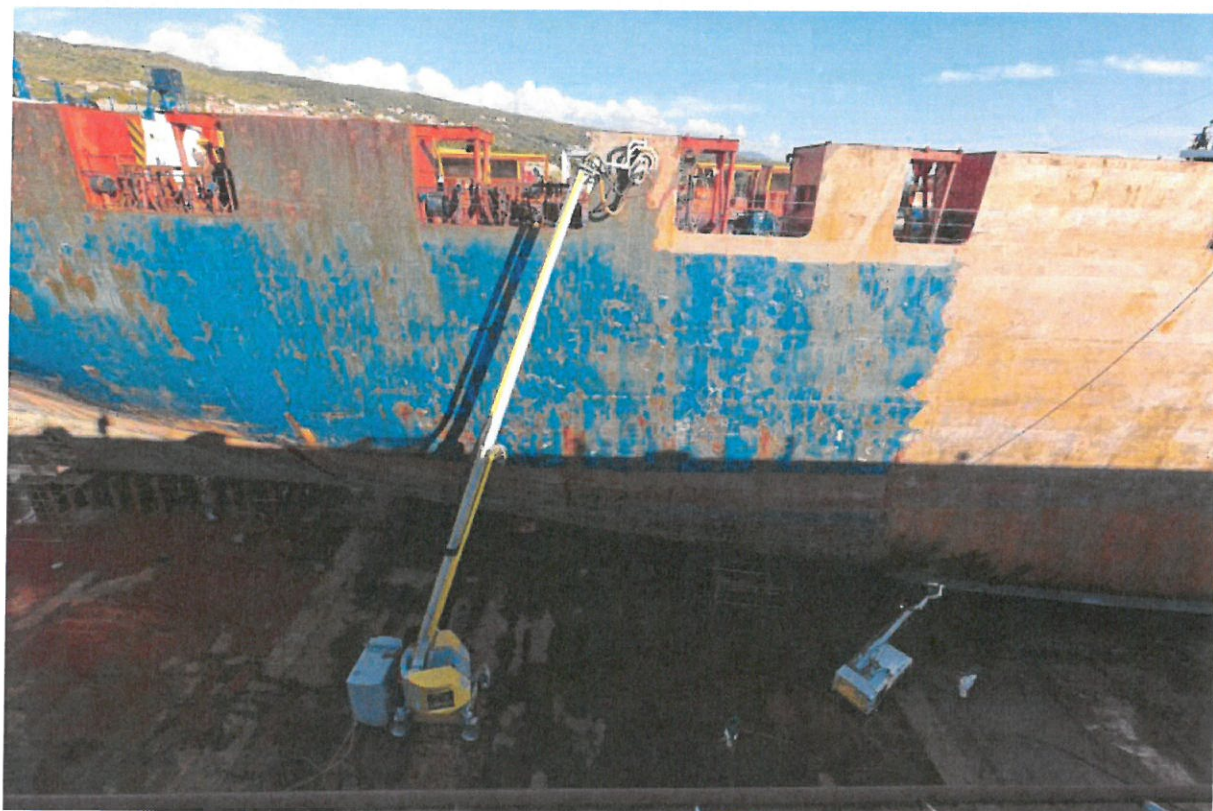


## TECHNOLOGICAL DEVELOPMENT AND INVESTMENT

During 2016 Viktor Lenac intensified investment activity and invested a total of 41.8 million Croatian Kuna in existing and new tangible and intangible fixed assets, of which a total of 24.4 million Croatian Kuna related to steel renewal works carried out on Dock 11 and Dock 5 to increase dock value and extend dock lifetime. Another significant investment having a value of 3.1 Croatia Kuna involved enlargement of mooring facilities and deepening underwater slope for safety of vessels with bigger draughts. Approximately 1.2 million Croatian Kuna was invested in the extension of CO<sub>2</sub> pipeline used for steelworks to increase productivity and reduce gas cost resulting in annual savings of about half a million Croatian Kuna.

The energy efficiency project involving outdoor lighting that started in 2015 in cooperation with HEP ESCO Ltd. was completed in the first quarter of 2016. The completion stage had a value of about 2.1 million Croatian Kuna. Another ESCO energy efficiency project was realized in 2016 to reduce fuel consumption and space and water heating cost. The project involved installation of an energy-efficient hot water distribution system with central monitoring that replaced traditional steam system enabling compressor heat recovery, including installation of a modern thermomechanical system to replace old installation. The value of the investment was 5.4 million Croatian Kuna. Based on lower energy consumption Viktor Lenac expects annual savings of nearly 700,000 Croatian Kuna, with additional benefits resulting from automated process with increased safety at work and reduction in harmful gas emissions.

During the year, many other investments were made in production, measurement, transportation and ICT equipment. Also, a new, ecologically friendly frequency converter for ship power supply was purchased having a value of 3 million Croatian Kuna, of which 1 million Croatian Kuna has already been paid as advance payment.





## QUALITY MANAGEMENT SYSTEM, INFORMATION AND COMMUNICATION, ORGANISATION



The Company's Business Process Management System involves continuous analysis and revision of the Company's operations aimed at increasing productivity and decreasing non-value added activities. Functional Organization and Project Organization are linked into a matrix organization structure where resources are allocated to multiple ship repair, conversion and offshore projects that may take place simultaneously.

The Company is committed to a continuous process of revising and improving its organization, eliminating misunderstanding and conflicts of interests which may arise between line and project/production management, defining and delegating authority and responsibility, raising awareness for personal responsibility for organizational achievement and development of managerial knowledge at all management levels.

Continuous monitoring of business process performance through internal auditing is reflected in constant improvement of the Shipyard's QMS documentation involving modifications and amendments to procedures and work instructions and changes in organizational roles aimed at accelerating and optimizing Shipyard's operations.

The Company's managerial staff is required to be more proactive in revising and optimizing business processes aimed at decreasing labour cost and increasing project success and customer satisfaction in a challenging market environment. This has led to a comprehensive business process reengineering in sales and production to increase the effectiveness of the inquiry response process involving preparation of a quotation or an estimate for main and additional works, and improve production capacity management. Changes in business process flow have led to changes in the organizational structure involving the two most important organizational units of the Shipyard: *Marketing and Sales Division* and *Technical and Production Division*.

Organizational development is closely related to the development of IT system, as a tool for the automation of business process activities.

In 2016, the focus was on Customer Relationship Management (CRM) aimed at enabling systematic monitoring and aggregation of all information on client needs, market trends, key project-related correspondence, financial performance indicators and feedback on customer satisfaction (including any complaints) in a single database. The key effect of the implemented system will be significantly improved sales management in terms of planning and realization.

IT improvement involved email account migration to Office 365 for moving to a cloud-based system using mobile apps and solutions. In addition to improved capability of integration with other business apps, enhanced security and availability of email services and increased storage capacity, significant savings in licensing and system maintenance will be achieved.

In cooperation with our business partners, we have developed mobile solutions for recording subcontractors' working hours and approving requisition forms for material, labour or services. In addition to increased process monitoring and faster data exchange, B2B portal will allow approved subcontractors access to information relevant to their business, such as performance evaluation, non-compliances, evidence sheets etc.

The ISO 9001: 2008 recertification audit was conducted by Bureau Veritas in September 2016. Viktor Lenac received its ISO 9001: 2008 certification for Quality Management System in 2011. Also, during the year, the



Shipyard underwent several audits conducted by their business partners. Internal Audit Plan for 2016 involved all business processes and organizational units.

Any recommendations and observations that may have resulted therefrom have been incorporated in the Shipyard's QMS procedures and attention will be put on the following issues:

- Defining key business performance indicators;
- Risk management;
- Raising awareness on the importance of quality management system.

Compared to 2015, the number of internal auditors decreased due to employee turnover, mostly in production organizational units. Decrease in the number of auditors has been identified as a weakness especially in production process control and non-conformities management. Viktor Lenac has, therefore, identified the need for additional training and increase in the number of internal auditors. Currently, the Shipyard is preparing for certification of its Quality Management System according to ISO 9001: 2015, and is planning to become certified to ISO 9001: 2015 to improve its energy-related performance.





## SAFE WORK, HEALTH AND SAFETY AT WORK, FIRE PROTECTION

Committed to by the Company, occupational health and safety aims have been incorporated in the Company's organizational and business management system. HSE activities involve execution of HSE tasks and duties in accordance with the Company's HSE rules and procedures, complied with the law, which make an integral part of the Company's Quality Management System.

In 2016, the Company adopted the new HSE Risk Assessment Plan in accordance with the new Regulations on Risk Assessment, involving each workplace, aimed at eliminating or reducing hazardous and harmful effects.

During 2016, the number of employees in the Shipyard's HSE Department has increased. The newly implemented WebZNR program is expected to improve HSE management practices and evidence.

During the year, the Company performed numerous HSE activities such as training for safe work, testing machines and devices for elevated level of danger, inspection of workplaces and activities for safe work in specific conditions with specific dangers, approvals of entrance and work in closed and limited spaces and monitoring.

Distribution of personal protective equipment was carried out according to established timelines and needs. Proper use of PPE is strongly monitored, involving both Shipyard's own workers and subcontractors.

Shipyard's workers employed at posts characterized with special work conditions pass obligatory medical examination at the Institute of Occupational Medicine. During 2016, a total of 270 workers underwent such examination. Aware of the importance of preventive healthcare, Viktor Lenac has renewed its agreement with a reputable medical establishment for ninth years in a row for annual preventive medical exams and other medical services for the benefit of its employees.

### Total funds spend in healthcare and safety at work:

	2011	2012	2013	2014	2015	2016
Annual preventive medical exams	719.280	907.091	376.875	618.546	655.688	675.861
PPE	820.559	665.333	653.745	783.165	680.286	654.411
	1.539.839	1.572.424	1.030.620	1.401.711	1.335.974	1.330.271

The implementation of HSE measures in recent years have led to a reduction in the number of injuries, evaluated both in the absolute number of injuries and relative to the number of workers. Looking at the index of severity of injury, usually it comes to minor injuries mostly involving concussions, wounds and sprains.

A total of 18 injuries were recorded with a total of 416 lost working days. Although the number of injuries has remained at the same level during the last two years, the number of lost working days has increased, indicating an increase in the injury index. Frequency index also increased due to the lower number of effective hours compared to previous years. Increase in the injury index is the result of two fractures of the finger, which accounted for more than half of total days of sick leave, although in general such injuries result in a much shorter duration of sick leave.

Of the total 18 work-related injuries incurred during 2016, five of them were severe and all involved fracture of the finger. Other injuries involved sprain and surface injuries. There were no fatalities because of accidents at work.



## Injury indicators:

	2011	2012	2013	2014	2015	2016
Number of effective hours	1.090.191	1.019.687	925.669	957.147	937.020	864.292
Number of injuries	29	23	23	18	17	18
Total number of days lost due to sick leave	636	557	738	556	354	416
Frequency Indeks	26,60	22,56	24,85	18,81	18,14	20,83
Number of injuries / Effective hours						
Severity Index						
Total lost days due to sick leave / Total effective hours	58,34	54,62	79,73	58,10	37,78	48,13
Number of injuries / Number of workers	5,00	4,03	4,44	3,58	3,45	3,64

Reducing the number, frequency and severity of accidents at work remains a goal of Viktor Lenac in future periods. The Company will continue to develop and take measures to improve safety at work and one of the most important tasks in 2017 will be raising awareness among all employees about safe work aimed at protecting health and reducing injuries at work in terms of number and severity.

The Shipyard's Fire Protection System integrates a spectrum of preventive measures among which inspecting work sites for issuing of permits for work with open flame, making emergency evacuation plan for each vessel, educating and training new employees, inspecting, maintaining and renewing firefighting equipment and practicing periodic firefighting drills and simulations.

Hot works such as welding and cutting can be carried out only after a preventive inspection has been performed and a hot work permit has been issued. In 2016, a total of 10,770 hot work permits were issued almost at the same level compared to the previous year. Also, more than 300 gas-free certificates were issued for works in tanks on board tankers.



Major investment in fire protection facilities involved extension of the sea water pipeline to the Berth 8 for purpose of the USS Mount Whitney repair project. Other investment involved new fire pipes and fittings, fire extinguishers, Motorola mobile phones and a comprehensive maintenance of three mobile fire pumps. Firefighting equipment has been arranged at various locations aimed at increasing availability of equipment and improving operational efficiency of the internal fire brigade unit. Fire

drills and simulations are conducted regularly in accordance with the Internal Fire Protection Plan and may be carried out at shipowner's request.



The Company adopted the new Fire Protection Plan based on safety assessments reviewed at the beginning of 2016. Both documents have been approved by the Ministry of the Interior and the State Administration for Protection and Rescue.

During the year, 8 initial fires and 5 technical interventions were recorded. The total material damage of the incidents is estimated at about 7,200 Croatian Kuna, which can be considered extremely low having in mind potential dangers and threats that may arise from a fire incident, high complexity of production processes and systems on board vessels, and the amount of flammable substances that can be found at the work site.





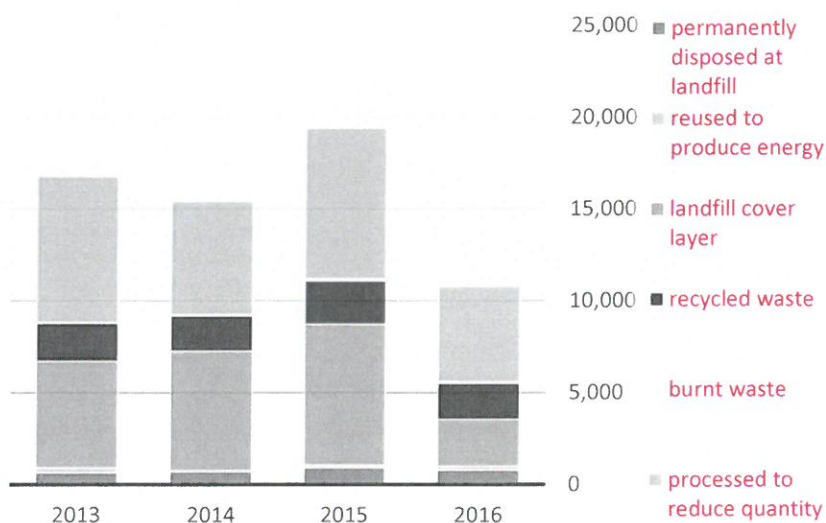
## ENVIRONMENTAL PROTECTION

The Company's Environmental Management System has been incorporated in the Quality Management System certified according to ISO 9001:2008 and is one of the most important building blocks in the Company's sustainable business model. The Environmental Management System is based on the principles of social responsibility aimed at ensuring quality coexistence with the local community through integration of technological processes, technological advances, professional rules and legal regulation.

To determine the impact on the environment, Viktor Lenac uses its own measuring equipment to continuously monitor the quality of the components of the environment, especially water, sea and air. Based on the findings, as interpreted by certified laboratories, Viktor Lenac is taking necessary actions aimed at eliminating or reducing emissions.

In July 2015, the Shipyard faced with sudden and unexpected changes in waste disposal because the landfill sites in the vicinity completely closed their doors for industrial waste, which has marked the turning point in the waste management strategy. Adapting to these changes is a major challenge for complex industrial systems such as Viktor Lenac and whose activities comprise of several technological processes that generate diverse types of waste.

### Waste disposal management



The Company's Waste Management System implements the 4R basic principles of good waste management (Reduce, Reuse, Recycle, Replace) with a tendency for continuous improvement of waste utilisation, especially after the closure of the landfill sites in July 2015. The Shipyard has introduced clean, ecologically friendly UHPW technology as an alternative to traditional grit blasting for ship surface treatment. The UHPW equipment has already been used in Dock 11 and in 2017 it is planned to purchase a new set of the equipment to be used in Dock 5.

During 2016, the Shipyard generated approx. 11,000 tons of waste, almost twice as much less compared to the previous year. Of the total amount of waste generated in 2016, 48% referred to oily waste which can go for energy recovery in cement plants after chemical and physical treatment, 24% involved abrasive sand which is mainly used as an intermediate layer to cover waste at landfill, about 18% of waste referred to waste metals, plastic and rubber that can be recycled, and only 8% of waste was burnt or permanently disposed at landfill. Of total waste, 2% was used to produce energy.



## HUMAN RESOURCES

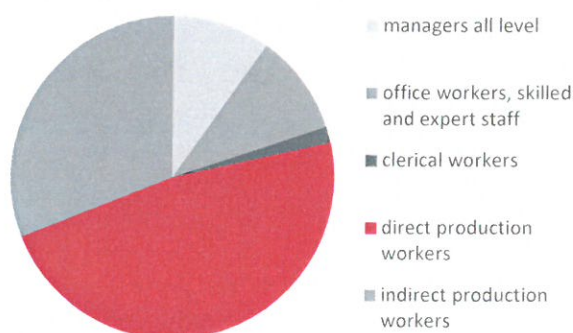
### Number and Structure of Employees



On 31 December 2016, Viktor Lenac had 488 employees or 5 employees less than at the end of 2015. The average number of employees during 2016 was 481 workers, or 16 workers less than the average in 2015. During the year, 52 employees left, of which 22 retired and 2 finished their contracts of employment of definite term, while one case involved inactive employment. The remaining 27 employees terminated their contracts by agreement, which means dysfunctional turnover that is mainly a consequence of a higher demand for shipbuilding workers, not

only in Croatia but also in other European Union countries. As of 31st December 2016, of the total number of employees, 86.5% had employment contracts of indefinite term.

Organisational structure



The Company's Employment Policy is aimed at keeping the number of employees at current level. In particular, Viktor Lenac relies in large part on subcontractors' services in its production activities. New workers are employed depending on need to increase the number of workers for timely execution of works in those activities in which it is not possible or not efficient to employ external labour. The Company's Human Resource Management Policy has been focused on employing and keeping employees with specific technical and commercial knowledge, especially important for Viktor Lenac such as sales engineers, project managers, technicians and similar with an emphasis on recruiting managers of elevated management level and

those who gained more experience in the international environment.

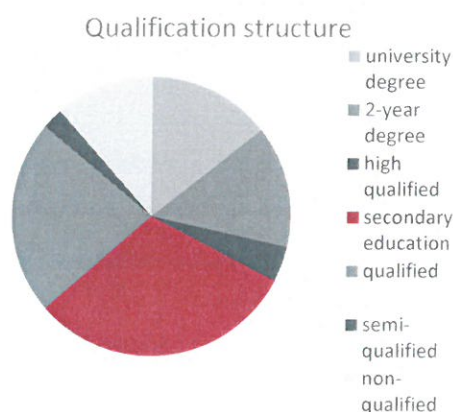
On 31 December 2016, Viktor Lenac's subsidiary company (Viktor Servisi Ltd.) had a total of 18 employees, of which 15 maintenance and repair technicians.

Put in the perspective of the total organisational structure of employees, there are 222 direct production workers and 150 indirect production workers that involve safety and environmental protection, maintenance, quality control, foremen and other production overhead. The remaining number of employees involve technical-commercial and other highly qualified and expert staff (57 employees), clerical staff (9 employees),



and project managers, heads of departments and managers of organizational units of all levels (total 50 employees).

Viktor Lenac's employee structure in terms of qualification and profession is satisfactory. A small number of employees refer to non-qualified workers and those are mostly workers occupied with cleaning works and simple manufacturing jobs which require internal training. The average age of the Shipyard's employees is 45.3 years. The Company's goal in the coming years remains rejuvenating the age structure of employees.

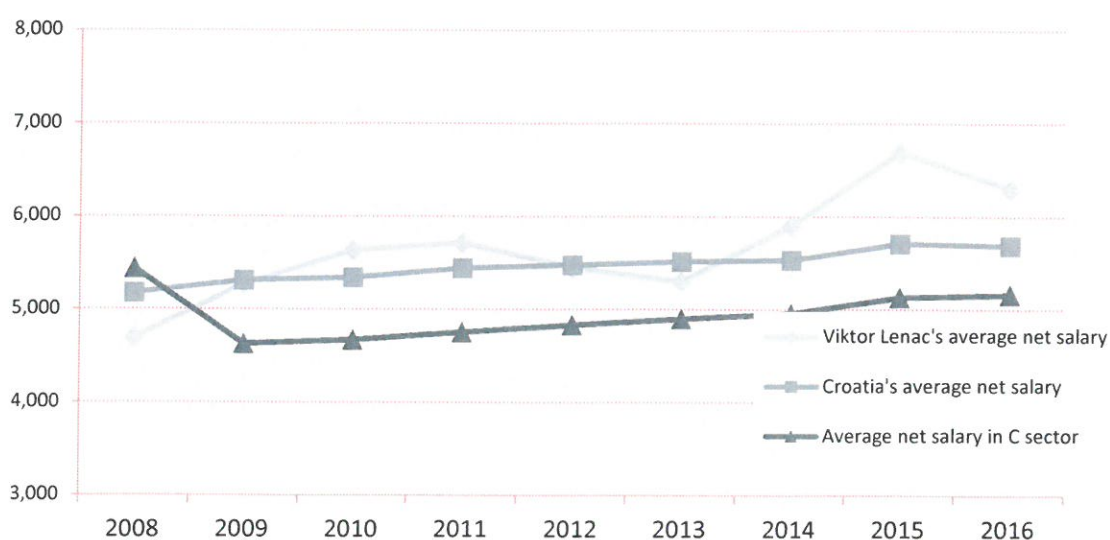


## Structure of Effective Work Hours and Salaries

In 2016, Viktor Lenac's employees produced total 1,004,3680 work hours in normal working hours, of which 79% or 793,000 were effective work hours, down by 2.3% compared to the previous year due to decreased capacity utilisation. Non-effective hours were related to vacation (11.2%), sick leave (5.8%), national holidays (3.3%) and paid or non-paid non-effective work hours (0.8%).

During 2016, a total of 67,000 overtime hours was produced, which is 15,000 hours, or almost 1/5 less compared to the previous year. The decrease in overtime is the result of a decrease in the capacity utilisation rate, but overtime work is still required due to the oscillations of the capacity utilisation rate that are partly managed through a system of redistribution of working hours, as agreed with trade union organizations, primarily with the aim of better utilization of working time and to decrease negative effects of frequent changes in capacity utilisation rate.

Average monthly net salary trend



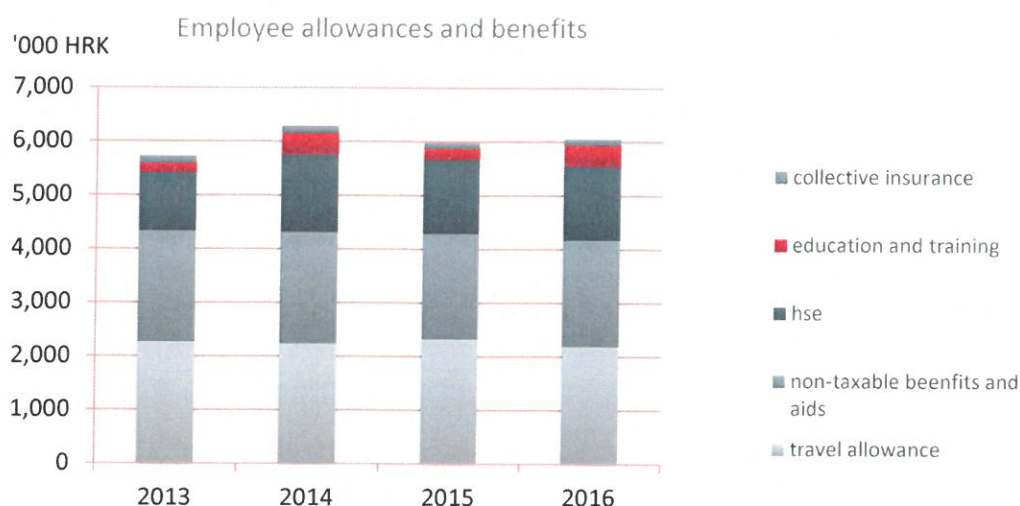
In 2016, Viktor Lenac paid a total of 66.9 million Croatian Kuna on the account of employee salaries, allowances and benefits, of which 62.3 million Croatian Kuna referred to salaries, while 4.6 million Croatian Kuna referred to allowances and benefits to which employees are entitled based on the Collective Agreement and Labour



Regulations. Compared with the previous year, the total salaries, allowances and benefits decreased by 6.8% primarily resulting from a decrease in the average number of employees and a decrease in overtime work.

Calculated in accordance with the State Statistics Institute's calculation methods, the average net salary per month in 2016 amounted to HRK 6,296.00, higher by 10% compared to the average net salary in Croatia or up by 22% compared to the average net salary for the 'C' sector (manufacturing industry). The salary consists of a fixed part and a variable part allowing increase or decrease depending on operating results and capacity utilisation rate. The Company's average salary, therefore, varies with respect to Croatia's average particularly if you look a few years back.

Salaries are paid regularly with all appropriate taxes and contributions, including all employee allowances and benefits, to which they are entitled pursuant to the Collective Agreement and the Labour Regulations.



## Employee Education

During 2016, the Company continued with permanent education activities at all business levels, intensified in the second half of the year. All employees are provided professional training and continuous education and improvement, considering the Company's business targets and production needs. The focus of educational strategy is to encourage workers to acquire additional knowledge and skills required to become multi-skilled to improve flexibility and efficiency.

During the year workers attended various courses and seminars organised by educational institutions such as Magnetic, Ultrasonic and Radiographic Testing Recertification, apprenticeship for maritime occupations, training in procurement and finance expertise, training in specific areas of work in occupational safety, environmental protection and fire protection, welding training courses, driver training courses for horizontal and vertical transportation, and special skills in the field of thermography and energy supply. Several courses have been held in leadership and marketing skills such as project management (PMP) and negotiating skills in marketing and sales. A total of 267 educational activities were carried out, involving 103 workers.

The costs of education and training activities during 2016 amounted to 392,000 Croatian Kuna, almost twice as much compared to the previous year, including the cost of travel-related educational activities.



## Social Dialogue

The year 2016 was traditionally marked with a social dialogue of mutual respect between the Viktor Lenac's Management Board and its social partners, the Unions and Workers' Council.

Cooperation between the Workers' Council and the Management Board is maintained at monthly meetings, where the Workers' Council is informed about actual situation and perspectives. The Workers' Council is regularly informed on all issues significant for employee economic and social status. In co-deciding processes, the Workers' Council participates in decision making in accordance with the provisions of the Labour Act. During 2016, the Workers' Council held ten sessions, of which all workers have been informed through their representatives and by the minutes of these sessions.

During the year, the Workers' Council held three sessions where the President of the Board informed employees on the Company's development plans.

In December 2008, the Management and the Unions concluded the Collective Agreement. The Collective Agreement stipulates all employee rights in terms of working hours, minimal salary, salary structure, health and safety at work, allowances and benefits. During last year, all provisions as adopted by the Collective Agreement were applied to mutual satisfaction of all interested parties.

In addition, on the Company's Intranet site and notice boards employees can find all valuable information about Viktor Lenac, new projects and other news and actualities.

Workers' representative is the fifth member of the Supervisory Board, being elected for the period of three years.

In October 2016, under the slogan '*Viktor Lenac - 120 years stronger than the sea*', the Shipyard celebrated its 120th anniversary. The attractive ceremony was attended by all employees including those retired, many foreign and domestic clients, major shareholders, business partners and the highest state and foreign officials.





## FINANCIAL RESULT

### Revenues and Expenses

In 2016, Viktor Lenac generated a total of HRK 302.6 million of operating revenues, while the Group's operating revenues were HRK 0.7 million higher and amounted to HRK 303.3 million. Compared to the previous year, the operating revenues decreased by almost 44%, primarily due to a lack of major projects as it was in 2015 - conversion of *USS Mount Whitney* and *Cable Enterprise*, making 2015 the record year of revenue. Revenues from the core activity (sales revenues) accounted for over 86% of total operating revenues, both for Viktor Lenac and Group. The periods of low capacity utilisation rate were used for own investment – steel renewal of the floating docks 5, 11 and RI-38, so in 2016, and the Company therefore recorded a higher share of investment, i.e. revenues from using own products in total operating revenue. Income from insurance did not have any material significance in 2016. More than half of the income from insurance earned by the Group in 2016 related to the subsidiary. Compared to 2015, an increase in other operating revenue was recorded, which is almost entirely attributable to Viktor Lenac with a very small influence of the subsidiary. Higher level of other operating revenue resulted from provisions reversed (HRK 2.9 million) and income from value adjustment of inventories (HRK 3.0 million). Other operating revenue referred to surpluses, write-offs, collection of outstanding receivables, rental income and other non-core revenues.

thousand HRK

	Viktor Lenac			Group			Influence of the subsidiary on the Group's results in 2016
	2015	2016	2016/2015	2015	2016	2016/2015	
Sales	520.569	261.560	50,30%	521.375	262.136	50,30%	0,20%
Revenues from using own products	8.440	28.754	340,70%	8.440	28.754	340,70%	0,00%
Sale of material and waste	3.615	2.989	82,70%	3.620	3.054	84,40%	2,20%
Income from insurance	856	21	2,50%	862	47	5,50%	55,30%
Other operating revenue	2.138	9.324	433,30%	1.907	9.266	485,90%	0,00%
<b>Total operating revenue</b>	<b>535.619</b>	<b>302.648</b>	<b>56,50%</b>	<b>536.204</b>	<b>303.257</b>	<b>56,60%</b>	<b>0,20%</b>
Financial income	319	343	107,20%	339	356	104,70%	3,70%
<b>Total revenues</b>	<b>535.938</b>	<b>302.991</b>	<b>56,50%</b>	<b>536.543</b>	<b>303.613</b>	<b>56,60%</b>	<b>0,20%</b>
Material cost*	363.923	192.511	52,90%	360.801	190.292	52,70%	1,20%
Salaries*	66.251	62.752	94,70%	68.665	65.005	94,70%	3,50%
Depreciation	23.399	21.832	93,30%	23.590	21.993	93,20%	0,70%
Other cost	50.665	18.829	37,20%	51.532	19.213	37,30%	2,00%
<b>Total operating expense</b>	<b>504.238</b>	<b>295.924</b>	<b>58,70%</b>	<b>504.588</b>	<b>296.503</b>	<b>58,80%</b>	<b>0,20%</b>
Financial expense	4.469	4.984	111,50%	4.476	4.995	111,60%	0,20%
<b>Total expenses</b>	<b>508.707</b>	<b>300.908</b>	<b>59,20%</b>	<b>509.064</b>	<b>301.498</b>	<b>59,20%</b>	<b>0,20%</b>
<b>Profit before tax</b>	<b>27.231</b>	<b>2.083</b>	<b>7,70%</b>	<b>27.479</b>	<b>2.115</b>	<b>7,70%</b>	<b>1,50%</b>
Profit tax	1.307	630	48,20%	1.336	642	48,10%	1,90%
<b>Net profit</b>	<b>25.924</b>	<b>1.453</b>	<b>5,60%</b>	<b>26.143</b>	<b>1.473</b>	<b>5,60%</b>	<b>1,30%</b>

\* Adjusted for the amount relating to the increase or decrease of work in progress in 2015, respectively 2016

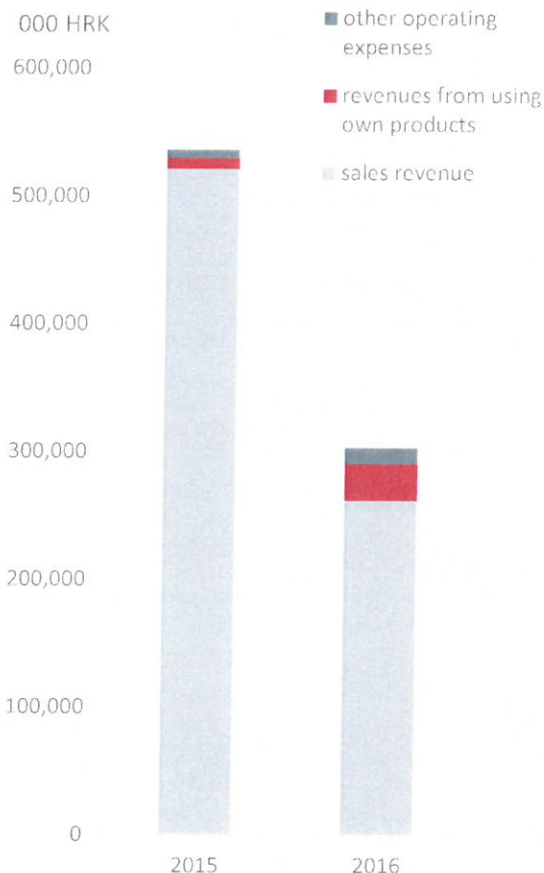


As a result of lower capacity utilisation rates in 2016 compared to the previous year, the decrease in operating revenue was accompanied by a decrease in operating expenses, both for Viktor Lenac and the Group. Due to a certain level of fixed costs in total costs, the decrease in operating expenses was by 2.2% lower than the revenue decrease. The total operating expenses produced by Viktor Lenac in 2016 amounted to HRK 295.9 million, while the Group's operating expenses were by HRK 0.6 million higher and totaled HRK 296.5 million.

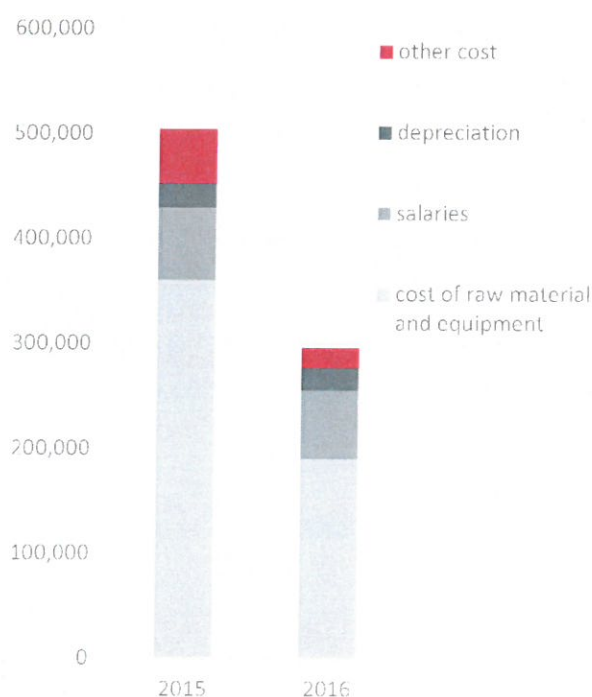
Put in the perspective of the total structure of operating expenses, the material costs were the most important and included raw material and equipment cost (26% compared to 30% in 2015) and external tangible services (74%) mostly involving subcontractor cost. Salary cost is fixed cost of approximately the same absolute amount but a different relative ratio depending on the capacity utilisation level where in periods of high capacity utilisation rate more subcontractors are engaged. Thus, the salary cost in 2016 accounted for about 22% of the total operating expenses, up by 9% compared to the previous year. Other costs related to various operating costs, mainly administrative costs that are relatively independent of the volume of operating revenues, such as various non-taxable employee benefits, insurance premiums, bank and utility fees. In the presented graph, other expenses include expenditures for unused annual vacations, court disputes, receivables and other operating expenses.

Costs are allocated to direct working orders that are

Operating revenue structure



Operating expense structure



the carriers of generation of revenue or creation of new assets. Of the total operating expenses (excluding depreciation), about 30% referred to overheads, which are mostly of a fixed nature. Their share in total expenses therefore varies, and in periods of high capacity utilisation rate their share is lower, whereas in periods of low capacity utilisation rate or oscillations of the capacity utilisation rate the share of such costs in total costs is higher. Given the trend in revenue in the observed years, in 2016, overheads accounted for 35% of total costs, while the share in 2015 was only about 26%. The most significant overheads are the costs of salaries of overhead workers and direct production workers for ineffective work and work that is not directly related to generation of revenue or creation of new assets, then energy costs, property maintenance costs, overhead material in plants and organizational units, non-taxable allowances and personal protective equipment, as well as insurance premiums, utility and bank fees.

By implementation of constant control and rationalization of all non-value added costs, the overhead cost tends to have a downward trend, both for Viktor Lenac and the subsidiary, especially in absolute

amount. Reducing non-productive cost burden remains a permanent task for future periods, which is especially felt in periods of the oscillations of the capacity utilisation rate.

Despite a lower capacity utilisation rate recorded in 2016, the difference between operating revenues and expenses in 2016 resulted in an operating profit before depreciation in a total amount of HRK 28.5 million (Group: HRK 28.7 million), representing a rate of almost 9.5 % in relation to the realized operating revenues.

Depreciation cost amounted to HRK 21.8 million (Group: HRK 22 million), down by HRK 1.6 million than in the previous year due to the write-off of assets.

After calculating the cost of depreciation and net financial expense, Viktor Lenac achieved a profit before tax in the amount of HRK 2.08 million and the consolidated profit before tax amounted to HRK 2.11 million.

The major item in financial income and expense involved interest on bank loans in the total amount of HRK 3.1 million, which is entirely related to the parent company Viktor Lenac. The major interest expense related to the investment loan for financing investments in fixed assets, and the rest referred to short-term interest expense on bank loans and financial leasing. In 2016, Viktor Lenac earned an income from interest in the amount of HRK 267,000 (subsidiary: HRK 10,000). In addition, financial income included dividend income and income from a money fund in which the parent company invested excess of liquid funds. Positive and negative exchange rate differences in 2016 resulted in a negative balance of HRK 1.85 million in Viktor Lenac's balance, and an additional HRK 10,000 in the subsidiary's balance. High negative exchange rate differences are the result of the fall of the USD exchange rate in the first part of 2016, as compared to the end of 2015, when Viktor Lenac recorded a significant receivable from the USS Mount Whitney project. Later trends in exchange rate movements of the USD and EUR currencies against the domestic currency partially mitigated negative exchange rate differences that occurred in the first quarter of 2016. As generally exchange rate differences do not have any material significance, Viktor Lenac still does not use any hedging instruments.

The profit tax liability for 2016 amounts to HRK 630,000 for the parent company and additional HRK 12,000 for the subsidiary. Viktor Lenac realized a net profit (after tax) in the amount of HRK 1.45 million, and the consolidated net profit of the Group amounted to HRK 1.47 million.

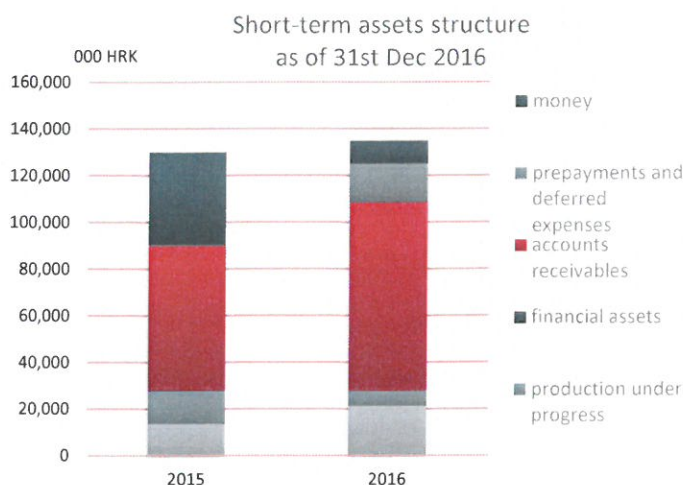
## Assets and Liabilities

As of 31st December

	Viktor Lenac			Group			Influence of the subsidiary on the Group's balance in 2016
	2015	2016	2016 /2015	2015	2016	2016 /2015	
Long-term assets	266.784	286.752	107,5%	267.255	287.134	107,6%	0,1%
Short-term assets	129.825	134.806	103,8%	131.326	136.332	103,9%	0,1%
Long-term liabilities	77.338	72.524	93,9%	77.350	72.543	93,9%	0,0%
Short-term liabilities	99.882	140.079	140,2%	98.724	138.799	140,6%	0,1%
Equity	219.389	208.955	95,2%	222.507	212.124	95,3%	0,1%
Total assets	396.609	421.558	106,3%	398.581	423.466	106,3%	0,0%

The total value of Viktor Lenac's assets on 31st December 2016 amounted to HRK 422 million, of which 286.7 million or 68% of long-term assets. The long-term assets of the subsidiary amounted to only about HRK 400,000. During 2016, long-term assets were increased by new investments in existing assets and the purchase of new assets, and the total investment amount exceeded the depreciation cost by approximately HRK 20 million, the total amount of which is its book value compared to the previous year.

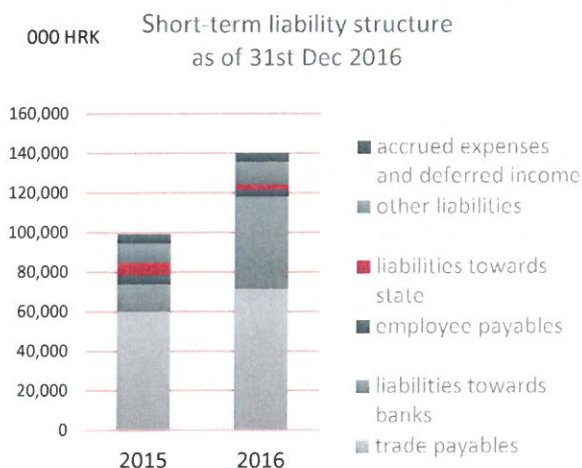




Short-term assets were increased primarily as a result of advance payments to suppliers in the USS Mount Whitney project for 2017, including accrued income that had been incurred but not yet received at the end of the year. The growth of short-term assets is followed by the growth of short-term liabilities, which have increased significantly on the account of preparatory activities carried out with respect to the USS MTW project, which caused growth of short-term bank loans, as well as on the account of redirecting working capital into long-term assets as a result of own investment in the reconstruction of own long-term assets (floating docks). Moreover,

short-term liabilities have also increased with current maturities of long-term loans, resulting in a decrease in long-term liabilities.

Tangible assets accounted for 94% of total long-term assets, with the most significant value being floating docks. The value of land and buildings is not significant, as production and business activities take place on a maritime good, based on a concession contract.



Out of the total value of short-term assets at the end of 2016, money and other bankable assets, including the value of production under progress, accounted for almost 85%. Inventories amounted to HRK 21.3 million, up by HRK 7.7 million compared to the end of 2015 on the account of preparatory activities for the USS Mount Whitney project.

Consolidated short-term liabilities increased by HRK 39.9 million compared to the end of 2015, while Viktor Lenac's short-term liabilities were higher for an additional HRK 1 million referred to liabilities towards the subsidiary. The largest increase in short-term liabilities was recorded in liabilities towards banks due to short-term loans for production financing (HRK 32.6 million) and trade liabilities (HRK 11.5 million). Trade liabilities

totalled HRK 69.6 million at the end of 2016.

Extensive investment in tangible fixed assets during 2016, with a modest business result, disrupted the balance and reduced the amount of working capital Viktor Lenac had available in the previous year. However, all liabilities towards suppliers, employees and banks are settled on a regular basis, and it is expected that next year, with the growth of the capacity utilisation rate, mainly on the account of the USS Mount Whitney project, will be further improved.

Total equity on 31st December 2016 amounted to HRK 208.9 million, only HRK 3.6 million lower when put into relation with the total amount of long-term and short-term liabilities. The decrease in equity compared to the previous year is the result of dividend payment pursuant to the decision on the allocation of profit made in 2015. Total consolidated equity amounted to HRK 212.1 million; by HRK 0.8 million higher than total consolidated liabilities.

## MAIN RISKS AND EXPOSURES

Having in mind the nature of Viktor Lenac's activities and its export orientation, the major effect to Viktor Lenac's business comes from the world's maritime market trends. When speaking about its productivity and production costs, labour market liberalization and labour mobility across the EU countries, in relation to the development of maritime market may pose significant challenges to further development of Viktor Lenac. Hence it follows that Viktor Lenac is mostly exposed to high labour cost risk, while it is believed that its exposure to financial risks is of minor importance. However, so far, no significant negative impact of labour market liberalization on the Company's labour costs has been observed given the relatively even impact spread across competition, except for Turkish competitors. At the same time, the Croatia's membership in the European Union did not affect the Company's revenues, considering that for many years the Shipyard earns more than 80% of its revenues from foreign market, where EU countries make the biggest piece of the pie.

### Market Risk and Competitive Risk

The ship repair and conversion market is conditioned by cyclic changes on the shipping market and changes in freight rates. It is unpredictable when the global economy and the world shipping trade will recover significantly over time. However, experience suggests that on the long-term it is likely to expect that enough vessels sailing within range of Viktor Lenac will need repair services. Issues of market risk and competitive risk with respect to Viktor Lenac's activities primarily have influence on changes in Viktor Lenac's prices arising therefrom, as well as capacity utilisation rates. Global influences such as oscillating oil prices have also been felt by Viktor Lenac over the last few years, however, without significantly affecting the Company's competitiveness given the relatively even impact spread across competition.

### Price Risk

On 1st July 2013, Croatia became the 28th member of the European Union. Compliance with the European laws has been completed in environmental protection, health and safety at work, fire protection and safety, causing an increase of overhead workers as well as overhead expenses deriving from fulfilment of such requirements.

Viktor Lenac can expect further cost increase, which will unavoidably lead to the necessity of increasing productivity and identifying internal resources. In other words, it is not likely to expect that increased costs could be compensated by raising prices, having in mind that shipyards are under intense pressure to reduce prices if they want to remain competitive.

Risks associated with changes in cost of raw material and other materials used in shipbuilding industry, such as steel, have no significant impact on Viktor Lenac. In particular, ship repair activities and production processes are characterized by short cycles, therefore, Viktor Lenac is not exposed to risk of loss due to firm fixed price contracts. Moreover, material cost participates in revenues with less than 20% and has relatively even impact spread across competition.





## Personnel Risk and Risk of Labour Cost

EU membership brings a risk of increasing cost of labour, though the cost of labour in Croatia is already higher than in some other EU members. Significant proportions of skilled labour migration to countries of the Western Europe can also be expected. Consequently, more pressure will be felt on labour price increase to acquire and maintain skilled workers.

Shortage in skilled workers is a problem that has been present in the shipbuilding industry for a long time. Generally, during the last few years, there has been a lack of interest for shipbuilding trades. Seeking to avoid risk of skilled labour migration, reduce consequences of labour mobility and provide skilled labour, Viktor Lenac is continuously investing in education and training of human resources. In such circumstances, an increase of the price of labour is inevitable. Viktor Lenac is trying to compensate it through introduction of modern technologies, aimed at the rationalization of production, and better performance in production and other business activities.

## Currency Risk

Most of the revenues from sales have been generated on foreign markets, mainly in EUR. Changes in exchange rates (EUR/HRK) may therefore have an impact on operating results. However, due to a high receivable turnover ratio, currency risk is not significant, which means that Viktor Lenac does not require an active hedging strategy in foreign currency transactions. On the other hand, the Company's liabilities are not exposed to significant currency risk, since most of these liabilities are denominated in local currency. The USS Mount Whitney Repair Contract stipulated in US dollars is not likely to bring a significant negative impact which may derive from current relation of EUR against US dollar as well as rapid turnover rate. However, it can be expected that part of the revenues is redirected from operating revenues into exchange rate gain. Given the expected currency fluctuations, and depending on future USD/EUR currency movements and forecasts, Viktor Lenac will, if necessary, use hedging instruments.

## Default Risk

Default risk refers to the possible loss arising from a financial transaction should the contract party not fulfil its contractual obligations. Viktor Lenac applies different payment terms depending on client's financial ability assessment. Guarantees and other payment security instruments are not common in ship repair; the Company, however, has the right to arrest a ship at any port in accordance with the maritime regulations. Customer receivables may involve many customers, so the risk of non-payment is dispersed. Due unpaid receivables made less than 1% of total receivables, except for an individual case of foreign client that went bankrupt.



## Liquidity Risk

Liquidity risk or funding liquidity risk (aka cash-flow risk) is related to market risk which involves oscillations of the capacity utilisation rate. Viktor Lenac manages liquidity risk through continuous monitoring of forecasted and realized cash flows. For larger projects that may have a significant impact on outflows, especially in the preparatory phase of project when there is no inflow, Viktor Lenac uses short-term loans.

## Other Risk

Other risks associated with Viktor Lenac's operations are described in Non-Consolidated Annual Financial Statements and Consolidated Annual Financial Statements.





## OWNERSHIP STRUCTURE

On the day of 31 December 2016, the total share capital of the Company amounted to 168,132,470 Croatian Kuna, divided in 16.813.247 registered ordinary shares, with the ticker symbol VLEN-R-B, having a nominal value of 10.00 Croatian Kuna each, registered in the depository of the Central Depository & Clearing Company. The total of shares has been included in quotation of public joint-stock companies on the Zagreb Stock Exchange.

During 2016, the Zagreb Stock Exchange recorded 767 transactions in trading of Viktor Lenac's stocks having a trade transaction value of 4,598,455.85 HRK from 717,312 shares, with the average cost of HRK 6.41 per share.

On the day of 31 December 2016, ten largest shareholders of Viktor Lenac participated with more than 90% in the company share capital as follows:

	Shareholder	Shareholder's Equity	%
1	Tankerska plovdba JSC, Zadar	62.127.380	36,95
2	Shipyard Uljanik JSC, Pula	58.297.850	34,67
3	Privredna Bank JSC, Zagreb/Collective Custody Account	13.672.680	8,13
4	Shipyard Viktor Lenac JSC, Rijeka	8.251.870	4,91
5	Jadroagent JSC, Rijeka	3.247.660	1,93
6	Croatian Restructuring and Sale Centre	3.110.100	1,85
7	Erste & Steiermarkische Bank JSC, Rijeka/ Collective Custody Account	1.408.000	0,84
8	R.L.E. Ltd., Drniš	1.052.110	0,63
9	Weiss Branka Maria	773.080	0,46
10	List Gmbh Austria	459.920	0,27
	Other	15.731.820	9,36
	Total:	168.132.470	100,00

Until 2011, in accordance with the decisions made by the General Assembly, the Company acquired a total of 825,187 own shares, representing 4.91% of the company share capital.

## CORPORATE GOVERNANCE

Corporate Governance can be defined as a framework for planning, organizing, directing and controlling of Company's business operations. Viktor Lenac's Management and Supervisory Board have been applying the corporate governance principles consistently with its fundamental objectives of successful and growing business and growing of share value for the benefit of its shareholders.

An adequate implementation of the principles of corporate governance ensures protection of rights and equal treatment of shareholders, business transparency and responsibility toward all interested parties.

After the termination of the bankruptcy in April 2008, Viktor Lenac has obtained the status of the joint-stock company. On 12 September 2008, Viktor Lenac's shares were included in quotation of public joint-stock companies on the Zagreb Stock Exchange, preceded by issuance of the Short Prospectus approved by the Croatian Agency for Supervision of Financial Services.

Since inclusion of its shares in quotation of the Zagreb Stock Exchange, the Company has been voluntarily applying the Corporate Governance Code made by the Croatian Agency for Supervision of Financial Services and Zagreb Stock Exchange.

Viktor Lenac has been applying recommendations of the Code, by publishing all information which is in the interest of its shareholders and as stipulated by regulations. In accordance with the Capital Market Act, obligatory information is displayed to the Croatian Agency for Supervision of Financial Services through the Zagreb Stock Exchange's website and Company's website ([www.lenac.hr](http://www.lenac.hr)). In addition, additional information is announced through the Croatian News Agency OTS service.

In November 2016, Viktor Lenac adopted the Code of Business Conduct to promote corporate culture and the implementation of the principle of socially responsible behaviour. The Code involves business ethics, transparency, non-discrimination and equal opportunities, respect for employees, hard work and results, community and humanitarian action, environmental protection and sustainability, and anti-corruption rules.

In 2016, Viktor Lenac's Supervisory Board held four sessions to evaluate the Company's financial performance, its position on the market, business plans and key projects. The members of the Supervisory Board receive detailed information on the Company's management and business performance enabling them to exercise supervision over the Company. The Committee for Audit held four sessions.

The Company's shareholders execute their rights at the General Assembly, where they decide on profit allocation, amendments to the Company Statute and appointment and revocation of members of the Supervisory Board. Furthermore, the General Assembly makes decisions over the Management and Supervisory Board performance, appointment of financial auditor and other critical issues stipulated by law and company statute. The General Assembly's regular session was held in June 2016. An extraordinary session of the General Assembly was held in September 2016 to dismiss the former member of the Supervisory Board, Mr. Mate Valčić who had been assigned to new position and appoint Mr. Luka Kolanović as the new member of the Supervisory Board. Also, the General Assembly confirmed the purified text of the Company's Statute complied with the provisions of the Companies Act.

By implementing the principles of the Corporate Governance Code, Viktor Lenac seeks to create a high-quality and long-term relationship with the entire investment community.



## SUPERVISORY BORD AND MANAGEMENT BOARD

### SUPERVISORY BOARD

Supervisory Board of the Viktor Lenac Shipyard is composed of five members, of whom four members are representatives of the two largest individual shareholders and the fifth member is a representative of the Shipyard's workers.

The members of the Supervisory Board, except for the workers' representative, are appointed by the General Assembly for a term of office of four years. The Supervisory Board is currently composed of the following members: Mr. John Karavanić (Chairman), Mr. Elvis Pahljina (Vice-Chairman) and Mr. Hrvoje Markulinčić and Mr. Luka Kolanović as members of the Supervisory Board. Mr. Luka Kolanović replaced Mr. Mate Valčić in his position of Member of the Supervisory Board in September 2016.

A workers' representative in the Supervisory Board is elected by the Workers' Council for the period of three years. In April 2014, with the new composition of the Workers' Council for a new three-year term, Mr. Božo Balen was elected as a new representative of workers in the Supervisory Board.

A Committee for Audit was established by the Supervisory Board in December 2014, composed of Mr. Elvis Pahljina, Mr. Genarij Sutlović and Mrs. Ines Mirković.

### Biographies of Members of the Supervisory Board

**Mr. John Karavanić** was born in New York in 1967. He attended St Thomas the Apostles Primary School in Queens where he grew up. He returned to Croatia and finished secondary education in Zadar. He continued education at the Faculty of Economics in Zagreb and in 1992 he acquired master's degree in economics. In the same year, he was employed as an intern in the marketing sector of the Tankerska plovidba Company. In 1993, he became full-time employed in the commercial sector as Assistant Manager in the Department for Transport of Petroleum Products and Chemicals. From 1997 to mid-1999, he held the position of Deputy Manager of the department. In 1999, he started his four-year term of office in London's affiliate of Tankerska plovidba, where he worked as a broker until 2004. Upon his return from London's Alan Shipping he continued to work in the commercial sector as Chartering Manager in the Crude Oil Tanker Department. Two years later, he became Head of Tanker Project Management Department and Deputy Commercial Director. Since August 2014, he is the sole member of the Management Board of Tankerska Next Generation.

**Mr. Elvis Pahljina** was born in Pula in 1971 where he finished his secondary education. After his graduation in economics and business in 1996 he begun to work as an intern in the Uljanik Shipyard at the Common Affairs Department. His career in finance quickly brought him to a place where in 1998 he became Manager of Foreign Currency Loans. From 2001 to 2013 he held positions of Assistant Financial Director, Assistant Director for Foreign Exchange Operations and Assistant General Director. In June 2013, he was appointed Director of Finance and then Financial Director of the Uljanik Group. He has been constantly upgrading his expert knowledge by participating in various seminars and training courses studying modern trends in financial operations, so in 2013 he participated in Project Finance Academy and obtained a certificate of Project Financing Advisor. He has also been developing other skills such as team and project management.

Mr. **Hrvoje Markulinčić** was born in Pula in 1975. After graduating from high school, in 1994 he entered the Faculty of Law in Rijeka, where he gained a law degree. After a few different jobs, in 2001 he was employed in the Uljanik Shipyard as PR Manager working in all major communications projects and promoting Uljanik as a modern group, oriented to building sophisticated ships. In 2007, he became Head of General Affairs, and then Director of Common Affairs. Along with the reorganisation of the Uljanik Shipyard, the Common Affairs Department was transformed into the Business Information Systems Department, consolidating all supporting functions of the group. He holds the same position today.

Mr. **Luka Kolanović** graduated from the Faculty of Electrical Engineering, University of Zagreb in 1997, and in 2015, he received a master's degree in Business Administration (MBA) from IEDC Business School in Bled. He became an employee of Tankerska plovdba in 1998 as a trainee in the Technical Department. He was then briefly employed by Tehnotrade limited liability company in 1999 as system engineer, and afterwards at the Zadar University from 1999-2001 as a CARNet system engineer. He returned to Tankerska plovdba in 2001 to a position of a System programmer in the Electronic Data Processing Department, advancing to a position of Head of the Electronic Data Processing Department in Tankerska plovdba in 2008. As of 2014, he is Head of Corporate Services in Tankerska plovdba. In 2011, he became a member of the Supervisory Board of Tankerska plovdba d.d. and as of 2013, he holds the position of the President of the Supervisory Board of Tankerska plovdba JSC. Since 2013, he is also a member of the Supervisory Board of Zadar Basketball Club.

Mr. **Božo Balen**, was born in Gospić in 1958. After finishing elementary school, he obtained a scholarship from the Viktor Lenac Shipyard and continued his secondary education in the Shipbuilding and industrial school in Rijeka, where he graduated in 1979. He was employed at the Viktor Lenac Shipyard, where he has been spending his entire working life. He acquired the fifth qualification degree as a specialist in labour, and since 1993 he has been holding the position of foreman in shipbuilding.

### Income and Ownership Interest of Members of the Supervisory Board

The total remuneration for the members of the Supervisory Board and Committee for Audit for 2016 amounted to HRK 572,188.64, including all taxes and contributions.

Mr. Božo Balen, member of the Supervisory Board owns 848 company shares, which he, as former bankruptcy creditor, acquired by converting his monetary claim into the company share capital.

## MANAGEMENT BOARD

The Company's Management Board is composed of the following members: Mr. Aljoša Pavelin, President of the Board & CEO and Mrs. Sandra Uzelac, Member of the Board. The Supervisory Board appointed Mr. Aljoša Pavelin as the new President of the Board on their session held on 28th April 2016 for a five-year mandate, starting on 1st May 2016, when he replaced Mr. Robert Škifić, the former President of the Board, whose employment relationship had been terminated by agreement of the parties. Mrs. Sandra Uzelac was appointed to the position of Member of the Board in April 2013 for a term of five years.

### Biographies of Members of the Management Board

Mr. Aljoša Pavelin was born in 1970 in Split. He graduated from the Faculty of Electrical Engineering, Mechanical Engineering and Naval Architecture in Split and obtained the title of a graduate electrical engineer. He started his career in telecommunications and ICT, holding various technical and managerial positions in *Hrvatski Telekom* and *Metronet telekomunikacije* during a period of ten years. From 2009 to 2013, he held the position of Chief Executive Officer in Marketing and Sales in renowned Croatian ICT companies - *Verso* and



*Recro-net Group*, during which period, he was responsible for developing business with key clients in the markets of Croatia, Bosnia and Herzegovina, Kosovo, Albania, Turkey and the United Arab Emirates. In 2013, he returned to Hrvatski Telekom to the position of Operational Director of the ICT Sector. In next two years, under his leadership, the ICT Sector achieved a significant growth in revenues. In May 2016, he assumed the position of President of the Management Board and Chief Executive Officer of the Viktor Lenac Shipyard with the task of increasing the Company's value. He completed the EMBA program at the IEDC Business School in Bled and attended numerous trainings and education on strategy, strategic management and leadership within the management training program of Deutsche Telekom. He believes that knowledge, hard work and personal integrity are the only guarantee of success.

Mrs. **Sandra Uzelac** was born in Rijeka in 1969. After finishing primary and secondary education in Rijeka, she graduated from the Faculty of Economics Rijeka in 1994. She has been employed in the Viktor Lenac Shipyard since 1994 at various positions: Office Worker in Salary & Economics of Labour Department from 1994 to 1997, Financial Officer and Assistant Accounting Manager in the Financial Department from 1997 to 2001 and Manager of Planning and Analysis Department from 2001 to 2004. From 2004 to 2008 she held the position of Head of Financial Division. After termination of the bankruptcy procedure, she has been appointed Member of the Management Board, and has also been holding the position of Financial Director. During the period from 1997 to 2006, she attended several specialized seminars and upgrading programmes. In 2013, she finished postgraduate economics in controlling) at the Faculty of Economics of Rijeka. She speaks fluently English.

## Income and Ownership Interest of Members of the Management Board

Every member of the Management Board receives income, which is stipulated by employment contract concluded with each member and approved by the Supervisory Board. The total amount of salaries, severance pay and bonuses paid to the members of the Management Board for the year 2016 was 4,245,071.49 Croatian Kuna, including all taxes and contributions.

Mrs. Sandra Uzelac, Member of the Management Board owns 1038 company shares, which she, as former bankruptcy creditor, acquired by converting her monetary claims into the company share capital.

Mr. Aljoša Pavelin, President of the Management Board does not own any company shares.

## FOR INFORMATION

### Management

**Branko Mataija**, Director of Marketing and Sales Division

**Zlatko Marović**, Director of Technical and Production Division

**Dražen Bevanda**, Head of HSE

**Aleksandra Masar**, Head of Quality Control

**Dolores Kuzmić**, Head of Procurement

**Alen Karnjuš**, Head of ICT, QA and Organisation

**Aleksandar Jurčević**, Head of Human Resources

### Auditor

INŽENJERSKI BIRO – REVIZIJA d.o.o. Zadar

### Contact Details

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In Rijeka, April 2017



Pursuant to Article 272.p and with reference to Article 250.a of the Companies Act (Official Gazette No. 113/93, 34/99, 52/00, 118/03, 107/07 and 148/08, hereinafter referred to as 'CA'), and pursuant to Article 22 of the Law on Accounting (Official Gazette No. 78/15, 134/15, 120/16, hereinafter referred to as 'LOA'), the Management Board of Viktor Lenac Shipyard (hereinafter referred to as 'Company'), on this April 20, 2017, makes the following

## STATEMENT

### on Implementation of the Corporate Governance Code

1. Company's shares have been included in quotation of the Zagreb Stock Exchange since September 2008.
2. Since inclusion of its shares in quotation of the Zagreb Stock Exchange, the Company has been voluntarily applying the Corporate Governance Code made by the Croatian Agency for Supervision of Financial Services and Zagreb Stock Exchange. The Code was adopted by the Croatian Agency for Supervision of Financial Services' decision dated April 26, 2007, class 011-02/07-04/28, reg. no. 326-01-07-02 (Official Gazette No. 46/07, hereinafter referred to as 'Code'). The integral version of the Code has been published on the Zagreb Exchange Stock's website.
3. During 2016, the Company was applying recommendations of the Code, by publishing all information which is in the interest of its shareholders and as stipulated by regulations.

During the last year, the Company published all information foreseen by regulations on the Company's website and on the Zagreb Stock Exchange's website, and informed the public on information availability through Croatian News Agency OTS service.

4. Supervision of the Company's business operations has been executed by the Supervisory Board in accordance with the Companies Act. The role of the Supervisory Board is defined by the Company's Statute. Members of the Supervisory Board are provided with detailed information on the Company's management and business operations to efficiently fulfil their supervisory role. Supervisory Board's report makes an integral part of the Annual Report submitted to the General Assembly.

The Supervisory Board has established a Committee for Audit, composed of three members, which was working throughout the year.

The Supervisory Board has not established Committee for Appointment or Committee for Rewarding.

5. The Company is implementing rules of the accounting policy, which regulate application of methods and techniques in presenting assets, liabilities, capital, revenues, expenses and financial results in financial statements. Annual audit of financial statements is performed by an independent auditor appointed by the General Assembly.

The Company has established and applies the rules and procedures for receiving, recording, approving and flow of financial and business related documentation, ensuring multiple model of supervision and transparency in revenue and expense recognition.

6. As of 31st December 2016, ten largest shareholders were the following ones:

	Shareholder	Shareholder's Equity	%
1	Tankerska plovdba JSC, Zadar	62.127.380	36,95
2	Shipyard Uljanik JSC, Pula	58.297.850	34,67
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5	Jadroagent JSC, Rijeka	3.247.660	1,93
6	Croatian Restructuring and Sale Centre	3.110.100	1,85
7	Erste & Steiermarkische Bank JSC, Rijeka/ Collective Custody Account	1.408.000	0,84
8	R.L.E. Ltd., Drniš	1.052.110	0,63
9	Weiss Branka Maria	773.080	0,46
10	List Gmbh Austria	459.920	0,27
	Other	15.731.820	9,36
	Total:	168.132.470	100,00

The right of the Company's shareholders to vote is not limited to a certain percentage or number of votes. The right to vote is recognized by number of shares registered on shareholder's account at the Central Depository & Clearing Company. Each ordinary share gives the right for one vote at the General Assembly. The Company is entitled to issue registered ordinary shares in accordance with positive legal regulations of the Republic of Croatia and Statute of the Company. In accordance with Article 172 of the Companies Act and Company's Statute, decision on share issue is made by the General Assembly. The Company's rights and obligations originating from acquisition of own shares are realized in accordance with the provisions of the Companies Act, hence it follows that the Company can acquire own shares pursuant to General Assembly's powers for their acquisition.

Amendments to the Statute of the Company are made in accordance with the Companies Act.

7. The Company's Management Board is consisted of two members, President of the Board and Member of the Board. Mr. Robert Škifić served as President of the Board until the end of April 2016. In May 2016, the Shipyard's Supervisory Board has appointed Mr. Aljoša Pavelin as the new President of the Board. Mrs. Sandra Uzelac has been holding the position of Member of the Board since 2013. The members of the Board represent the Company independently and individually and run Company's business jointly or individually, in accordance with the Statute of the Company and Management Rules of Procedure (acquisition, abalienation or encumbrance to real estate; issuing, abalienation or acquisition of shares; issuing guarantees except for obligations of subsidiary company; taking loans and credits beyond normal business operations of the Company etc.) and in other cases, when required by law, can be undertaken by the Management Board, authorized by the Company's Statute or Supervisory Board's decision, only with previous consent of the Supervisory Board. The Management Board is appointed and revoked by the Supervisory Board for a term of office of five years.

The Supervisory Board of the Company is consisted of five members. The General Assembly elects and relieves of their office four members of the Supervisory Board, while one member is elected, appointed and revoked by the Company's employees in accordance with positive regulations of the Republic of Croatia. The Supervisory Board is currently composed of the following members: Mr. John Karavanić (Chairman), Mr. Elvis Pahljina (Vice-Chairman) and Mr. Hrvoje Markulinčić and Mr. Luka Kolanović as members of the Supervisory Board, including Mr. Božo Balen, the fifth member of the Supervisory Board in quality of the workers' representative. Mr. Luka Kolanović replaced Mr. Mate Valčić in his position of Member of the Supervisory Board in September 2016.



The Supervisory Board acts as collegial body at sessions, which take place at least once quarterly, where all issues within its competence, as required by the Companies Act and Statute of the Company, are discussed and decided upon. Decisions of the Supervisory Board are made by majority of votes of present members. In 2016, four sessions of the Supervisory Board were held.

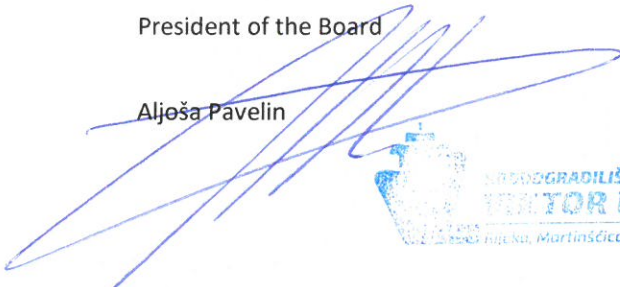

The Committee for Audit was established in December 2014 with the aim of providing support to the Company's Management Board and Supervisory Board in effectively executing their obligations in corporate governance, financial reporting and control. In 2016, the Committee held four sessions to evaluate Company's financial performance. The Committee for Audit is currently composed of the following members: Mr. Elvis Pahljina, Mr. Genari Sutlović and Mrs. Ines Mirković.

8. The Diversity Policy sets out the Company's commitment to diversity and inclusion of members of different age, gender, education and profession in its executive, management and supervisory bodies.

9. In accordance with Article 250.a, item 4, and Article 272.p of the Companies Act, this Statement represents a separate section and makes an integral part of the Company's Annual Report 2016.

President of the Board

Aljoša Pavelin

Member of the Board

Sandra Uzelac

